

CASE NOTES

Patent Law—Previously Paid Royalties—No Recovery by Licensee upon Judgment of Invalidity—*Troxel Manufacturing Co. v. Schwinn Bicycle Co.*¹—Following notice from Schwinn that Troxel Manufacturing Company was infringing a design patent held by Schwinn,² the two companies entered into a licensing agreement.³ The agreement, which released Troxel from liability for the alleged infringement, conferred upon Troxel the non-exclusive right to manufacture bicycle seats covered by the Schwinn patent.⁴ In return, Troxel agreed to pay a royalty on each seat sold,⁵ and Schwinn agreed to take action against alleged infringers.⁶

As the result of one such action for infringement, the United States District Court for the Northern District of California entered judgment against Schwinn on January 8, 1969, declaring the patent invalid.⁷ Troxel thereupon notified Schwinn of its intent to escrow

¹ — F.2d —, 175 U.S.P.Q. 65, Nos. 72-1106-07 (6th Cir., Aug. 11, 1972).

² Schwinn was the assignee of design patent D-204,121 issued to Frank Brilando on March 15, 1966. Schwinn, over a four-year period, marketed 1,295,630 bicycle seats embodying the design of this patent. Brief for Appellee at 3, *Troxel Mfg. Co. v. Schwinn Bicycle Co.*, 175 U.S.P.Q. 65, Nos. 72-1106-07 (6th Cir., Aug. 11, 1972) [hereinafter Brief for Appellee].

³ On June 1, 1967. Brief for Appellee, supra note 2, at 4.

⁴ Brief for Appellant at 3, *Troxel Mfg. Co. v. Schwinn Bicycle Co.*, 175 U.S.P.Q. 65, Nos. 72-1106-07 (6th Cir., Aug. 11, 1972) [hereinafter Brief for Appellant]. Licenses may be exclusive or non-exclusive. A non-exclusive license merely nullifies the licensor's right to bring suit against the licensee for infringement of the patent. In contrast, an exclusive license, besides serving as an agreement not to sue for infringement, may also prohibit further licensing and use of the invention by the licensor. R. Ellis, Patent Licenses § 211, at 238 (3d ed. A. Deller 1958) [hereinafter cited as Ellis]. Further, a non-exclusive licensee may not be a proper party to an infringement suit. Id., § 387, at 425. On the other hand, the exclusive licensee holds fuller rights in the patent, and he may be entitled to be a party in a suit for infringement. Id., §§ 381, 386 at 425.

⁵ The particular arrangement between Troxel and Schwinn was for a per-unit royalty, payable quarterly. Appendix to Brief for Appellant, supra note 4, at 21-22. For examples of other royalty agreements see *Automatic Radio Mfg. Co. v. Hazeltine Research, Inc.*, 339 U.S. 827, 830 (1950) (royalties calculated on basis of sales); *Kraus v. General Motors Corp.*, 120 F.2d 109, 110-11 (2d Cir. 1941) (fixed royalty per unit manufacture with guaranteed daily production minimum); *Tesra Co. v. Holland Furnace Co.*, 73 F.2d 553, 554 (6th Cir. 1934) (royalty payment per unit manufacture until royalty maximum has been reached); *Bird's-Eye Veneer Co. v. Franck-Phillipson & Co.*, 259 F. 266, 267 (6th Cir. 1918) (fixed monthly payment). See generally Ellis, supra note 3, § 129, at 148.

⁶ Appendix to Brief for Appellant, supra note 5, at 22. By agreement, either party to a license may bring suit against alleged infringers, either at the expense of the party bringing suit or at the expense of both parties. Ellis, supra note 3, § 193, at 221. However, any action required to be taken must be reasonable in light of the licensee's interests. Id., § 195. The relationship between the expense involved in bringing the suit and the benefits to be received therefrom is relevant to a determination of the adequacy of the steps actually taken to protect the patent. Id. at 223.

⁷ *Schwinn Bicycle Co. v. Goodyear Tire & Rubber Co.*, 160 U.S.P.Q. 587 (N.D. Cal., Jan. 8, 1969).

further royalty payments pending outcome of the appeal of the district court decision to the Ninth Circuit. Pending decision by the Ninth Circuit, Schwinn brought suit against Troxel in the District Court for the Northern District of Ohio in December 1969 to collect the escrowed royalties.⁸ The suit was settled when Troxel agreed to pay in full the overdue royalties and to continue royalty payments.⁹

The decision of the California district court was affirmed on December 22, 1970.¹⁰ Following the affirmance, Troxel made no payments to Schwinn for the last quarter of 1970.¹¹ Thereafter, Schwinn acknowledged that the patent was invalid as adjudged and that no further royalties would be required for any seats sold after the date of the affirmance.¹²

Three months later, Troxel initiated an action in the District Court for the Western District of Tennessee to recover *all past* royalty payments together with interest from the date of each payment or, alternatively, those royalties paid after the California district court decision together with interest from the date of each payment.¹³ Schwinn counterclaimed for royalties which Troxel had failed to pay for seats manufactured in the last quarter of 1970.¹⁴ Troxel moved for summary judgment.¹⁵

The district court granted Troxel's motion and held that Schwinn must return *all* royalty payments to Troxel, with interest accruing from the date of entry of such judgment.¹⁶ The court reached this decision by applying to the facts of the case—and, it will be submitted, by unduly extending—the federal policy¹⁷ encouraging early challenges to the validity of a patent as pronounced by the Supreme Court in the landmark decision *Lear, Inc. v. Adkins*.¹⁸

⁸ Brief for Appellee, *supra* note 2, at 4.

⁹ *Id.*

¹⁰ *Schwinn Bicycle Co. v. Goodyear Tire & Rubber Co.*, 444 F.2d 295, 301 (9th Cir. 1970).

¹¹ Brief for Appellee, *supra* note 2, at 5. Troxel paid royalties of \$77,158.55 from Jan. 8, 1969, the date of the California district court decision, up to the fourth quarter of 1970. *Id.* at 4.

¹² Brief for Appellant, *supra* note 4, at 4. Total royalties paid by Troxel to Schwinn from the date of the licensing agreement up to the fourth quarter of 1970 amounted to \$125,915.25. *Id.*

¹³ *Id.* at 2. In addition, Troxel sought a declaration that it was not liable for royalties due in the last quarter of 1970. *Id.*

¹⁴ *Id.* at 3.

¹⁵ *Id.*

¹⁶ *Troxel Mfg. Co. v. Schwinn Bicycle Co.*, 334 F. Supp. 1269, 1272 (W.D. Tenn. 1971).

¹⁷ At this point it is appropriate to remind the reader that public policy "is a very unruly horse, and when once you get astride it, you never know where it will carry you." *Richardson v. Mellish*, 2 Bing. 229, 252 (1824). It is hoped that this note, in examining the effect of recoupment on federal patent policy, will shed some light on an old saw.

¹⁸ 395 U.S. 653, 670 (1969). *Lear* is the leading case delimiting this federal policy. There the Supreme Court resolved a long-standing conflict between state contract law and federal patent law. *Lear* held that federal patent law preempted application of the state doctrine of licensee estoppel. For an exhaustive discussion of *Lear* and the issue of pre-

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The Sixth Circuit, however, reversed and HELD: a licensee may avoid royalty payments due *after* he has repudiated the license and the patent has ultimately been adjudged invalid, but he may not recoup royalty payments made prior to repudiation.¹⁹ The court concluded that the federal policies which foster technological progress and the free use of ideas belonging in the public domain are sufficiently served by existing remedies, making unnecessary the additional remedy of total recoupment of royalties.²⁰ Moreover, the Sixth Circuit found that the district court's stretching of *Lear* would in fact *discourage* a licensee from bringing an early challenge to the validity of a patent.²¹

This note will examine the arguments mustered by the court of appeals in reaching its decision to refuse recoupment of past royalty payments by a licensee following a judgment of invalidity. Discussion will center initially upon the facts and holdings in the seminal Supreme Court case of *Lear, Inc. v. Adkins*.²² The rationale propounded by the Supreme Court in *Lear* will then be distinguished from that of the district court in *Troxel*, and the propriety of the remedy fashioned by the district court will be assessed in light of that distinction. An examination of the arguments espoused by the court of appeals will then serve to elucidate the court of appeals' analysis of the effect of recoupment on the patent system. Briefly, the circuit court warned that the remedy of recoupment would discourage early challenge of a patent's validity, inhibit the licensor's profitable use of the royalties, and impede technological progress by compelling resort to trade secrets as the sole means of exploiting an invention. In addition, the court considered the possibility of recoupment in light of the eviction doctrine. The note will conclude with a brief analysis—not undertaken by the circuit court—of the viability of the recoupment remedy when tested by principles of state contract and federal antitrust law.

The Sixth Circuit held that the decision of the district court was grounded upon an unwarranted extension of *Lear*.²³ Comparison of the facts in *Lear*²⁴ with those in *Troxel* reveals their dissimilarity and exposes the weak fabric of the district court's opinion. Adkins, an inventor, was employed by Lear to discover an economical gyroscope which would meet the exacting standards of the aviation industry. The employment agreement specified that any of Adkins' inventions relating to gyroscopes would remain his personal property and that Lear would

emption, see, e.g., Arnold & Goldstein, *Life Under Lear*, 48 Texas L. Rev. 1235 (1970); Comment, The "Decent Burial" of Patent Licensee Estoppel, 1970 Duke L.J. 375; Comment, The "Decent Public Burial" of the Doctrine of Patent Licensee Estoppel, 11 B.C. Ind. & Com. L. Rev. 517 (1970).

¹⁹ 175 U.S.P.Q. at 70.

²⁰ *Id.*

²¹ *Id.* at 68.

²² 395 U.S. 653 (1968).

²³ 175 U.S.P.Q. at 66.

²⁴ The following recounting of the facts in *Lear* is taken from the opinion of the majority in that case. 395 U.S. at 655-63.

be granted a license on a royalty basis to be determined. Subsequently, Adkins developed a valuable gyroscope which Lear promptly incorporated into the manufacture of its aircraft, and Lear and Adkins undertook to negotiate a licensing agreement while Adkins filed an application for a patent. The agreement produced by that negotiation granted Lear the right to terminate *if* the Patent Office refused to grant the patent or if the patent, once granted, were later adjudicated invalid. Pursuant to the agreement, Lear paid royalties to Adkins for the use of the gyroscope pending decision by the Patent Office. However, after the Patent Office had twice rejected Adkins' application, but while another application was still pending, Lear repudiated the agreement by announcing that it had uncovered prior art which anticipated Adkins' gyroscope, and that it would pay no further royalties. Three years later, the Patent Office issued Adkins his patent and he immediately brought suit in state court for the accrued royalties. Lear asserted the invalidity of the patent as a defense,²⁵ but the California Supreme Court held that the doctrine of licensee estoppel precluded its making such a challenge,²⁶ notwithstanding the considerable disrepute in which the doctrine was viewed.²⁷ The Supreme Court reversed, abandoning the estop-

²⁵ 35 U.S.C. § 282 (1970) provides in part that invalidity of a patent may be pleaded as a defense to an infringement suit.

²⁶ *Adkins v. Lear, Inc.*, 67 Cal. 2d 882, 891, 435 P.2d 321, 325-26, 64 Cal. Rptr. 545, 549-50 (1967).

²⁷ The doctrine of licensee estoppel prevented a licensee from challenging the validity of the patent upon suit by the licensor for royalties due under the license. It rests on the assumption that a licensee derives a double benefit from the license. First, he protects his own commercial operations from unlicensed competitors. Secondly, he retains immunity from suit for patent infringement which otherwise may be brought by the licensor. Thus, under the doctrine, a licensee has received what he had bargained for and he cannot avoid payment by showing that the patent is, in fact, invalid. *Ellis*, supra note 3, § 225, at 255.

Wilder v. Adams, 29 F. Cas. 1216, 1217-18 (No. 17,647) (C.C.D. Mass. 1846), the case which first spawned the doctrine, analogized the patent licensing agreement to a lease of land. Under the latter agreement, a lessee could not challenge the lessor's right to lease the property while the lessee continued on the land, enjoying the use thereof. The Supreme Court approved the rule in *Kinsman v. Parkhurst*, 59 U.S. (18 How.) 289, 292-93 (1855), holding that a licensee can no more be allowed to deny the validity of a patent while enjoying its use than an agent, who has collected a debt for his principal, can insist on keeping the money, by alleging that the debt is not justly due.

Other courts described the doctrine similarly. For example, *Marston v. Swett*, 82 N.Y. 526, 533 (1880), held that a licensee got what he bargained for and could not affirm and disaffirm a patent at the same time. However, the doctrine of licensee estoppel waxed and waned until its final demise in *Lear*.

The courts were ingenious in avoiding the doctrine. In *Pope Mfg. Co. v. Gormully*, 144 U.S. 224, 235-38 (1892), the Court, on grounds of public policy, refused to grant an injunction to enforce a clause within the licensing agreement in which the licensee had promised never to contest the validity of the patent. In *Westinghouse Elec. & Mfg. Co. v. Formica Insulation Co.*, 266 U.S. 342, 350-51 (1924), the Court forcefully limited the doctrine by stating that although an assignor of a patent could not attack the validity of the patent, he could introduce evidence to narrow claims made therein with regard to the issue of infringement. *Casco Products Corp. v. Sinko Tool & Mfg. Co.*, 116 F.2d 119, 121 (7th Cir. 1940), limited the doctrine further, permitting a licensee to introduce evidence of prior art to show that he did not infringe upon the claims in the

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pel doctrine with resounding finality.²⁸ It held that a licensee is not estopped from challenging the validity of the patent which forms the basis for the license granted to him by the patentee.²⁹

The Court explicitly noted that the decision was dictated by the policy encouraging early challenges to the validity of a patent.³⁰ This policy, the Court pointed out, was a necessary result of the broad policy, recently emphasized in *Sears, Roebuck & Co. v. Stiffel Co.*³¹ and *Compco Corp. v. Day-Brite Lighting, Inc.*,³² of ensuring to the public the free use of ideas in general circulation. Although the Court did not enter into any general considerations of the patent system, it should be emphasized that this policy is of course a natural concomitant of the constitutional mandate to "promote the Progress of Science and useful Arts, by securing for limited Times to Authors and Inventors the exclusive Right to their respective Writings and Discoveries."³³ Indeed, the nature of the patent grant is intimately related to this policy. A patent is a privilege,³⁴ limited in time,³⁵ which is granted by

licensor's patent. In *Scott Paper Co. v. Marcalus Mfg. Co.*, 326 U.S. 249, 257 (1945), the Supreme Court, resting its decision on patent policy, further modified the doctrine. The Court prevented the assignee of a patent from invoking estoppel against the assignor where the assignor, defendant to a suit for infringement, claimed that the alleged infringing device was really covered by another patent which had expired. Further inroads were made on the basis of antitrust principles. In *Sola Elec. Co. v. Jefferson Elec. Co.*, 317 U.S. 173, 175-77 (1942), the Court held that where a licensing agreement based upon an invalid patent would be in restraint of trade, licensee estoppel could not be used to preclude an investigation into the validity of the patent. Similarly, the Court in *Edward Katzinger Co. v. Chicago Metallic Mfg. Co.*, 329 U.S. 394, 400-01 (1947), and *MacGregor v. Westinghouse Elec. & Mfg. Co.*, 329 U.S. 402, 407 (1947), declined to estop a licensee from challenging the validity of the patent where the licensing agreement contained a price-fixing clause.

This steady decline in use of the doctrine was briefly interrupted by *Automatic Radio Mfg. Co. v. Hazeltine Research, Inc.*, 339 U.S. 827, 836 (1950), which seemingly revitalized the doctrine as "the general rule." However, *Hazeltine* was expressly overruled by the Supreme Court in *Lear*. 395 U.S. at 671.

The history of the doctrine is well-documented. See, e.g., Note, 45 N.Y.U.L. Rev. 386 (1970); Note, 21 Case W. Res. L. Rev. 279 (1970); Note, 54 Minn. L. Rev. 872 (1970); Note, 48 N.C.L. Rev. 391 (1970).

²⁸ 395 U.S. at 671.

²⁹ Id. at 670-71.

³⁰ Id. at 668, 670, 673-74.

³¹ 376 U.S. 225 (1964).

³² 376 U.S. 234 (1964).

³³ U.S. Const. art. I, § 8, cl. 8.

³⁴ "Privilege," as used herein, conforms to the definition proposed in W. Hohfeld, *Fundamental Legal Conceptions* (W. Cook ed. 1919). Hohfeld categorizes the legal relations which may arise between two persons, distinguishing the concepts of "right" and "privilege." If a person holds a right, then, as a corollary, someone else owes a duty to him. The holder of the right can enforce it against the bearer of the duty. Id. at 38. In contrast, a person may hold a privilege. A privilege to act presupposes the absence of a duty to refrain from acting. The exercise of the privilege does not invade the rights of another party. Other parties possess a "no-right" to performance by the holder of the privilege. Id. at 38-39.

Applying this theory to the issuance of a patent, the patentee may be designated as *P*, and the general public as *G*. *G* has a right to the free use of those ideas in general

the federal government to the inventor of a sufficiently creative idea.³⁶ In return for this privilege the inventor provides a prompt and complete disclosure of his invention to the ultimate benefit of technology.³⁷ The patent grant encourages the research and development necessary for the proliferation of invention by tendering an exclusive opportunity to exploit the patented idea commercially.³⁸ Moreover, by offering investors a unique opportunity to participate in a commercially profitable venture, the patent induces them to supply the risk capital necessary to make a patented idea available for public use.³⁹

However, the temporary grant of exclusive use is but one element of the patent system. Besides rewarding inventiveness and promoting disclosure, the *Lear* Court stressed the safeguards simultaneously afforded by the system to the public's right to free and competitive use of unpatentable ideas belonging in the public domain.⁴⁰ One method of pursuing the latter policy is the encouragement of prompt challenges to improperly granted patents.

It was this aspect of patent policy that the *Lear* Court developed in laying to rest the doctrine of licensee estoppel. The Court reasoned that an essential tool for weeding out specious patents from the patent system was the early challenge to the validity of the patent, brought in the adversary context of a lawsuit.⁴¹ Licensee estoppel impeded such early challenges. Moreover, an estopped licensee, who is normally the only party with sufficient interest to challenge a patent's validity, could be forced to pay tribute to an invalid patent, with attendant

circulation and not protected by a patent. Accordingly, *P* has a duty not to arrogate those ideas for his exclusive use. However, *P* may acquire the limited privilege of exclusive use of a sufficiently creative idea. This privilege stems from the patent grant. Accordingly, *G* may be said to have a no-right against *P*'s use of the privilege as long as *P*'s conduct is confined to the boundaries of the privilege. However, *P* has a duty not to impair *G*'s right to the free use of ideas belonging in the public domain. In addition, *P* has the right to exclude use of the patented idea by *G*. Cast in other terms, *G* has a duty not to infringe *P*'s patent.

³⁶ 35 U.S.C. § 154 (1970) provides in part: "Every patent shall contain . . . a grant to the patentee, his heirs or assigns, for the term of seventeen years . . . of the right to exclude others from making, using, or selling the invention throughout the United States"

³⁷ The invention must satisfy the statutory criteria of patentability. An invention is patentable if it is new and useful, novel, and non-obvious. 35 U.S.C. §§ 101-03 (1970). For discussion of the standards employed in determining the prerequisites to non-obviousness, see *Graham v. John Deere Co.*, 383 U.S. 1, 12-19 (1966), and *United States v. Adams*, 383 U.S. 39, 48-52 (1966).

³⁸ *Briskin*, *An Area of Confusion: Patents, Monopolies and the Antitrust Laws*, 45 *J. Pat. Off. Soc'y* 741, 745-46 (1963).

³⁹ See Subcomm. on Patents, Trademarks, and Copyrights of the Senate Comm. on the Judiciary, 85 Cong., 2d Sess., *An Economic Review of the Patent System* 56 (Comm. Print 1958) (Remarks of Prof. Machlup) [hereinafter Machlup].

⁴⁰ Kennedy, *Patent and Antitrust Policy: the Search for a Unitary Theory*, 35 *Geo. Wash. L. Rev.* 512, 515 (1967); Machlup, note 38 *supra*.

⁴¹ 395 U.S. at 668, 670, 673-74.

⁴² *Id.* at 673-74.

adverse competitive consequences to the community as a whole.⁴² The Court sought to supply the licensee with economic incentive to bring an early challenge to invalid patents and thereby protect these public interests. Accordingly, *Lear* permitted the licensee to suspend payment of all royalties upon repudiation of the license, pending adjudication of the issue of validity.⁴³ Unless the financial burden of simultaneously paying royalties and litigation costs were lifted from the shoulders of the licensee, he might be discouraged from engaging in litigation.⁴⁴

In *Blonder-Tongue Laboratories, Inc. v. University of Illinois Foundation*,⁴⁵ a case decided after *Lear*, the Supreme Court provided further stimulus to the licensee. The Court there held, in accordance with *Lear*, that procedural obstacles to suits brought by those disposed to challenge the validity of patents should be eliminated in order to avoid use of the patent as a means of propagating economic coercion and insulating from free public use ideas disclosed but not worthy of patent protection.⁴⁶

⁴² Id. at 673.

⁴³ Id. at 670-71, 674.

⁴⁴ Id. at 673-74. Arguably, suspension of royalty payments prior to an actual adjudication of invalidity constitutes a deprivation of the licensor's property without due process of law. In *Goldberg v. Kelly*, 397 U.S. 254 (1970), the Supreme Court held that procedural due process required that a welfare recipient be afforded an evidentiary hearing before termination of welfare payments. The Court there found a post-termination "fair hearing" inadequate despite the fact that a recipient who prevailed at such a hearing would recover all funds erroneously withheld. *Goldberg* turned on the theory that the recipient's interest in avoiding the loss of benefits outweighed the governmental interest in employing summary proceedings to terminate fraudulent welfare claims quickly and with minimal fiscal and administrative expenditures. The welfare payments were likely to constitute the sole support of the recipient.

The recipient's right to welfare benefits may be likened to the right of a licensor to payments on the license. Depending upon the outcome of the balancing test used by the Court in *Goldberg*, suspension of royalty payments may not be justified prior to judicial determination of the validity of the patent. However, contrasted to the overriding dependence of the welfare recipient, a licensor may well be able to afford the temporary suspension of royalty payments. Furthermore, suspension of royalty payments serves the paramount federal purpose of inducing early challenges to the validity of a patent. The scales appear to tip most definitely against the licensor. Therefore procedural due process should not require guaranteeing a pre-suspension hearing to the licensor. *Lear* and *Goldberg*, then, appear reconcilable.

⁴⁵ 402 U.S. 313 (1971).

⁴⁶ Id. at 338. The precise holding in *Blonder* abrogated the doctrine of mutuality of estoppel in suits for patent infringement as set forth in *Triplett v. Lowell*, 297 U.S. 638, 642 (1936). *Blonder* provided that a prior decision of invalidity between the licensor and a third party may collaterally estop the licensor from establishing the validity of the patent in a subsequent suit for infringement against the licensee, 402 U.S. at 350. The case also considered at great length the harmful economic effects flowing from the imposition of procedural obstacles to challenges of specious patents. Briefly, these effects are: the waste of time and money to both the parties and to the court in relitigating an issue once properly decided, especially when the resources of the litigants could otherwise be channeled into further research and development, id. at 334-38, and the anticompetitive effects inflicted when one infringer must absorb royalties and lose profits,

The district court in *Troxel* utilized the statement of the Court in *Lear* that a licensee is entitled to avoid payment of all royalties accruing after the *issuance* of the patent if the patent be shown invalid.⁴⁷ On the narrow circumstances in *Lear*, the licensee was entitled (1) to suspend all royalty payments accruing after the *issuance* of the patent and (2) to avoid those payments absolutely if he could show the patent to be invalid.⁴⁸ Applying the *Lear* policy to the facts of *Troxel*, the district court argued that Troxel, who had paid royalties pursuant to a licensing agreement entered into *after* the patent had issued, was entitled to recover *all* royalty payments when the patent was subsequently found invalid.⁴⁹

It is submitted that the court of appeals was correct in deciding that the district court, in failing to distinguish the factual situation in *Lear* from that before it, distorted the federal policy enunciated in *Lear*. The court of appeals ruled that the general statements in *Lear* were limited by the particular facts of that case: notably, in *Lear*, *repudiation of the license occurred before issuance* of the patent.⁵⁰ Upon issuance of the patent, Adkins initiated the action against Lear, and only then was the issue of validity presented for adjudication. The suspension of royalty payments was viewed as a means of encouraging Adkins to undertake the expensive business of litigating this issue, and upon proof of invalidity the licensee was released from any obligation to make these or future payments to the patentee. In contrast to the facts in *Lear*, Troxel entered into the license *after* the patent had issued.⁵¹ Hence the date of issuance of the patent did not signify the advent of litigation in *Troxel* as it had in *Lear*.

In *Lear*, the Supreme Court permitted the licensee to avoid royalty payments after the issuance of the patent in order to provide the requisite incentive for an early and effective challenge to its validity: by suspending royalty payments, Lear could use the retained funds to finance the litigation required to declare the patent invalid.⁵²

However, it must be stressed that in *Lear* the Court could not have been focusing upon the issuance of the patent per se as the event after which a licensee could avoid royalty payments. Rather, the Court appeared to regard the *act of repudiation*—inasmuch as that act is necessarily correlative with undertaking litigation—as the watershed

while another possesses sufficient financial resources to resist the economic thrusts of a patentee. *Id.* at 346.

⁴⁷ 334 F. Supp. at 1271.

⁴⁸ The precise language of *Lear* was: "[Lear] must be permitted to avoid payment of all royalties accruing after *Adkins'* . . . patent *issued* if Lear can prove patent invalidity." 395 U.S. at 674 (emphasis supplied).

⁴⁹ 334 F. Supp. at 1270-71.

⁵⁰ 175 U.S.P.Q. at 69. Lear repudiated the licensing agreement two years before the patent issued. Thus, the suspension of royalty payments in *Lear* extended over the entire life of the patent. In other words, Lear had never paid royalties under the patent, all payments having been made under a pre-patent agreement.

⁵¹ 175 U.S.P.Q. at 66.

⁵² 395 U.S. at 673-74.

event no matter when it occurs. This conclusion seems to be required by the Court's warning that the case before it, involving a *pre-patent* licensing agreement repudiated before the patent issued, was not "the one which arises in the most common licensing context."⁵³ Presumably the cases which are "most common" are those like *Troxel*, wherein the patent is issued *before* the agreement is repudiated. In such cases, using the issuance of the patent as the event from which avoidance—and hence recoupment—should run would not serve the federal patent policy that is the basis of the *Lear* rationale: the encouragement of early challenges by a licensee to patent validity. Rather, that policy is served by allowing avoidance to begin when the licensee takes the decisive step of repudiation. Conversely, to permit a licensee, upon proof of patent invalidity, to recover royalties paid prior to repudiation—as the district court would have done—does not motivate the licensee to repudiate earlier than he would do in the absence of such recoupment privileges. It is submitted, then, that the Sixth Circuit was correct in holding that *Lear* does not confer upon the licensee the right to recover payments made to the licensor before repudiation of the license.

Having set straight the district court's rather crooked construction of the policy espoused in *Lear*, the Sixth Circuit in *Troxel* then considered the drastic consequences which might result from recoupment. First, the court noted disapprovingly that, in seeking recoupment, *Troxel* relied on a prior adjudication of invalidity in a suit to which it had been a stranger.⁵⁴ The court predicted that the ultimate effect of permitting recoupment to a licensee who so relied would be to encourage dilatory tactics on the part of the licensee, who would naturally prefer to reap the benefits of third party adjudication without himself sowing the seeds of litigation.⁵⁵ Moreover, the court argued, even if no third party materialized to challenge the validity of the patent, a licensee would be encouraged to refrain from litigating the issue of validity until the end of the patent's term was so near that the risk of injunction⁵⁶ was minimal.⁵⁷ At that point the licensee could begin litigation, hoping to recover all past royalties, after enjoying many years of protection from the license.⁵⁸ Hence the court reasoned that recoupment, especially in conjunction with third party litigation, would *discourage* an early adjudication of the issue of validity and so would run counter to the policy expressed in *Lear*.⁵⁹

In taking heed of this potential for delay by reliance on third party adjudication, the court failed to consider that the Supreme Court had authoritatively established in *Blonder-Tongue Laboratories, Inc.*

⁵³ *Id.* at 671.

⁵⁴ 175 U.S.P.Q. at 68.

⁵⁵ *Id.*

⁵⁶ 35 U.S.C. § 283 (1970) provides that an injunction may be granted to prevent the violation of any right secured by a patent.

⁵⁷ 175 U.S.P.Q. at 68.

⁵⁸ *Id.*

⁵⁹ *Id.*

v. University of Illinois Foundation that third party adjudications of a patent's invalidity may be given collateral estoppel effect in subsequent litigation by another party against the same patentee.⁶⁰ Assuming *arguendo* that the *Blonder* rule could encourage the licensee to postpone litigating the issue of validity of the patent, it is submitted that this "disincentive effect" could be eliminated by requiring that a licensee who pleads estoppel show that, in light of all the circumstances, the estoppel defense is exercised with diligence and for good cause, consonant with both the policies of the patent system and those justifying use of the plea.⁶¹ The licensee would have to bear the cost of a full-scale trial of the issue of validity if he had not, in good faith, sought expeditiously to challenge the patent.

Such a precaution, however, may be unnecessary, since a "fence-sitting" strategy is of questionable value to the licensee. After *Blonder*, if a patent is adjudicated invalid in a prior suit, a competitor of the licensee, who before *Blonder* may have been persuaded by the prospect of an enforceable patent to refrain from competition with the licensee, may now free himself with minimal cost from the patentee's stranglehold.⁶² The nominal cost of obtaining summary judgment on the issue of patent validity, based on collateral estoppel, would not be a significant obstacle to a challenge of the patent. Accordingly, any attempt by the licensee to postpone litigation in order to preserve the aura of enforceability of the patent and so attenuate competition will be fruitless, since his competitors will not be deterred from using the patent by the cost of an infringement suit which may be summarily adjudicated. As a matter of fact, unless the licensee acts *with dispatch* to attack the patent he will be set back competitively, since he alone is encumbered with royalty obligations under the license.

The disincentive that theoretically could result from collateral estoppel, then, appears to pose no real threat to the policy of early challenges established in *Lear*. A broader question remains: does recoupment, as the Sixth Circuit reasoned, *necessarily* encourage dilatory tactics on the part of a licensee to the detriment of the *Lear* policy? It is submitted that the facts in *Troxel* indicate only part of the answer. Troxel exhibited a remarkable reluctance to litigate the issue of validity of the patent. Even after another litigant had mounted a successful challenge of the Schwinn patent, Troxel continued to pay royalties under the license,⁶³ an indication that Troxel found life under the

⁶⁰ 402 U.S. at 350.

⁶¹ See discussion of this proposal in the class action context in Comment, *Class Actions in Suits for Patent Infringement in Light of Blonder-Tongue Laboratories, Inc. v. University of Illinois Foundation*, 13 B.C. Ind. & Com. L. Rev. 1473, 1498-99 (1972).

⁶² Unless the licensor can show that he did not have a full and fair opportunity to litigate the validity of a patent in a prior suit in which the patent was adjudged invalid, any party sued for infringement by the licensor will be able to avail himself of collateral estoppel and obtain summary judgment on the issue of validity. 402 U.S. at 333.

⁶³ 175 U.S.P.Q. at 70. *Blonder* had not yet come down when the district court decided *Troxel*. Consequently, Troxel could not repudiate and avoid a full-scale trial on

agreement to be quite satisfactory. There, Troxel enjoyed freedom from liability for alleged past infringement, as well as Schwinn's agreement to protect Troxel against prospective unlicensed infringers. Troxel, then, had the benefit of the use of Schwinn's idea to the exclusion of non-licensed competition.⁶⁴ It is not unlikely that Troxel found it advantageous to uphold the facade of enforceability of the patent in order to maintain a competitive edge over other manufacturers.

However, in a different market, where a licensee is surrounded by competitors disposed to ignore the patent,⁶⁵ he cannot afford such forbearance. To the extent that a licensee must pay royalties for the use of an unpatentable idea pursuant to a licensing agreement, while other manufacturers who had not entered into similar agreements with the patentee may use the idea without commensurate expenditures of capital, the licensee may suffer a severe competitive disadvantage.⁶⁶ In short, hesitation to challenge the validity of a patent depends upon the security of the licensee's competitive position, in turn a function of both the *strength of the patent* and the *level of competition* in the market. It is suggested, first, that if recoupment discourages hasty judicial assault upon a strong valid patent, this is commendable, since judicial economy is served thereby and valid patents lie outside the ambit of *Lear* anyway. *Lear* aimed its arrows at specious patents. And secondly, in a competitive climate, weak patents, which we may assume are likely to be invalid, cannot be allowed to go unchallenged by the licensee. Presumably a licensee operating in such an atmosphere will have to bring an early challenge to the patent's validity, whether or not he is given recoupment. The possibility of recoupment will represent only an additional benefit to be attained if his suit is successful.

Finally, in view of the probability that after *Blonder* collateral estoppel may be liberally applied by competitors of the licensee against a patentee who seeks to reestablish the validity of a patent previously adjudicated invalid, an early challenge to the patent by the licensee is all the more likely. Hence, while recoupment may conceivably limit the eagerness of a licensee to mount an attack against the patent where the market is sluggish and where the patent is more than frail, the possibility of recoupment will not necessarily persuade a licensee to postpone litigation until near the expiration of the patent. The Sixth

the issue of validity, summary judgment not being likely. Arguably, this deterred Troxel from repudiating the license.

⁶⁴ Moreover, the fact that Troxel continued to pay royalties would indicate that the business derived from use of Schwinn's invention was rather profitable. Cf. *Pollack v. Angelus Block Co.*, 171 U.S.P.Q. 182, 185, No. 882198 (Cal. Super. Ct., Jan. 7, 1971).

⁶⁵ For purposes of the accompanying textual discussion we may assume that there has been no prior adjudication of invalidity so that *Blonder* does not apply. Taking *Blonder* into consideration, that is, taking the effect of collateral estoppel based on a prior adjudication of invalidity into account, the conclusions reached would be strengthened. See text at note 66 infra.

⁶⁶ 334 F. Supp. at 1271. However, the licensee to a pre-patent licensing agreement may receive the benefit of a "tooling-up" period withheld from its competitors.

Circuit's assumption that such postponement will be a necessary result of recoupment appears incorrect.

It must be admitted, then, that the prospect of recovery of royalty payments made prior to repudiation may in certain circumstances have no effect upon the disposition of a licensee to challenge the patent's validity. This admission, however, does not appear to qualify significantly the essence of the Sixth Circuit's reasoning: that in many circumstances recoupment would encourage the licensee to delay litigation and to that extent weaken the functioning of the patent system.

The appellate court, however, did not rely solely on the argument of delayed litigation. Its rationale pointed to other corollaries of recoupment that would threaten the very roots of the patent system. The court argued that if all royalties received were subject to eventual reclamation by the licensee barring the expiration of an appropriate statute of limitations,⁶⁷ the licensor would be forced to retain funds sufficient to cover such contingent liability.⁶⁸ Where there are several licensing agreements based on the same patent, this liability would be amplified because all licensees might sue individually or as a class to recover past royalties paid under the various agreements.⁶⁹ The court found further objectionable consequences. Any licensor owning more than one patent would be likely to demand higher royalties for licensing agreements based on diverse patents in order to protect himself against possible suit for recoupment under any one of the agreements.⁷⁰ In addition, under the federal tax laws, these royalties might be taxable as ordinary income to the licensor.⁷¹ Such taxes, coupled with the ever-present threat of recoupment, which in turn would limit the kinds of investments the licensor could make, would discourage all but the wealthiest licensor.⁷² Thus the court concluded that the possibility of costly recoupment suits, together with the resulting impediment to

⁶⁷ Generally, the state statutes of limitations for actions in contract is six years from the time the cause of action accrued. See, e.g., N.Y.C.P.L.R. § 213 (McKinney 1972); Mass. Gen. Laws ch. 260, § 2 (1959); Tenn. Code § 28-309 (1955).

⁶⁸ 175 U.S.P.Q. at 68.

⁶⁹ In a class action against Carter-Wallace, Inc., filed on February 25, 1972 by Zenith Laboratories in the United States District Court for the District of New Jersey, the patentee was sued for \$130 million in royalties paid by the licensees under the sixteen-year-old patent. The suit was filed one week after the patent had been declared invalid. Wall Street Journal, Feb. 29, 1972, at 12, col. 2.

⁷⁰ 175 U.S.P.Q. at 68.

⁷¹ Int. Rev. Code of 1954, § 1235, provides capital gains treatment for royalties based upon a transfer of "all substantial rights to a patent." See, e.g., *Fawick v. Commissioner*, 436 F.2d 655, 663 (6th Cir. 1971). An exclusive license may qualify for this treatment, but a non-exclusive license will not. Thus, royalties under non-exclusive licenses will be taxable as ordinary income to the licensor. See, e.g., *Reschelberg v. United States*, 330 F.2d 56, 60-62 (6th Cir. 1964); *Redler Conveyor Co. v. Commissioner*, 303 F.2d 567, 568-69 (1st Cir. 1962); *Gruber v. United States*, 158 F. Supp. 510, 513-14 (D. Ore. 1958); 5 CCH 1973 Stand. Fed. Tax Rep. ¶ 4745.40. And royalties under the non-exclusive license are deductible business expenses to the licensee. Int. Rev. Code of 1954, § 162(a)(3); 2 CCH 1973 Stand. Fed. Tax Rep. ¶ 1382.521.

⁷² 175 U.S.P.Q. at 68.

many forms of investment of royalty payments, would tend to make a patent licensing agreement an impractical venture. Consequently, quite aside from the possible effects of recoupment on licensees' motivation to bring early challenges, the severe blow which would be dealt industry by discouraging use of a major instrument of commercial exploitation—the patent licensing agreement—justifies denial of the remedy of recoupment. Only if other means for commercial exploitation of an invention could take up the slack created by a neglected patent system might this argument against recoupment be adequately countered.

Assessing this danger, the court observed that recoupment would discourage an inventor from turning to the patent system in the first instance in seeking to exploit an idea commercially.⁷³ The court held that the virtual uselessness of the licensing agreement to the patentee threatened with recoupment would forestall indefinitely the patentee's public disclosure of his invention. An inventor threatened by the danger that he might have to restore all royalties might well resort to other, more secure means of exploiting his invention, namely trade secret agreements.⁷⁴ Of course, it must be admitted that, where the patent is specious, foreclosing the patentee from use of the commercial channels at the heart of the patent system is commendable. At the same time, the commercial utility of the idea may be realized through the use of trade secret law and so benefit technology. Where, however, the idea is worthy of the patent grant⁷⁵ and the patentee has the very real choice of patent or trade secret protection, recoupment may retard drastically technological progress by prompting him to choose the latter.

It is submitted, then, that a significant drawback of recoupment is the threat that it poses to the federal patent system. The Sixth Circuit only adumbrated the potential consequences, and this note will endeavor to explicate them by indicating how recoupment would discourage use of the federal patent system, thereby encouraging inventors to utilize instead a relatively deficient system of trade secret law. The arguments generated in the judicial decisions concerning preemption

⁷³ *Id.*

⁷⁴ Trade secret status exists when the subject matter is used continuously in business, is not generally known or readily ascertainable and is maintained with due regard to protecting secrecy. Restatement of Torts § 757, comment *b* at 5-6 (1939); R. Milgrim, 12 Business Organizations: Trade Secrets §§ 2.01-09 (1972); Marmorek, *The Inventor's Common-Law Rights Today*, 50 J. Pat. Off. Soc'y 369, 375-81 (1968). The courts generally view trade secrets as property. E.g., *New Method Laundry Co. v. MacCann*, 174 Cal. 26, 31, 161 P. 990, 991 (1916). The value of the trade secret depends substantially upon the secrecy with which it is maintained. E.g., *E.I. duPont de Nemours & Co. v. United States*, 288 F.2d 904, 911 (Ct. Cl. 1961). In the absence of secrecy, the "property" disappears. Cf. *Smith v. Dravo Corp.*, 203 F.2d 369, 373 (7th Cir. 1953). The major disadvantage of trade secret protection to the owner is that proper disclosure of the secret is possible and this may result in heightened competition with the owner or even forfeiture of trade secret status. *Id.* at 375. See text at notes 89-105 *infra*.

⁷⁵ Every patent grant is accompanied by a statutory presumption of validity and the burden of establishing invalidity rests on the party asserting the defense. 35 U.S.C. § 282 (1970). However, this presumption may be primarily honored in the breach. See, e.g., note 130 *infra*; Comment, *supra* note 61, at 1476 n.25.

of trade secret law by federal patent law support this thesis.⁷⁶ Absent recoupment, trade secret law and the patent system are poised in a favorable balance that facilitates fulfillment of the constitutional purpose of fostering technological progress.⁷⁷ However, recoupment disturbs this desirable equilibrium between the patent system and trade secret law.

The question of preemption of state trade secret law by the patent laws, once a raging controversy, is illuminated by two Supreme Court decisions not dealing directly with trade secrets. In *Sears, Roebuck & Co. v. Stiffel Co.*⁷⁸ and *Compco Corp. v. Day-Brite Lighting, Inc.*,⁷⁹ the Supreme Court held that a state cannot, under veil of unfair competition laws, provide protection of the type "that clashes with the objectives of the federal patent law."⁸⁰ Thus the Court held that a state could not prohibit the copying of a marketed article that was unpatentable despite a resultant likelihood of source confusion, since that injunction frustrates paramount and uniform federal standards of patentability.⁸¹

On the facts before the Court, *Sears* and *Compco* held merely that an unpatentable product which has been disclosed to the public can be copied freely by anyone.⁸² Unfortunately, the language employed by the Court proved susceptible to a broader construction. With respect to unpatentable ideas, the Court feared that state laws like the one before it, "could allow perpetual protection to articles too lacking in novelty to merit any patent at all under federal constitutional standards."⁸³ To the unwary these words might purport to mandate the dedication of all unpatentable ideas, disclosed or secret, to the public domain.

The seed planted in *Sears* and *Compco* was nourished in *Lear, Inc. v. Adkins*. *Lear*, in abolishing the state doctrine of licensee estoppel as applied to patent licensing agreements, brought the delicate balance between trade secret and patent law into sharper focus.⁸⁴ There the Supreme Court took pains to point out that licensing agreements could occur at two distinct points in time.⁸⁵ Accordingly, the Court first considered licensing agreements negotiated after the issuance of the patent. Secondly, the Court examined licensing agreements entered into before issuance of the patent, i.e., during the gestation period of the patent. In

⁷⁶ See text at notes 77-98 *infra*.

⁷⁷ See, e.g., Milgrim, *Sears to Lear to Painton: of Whales and Other Matters*, 46 N.Y.U.L. Rev. 17 (1971).

⁷⁸ 376 U.S. 225 (1964).

⁷⁹ 376 U.S. 234 (1964).

⁸⁰ *Sears*, 376 U.S. at 231 (footnote omitted).

⁸¹ 376 U.S. at 230-31. See, e.g., Note, Unfair Competition Protection After *Sears* and *Compco*, 40 N.Y.U.L. Rev. 101 (1965); Note, 50 Cornell L.Q. 118 (1964); Note, 6 B.C. Ind. & Com. L. Rev. 138 (1964).

⁸² *Sears*, 376 U.S. at 230-31. The *Compco* opinion repeats the *Sears* holding. *Id.* at 237-38.

⁸³ *Id.* at 232.

⁸⁴ 395 U.S. at 674.

⁸⁵ *Id.* at 669, 671.

considering the latter, which is of concern here, the Court drew upon trade secret law. Thus the Court cautioned: "At the core of this [pre-patent license] is the difficult question whether federal patent policy bars a State from enforcing a contract regulating access to an unpatented secret idea."⁸⁶ But the Court sidestepped the issue, remanding to the state court "to reconsider the theoretical basis of their decisions enforcing the contractual rights of inventors [it being] impossible to predict the extent to which this re-evaluation may revolutionize the law of any particular State in this regard."⁸⁷ Despite the opinion of the majority, a minority of the Court found state trade secret law to pose so significant a threat to the federal patent system as to warrant the former's preemption on the basis of *Sears and Compco*: "The national policy expressed in the patent laws . . . cannot be frustrated by private agreements among individuals, with or without the approval of the State."⁸⁸

Trade secrets and patents represent alternative means of exploiting an idea and, as will be shown, each strongly reinforces the other. *Sears*, *Compco*, and *Lear*, however, generated considerable confusion concerning the permissible bounds of trade secret law. In the wake of these decisions, the United States District Court for the Southern District of New York held in *Painton & Co. v. Bourns, Inc.* that federal patent law preempted state trade secret law, so that an inventor must submit his idea to the Patent Office before licensing the use of his idea.⁸⁹ The Second Circuit promptly reversed. In reversing, the Second Circuit reestablished the inventor's long-standing right to exploit his invention by private agreement.⁹⁰ The court held that any idea not patented may be exploited by the use of state trade secret agreements.⁹¹ Although the inventor of a patentable idea may seek the fuller protection of a patent, the court declined to impose an obligation to do so. Nor did the court deny trade secret protection to unpatentable ideas.⁹²

The Second Circuit's analysis of the interrelationship between the patent and trade secret laws was directed at the issue of preemption spawned by *Sears* and *Compco* and nurtured by *Lear*, but it sets the stage for consideration of the Sixth Circuit's objection to recoupment.⁹³ The grounds for this objection were not fully presented by the court. However, it is submitted that the following analysis of the effect of

⁸⁶ Id. at 672 (footnote omitted).

⁸⁷ Id. at 675.

⁸⁸ Id. at 677.

⁸⁹ 309 F. Supp. 271, 274 (S.D.N.Y. 1970). The court, however, left open the question of whether the licensor could demand royalties for use of the idea pending issuance of the patent once an application had been filed. Id.

⁹⁰ *Painton & Co. v. Bourns, Inc.*, 442 F.2d 216, 225 (2d Cir. 1971), rev'g 309 F. Supp. 271 (S.D.N.Y. 1970). The court politely chastised the rather broad holding of the court below made "without benefit of brief or argument from the parties who had been concerned solely [with another unrelated issue] . . ." Id. at 221.

⁹¹ Id. at 222 n.2, 225.

⁹² Id. at 225.

⁹³ See text at notes 78-88 *supra*.

recoupment on the relationship between patents and trade secrets will prove the court's general observations to be correct. The Second Circuit briefly pointed out that, should an inventor know his idea to be unpatentable, he would naturally choose the vehicle of the confidential agreement, which would allow only the very limited disclosure permitted by trade secret law.⁹⁴ However, if instead the idea were submitted to the Patent Office, no patent could issue and *no* disclosure could result.⁹⁵ If trade secret protection is denied this inventor, he is likely to hoard his idea to prevent *any* disclosure. The trade secret agreement, then, offers a commercially attractive method of using the unpatentable idea, thus augmenting the mainstream of invention which nourishes science and the useful arts.⁹⁶ On the other hand, by affording protection to an unpatentable idea, trade secret law threatens to undermine federal standards of patentability, a major concern of the Court in *Sears and Compco*.⁹⁷ However, in light of the limited protection offered by trade secret agreements⁹⁸ and the benefits to be derived from the commercial exploitation of unpatentable ideas, this minor incursion into the zones of free competition and uniform standards of patentability seems tolerable.

In seeking refuge under the cloak of trade secret law, the inventor acquires minimal protection for his invention, since he binds *only* the licensee to a confidential agreement.⁹⁹ The inventor has no recourse against a third party who might legally discover and use the invention.¹⁰⁰ In contrast, a patent bars everyone but the patentee from using the idea during the term of the patent, even in the event of independent discovery, in return for full disclosure of the idea.¹⁰¹ Thus, where the idea is patentable, the inventor is likely to resort to the federal system in order to secure the significantly greater protection of the patent grant.¹⁰² A favorable balance exists, then, between trade secret and patent law. An unpatentable idea may be exploited by a trade secret agreement, and patentable ideas will invariably be exploited under the aegis of the patent system. This equilibrium means that, far from retarding disclosure of commercially useful ideas, trade secret law ensures maximal disclosure. Moreover, pending issuance of the patent grant, the trade secret agreement supplies a method for immediate exploitation of the patentable but not yet patented idea, i.e., a "head

⁹⁴ 442 F.2d at 224.

⁹⁵ 35 U.S.C. § 122 (1970) prescribes the confidential status of applications. 37 C.F.R. § 1.14 (1972) provides in part: "[P]ending patent applications are preserved in secrecy."

⁹⁶ Cf. 442 F.2d at 224.

⁹⁷ 376 U.S. at 230-31 (footnote omitted).

⁹⁸ See text at notes 99-101 *infra*.

⁹⁹ Restatement of Torts § 757, at 13-14 (1939).

¹⁰⁰ *Id.*, § 758.

¹⁰¹ 35 U.S.C. § 271 (1970).

¹⁰² Moreover, an inventor must apply for a patent within a year after he begins to use his invention or else he will be precluded from receiving letters patent. 35 U.S.C. § 102 (1970).

start."¹⁰³ Thus, in conjunction with the patent system, trade secret law provides significant impetus for technological development.¹⁰⁴ However, trade secret law standing alone could not guarantee the incentive for invention and disclosure requisite for the most complete technological advances.

It is therefore submitted that recoupment would destroy the present equilibrium between trade secret and patent law. In order to avoid the threat of recoupment, inventors in great numbers might feel compelled to choose the trade secret agreement regardless of the patentability of their ideas, relying on the fact that, as long as the other party to the agreement did not breach the confidential relationship and independent discoveries did not materialize, the inventors would enjoy perpetually exclusive markets rather than the temporary exclusiveness granted by patents.¹⁰⁵ With the scale thus tipped in the favor of trade secrets, the patent system would then tend to be bypassed, with consequent impact upon the direction and tempo of technology. And trade secret law alone cannot serve the needs of technology—industry and commerce must suffer, since only patent law requires *full* disclosure of inventions. Thus the Sixth Circuit had good reason to fear the adverse effects which recoupment would have on the fine balance between state trade secret and federal patent law.

In short, trade secret law complements the patent system and, in juxtaposition, the two bodies of law encourage the invention and the utilization of all commercially feasible ideas, with minimal adverse competitive effects and maximal disclosure; however, were the patent system to be reduced to a relatively insubstantial role by introduction of the remedy of recoupment, trade secret law would prove incapable of supplying the impetus necessary to ensure the progress of science and the useful arts.

After assessing recoupment in terms of its probable effects on early challenges, its limitations on the investment possibilities of the licensor, and its upset of the delicate balance between trade secret and federal patent law, the Sixth Circuit considered the possibility of re-

¹⁰³ Doerfer, *The Limits on Trade Secret Law Imposed by Federal Patent and Antitrust Supremacy*, 80 Harv. L. Rev. 1432, 1447 (1967); Adelman & Jaress, *Inventions and the Law of Trade Secrets after Lear v. Adkins*, 16 Wayne L. Rev. 77, 88 (1969). Until the public is able to discover the trade secret, the licensee decidedly has a competitive advantage. The immediate commercial use of the idea is thereby encouraged. Thus, the inventor receives a reward of pre-patent royalties for permitting the licensee to "tool up" for commercial production prior to issuance of the patent. If a licensee were able to recover all of his royalty payments after the patent application was rejected or the patent granted was later declared invalid, then the licensor would be reluctant to enter into such a pre-patent licensing agreement and "headstarts" would evaporate.

¹⁰⁴ Further, trade secrets serve social policy well by discouraging unscrupulous business practices ranging from fraud to interference with advantageous business relations. Doerfer, *supra* note 103, at 1450.

¹⁰⁵ *Pennock v. Dialogue*, 27 U.S. (2 Pet.) 1, 19 (1829); Adelman, *Trade Secrets and Federal Pre-Emption—The Aftermath of Sears and Compco*, 49 J. Pat. Off. Soc'y 713, 729 (1967).

coupment in light of the eviction doctrine. The court reasoned that "public interest [was] adequately protected under *Lear* without imposing on the patent holder the obligation to refund royalties paid under the license of a patent procured and asserted in good faith."¹⁰⁶ In propounding the adequacy of *Lear* in this respect, the court attempted to reconcile this Supreme Court decision with the Sixth Circuit doctrine of eviction¹⁰⁷ as developed in *Drackett Chemical Co. v. Chamberlain Co.*¹⁰⁸ *Drackett* involved circumstances quite similar to those in *Troxel*. *Drackett* and *Chamberlain* had entered into a licensing agreement based on a *Chamberlain* patent. The two companies, as joint plaintiffs, brought suit against *Babbitt* for infringement of the patent. The district court that heard the case indicated at a hearing that the *Chamberlain* patent did not cover the *Babbitt* product. *Drackett* then notified *Chamberlain* that it would cease royalty payments if the patent were held invalid. The district court ultimately adjudged the patent invalid, and this decision precipitated the suit between *Drackett* and *Chamberlain*.¹⁰⁹ Quoting Judge Learned Hand, the Sixth Circuit outlined the doctrine of eviction: "It is quite true that a licensee may not dispute the validity of a patent in a suit for royalties . . . though the contrary is the case *after decree of invalidity in another suit*."¹¹⁰ The court further explained that the adjudication of invalidity by another court triggers "a complete failure of consideration—an eviction—which should justify a termination of the contract."¹¹¹ However, the court continued: "*Prior* to such eviction, the mere invalidity of the patent is properly held *not* to be a sufficient defense . . ."¹¹²

The district court in *Troxel*, confronted with claims by *Troxel* that eviction occurred as of the date of the Ohio District Court decision of invalidity and conflicting claims by *Schwinn* that eviction could occur only as of the affirmance of that decision by the Ninth Circuit, evaded the issue entirely, holding that *Lear* required restoration of all royalties regardless of eviction.¹¹³ The Sixth Circuit resolved the issue by holding that *Lear* superseded the *Drackett* doctrine with respect to the date of eviction. Under *Drackett*, a licensee would be permitted to suspend royalty payments only following eviction, i.e., a final adjudication of invalidity.¹¹⁴ In contrast, under *Lear*, a licensee would be permitted to repudiate and cease royalty payments at any time, secure in the knowledge that the validity of the patent could be effectively

¹⁰⁶ 175 U.S.P.Q. at 70.

¹⁰⁷ *Id.* at 69.

¹⁰⁸ 63 F.2d 853 (6th Cir. 1933). The facts recounted are taken from the court of appeals opinion, *id.* at 854-55.

¹⁰⁹ There appears to be no report of this district court opinion. The court of appeals discusses it at 63 F.2d at 855.

¹¹⁰ *Id.* at 854 (citations omitted, emphasis supplied).

¹¹¹ *Id.*

¹¹² *Id.* (emphasis supplied).

¹¹³ 334 F. Supp. at 1270.

¹¹⁴ See text at notes 111-12 *supra*.

challenged upon suit by the licensor for unpaid royalties.¹¹⁶ There need not be a prior adjudication of invalidity. Thus *Lear*, in not limiting the licensee to repudiation subsequent to a third party adjudication of invalidity, is more expansive in scope than *Drackett*. However, the two opinions are reconcilable to the extent that royalties must be paid up to the date of repudiation in both cases. Finally, the Sixth Circuit noted that *Blonder*, in permitting a licensee to assert the defense of collateral estoppel (based on a third party adjudication of invalidity) in a pre-trial motion for summary judgment, also changes the *Drackett* rule somewhat. Thus, in contrast to *Drackett*, where repudiation is permitted only after a final third party adjudication of invalidity, *Blonder* permits repudiation prior to an adjudication of invalidity, which may be obtained subsequently in summary fashion. Nevertheless, the Sixth Circuit insisted upon maintaining the doctrine of eviction and utilized it in reaching its decision that royalties could not be recovered up to the date of repudiation, even though the doctrine's goal of lessening the burdensome effect of licensee estoppel was accomplished by the action of the Supreme Court in *Lear* and *Blonder*.¹¹⁸

The essence of the Sixth Circuit's decision was its holding that recoupment, as the district court wished to employ it, conflicted with federal patent policy. Under basic preemption doctrine,¹¹⁷ then, the remedy could not be allowed to stand.¹¹⁸ It is submitted, however, that the appellate court could have reached the same result simply by evaluating the district court's remedy in terms of fundamental contract doctrine.¹¹⁹

The recoupment remedy proposed by the district court was, of course, a remedy tantamount to restitution. Under principles of state

¹¹⁶ See note 48 *supra*.

¹¹⁷ See text at notes 41-46 *supra*. The Sixth Circuit held that *Lear* overruled *Drackett* to the extent that the latter prohibited suspension of royalty payments prior to a third party adjudication of invalidity. 175 U.S.P.Q. at 69. In addition, referring to the facts in *Drackett*, viz., that the third party adjudication there had not been appealed and so had become final, the court held that the doctrine enunciated therein depended upon final adjudications of invalidity. *Id.* at 66. It followed that, in the instant case, the adjudication became final upon affirmance by the Ninth Circuit. *Id.*

¹¹⁷ For general consideration of the preemption doctrine, see Mishkin, The Variousness of "Federal Law": Competence and Discretion in the Choice of National and State Rules for Decision, 105 U. Pa. L. Rev. 797 (1957); Note, The Competence of Federal Courts to Formulate Rules of Decision, 77 Harv. L. Rev. 1084 (1964).

¹¹⁸ The Sixth Circuit nowhere used the term preemption, but that concept is of course at the heart of the holding that recoupment was an inappropriate remedy to the extent that it conflicted with federal policy.

¹¹⁹ Of course, state contract law does not apply if it collides with paramount federal law. U.S. Const. art. 6, cl. 2. *Lear* abolished the narrow contract doctrine of licensee estoppel only. 395 U.S. at 668, 674. And *Painton* expressly reserved to the states the power to enforce trade secret agreements. 442 F.2d at 225. Thus, until *Troxel*, the usual principles of state contract law applied to the law of patent conveyancing. Hearings on S. 643 Before the Subcomm. on Patents, Trademarks and Copyrights of the Senate Comm. on the Judiciary, 92nd Cong., 1st Sess., pt. 1, at 264-85 (1971) (testimony of Assistant U.S. Att'y. Gen. R. McLaren).

contract law, a licensee may seek rescission and restitution of royalties based upon the licensor's breach.¹²⁰ In providing relief to the licensee the court's objective would be to restore the licensee, as the aggrieved party, to the position that he occupied before the contract was made.¹²¹ This would be accomplished by requiring the licensor to restore the royalties that he had received from the injured party.¹²² However, the licensee seeking restitution would be required to return what he had received as part performance by the licensor.¹²³ Where the benefits received by the licensee would be incapable of return in the form rendered, their value might be used to offset the amount awarded in restitution to the licensee.¹²⁴ Applying this principle to Troxel's case, the benefits received by Troxel would be apportioned equivalently to the royalties paid. The agreement was of considerable benefit to Troxel, allowing it to avoid a costly infringement suit and deterring others from competing with it.¹²⁵ Even if the licensing agreement were based on an invalid patent, it must be presumed that until there was an adjudication of invalidity, the statutory protection¹²⁶ flowing from the presumed valid patent¹²⁷ deterred those potential competitors who were not willing to defend a costly infringement suit from using the

¹²⁰ For a general discussion of the remedy of rescission, see 12 S. Williston, *A Treatise on the Law of Contracts* §§ 1455, 1460 (3d ed. W. Jaeger 1970). In seeking rescission and restitution in the *Troxel* situation, the plaintiff's action would be grounded on the theories of breach of implied warranty and misrepresentation. See text at notes 129-32 *infra*.

¹²¹ 5 A. Corbin, *Contracts* § 1102, at 548 (1932). Restitution is appropriate where there has been a failure of consideration, that is, a breach which goes to the essence of the contract. *Id.*, § 1104, at 558. The breach must be total, discharging the injured party from any contractual duty. *Id.* at 562. In the case of a severable contract, where a distinct part of the licensee's performance would be exchanged for some apportioned part of the licensor's performance, restitution would be available for the part totally breached. *Id.*, § 1111, at 591.

¹²² *Id.*, § 1108.

¹²³ *Id.*, § 1114, at 608.

¹²⁴ *Id.*, § 1114, at 613 & n.69.

¹²⁵ Moreover, a licensing agreement is normally negotiated according to an evaluation of the patent's validity, strength, and value. Thus, payments under a license represent no more than the estimated worth of the patent. In addition, the licensee will pass on to the public the royalty expense in the form of higher prices. To permit restitution of the royalty payments would thus result in double collection of royalties by the licensee. Brief for the New York Patent Law Association as Amicus Curiae at 12, *Troxel Mfg. Co. v. Schwinn Bicycle Co.*, 175 U.S.P.Q. 65, Nos. 72-1106-07 (6th Cir., Aug. 11, 1972).

¹²⁶ 35 U.S.C. § 281 (1970) provides: "A patentee shall have remedy by civil action for infringement of his patent." In addition, 35 U.S.C. § 283 (1970) provides: "[C]ourts having jurisdiction . . . may grant injunctions . . . to prevent the violation of any right secured by patent. . . ."

¹²⁷ A presumption of validity arises from the issuance of a patent. 35 U.S.C. § 282 (1970). See, e.g., *Graham v. Jeoffroy Mfg., Inc.*, 206 F.2d 769, 772 (5th Cir. 1953). However, this presumption may be more conjectural than real. See *Lemelson v. Topper Corp.*, 450 F.2d 845, 849 (2d Cir. 1971). This presumption, an already fragile element of the bargain, may be rendered entirely immaterial by permitting recoupment of royalty payments. Brief for the New York Patent Law Association as Amicus Curiae, *supra* note 125, at 10.

patented idea. In addition, the licensee under a pre-patent licensing agreement may acquire the further benefit of a "head-start" before the patent issues.¹²⁸

Accordingly, under the principles of restitution, Troxel could not be awarded any restoration of royalties since it would be found that the reasonable value of the counter-performance Troxel had received—i.e., forbearance from suit for infringement and protection against other infringers—offset any royalties it had paid. Hence it would appear that the *Troxel* district court, in awarding recoupment of royalties, did so in contravention of basic principles of contract law.

In addition to the unavailability to the licensee of the desired remedy of restitution, it is submitted that the underlying claim of breach of contract is arguably invalid. As has previously been demonstrated, Troxel's action against Schwinn for breach of contract arising from invalidity of the patent would not give rise to total restitution of all prior royalty payments to Troxel. It would appear that a licensee in Troxel's position could not have obtained the recovery sought under a breach of contract action based on either a breach of warranty theory or a misrepresentation theory. An allegation based on breach of an implied warranty of a patent's validity or utility would have been hard to sustain,¹²⁹ as would one involving an implied warranty of merchantability or fitness for a particular purpose.¹³⁰ Success would not

¹²⁸ See note 103 supra.

¹²⁹ Comment, Implied Warranties in Patent, Know-How and Technical Assistance Licensing Agreements, 56 Cal. L. Rev. 168 (1968). Thus, the licensor, in entering into a licensing agreement with the licensee, may be presumed to warrant the validity and utility of the patent. Arguably, an adjudication of invalidity could place the licensor in breach, thereby entitling the licensee to rescind the licensing agreement and recover past royalty payments.

However, as a rule, a patent license does not import a warranty of the patent's validity. R. Ellis, Patent Licenses § 216 (3d ed. A. Deller 1958) [hereinafter cited as Ellis]. See, e.g., *Eastern States Petroleum Co. v. Universal Oil Products Co.*, 22 Del. Ch. 333, 338, 2 A.2d 138, 140 (1938) (representation by patentee that patent is valid is expression of opinion and licensee is not entitled to rely on it); *Leese v. Bernard Gloekler Co.*, 287 Pa. 295, 298, 135 A. 206, 207 (1926) (assignment of patent creates implied warranty of title in assignor but not warranty of validity). Nor is there a warranty of the patent's commercial utility. Ellis § 215. See, e.g., *Fair v. Shelton*, 128 N.C. 105, 107, 38 S.E. 290, 291 (1901); *Van Norman v. Barbeau*, 54 Minn. 388, 393, 55 N.W. 1112, 1113 (1893). Since the commercial utility of the patent is a secondary indicator of the patentability of the idea under 35 U.S.C. § 103 (1970), 383 U.S. at 17-18, a warranty of commercial utility would amount to a partial warranty of validity—a warranty which will not be implied. A licensee does not receive an implied promise that the patent, although granted by the Patent Office, has actually met all of the requirements of the patent laws. Even though the determinations of the Patent Office are the result of a lengthy period of search and deliberation, the extreme technological difficulty involved in such a procedure, the ex parte nature of the determination, and the Office's reliance upon the representations of the applicant, leave such determinations of patentability open to judicial review subject to the presumption of validity. Absent congressional action to the contrary, the court of appeals in *Troxel* refused to imply a warranty of validity on similar grounds. Cf. 175 U.S.P.Q. at 70.

¹³⁰ Uniform Commercial Code §§ 2-314, 2-315 [hereinafter cited as U.C.C.], defines these implied warranties. These warranties generally apply only to transactions in goods,

appear more likely in a contract action for rescission of the licensing agreement alleging fraud as a material breach of the contract,¹³¹ or in a tort action for the licensor's deceit in inducing the licensee to enter into the licensing agreement.¹³² As in an action for breach of contract, the licensee would have grave difficulties in utilizing any of these actions to prove himself entitled to relief consisting—as recoupment does—of full restitution. In sum, even if the remedy of recoupment were impossible to grant on grounds of preemption—specifically, on account of its inconsistency with federal patent law—it is inappropriate in an action under state law for restitution.

Finally, although the court of appeals did not analyze the anti-trust aspects of the case, it is submitted that the recoupment issue could have been decided under such a theory. The patent plays a prominent role in a competitive economy. It is a privilege of exclu-

covering the use of an item of sale. U.C.C. § 2-102. Furthermore, U.C.C. § 2-105 defines "goods" as "all things (including specially manufactured goods) which are movable at the time of identification to the contract for sale." This definition clearly excludes the licensing of patent rights. Even though, as in a sale, the licensor acquires substantial rights in the use of the patent and the licensor receives valuable consideration from this transaction (Comment, *supra* note 129, at 174, 178), a non-exclusive license, like the one held by Troxel, is unlike a sale, since the licensor retains property rights in the patent. *N.V. Phillips' Gloeilampenfabrieken v. AEC*, 316 F.2d 401, 409 (D.C. Cir. 1963). A further obstacle arises in attempting to cast the licensor in the role of a merchant and in establishing a trade or use by which the merchantability of a novel patent may be judged. Comment, *supra* note 129, at 183-85. Moreover, in applying the implied warranty of fitness, a licensee, whose skill and knowledge are equal to that of the licensor and who has inspected the materials to be licensed, has probably not justifiably relied on the licensor. E.g., *Gillette v. Kelling Nut Co.*, 185 F.2d 294, 297 (4th Cir. 1950); *American Radiator & Standard Sanitary Corp. v. Titan Valve & Mfg. Co.*, 144 F. Supp. 841, 845 (N.D. Ohio 1956).

¹³¹ Restatement of Contracts § 476, at 904 (1932) asserts that a fraudulent transaction is voidable as against the defrauded party. When a contract is voidable due to a fraud, the injured party may escape liability. *Id.*, § 475, comment *b* at 906. Even if Schwinn had made misrepresentations amounting to a material breach of the licensing agreement, *id.*, § 489, at 932, to the extent that Troxel would be unable to restore what it had received from Schwinn, restitution would be denied. *Id.*, § 480, at 916.

¹³² The courts have held that a licensee may be entitled to recover royalty payments if he can show deliberate misrepresentation by the licensor before the Patent Office. *Monsanto Co. v. Rohm & Haas Co.*, 312 F. Supp. 778 (E.D. Pa. 1970); cf. *Nashua Corp. v. RCA Corp.*, 307 F. Supp. 152, 158 (D.N.H. 1969). See Carney, *Misrepresentations Before the Patent Office: Antitrust and Other Legal Effects*, 12 B.C. Ind. & Com. L. Rev. 1005 (1971), for discussion of the elements of proof in an action to recover damages from the licensor for fraud on the Patent Office. However, where a licensee seeks relief for injuries caused by misrepresentations made to him by a fraudulent licensor, he must prove damages under the "out of pocket" measure as the difference between that which he has parted with and that which he has received. *W. Prosser, Law of Torts* § 110, at 734 (4th ed. 1971). This "out of pocket" rule is akin to restitution in that it looks to the inequity of permitting the licensor to retain royalty payments procured by fraud rather than to the damage which the licensee has sustained. *Id.*, at 732. Accordingly, to the extent that a fraudulent licensor has derived benefit from the royalty payments in excess of the benefits derived by the licensee from use of the patent, the licensee is entitled to some recovery. However, Troxel drew valuable benefits from the licensing agreement in return for royalties paid and recoupment would again be improper.

sive use and is intended to benefit the public as well as the inventor.¹³³ However, the public is not entitled to disclosure of the inventor's idea unless he chooses to exploit his invention according to the patent statute.¹³⁴ The grant is therefore not a "monopoly" as the term is employed in the antitrust laws.¹³⁵

A patentee does not violate either patent or antitrust laws by using his invention within the limited terms of the patent grant. However, an aggressive patentee may "misuse" the patent. For example, a license which extends beyond the scope of the subject matter of the patent or the term of its effectiveness constitutes "misuse" of the patent.¹³⁶ Consequently, the licensor will be denied relief for infringement which transpires during the period of misuse.¹³⁷ Application of the misuse doctrine, however, does not result in forfeiture of the patent grant.¹³⁸ The concept originated as nothing more than a species of the equitable "clean hands" doctrine, withholding from the licensor his remedy for infringement as long as he abused the patent privilege. Hence the doctrine first served only as an *equitable* defense against a licensor's infringement suit, but courts came to incorporate within the doctrine antitrust as well as patent violations, and accordingly the defense of patent misuse may now serve as a complete defense in a patent infringement suit.¹³⁹

In opposition to this trend, however, it has been argued that, as a matter of patent policy, the misuse doctrine should be used solely to prevent the licensor from extending the scope of the patent beyond the express terms of the grant.¹⁴⁰ Otherwise, by permitting a patent infringer to choose between a patent or an antitrust defense, depending upon which would be more advantageous to him, the courts will increase the profitability of patent piracy.¹⁴¹ This school of thought, then, proposes a return to the limited application of patent misuse as an equitable bar to the licensor. In contrast, there are those who pro-

¹³³ E.g., *Kendall v. Winsor*, 62 U.S. (21 How.) 322, 327-28 (1858).

¹³⁴ In *United States v. Dubilier Condensor Corp.*, 289 U.S. 178, 186 (1933), the Court explained:

The term monopoly connotes the giving of an exclusive privilege for buying, selling, working or using a thing which the public freely enjoyed prior to the grant. Thus a monopoly takes something from the people. An inventor deprives the public of nothing which it enjoyed before his discovery, but gives something of value to the community by adding to the sum of human knowledge.

In other words, although all ideas in general circulation must be dedicated to the public good unless protected by a valid federal law does not require that all ideas be put in general circulation. 442 F.2d at 225.

¹³⁵ See note 133 *supra*.

¹³⁶ *Zenith Radio Corp. v. Hazeltine Research, Inc.*, 395 U.S. 100, 136-37 (1969).

¹³⁷ *Morton Salt Co. v. Suppliger Co.*, 314 U.S. 488, 493 (1942); *Nicoson, Misuse of the Misuse Doctrine in Infringement Suits*, 9 U.C.L.A.L. Rev. 76, 82-83 (1962).

¹³⁸ *Nicoson*, *supra* note 137, at 78.

¹³⁹ *Id.* at 88-91.

¹⁴⁰ *Id.* at 110.

¹⁴¹ *Id.* at 92.

pose that the concept of *patent* misuse be wholly abandoned and that a test looking only for *antitrust* violations be adopted.¹⁴² Proper use of a patent would then be assured by a uniform application of the antitrust laws.¹⁴³ Under this approach, the court would measure anti-competitive activity only in terms of antitrust standards, whether or not the alleged antitrust activity occurred through misuse of a patent.

Following the latter approach, the decision in *Lear, Inc. v. Adkins* has been postulated in terms of antitrust law.¹⁴⁴ Assuming *arguendo* that this approach is appropriate, a court would apply it to a patent case in the following manner. The premise of the court's analysis of the facts before it would be that agreements or state legal doctrines which insulate a patent from legal challenge, such as licensee estoppel, may unreasonably restrain trade or tend to create or perpetuate monopoly.¹⁴⁵ The court would then apply a two-step test to the restraint in question, a test that reveals the interplay between patent and antitrust laws.¹⁴⁶ First, it would decide whether an exemption from the antitrust laws must necessarily be judicially implied¹⁴⁷ to ensure the effectiveness of the fundamental incentive sought to be encouraged by the federal patent system—specifically, the incentive to invent.¹⁴⁸ Conduct necessary to preserve this incentive includes the right to enforce the patent, and the right to enter into royalty-bearing licenses¹⁴⁹ prior to an adjudication of invalidity, should one materialize.¹⁵⁰ If the implied exemption is unnecessary to the effective working of the

¹⁴² Kennedy, Patent and Antitrust Policy: the Search for a Unitary Theory, 35 Geo. Wash. L. Rev. 512, 559 (1967).

¹⁴³ See Austern, Umbras and Penumbras: the Patent Grant and Antitrust Policy, 33 Geo. Wash. L. Rev. 1015 (1965); Briskin, An Area of Confusion: Patents, Monopolies and the Antitrust Laws, 45 J. Pat. Off. Soc'y 741 (1963); McCarthy, A Patent Licensing Policy for Minimizing Antitrust and Misuse Risks, 46 J. Pat. Off. Soc'y 547 (1964).

¹⁴⁴ Stern, Antitrust Implications in *Lear v. Adkins*, 15 Antitrust Bull. 663, 667 (1970).

¹⁴⁵ The question arises as to whether this is a violation of the antitrust laws per se, or whether evidence is admissible to rebut this claim. The Supreme Court, in *Walker Process Equip., Inc. v. Food Mach. & Chem. Corp.*, 382 U.S. 172, 178 (1965), holding that fraudulent procurement of a patent may constitute a violation of the antitrust laws, noted that the area of per se illegality is carefully limited. As a result, evidence must be presented in each case of actual anticompetitive effects, the exclusionary value of the fraudulent patent claim being measured in terms of the relevant market for products covered by the patent claims. A claim to recover past royalty payments might be subject to a similar standard of proof.

¹⁴⁶ Adelman, An Antitrust Decision: *Lear v. Adkins*, 46 A.B.A.J. 45 (1972).

¹⁴⁷ Adelman & Jaress, Patent-Antitrust Law: A New Theory, 17 Wayne L. Rev. 1, 6 (1971). The antitrust laws do not provide for an express exemption. However, the patent laws would be hollow indeed without such immunity. *Id.*

¹⁴⁸ *Id.* Other incentives often attributed to the patent system are the incentives to innovate and to invest. By a careful scheme of definitions these incentives may be distinguished from the incentive to invent, the only activity which always precedes a grant of letters patent. *Id.* at 6 & note 19.

¹⁴⁹ *Id.* at 15.

¹⁵⁰ *Id.* at 9-10.

patent incentive scheme, then the restraint will be measured by general antitrust principles.¹⁵¹ Presumably some of the traditionally-used restraints would be found violations of antitrust law.¹⁵²

In *Troxel*, the Sixth Circuit did not employ the two-step method described above in determining whether recoupment was a suitable remedy. Initially, the court decided that recoupment was repugnant to the structure of the patent system. In light of its attendant adverse effects upon the patent system the court declined to grant such recovery.¹⁵³ Thus, in effect, *Troxel* concluded that the federal patent laws preempted the state remedy of recoupment where patent licensing agreements were concerned.¹⁵⁴ In this respect *Troxel* followed the judicial pronouncements in *Sears, Compco*, *Lear* and *Painton*. However, the court might instead have focused on the issue of preemption of the remedy of recoupment by the federal *antitrust* laws once it concluded, *without more*, that the remedy did not preserve patent incentives. Although the remedy of recoupment is judicially bestowed, it may be regarded as a contractual provision of the licensing agreement.¹⁵⁵ Consequently, the license, if augmented by an implied provision for recoupment, could be found to fall within the ambit of section 1 of the Sherman Act¹⁵⁶ as a "contract, combination or conspiracy" in unreasonable restraint of trade.¹⁵⁷

In conclusion, the court of appeals in *Troxel* refused to permit the licensee the additional remedy of recoupment primarily because it would have conflicted with the federal patent laws and hence could not be allowed to stand under preemption principles. A secondary reason was that existing means of encouraging challenges to improvidently granted patents were adequate without the addition of the proposed remedy. The court correctly ruled that the district court, in failing to distinguish the facts in *Lear* from those in *Troxel*, had extended *Lear* beyond the bounds required, and indeed permitted, by federal patent policy.

It is arguable, however, that the Sixth Circuit was mistaken in reasoning that recoupment would necessarily deter licensees from

¹⁵¹ Id. at 8. Adelman's two-step method is slightly different from a procedure outlined by then Assistant Attorney General Richard McLaren in Patent Licenses and Antitrust Consideration, BNA Antitrust and Trade Reg. Rep. No. 413 at X-12 (June 12, 1969):

In considering whether to attack a particular licensing provision or practice, we ask ourselves fundamental questions. First, is the particular provision justifiable as necessary to the patentee's exploitation of his lawful monopoly? Second, are less restrictive alternatives available to the patentee? Where the answer to the first question is no and to the second, yes, we will consider bringing a case challenging the restriction involved.

¹⁵² Adelman & Jaress, *supra* note 147, at 10-23.

¹⁵³ 175 U.S.P.Q. at 68.

¹⁵⁴ See note 118 *supra*.

¹⁵⁵ Adelman, *supra* note 146, at 46.

¹⁵⁶ 15 U.S.C. § 1 (1970).

¹⁵⁷ Cf. 175 U.S.P.Q. at 68.

bringing early challenges to specious patents: *Blonder*, in permitting summary judgment of an infringement suit instituted subsequent to a third party adjudication of invalidity, would permit competitors of the licensee to engage in open violation of a weak patent with little economic risk, thereby compelling the licensee to challenge the patent as early as possible, regardless of whether or not recoupment would accompany a successful challenge. It is submitted that further development of a point made in the opinion would add support to the court's conclusion: that recoupment might erode the very foundations of the federal patent system by compelling inventors to forego patents and seek instead the protection of the trade secret agreement, thereby upsetting the present delicate balance between patent and trade secret law. Finally, principles of state contract law and antitrust law provide additional grounds, though not utilized by the Sixth Circuit, for refusing recoupment. Specifically, Troxel should be barred from seeking restitution of royalty payments under state contract law because he had received considerable benefit from use of the patent; and if recoupment were made available as the district court proposed, licensing agreements could be deemed to incorporate the remedy by implication and accordingly would be characterized as unreasonable restraints of trade.

HOWARD B. BARNABY, JR.

Securities Regulation—Investment Company Act of 1940—Control Transfer Profits—Fiduciary Duty of Mutual Fund Advisers—*Kukman v. Baum*¹—Securities Supervisors, Inc. (Supervisors) served as the investment adviser and principal underwriter² for three open-end investment companies³—Selected American Shares, Inc. (Selected American), Selected Special Shares, Inc. (Selected Special), and Selected Opportunity Fund, Inc. (Selected Opportunity)—pursuant to management agreements between each of the funds and Supervisors.⁴

¹ 346 F. Supp. 55 (N.D. Ill. 1972).

² As investment adviser, Supervisors provided, in addition to other incidental services, supervision of investment and analysis of companies, securities, and economic conditions, and also furnished statistical, administrative and bookkeeping services, as well as office space and personnel. *Id.* at 56 n.1.

"As principal underwriter, Supervisors acts as agent of the funds in selling their shares, at a discount from the public offering price, to dealers who in turn sell the shares to the public at the applicable public offering price." *Id.* at 56.

³ The funds are investment companies registered pursuant to the Investment Company Act of 1940, 15 U.S.C. §§ 80a-1 to 80a-52 (1970) [hereinafter referred to as the Act]. Section 80a-5(a)(1) defines an open-end company as "a management company which is offering for sale or has outstanding any redeemable security of which it is the issuer." For a collection of authorities discussing the history of the Act see Comment, Protecting the Interests of Mutual-Fund Investors in Sales of Management-Corporation Control (or, Policing the Traffic in Other People's Money), 68 Yale L.J. 113 n.4 (1958).

⁴ Section 15(a) provides: "It shall be unlawful for any person to serve or act as