SMALL ENTITY STATUS – WHAT'S FAIRNESS GOT TO DO WITH IT?

PROPOSED CORPORATE PROCEDURE MINIMIZING LIABILITY FOR PATENT INFRINGEMENT & WILLFUL INFRINGEMENT

PATENT CLAIM DRAFTING IN THE NEW ECONOMY

Intellectual Property Today™

www.iptoday.com

I. P. Today, 375 W. Northwest Hwy., Palatine, IL 60067

A Publication of Omega Communications

July, 2001 $9.00 Volume 8, No. 7

The Corporate Patent Scorecard

Small Entity Status

What's Fairness Got To Do With It?

BY JOHN RIZVI

All of us remember the fleeting moments in law school where we were presented with clear and concrete rules. Black-letter laws. The areas most professors never tested on because there was no room for persuasive policy or fairness considerations. No potential for creative argument or advocacy. You simply memorized a set of hard, cold, inflexible rules and applied them mechanically to the facts. Sometimes the results seemed fair. Sometimes they didn't. But it was always an efficient process. Starting to sound familiar? Welcome to the law defining small entity status at the United States Patent and Trademark Office ("PTO").

A patent applicant's status as a "small entity" is important because it entitles the applicant to a fifty percent reduction of most patenting fees. This article examines the small entity status qualifications at the PTO from the viewpoint of fairness to the applicant.

STATUTORY BASIS FOR SMALL ENTITY STATUS

The small entity status qualifications were created by the legislature to reduce patenting fees for non-profit organizations, independent inventors, and small businesses by fifty percent. 35 U.S.C. § 41(h)(1). The purpose of the reduced fees for certain classes of applicants was to encourage innovation by those believed to be least able to enjoy patent protection absent a fee reduction. Many of the greatest technological advances in history have come from individual inventors and small businesses. For example, the airplane was the creation of the Wright brothers, two bicycle mechanics in Dayton, Ohio. The electric light, the creation of a farm boy who never completed high school, Thomas Edison. Whether you are looking at AT&T, Dow Chemical, Goodyear, Eastman Kodak, Xerox, 3M, or Hewlett-Packard, the fact is that many of the greatest American innovations were created by individual inventors and small businesses. The PTO fee reduction is designed to encourage the creativity and innovation of these smaller entities by reducing their overall cost of obtaining patent protection. Just how does the PTO decide who pays full fees and who is entitled to the half-fee reduction? The qualifications for meeting "small entity status" vary depending upon whether the applicant is a non-profit organization, independent inventor, or small business.

NON-PROFIT ORGANIZATIONS

Patent fees are reduced by fifty percent for non-profit organizations. A non-profit organization is defined by Section 501(c)(3) of the Internal Revenue Code generally as a university or other institution of higher learning, or a non-profit scientific or educational organization. The qualifications for a non-profit organization are relatively straightforward. As such, this article focuses upon the PTO small entity qualifications for independent inventors and small business concerns.

INDEPENDENT INVENTOR

An independent inventor is an "inventor who (1) has not assigned, granted, conveyed, or licensed, (2) and is under no obligation under contract or law to assign, grant, convey, or license, any rights in the invention" to any person who does not qualify as a small entity. Clearly, this definition is designed to exclude inventors who assign their invention to a large corporation. The justification for the independent inventor receiving reduced fees is not present in such situations since the corporation typically pays, or reimburses the inventor, for all patenting fees.

Many inventors, however, are obligated under their employment agreement to assign any patents arising out of their employment to their employer. What happens in such circumstances when the employer decides not to pay for the inventor's patenting fees? Perhaps the employer doesn't find merit in the invention or has doubts about its commercial viability and decides not to pursue patent protection. Can inventors pursue patent protection on their own? Sure they can. But they will not be entitled to a reduced fee due to the assignment. What if the inventor is a lower to middle class factory worker? Tough. The financial ability of the inventor to pay is irrelevant. One of the purposes of offering the reduced fee in the first place was to encourage patenting by those who are least able to afford it. Ironically, however, Bill Gates is entitled to the same fee reduction under the Patent Office small entity qualification standards as a low-wage factory worker. In fact, if the low-wage factory worker is under an employment contract to assign his invention to a large entity, he is not entitled to any reduction in fees at all. This is true even if the employer is not paying for or reimbursing the factory worker for the expenses of securing patent rights. Bill Gates, of course, can continue to qualify for the small entity fee reduction as long as he does so individually and not through a large entity. Is this fair? No, but it is hard to argue that it isn't efficient.

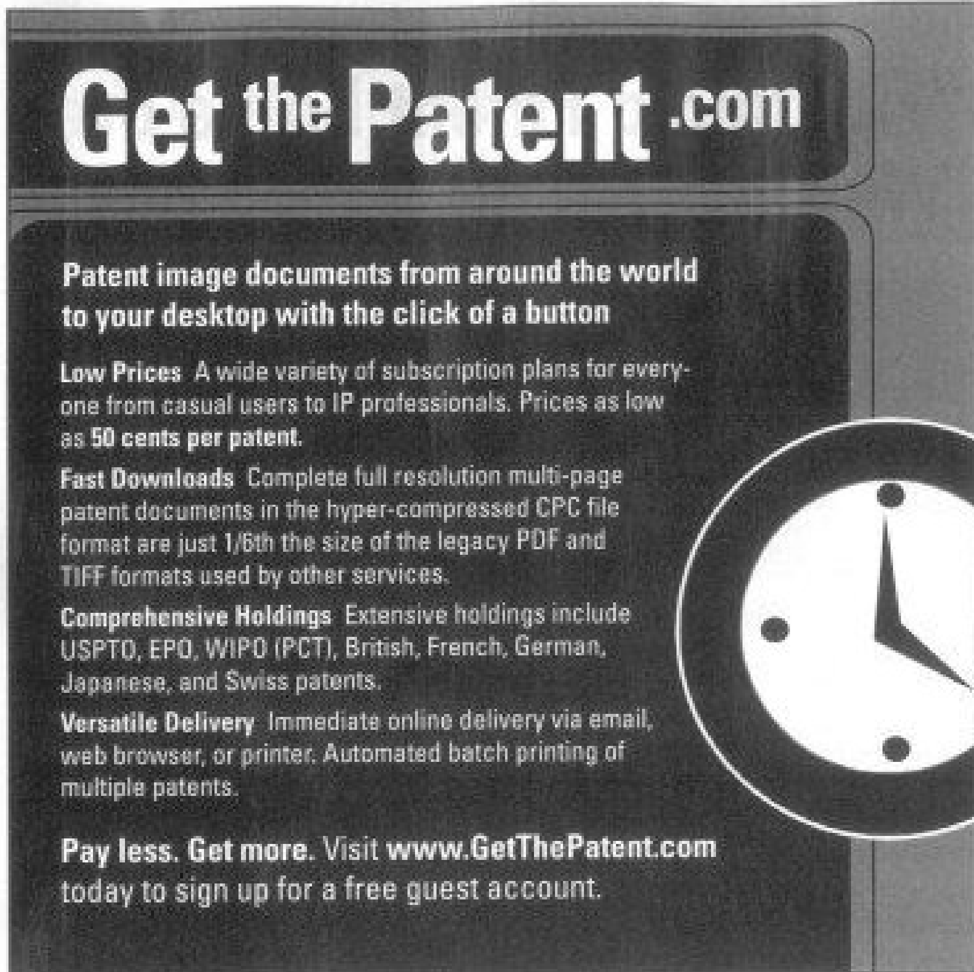
SMALL BUSINESS CONCERN

The PTO provides that patent fees "shall be reduced by 50 percent with respect to their application to any small business concern as defined under Section 3 of the Small Business Act." 35 U.S.C. 41(h)(1). A small business concern is defined by the SBA as one whose number of employees, including those of its affiliates, does not exceed 500 persons, and who has not assigned rights to an organization that does not also qualify as a small entity. 13 C.F.R. 121.1301-121.1305 (1998).

A small business concern is defined solely by the number of employees a business happens to have. The number of employees is determined by counting the number of persons the concern and its affiliates employed on a full-time, part-time, or temporary basis during the previous fiscal year of the concern and of its affiliates. The number of employees is not determined at any single point in time but is based upon the average number of employees during the fiscal year. Under this simplistic scheme, an entity that happens to have 501 employees is subjected to payment of the full fees while another entity with one fewer employee over the previous fiscal year will qualify for a fifty percent discount. Is this fair? No, but once again, it certainly is efficient.

It appears as if the PTO has found the tree but lost the forest. A goal of the small entity reduction of fees was to encourage innovation and help those obtain patent protection who are least able to do so without the reduction in fees. A strict determination of small entity status based upon the number of employees a company happens to have during the previous twelve months is hardly structured to meet this goal. Under the current qualification scheme for a small entity reduction of fees, there is no direct correlation between the financial ability of the small business to pay patenting fees and its entitlement to reduced fees. The convoluted correlation between the

number of employees at a company and the company's ability to pay full fees is tenuous at best. If such a correlation was ever plausible, it was before the industrial revolution when businesses were heavily dependent upon manpower for productivity. For example, it is not difficult to envision the close correlation between the number of workers on a sugarcane plantation and the revenues generated by the enterprise. Productivity and revenues for companies at that time were heavily dependent upon the number of man-hours employed and readily available. Today, however, such a correlation is faulty. For one thing, any possible relationship between employee counts and revenues will vary wildly depending upon the particular industry involved. Yet, under the current qualification scheme for a small entity status fee reduction, an Internet start-up with 150 employees and a valuation of $350 million will qualify for the fifty percent fee reduction. A small clothing manufacturer, on the other hand, with just over 500 low-wage factory workers and a valuation of $5 million would not qualify. To provide a small business concern with a fee discount simply because it has fewer than the arbitrary 500 employees needed to qualify is ridiculous.



A MODEST PROPOSAL

Sliding Scale Fee Reductions

There is little doubt that the PTO qualification standard is an efficient way to determine eligibility for a fifty percent reduction in fees. An entity having less than 500 employees gets the discount and an entity having more than 500 employees does not. In fact, it is difficult to imagine small-entity determinations being made in a more cursory manner. But a draconian efficiency cannot be the paradigm of good law. Proponents of maintaining the status quo believe that having a sharp cut off at 500 employees provides a clear, simple, and precise way to determine eligibility for reduced fees. Unfortunately, it also provides small businesses having around 500 employees with a difficult choice to make regarding whether or not to claim small-entity status. Improperly affirming small entity status may be seen as a fraud practiced on the PTO and can render a patent unenforceable.

In DH Technology, Inc. v. Synergystex International, the alleged infringer asserted the defense of inequitable conduct based upon the patentee's erroneous claim of small entity status. 154 F.3d 1333 (Fed. Cir. 1998). The patentee asserted that it had 512 employees at the time it filed its application but that it honestly, albeit erroneously, believed it had fewer than 500 when it claimed the fee reduction. The Federal Circuit remanded for a determination of the patentee's intent at the time of filing. It is disturbing that several years and hundreds of thousands of dollars in attorney fees, accounting charges, and court costs are necessary because an applicant happens to have 12 more employees than the 500 employee cut off required to qualify for the small-entity fee reduction. Perhaps it is time to introduce a sliding scale fee structure to eliminate the harsh penalty exacted from a business that has just slightly over 500 employees. The following stepped fee structure is proposed:

SLIDING SCALE FEE REDUCTION SCHEDULE

Number of Employees	Fee Reduction
Under 100	50%
100-200	40%
200-300	30%
300-400	20%
400-500	10%
500 or more	No Fee Reduction

The gradual fee reduction schedule set forth in the Table above will soften the draconian effect of a strict cut off at exactly 500 employees without adding undue administrative costs to either the PTO or patent applicants. In close cases, an entity always has the option of paying a 10% greater fee and filing under the higher fee category. As previously pointed out, the correlation between the number of people a business employs and its ability to pay full patenting fees is imprecise. Since the correlation is hazy at best, it only makes sense for the fee structure to be graduated.

If the PTO wishes to continue to use an employee count as the touchstone for small entity eligibility, the least it can do is model the fee structure to be a gently sloping hill instead of a jagged cliff. Admittedly, this is a small step towards a more rational small entity eligibility determination. Implementing a small step towards fairness now, however, may be better than waiting for the major leap that never materializes. IPT