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Compensation Patterns in U.S. Foreign Licensing

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SUMMARY

THIS STUDY IS ONE in a series of studies by the Institute on the subject of licensing. It focuses on licensing as an income producer in the context of U.S. international trade. More public information has long been needed on foreign licensing compensation patterns, particularly royalty rates charged by various industries for patents, trademarks and know-how licensed abroad. There has also been a lack of precise information on geographic sources of U.S. firms' foreign licensing income. This study is based on findings from completed questionnaires by 58 firms in a wide variety of manufacturing industries. The findings relate to their compensation methods, bases for payment calculations, royalty rate patterns and geographic sources of income. An in-depth study of the types of industrial property rights licensed overseas is also included.

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INTRODUCTION

THE PTC RESEARCH INSTITUTE has had underway comprehensive studies on the subject of licensing both in foreign and domestic contexts. These studies, the results of which are published in *IDEA*, range over many aspects of the subject, such as licensing relative to foreign investment, tax treatment of licensing income, trademark control and licensing, and use limitations in patent licensing.¹

Currently, the Institute is directing specific attention to licensing factors in U.S. international trade. Growing demands from abroad for U.S. technology and know-how, and increased interests by U.S. firms in foreign licensing for purposes of producing income as well as to augment export sales and investment programs, have prompted the Institute to focus on the international scene.

In the U.S. balance of payments context, licensing income is becoming an important factor. Latest Department of Commerce published statistics show that in 1968 U.S. firms' receipts of licensing royalties and related fees from their foreign subsidiaries, affiliates and branches amounted to \$1,279 million, up from \$1,136 million in 1967.² This trend is further exemplified by comparison with earlier published figures showing such income as slightly over a billion dollars in 1964.

One aspect of the international picture in which more public information is needed concerns compensation patterns. Information has been particularly tenuous on royalty rates generally charged by various industries for patents, trademarks, and know-how licensed abroad; also, on distinctions between one time flat fee and continuing royalty payments. Moreover, there has been an apparent lack of precise information on geographic sources of U.S. firms' foreign licensing income. The Institute has therefore undertaken a research project on these elements of U.S. licensing, the results of which are reported in this article.

LICENSED SUBJECT MATTER

Technical property rights subject to licensing are synonymous with the term "industrial property." As presently used in the "Paris Union"

¹ This study deals with private licensing contracts; earlier articles on The PTC Research Institute's studies in this context are listed in Appendix B. "Licensing" in the context of government R&D patent policy (i.e., licensing v. title policy) is covered in other Institute research projects and related articles.

² U.S. Department of Commerce, *Survey of Current Business* (October 1969), p. 34.

Convention and other international contexts, "industrial property" covers a wide variety of subject matter.³ This particular survey, however, does not deal with all of the detailed breakdowns appearing in the Convention. It concentrates on the three basic categories of intangible property rights generally licensed by U.S. firms overseas—patents, trademarks and know-how, including trade secrets. It was left to the discretion of our respondents where to categorize more specific property rights (some companies, for example, grouped industrial design registrations in "patents"; origin markings and commercial names in "trademarks," et cetera).

In only a very few instances were patents, trademarks and know-how licensed by our respondents separately; they were generally licensed as a combination of technical property rights to a licensor. With respect to patents overseas, it appears that those on processes may be more important than those on products. In many countries, unlike the U.S., product patents are not obtainable in certain industries, most notably drugs, chemicals and food products. Patent applications are also important for licensing purposes.

The most prevalent element in foreign licensing appears to be know-how. Even where a foreign-owned patent is licensed for permitted imports, as distinct from local manufacture, know-how techniques are also made available for maintenance and servicing. For purposes of this survey, the term "know-how" includes unpatented technology that the licensor has developed, such as production techniques, formulae and other types of technical skills and trade secrets. The kinds of documents disseminated may include manuals, diagrams, blueprints, designs, specifications, and other printed engineering and manufacturing data. Materials detailing company sales techniques may also be included. Engineering and consulting services are, of course, important functions in transferring technical know-how in a licensing operation. Although know-how subject matter is not registerable as such for purposes of protection against infringement, it is generally recognized in the industrialized countries as a form of property right that can be sold, licensed, assigned, taxed, and exchanged for equity in a firm. Protection is generally established through contractual enforcement but there is virtually no international uniformity as in the patent

³ In the International Convention for the Protection of Industrial Property (Paris Union Convention), "industrial property is concerned with patents, utility models, industrial designs, trademarks, service marks, trade names, and indications of source or appellations of origin, and the repression of unfair competition" (Article 1 (2) of Lisbon Treaty (1958 Revision), latest in force.)

and trademark field. Unfair competition laws and common law procedures provide such enforcement machinery as exists.⁴

There are occasions where trademarks may be primarily licensed, particularly where the mark is "famous" or "well known" for U.S.-made products exported throughout the world. An important factor in foreign trademark licensing is maintenance by the licensee of quality control standards established by the licensor. Many foreign trademark laws provide specific enforcement procedures for this purpose, as in the "registered user" provisions of British Commonwealth and other countries.

There may be occasion for manufacturing firms to license copyrights on their advertising and promotional literature, as well as technical documents transmitted to the licensee. Foreign-owned design and utility model patents and other lesser forms of industrial property rights abroad may also be subject to license. Our respondents, who are primarily product manufacturers, did not indicate that such property rights were important in their licensing operations.

PAYMENT COMPUTATION METHODS

Before discussing our specific findings, it is desirable to cover briefly the general subject of compensation determinants.

In licensing, royalty income is the most obvious and identifiable form of compensation.⁵ There may be no such thing as a "usual" royalty rate but, as will be seen later, definable patterns emerge within industry categories. Once the royalty rate is decided upon, it may be applied to the price at which a product is sold, or to the profit on sales made by the manufacturer. Specific cash-calculated royalty payments (as distinct from rates) may also be assessed on the licensee (i.e., "x" cents or dollars per quantity or measurement of the product). In any event, once the payment method is calculated, it can be based on price or profit per quantity, weight, volume, or other physical measurement, if the invention concerns manufacture and/or sale of a product. If a process is being licensed, royalties may be based on the compositions utilized, the objects treated, or the products made by the process.

⁴ For an excellent in-depth analysis of the international situation on this subject, see article "Legal Protection of Know-How" by Dr. Stephen P. Ladas in *IDEA*, Vol. 7, No. 4 (Winter, 1963-64), p. 397.

⁵ That is, as compared to lump sum or flat fee payments, technical assistance fees and/or equity participation in a project. The term "royalty" in the context of this study is used to describe compensation for licensing on a continuing, periodic basis during the life of the agreement—of patents, trademarks and know-how. It is not synonymous with "rentals," used in the context of tangible property.

If the royalty rate is based on price, factory or retail price may be used, although factory is more common. In such instances, royalties will usually be paid either on gross sales (manufacturer's calculated receipts for all sales as though paid for in full) or net sales (gross sales less returns and allowances, i.e., actual payment received for products made under the license). The net sales method is more commonly used.

The method of royalty rate payments based on profits has not been as widely used by U.S. firms. Difficulties between potential licensors and licensees in computing costs and other elements of overhead and division of profits based on ownership, risks and investments, have tended to discourage use of the profit, in deference to the price, basis.

Royalties fixed, not at a rate, but at specific payment for given numbers or sizes, may be based on total licensed products made or sold, the former being obviously more advantageous to the licensor.

With respect to royalty rates, there may be agreements that provide for a decreasing rate as the volume for calculation purposes rises. Rates may also vary with different qualities of a product based on classes or grades. Rates may also be based on items that are "installed" even after being "sold." Provisions may be made for reducing the rate when additional licensees enter the original licensee's market, or the license is otherwise changed from exclusive to nonexclusive.

DESCRIPTION OF THE SURVEY AND QUESTIONNAIRE

Our questionnaire (see Appendix A) was sent to 325 leading U.S. firms (as measured by annual sales) in a wide variety of industries to secure the best possible sampling base of manufacturers licensing abroad. We established five categories of industries for mailing purposes:

- (1) Aerospace and electronics (including communications equipment, electrical machinery and other closely related fields);
- (2) Industrial machinery (including generators, machine tools and other heavy machinery and equipment);
- (3) Metals, chemicals and other materials (including primary and fabricated metals, rubber products, building and construction materials);
- (4) Consumer-type products (including household goods, softwear and other textile products); and
- (5) A miscellaneous category (including such industries as

laboratory supplies, precision and scientific instruments, medical equipment and photographic supplies and equipment).

While we included manufacturers of industrial chemicals, this particular survey was not directed to drug and pharmaceutical licensing. Licensing, as well as patent protection, in the drug and pharmaceutical fields abroad is subject to highly restrictive controls. These are characterized by such conditions as patent protection only for processes, or no patent protection at all, such as in Italy and Brazil; stringent ceilings on royalty rates; and immediate compulsory licensing without any grace period.⁶ In view of this situation, The PTC Research Institute believes that foreign drug and pharmaceutical licensing should be the subject of a separate research project which it plans to undertake in the context of our overall licensing research program.

Fifty-eight usable responses were received. While we had hoped for a larger return, we are very satisfied with the distribution of industries represented by the respondents, as well as the completeness of their replies. We believe that a highly useful sampling base was obtained for purposes of this survey. Fourteen of the 325 companies to whom we sent questionnaires stated that they had no foreign licensing program.

The questionnaire was designed to expedite response by a person familiar with the subject without extensive record searching. The first two questions asked for information on the type of manufacturing undertaken by the firm, its annual sales in 1968, and the types of

⁶ Countries members of the Paris Union Convention (1934 and 1958 Revisions) cannot order compulsory licensing of patents on grounds of failure to work or insufficient working before four years from application filing date or three years from patent issue date, whichever is later (Article 5.) Also forfeiture of a patent cannot be prescribed on such grounds until two years after grant of the first compulsory license. These grace periods, however, apply only to abuses which the government believes have resulted from failure of patents to be worked. They are not intended by the Convention to apply under conditions where the government determines at the outset that certain patents concern a country's vital interests, such as in the public health field. Thus, many countries have provisions in their laws and regulations enabling the authorities to order immediate working or licensing of drug and pharmaceutical patents (or imports of products covered in their specifications) in the public health interest. Industries related directly to nuclear energy and military security appear to be the only others as completely subject to such compulsory licensing procedures.

A number of countries have strict controls relative to royalty rate ceilings on remittances abroad basically for exchange control purposes, and applicable to virtually all types of licensed products. Royalty ceilings imposed on pharmaceutical licensing agreements appear to be governed by policies of maintaining low price ceilings, as well as foreign exchange reserves.

industrial property rights it licensed overseas. The next two questions asked what methods of payment were most prevalent from licensees (flat fee, royalties, or both) and, if royalty payments were made, what rates were arrived at, and on what basis. In question five, we asked for the number of foreign licensees the recipient had, by geographic source, and also whether these licensees had "combination type" arrangements or were licensed to one type of property right (patents, trademarks or know-how, only). Finally, we asked the recipient firms for comments on the factors entering into their determination of compensation patterns for foreign licensees.

GENERAL ANALYSIS OF FINDINGS

The 58 respondents to our questionnaire had 634 licensees abroad. Our survey did not focus on numbers of arrangements negotiated with these licensees, since it was not considered necessary to have such detail for analyzing compensation and geographic patterns. The larger industrial manufacturer respondents—in aerospace, electronics, industrial machinery and base materials—averaged 10 to 15 foreign licensees, compared to lesser averages for consumer products and miscellaneous manufacturers, primarily those in the laboratory and scientific instruments fields. One of our respondents, a conglomerate with sales of over \$1 billion in a wide variety of industries (metals and chemicals, machinery, electrical control systems, fire-fighting and automotive equipment) reported 18 foreign licensees.

Property Rights Licensed and Payment Terms

Table 1 (Appendix C) shows the type of industrial property rights licensed abroad by our respondents, and the general type of payments in their agreements. The resources of the larger U.S. manufacturing firms, enabling them to acquire extensive foreign patent and trademark portfolios and to develop valuable know-how for licensing abroad, are indicative of the figures shown in the first seven columns.

Also to be noted from Table 1 is that exactly half of our 58 respondents licensed their patents for royalties only; and 21 for payment of an initial flat fee and continuing royalties. None licensed patents only for a flat fee. Three of our respondents licensed patents under cross-licensing or other royalty-free arrangements. Five others did not license patents.

Twenty-three respondents licensed their trademarks for royalties only. Nine received an initial flat fee and continuing royalties. As in the case of patents, no firms licensed trademarks only for a flat fee. Four firms licensed trademarks under cross-licensing or other royalty free arrangements. A substantial number of respondents (22) did not license this type of industrial property right.

In the field of know-how, unlike patents and trademarks, more firms licensed for payment of an initial fee and royalties, than for royalties alone. Twenty-eight respondents licensed for an initial fee plus royalties and 20 for royalties only. Also, unlike the other fields, 3 firms licensed their know-how for payment only of a flat fee. Five firms licensed no know-how and 2 licensed it on a royalty free basis.

Royalty Rates

Most of our respondents based their royalty rates on "net sales price" of the products made under their licensed patents and technology, and/or bearing their licensed trademarks. The rate was applied to each unit sold.

In some instances, firms used different bases within their own administrative structures for charging royalties, depending on the types of industrial property rights licensed. For example, one firm assessed its royalty rate for licensed patents on the net sales price, and for know-how, on the production cost of each product. Another also assessed its rates for patents and trademarks on units sold (per net sales price), but charged royalties for know-how on an overall periodic sales volume (rather than individual units) of the products sold. A third firm charged a fixed cash price (by weight, size or cost) for each unit using the patent licensed, and a royalty rate based on value of the know-how licensed. More specific variations in royalty rate bases are discussed in the section dealing with industries.

As to the rates themselves, most respondents charged 5 percent or less for use of their patents and know-how abroad (see Table 1). Quite a number of firms charged rates up to 10 percent and only a few, rates over this amount. Of the 46 firms that provided royalty rate figures on patents licensed abroad, 26 did so for 5 percent or less, 18 for up to 10 percent and 2 for over 10 percent. Regarding know-how, 25 firms licensed for 5 percent or less, 17 for up to 10 percent and 4 for over 10 percent.

Only 27 firms reported royalty rates for trademark licenses overseas—14 charging 5 percent or less and 13 up to 10 percent. None reported that they charged rates over this amount.

Although Table 1 shows the rates charged according to three "upper limit" categories, the rates reported by many individual companies varied widely. Some reported individual ranges of $1\frac{1}{2}$ to 10 percent, 1 to 10 percent, 1 to 15 percent and $11\frac{1}{2}$ to 15 percent. In the lower ranges, the individual rates generally went from 1 or 2 to 5 percent with a few up to 3 percent. In the "up to 10 percent" category, the rates generally started at 2 percent or above. Typical were rates such as 2 to 6 percent, 3 to $6\frac{1}{2}$ percent, 5 to 8 percent and 6 to 10 percent. There were no rates reported over 15 percent. In the few cases where the rates ranged over 10 percent, they started between 1 and 5 percent.

Where one rate, rather than a range was reported, 5 percent was the figure appearing most frequently. The next most prevalent figure was 3 percent. No singly used rate above 5 percent was reported, only ranges. Only a few companies reported that they assessed royalties on a cash, rather than rate, basis.

A more specific analysis of the royalty pattern by reporting firms also appears later in this report.

Scope and Geographic Sources of Licensees

Few respondents licensed patents without related know-how, or trademarks without related patents or know-how. Most of their foreign licenses were of a "combination type," (see Table 2 appended). Only in the aerospace and electronics industries were there an unusually high percentage of "one type" of industrial property rights licensed, mostly patents or know-how.

In grand total (see also Table 2), most of the foreign licensees of our respondents (141) were in the British Commonwealth countries (Canada, U.K. and Australia, primarily), and in the six European Common Market countries (134). Ranking third, fourth and fifth were Western Europe (other than Common Market) (80), South America (74), and Japan (70). Central American (46) and other Far Eastern (34) countries followed. The three lesser regional sources of foreign licensees were Africa (21), Middle East (8), and Eastern Europe (6).

Respondents in the aerospace and electronics industries (the larger firms in our sampling base) had their 220 foreign licensees subtotaled in the same general proportions, in the same regional areas, as appeared in the grand totals. The only difference was that Japan ranked fourth and South America fifth, the reverse of the grand total breakdowns.

In the industrial machinery and tools industries, which reported 101

foreign licensees, Japan and South America ranked third and fourth as their source, after the British Commonwealth and European Common Market. Other Western European countries ranked fifth, Central American and other Far Eastern countries sixth, and Africa seventh.

The European Common Market, rather than the British Commonwealth, was the principal source of the 206 foreign licensees of respondents in the metals, chemicals and other materials industries. Japan again ranked high, appearing third together with "other Western European countries." Countries in Central and South America and others in the Far East ranked relatively close as fourth through sixth.

The 42 foreign licensees of respondents in the consumer products industries were mostly in the British Commonwealth (16), South America (7) and Western Europe (5) other than Common Market. Respondents in our miscellaneous category of manufacturing reported that most of their 47 foreign licensees were in the European Common Market (15), South America (12), British Commonwealth (11) and Japan (5). The conglomerate respondent had 6 of its 18 foreign licensees in Western European countries outside the Common Market, 4 in the British Commonwealth, 3 in Japan and the others in Latin America and Africa.

Only one industry category—metals, chemicals and other materials—reported licensees in Eastern Europe. Three (the above plus aerospace and electronics, and consumer products) had licensees in the Middle East. These areas were the only ones with a comparatively sparse distribution of foreign licensees of our respondents.

ROYALTY RATE PATTERN (BY INDUSTRIES)

This section analyzes our findings on royalty rates, in specific industries, charged by our respondents on their foreign licensees. For convenience of presentation, the respondents are grouped in the industry categories described on pages 5 and 6 with sub-groupings according to their sales values in 1968. The "miscellaneous" category also includes the conglomerate respondent to our questionnaire.

Aerospace and Electronics (15 firms)

Sales—\$1 billion and above (4)

Rates charged by these larger firms for know-how were generally higher than those for patents. Trademarks were not too significant as royalty earners.

One firm licensed its patents and know-how at rates of 1 to 5 percent; it licensed no trademarks. Another licensed its patents at 5 percent, and know-how at 10 percent; it licensed trademarks for "no separate royalty . . . usually combined with know-how." A third firm licensed its patents and trademarks at 5 to 10 percent and know-how at 5 to 15 percent. All three assessed their rates on the basis of net selling price. A fourth firm licensed its patents at \$1 to \$170 per "unit using invention . . . amounts per unit arrived at by either weight, size or cost or a combination thereof." It licensed know-how at 1 to 15 percent of "licensee's sale price," noting that "rates may vary for value of technology; nature of licensed technology; or spare parts." It licensed no trademarks.

Sales—\$200 million to \$1 billion (5)

The rates set by these respondents for patents and know-how were generally more uniform within each firm itself than was characteristic of the larger sized firms in the above category. However, as with the larger firms, those in this lesser sized category also placed trademarks in a much less important role for earning purposes.

One firm charged 2 to 10 percent for both patents and know-how on "units of sale." Another charged 2 to 4 percent, a third 2 to 8 percent, and a fourth 5 percent for patents and know-how, all at net selling price. The latter two also licensed trademarks at the same rates. One firm did not license patents or trademarks, only know-how, at 1 percent of "retail price."

Sales—Under \$200 million (6)

In this lower sales range there was even less uniformity within individual firms, relative to their royalties, than existed among those in the \$1 billion and above category. Only two firms showed a semblance of internal uniformity in their rate patterns, one reporting a 5 percent charge for patents, trademarks and know-how "as a package" and another, 5 to 10 percent for all three types based on "value of units of sales." The highly varied internal compensation patterns used by the other firms are exemplified as follows: One licensed patents at 4 percent of "sales price," and know-how at 4½ percent of "production cost." It licensed no trademarks. Another licensed patents and trademarks at 3 to 7 percent, noting that the rate varied according to value and volume of sales (lower scale for higher value and volume). It licensed know-how at 5 to 7 percent, based on

value of types of products with which it was used. A fifth firm licensed its patents at 1 to 5 percent of net selling price. It had two different scales for know-how—a royalty rate of 1 to 5 percent of net selling price and a cash basis of 1 to 5 cents per unit of product employing the know-how. It licensed no trademarks. A sixth respondent did not state its royalty rates, but only that they varied “country by country and licensee by licensee.”

Industrial Machinery and Tools (11 firms)

Sales—\$200 million and above (5)

Here again, there was little consistency in rates, both within the companies themselves and as compared to each other.

Two companies did not license know-how. One licensed patents at $\frac{1}{2}$ to 10 percent of net sales price and the other, patents and trademarks at a “fixed amount,” the first based on “units,” and the other on a “yearly” derivation. Two other firms each licensed patents, trademarks and know-how, one at 5 percent and the other at 2 to 6 percent, of net sales price. A fifth licensed its patents at 5 percent and know-how at 5 to $7\frac{1}{2}$ percent on the same basis. It did not license trademarks.

Sales—Under \$200 million (6)

The intra- and inter-firm rate pattern in these six lower sales range firms followed the same general pattern of inconsistency as above. They even licensed more types of property rights at wider royalty rate ranges.

Four of them licensed patents, trademarks and know-how, one at 5 to 8 percent and another at 6 to 10 percent; the third licensed patents at 5 to 10 percent, trademarks and know-how at 5 percent; and the fourth, patents and trademarks at 2 to 5 percent, with know-how at 8 to 12 percent. A fifth licensed patents at $\frac{1}{2}$ to 3 percent and know-how at 5 percent; it licensed no trademarks. The sixth licensed no patents, only trademarks, at 5 percent, and know-how at a “negotiated figure.” All rates were based on net sales price.

Metals, Chemicals, Other Materials (21 firms)

Although the larger firms in our sampling base were in aerospace and electronics, and industrial machinery and tools, the greater per-

centage of reporting firms appeared in this particular category of industries. Their royalty rates were generally lower than those for respondents in the other two categories. Most metals, chemicals and materials firms licensed patents and know-how at the same royalty rates for each type of property right within the firm itself. Few licensed trademarks.

Sales—\$300 million and above (4)

All of these firms licensed patents, trademarks and know-how. One licensed them at 4 to 5 percent and another at 1 to 10 percent of net selling price. A third licensed patents at 1 to 2 percent based on "production," and trademarks at $3/4$ to $1\frac{1}{2}$ percent, based on "sales"; know-how was licensed at a flat fee. A fourth firm received "no payments per se—all help necessary (was provided) to affiliates in mutual interest."

Sales—\$100 million to \$300 million (5)

Only one firm licensed patents, trademarks and know-how; its rates ranged from 1 to 5 percent of net sales price. Two licensed only know-how; one at $1\frac{1}{2}$ to 15 percent and the other at 1 to 4 percent based on "units, sales or production." A fourth firm (in metal manufacturing) licensed both patents and know-how "with no division of royalty" between them. Its charges were 15 to 50 cents per ton (for cast iron products) and 1 to 5 percent of net sales price (for steel products). A fifth respondent licensed patents at 1 to 3 percent of "market value" based on "annual tons (of) product"; know-how was licensed at a flat fee.

Sales—\$50 million to \$100 million (6)

Only two firms licensed all three forms of property rights, one at 5 percent and the other at 4 to 6 percent of net sales price. One licensed only know-how at 1 to 3 percent of the product's net selling price. The remaining three each licensed patents and know-how as follows: The first firm—patents at 2 to 5 percent of "units of sale" and know-how at 2 to 5 percent based on "annual fee and/or sales volume"; the second—patents at 5 percent and know-how at 3 percent of net selling price; and the third—patents at 5 percent and know-how at 3 to 6 percent, either at "flat fee per unit or percentage of sales."

Sales—Under \$50 million (6)

Only one firm reported that it licensed patents, trademarks and know-how for royalties. It did so at 3 to 6½ percent of net sales price. Two licensed only know-how, one at a rate declining in proportion to increased volume (about 5 percent average) and the other at 3 to 5 percent "after taxes." A fourth licensed only patents on the following basis: (1) 5 cents per unit up to 25,000 and 3 cents over 25,000; (2) \$500 minimum royalty payment on signing of agreement and 4 cents per unit to be charged against that total. After charges total \$500, licensee must pay accumulated royalties of 4 cents for each unit. Two firms reported no royalty rates. One said that its "Patent rights and know-how are exchanged on a continuing basis, any imbalance of benefits to be negotiated"; the other said that its royalty rates "depend on subject involved."

Consumer Type Products (5 firms with sales of \$100 million to \$300 million)

The five respondent firms are manufacturers primarily of textile and related products, and household appliances. Only three reported royalty rates—one specified charges of 1 percent of "sales" for patents, trademarks and know-how; another, 2 percent for patents only, based on "units sold"; and a third, 3 percent "average" for know-how which "varies by volume of licensee." Another said that its "Royalties vary by products and price range. No fixed pattern," while a fifth reported its rates were "confidential."

Miscellaneous (A) (5 firms with sales of \$25 million to \$200 million)

Most of these firms are manufacturers of laboratory, medical, photographic and other precision equipment and supplies. Five percent appeared as the more prevalent rate among these firms which, when taken in total, emphasized trademarks as much as patents and know-how.

One firm stated that "Normally our license includes patents, trademarks and know-how for which a single rate is charged." It reported royalty rates of 3 to 10 percent on net selling price, noting that "Licensees are all affiliated companies and tax authorities in many countries have maximum royalty rates they allow a subsidiary to pay to

a foreign parent and deduct for tax purposes. Hence the range." Two firms licensed only patents and trademarks, one at 5 percent of net selling price and the other, patents at 5 to 10 percent and trademarks at "less than 5 percent," on this basis. Two licensed only know-how. One did so at 5 percent of "sales volume," and the other at 1½ to 5 percent, specifying that the rate "Varies with product and over market areas as well as volume."

Miscellaneous (B) (conglomerate firm with sales over \$1 billion)

This firm encompasses a wide range of manufacturing industries reported as "metals and chemicals, capital machinery, electrical control systems, fire fighting and automotive parts." It reported royalty rates "up to 10 percent" on the basis of "sales."

RESPONDENTS' COMPENSATION DETERMINANTS

Our questionnaire also sought insights into licensors' methods of determining how much a foreign licensee should pay for use of industrial property rights. The questionnaire recipients were asked to comment on factors taken into account in making such decisions.

Twenty-six firms provided us with usable information. Eight indicated a pragmatic approach to compensation determination with no outstanding emphasis on any particular factor. The other 18 generally focused on one or several factors in deciding how much a licensor should pay. The following comments by our respondents provide insights into their decisions.

Five of the eight firms that used the pragmatic approach indicated no particular order of importance to the factors they took into account. They noted, respectively:

We use no definite factors—each license is considered separately in light of what is best for us at that time in that place.

This [compensation] is determined by the technology involved, the patent position in the country of the licensee and the need of the licensee for the technology.

Generally we evaluate product line on basis of market, unit price and assistance we must render to licensee and equate these factors to royalty and flat fee.

We have no set policy as each case is considered on its individual merits; research costs of the industrial property rights, prospects of

export sales in country, prospects of subsidiary manufacturer in country, scope of patent, possible profit margins of licensee, and existence of competition are all considered. Obviously, it is our goal to obtain as much as possible in royalties and most final figures are arrived at by negotiation.

Our licensing experiences have involved a variety of products, processes and apparatus. As a consequence each license has been a subjective determination with no two being identical. Many factors are taken into consideration these . . . not necessarily listed in their order of importance. . . .

The other three firms attached an order of importance to their factors as follows:

The more important factors relative to compensation comprise a combination of value of know-how granted, total estimated return and market competition.

Listed in order of importance—

- a. Country involved—economic and political status
- b. Plant size and quantity of product
- c. Competition

Factors: a. How important is data to us—present and future?
 b. Will data establish a new competitor in future?
 c. How large is potential market in licensee's territory?
 d. What is competitive situation in market?
 e. How strong is our patent or proprietary position in country under consideration?

Of the 18 firms that attached particular emphasis to one or a few factors, 2 focused on local government policies, 4 on the licensee's marketing capabilities, 4 on cost factors, taxes and competitive nature of the licensee, 6 on specific cash and return technology value to licensor, and 2 on potential value to licensee. Comments illustrative of these companies' policies follow:

Considerations of Local Government Attitudes

We try to secure the maximum royalty rate. This is frequently limited through Government validation.

We charge a 10% royalty where the local tax authorities will allow one for tax purposes since this rate reflects our own continuing research and development costs with reasonable accuracy.

Licensee's Marketing Capabilities

We generally consider most important the production and marketing capabilities of the licensee [as it pertains to the subject matter

being licensed] and negotiate the royalty rate accordingly giving due consideration to other factors such as country or countries involved, competitive situation, costs, taxes, nature of license grant, etc.

We license overseas to reach markets that are otherwise not available to us. The rate of royalty is chosen on the basis of a fair reimbursement for what we are giving the licensee [in terms of new designs, support, service, market and patent protection] keeping in mind the need the licensee has to keep total costs at a level such that he can market the product.

Once having elected not to enter a particular market and having elected to grant licenses, our licensing fees are based upon what might be termed a reasonable return for what has been put in the hands of the licensee. Such fees must obviously be within reason so as not to inhibit the normal development of the licensee's market.

[Compensation determinants based on:]

- (1) Extent to which licensee will buy our component parts;
- (2) Extent to which licensee will aid our penetration of a marketing area and/or complement our other product lines;
- (3) Reasonable rate of return on cost of initiating and administering license.

Emphasis on Cost Factors, Taxes and Competitive Nature of License

This is determined by the going rate used by competition.

Our decisions relative to the compensation are weighted heavily towards competitive and tax factors.

[in order of importance]

- (1) Degree or nature of the use or assistance
- (2) The potential
- (3) Prevailing rate for similar arrangements
- (4) The burden—costs, taxes, etc.

[Determinants based on:]

- (1) Our development cost
- (2) Cost to service license
- (3) Nature of product
- (4) Whether or not we want limited licensing or broad licensing, exclusive or nonexclusive
- (5) Royalty product can bear in competition

Specific Returns to Licensor

Each licensee should return at least \$250,000 income over a period of a 15-year technical assistance agreement.

It [royalty rate] is somewhat arbitrary. Five percent of net selling price is always a good start. It is usually concluded by negotiation

and actual economic value each party can place on the use of the invention.

Principal factor for licensing is obtaining rights to other's technology in return for ours.

Look for minimal royalties for own products—generally discourage or refuse licensing unless return technology is involved. Present and past U.S. costs prohibit general sale of products manufactured in the U.S.—so licensing can produce some additional return.

Our agreements usually provide for slightly higher fees on export sales and also provide for marketing assistance in the export territories. We cannot always obtain these rates because of the attitude of the licensee, competition, etc. Therefore, in some cases we may shade these rates but in return we may ask for an initial disclosure fee or some equity participation.

Potential profitability of license	50%
Proprietary value	25%
Cost of development	25%

a. Return on original investment to produce know-how or patent	90%
b. Cost of servicing agreement	5%
c. Taxes and others	5%

Potential Value to Licensee

The primary consideration is given to the value of the licensed property rights to the licensee, which in turn depends upon such factors as the availability and cost of equivalent rights from other sources, the degree of exclusivity afforded by the license, etc.

Consider local problems to be a decisive factor in a decision [re royalty rates]. Generally a licensee expects and gets more than an investment of the same as ours would provide if he started cold in a line of business like ours.

CONCLUSIONS

U.S. manufacturers who license abroad, in considering the type of compensation to be sought, whether it be a single fixed amount, a continuing payment, or a return other than monetary, generally regard the royalty method as more practical and advantageous. Royalty payments bear a clearer relationship than do other types to extent of use of the licensed technology. Future sales become less of a problem in calculating compensation. Further, the varied bases upon

which royalty payments may be assessed enable greater flexibility in negotiations—a situation which also applies in determining the rates themselves.

This is not to disparage other types of payments or to imply that there are no disadvantages in the royalty method. Royalty licenses are quite vulnerable to greater misunderstandings and litigation unless clearly and carefully negotiated. Many firms provide for an initial “down payment,” as a guarantee to cover expenses, either separately or against which future royalties may be credited. Also important are related technical assistance fees, usually paid at a flat rate for a specified time. Equity participation with the licensee in a venture may also be a prime consideration. And, licensing primarily for technical exchanges and infringement immunity purposes is not to be overlooked. On balance, however, it is apparent that the U.S. licensor’s greatest concern in negotiating his “payment package” is royalty receipts.

Royalty rates and their bases for calculation are so varied among our respondents that it is not possible to specify a meaningful overall figure in any of the industries covered. No typical rate can be clearly identified. There are also wide variations intra-industrywise, in our respondents’ royalty rate ranges but patterns are definable for comparison purposes. Our findings indicate that the higher royalty rates in overseas licensing operations are negotiated by firms in the aerospace and electronics industries, followed by industrial machinery and tools, and metals, chemicals and other materials. Firms in the consumer products and miscellaneous categories covered in this report negotiate rates in foreign licensing agreements far lower than those in other industries.

Royalty rates within individual manufacturing firms are not necessarily consistent for each type of industrial property right licensed abroad. In quite a few firms there are considerable variations in rates and their assessment bases for patents, trademarks and know-how. Patents and know-how are seldom licensed separately. Likewise, trademarks are seldom licensed without related patents, or know-how. In the context of royalty payments, our respondents have generally indicated that patents, know-how and trademarks rank in that order of importance.

In the next phase of its licensing study, The PTC Research Institute will examine in further detail the relative importance of patents, trademarks, know-how, and other technical property rights, as income earners. This study will include an evaluation, not only of their royalty earning capacities, but their asset values for sales purposes.

Geographically, most foreign licensees of U.S. manufacturers are located in the industrialized countries of the British Commonwealth and Western Europe, and the industrialized countries of South America. Japan is also singled out as a leading country for U.S. licensing activities. Central America, Africa, Far and Middle East and Eastern Europe are not too important in U.S. overseas licensing operations.

Many factors enter into a firm's determination of the type and size of payment it will seek from a foreign licensee, whether it be in the form of flat fee, continuing royalty, or equity participation. A number of companies have no firm policy, reaching their decisions on a case-by-case basis, while others have a specific "check list" of considerations generally applicable to all licensees. In the final analysis, the licensor firm's basic consideration is a profitable return. It may be concluded that in most, if not all, cases this is the first factor to be taken into account.

In many countries, foreign licensing agreements must be approved by the government before transfer of royalties can be made. For exchange control purposes, such approval is generally conditioned on sanction of the central bank, which may impose limitations on transfers of royalties, as well as ceilings on royalty rates in licensing agreements. For example, in Colombia, the Bank of the Republic controls the transfer of royalties for patents and trademarks. In New Zealand, each royalty remittance requires approval of the Reserve Bank, as do licensing agreements themselves involving royalty payments. In Brazil, remittances or royalties by non-subsidiary firms and of all technical assistance fees are limited to 1 to 5 percent of gross receipts from the sale or manufacture of given products for which royalty and technical assistance payments are incurred abroad.⁷

⁷ International Monetary Fund, *20th Annual Report on Exchange Restrictions* (Washington, D.C.: 1969).

APPENDIX A

THE PTC RESEARCH INSTITUTE
THE GEORGE WASHINGTON UNIVERSITY

Questionnaire on Compensation Patterns for Licensing of Industrial Property Rights

1. Please indicate manufacturing industry in which your firm is generally categorized (primary metals, transportation, electrical machinery, drugs, etc.)

Also indicate (in approximate figure) total value of your company's sales in 1968

2. Does your company license any of the following types of industrial property rights to firms overseas (either affiliated or non-affiliated)? Please check.

	Yes	No
Patents		
Trademarks		
Trade Secrets and Know-How (unpatented)		
Other (specify)		

3. What methods of payment by your licensees are *most prevalent* in your licensing agreements now in force? (Please check below)

	Payment of:			
	Flat Fee (one time payment)	Royalties (continuing payment)	Flat Fee & Royalties	Other (specify)
For patent use				
For trademark use				
For use of trade secrets & know-how				
For use of other industrial property rights (specify)				

4. If you use the royalties basis for payment (either alone or with flat fee), please indicate below the approximate royalty rate (single percentage, or range of percentages figure) you generally arrive at and basis for its assessment (value, or units,

of sales, or production, etc.) If rate varies, please explain if variations are country-by-country, licensee-by-licensee, or both, or for any other reason.

	Royalty Rate (or rates)	Paid on Basis of:	Comment Re: Variations
Patents			
Trademarks			
Trade Secrets & Know-How			
Other Types (specify)			

5. Please specify below approximate (if exact calculation is not feasible) number of your licensees that are located in each geographic area. If possible, also fill in the subtotal columns.

	Number of Licensees	Subtotals	
		Number of licensees that have combined licenses (i.e., patent, trademark, trade secrets, etc.)	Number of licensees having only one type of license (i.e., patent, or trademark, or other)
British Commonwealth			
Western Europe Common Market Other			
Eastern Europe			
Middle East			
Far East Japan Other			
Africa			
Central America (including Mexico)			
South America			

6. We would appreciate your providing brief comments (no specific figures or financial data are being sought) on the weight you generally accord the factors entering into your company's decisions relative to the compensation it determines foreign licensees should pay for use of industrial property rights (e.g., costs, competition, taxes).

APPENDIX B

PREVIOUS PTC RESEARCH INSTITUTE LICENSING STUDIES

Studies on Licensing Abroad

- 1957—Vol. 1, Nos. 1 and 2
- 1958—Vol. 2, Nos. 1 and 2; Conference Number
- 1959—Vol. 3, Nos. 1, 3 and 4
- 1960—Vol. 4, No. 2
- 1961—Vol. 5, Nos. 1 and 2; Conference Number
- 1969—Vol. 13, Conference Number
- 1969-1970—Vol. 13, No. 4

Taxation and Licensing

- 1960—Vol. 4, No. 2
- 1961—Vol. 5, No. 3
- 1964—Vol. 8, Nos. 1, 2 and 3
- 1965—Vol. 9, No. 3
- 1968—Vol. 12, No. 1
- 1969—Vol. 13, No. 2

Miscellaneous

- 1962—Vol. 6, No. 2
- 1966—Vol. 10, No. 4
- 1967—Vol. 11, No. 2
- 1968—Vol. 12, No. 1
- 1969—Vol. 13, No. 3

APPENDIX C

TABLE 1

RESPONDENT FIRMS' INDUSTRIAL PROPERTY RIGHTS LICENSED ABROAD AND COMPENSATION PATTERNS

		Number of Reporting Firms That:											
Industries— Annual Sales Range	No. Firms Report- ing	License Following Property Rights						Charge Royalties to Following Maximum Rates					
		Patents		Trademarks		Know-How		Patents		Trademarks		Know-How	
		Flat Fee Royalti- ties	Royal- ties Only	Flat Fee Royalti- ties	Royal- ties Only	Flat Fee Royalti- ties	Royal- ties Only	To 5%	To 10%	Over 10%	To 5%	To 10%	Over 10%
Aerospace & Electronics													
Over \$1 Billion	4	1 ¹	1	1	1	1	1	2	2	—	2	2	2
\$200 M-999 M	5 ⁴	2	2	—	2	3	1	2	2	—	1	1	2
Under \$199 M	6	2	2	1	2	1	4	2	2	—	3	2	—
Total	15	5	5	3	1	5	1	3	3	—	3	3	—
Industrial Machinery & Tools—													
Over \$200 M	5 ⁴	1	4	1	2	3	6	7	7	—	2	6	2
Under \$199 M	6	1	4	1	5	—	—	2	2	—	1	3	—
Total	11	2	8	2	7	3	3	4	5	—	4	5	1
Metals, Chemicals, Other Materials—													
Over \$300 M	4 ⁸	—	3	—	3	2	2	2	1	—	2	1	—
\$100 M-299 M	5	2	2	—	1	1 ⁵	1	3	—	—	1	—	1
\$50 M-99 M	6 ⁴	5	1	2	—	4 ⁵	2	5	1	—	3	2	—
Under \$49 M	21	2	1	—	1	4	1	—	1	—	4	1	—
Total		9	7	2	5	11	6	10	3	—	10	4	1
Consumer Type Products—													
(Total)—\$100 M- \$300 M	5 ⁵	—	5	—	3	1	3	3	—	—	2	—	—

Number of Reporting Firms That:															
License Following Property Rights							Charge Royalties to Following Maximum Rates								
No. Firms Reporting	Patents		Trademarks		Know-How		Patents			Trademarks			Know-How		
	Flat Fee Royalties	Royalties Only	Flat Fee Royalties	Royalties Only	Flat Fee Royalties	Royalties Only	To 5%	To 10%	Over 10%	To 5%	To 10%	Over 10%	To 5%	To 10%	Over 10%
Industries— Annual Sales Range															
Miscellaneous (A) (Laboratory Instruments, Scientific Equip't & Supplies, etc.) (Total)—\$25 M–200 M	—	4	—	3	2 ^s	2	2	2	—	2	1	—	2	1	—
Miscellaneous (B) Conglomerate Firm (Over \$1 Billion)	1	—	1	—	1	—	—	1	—	—	1	—	—	1	—
Grand Totals	58 ⁷	29	9	23	31 ^s (28)	20	26	18	2	14	13	—	25	17	4

¹ Only the number of firms below licensed the type of industrial property for the type of payment shown; figures on horizontal lines for each type of property right shown do not in all instances add to total number of firms responding.

² Only the number of firms below reported a specific royalty payment rate for their licenses of the type of property shown; in some trademark cases shown in footnote 1, payment was not called for, mark licensed free as part of package deal.

³ One firm licenses patents for no payment; only for cross-licensing purposes.

⁴ One firm did not report royalty rates; specified "fixed amount" only.

⁵ One firm receives flat fee only, no royalties (3 firms in grand total receive flat fee only).

⁶ One firm stated no fixed pattern of royalty rates, varies by products; another stated its rates are confidential.

⁷ See footnote 1 for explanation of why horizontal subtotals do not add to same as vertical totals.

TABLE 2

RESPONDENT FIRMS' LICENSEES ABROAD BY SCOPE OF LICENSES AND GEOGRAPHIC SOURCES

Industry	Total No. Respondents (U.S. Licensees)	Total No. Their Foreign Licensees	(Sub-Total) Licensees by Scope of License Granted		(Sub-Total) Licensees by Their Source								Centr. Am.	Africa	Other Far East	South Am.
			Combination Type	One Type Only	Br. Commonw'th	Eur. Common Mkt.	Other Western Eur.	East'n Eur.	Middle East	Japan	Other Far East	Africa	Centr. Am.			
Aerospace & Electronics	15	220 ¹	139	61	49	45	35	—	1	27	5	3	10	3	5	25
Industrial Machinery & Tools	11	101	96	5	21	20	11	—	—	13	9	6	9	6	9	12
Metals, Chemicals, Other Materials	21	206	170	36	40	52	22	6	4	22	17	7	20	7	17	16
Consumer Type Products	5	42	40	2	16	2	5	—	3	—	2	4	3	4	2	7
Miscellaneous; Laboratory Instruments, Scientific Equip't & Supplies, etc.	5 1	47 18	44 14	3 4	11 4	15 —	1 6	— —	— —	5 3	1 —	— 1	2 2	— 1	— —	12 2
Conglomerate	58	634 ¹ (614)	503	111	141	134	80	6	8	70	34	21	46	21	34	74
Totals (Percentages Rounded)		(100)	(82)	(18)	(23)	(22)	(13)	(1)	(1.5)	(11)	(6)	(3)	(7.5)	(3)	(6)	(12)

¹ One firm with 20 licensees stated it cannot disclose types or sources (subtotals thus add to 20 less than grand total).

The Patent Cooperation Treaty: Views of Informed Innovators

The PCT Clinic

The Clinic on the proposed Patent Cooperation Treaty was held by The PTC Research Institute November 25, 1969, at the Institute's headquarters on the campus of The George Washington University. It was limited to a relatively small, invited group of knowledgeable persons from government, universities and industry. The last category included company executives, professional inventors and patent attorneys. Thus, the attendees constituted a cross-section of those in our society directly affected by present plans for a Patent Cooperation Treaty. The "Outline of the Clinic" that accompanied the invitation appears as an appendix to this publication.

The major subjects which governed the day's discussion were:

- (1) Finance: How will costs under PCT compare with the present situation?
- (2) Procedure: Are the procedures proposed advantageous or not?
- (3) Time Factor: How significant is the 20-month period as contrasted with the present 12 months?

The Clinic discussion was moderated by John C. Green, Project Leader, International Trade and Development Studies, of The PTC Research Institute. The Agenda appears on page 62 and the Summaries of the Moderator appear on pages 83, 94 (Financial and Administrative Features of the Proposed Treaty); pages 100, 112 (International Trade Considerations); and pages 121, 122 (Looking Ahead). Key presentations were made by the following two experts: Leonard J. Robbins, senior partner in the firm of Langner, Parry, Card & Langner, New York City (pages 35-41), and William R. Woodward, General Patent Counsel, Allied Chemical Corporation (pages 41-52).

The excellent exchanges make the record worthy of the wider audience which is available through this publication. The Institute wishes to express its sincere appreciation to all participants for their interest and willingness to share their special experience.

Participants in the PCT Clinic

Edgar W. Adams, Jr.	—Patent Attorney Director, Bell Telephone Laboratories
Robert B. Bangs	—Principal Investigator, The PTC Research Institute; Economist, U.S. Department of Commerce
Carl T. Becht	—Vice President, Engineering, Senco Products, Inc.
Jack N. Behrman	—Consultant, The PTC Research Institute; Professor, School of Business Administration, The University of North Carolina
James Brennan	—Acting Director, Office of International Patent and Trademark Affairs, U.S. Patent Office
John C. Green	—Project Leader, The PTC Research Institute; Scientific Communications and Research Consultant, Washington, D.C.
L. James Harris	—Director, The PTC Research Institute; Professor of Law, The George Washington University
Wallace R. Johnston	—Thomas Alva Edison Fellow, The PTC Research Institute
Donald C. McGaughey	—Attorney, Patent Law Section, Allis-Chalmers
Neil Mulcahy	—Assistant General Counselor, Pharmaceutical Manufacturers Association
F. S. Muller	—Partner, Vereenigde Octrooibureaux, The Hague, Netherlands
Axel Nielsen	—President, Shellback Manufacturing Company
J. Harold Nissen	—Partner, Haseltine, Lake & Company
Jack Rabinow	—Inventor, Director of Rabinow Laboratory

Leonard J. Robbins	—Senior Partner, Langner, Parry, Card & Langner
Joe A. Robinson	—Advisor for International Activities, Office of the Assistant Secretary of Commerce
David C. Ross	—General Manager, International Licensing Department, General Electric Company
Edmund C. Rowan	—Staff Director, Advisory Committee on International Organizations and Programs, Office of the Foreign Secretary, National Academy of Sciences
John H. Schneider	—Assistant Commissioner of Patents, U.S. Patent Office
Irving H. Siegel	—Consultant, The PTC Research Institute; Staff Member, W.E. Upjohn Institute for Employment Research
William A. Smith III	—International Patent Specialist, Office of International Patent and Trademark Affairs, U.S. Patent Office
Jack M. Squier	—Manager, Engineering Services, Clark Equipment A.G.
George W. Waldes	—President, Waldes Kohinoor Inc.
William R. Woodward	—General Patent Counsel, Allied Chemical Corporation

The Patent Cooperation Treaty: Views of Informed Innovators

DIRECTOR L. JAMES HARRIS: I want to welcome you on behalf of The PTC Research Institute of The George Washington University. We are pleased with the good representation from other cities, particularly the more distant ones. I want to note at the outset that we are now celebrating our Charter Vicennial year! This is the twentieth anniversary of the signing of the charter of the Institute. Back in February 1949, the American Patent Law Association, by resolution at its stated meeting and subsequently by referendum vote, recognized the need for research and education under university auspices on the patent and related systems. In accordance with this resolution and referendum The George Washington University undertook the establishment of The PTC Research Institute (then known as The Patent, Trademark, and Copyright Foundation). On August 3, 1950 the President at that time, Cloyd H. Marvin, along with the Secretary of the Board of Trustees, signed the Declaration of Trust. From Novem-

ber 1969 through August 3, 1970 all our activities are going to be in the spirit of the Vicennial.

The purposes of the Clinic are several. First, we seek to develop a more effective instrument of communication. Second, we want to deal in depth with frontier problems and, third, to develop generally inaccessible types of information. Finally, we want to develop a record as a basis for additional research of the Institute.

To accomplish these purposes, we invite teams of leading specialists, representing a range of disciplines. These people are selected for their experience and for the positions they hold. It is understood that our deliberations are in strict confidence until participants have edited their remarks. This is very important to a free and uninhibited discussion.

We employ the Clinic as a research tool. What we want to do is diagnose and if possible find some practical remedy, and also use the meeting as an instrument of instruction. In other words, we want to comprehend the "disease." We want to know what is wrong. We want to find out where it hurts and, perhaps, we can come up with a remedy. But to do so it is important that we let our hair down. We don't want to pry into company secrets but we must, at least, tell ourselves the facts. We've got to have a maximum of trust among experts. Publication of any part of these proceedings—they are being recorded—will only occur after the participants have had an opportunity to edit their remarks.

We find that this type of open and frank discussion can best be accomplished under academic aegis. The Institute has undertaken these Clinics as part of its research function and as an activity in the public interest.

This Clinic is part of a continuing series. Our most recent one was on the Legal Protection for Computer Software. That was in June of 1969. Our next one is going to be on Trade Secrets, in February, and in April we have scheduled one on Unfair Trade Practices Relating to Industrial-Intellectual Property.

The formats of our Clinics are not alike. They depend, essentially, on the subject matter under study. This PCT Clinic will begin with a concise presentation by Mr. Leonard Robbins of the firm of Langner, Parry, Card & Langner. He is sitting on my right. Mr. William Woodward of Allied Chemical Corporation, on my left beyond Mr. Green, will then have an opportunity to comment briefly or add to Mr. Robbins' presentation. The discussants, who are seated around the table, will thereafter engage in free discussion.

The Moderator, Mr. John Green, here on my left, will present the broad outline of the items we plan to cover today. Mr. Green is the Project Leader on the study of which this Clinic forms a part. The study is formed as a trilogy: Part one is this Clinic; part two is comprised of a set of mail questionnaires on PCT; and a series of personal interviews make up the third part.

The participants who are not seated around the table should raise their hands to be recognized, and the Moderator will do so at an appropriate time. I want to emphasize that you are all participants in this discussion. Our procedure is informal, and we hope you will keep it so. The discussants at the table do not require recognition. They will talk with their fellow discussants as the spirit moves them.

Luncheon will be served at 12:30 in the Adam's Rib Restaurant on the ground floor of this building. The Clinic will run until five. At the completion of the Clinic, Mr. Green will briefly sum up. Please—and this is very important—identify yourself before speaking, or at least after speaking, but do identify yourself so that we can make an accurate transcription. This is essential. But keep it informal, as I say, so that we don't lose our spontaneity. Before turning the Clinic over to the Moderator, let's go around the table and then around the room and identify ourselves by name and organization. My name is Harris, I'm the Director of the Institute.

MODERATOR JOHN C. GREEN: John Green.

MR. WOODWARD: Bill Woodward.

MR. BRENNAN: Jim Brennan.

DR. SIEGEL: Irving Siegel. I'm on the staff of the Institute.

MR. RABINOW: I'm Jack Rabinow of Control Data Corporation.

DIRECTOR HARRIS: Mr. Brennan is with the Patent Office and, as I mentioned before, Mr. Woodward is with the Allied Chemical Corporation.

MR. ROBBINS: Leonard Robbins—Langner, Parry, Card & Langner.

MR. BECHT: Carl Becht, Sinco Products.

MR. SQUIER: Jack Squier. I'm an engineer with Clark Equipment Company, representing our international operations.

MR. ROSS: Dave Ross, General Electric Company, responsible for our foreign licensing activity.

DIRECTOR HARRIS: Gentlemen, Dr. Muller.

DR. MULLER: Muller from Holland, Dutch State Mines. Manager of Patent Department, retired. Now a partner in the firm of "Vereenigde Octrooibureaux" The Hague; Kantoor Zuid Nederland "De Grote Beer" in Maastricht, Holland.

MR. ADAMS: Ed Adams, Bell Telephone Laboratories.

MR. WALDES: George Waldes, Waldes Kohinoor.

COMMISSIONER SCHNEIDER: John Schneider, Assistant Commissioner of Patents.

MR. SMITH: Bill Smith, Patent Office.

MR. MULCAHY: I'm Neil Mulcahy with the Pharmaceutical Manufacturers Association in the international section.

MR. NIELSEN: I'm Axel Nielsen, Shellback Manufacturing Company.

MR. MCGAUGHEY: Don McGaughey, Allis-Chalmers—foreign patents and licensing.

MR. ROWAN: Ed Rowan from the Office of the Foreign Secretary of the National Academy of Sciences.

MR. JOHNSTON: Wallace Johnston, the Thomas Alva Edison Fellow of The PTC Research Institute.

MR. ROBINSON: Joe Robinson, Department of Commerce.

DR. BANGS: Robert Bangs, PTC Research Institute Staff.

DR. BEHRMAN: Jack Behrman, Professor of International Business, University of North Carolina.

DIRECTOR HARRIS: Now I turn the Clinic over to the Moderator, Mr. Green.

MODERATOR GREEN: O. K. Well, I think we ought to note that the question of the proposed Patent Cooperation Treaty is not a new topic; it has been analyzed, discussed and commented on by people who perhaps know most about its mechanics. That's the patent profession. The Institute feels that while the views of the profession are most important, there is a need to complement them by the insights and the knowledge of innovators. And so what has been done here this morning is deliberately to look for a cross section of personnel who are concerned with other aspects of invention than the protection of invention, than the professional people. As you heard when the men identified themselves, representatives of the academic community are here, people from government are here, there are people who are at the executive level and there are competent inventors. So we hope that out of the cross-fertilization today of their information and their insights that we may come up with some new information, some useful information for those who must make policy here in the United States government with respect to the proposed Treaty. I don't think anybody has any hard prejudices or bias, certainly not in the Institute. We're dispassionate, objective. Well, it seemed to us that the best way to kick it off, although we assume that everyone

has a general knowledge of the Treaty, the best way to kick it off is to ask one of the experts if he would be kind enough to give us a concise and objective explanation of the Treaty, its history, and its salient features. Mr. Robbins has agreed to do this, and I believe Mr. Woodward has agreed that he will complement, supplement, make additional comments after Mr. Robbins finishes. Leonard.

LEONARD J. ROBBINS: Thank you, John. I will begin with two assumptions. I assume everyone present here is generally familiar with the broad objectives that have been asserted for PCT. That is, to avoid multiple searching of the same invention in different countries and therefore reduce the burden on patent offices, to provide an applicant with more time for foreign filing, to simplify filing procedures, to reduce expense and to improve international publication procedures. I will also assume that everyone present is generally familiar with the PCT/DC/4 final version as it now stands, 65 Articles and 95 Rules, which contain the new principles of (1) an international application having the effect of a national application in all designated countries; (2) five parallel and alternative searching authorities to provide a search report to accompany an international application wherever it goes; (3) an optional patentability examination (Part II); and (4) a new role for BIRPI in Geneva as an active procedural instrument in international foreign filing, intervening between the originating applicant and foreign patent offices. Now, it is hardly a secret that I, and many others, criticize PCT in its present form as being far too complex and contend that much simpler procedures are available to achieve the stated objectives. Therefore, I asked Lou Harris if I was to appear as the devil's advocate but he said "No, you're to be impartial, non-controversial, comprehensive, concise" and a few other things. Well, at any rate, I will try to be objective, but it is almost impossible to explain the past history or present structure of PCT without injecting some personal views. I therefore made a few notes to avoid going astray.

PCT was conceived by a small group of men. They established the principles of PCT and produced the first draft of the Treaty in printed form as a *fait accompli*. Government officials have stated that real alternatives will not now be considered. No surgery will be allowed. At the recent American Bar Association meeting in Dallas this year, Dr. Bogsch of BIRPI (who is the principal architect of PCT), was reported as stating: "The Patent Cooperation Treaty draft . . . is the result of two and a half years roughly of negotiations and underwent several redraftings. However, the basic features of the

draft Treaty haven't changed." As a result, attempted discussion of basic principles has been rather frustrated. During recent years, numerous meetings of numerous associations have occurred which have been largely devoted to wording rather than substance. And the result has often been rather stultifying.

We are not here today to go from A to Z with regard to these 65 Treaty Articles in detail. It will obviously be necessary to refer from time to time to specific articles, but I believe our main purposes in the light of the questionnaire which was sent out by Lou Harris, should be first, a very brief and possibly philosophic discussion for the record, of whether PCT ought to have been conceived and born in this existing form; and secondly, on a more practical level, assuming that it will reach the Diplomatic Conference stage in 1970, how could it be improved, and what should the U. S. attitude be on the basis of self interest.

As regards achieving the asserted objectives of PCT, these are my personal views. I consider the only sound foundation for international cooperation in this field would be a single computerized search office available to all national patent offices. I believe the technology is or soon will be available. However, Dr. Bogsch said at an NAM meeting about six months ago in New York, that this would be far too expensive and it would be impossible to raise the money. Therefore, PCT has adopted the compromise of the five individual search authorities—the U.S., the German, the Russian and the Japanese patent offices and the IIB Institute in the Hague. I consider this would be permanently unsatisfactory and would never produce uniform results. It may help on the "head start" theory, but the strict examination offices, including the U.S. Patent Office, will still have to conduct their own searches.

Providing more time for foreign filing, up to 20 months, is indeed very useful, but this could be achieved merely by extending the international convention year. However, Dr. Bogsch also said, at the Dallas ABA meeting, this had been considered by all governments and unanimously rejected, but he gave no reasons whatever. He merely insisted there was no hope for this alternative. The availability of a search report before completion of foreign filing may prevent some wasted expense if the Chinese copy type of citation should turn up. That, of course, is quite rare. But in active competitive fields the corporate applicant at any rate is not likely to be deterred by prior art, and it seems doubtful whether responsible patent attorneys would make substantial amendments in a case before patentability examina-

tion by national examiners takes place. Thus "buying time" is very interesting, but hardly of major significance.

Any completed foreign filing program by the PCT route would clearly cost more than under present conditions. In addition to the preliminary international filing fees, novelty examination fees, et cetera, all normal fees and expenses would eventually have to be paid. Domestic attorneys and agents in individual countries are hardly likely to forego their representation fees. So deferring expense is not actually in most instances in the long run a saving. As regards the enlarged role of BIRPI, and ignoring the question as to who will pay for its enlarged staff, the only real argument I have heard in favor, is that it would certify all international documents. This seems to imply that applicants could not be trusted to file nationally in conformity with the international application—a rather dubious proposition. Most certified copies remain unlooked at. It is far more sensible to file them only in case you need them.

I will not go into the optional Part II of PCT, which is highly controversial and involves substantive aspects which do not appear to be favored by our government officials.

In general, I submit that an unanswered case exists for the much simpler proposals that have been presented to achieve the same objectives. One is the so-called FICPI-II Plan produced by the European patent profession, which has been published in this country. It is not clear why the previous and the present administration pushed so hard for PCT, since no solid reasons have been given why it would be positively advantageous for U.S. interests in general.

There is another issue I would like to mention at this point. Section 35 of the Report of the President's Commission stated,

The Commission believes that the ultimate goal in the protection of inventions should be the establishment of a universal patent, respected throughout the world . . . subject to the proviso that any attempt by revolutionary change to scrap present systems in favor of new ones in the United States or abroad is neither feasible nor desirable. It is, however, both possible and advantageous to promote and direct interim steps towards the ultimate goal of universal patents.

I think it is a fair question to ask, "Does this Administration believe that a universal patent system is a desirable goal?" If so, then this would undoubtedly affect our general viewpoint with regard to PCT. It would not have to be considered as a treaty of a relatively permanent nature, but merely as an interim step along the road towards complete replacement of the existing U.S. patent system.

Now let us consider this Treaty on the practical assumption that there will be a Diplomatic Conference in 1970, and that the U.S. will sign up and join. The U.S. delegates will undoubtedly be the most powerful present and could probably insist on final revisions. What are the principal areas where change would be desirable? In this connection I should like to refer to the report of Committee 102 of the Patent Section of ABA which was published quite recently and contains proposed resolutions for submission to a special meeting of the Patent Section on December 4, 1969 in Washington. These resolutions have been very carefully prepared and they are mostly in positive form. They approve in principle certain aspects of PCT while also recommending a number of changes.

I would first like to mention Resolution 29 at the end. This suggests an alternative to PCT along the lines of the FICPI proposal, with the commentary "This Resolution 29 reflects a continued expression of concern by the members of this Committee for some simpler alternative to the proposed PCT for obtaining international cooperation and an international patent system."

There are two important practical problems: one is procedural and one is substantive.

The first procedural problem involves Article 20, Rule 47, and Article 22. Article 20 and Rule 47 state that BIRPI shall send copies of the international application and search report promptly to the designated national patent offices, subject to the proviso that any designated office can waive this requirement. These copies remain quiescent until the applicant makes up his mind on foreign filing. If he goes ahead, he himself (or of course his patent counsel), not BIRPI, is supposed to supply all missing documents and fees to constitute national applications in the designated offices, according to Article 22. The Treaty is silent concerning the completion procedure. But this is a most vital stage for the foreign national patent applications, when the domestic counsel for the applicant and the local foreign attorney or agent should undoubtedly be in close touch. How is the local foreign patent attorney in any given country to be alerted that BIRPI has filed an international application? How do the domestic counsel and foreign attorney coordinate their activities?

Assume there may be 20 or 30 countries involved; that means applications to be completed in 20 or 30 countries filed more or less at the same time and very likely urgently at the last minute—all have to be coordinated back to the applicant's home base. Consider the situation of a busy U.S. attorney when, say, a German application in

the German language is transmitted by BIRPI directly to the U.S. Patent Office. How is he expected to handle the completion if his German client decides to proceed?

Great efforts have been made to persuade the drafters of the Treaty that an applicant ought to have at any rate the option of conducting his own foreign filing by the established attorney-attorney procedure. This problem is dealt with in ABA Resolutions 16 and 17. Resolution 16 would eliminate BIRPI entirely as the filing agent, while Resolution 17, alternatively, would give applicants the choice of filing themselves rather than by BIRPI. Actually for further simplification, it appears that Article 20 might be completely eliminated, in favor of all filing documents being submitted to designated offices on behalf of applicants, and not through BIRPI.

Some 25,000 applications from abroad are filed each year by U.S. patent attorneys. U.S. patent attorneys are responsible for the filing of probably more than 100,000 applications throughout the world through local foreign attorneys. Foreign attorneys, likewise, depending on the individual countries, have similar domestic and foreign filing patterns. I don't believe enough attention has been given to this purely practical procedural problem if the PCT route were to be fully adopted here and abroad. Do the inventors and company representatives here want BIRPI as a sort of fifth wheel without basic responsibility or flexibility when the original immaterial international application is being converted into actual and specific national filings?

The second substantive problem involves Articles 11 (3) and 27 (5). Dr. Bogisch has said on more than one occasion that Article 11 (3) is the cornerstone of the Treaty. According to this Article 11 (3), an international application shall have the effect of a regular national application in each designated state, as of the international filing date. Article 27 (5) introduced in the last text, apparently rather reluctantly as a concession, makes certain rather ambiguous qualifications with regard to the dominance of the national law. The U.S. patent law is of course unique and foreigners, particularly Europeans, have long protested at what they consider a certain amount of discrimination. But Article 11(3) would apparently place the boot on the other foot. The U.S. would apparently give far more than it received under the "buying time" feature of PCT. For a foreign PCT applicant, the filing date in his home country—possibly 20 to 25 months before he completes his U.S. application by filing an English translation if necessary, and paying the U.S. filing fee—would be the actual filing date in the U.S. Thus according to the wording of Article 11 (3), this would be

the actual U.S. filing date, even though the U.S. application had not yet been physically filed.

The processing of the foreigner's U.S. application would therefore be deferred for this 20 to 25 month period. Therefore the foreigner would get an actual U.S. filing date which establishes the excusal period of prior publication and use under the U.S. law, and allows filing before issuance of a corresponding foreign patent, and also makes the U.S. application effective from its foreign filing date as a prior publication in the U.S. There are no corresponding provisions abroad. Do the innovators present here, for example in the pharmaceutical and electronic fields, desire to invite foreign time bombs in the U.S. Patent Office?

I have merely scratched the surface of this topic. I would refer to ABA Resolutions 26, 27, and 28 and the very extensive discussion of them. In effect, these resolutions would modify Article 11 to provide that an international application creates nothing more than a priority right in the designated country. In other words, that it extends the priority year. This is in a way a head-on confrontation with the BIRPI proposal. If we adopt the principle that adherence by the U.S. to an international treaty overrides domestic law, there are clearly a number of conflicts with various sections of the U.S. Patent Act and also with the recent *In re Hilmer* decision. Whether an international treaty does override domestic law is a very grey area. Apparently, the last reported case in this field is 40 years old and it said treaties dealing with patent rights are not self-executing without supporting legislation unless their language compels a different interpretation. It seems clear that Article 11 and specifically Article 11(3) would provide conflict with the present U.S. patent law and would apparently require some amendment if the United States adhered and lived up to its treaty obligations. Do the alleged advantages of PCT for U.S. nationals abroad justify revising the U.S. patent law for the benefit of foreigners? All this is very well discussed in the ABA record.*

I fully appreciate that even a brief summary of this very complex situation is difficult from the point of view of innovators, inventors, and company executives without apparently overemphasizing the legal aspects. Therefore, in conclusion, I would refer to the following broad propositions:

- (1) Do we actually need more international cooperation in this field? I think the 100 percent answer is yes, we do, to cope with

*See also "A New Look in Foreign Patent Practice, or a Treaty of Versailles," by Michael N. Meller. *JPOS*, Vol. 51, No. 11 (November 1969).

the exasperating problems of multiple foreign filings and the undoubted over-burdening of some patent offices.

- (2) If so, should we adopt PCT in its proposed form, or would it be preferable to have some simpler alternative?
- (3) If we do adopt PCT in its proposed form, are we prepared for the possible effects on the U.S. patent system?
- (4) Is this a step along the road to a universal patent and if so is the U.S. government committed to this ultimate goal?

WILLIAM R. WOODWARD: Mr. Chairman, I was involved in an antitrust case once in which the government had filed its usual type of antitrust complaint. It had many paragraphs with all sorts of invidious implications from everything on the subject that was ever found in any public print, and a number of things that weren't, and the question was when you file the answer—and after all the answer is not an argument. Do you just say we deny allegations to paragraph so and so and run right down that whole thing? No, obviously you don't. The first part of the answer to that was a very much shorter but equally argumentative statement that the defendant had been one of the, well, my father used to say *the* only Simon Pure corporation in America and I think our answer supported that proposition. It was very clear that you really have to do that, because a lot of the sharpest argument is on these things that are apparently irrelevant.

I will try to condense my reply to Mr. Robbins. But it is really part of the argument to ask how did this sort of thing come about—how can you do that to us? Just as Mr. Robbins started by referring to the report of a Committee of which one of his partners was the Chairman, I'm going to begin by referring to an article that I've just read by François Panel. It's called "What Does Industry Expect of the European Patent?" It's directed to the European patent, and so only about the first three-quarters of it is material to the questions before us. Mr. Panel is the Chief of the Industrial Property Services for the Compagnie Générale d'Electricité. He presented these remarks at Strasbourg on the 25th of September or thereabouts at a meeting called to consider the European patent. Strasbourg, as you probably know, is the French university chosen to have a center of industrial property law. There were many other people speaking at that gathering. Mr. Panel's paper is a very penetrating, interesting piece of work and it reflects here and there a lot of respect for the American position, which is something that, after listening to a number of Frenchmen in some PCT meetings, I really didn't quite expect. I think it is an objective piece of work. I hope you will get a chance to read the first

half of it sometime when it is translated and the rest too if you want to study it very closely and if you are interested in the European patent.

With respect to the background of the PCT, I was surprised to find when I first got into this subject in 1967 that this kind of work had been going on not for a year or two, but for a good many years, mostly in Europe. I think the first important date is 1957 when something known as the Vienna Plan was concocted. And this was concocted as a result of something called ICIREPAT, an association of the examining patent offices. The United States Patent Office had a look-in on these discussions, because it was a member of ICIREPAT. The interest in a new treaty was then largely among Europeans. The first idea came from a practicing patent attorney, that there ought to be some way of having a single search (and a little more time) before the applications become perfected in the countries of later filing. What was proposed was something that would be particularly of interest to Europe. In fact the idea was taken over by the Council of Europe to rework the idea before seeking to push it. The 1957 plan was something like the FICPI plan that has now been talked about. It had some awkwardnesses, and so on.

The next important date is 1963 when the Council of Europe prepared a draft (which was never published—it hasn't been published to this day) of a type of patent cooperation treaty proposed by the Council of Europe. I think that you have to remember that the Council of Europe has been concerned with additional patent conventions for the last 15 years. They have done some work on a convention on formalities signed in 1953. There has been a convention on substantive law that has been signed but nobody has ratified, even though the new European patent laws tend to fall in close to its orbit. The new Scandinavian patent laws derived something from it. We've been too busy in the United States to be much concerned with things that concern mainly foreign practice. Besides, much of the work in question wasn't published. But all the European suggestions were available to our government people, who were at the meetings as observers but because they were bound by things that weren't going to be published they naturally were not in a position to publish it. The 1963 Plan, which was a more sophisticated version of the Vienna Plan, was not published because at that time the Common Market countries, which had been among the promoters of that plan, decided that they wanted a much more tightly connected European patent. They proposed the European Patent Convention which did not get signed because it didn't get a wide enough agreement among the six Common

Market countries and the Treaty of Rome countries. The idea of a European patent has been picked up again, partly because France has gone to a semi-examination patent system and is no longer so much opposed to some of the strictly examination oriented principles of the original European Patent Convention.

One of the things that is interesting in Mr. Panel's article is that he believes that the proposed Patent Cooperation Treaty and the European patent are entirely consistent and that they are working towards similar objectives. He says the Europeans as such need a somewhat closer amount of patent cooperation, hoping some day to have a convention that will settle some things for a substantive patent law which the various judicial systems will each interpret, in which case they will be interpreting the same thing. This is something that is obviously out of the question for the PCT, but the two things are not competitive. In the 1965-67 period, during which the PCT first draft was hatched, I was not part of the small group which had anything to do with it or any of the American part, but I understand there was a call together—and the U.S. did propose at a meeting of the Executive Committee—that something should be done about it and that the Secretariat ought to prepare a draft.

This is the logical way to start a supplement to the Paris Convention. The United States people concerned had consulted the people over here. They perhaps made the mistake of not getting a wide enough group from the people who are known to be very active in the practice but they did consult a representative group and of course it would never be very big for a country as big as the U.S. However, the first draft that came, I think, surprised even the Americans. People had said let's get the Secretariat to do it. Result: the 1967 draft was in many ways disastrous. They tried—they were going to try to fix it up as much as possible at the last minute—but finally decided that after all, this was just putting it on the table. This is not something that can't be changed, and so it was put out pretty much the way it was.

The reason it came out the way it did is perfectly obvious. The Secretariat had been administering the Madrid Agreement on Trade-marks. That had been going on for a long time. America, England, Canada, and many other countries had not wanted to take any part of the trademark agreement, because they don't like to register trademarks before grant—while they are merely on application—even when the registration is subject to future conditions. We like to have an application first and registration only after examination. There are also other reasons why we don't like the Madrid Agreement, but it is a

going thing and it is therefore rather hard to blame the Secretariat for producing a draft patent treaty having some earmarks of the Madrid Agreement. These of course were sheared off very rapidly in the 1967 conference. There were very substantial changes made to the draft after that conference, which I won't attempt to trace. It is not true that there was a *fait accompli*, that it couldn't be changed. The reason why the 1969 draft reads as it does is largely because the representatives of the various governments have for one reason or another tended to choose those features rather than some others.

Now the reason why the European governments don't back the FICPI plan, and none of them have backed the FICPI plan, although it is a European proposal, is perhaps they went all through this from 1957 to 1963 to 1967. It's certainly not for not having been familiar with it. The European governments have preferred the type of treaty that we have before us for one reason or another. It's true that the patent agents in those countries don't have as much influence as they do here, because they aren't connected with the lawyers in a common association. The lawyers over there have not been as active proponents of the FICPI plan as the patent agents are and they do not appear to have raised any opposition to the draft of the Patent Cooperation Treaty as it has now evolved.

Most of the complexity of the Treaty arises from the fact that it attempts to simplify formalities, in addition to providing for more time before the translation of applications and to providing for a search report in the meanwhile. The complexity, as I say, comes from the attempt to simplify formalities, and the only way you can do that really is to follow the basic pattern of the Council of Europe Convention of 1953, which is to say, "If you do it this way, there can be no further objection as to form." If the various countries want to *permit* various other things, that's completely up to them, but you provide one particular form which all must accept—and, of course, you mustn't specify it too narrowly—but you have to find one form that will be acceptable. This unfortunately does require a lot of details in the regulations. I think the PCT does a better job than the Council of Europe Convention. That part of the Treaty and regulations, however, could be completely removed from the PCT. Most of the objections that Mr. Robbins stated were to that part.

The searching authority problem is well set forth by Mr. Panel, because the French have been the chief believers in a unified search system. The French have a particular reason for favoring a single search office, and that is that their own patent office is going to use the

International Patent Institute at the Hague as its search organization, as its technical branch, on a contract basis. And naturally if that Institute could be made the world searching office that would be even better. So it wasn't a bad idea but they had other reasons besides a purely theoretical one for liking it. Unfortunately the International Patent Institute does not have the size staff of any of the big four patent examining offices, and it doesn't have the kind of financial resources that the national administrations do have. Unlike the European governments, it can't levy patent maintenance fees, on which most of the governments get the money to run their patent offices. So there are reasons why the Institute is going to grow a little slowly.

If we have the parallel searching authority system, however, in which each applicant will get a search report on his international application from a searching authority related to where the application comes from, the applicant isn't going to be able to shop around among searching authorities. Still, when the application gets into the national phase after the international procedure, one or another of the countries that has its own examining office, perhaps one that has its own searching authority, can second-guess the search report. We will find out soon enough the deficiencies of the various searching authorities when they start to double check each other thus. Many of them will learn this through the process, and will improve themselves, and the ones that don't will probably drop out. This is the only way we can go, as Mr. Panel recognizes even on the French scene.

There will be a considerable savings in any event, even though we may have searching authorities that don't have quite the same notion of what is the closest art. It will be much easier for a national examining office to start after someone else has already jumped off on the case. The savings, of course, will not come back to the applicant directly, because if the United States Patent Office gives a search report, and the Germans, the Russians, the Japanese, and the International Institute also double check it as the case gets into the national phase in Germany, Russia, Japan, and France, there will be some savings to these other examining offices in that the job is partly done already. Those savings will unquestionably redound to the national administrations. I think that you can all be fairly sure that this will get back to the applicant, because these national administrations, other than the U.S. office, are all self-supporting. They support themselves through maintenance fees. This will mean that the demand for *increasing* the maintenance fees will be postponed to the extent that work is saved through the PCT system. Now this is a pretty far-off

promise to the applicants that the increased efficiency of the national offices will work to their benefit, but that would be really meaningful, because you all know that the maintenance fees are going to be kept high enough to run the cost of the national administrations. In the examining offices like the Dutch and the German, which give you a search report for very much less than it costs them to do it, the maintenance fee is the only balancing fiscal element. None of these countries is likely to increase its maintenance fees beyond the high level necessary to run an examining patent office.

The extension of the international convention year is a very good way of getting more time for the applicant, and I think the Americans in general would have no objection to it. I don't want anybody to think that I wouldn't prefer that. I think it would be very simple. The proposal is to extend for four, six or eight additional months the time during which you can substitute a completely different application claiming as priority documents all the earlier ones that have been filed in various other countries of the Paris Union. This is something like our domestic continuation-in-part practice, where before an application has been patented, or before proceedings have been terminated on it, we can abandon it and file a different one incorporating that and some other matter. The new matter speaks as of the new date while the priority of the previously disclosed matter is preserved.

This principle holds internationally under the Paris Union during the one year priority period. The Canadian Patent Institute, the Australian Patent Institute, and most of our professional groups too, would like to see this extended as a very simple way of getting more time for the applicants. The only reason this couldn't be "sold" internationally is the feeling abroad about rewriting an application and claiming dates, various dates, for the different elements of it, as shown by various priority documents. They think that 12 months is enough for that sort of thing. This is a practice that makes it very difficult to know as of what date any particular element speaks, because when you rewrite your application you mix it all together in one write-up, and you have only these earlier documents to show at what date this or that concept began. It is hard to trace from the earlier disclosures to the elements of a final application, even more into the various claims.

So the European approach—and in their domestic law—has been that if you want to bring in some additional material to support your invention, you file a patent of addition, where the term expires with the main patent. Unfortunately in many countries there are some rules

about what you can have as a patent of addition that don't give you as wide a scope as you might feel entitled to enjoy. The general feeling is that the patent of addition technique can give the applicants all they really deserve for adding a new matter to an existing invention and "filling out" a previous disclosure. Therefore, once your priority year has expired, the Europeans feel your disclosure should become fixed. You may have an opportunity to amend your application to make it more clear and so forth, but you're not supposed to add anything after that one year. And if you do, you put it in a separate document.

That is the universal rule except in the U.S. and Canada. In Canada they don't use our system, they use "supplementary disclosure," which is used on occasion. Again, it's a supplementary disclosure that speaks as of a separate date. You don't just write a new thing and mix everything up and say, well you can tell from my priority documents as of when some particular feature speaks. The prejudice against this, I must admit, is much more prevalent among the patent offices than it is among the applicants. Most of the applicants have lived with this and consequently they don't appear, in Europe or anywhere except the United States, Canada and Australia, to want very much to change this practice and to go against the feeling of their patent offices. So the extension of the priority period is a very fine concept, but so far as I can see, it can't be sold. You could have a patent cooperation treaty on that basis between the United States, Canada, and Australia, but I don't think you could get even the English to join.

I turn now to Article 20 and Article 11 which have been mentioned in specific matters. The objection to Article 20 is perhaps symptomatic of the type of debate on which this Treaty is going to stand or fall. The notion of the drafters of the Treaty was that, in order to have something different from merely extending the priority year and letting people have priority documents to trace ideas back to, you would have to have a common filing agency of some kind where the application would be filed, and it would be filed in the original language and treated as filed in all the various countries. This was an idea borrowed from the Madrid Agreement. In its original form, it was much closer to the Madrid Agreement than now: you would have filed your international application in Geneva, at an agency that would receive applications for all the designated countries and that would constitute a filing in all of them.

There was much objection in 1967 to having an international filing office of this particular sort. However, in order to get something different from just another priority document, the device was modified

by saying, we will have an application in the home country and the receiving office will be treated as receiving an application for all the designated countries. Still, in order to authenticate exactly what was deposited there, so it won't be in the power of all of these countries by chaotic filing procedures or something else to allow this international filing to lose its integrity, the receiving office will immediately send a record copy to an international repository. In other words, the international bureau is no longer a filing agency, but is an authenticating type of repository. We will have a record copy sent there, and instead of saying it has to get there within the 12 months, we'll say we'll let the 12 months apply to when the applicant gets it in his home country, but we'll allow another month. They finally allowed a little more than another month for the record copy to get to Geneva. This deadline is at the applicant's risk. The record copy must get there within the delays allowed. For that reason the applicant was given an option, if the receiving office did not get it to Geneva by some time ahead of the deadline, to take care himself of transmitting a copy to Geneva. Because of this risk, it was important to give the applicant an alternative way of handling his application.

Except for this, none of the deadlines in papers being handed back and forth between the receiving office and searching authority, the international bureau, and the designated offices are critical deadlines. It is nice for the applicant to know when they happen and usually he will be notified. He isn't going to be kept in the dark—nobody wants to keep him in the dark. If the international bureau, which acts as an authenticating office, does not communicate the international application in its search report in the various countries very promptly, the applicant doesn't lose any rights. Certainly, the foreign country can't proceed as fast as it would like to process it perhaps, but it is not necessary to give an applicant an option to send papers to the designated office, he can always do that anyway. He himself has to provide the national fees and the translations, if necessary, through his agent. If he wants to include a working copy of the application just in case the officially communicated copy should be late there is nothing to prevent him from sending a working copy when he pays his national fees. You don't really need to write it in the Treaty that he has a right to do it. And it is also provided in the Treaty that if a national office wants to waive getting the official copy, it can do that. But there is no reason to provide that the applicant can tell BIRPI "don't send it, I'm going to take care of it myself." The cost of BIRPI sending that is low, since BIRPI can send its communications in batches to each national

office. So the objection to this aspect of the Treaty is very difficult to understand. And this is why when this came up in Geneva, I think it was December 1968, at one of the meetings of the working group, many of the delegates who were not in the profession wondered why this option was being proposed—why would anyone want to use it? It's hard to understand why people want to have the option, except they just don't like to see governments doing something for modest fees that could be part of a service provided by a private organization.

Now I want to consider Article 11. As I explained before, in order to establish an international application and not merely extend the date on which you can claim the priority of an entirely differently written application, you really have to have some kind of an international application, such that when filed somewhere, it would be treated as a disclosure properly supporting a patent application in all the various countries.

Now the trouble that came up with respect to Article 11 is that people said, as of what date do these documents speak for defensive rights in the various countries? In other words, as prior art. Article 11 now treats the international application as creating immediately an application in the various countries. Although the international application doesn't have to be filed near the end of the priority year, everybody expects it will be filed about then because that delays all the maintenance fees and the term and so forth. But it could be filed right off the bat, without claiming the priority of an earlier national application, and this might then mean that the various designated countries couldn't get a copy of it for about 12 months, and they wouldn't get the translations for 20 months. And if the international application is a national application from its international filing date in all these various countries, it speaks as a reference in at least five countries as of that date if it should ever get far enough to become either patented or published. Then you have possibly a sleeper reference, which might mean that after the patent is granted one might find that here comes a reference that should have been considered. Of course even now references are frequently missed.

Actually in the Scandinavian countries that have adopted this notion of defensive rights in their new law, this isn't much of a problem because they have deferred examination. So the few cases in which examination will go ahead, they can find some fairly economical way of going after these sleeper references, and it would involve examination of only a relatively few cases. In the U.S., on the other hand, we don't have deferred examination—we want to examine all patents on a

fairly close schedule and therefore we consider this a problem. The simplest way, or let's say the way which will involve the least redrafting of the Treaty, that we could deal with it is that we could say well we'll rely on our right to get copies of the international applications under Article 13 as soon as we can. These are confidential copies. They can't be made available to the public until 18 months from the priority date but we can get them in the 13th month. And 40 percent of these will be in English, as our present experience predicts, so that those won't have to be translated. We can put them in our search files. And as to the others, we can translate the abstracts. And then to the extent, in the course of our examination, that we find one or another to be pertinent, we can have the whole disclosure translated. This is about what the Russians are going to do, not for the reasons of examination I suspect, but they want to say, well, any of these things that are coming to us, we want to know what they mean at the earliest possible date. That's for their basic technology file. So they are going to avail themselves of Article 13 to get copies as early as possible, even though they know they will get them eventually in the 20th month. So this isn't impractical and it will probably take care of most cases.

We have been concerned also because we don't see why these things should speak as prior art as of the early date. We think that the effect of our law, that an application filed in the United States speaks as of its filing date as a reference, ought perhaps not to apply to an application that is not at that date available in English translation, and for which no national filing has at that time been made. Under our present law if we adopted the Treaty I don't think there would be any ambiguity. It seems to me that we would treat the international filing date as a filing date in the United States. Section 102 (e) doesn't say "actually" filed in the United States. That word "actually" is something that somebody wants to put into the corresponding section of a new law. I've just read an article on Section 102 (d) that doesn't make any sense at all because it assumes that an application under the PCT wouldn't be "filed" in the U.S. until the translations are available in the 20th month.

I can't imagine even the court that decided *In re Hilmer* raising that kind of a result in this case. I don't think that the filing of an application under Article 11 is at all similar to filing of a priority document in some foreign country. In order to provide flexibility in this situation the Article 27 (5) has been drafted in conformity with the principle that the purpose of the Paris Convention and of the

proposed Patent Cooperation Treaty is not to give early dates to references but to give early priority dates to patent claims. Therefore, defensively, each country should be able, under its national law, to decide as of what date the reference speaks, whether it is a PCT application or any other kind of application. This seems to me a very reasonable thing to do. Of course, there are many applicants who would like to get as many defensive rights as they can with their applications. Of course, they can always do that by publishing them, or they can just go outside the PCT and file it in the U.S. in the regular form if they want to make themselves a reference.

I think the question is going to come up on our whole approach in a more serious way in connection with whether the proposed European patent will be unconditionally accessible to Americans. That will be something that will probably come up after the PCT has been drafted, so that it may be premature to argue that out here. I think that Article 27 (5) is something that can be satisfactorily framed. Most of the people who want the PCT feel that this paragraph (5) isn't particularly obscure, although naturally if you don't like Article 20, you may think that Article 27 (5) is also impossible and unworkable.

I'm not saying anything about Chapter II either. But I will say as one final statement with regard to how much the PCT affects the U.S. law—Dr. Bogsch, the assistant director of BIRPI, is an American citizen. He has worked in the U.S. Patent Office. He is fully conversant with the American law and all of its details, and had on his staff Americans who were detailed there from the U.S. Patent Office. The various possible effects of the PCT on the details of U.S. law and practice have been very fully scouted. Now I'm not guaranteeing that none have been overlooked, but things like our requirement that the best mode be shown, and our requirement of drawings and so forth, have all been taken care of. Also our requirement that the applicant should trace his title from the inventor, and so on. In many cases, this has been done by saying that the national law can require this, rather than by saying this is required under the PCT. But every one of these things has been taken care of.

The few unresolved items relate to our divisional practice, which is not really a question of our laws, and our practice on claims that depend on more than one other claim, which again is a matter of practice rather than our law. And even there, there is serious effort to accommodate the proposed international procedure to our practice. I think it has gone very much farther than anything that has been done with respect to the national laws of foreign countries. For example,

Japan has a practice of having only one claim in almost every case. They have a few cases where you can have two or three claims. The PCT would mean, if you file an application with six or seven claims, under the format which conforms with the PCT format, that the Japanese can't reject it as a matter of form because it has too many claims. That's a purely formal matter.

The publication practice in Germany of publishing in the German language 18 months after priority date is yielding to the PCT procedure. The Germans in effect have said well, if it is going to be published in the original language in the 18th month, we're willing to wait for the translation until the 20th month. That means it can't be published in German until some time after that. The foreign countries are taking much bigger effects on their national laws than we would be willing to take.

I think I should close my remarks now. I think I've touched on the things that are the points of debate and I apologize if I haven't been sufficiently analytical in looking at the whole thing.

MODERATOR GREEN: Certainly, Mr. Robbins and Mr. Woodward have covered in great detail all of the significant features of the Treaty, but I wonder if some of our audience may still be a bit baffled as to what they as innovators would do if the Treaty came into effect. I don't want to prolong this, but I wonder if there is any interest in the audience in hearing just what an inventor ought to do if he chooses under the PCT to obtain patent protection in two or more countries.

CARL T. BECHT: I'd like to say something, Mr. Green.

MODERATOR GREEN: Surely.

MR. BECHT: I feel like I've wandered accidentally into a den of wolves. I have sat here and listened to both of the opening speakers and I have to say that at this point, I am completely disillusioned. I have never heard so many negative statements. First, all of the reasons why the PCT couldn't possibly work. Then basically I have listened to all of the reasons why it can't possibly be changed from the way it is. I don't know about the rest of the people here, but basically, I'm a manufacturer and an innovator. I don't think that anything that I can do here today is going to change the thinking process and the work that has gone into the draft of the Treaty. I wouldn't expect it to. On the other hand, I'm sure that there is one area in which, as businessmen, we can substantially affect what happens to that Treaty. That is how well we use it, and what we use it for. It doesn't make too much difference to me as an innovator what kind of rules you want to write for the game that we are going to play. And that is really what we're

talking about—the rules for the game. We are going to play by those rules. I do think we ought to take a good look—a hard look—at what effect it is going to have as far as U.S. innovation is concerned and our contribution to the world picture.

I think that those companies that are involved in international efforts have an awful lot of soul-searching to do in relation to their patent practices—just how is this Treaty going to affect them. I know that our particular company—we do quite a bit of work in Germany—will probably substantially change the procedure that we would use for filing applications within Germany. I have to confess ignorance on some points. I think the basic outline of the goals and objectives of the Patent Cooperation Treaty are pretty specific. Again, I feel like we're trying to write rules for a game that we haven't quite yet defined. I think everybody has agreed that they are going to play. Without a doubt, in my own mind, industry is after one thing—patents.

What little brush I've had with both the legal profession and those responsible for writing the rules and regulations and contributing to these treaties, I've found that their thoughts are quite diverse from industries'. They seem to be more concerned with the mechanics of getting the job done than they are with getting the job done. I don't believe industry feels that way. Industry wants *good* patents. I don't believe that PCT, with its limitations, is going to provide industry with any better patents than it has had before. I am amazed at the loopholes that seem to be at the end of each paragraph, which basically say that each country will conform to whatever the existing law is in that particular country, if they so desire. That's my interpretation of just about the last line of each and every article. Maybe that's a layman's interpretation, but that is the way I read it.

I don't think that there is any question that we will have to conform to it. I think it will take an awful lot of time and an awful lot of expense. That's one place that I would have to agree with Mr. Robbins. I think that anyone who thinks he is going to get a patent cheaper today than he did yesterday might as well forget it. It isn't going to happen. I don't think the legal profession will let it happen and justly so. They're not going to go out of business, they are still going to make a living. The expense involved basically will be additional expense.

As far as U.S. inventors are concerned in protection abroad, I don't see or I don't feel that there is any significant change in the availability of protection for U.S. inventors within the Patent Cooperation Treaty. I haven't been able, again as a layman, to interpret the Treaty

much past the point of specifying the mechanics of carrying out the issuance of a patent, and I don't see any particular advantage as far as protection is concerned to the individual inventor or the means of getting that patent faster than what we have today. I do foresee some added complications in upholding these patents.

As far as licensing is concerned—I've had a few brushes with licensing—I would say that probably domestic law has more effect on licensing and what companies will consider licensing-wise than the Patent Cooperation Treaty. I think the gentleman here from General Electric is quite involved in licensing and he ought to have some real good thoughts on our friend Justice Douglas' decision and how he shapes a little bit of thinking as far as licenses are concerned. I know myself in relation to licensing here in the U.S., he's done a little more for me than the Patent Cooperation Treaty would do.

I don't really think that as a group we can do much to rewrite or contribute to the rewriting of PCT. I think that is somebody else's job. I think as a group we may be able to give them something to think about though, with respect to how we attempt to use it, and what effect the Treaty will have on what we're doing.

MODERATOR GREEN: Well, let me say that those remarks are excellent. I would agree first with your fundamental thesis that this group is not in a position of rewriting it but it certainly can give those who are concerned with the rewriting something to think about. The new Assistant Commissioner of Patents is in the audience, and Mr. Brennan of the Patent Office who is working on this, and these are the policy officials who are going to be involved. You did make three observations that I feel are worthy of additional discussion here. Let's take the first one—you said that if PCT comes into effect you will substantially change your procedures with respect to filing in Germany. Could you enlarge on this?

MR. BECHT: Yes, I would probably take advantage of the entire available time period for filing of the U.S. application, which presently we do not do.

DAVID C. ROSS: Are you talking about inventions originating in Germany?

MR. BECHT: Originating in Germany—yes. I understand after reading the PCT, it must be filed in the country of the national or the country in which he is residing if it is to be an international application, which would necessitate filing it out of Germany. Correct? And under those conditions we would take advantage of the entire

time period. Now this has some good and some bad features. That's my first thought of it.

MODERATOR GREEN: Do you think that you would file more cases in the United States than in the German office?

MR. BECHT: I'm not sure I understand your question.

MODERATOR GREEN: Well, you were talking about patents of German origin. You now file, let us say, 10 a year—would you file 5 or 20?

MR. BECHT: I don't think this would have anything to do with it—it shouldn't involve the number. This has to do with how spontaneous our people were in Germany.

MR. WOODWARD: May I ask, would you file your international applications near the end of the priority year?

MR. BECHT: Yes.

MR. WOODWARD: So that, in effect, this would mean that the English translation would be delayed for about eight months before getting here.

MR. BECHT: Right. And again this would be only basically to keep competition from knowing what we were doing.

MODERATOR GREEN: Any one else want to comment on that particular statement?

MR. ROBBINS: John, here is one point. I think everybody must admit that there are these opposed problems of U.S. patent law and PCT that are totally unresolved at present. The implication is that they will end up in the courts some time or that there will be special U.S. legislation—all that could be years ahead, so that for any important invention, if I were an inventor abroad of a potentially important invention, in Europe for example, I would rather hesitate to take the PCT route for filing in the U.S., because it might run into complications and end up in the courts after years of expense and effort. So under those conditions it might be better to file by the normal route in the U.S. Patent Office where more or less you know where you are.

MR. BECHT: Well, maybe I'm too much of an idealist. I'm assuming that every country or every state that will put its name on the bottom of that Treaty would be basically agreeing to go along with the rules. Now, I know there are going to be some bumps on the road—there have to be, but I would assume that they are basically agreeing to go along with it. It should afford a greater time period—that would be all I could add.

JAMES W. BRENNAN: John, let me comment on Leonard's statement. This is symptomatic of the attitude that we have had from a segment of the Bar. You know, lawyers are guided by precedent, so they look to

the past to determine what they are going to do in the future. Even patent attorneys are not by and large a very innovative group! And so, when Leonard talks about having an important case and not using PCT, I think he is giving voice to a philosophy that goes back to the early thinking on PCT—specifically, the comments we have had about Article 11(3). We've got a priority system now and it works—sometimes pretty well—sometimes not so well. Article 11(3) is a new system—it's a new concept. We've heard from Mr. Robbins that he likes the old system. He'd like to have a bigger old system. Instead of a 12-month priority period he is suggesting that we increase it to 20 months—but have the same system.

And he asked a question twice during his original presentation that he never answered for himself. He asked whether the Patent Office thought it would be desirable in the long run to have a universal patent system. And I think this is a very critical question. If you do think that in the long run—30-50 years from now—a universal patent system is desirable, you're not going to take any steps toward that universal patent system if you just keep increasing the priority period. You've got to make that little step for mankind but giant step for the patent profession, the step of being with this new concept of the one filing being a national filing.

Now, this is certainly what you are going to have when you do arrive at a universal patent. If the industrial people and the innovators think that the universal patent is ultimately a good idea, they might look at this proposed Patent Cooperation Treaty as saying, "Well, this is the first step." The next step may be a long time coming, and it may be a long road to go, but we'll never start towards this goal unless we make this first step. And I would like to ask Leonard whether he does think a universal patent would be a desirable goal?

MR. ROBBINS: Well, this involves questions of psychology, nationalism, even anthropology—is mankind generally internationally minded, or is it tribal in organization? I personally think that a universal patent system might favor inventors in the U.S. and a few of the large industrial countries, but to the possible detriment of their own economies and at the expense of the smaller countries.

Take the case of an invention made in the U.S. It would presumably be examined in the U.S. Patent Office, since there seems no hope for a central authority, and in effect then would be rubber-stamped for the rest of the world. Assuming innovation and invention continue at an active pace in say, Germany, Russia and Japan, these would be examined in their own patent offices. I cannot believe they will ever

have identical examination systems or will adopt the same viewpoint. So the U.S. would presumably then be flooded with rubber-stamped Japanese, German and Russian patents. What would happen in the U.S. courts—trying to interpret two, three, four different systems? In the smaller countries local industry would have to operate under a thick blanket of foreign-owned patents.

I think these points are relevant and should be considered. Universalism may be possible in some broad fields but I consider the patent system is far too technical and specialized for that sort of approach. To adopt PCT on the ground it would be advantageous as a first step towards the universal patent does not seem a sound argument.

DIRECTOR HARRIS: Could I break in a second here, excuse me, and ask you a question? We're discussing 11 (3) as though we're giving up something for nothing. Aren't some of the other countries giving up something under 11 (3)?

MR. BRENNAN: You have to remember that when we say national filing in every country we mean *every* country. It's a national filing in every single country that is designated. They each have some advantages and some disadvantages. It depends on the peculiarities of the local law. In the United States, because of the *Hilmer* case, the national filing concept under the PCT gives the foreign applicant an advantage that he didn't have before. We're not giving up 104, though. He can't prove foreign acts any more than he can under the present law. He only goes back to his filing date. Just as today he goes back only to his German or French filing date in the case of an interference. So I sometimes feel that some of these "problems" are blown up out of proportion. We're, after all, only talking about unclaimed disclosure that might be in a foreign-origin patent that we issue in the U.S.

MODERATOR GREEN: Mr. McGaughey raised his hand earlier.

DONALD C. MCGAUGHEY: Don McGaughey from Allis-Chalmers. My work relates to foreign patent filing, prosecution and foreign know-how licensing. I have had a chance to be exposed to the problems related to foreign patent filing. I see a need for a change in procedure and my company sees a need for a change. At present, we have a very thorough system at Allis-Chalmers for determining what inventions should be filed in foreign countries. We do everything humanly possible to see to it that we file our significant inventions abroad. Because of costs, we are selective. We have patent committees located within the domestic groups which carefully analyze every invention. These committees make recommendations. The U.S. attorney who

writes the case prepares a short but elaborate memorandum detailing the practical factors involved, the commercial advantages and the scope of protection we hope to obtain. The managers of licensing in our international group study this information and all recommendations very carefully.

However, the present Treaty provides only a 12-month priority period which is not time for efficient review. All of our decision-making must be accomplished within a few months after the U.S. filing. During this period the invention is beautiful; everybody loves her but nobody knows much about her faults. We always learn about faults after the foreign patent applications have been filed. Thus, at Allis-Chalmers, we do everything possible to make correct foreign filing recommendations but the net effect is that we incorrectly recommend some inventions for foreign filing. I'm appalled at the amount of money that my company spends on inventions that ultimately do not become commercialized.

Therefore, I see a need for a better system which affords companies more time to evaluate an invention. W. C. Fields had a very famous line where he said, "Mere details, gentlemen." We sit here and we talk about all the problems of PCT and I say they are mere details. We need to improve the system. Now, maybe the PCT is a small advance, but I think it offers a hope for improving the system, and I think we have to approach it in that way. One of our vice presidents had a sign on his desk that said if every objection has to be met before something is done, nothing will ever be accomplished. Every discussion I attend seems to prove the truth of that statement. We seem to hope to meet every objection before we take a step.

I personally feel from my experience that my company is going to save money through the use of the 20-month period that PCT will offer. We will file our international case, designate the countries and then, as close to the 20th month as possible, we'll sit down and make a last review of these cases to determine if we should continue prosecution in the individual foreign countries. I say that the nominal fee (\$15.00 has been mentioned) I have to pay to designate a country is well worth it to buy the 20 months of time. I also want to emphasize that Allis-Chalmers is interested only in good patents.

Now, if the invention is commercial, we'll prosecute to obtain even narrow protection. But Allis-Chalmers will look at this international search carefully and thoroughly, and in cooperation with commercial people. We do this now, and we abandon cases because we do not believe that the protection is valid over art that is cited in one or more

foreign countries. We don't want an invalid patent. We want good patent coverage but we want fair coverage commensurate with the degree of novelty of the invention. I see a need for PCT. I personally think we are on the right track with PCT. I think foreign filing is going to cost less with PCT. I also think PCT is going to improve the procedures for foreign filing and I believe everyone ultimately is going to benefit.

MODERATOR GREEN: If I read you right, you're saying that the opportunity to have eight more months in which to evaluate the quality of this invention is so important to your company that this overbalances other considerations, and you will save money.

MR. MCGAUGHEY: I think we will save money. Now, I don't know whether it overbalances any other consideration.

MR. WOODWARD: Mr. Chairman, I'd like to show how much these eight months mean by pointing out that you can't really begin to get evaluation from abroad for six months. This is because of security regulations. For a company to evaluate the situation abroad—especially the type of thing that's made, which may be different from the U.S. equivalent—it likes to have some feedback from abroad on its foreign filing program. Today one often recommends filing based on the U.S. point of view of what's done. You can't get much feedback from abroad until you tell them after the six months and it comes back months later. At best you wait, say, until about the ninth month and so then you have three months in which to file. Under PCT you would get 11 months instead of those three. This is a great multiplication—it isn't just 20 months instead of 12. From a practical standpoint for the kind of consideration you have to have, the kind of dialogue you'd like to have to do it intelligently, you're getting 11 months instead of three to do the job.

MODERATOR GREEN: I think you commented on this earlier, but let me put it this way. If this is the dominant feature, if this is the most important thing to American innovators, can you achieve this without PCT?

MR. WOODWARD: You mean—

MODERATOR GREEN: Get an extension of time through some other, simpler mechanism?

MR. WOODWARD: Well, this is extension of—the Paris Convention period would do fine. It would be no problem if you could sell it.

MODERATOR GREEN: But your earlier statement, if I read you correctly, was that you didn't think it could be sold.

MR. WOODWARD: I've asked Europeans why they wouldn't like it. I

mean people who are in the type of work I'm in. They weren't even anxious to have it. Maybe they have been conditioned by their governments and their laws and their patent offices. The patent offices won't have any part of it. They say, we want to know as of what date the document speaks. You can't get into much of an argument about it. Maybe if we pushed harder we could do it. It's an alternative way of getting the time—and as I say, it has some features that are objectionable to people who don't have the type of domestic practice that we have, where you can keep on substituting new applications as long as the previous one isn't patented or abandoned.

J. HAROLD NISSEN: Mr. Chairman, may I break in?

MODERATOR GREEN: Mr. Adams has had his hand up for a while—can I catch him first?

EDGAR W. ADAMS, JR.: Probably this speech would have been better made before that of my friend from Allis-Chalmers here. I've been sitting here now roughly two hours as a non-discussant and am probably greatly misled by the ground rules which were sent out to us. I came prepared to talk about what we would do if there were a patent cooperation treaty: Would we use it? How would we take advantage of it? Are there disadvantages? I've listened to a debate which God knows I'm prepared to enter into if anyone wants me to as to whether the proposed Patent Cooperation Treaty is the best approach, has viable substitutes, has defects and what not. That debate has been had. It has been argued. It will be argued again, I suppose, at least another half-dozen times between now and spring.

It is my view that if this exercise today is to do any good, and if it is to help anyone, bearing in mind the composition of the group invited to come here, we should be talking about the questions that I thought were to be asked as to what would you do under such a plan, if there were such a plan? If I'm out of order, my apologies to the gentlemen involved. If I'm not out of order, I hope that, after lunch at least, we will talk about what most of us, I believe, came here prepared to discuss.

MODERATOR GREEN: I think your point is well taken. I do think we needed a little bit of a grounding in the Treaty, but I think it would be unprofitable to continue the debate on specific articles as you indicated. A few people have raised their hands. Dr. Muller, I think you had a question.

F. S. MULLER: Well, on two things, Mr. Chairman—my name is Muller, by the way—two things on which I would like to remark. One thing is about the universal patent and the desirability of it. Of course,

there is an intermediate way—it need not be a universal patent at once—there's an intermediate step that can be taken and that is harmonizing, harmonizing laws. I think one of the things industry is interested in is to have perhaps 20 filings in 20 different countries or through the PCT, that doesn't matter, but one final document which substantially gives the same protection in all the countries. That is the main objection against the present system, that if you can get a patent in Belgium which gives you this scope, you get a patent in Spain which gives a different scope, and so on and so on. So let us not aim too far trying to get a universal patent and let's not discuss the question whether PCT is an initial step towards such a universal patent, but whether in bringing PCT into working one gets a means to get something harmonized. Too many times I have the impression, especially when I am in an audience where Anglo-Saxon people are, that they are always thinking is the new system consistent with my law and they don't look at it the way—can I do something with my law in order to make it consistent with the international system?

A second remark I would like to make is that I am very much in favor of what was said by my friend from Allis-Chalmers. It is remarkable that so many people are coming forward with all kinds of plans, and the ultimate fate of such plans is always that there aren't sufficient people who can adhere to it and the thing is dropped. Ultimately the result is that we don't get anything. It's about time, I think, in the 20th century that we are able to cooperate in such a way that a simple thing as a patent case, which is so much less important than many other things, that we can through a simple means get protection in the countries we want by one instrument which substantially gives the same protection. And if we have objections against PCT, well, let's start with it and let's improve it, but let's not try to impede bringing it into being.

MODERATOR GREEN: Anyone wish to comment on Dr. Muller's remarks?

DIRECTOR HARRIS: May I respond to Mr. Adams first? This meeting, in a way, is an experiment; we are continually seeking to improve the Clinic concept. The participants around the room who are not seated at the table should not feel inhibited because they require formal recognition by the Moderator. I asked the discussants at the table to react one to another without formal recognition because this kind of group-in-a-group format permits us to serve a larger number of participants without losing the spontaneity of a smaller group. I think your other point is well taken, Mr. Adams. The essential reason we are

here is to find out what our innovators think and, particularly, what they are going to do under these circumstances. However, we had to have some type of orientation, especially for the participants who have not been too close to PCT developments.

MODERATOR GREEN: Accepting what you say, it seems to me that we should concern ourselves with principles and not specific legal requirements. It seems to me that the three general topics that deserve attention might be grouped as follows: Your topic A might be called the Financial and Administrative Features, and within that topic I think you would have the question of costs, the question of new procedures, and the element of the additional time that has already been discussed. A second general topic that I think is significant is International Trade Considerations, and within this area it seems to me we are interested in the effect it would have on filings overseas, how you would behave when you are filing overseas, and the question of filing in this country by foreign firms or foreigners with the recognition that this means that substantially a larger number of patents might be held by people from abroad. And then the point that Mr. Becht touched on, the question of transfer of technology through commercial channels, the sale and licensing of patents. And I would suggest a fourth variation, which is the possibility of Transfer of Technology to New Countries, countries which do not now have search systems, which might take advantage of the search systems which are provided. This is the developing country philosophy.

Then my last general category or topic would be Looking Ahead. There has been some discussion of the question, is the universal patent system a desirable goal? A related question, where does PCT acceptance take you as innovators? In other words, will it be in the interests of U. S. innovators to go down the road of harmonization? Another item that has been touched on briefly here—there are alternative plans—EEC—the European patent. Are innovators as interested in PCT if these should come into effect and the U. S. might have access to them? I suggest that we worry in the environment that Mr. Adams spoke about. Assuming that PCT will come into effect, what impact does it have on your financial and administrative point of view? How does that affect your overseas dealings, and what do you think is taking you down the road? Does this seem reasonable?

DIRECTOR HARRIS: And we are interested in your reaction to the rationale behind the major elements of PCT, including how you would operate under it. Incidentally, John do you want to give the participants an opportunity to write down the outline you just presented as the program for the day?

MODERATOR GREEN: Is it worth repeating? Why don't we do this—Leona, will you type it while we're at lunch so we can have copies—

DIRECTOR HARRIS: So copies of the program for the day are distributed to all.

MR. BRENNAN: John, could I—

MODERATOR GREEN: Yes.

MR. BRENNAN: Just one more background comment, and this is occasioned by your topic A and your topic on the impact of the EEC patent. We have heard some things that might be of interest to the people in this room in helping them form their views on how they would act. If the EEC patent does become a reality, and it looks now as though it is politically possible, we understand that there is a provision in the proposed EEC treaty that would provide for a search by the IIB or, in the alternative, a PCT search. Now, this would mean that if PCT and EEC treaties came into effect and we were able to get access to the European treaty, we would be able to have a search conducted by the U. S. Patent Office which would be acceptable under the EEC as a search equivalent to that conducted by the guy at the IIB. I think that this may be something that these people should bear in mind in making their considerations and judgments. I think also that this shows that these are not alternative treaties but are in fact complementary arrangements.

MODERATOR GREEN: Well, let me ask Dr. Muller.

DR. MULLER: Yes, I am a little bit surprised by this remark, because if I am well informed—one of the reasons for the revival of the EEC system was especially that the French people were afraid of being flooded by PCT applications with a U.S. search report and they would like to avoid that by introducing the EEC patent with a compulsory novelty search being carried out by the IIB. So I am very much surprised that this as an alternative would be acceptable.

MR. BRENNAN: I believe that the entire philosophy of the EEC treaty has undergone a great revision in these last 18 months and that the participants have become much broader in their outlook. They are now thinking of permitting, under a dual treaty system, applicants from many European countries, not only the six of the Common Market, to file, and it may well be that they feel that this has grown to such great proportions that it would not be physically possible for the IIB to conduct all the EEC searches plus the searches that will be done by the IIB for the PCT. I don't know all of the reasoning behind that. I'm not sure that it isn't suggested in order to make it a little more

attractive to U.S. interests. I don't know. But we have heard from good sources that this is in the latest draft.

DR. MULLER: Recently?

MR. BRENNAN: Within the last two months.

DR. MULLER: Well, you have better information, of course, than I have.

MR. NISSEN: The question of accessibility to Americans is still under discussion. That has not been resolved and that's a big issue there. I'd like to make a comment on some of the statements made before. I agree with what Mr. Adams stated, I thought this was going to be post-PCT. And one of the points that intrigued me very much was the question that we were discussing, the extension of time. Historically, the international convention has had the period extended from a shorter period of about four to 12 months. We've gone from a short convention period to a long one in time of increasing communication, and yet you hear people saying that we must go to a shorter time—just the reverse.

The other point on which I would like to comment is the question of disclosures that you send abroad. Now, that will work both ways. There are some Europeans who would like to send disclosures here. There are many times when I will send a disclosure abroad by first obtaining a license from the Patent Office before a U.S. application is filed. I will obtain that license and send that disclosure abroad. So I'm not hogbound to wait six months to get a free license—the five dollars that it costs to get that license really is unimportant. Now, even though you can get the license and check your people abroad within that short time, the PCT will give you an additional eight months. There is no question about that. The big issue, as I see it, is that the U.S. applicants now have a one-year free period in the U.S. When you go abroad you sometimes lose that time because there are certain countries that have an absolute novelty requirement. By that I mean you can't disclose the invention in any way. As an inventor you must keep that completely secret except from those who might be in privity with you and nothing else.

Now, the European or the foreign applicant, except for the Philippines or the Canadians, have always had that problem. They have never disclosed. Their problem has always been that they have made an invention, they have rushed down to the patent office to get a filing date, and then they have an opportunity to disclose. We don't have that concept in the United States, and as I understand PCT, the European will now have the opportunity to run to his own patent

office and file it there, and at the same time have that filing as an effective filing date in the U.S.

Now, what will we do in the U.S. to achieve that same purpose? It will become difficult to discuss post-PCT and how it will work later on, as this depends upon what your view is with respect to 11 (3), which is whether the first filing is an actual filing in a foreign country or merely a priority term. And it is my understanding that the French, who have been pushing the EEC patent, which will eventually lead to the European patent, also seem to dislike that 11 (3) provision. We are not the only ones, and I think you must separate the PCT and 11 (3) from the developing countries because if you really want to do something for developing countries you should have encouraged confirmation patents years ago. I also think that if you are in favor of the PCT you should be in favor of that Phase II. In other words you should go all out for it rather than just one portion. Because the problems of Phase II are more magnified and more evident. They are more obvious. But many of those same problems have analogies in Phase I.

DIRECTOR HARRIS: Mr. Chairman, I want to repeat, in view of what Mr. Nissen said about confining the discussion to post-PCT, to make sure that our innovators understand that they can question the rationale behind any part of PCT, or discuss how they operate under PCT. We want you to feel free to express your informed views either way. I don't think Mr. Nissen is suggesting that we confine you to information on the procedures you would or could follow if this draft of PCT comes into effect, although this is important to know. We want the informed opinion of innovators on any major aspect of the proposed treaty, particularly from non-patent attorney innovators who have not yet been heard. In short, if we are to join a treaty, let us do so with as much preparatory information as possible and draft the treaty accordingly.

Now the lunch period is upon us.

MODERATOR GREEN: It's about the right time to break for lunch.

JACK RABINOW: Can I—

MODERATOR GREEN: Yes, Jack?

MR. RABINOW: I'm Rabinow, and I wear two hats, one—I'm employed by Control Data and, the other, I have my own patent business, if that may be the right thing to call it. I'm concerned, first of all, with the argument that you have to walk before you run. I know that in some cases you may have to do something which isn't the best thing to be done—but you may get stuck with it for many generations to come. I'm not at all sure that PCT is the right direction to go on the way to a

universal patent, which I'd like to see. I certainly would like to see regional patents if I can't get a universal patent—say North American patents, South American patents, European patents—I believe that a universal patent is still necessary. I think that it will save money and time. I think the other—the PCT—won't.

As far as the eight months versus two months goes, that reminds me of the argument the attorneys put up when the Patent Office shortened the time for action. Everybody was going to collapse. Nothing happened. The attorneys just worked a little harder at first and then they got used to it.

I think that, for example, the security rules could be changed quite easily to avoid the six months' delay because I think, in many patents, these are silly rules anyway. I think they could say that the rule pertains only to certain classes of patents and the rest of the patents could be exempted, or maybe the waiting period could be cut down to three months. I don't see why it takes six months, for example, to see if my phonograph arm, violates security. That's ridiculous. I think that security should be applied to certain type patents—atomic energy, perhaps—weapons—something like this.

I'm afraid that if the PCT is adopted, and I suppose it will be, what is going to happen is that it will be very, very difficult to change it for 50 to a 100 years. I would prefer personally to see it not go into effect, and keep pushing for something which would result in a universal patent and which would result in much simpler procedures than PCT. We have this problem in a big company, Control Data. I'm sure you all have it in your companies. You make the wrong machine, thinking that it is temporary. You'd like not to do it, you'd like to delay it for another year and get a good machine. And you do the wrong thing, you make the machine quickly and then you are stuck with it and you can't change it for 10-20 years because you were rushing a little ahead of time.

I think this is the same case. I don't think it is a step in the right direction, I think what is going to happen is that we are going to be stuck with the PCT. I don't think it's a very good solution. I think it is cumbersome, it's an attempt to adjust to the present situation which is crazy, of course, and I think what is going to happen is that we are going to be stuck. I would much rather see us work for something much better, even if it is delayed for another 10 years. This will delay it by 50 to 100 years.

MODERATOR GREEN: That's a blast if I ever heard one. (Laughter)

We ought to break for lunch, Jack, on this. I'll buy you a drink.
(Laughter.)

DIRECTOR HARRIS: We'll have lunch at the Adam's Rib at 12:30, and resume the session at 1:30. We don't want to lose too much valuable information at table. After a drink we'll probably talk a little more freely. We'll come back here at 1:30. Gentlemen, we stand adjourned temporarily.

AFTERNOON SESSION

DIRECTOR HARRIS: Gentlemen, let us begin the afternoon session. We have a number of matters to discuss. We will attempt to stay on schedule. John.

MODERATOR GREEN: Gentlemen, did you all get copies of this outline which I roughed out before we met? I have no pride in the style of the words, but could we in a sense divide up our afternoon into these three topics—the first one being the Financial and Administrative Features? Here it seems to me that what we are worrying about is your behavior if something reasonably like the current PCT comes into effect. Would it cost you more, would it cost you less, are the differences negligible? And, second, how about these New and Alternate Procedures? Are they advantageous? Are they not advantageous? Are they negligible? And third, this question of Time, which was touched on this morning. How significant is the 20 months' advantage to you? I would like to throw the floor open. Mr. Squier—

J. M. SQUIER: I'd like to get you in one of our engineering meetings some time and confuse you with the aesthetics, I guess that's what we call them, of some of our engineering decisions. I'm going to talk for a minute about my philosophy toward the proposed patent treaty, as a layman and as an administrator very actively engaged in trying to get these things locked up, so to speak, all over the world—with our lawyers who give me good advice—I hope. But first of all, it is my observation, not only in engineering meetings but in a meeting like this that we tend to become over-sophisticated with the details—the

technical aspects of whether or not things can be done. And furthermore we tend to conjecture as to whether or not all these things will happen, and how fast they will happen if we do engage in them. So I will direct my comments first to Jack's that he made just before lunch, wherein he said that he disagrees that the PCT, if it goes in, will ever change for 50 years.

It is my personal feeling as a layman that you need an action to create a reaction. I guess it's not as a layman but as an engineer and observer of social and political trends in this day and age. We have a lot of people who don't do anything until something is done. And I think this is a truism. We'll sit back and talk the PCT to death as experts and we'll conjecture as to whether this or that or the other detail is right. This other fellow over here quoted a saying a while ago, and I think it's very apt—that if we wait until everything is perfect we'll never get anything done.

But, getting back to the point, it is my personal feeling that we do need a uniform format to operate from, from an administrative standpoint. We have so many confusing elements that bombard us from all directions in this day and age, that any uniform format, even a bad one, provides us an opportunity to collect our thoughts and then to legislate or direct our attention toward the bad parts of that uniform format. I think that this PCT treaty gives us the opportunity. I'm sure that, like an engineering design, we can pick the damned thing apart forever. But, I still feel we need this benchmark or this platform to launch a uniform program worldwide. We can discuss it later in detail.

I have some backup thoughts on this. I disagree that PCT is a bad thing. I think it's a good thing from a uniformity standpoint. I disagree, secondly, that this program will not change for 50 years. I think all of us have heard this cliché, that in this day and age things are going to happen and they are going to happen at a faster pace than we think they are going to happen. If we look back a decade in our lives this just has to be true. Therefore, the result of this action, in my opinion, would create change faster than as if this Patent Cooperation Treaty were not entered into. And this is by no means perfect—neither is our legislation. It's all based on social and political environments. And in the international field, those of us who are in it realize more clearly than others that there is no single set of rules that we could follow. We make a good set of rules and we try to adhere to them and then we're flexible as to how we operate within the rules. A set of rules gives us a common foundation to operate with and within.

Now, secondly, from the administrative standpoint, I feel, and I'm

just going on record with a few other people here, that the time element in PCT (20 months)—if we are smart enough not to sit back and say, “Well, we’ve got that much longer to work” and we end up in the same dilemma we’re in now—will afford us the time to search domestically the validity of a given invention and so on. Then we won’t panic into disclosing or filing in certain countries a very poor or unusable patent way in advance of when we’d like to. I think, as Leonard Robbins pointed out in his argument—and I appreciated your arguments, that’s the right way to start—I disagree that costs may end up higher. I do agree that probably for an individual patent the cost may be higher. But I’m looking in terms of many patents which are filed. I think the overall cost will end up less if we pursue the good patent approach.

Now one more personal philosophy—I don’t think in this day and age—that we can afford to do anything selfish in nature, protective in nature, in terms of world agreements which will work. I believe the Patent Cooperation Treaty obviously has elements that advantage other countries which today we consider to be at a disadvantage. I think that if this Patent Cooperation Treaty is going to be good, workable, good for the future of our country and our companies and our people, that we have got to give more than we take, in our opinion. But I don’t really think that if we go along with this Patent Cooperation Treaty and we accept some of the things that tend to advantage at the moment other countries, that we will lose one step. I think our momentum will keep us out in front, our ingenuity in bending and bobbing and flowing with this trend of events will keep us right where we want to be, and for that reason I think we have to adopt or accept something which tends to advantage some of these other people, at least on paper, more than it does us. If we generate a document as a starting point which tends to be an equalizer, I think it’s right.

Now that isn’t looking at it from the legal standpoint obviously but it is looking at it from a philosophical standpoint, and I’m sure in the final analysis we’re going to be able, as managers, to contend with the Patent Cooperation Treaty very well. We have already washed out some of the original complication in the wording, and so on, that did tend to confuse a little—it is still not an A B C document that tells us everything, but we think from our company standpoint, and you have to look at it that way, in our kind of business with a volume of patents in the countries that we are in, we think this is an advantage to us, having this kind of a treaty. That’s the end of my remarks.

MODERATOR GREEN: To relate your comments to my little outline—

let me see if I can play them back accurately. In the topic of cost, you see no savings per patent but you feel that the ability to interpose judgment and save time will weed out some patenting that over all—

MR. SQUIER: Let me qualify that a little in terms of the statement from Allis-Chalmers. I feel again, getting back to the philosophical, that we are better off having a good patent, a solid patent, than having a number of rather marginal patents that we need to defend for example against claims or counterclaims and so on. Therefore the extra time would perhaps give us more opportunity—well, for example just to get our own research done before we have to declare within the 12-month period. My goodness, we have to file a number of them and if we had to clean something up in our own house, it would be to get our own research done a little faster in the U.S. so that we knew going in, that at least we were on solid ground with a patent in the U.S. before we had to commit the filing in various countries all over the world. As a result of the research that should be contained in PCT if it worked well, I think we are going to be able to purify our patents and have them stronger patents, perhaps fewer of them, and the net cost could perhaps be higher with better patents or it could be lower with better patents. Does that clarify that?

MODERATOR GREEN: Yes, I think it does. I wanted to go back to the comment that Mr. Becht made earlier in which he says that industry wants good patents and he saw nothing in the Treaty which would provide any better patents than heretofore. Is that correct?

MR. BECHT: Yes, I'd like to ask exactly what is different in PCT today that would promote better applications originally. This is either a point I'm missing or I don't understand. I don't see the vehicle there to make a better application just because you have an extension of time.

MR. SQUIER: Well, I can answer that, I think. There are many times when I'm faced with a decision and I'm sure others are, as to whether or not we want to file a given patent within the 12-month period which we have around the world. Many times, and I'm sure this is the case everywhere, we don't even have our own patent search completed to the extent we would like to find out if that would even be upheld within the U.S. Well, it's foolishness to spend our time, money and efforts to file a patent all over the world which won't even hold water in the United States against another patent. Basically the extra time and research would give us time to refile and a few other things which we may want to do.

MR. BECHT: I would be forced to ask you then why you filed

originally in the States before you conducted your investigation of the search of the patent. This is open to you right now. Basically the system in the U.S. as I understand it—and we were discussing it at lunch with Dr. Muller—is basically first-to-invent not first-to-file. So you have the availability within the States and the system right now to investigate early any application that you would like to place in the States. The only reason for going ahead and filing an application in the States that I know of is to compete on a foreign basis with those countries in which there is a first-to-file rule.

I don't see this changing under the present scope of PCT in relation to the foreign situation because you're governed as it stands right now by the individual rules of the country. Correct? Unless there would be some common rules—and these are all hypothetical—you can't really discuss the cost of application unless you put some ground rules in—some common basis for when you file and what the ground rules for filing and establishing dates and priorities are. I don't see where the ground rules have really changed that much.

MR. SQUIER: Well, they haven't. Perhaps I'm talking about some own dirty linen within our company, perhaps I'm not. But there are cases where we have gone ahead without having all of the steps completely firmed up here and filed in other countries that we probably would not have. There's no question about it with the volume we handle. Maybe this is our problem. We have to do a lot more work within a short period of time with a limited staff than you would if you had a little bit longer with the same volume, if you wanted to look at it that way. In that case, there is a cost element that enters into it, and a certain amount of—I hate to use the word, guessing—I guess.

MR. NISSEN: May I ask a question? How would your procedure differ if you had an opportunity right now to make an international search or if the U.S. Patent Office gave you an international search which would provide you with all the art that you feel is necessary to make that decision to file and have that given to you, say nine months after filing the U.S. application? Would that accomplish what you want to accomplish? Or do you still need the additional eight months to incur the expense of filing fees and translation fees?

MR. SQUIER: Well, I guess if I can interpret your remarks—if we had another way than what is proposed in PCT to do the same thing, how would you feel about it? Well, certainly for that particular element overlooking the fact that here's an opportunity to engage in a patent treaty which might be a vehicle towards something better, I would have to agree probably that's fine.

MODERATOR GREEN: Mr. Nissen, I fell off the wagon here—What kind of a plan could the U.S. Patent Office visualize to do this?

MR. NISSEN: Well, the U.S. Patent Office, at least under Commissioner Brenner, had indicated that they would like to get down to an 18-month allowance period. If they go down to an 18 months' allowance period, they would have to issue their first action about nine months after filing. The present system of two official actions before finalization, three-month terms, you would have to have a period prior to the 12-month period within which a good first action were issued. And at that point you should have a fairly good idea as to what you have in that application.

Secondly, there has been a proposal for a patentability brief which I have interpreted, and maybe incorrectly so, as the first official action being issued by the applicant himself. He makes a search, looks at the art, and he then assesses what his chances are. He then files his application putting forth the best arguments in the specification to support the patentability of that disclosure or that invention and the Patent Office comes along to examine that application with that patentability brief, looking for any additional art which they feel is pertinent, which should come to you about, or at least, prior to nine months after filing. So you then are in a position where at that period, you have a fairly good idea as to what the state of the art is. Now, I'm discounting at that point the idea of uniform documents and uniform formalities because this can be accomplished in another way and a much simpler way, which is another point I think may be bothersome and troublesome to you.

MR. SQUIER: Well, the nine-month period, if we knew within that time the value of our application, certainly that would solve that part of the problem. I'm going to take this opportunity to say something that I'd forgotten to say the first go around. We have a great deal of concern over the Japanese aspect of our patent association. I have a couple of very very clear disastrous cases which I could cite and I won't, about the problem involved in Japan with the single-claims rule which really hurt us badly. So again I'm looking at a uniform format, I guess in this case selfishly, wherein if we could through PCT generate our claims in a more uniform method of approaching these other governments and other situations it would help us a great deal in filing and in accomplishing what we're trying to accomplish. That's our company.

MR. NISSEN: I understand your Japanese situation. Yet the Japanese have gone from a system which was closer to ours where they had, and

I don't want to call these subclaims, but they were additional statements. Some people interpreted these as claims, others did not. It was a system which could be considered to be a subtype of the type you are considering and yet the Japanese have gone the other way, with the theory being that there is one statement that you use to define the invention and you really don't need a number of statements to define that invention.

MR. SQUIER: Well, not an invention—claims to an invention. We know that it failed the course, and of course the problem in licensing—I'll get into that which is predominant and should be predominant in everybody's mind as a separate issue in this whole situation, is that when you face—well let's take Argentina and Brazil, and Japan as a prime example—governmental units which recognize for various reasons patent validity and claims, individual claims which give credence to the validity, you must somehow get better recognition of the patent and its claims, whether you call it substatement or sub whatever, because as an operating company you absolutely must achieve these goals in connection with the patent. In other words, we must recognize the fact that a patent is one thing, but what it does for other reasons is also important to a company. And it's all wrapped up in one bag really. And it's important in my opinion to have a better handle on our part as to whether or not it is good or bad going in than later on fighting it in a futile case.

MR. NISSEN: You would really like to see a harmonization of all the laws of the world where the patent law in each country is essentially the same.

MR. SQUIER: Well, certainly, I guess if you wanted to pin me down personally to that philosophy, I'd have to say that I think as a country with a fully homogenized system with everybody recognizing the system worldwide as a final result—that we'd make out just fine and it would simplify a lot of our lives, un-complicate a lot of our lives and help us make better management decisions if we knew that we were operating from a common base. So, yes, I'd have to say very definitely. I don't think we need to hide behind an advantage or anything else in this. I think we should go after something which is the same all over.

MR. NISSEN: Would you be willing to adopt the Japanese system for the U.S.?

MR. SQUIER: I didn't say that.

MR. NISSEN: I know, I know you didn't.

MR. SQUIER: I don't even know what it is. (Laughter) I'm a layman. (Laughter)

MR. NISSEN: But we have been considered to be out of step with the rest of the world and we are consistently in the minority in this particular area. I think the Japanese themselves are also in the minority here too. Now whether they will adopt the so-called continental form of claiming and whether we will adopt it, is something that I don't think PCT will accomplish.

MR. SQUIER: Well, being serious, we find that the Japanese probably more so than many other countries, in spite of the differences in our system, tend to respect strong claims, strong anything in a legal contract, whether it be a patent, a technical assistance agreement, a trademark agreement, or whatever. Once it is made with Japan they are very respectful of it. So in that sense I don't have much fear if it's done as a world treaty agreement.

MODERATOR GREEN: Mr. Adams.

MR. ADAMS: I'd like to talk about costs and time, which is the first question raised by the material. And I want to use the outfit I work for as an example. I won't say typical of all, but certainly of some. We like to think we're innovators and that if we aren't, we aren't doing our job. One of the things we do is try to obtain patent protection in foreign countries which we can trade for patent protection foreign innovators obtain in this country. We go through all the agonies that my friend from Allis-Chalmers here outlined and maybe a few more sophisticated agonies and we probably don't come up with any more sophisticated results. In fact, maybe ours aren't even as good as his.

What we are interested in is improving our performance in spending our foreign patenting budget. Whether we can improve that performance, the costs in terms of fees and the like, is not a substantial consideration. We would contemplate probably having about the same budget we have now for filing in foreign countries. Right now, and I regret to say I've been a part of doing it, we inevitably make our decisions as to which cases to file partly in ignorance, partly in cowardice. There should be some background here. First off, we have a policy of permitting very wide and liberal publication, which is ingrained in history, and which is apparently necessary to encourage scientists to work for us who would otherwise be working in university research laboratories. This means our decision as to whether or not to file a patent application in the U.S. is made early (and often made for us).

When our people have an idea with any substance, they want to publish it at least yesterday and maybe the day before, and we have to worry about whether or not there is an invention here, and if there is,

whether or not we should file an application. We do our own searching by and large and we file our U.S. applications. This happens without reference to foreign filing considerations. So we are now presented—

MR. RABINOW: Excuse me, you mean nobody checks to see if it will jeopardize your foreign filing in the material that you publish?

MR. ADAMS: Yes and no.

MR. MCGAUGHEY: You file early.

MR. RABINOW: You mean a scientist can publish—

MR. ADAMS: He publishes after we have filed in the United States.

MR. RABINOW: And nobody tells him that he should wait awhile to begin foreign filing.

MR. ADAMS: Where do you jeopardize anything except maybe in Argentina?

MR. RABINOW: Well, O.K. so you make sure that you get the filing date so that you can use the convention date.

MR. ADAMS: We file in the United States so that they can publish. Does that answer your question?

MR. RABINOW: Yes.

MR. ADAMS: So now we're faced with lots of U.S. applications and we're trying to decide which ones of these we should put our money on for foreign filing. Everyone of these has a backer in the technical area. Not only the inventor but sometimes his management says this is the way the art is going to go; this invention is going to be important. And this is why I used the word cowardice. We don't decide against this kind of statement as often as we sometimes wish we had. We file abroad and (more disastrously, of course) we sometimes don't file if there isn't a strong contrary opinion.

Our performance in making the right guess as to the future is not nearly what it might be. When we look at these cases later on to decide whether to maintain them or whether to continue to prosecute them—and now we're having deferred prosecution—or whether to keep deferring them, we often get a new set of facts: The inventor of A who by now has actually tried to build the thing, discovered there was a small difficulty in his calculations. It doesn't work. We're now off on approaches B, C, D, E, and F, any one of which is better than A. It's the feeling that given time for this kind of thing to happen, we'd make better decisions. I don't think any of the people who have discussed it in our outfit think we're going to save foreign filing fee costs. We only hope that given time we can do a better job of investing the dollars we are willing to commit for this activity.

MR. RABINOW: You mean eight months would make a difference. I can see that five years would make a difference, or ten years.

MR. ADAMS: The difference is between eight months and—well, normally at the end of the third month we are worrying about this question.

MR. RABINOW: And you think that having another five or six months would give you a better choice on whether the invention is valuable enough for the effort?

MR. ADAMS: We think so.

MR. SQUIER: Being blunt about it, any extra time enhances your chances of making a better decision. The way our business is run today, boy, it's a matter of six months that makes a tremendous difference in whether a decision is economically right or wrong. It's true. We're moving pretty fast.

MR. MCGAUGHEY: Actually, I don't agree with bandying about this eight month figure. It's true that you file a U.S. patent application early if you have international aspirations so your people can publish articles. Allis-Chalmers does the same thing, and we have the same grief because immediately after U.S. filing, our international operation and our commercial people are forced to make a decision as to foreign filing. They must start this decision-making three months after the U.S. case is filed.

I can predict what will happen under PCT in our company. We will spend the \$15 to designate each country in the international application, we will then wait for the 18th month, then review the international search results and make our decision. We will not start in-depth decision-making relative to foreign filing within three months after our U.S. application is filed. We will leave our in-depth review until after we study the international search. Therefore, as a practical matter, Allis-Chalmers will obtain more than eight months to consider foreign filing of an invention. That time is very valuable to us; and we'll pay the designation fee for each country to obtain this added time.

MR. WOODWARD: I think there will be a two-stage operation there. I would expect that if the operation is divided on a divisional basis, on a technical subject matter, small-group basis, the decision of whether to file the international application will be made in that small group. They will screen out the cases that were just filed here so that somebody could publish, while nobody really thinks there is anything more than a defensive interest there.

As for the other cases, they will know they're spending a hundred

dollars or so to keep the gates open to file abroad. But this will not be the big review. John Shipman said, "We're only going to review these in depth once. Instead of doing it within the 12-month period, we'll have our serious review at the stage when we have to furnish money for translations and national filing fees."

MODERATOR GREEN: Will you wait a second, I think someone over here raised his hand. O.K. Do you want to enlarge on your comments?

MR. ADAMS: Well, I guess I was inspired to a few further words. I have to second what Bill was saying and what the gentleman from Langner was saying. That is, we would contemplate in most instances paying the designation fees, having decided in some gross kind of way which cases are worth—seven countries say—which are worth \$15, which are worth \$20, and then make the major decision when you have to go the rest of the way and complete the filings. This isn't to say that we don't recognize there might be times when we didn't want to use the Patent Cooperation Treaty at all. I don't visualize very many of these times for our own company. However, friends of mine who are in the pharmaceutical business, for example, sometimes prize secrecy more than patent rights and would like to avoid being forced to the automatic publication which happens under the Patent Cooperation Treaty even at the expense of losing rights. I would suspect that these people would have to make an additional decision which wouldn't bother us very much. I doubt we'd go down this route in the first instance. I don't think that would bother us very often and we wouldn't have that decision. We would not in general, unless there was some very special reason with a flag attached to it, do anything other than simply make a gross decision—is it worth X number of countries, or Y or Z number—pay the designation fees and then make the ultimate decision after we've had the benefit of the additional time.

MODERATOR GREEN: Mr. Mulcahy, you're with the Pharmaceutical Association, do you have any comments on particular problems of the pharmaceutical firms?

NEIL MULCAHY: Well, I can't speak for any individual company as to whether they're going to attempt to maintain trade secrets or seek patent protection, but I feel in general that there is a trend in industries that generate technical subject matter that could be protected by trade secrets to seek trade secret protection rather than patent protection. Certainly in the United States where the pharmaceutical industry has encountered numerous antitrust problems in trying to license patents, the trade secret route should be considered. Of course trade secret protection is applicable only to those technologies where

the subject matter to be protected is not obvious from inspection of the marketed product, such as pharmaceutical processes where it is not obvious what the process is.

MODERATOR GREEN: Now, if I understand Mr. Adams, he said that the publication features of PCT might make the pharmaceutical firm more reluctant to go that route.

MR. MULCAHY: Certainly if a company in the pharmaceutical industry in the United States is weighing trade secrets against patent protection, the compulsory publication features of the PCT would tend to make them look only to the presently available methods of obtaining patent protection without the PCT.

MR. SQUIER: May I ask a question, Mr. Chairman?

MODERATOR GREEN: Surely.

MR. SQUIER: How would the PCT route differ from the present route today if you chose to patent the thing in the United States, at least within the United States? I'm a little vague on this.

MR. ADAMS: I'll take a crack at that. As I understand the pharmaceutical viewpoint—in the United States until the patent issues, you can always abandon your application and keep it from becoming public knowledge. And if you make appropriate choices of what countries you file in abroad, you still have this option. Under the Patent Cooperation Treaty, unless you pick very carefully those countries in which you choose to get protection, your application is going to be published in 18 months. This is not as long as you can put off the ultimate choice between publication and secrecy, if you stay out of the Patent Cooperation Treaty, as I understand it.

MR. NISSEN: Well, there's one further point you should consider. Even if you want to consider the PCT and the non-PCT route to be optional routes, the PCT requires that the application be published unless you designate a country—unless you designate only these countries which have positively indicated that no publication should take place. For example, you have X, Y, Z countries. If you go a non-PCT route they have no provision for publication, no publication of the invention is made. Now, if for some reason that country doesn't make a reservation on the Patent Cooperation Treaty and you file through the Patent Cooperation Treaty selecting only, excuse me, designating only those countries which do not formally provide for publication, the PCT will publish after 18 months.

MODERATOR GREEN: Thank you. I think we've heard from—shall we say the large and the well heeled research organizations and compan-

ies. How about some of the smaller outfits. Mr. Nielsen, you're president of your own company. How do you feel about this?

AXEL NIELSEN: Yes, I'm kind of a little upset when I sit back here and hear this gentleman talk about \$15 for filing in some foreign country. I have never filed anything for less than 500 bucks—\$400, \$450, \$500. Now you see we are two different kinds of people. This gentleman here is talking about what it costs the corporation to file, forgetting all the time that the corporation is paying his wages. We do not maintain a patent attorney. So it does not cost \$15 to file but it costs perhaps your company \$600 to file. And that's a little oversight there on your part. (Laughter)

MR. MCGAUGHEY: No, I don't think so actually.

MR. NIELSEN: Well, it just appeared that way to me. Anyhow I had my girl count it the other day. I think there are 17 or 18 unexpired U.S. patents and all we've got to do—we go out and hire a big firm of patent attorneys and it always costs between \$400 and \$500 just to file. Then we must figure out what it is we are claiming and what it is we have got and so on.

Now, the patent application comes to Washington and after perhaps 10 months, sometime a little bit longer, the examiner grabs two patents that seem similar to him and he cites the two patents He just signed 400 bucks out of my checkbook (laughter) because now it's going to be amended by the attorney here who charges the \$400, so I just want to talk about these prices. Because I'm not used to any of these bargain prices that you gentlemen are talking about. I never heard \$15 until today. I want to ask the question here in front of this audience. This gentleman did answer to me personally in the elevator. The thing that has bothered me all along is specifically what is the disadvantage, what is the disease, what is the illness that we are trying to cure in the present patent system? I'm a free lancer. I don't know of any inventors who have complained about the system as it has been up to now. What is really the trouble with the system we've got, because I wasn't aware we had any.

MODERATOR GREEN: You're talking about international as well as at home, now?

MR. NIELSEN: Yes.

MR. RABINOW: I'll tell you the trouble with the system. I invented a magnetic particle clutch and I was given all the foreign rights, and it cost \$37,000 to file in foreign countries before we got a single action—just 22 countries, 44 patents. And it was worth it, as it happened. But this is the trouble. I'll give you another trouble with

the system. I invented a phonograph arm which is now commercial. I filed only in the United States. Last month Thorens from Germany said they'd like to have a foreign license. I said "I can't give it to you. I don't have any foreign patents." I lost a lot of money because I couldn't afford to file for foreign patents on this invention.

I have 189 patents, of which maybe half belong to me, and half to the company I work for. If I filed in 10 countries on 100 patents—you can do your own arithmetic. That's the trouble with the system. Suppose you have 10 patents and you'd like to file them in 10 countries each. That's 100 patents—100 patents will cost you, say \$100,000. If we had a uniform world system of some kind this would cost you perhaps \$1,000 a patent. It won't but it should.

So in a small company, which was my own company for 10 years, we just couldn't get patents in foreign countries—we couldn't afford them. We turned out a lot of inventions. I had a staff of people who did this. We'd like to have patented some 50 reading machine inventions in 10 countries each. This is 500 patents. We couldn't afford \$500,000 or some such money. This is the trouble with the system.

Today foreign patenting is terribly expensive and, incidentally, it isn't \$15 for the other guys either. It takes a lot of money, and something should be done about this, because we're all doing international business and we all can't afford to get adequate patent protection. Only the very rich can afford it and, perhaps, they can't afford it either. That's the problem.

MODERATOR GREEN: Allis-Chalmers again.

MR. MCGAUGHEY: Let's refer to the procedure under the proposed PCT because you're right in terms of it costing you \$500 to file in a foreign country. It costs us the same amount of money. What intrigues my company about PCT is that instead of committing this \$500 per foreign application at the time you file your U.S. application, we will designate foreign countries at about \$15 per country and obtain an international search. If you designate and then abandon because the search shows the invention to be old, you're only out \$15 per country. Under present procedure, if you abandon you are out \$500 per country. Further, and more important, you almost never have a search from the U.S. Patent Office at the time you are deciding to spend \$500 per country to file the foreign applications.

Right now, we're filing foreign applications blind. I like the proposed procedure under PCT because we need to only spend \$15 to reserve and designate each country. We will wait for our search and then between the 18th to 20th months, we will make a decision. I

think we will abandon a number of cases just because we will have the search and the benefit of commercial feedback concerning the merits of the invention. Thus, we may pay \$15 per country and save spending \$500 per country. I think most people will be willing to pay \$15 per country to designate and reserve the right to review between the 18th and 20th months.

MR. NIELSEN: Do you gentlemen realize that I said with a little company that has 10 employees, no matter how good the patents we have, we can of course not spend \$100,000 for foreign patents. It's just out of the picture.

MR. ROBBINS: Gentlemen, it is highly interesting to me that both large and small corporations apparently do attach such great importance to this extra eight months—the prolongation of the convention year. Have you really considered the ignored FICPI-II Plan which is so simple? There you get your 20 months but you don't have to do anything for the 20 months. You don't have to pay \$15.00, you don't have to select in advance, you just go ahead if you want to where you want to within 20 months. You file your so-called international application, which reserves your right to file it with a search report in countries of your choice before the 20 months' period expires. Actually this is the essence of PCT but in the simplest form.

MR. SQUIER: Leonard, isn't it true—I'm just going back to your opening remarks here that the FICPI Plan, whatever it is, has nowhere near the likelihood of acceptance. It has been run around a bit but there's no hope that—

MR. ROBBINS: Well, the European patent profession has little political power and the governments there are uninterested. There are no votes attached to patents. So it's just been brushed aside.

MR. SQUIER: Whereas the PCT plan does have some hope—

MR. ROBBINS: Yes, but this is far simpler and answers the criticisms that many people have raised.

MODERATOR GREEN: Mr. Nissen has a comment—

MR. NISSEN: Let's assume that the Patent Cooperation Treaty has passed, a number of countries have ratified it. It's a *fait accompli*. Now not all countries will ratify it, not all countries will become a member. How do you achieve the advantages of the Patent Cooperation Treaty for those countries that have not ratified it?

There is still a vehicle to accomplish the same thing today. BIRPI will tell you that the IIB, which is the International Patent Institute, will perform a search for \$100 to \$150. I think the figure is wrong, I would use about \$250 to \$300. Now, for those applicants who believe

they would like to have a good search, that might be the vehicle to obtain a search, obtain it before the 12 months' period is up, and then assess whether they will file foreign applications.

The other vehicle would be to have no publication made of the invention at any time, and I know the problem that Mr. Adams pointed out, which is a difficult one, to prevent your engineers and your technical people from publishing. But have no publication made anywhere and after your search is made, then file. So there are vehicles under the present system to accomplish everything that PCT will accomplish with the exception that you do not get the eight additional months that PCT will provide.

MODERATOR GREEN: Dr. Muller.

DR. MULLER: May I just ask one question? What I'm hearing now is only from the viewpoint of the applicant. You are saying something about publication and secrecy and so on. But I don't hear anything about the interest you may have in your competitors' patents which are also published under the same rule. And it is always a question of balancing an advantage against a disadvantage. It's advantageous for yourself perhaps to keep the thing secret but it is a disadvantage if your competitors also have the possibility of keeping the thing secret. So a system according to which there is a compulsory publication after 18 months has the advantage that you are not faced by surprise with something that prevents you from applying whatever you have in mind to apply.

MR. NISSEN: Well, many times a problem does arise where someone comes into an office and says, look I have something here, I'd like to get the maximum protection possible yet I don't want anybody to know about it. Now you will select those countries where you know from the law that publication will not take place or you will select countries where you know a publication may take place and you may withdraw the application just prior to publication. So for that individual, that company, or that applicant, you may file only in those countries or file at a later time to prevent the dissemination of knowledge, even though one of the purposes of patents is to disseminate knowledge. There is still a desire among many to keep matters a trade secret and obtain patent protection so that the protection will be available when you decide to market the invention.

MODERATOR GREEN: If I understood what Dr. Muller was saying—apart from these devices—there has been some concern about the publication feature of PCT because it does force this 18-month publication which some firms at least may find disadvantageous. He says, on balance—the fact that everybody has to publish is in the public

interest, and you gain as much by knowing what your competitor is doing as being forced yourselves. Is there a reaction to that comment? Mr. Adams.

MR. ADAMS: I'd like to react to that and I would like to answer two comments that were made from the table. Sure we think there is an interest in publishing. We do it. And we wouldn't be adversely affected by an 18-month publication under the Patent Cooperation Treaty. Almost everything we do is published anyway.

As to your comment, Mr. Robbins, about FICPI, if FICPI were a viable negotiated treaty which provided the time for making better decisions, we'd use it. And to Mr. Nissen, whose question was directed to why don't you use the IIB to get a search. Our problem is, I tried to explain it—is not so much getting the search since we make our own searches by and large. The problem is to make better decisions in committing our funds to go the rest of the way, to decide whether or not actually to file the application.

MODERATOR GREEN: In the interests of moving ahead on our schedule, let me see if I can summarize the consensus with the view that people can then correct me. Of the three topics—costs, procedures and time—it appears that procedures are not of great significance to PCT. There don't seem to be any great advantages gained from them or any substantial disadvantages with the possible exception of this publication feature we have just been discussing. Here some firms, particularly those who find trade secrets are important to them, might choose not to use PCT.

Now the questions of costs and time seem to be interwoven. And I got the impression that most people felt that on a per-case basis, there would be no savings in costs, but that the time advantage—the opportunity to reflect, to examine the economic potential and decide on where the “best bets” lie, meant filing of fewer cases abroad and therefore on the overall annual patent program there would be a saving. Now is this a fair summary? Mr. Ross.

MR. ROSS: First of all many people have already expressed what would be my considered views on this, but on this one item of costs, I agree with many of our people here that probably the opportunity for reduced total costs would be present. But how does a large, well-heeled company do its foreign filing? It generally establishes a budget and then it fills up its costs with whatever it can do. So that if you are going to do more selective filing, you'll probably end up filing just about as much as you did before, hopefully you're using better judgment.

I'm going down into the international trade considerations here. I

think to the point made by the gentleman at the end of the table, if he's got some valuable patents and he wants to file them overseas and he's faced with a \$37,000-\$50,000 bill, there's nothing in here that relieves him of that. The operative condition here is that he has already established in his view that these are valuable inventions and he wants to file them.

Where the more diversified approach is benefited is that we have constantly to make the cowardly decision that Mr. Adams was talking about, where you have a speculative invention, and all the time you can get to determine whether it's going to fly or not, is very, very valuable. But I think where you are in the business of making overseas filings and you have an organization in place which is motivated to do this and you have a budget, that as you cut out the cases that you are actually filing, it gives you more room in your budget either to file in more countries or to take a larger slice of your original grouping.

For example, representing General Electric as I do it's a—whatever else it is—it's a large diversified company and we therefore come up with inventions in many fields—some valuable and some quite cursory. When we are faced with filing these overseas—there are so many places you can't file and maybe at least 50 that are worthy, that have patent systems worthy of the name. But if we were to take all of our U.S. inventions and file them in say 50 countries overseas, we would have an astronomical cost that there would be absolutely no justification for in terms of any possible return. So just pragmatically as it works out, being more selective and having perhaps different criteria for filing, we end up with about three times the filings overseas that we have domestically. And this is roughly composed of something less than 50 percent of our U.S. inventions filed in an average of seven countries.

Now why seven countries? Well, this leads into some of these other things when you talk about a universal patent system. It has been our observation that you can have a very valid patent but it is no use to file in a country where there is no foreseeable opportunity for someone in that country to exploit it. Let's say you have something wonderful in space technology. Well, you're not going to file this in any country—you shouldn't—you really have to think before you file it in a country where there is probably not going to be any significant effort made by entities in that country in space technology. It just isn't worth it. So the tendency as you're hedging your bets is that you pick the highly industrialized countries as primary. Then as the importance of your invention in your view is greater or has a more catholic use, you extend this to other countries.

I think that if we go to a universal patent—so-called, that we really won't need this patent for many inventions in many countries even if it is acceptable. Because in these countries, whereas they may establish to our satisfaction or to our custom an ordering of patents, the very socialized, nationalistic form of government reduces the value of the patent because it alone is not sufficient to warrant any licensing arrangement or any return from your invention. You have to go in and either put these people in business and provide them with technology and training and maybe investment in order to practice the invention. So I'm for a universal patent system which would reduce costs but I would only see the value of this in say a European patent or one which would include essentially the highly industrialized countries of the world. When you get beyond this I haven't seen too much value in it. Perhaps I'm going ahead beyond—

MODERATOR GREEN: No, I think your timing is exactly right. You took us over into Roman numeral II, but before we do go back to it I'd like to know if anyone disagrees with my oversimplified summation of the financial and administrative features.

MR. MCGAUGHEY: McGaughey from Allis-Chalmers—I don't disagree but I do think there are advantages to the procedures under PCT. If you are filing foreign applications in many foreign countries, you bog down in a tremendous amount of formal paper work. Under present procedures, there is a high volume of paper work completing forms and legalizations just to get the application on file in the individual foreign countries. Of course, this work accounts for part of the \$500 cost that we talk about. I sincerely believe that PCT will be a vehicle whereby we can simplify these formal procedures because they are complex, they are expensive and they are time-consuming.

MODERATOR GREEN: Anyone wish to comment on that observation?

MR. NISSEN: I think you'll still need powers of attorney, and you'll still need assignment documents. Now there is nothing here to eliminate that. It's a separate problem and certainly I can understand and visualize a worldwide assignment which would be good. In fact, we use certified copies to record these many times.

MR. MCGAUGHEY: I do too.

MR. NISSEN: Which is the intermediate step really.

MR. MCGAUGHEY: But under PCT, I would not have to provide powers of attorney and assignments before I analyze the international search and perfect the national application. I would hope that PCT would permit me to hold off preparing these formal documents.

MR. NISSEN: I think this is minor. I think you're getting to a side issue. I think you're getting away from the direct issue involved.

MR. MCGAUGHEY: I have three girls working on this in our office and it's not minor. (Laughter)

MR. SQUIER: The other thing I'd like to point out is I think we're looking for a panacea here. When we talk about a savings in industry, we'll break our necks to design a vehicle to save two or three percent. This load of money, if you want to look at it that way, is no small amount of money to some of our companies today. We have to take an approach if we're looking towards some improvement, and I think even if we were looking at a savings of 5 or 10 percent, being real optimistic, and for better organization of our thoughts, which would help us from stumbling and making mistakes at the same time, I think we personally feel that it is worthwhile. We're not looking at a big savings, like \$500 per patent. Let's save \$50 of it, if you could make it \$450 somehow. That's a real good savings to anybody.

MODERATOR GREEN: Now if I might revert to Roman numeral II. Mr. Ross said much in his comments that covered most of these topics. I'd like to "play back" Mr. Ross to make sure that I comprehended. On volume of filing overseas, you said this is controlled by your annual budget and if PCT comes into effect, you may file different applications in different countries but the annual volume would be about the same.

MR. ROSS: The operative thought behind that is not just to fill the vacuum of budget. We're just as willing to save money as anybody else. The thing is that we are already filing up to where it hurts. And if you've got a little more hurting room, well, we'll probably file some more.

MODERATOR GREEN: And you felt that PCT would be significant to you only in connection with the industrialized countries because you have found by sad experience that where you don't have a strong patent system and a strong industry, the obtaining of a patent is of little significance.

MR. ROSS: It's of little significance. It has been of little significance to us.

MODERATOR GREEN: We'd like now to throw the floor open to other comments on this subject of international trade considerations.

MR. NISSEN: Earlier someone mentioned the question of regional patents. I think that may be the direction to which we probably should be heading. There are many countries now that use the same language, and really the same laws, and I think these countries are ripe

for regional patents and yet nothing is being done in that direction. The United States is being criticized in many quarters and yet the United States is unique in the sense that we don't have 50 different patents and we could have 50 patents because of the state-federal system which exists.

MR. RABINOW: Bite your tongue. (Laughter)

MR. NISSEN: That's why I say we are unique. It could be that way.

MR. RABINOW: That's all we need. (Laughter)

MR. NISSEN: And I think there should be an encouragement in many of the countries to go the way that the OAMPI went—to have one patent for a portion of a region of Africa.

DR. MULLER: Like EEC—second convention?

MR. NISSEN: Or the European patent?

MR. RABINOW: The Nordic countries have one too, don't they?

MODERATOR GREEN: I believe Allis-Chalmers had a comment.

MR. MCGAUGHEY: I was interested in what Mr. Ross had to say about developing countries because that's going to be absolutely true in a lot of cases. However, this may not hold true where a company has process or method technology. I can cite you an example. Allis-Chalmers manufactures a very fine iron ore pelletizing system. The basic process is patented. When we look at inventions relating to the processing of iron ore, we will file applications in the developing countries where abundant natural resources of iron ore are available because our process may be used in these countries. You must file a process invention in the country where the plant will be constructed and operated. This rationale can apply to almost any natural resource that is processed in the country where it is mined. It just depends on what technology the company is interested in. If a company has technology for processing natural resources, they will use PCT to file applications in developing countries to obtain necessary process patents.

MR. ROSS: I surely can't debate this with you because you're talking about lines of business that I'm not in.

MR. MCGAUGHEY: That you're not in. Right.

MR. ROSS: But I would submit that the chance of unauthorized competition, if I can use that expression, is much lower there. You've got to get some sort of a license from the government to supply this process and to take the ore out, and perhaps your competition is, say, a German concern or a Czechoslovakian concern that comes in, and that concern has to be licensed by the government. You're telling me that

the government would not license a German or Czechoslovak out of respect for your patent. And I rather doubt that.

MR. McGAUGHEY: Again, it's a matter of facts of the particular situation. You may find that your process patent has unusual value in protecting the sale of your processing equipment and in protecting the market for the product. For example, if you knew that the iron pellets to be made in Algeria were going to be sold in Germany, you could legally use your German process patent to bar the importation of the finished pellets into Germany.

MR. ROSS: A German patent will, yes.

MR. McGAUGHEY: Yes. You get into many situations where patents in developed and developing countries help your commercial situation and that's why you need to look at every situation in the light of its particular facts.

MR. WOODWARD: Excuse me, you can't depend entirely on patents in the countries where these things are going into because very often they come into those countries in little bits of shipments to ultimate users and so forth. If you could go to where the process is actually being practiced as well as to these other places, you're very much better off.

MR. ROSS: Well, I guess my only point had been that in our experience there's a law of diminishing returns and for us the cutoff point is perhaps a bit sharper than it is for some others.

MODERATOR GREEN: Dr. Muller, you had a comment?

DR. MULLER: There's one thing, it's just a minor point. One of the things which determines sometimes whether you can get your processes exploited in one of these underdeveloped countries is not the consideration of being patented, but whether you get your money—

MR. McGAUGHEY: Amen.

DR. MULLER: —whether it's supported by the U.S., the Japanese, or Russians or even political questions—

MR. WOODWARD: I had an interesting conversation just the other day that I think I ought to mention at this point. I was talking to Alan Swabey who is going to the ASIPI Conference to discuss PCT with South Americans. He said what he was concerned about was that it might not be good for an undeveloped country to have an "absolute novelty" type of law, that nothing could be patentable if it had been published anywhere. The type of search report and preliminary examination provided under PCT wouldn't do them an awful lot of good, he thought and added that perhaps they should be encouraged to allow some things to be patented, that are not strictly novel, as long

as they are not available in those countries, as for example by patents of importation or something like that.

My answer to him was this: It seemed to me that no harm could come in the long run from having the basic facts on the record, the kind of references that are referred to in the PCT, even though written on an absolute novelty type of standard—and perhaps some preliminary evaluation of them—that's all going to be advisory anyway. There are some cases where those countries will not want to just take patents at face value anyway, even if it might be to their advantage to grant some monopolies on things that are not strictly new.

It seemed to me that the proper attitude in their case would be for them to adopt what England adopted when it was an undeveloped country and still retains, that is, a reference publication isn't prior art unless it reaches the particular country. That's the law in India I believe. I remember when an Indian patent attorney was discussing this with me he said, I don't like to see that changed. I asked him why. He said, We don't have some of those references here. We find it hard to study them. I said, Oh, there's no problem of getting them. All you do is ask the foreign applicant to list all the art that's been cited against him in his country of origin and all the other places that he's applied to, and to furnish copies and then you have them and you can read them. He said, Well, that isn't the problem. He said, If this thing hadn't really got here until he applied we ought still to grant a monopoly because if we take this other attitude we're simply not going to get applications and we're not going to get the development. It then seemed to me that if the country is in a position where it wants to attract businesses on things that are perhaps known in other places but are not known within the country or in the language, that they can make their domestic law have these limitations, but it won't help them particularly to stay out of the PCT. I think that they should know that at least these are the references abroad and if some of them don't count, you disregard them in their particular national procedures.

MODERATOR GREEN: Saying that another way, are you saying that PCT is going to have no effect one way or another on this problem?

MR. WOODWARD: No, because to the extent that they do become sophisticated, and in many areas they are, having the facts on the table will make things better—they will not regard patents as things that are suppressive as they would regard them if they came without a search report in a country that has a registration type system. And furthermore they will not be tempted to put the facts on the record by asking

the applicant to list everything that has happened in all the other countries so they have that in their language on their records. You have something standard, something they can respect, that will be an efficient piece of paper work. It will give the competitor in that country a reasonable starting point for evaluating the patent. He won't be operating entirely blind although he will, as in many other countries, have some references there that are not particularly prior art under the national law—that will be true in our country too.

MODERATOR GREEN: May I ask a question? The government of Argentina, recognizing it was spending a fair amount of money on scientific work, approached the U.S. National Academy of Sciences, Mr. Rowan's organization here, with a view to getting advice and guidance as to how they could relate their scientific efforts to economic development. Dr. Harrison Brown and Mr. Rowan put together a team that went to Argentina in August. I was a member of the team. I went, not on a matter of patents, but on scientific communication. I found that the policy makers in Argentina know very little about the patent system and they don't have any conception that it may be an economic stimulus or deterrent. And yet they seemed quite open-minded to change. Is the problem the fact that those who are concerned with patents in Argentina don't make their views known at the proper policy levels?

MR. WOODWARD: I don't think Argentina is a good example. They have an examination type system. They are nowhere near as undeveloped as most of the countries we are considering. They have a lot of problems because the relation to the government of industry and science and everything else has been mixed up by a vast amount of political complications. But they are a relatively sophisticated, educated and developed country. The real type problem is that of the undeveloped country where you have a heavily one-industry economy like Venezuela's or a country that cannot afford an examination type office like many of the African countries. Even India considers, although it is an examination type country, that it cannot do as thorough a job, say, as Argentina could.

MODERATOR GREEN: Well, maybe I can put my question another way: Looking at Venezuela, is acceptance of PCT going to be desirable from their point of view and from the point of view of U.S. firms that want to do business in Venezuela?

MR. WOODWARD: I've just discovered that Venezuela is an important country for automotive matters. I never realized that. I understand that our company files some of the seatbelt cases there. Not because

they make cars but because they use them there more than somewhere else because that's one of the places that has developed fuel sources. I'm not quite sure of the exact answer to that, but I feel that if there is going to be any controversy over patents or any question as to whether the patents have been respected or not, if there's a search report attached to every patent rather than that the think is merely registered, I think it will have more respect and it will be better than a patent of confirmation, because a patent of confirmation is one that is issued in the home country and to some extent you're bowing your judgment to what has been done in another sovereignty which might, if you get into a fuss with a patentee, be one that you don't particularly like. The PCT search report and even the chapter II preliminary examination report, because it's done under international auspices and in many cases will be done by an international organization like IIB, is likely to produce patents that look better than patents of confirmation.

MODERATOR GREEN: Mr. Nissen.

MR. NISSEN: I thought Mr. Green's suggestion of Argentina was a very good one because Argentina is a country which has ordinary applications, is a member of the international convention so you can obtain convention priority, and still grants confirmation patents and furthermore has some form of an examination system. And the original theory I believe for confirmation patents was to introduce technology into a country because no one else had ever introduced it, the knowledge was not available in that country, and for that introduction they would give you a right called a patent right. That patent right would be granted for a limited period to you to exploit it. Argentina is a country in which if you don't exploit your patent, they become voidable. So I thought that was a fairly good country to pick which would really exemplify whether this search report would be of any value.

The patents that would be attached to the search report would not be Argentine patents. There would be no indication that they were patents which were introduced into Argentina. It would not even include any information pertaining to knowledge in the words of the law that was introduced into Argentina. So that all the search report would do is to assist someone who would like to infringe or break an Argentine patent and to check and see well, here's a starting point, let's see what Argentina has that is related to it. Now, effectively if you are going to do something in Argentina you're going to make a good search there anyway. You're not going to rely on a patent office search,

I don't care what patent office it is in the world. You will use that patent office search but you're not going to rely on it solely.

MODERATOR GREEN: Mr. Waldes.

GEORGE WALDES: Speaking of countries of South America, not necessarily Argentina, I'm not as well versed with that, but Venezuela for example—even Mexico which isn't South America—those governments control not by patent but by transfer of foreign exchange. Now no company in its right mind will invest or try to invest in such a country when it knows that the benefits of this invention can never be taken up in some form or other. As our experience shows, you might have an invention, no matter how good or even more economical and more suitable for such a country—it will not be allowed into the country if there is a home industry which uses a method of maybe 50 years ago. But it does not mean that there monies must be invested into something more important than improving said state of the art. So consequently when you analyze patents in the light of such countries as South America, I don't think the norms apply exactly.

MODERATOR GREEN: Let me see what I've gotten out of this so far and I want to stop here. Mr. Ross observed that commercial transactions, transfer of technology, licensing, sale of patents with countries which don't have a favorable economic environment is not a very good bet. Mr. Waldes I think has just said the same thing. He's specified—

MR. ROSS: He's giving the specific example of how they control this invention.

MODERATOR GREEN: Mr. McGaughey has observed that raw material exploitation, where you have process patents, may be the exception to the case where you are going to develop the plant that makes it. But then, are we then saying that adoption of PCT by the developing countries will not make much difference to American firms because it won't change the fundamental economic environment in those countries.

MR. ROSS: That's my view—

MR. SQUIER: I think I'd agree that that basically is a true statement if you want to look at today but I don't think we can afford to look only at today. I mean we've got to assume that it's true today but if we have some solid ground to work toward another deal tomorrow it could be important.

MODERATOR GREEN: There's an international economist in the back row who's been awfully quiet. Jack, how does it happen you're not speaking?

JACK N. BEHRMAN: I'm taking a few notes: (Laughter) Well, on

this particular issue, John, it seems to me that we start with the proposition that PCT is not aimed at changing the patent system, the patent law, in any one of the signatory countries and therefore the discussion shouldn't be as to whether it is advantageous to sign the PCT to change the protection or the ability to gain a patent at all, it's not for that purpose. It is however relevant it seems to me to ask whether this is an appropriate step to achieve a kind of harmonization which you've got in your top line here, or a regional patent which is a desirable thing or secondarily desirable. That is, to start with the question is it desirable to harmonize or regionalize patents? Is this an appropriate step to do it? Can you entice these countries into the first step which then induces them to take the second step? That I think is a useful kind of discussion, but as to whether PCT itself does anything right now, the answer is no, it doesn't do anything. It wasn't designed to do so.

MODERATOR GREEN: Putting the question another way. If it should develop that PCT would be an incentive to international trade, if it would make it easier to have international trade with these countries, it would certainly make our government more excited and it would be another plus as far as PCT is concerned. So far people are saying that isn't so.

DR. BEHRMAN: It's not designed that way. Look at the original question that they were talking about.

MODERATOR GREEN: Mr. Adams.

MR. ADAMS: Speaking to your comment, I had the understanding or maybe misunderstanding with respect to countries which are really emerging, that really need to emerge, that the Patent Cooperation Treaty (if you buy both phase I and phase II) would provide such of those countries as were interested with an instant patent system where they previously had none. They could indeed without having any expertise in either technology or the law, grant patents which would have some degree of relationship to alleged inventions rather than the patent to exploit salt for example or something of that sort. Now is this an advantage to the United States? This is a question on which I'm not qualified to comment. I would suppose without ever having had any experience at all in this area, that if you were going to commit funds in such a country you would hope that either you or the other people in that country would have patents or something else which defined their rights in intellectual property so you would have some place to start from in assessing the problems.

MR. WOODWARD: I'd like to add on that—that when you go into a

country where you haven't worked before to put some type of process in, you may be interested in what kind of patents you can get, but you are terribly interested in what kind of patents other people may have, because one of the things you may find is that their language isn't even written in Roman letters and you have to make a search, and if you're told beforehand that the records are chaotic even for people who know the language, you've got one terrific problem.

On the other hand, if you know that their patent laws follow the system that an invention isn't patentable if it has been published anywhere in the world before the filing date, this at least gives you something—to know that a reference that's good in the U.S. is at least as good over there. And if you know enough from searching in the developed countries as to what kind of people have purported to have made inventions in this thing in the last 20 years, you can take something of a calculated risk without making a search that would be expensive and unseemly. This is true of course without the PCT, the Paris Union, or anything else. I would think that you would be taking a little less of that kind of risk and have a little better area to work in if those countries which issue patents on a registration basis because they don't want to have an examination system, also provide some kind of a search report.

MODERATOR GREEN: Can I amend my original summary along the lines of the comments that have now been made, that is to say that whereas now adherence to PCT would not seem to be especially advantageous from the point of view of American firms engaged in international trade, as these developing countries move from an agricultural, a primitive society to an industrial society they should also create the institutions of an industrial society, and one of those institutions is a patent system and perhaps the search mechanism of PCT would accelerate that. Is that a fair summary?

MR. BECHT: I think that's a fair assumption. There has been an awful lot of comment this afternoon and probably rightfully so about this magical piece of paper which is going to travel around with this application, known as the search report. Now, as I understand it, there are four countries basically that have been approved as searching countries. I don't know about the rest of you but I'd like to hear from somebody in the Patent Office who can tell me and the group what they would anticipate doing differently under these circumstances than they are doing today. Within our own limited field, I have a larger volume of foreign art concerning my field in my office in Cincinnati than the Patent Office has out in Crystal City. And I know that I have

to mail it to the Patent Office if I want it considered in the time that they have to make an action. Also I'd better go to the trouble to get this foreign patent translated because they can't get it translated quick enough to get it included in the action. And I've done it many times.

To me it seems to be a focal point of this whole thing—the extension of time, the availability of information, just how good this search is I think ties in with what Jack says back there too. PCT is basically not changing or is not designed to change the patent system or the quality of patents it is issuing. Basically I would agree with that with the exception that there seems to be an awful lot of faith and an awful lot of prestige put in this international search report. It seems to be that it's going to be the vehicle that puts the tag on the patent all the way around the world. I'd like to hear—if anyone from within the patent organization would like to volunteer—what they would do differently from what they are doing today.

MODERATOR GREEN: Before you answer that, Mr. Brennan, could you couple with that the impact on the U.S. Patent Office that some people say will result because of increased filings here by foreign firms and foreign inventors.

MR. BRENNAN: Well, I think the first thing that we should get straight is that there has been no appointment of any searching authority as such yet. The Treaty does not provide in terms for specific national offices. There have been some indications by the U.S. Office, by the Japanese Office and the German Office and the IIB that they would like to be searching authorities. But this is not set. We in the Patent Office expect that during the first years of operation of the Treaty we will be getting search reports from various countries that will have to be completely re-searched by our examiners. And we expect that after a trial period, we will be able to say that—the Germans, for example, give us very good searches in the optics field and the Japanese appear to be giving us extremely good searches in the semi-conductor field. After a little more time we may be able to say that Hans Schultz in Germany is a very good examiner, he knows his art and we haven't found better art than that in any of his searches. When we get to that point we will be able to rely more and more on the search of Hans Schultz and give it more and more credence.

Over the long haul we will be able to ease some of the searching burden that we have with respect to foreign applications coming into this country. But I think initially we're not planning on any great savings in searching and this may extend for several years before we begin to feel any relief at all. I think this is one of the things that we

just have to accept. We're not pushing the PCT as a cure to our backlog disease, if you want to call it a disease. We think there are other features in it for the American applicant which make it attractive.

As far as being overloaded with foreign applicants, this is a guess on anyone's part. I was just looking at the figures the other day for our incoming applications. We had something like 66,900 U.S.-origin applications filed in 1962. In 1968 we had something like 67,200 which is just 300 or 400 greater than it was six years ago. In the same time, foreign applications coming into the country ran from some 18,000 up to about 26,000. So you can see that during this period the amount of increased filing that we have experienced in the U.S. Office has been generated primarily by foreign applicants who are filing more and more in the U.S. I think this is a trend that will continue because the U.S. is after all a very rich market, and it's a very good place to exploit a patent.

Whether the PCT will dramatically increase this I frankly doubt, but I don't know. I think that what will happen in the long run is that as the searches get better and more reliable the amount of work that the Patent Office will have to do on all these applications will probably level off or perhaps decrease, since the international search will tell the applicant who files blind that he shouldn't go ahead and continue with his application in the United States because there is art that he didn't know about when he filed. Or he may find out that developments in the field have changed things so that it is no longer a commercial proposition. By the time the 20th month rolls around we may find many of the applicants who originally designated the United States have decided for one reason or another that they are not going to continue with it.

If we do get more applications in the United States, we should be happy because this means that we are getting technology that we wouldn't have had otherwise. If patents are granted and the inventions are commercially attractive propositions, U.S. industry will pay a reasonable royalty to use these advances, and I think that the ultimate benefit is obvious. If you are against attracting foreign inventors you may well be questioning the fundamental basis of our whole patent system. We've never before tried to foreclose foreigners from filing in the United States. I don't think we should try it in the future.

MR. WALDES: I would like to ask you a question. Somebody mentioned here before about harmonizing, or correlating, I guess, may be the word, the various approaches to patent questions in the

respective countries. Now, I've always been bothered with Hans Schultz and Joe Smith in Washington examining the same patent; their backgrounds legally and technologically speaking have been different. Their approach or their evaluation of granting or not granting the same patent, in my opinion, is quite different. So now we go ahead and say, well, heck, let's have Hans Schultz do it in the United States, it might have passed, but in Germany not, or the other way around. Is this correct or is this rumor or is this no problem?

MR. BRENNAN: Well, I think you've put your finger on something that ought to be explained in a little more detail. That is, what is this search? It is not the search and examination that you get from the patent office today. It's not a listing of references with application of the references to the claims. The foreign examiner is going to be looking for pertinent art. He will list the pertinent art. And he will list it on a universal basis. He may, for example, list a patent that has a U.S. filing date which would make it a reference in the United States. On the other hand it may not be a reference in, say, France because France may use the U.S. issue date as the effective date. This does not mean that we're trying to get the U.S. and the French necessarily to have the same criteria for prior art. The search report is just a listing of pertinent references saying, for example with respect to Claim 1, here are five references that the examiner thinks are pertinent. It is up to each individual country to evaluate whether or not they are in fact, under their own local standards of patentability, actually pertinent. There may be many reasons why in one country it would be considered to be a good reference, and in another not so good, and in another country it might even be considered not germane.

MR. WALDES: My experience confirms that.

MR. BECHT: I seem to get out of your talk on the searching system that you anticipated that these searches will go to different countries depending upon the art.

MR. BRENNAN: If I gave that impression, I'm sorry. The search report would ultimately get to each designated office. It would be the same search report, same list of references.

MR. BECHT: I don't feel as though I'm asking the right question, or you're not going to answer it, one of the two, I don't know which.

MR. BRENNAN: Well, I'm afraid I don't understand your question.

MR. BECHT: O.K. We've got the PCT. The U.S. just won the right and they are now an official international searching group, and I filed my application and I said, fine, I want an international search. What would you anticipate would be done differently out in Crystal City as

opposed to what is being done today to give me an international search?

MR. BRENNAN: That's a very good question and I'm glad you asked it. (Laughter.) We will be doing exactly what we are supposed to be doing today. We will have the same examiners that we have today, looking through the U.S. search file to find references. We are supposed to have in the U.S. patent search files U.S. patents and various foreign patents. Under the PCT we will have to have U.S. patents, Russian inventor certificates, German, Japanese, French and British patents, and selected Swiss patents, from 1920 onward, I believe. Although we have these physically in the Patent Office right now, they are not perhaps classified as well as they could be. And I'm sure that in your experience you may find that foreign references are not cited as often as they might be in the U.S. prosecution. They are still good references in the U.S. under our present law, and we should be citing them. And we will try to do a better job.

I don't think for one minute that we are going to be a perfect searching authority as of the first day we open up our shop for searching international applications. We will do as well as we can and we will hope to improve. But at the same time the international search will be exactly the same search that we will perform on the domestic application. This is how we expect to be able to give an international search report at a fairly reasonable price without subsidizing the international applicant in any way. We intend to recover through our fees more than our full cost of operation as a searching authority under PCT. But where we have the U.S. applicant who files both in the U.S. and internationally, we are only going to charge him the differential cost which is essentially due to an updating of the search and the cost of transferring it to a different form, which would be a clerical operation.

MR. ROBBINS: Mr. Brennan, if an applicant files a regular national U.S. application in the U.S. Patent Office, since searching speed is improving all the time in the U.S. Office, you would give him his search in this national case in say six or seven months; then in eight or nine months he files a corresponding international application. Do you say, well, we've done the search already?

MR. BRENNAN: Yes, we would say we've done the search already; all we have to do now is update it because the national search was made in search files current as of several months earlier.

MR. ROBBINS: I see. So you do that extra work just for the differential.

MR. BRENNAN: That little differential for the last six, seven or eight months, whatever it happens to be.

MODERATOR GREEN: Dr. Behrman.

DR. BEHRMAN: Is it possible to computerize the search as compared to the examination?

MR. BRENNAN: I think it's at least equally as possible to computerize the search as the examination.

DR. BEHRMAN: Meaning, it's impossible to do either. (Laughter)

MR. BRENNAN: I think Jack might have some comments on that. (Laughter) This is a technical problem.

DR. BEHRMAN: Well, I gather that it is impossible to computerize the examination. What I was trying—

MR. RABINOW: Do you want me to speak for Jack Rabinow or Control Data? (Laughter) Well, in my opinion, and it isn't shared by everybody—IBM, for example, disagrees—you cannot search by computer. No present-day computer, including the largest we make or all of them put together, can do even a medium search for a patent. Take it or leave it, I'm going to bet big money on this. Control Data—our scientists think it can't be done. It cannot be done for the same reason that you can't translate languages, that is not a machine function. There are people who think they can do it, and my answer to that is—we'd love to see it. I'll cheer them in the streets.

MODERATOR GREEN: I'm amazed—I was a member of the first committee to mechanize Patent Office search under Dr. Bush. Jack came in in those days and said it couldn't be done, and he still says it can't be done. (Laughter)

MR. RABINOW: Well, the thing that people have to realize is that the machines haven't changed except that they have gotten bigger. Their logic hasn't changed basically. Computers are still the same kind of machines except that they are faster and larger. As for machine translation or searching patents, you need a different kind of machine because you aren't looking for specific words, you are looking for ideas. If you tell me what an idea is, then maybe we can do it.

MODERATOR GREEN: Wouldn't you say, Jack, that at the current state of the art there are simpler searching tools that do it as well?

MR. RABINOW: Oh, no, I didn't say that you can't use computers in the Patent Office. There are many things that you can do to help with the work. There are many things that the Patent Office does that makes my hair stand straight up. You know it takes two days to get a copy of something, and so on. There are many things that you could do to mechanize—so your searching could be efficient—you should use

the brain only where necessary and everything else be mechanized. But the search itself—the thinking cannot be done by computers today. They could mechanize many things to be much more efficient. If they were a private industry and they were competing with some other outfits on a direct dollar-for-dollar basis, I think they would mechanize much more.

MODERATOR GREEN: Well, to get back to our subject—the question of whether under PCT if PCT were in effect today—the question of whether there would be more filings in the United States or not cannot be precisely answered. Mr. Brennan thinks there probably will be some more but he isn't sure how many. This would mean some additional workload on the Office. But I gather the Office feels that it can encompass this and, as Mr. Brennan observed, if we get more technology into this country either through publication or through licensing to American firms, this would seem to be a net benefit. Is there anybody who disagrees with that general observation? I feel that I'm leading this group. I hate—

MR. SQUIER: You don't have to apologize for being right. (Laughter)

MR. BRENNAN: A man who files in Canada may also file in seven other countries, so you don't want to exclude Canada.

MR. NISSEN: Well, I would like to exclude those applications which are just filed in Canada from your figures of those that have to go out.

MR. BRENNAN: I can't give you that figure.

MR. NISSEN: I think that would be a very important figure.

MR. BRENNAN: Well, I know this, that we file 14,000 in Britain, and Germany runs about 12,000, and Japan runs about the same.

MR. NISSEN: Even Britain would be a good country to exclude because of the British filing fee.

VOICE: Would you care to exclude Germany and Japan? (Laughter)

MR. NISSEN: No, no—but I don't think the decision to file in Britain at the time you file is that paramount. I don't think the eight months is such a large expense to any company, whether it's \$15 or a little more. I don't think the British filing fee is that much more than \$15, so that if you (the U.S. Patent Office) are going to give a good search as you say you will and that search will not affect your British filing, it has no effect upon Britain. It only affects those countries which are translation countries where you have a large application so that you have to incur a large translation expense.

MR. RABINOW: Well, this is about 70,000 patents. If you take off the Canadian and the British, you would get about 70,000.

MR. BRENNAN:—85,000.

MR. RABINOW:—85,000. That kind of number—75-80,000 translation types of patents.

MR. BRENNAN: I might want to say just one more thing.

MR. RABINOW: Well, he's worried about translation costs.

MR. NISSEN: Well, first I was worried about inventions, then I would want to separate the translation costs from that. There are two concepts there. One is inventions which come into the U.S. from abroad, to find out of what assistance this is to U.S. industry because we are a single country with inventions coming in. The other is what inventions we are sending out, because we may send out a single invention to a PCT or a European patent country, which may eliminate these separate countries which you've indicated. It will not eliminate Japan, but it will eliminate the continent. And I was trying to get at the figure of single inventions that go out.

MR. BRENNAN: In Germany-Japan, we file roughly 12,000 per country. Now, this does not necessarily mean that they are the same inventions or they are not the same. For example, we may file, say, 12,000 in Japan and 12,000 in Germany. They may look something like this—9,000 are the same and 3,000 are different. So it's very hard to come down to a number on this—the way you want it. They don't add to each other and they don't exactly duplicate each other. So it's very difficult to come down with one number and say this is what is filed in Japan and no place else.

MR. RABINOW: Why are you interested in invention rather than the patent in cost terms?

MR. NISSEN: Because there are many applications which will be dropped after the 20-month period too. There will be many dropped afterwards, also. Twenty months is some magical date that was concocted in this Treaty.

MR. RABINOW: But I want to know why you worry about inventions—why don't you just stick to patents—then as far as the value of the Treaty goes and the value of the money involved—labor involved, and search involved—it's the patents that are important. Why concern yourself with whether it's one invention or 100,000 inventions—what's the difference?

MR. NISSEN: Well, because on the question of translations I have had another theory that it's unimportant to translate by the 20th month or the 18th month. I think the only time you should file a translation in a foreign country is when that foreign country indicates they are ready to examine the application. Otherwise, you have a

translation sitting in that country and it is of no value at that point either. But we've got a magical date of 18 to 20 months when you've got to incur translation costs. Now, for example, suppose you do file in Germany or you designate Germany. In 20 months you submit your German translation. It would be much less costly to submit a digest or an abstract of the broadest claim that you are going for, translate that and then sit for seven years on deferred examination, and just incur the annual fees to maintain that application. Or, if you decide after the fifth year that you have an important invention, you request examination in Germany, then you make your translation. That would really give you a saving.

MR. BRENNAN: Harold, this is only one side of the coin that we run into so many times. You point out what a good thing it would be for the American applicant to do this in Germany, but what are we going to do with all these German cases sitting over here, and the Japanese cases?

MR. NISSEN: Yes, because you would then be getting—it's a very good point you raise about considering the effect on the U.S. law. You would then be getting the broadest claim that the other party wants to assert. You would be getting an abstract. Now, if for some reason you felt that there might be subject matter of a narrower scope, you could then ask for a translation of those claims that the applicant would now assert, which would satisfy your searching problems.

MR. NISSEN: Mr. Brennan, you've just indicated that over 28% of the total applications come into the U.S. from the outside. What percentage of the applications that originate in the U.S. are filed outside of the United States other than Canada?

MR. BRENNAN: We estimate that there are about 22,000+ inventions filed in foreign countries.

MR. NISSEN: Does that include Canada?

MR. BRENNAN: Yes, it includes Canada. And of these, on the average, they are filed in five to six countries so that we figure that there's about 125,000 applications filed worldwide. About 100,000 applications would be filed by U.S. applicants in all foreign countries with the exception of Canada.

MR. NISSEN: I was looking for a figure which would be just an invention figure, not an application figure—not a duplication figure.

MR. RABINOW: Divide roughly by three if you exclude Canada. You said the number of inventions like 30,000.

MR. BRENNAN: 22,000. Let me see if I can go through this again.

MR. NISSEN: You have 125,000, take away 25,000.

MR. RABINOW: No, he gave it to you backwards; he started with the inventions, then he multiplied by five and subtracted Canada. Try it again.

VOICE: —22,000.

MR. BRENNAN: I believe these are filed in Canada too. Isn't that right, Bill?

WILLIAM A. SMITH III: That's right. We have about 19,000 filed in Canada—1968 figures here show 22,000 inventions originating in this country, 19,000 of which were filed in Canada.

MR. NISSEN: Because PCT is of no value in Canada.

MR. BRENNAN: You would have to do this but then you've got the question of here comes the reference, the potential reference that we've heard so much about in the 20 months' delay, and it is still in German, and you're suggesting now that it still should be in the foreign language. Not too long ago we've heard attorneys saying you've got to get that translation as soon as possible or else don't let this thing be a reference.

MR. NISSEN: Not from myself—you've never heard that. (Laughter) But from the point of view of the U.S., as soon as the foreign applicant files in the U.S. you can tell him "Look, division or group so and so is up to this point. In three months we expect to examine your application, submit your translation, if you don't your case is held to be abandoned."

MR. BRENNAN: Now here's a complication! We will soon be hearing about a different patent system for each division.

DIRECTOR HARRIS: Excuse me. Mr. Chairman, could we come back to the broader interests of our innovators? (Laughter) We're getting a little too technically far afield.

MODERATOR GREEN: I'm reluctant to hold this conversation down here, but I do think we were getting a little bit of a debate here.

DIRECTOR HARRIS: A technical, legal debate.

MODERATOR GREEN: Before we leave this topic, though, there's a fellow named Joe Robinson from the international side of the Office of the Secretary of Science and Technology. Joe, you've been awfully quiet today. Is there anything you want to say about this international trade item?

JOE A. ROBINSON: Well, I've been getting educated, John.

MODERATOR GREEN: That's good.

MR. ROBINSON: You and I have been involved in the transfer of technology problems of less developed countries. I'm frankly interested in knowing a little more about how it would help in that

problem, what advantages there would be from the standpoint of American industry and what disadvantages there might be.

MODERATOR GREEN: Well, let me see if I can respond to that on behalf of what I think the group has said. Essentially the developing country's problem is such a complex one interwoven with the attitudes of the particular country, the economic environment, the climate for risk-taking, the attitude of the government—the control the government takes over financial transactions—that whether you had a PCT with Bolivia or not wouldn't make much difference to the economy of Bolivia. Therefore aid to the developing countries is not a significant reason for putting in PCT. Is this a clear statement at this time?

MR. WOODWARD: I think you have to consider, though, that the developing countries hope to have something in it for them. They have been invited to the Conference. They are going to be in there negotiating the text and the mere fact that you say that it won't help us in the developing countries and we're not counting on that, doesn't mean at the Diplomatic Conference you're not going to have representatives from some countries saying, "We don't see anything in this for us." Well, of course, it may mean that we don't care whether they sign or not, but on the other hand, if we want to put an addendum on the Paris Union that would be of some advantage, I think we ought to pay some attention to be able to assure them that at least it won't harm them, and that they might possibly get some good. One report that I heard that's very interesting—about how people vote at some of these working conferences—I heard a statement that the Russians were saying that if in doubt they vote the way the United States votes because what's good for the U. S. now will be good for the Russians in ten years.

MR. RABINOW: Oh, it's down to ten years now. (Laughter).

MR. WOODWARD: I think that the developing countries may very well take this very same point of view that maybe it won't help them very much now, but they'll take it if we can prove to them that it won't hurt them now.

MR. ROBINSON: There are some practical aspects of this now, though. Some of the developing countries are beginning to think about establishing their own patent office. For example, I understand that Taiwan has given some thought to that. But I've heard the opinion expressed that at this stage of Taiwan's development, and using Taiwan as an example of other countries also, it would be premature for them to lay out funds to develop a full-blown patent office. Later, perhaps some years from now, it might be worth their while. At

present it might be cheaper if they simply contracted out the kind of patent services they need until they reach a point in their development when they really need a patent office. Then would be the time to think about establishing one but use the resources now for other aspects of development. Now, if and when they reach that point, will the Patent Cooperation Treaty be an assistance to them or will it make any difference to them whether you have the Patent Cooperation Treaty? I would think that it would be of considerable assistance to them.

MODERATOR GREEN: You made a reference to an instant patent system a while ago—

MR. ADAMS: I hope I'm not just repeating my own statement, but I have the impression that the United States is an exporter of technology and certainly the United States is an exporter of money. It seems to be that any time you export these commodities to a country that has a patent system, however constituted, you export with slightly more certainty than you do where this kind of a system does not exist. To the extent that the Patent Cooperation Treaty either cons a country into having a patent system or encourages it to want one, it would seem to me that there is an advantage to the proposed system.

MODERATOR GREEN: May I tell a small story? Two years ago I was in Greece at a United Nations conference on industrial development. This was a fairly highly structured conference on what these developing countries should do—I think there were over 100 of them there—to develop their industries and get to a higher economic level. There was a fellow from BIRPI who tried to get on the program to make a plea that there be a resolution coming out of that conference which simply said that a patent system was one of the basic elements of an industrialized society. He couldn't get on the program, they wouldn't listen to him from the floor and they wouldn't give him any time. I was curious as to why this was so and I talked to quite a few of these representatives of the developing countries. They said in effect, "We know we don't have any entrepreneurs in our country, we know we don't have these local inventive resources and the capital structure, if we set up a patent system it's just going to increase overseas monopolies, we're going to have a species of colonialism imposed on us." I think that's wrong, but this is the attitude of many of the developing countries.

E. C. ROWAN: John—

MODERATOR GREEN: Yes?

MR. ROWAN: This prompts me to ask a question on the patent

policy of developing countries. To get a running start on it, you know, I don't think others know, that I'm completely an amateur in this area. I deal with international scientific organizations and don't have anything to do with patents. This also gives me certain license to ask outrageous questions.

I gather a patent is something that a government in an advanced country gives to an individual or a corporation as an incentive in the way of a monopoly to advance innovation and disclosure. It seems to me that this is not necessarily in the interest of a developing country. A developing country, if it is going to grant a monopoly, should not be giving it to somebody 10,000 miles away but grant the monopoly as a reward to somebody who is going to come into that developing country and produce something irrespective of whether it is with new information or well established techniques. Now, this may not be particularly to the advantage of the United States or to companies of the United States, but looking at it from the point of view of the developing country, if they want to induce people to come in and produce in that country, the way to do it is to give them a monopoly for a certain stated number of years, irrespective of whose process they use.

MODERATOR GREEN: And this is what they do. That's right.

MR. ROWAN: And this is what they should do from the point of view of their interests, like the Soviet Union with the copyright. From the point of view of their interest, why should they issue a copyright?

MR. RABINOW: You're confusing the issue here. There's nothing that precludes a country from saying that we'll give a patent to the inventor but we'll also give certain circumscribed rights to exploit it or we'll tax it in such a way that the only one who will get any benefit out of it will be the guy who comes into the country. The fact is that you must have a base structure on which you can base this patent business. On whom should it be based? If you give the monopoly strictly on the basis that the government will sit around a table and say, "We'll give it to Joe because Joe says he'll invest some money," and if you will use none of the usual criteria, you'll find that they will give it not based on any value, but probably on who will pay the biggest graft. I think this is quite commonly done in some of the underdeveloped countries. This is one of the main reasons they are underdeveloped. I think that if there is a patent system, they could still have the patents so heavily taxed so that if you don't use them, for example, or if you don't use them locally, they could go out of existence very quickly. Some countries do this. They have very strong "working" laws—in other words, you must use the patent. At least there's a possible legal structure that says, if General Electric comes in and develops and sells

its electric irons in this country, it has a monopoly. If the underdeveloped countries don't grant a monopoly, the foreigners simply don't come in.

I spent the day with the patent commissioner of Israel trying to understand their system. They have very strong socialist leanings. They have a patent system and it's getting stronger. As you talk to them, you realize that our capitalist point of view is foreign to them to some extent. They understand this and they'd like to change it because they find that unless they give patent and certain tax inducements and some other things, outside business people just don't come in.

If you don't have a patent system you don't have a sound structure. You cannot use any judgment that depends on the whim of the government. The whim of the government, I think you will agree with me, is a pretty poor basis for judging whether you should go in and spend money to develop an industry or build a factory because that whim could change tomorrow. In other words, they can give you the necessary rights and then three years from now they can give somebody else the right. This means that there is really no structure on which you can base your economics.

I think that the underdeveloped countries, when they take the position that somebody is trying to exploit (destroy) them by patents simply means that they don't understand the system. They don't understand what they can do to protect themselves. They should protect themselves and they can. I think it's a tragedy for them that they don't understand the patent system. I think the net result is that people don't come in to invest money because they don't know where they will stand today, tomorrow, or next week.

MODERATOR GREEN: Can you blame them for not understanding the patent system when very many people in our own country don't understand it?

MR. RABINOW: Well, I can blame Israel. I think they should have enough brains, if you'll forgive me, for understanding what a patent system is. When you talk to them, you discover how their system of incentives operates and how much of it is unsophisticated. They want you to come in and invest but they can't give you a guarantee that you'll end up with protection. They say, why don't you open a factory here, and you say, what guarantee have I that you won't give the same right to the next guy who'll come in and have the same right without having to do the original pioneering? They understand it better now. They'll be capitalists before long. (Laughter)

MODERATOR GREEN: They listened to you.

MR. ADAMS: I use the word certainty, and I think Jack Rabinow is touching on the same thing. I wasn't so concerned with the notion that the U. S. firm, whoever it was, might get a monopoly in exchange for coming in as I was just in increasing the certainty that if I made my investment there I would know what rights someone else might have to assert against me. Would I invest my dollars and my technology and then discover that the government of the country had given this exclusive right to somebody else and that he was going to expect tribute from me or else take away my investment. That's the kind of certainty I think I was talking about.

MR. RABINOW: You just have to know where you stand.

MR. SQUIER: John, back to the basic question here—if I can, I'd like to draw a corollary which might explain my feelings about why the PCT in its present form, for better or worse, is attractive. In our industry, like Allis-Chalmers, we have an association called ITA—Industrial Truck Association, and back several years ago we started working together as a group to formulate some rules and regulations. Of course, this is not unlike many industries, but again I'm trying to draw a corollary as to how we think that product should behave in the marketplace and what kind of industry rules we should establish. As an industry, we wanted to establish these so that we, whom we think know more about that product than most people, had a chance to put our words on paper. We did this. It has worked well and in the past decade we have seen the acceptance, in countries that you wouldn't believe would even be interested, of the same basic format almost word for word as we've established in our industry.

I don't think that the patent treaty worldwide is really a much different situation. If I can explain why I feel so strongly about a treaty, I think it's for this reason. It will put in front of people who don't even know that this thing exists, if you will, that the problem exists—a format. A format which by osmosis eventually will yield some sort of a uniform program. Something they can work from.

MODERATOR GREEN: Mr. Nielsen?

MR. NIELSEN: Assuming that we could all get together on this side of the Atlantic Ocean and decide that this is the thing to do, what assurance or what chance have we got to negotiate that with the various European countries, keeping in mind that the French don't want to let the English into the Common Market—the English wouldn't let them get in if they got in—they all have various patent systems and this gentleman over here was just referring to the patent system of Israel—are we going to be persuasive enough to come over there and make them mend their ways and see our point?

MR. SQUIER: We were talking about this at lunch a little, and I think we've overlooked a truism here of industry in the United States and it's true of other places. We sit here talking about U. S. industry and our involvement and just how we fit in this whole world picture. And again, like G. E. and Allis-Chalmers we're talking about ourselves. Today we have thousands of employees in these countries—we have legal people who work for us, we have engineers who work for us, and we sit on technical committees and we go to seminars like this in those countries, separate from anything we're doing here. And if we don't think that we are influential in what's going to happen down the road in those countries—forget it, we are.

MR. WOODWARD: It works the other way once in a while. There are one or two big bosses over there who have subsidiaries with staffs here.

MR. SQUIER: True. But certainly we are going to have an impact as to whether or not some of these programs are going to be adopted and used and followed. I must believe it's true.

MODERATOR GREEN: I think it's a good question. I wonder if Dr. Muller here from Holland may be able to give us an insight or two from the European point of view.

DR. MULLER: Well, it's a hard thing to answer. But I think you have to make a distinction between the various countries. If you are referring to, say, Bolivia or Syria, or something of this kind, it's quite different from a European country like Denmark, Norway, or Germany. I don't think that your influence in countries like the developed, established industrial countries in Europe, will be substantial. At least not directly. Indirectly, yes, because it is undeniable that American influence in European countries is growing. You don't get a seat on a government, of course, but by the mere fact that you are there and you are taking part in the economic life—that you have some of your people there, you are employing our countrymen in Europe in U.S.-dominated industry, you are the boss. And this has a tremendous influence, especially if the share of the total volume of the production of the country is increasing. So that explains what differences there are. I wouldn't mention one specific country or another where the influence is more or less, I couldn't say. On the other hand, there are countries like, for instance, South American countries, Indonesia and so on, where I think the influence would be much greater, not by direct participation in the government itself but by your various agencies over there, by your taking part in international work which is done there—the International Health and the Food Organization, and so on.

To give an example that perhaps is more convincing—and I take it from another field which is related to the patent field, and that is

antitrust—you perhaps may not realize how your antitrust ideas have blown over to European and other countries and how this idea is growing, however little we might like it (laughter), and perhaps you don't like that, but still it's a fact. If you think of the Freiberg School in Germany, where scientists are sent over to this country and come back and preach the gospel in Europe. That has a terrific impact on the thinking in European countries. And I have attended conferences where this was referred to as a disease which, just after the war—coming over with American people—was spreading around. Nobody could help it.

MODERATOR GREEN: Infectious disease. (Laughter)

DR. MULLER: So something of the same kind will happen with the notion of industrial property.

MR. WOODWARD: Mr. Chairman, I'd like to reply to Mr. Nielsen's question with a note of hope, and that is this. That patent systems have existed in the European countries for quite a long time. They haven't been the kind we have. Many of them are registration systems and almost all of them are first-to-file systems. But when you get down to an infringement case, it's surprising—whether it's a Belgian case, Italian, French, German or English—on the basic issues of, is this an invention and is it being used, the language is very much the same. And one of the things Mr. Panel talks about in his article are the different tests of invention. In fact, he cited the U. S. Supreme Court and quoted from it, saying that was really one of the best statements. And he said, whether it's inventive step, or obviousness or, and he named several others, that doesn't really make much difference. What we like to have in a European patent, he said, is to pick one particular set of words and let that be it. But even though they have different sets of words, they mean pretty much, basically, the same thing.

We have a community of understanding among the developed countries that is a background for everything. We've not going to have any great deal of difficulty in reaching some understanding as to improving international patenting procedures with those countries. The biggest difficulty is going to be our own interests and our own dislikes for first-to-file and a whole lot of other things, and getting the American law to fit—getting the thing not to worry the American law one way or another. If we can overcome that, we won't have any problem.

MR. NIELSEN: May I make a remark?

MODERATOR GREEN: Surely.

MR. NIELSEN: There are some countries over there now where you may not own property unless you are a citizen of that particular

country. You can own publications and money and bonds but you cannot own real property. Denmark and Sweden are two in case. And so, if you had a good patent and you were to come over there and wanted to build yourself a plant, you couldn't do that unless it were owned by a Swedish or a Danish citizen. Germany, I understand, is looking that over, too. I just returned from Europe.

MR. WOODWARD: I understand in many of those countries you can't have an enterprise unless it has a majority local control.

MR. NIELSEN: That's right.

MR. WOODWARD: Although, I don't think you can charge that to the patent system. Almost all of them permit foreigners to own patents.

MR. NIELSEN: But not the plant facilities.

MR. WOODWARD: But they also allow you to get royalties out in ways that you can't get other types of money out. That's done under the tax treaties and because they want to encourage technology to come there. I think, when you talk about building plants abroad, you're dealing with a whole other set of factors that don't necessarily follow from an international patent system—that you should be able to have completely foreign-owned or foreign-controlled plants abroad. Maybe the wealth will develop where it can, because we have had it in the past in this country and elsewhere. But the prejudice against that is another universal discord.

MR. WALDES: I was just going to comment—or maybe I should say, ask—you brought up a question which often bothers me, about the difference of a European approach to the patent as compared to our American approach to that patent. Now in the case of infringement, as far as I know the statistics, you go to court with a patent trying to uphold your patent, and your chances are statistically less than 8 percent to uphold a patent. In Europe, it's probably the other way around. I'm speaking of Germany or France, or what have you. The patent is a document which is examined and then certified that this is an invention. At least, that's how I understand it. And this is when we talk about universal patents and so on—evaluation of the very same document that is certified by these governments that will become partners to this Treaty, hopefully, here we have a great schism. It's just a comment—I don't know what you're going to do with it.

MR. BECHT: I don't think the comment is wholly accurate.

MR. RABINOW: No, that's not accurate. We disagree. Mr. Waldes, this is not quite correct. It isn't 8 percent in the United States.

MR. WALDES: It depends on the court you use.

MR. RABINOW: No, no, it isn't anything as bad as that. It's about

half, depending on the court and it also depends on the case. My attorneys tell me that if you have a good patent they'll bet three to one—four to one—that the courts will uphold it. If you have a weak patent, a detail-improvement patent, it may be less than this. But the general belief here is that those cases which go to court are probably selected because they are weak. The good cases are usually settled before they go to court—at least that has been my experience. So, the ones that end up in court are not the best cases, and even there, half are upheld, roughly—I don't know the exact number but it is roughly half. It is not as bad as you say.

MR. WALDES: I challenge that. The Eastern District Court has the worst performance.

MR. RABINOW: I think you can get a judge who hates patents. (Laughter)

MR. WALDES: I've been looking for him. (Laughter) But there are different results in different courts.

MR. BECHT: Did you refer specifically to Germany? Within the German patent system, when you get a patent to the point of settling infringement, it is basically done in a civil court, the same as it is here in the States. But there is no question about the patent. However, there still are plenty of legal means within the patent system to wind up with the same result—nullity suits or this type of thing. And if you put all those actions together, the odds would probably come out about the same.

MR. WALDES: I merely meant that the document perhaps should have the same value or respect.

MR. BECHT: I think it does.

MR. WALDES: In those terms. I didn't mean to get into statistical numbers games in that sense.

MODERATOR GREEN: You want to harmonize the courts' decisions. (Laughter)

MR. WALDES: Well, no, I figure it is a valid document that's properly examined. That's what this is all about, isn't it? And when it is approved as such, then it should be approached in that sense.

MODERATOR GREEN: Perhaps this is the time to move on our last topic. The afternoon's moving on. Looking Ahead—essentially what we mean here is—if, as we seem to be doing, we're embarking on the road of PCT, where is that road leading us? And within that general subject, Mr. Robbins earlier asked the question, "Is the universal patent system a desirable goal?" There was some discussion of alternatives, not necessarily simplified but variations such as the EEC and

European Patent. How does the innovator feel accepting PCT at the present level, with respect to further steps in harmonization? What might they be and how does he react to them? Does anyone want to kick this one off? It's nice and quiet.

MR. BECHT: There's one in every crowd, and I might as well be it again.

MODERATOR GREEN: Mr. Becht.

MR. BECHT: To begin with, I think we have to say that it's utopian to desire a universal patent system. Personally I don't consider myself blessed with enough vision to be able to visualize any type of system under which it could possibly work, but I still think it's the end goal that's out there somewhere. And it's the direction that we want to go to. I think that without doubt the world is daily getting smaller. The smaller it gets the more necessary it's going to be in the long run to have it. How it could possibly work, I couldn't begin to visualize, with what we have available today.

As far as PCT is concerned, speaking for myself, I don't particularly agree that it's the best step that could have been made for the problems that exist. That's 20-20 hindsight, and we're all blessed with a little bit more of that than foresight. I have great hopes for it being at least a step to continue moving towards the utopian idea that's somewhere down the road. I would have little hope for substituting any different plan at this point. Considering the time, and the general overall acceptance that there seems to be from the member states that have participated in getting the draft of this treaty to the point that it is—I would have no hope for any alternate plan substituting for PCT.

MODERATOR GREEN: Jack, a little earlier you said that you thought it would be wise to sit back and look at this and reflect on it a while.

MR. RABINOW: Well, many years ago, John, as you know, I wrote to Adlai Stevenson and suggested that the U. N. issue a patent which would not be utopian. It would be a piece of paper that says "You invented this, you disclosed the following thing and the claims describe the thing specifically." I do not believe, incidentally, that the difference between claims in Germany or any other country are really that basically different. I think that it is perfectly possible with today's technology to understand each other. I think the Germans, the Americans, the Russians with whom I have spoken understand claims perfectly well. The differences are quite trivial in the technology of the claim. An invention is an invention and I believe that we all understand each other very well, actually.

Repeating, I think a patent could be issued which would say that

this is your invention, you did it, just as a book is copyrighted. This is your book. However, the laws of each country could be quite different. You could sell here, you could sell for capital gains. There you couldn't sell it at all, and so on. Each country could have its own set of laws saying this is a piece of property that is ruled by the country's laws. In Germany you would have to abide by German laws, in Holland by Dutch laws, and so on. And each country could have its own system of laws, graft, customs, whatever you like. The deals could be quite different as they are today. I think this is not utopian. I think this can be done and I think that if it costs \$2000 to make such a universal search it would be very cheap. I think that the search could be extremely extensive, it could cover all the files in the whole world and still be cheaper than to do what we do today. In other words, I see no reason why all the files couldn't be combined if you wish to have an international patent. They can all have copies and if they searched to the tune of \$1000 just for the search it would be very, very cheap. I would be very happy personally to spend that kind of money on a single search if it covered all of the available art there really is. And I think this today could be done with or without computers; whatever the computers can do technically to help could be used.

I think such a proposal today could carry weight. I think industry is sufficiently international today. We at Control Data work in all of the countries of the world, practically, and I'm sure this is true of everybody sitting in this room. And we would have a great interest in getting such patents. I think the underdeveloped countries could protect themselves against exploitation, against monopolies, very easily. Each country could insist that its citizens have to be involved. Japan does this unofficially. You cannot get a patent in Japan unless you have Japanese partners. I may be misquoting somebody, but I think I am essentially correct, that in Japan you cannot open a business unless you have Japanese partners and you will not get a patent issued in Japan unless you have Japanese partners.

MR. BECHT: No, the partnership isn't—

MR. RABINOW: Well, isn't it much easier to get it if you have a Japanese partner?

VOICES: No.

MR. RABINOW: Well, then the people who informed me misquoted, but the fact is they tell me it is much easier to do business in Japan if you have Japanese partners, whatever the techniques are, whether they are formal or informal, I really don't care. I'm perfectly willing to have Japanese patents. Anyway I think a universal patent system could

be achieved. I think a system could be developed which is much simpler than this treaty type of thing. I think a single patent is best—if we can't do it, I'd like to see regional patents. I'd like to see a North American patent, a South American patent, perhaps, an African patent, maybe two African patents—a white and a black patent—(Laughter) I think it would be perfectly possible to have—

MODERATOR GREEN: You don't want to see a Jewish patent, do you?

MR. RABINOW: No, I don't want to see a Jewish patent. I think that would be part of the North American patent. I think we can get a Nordic patent, a European patent, possibly a single European patent. I think that Russia will play ball.

I talked to the Russian Commissioner of Patents. I speak Russian fluently and he is interested in making deals, exchange of patent rights, getting royalties both coming and going. He said he'd even let us sue him in the Russian Court. I thought that would be kind of interesting. (Laughter) I think when conditions are right we'd win automatically. I don't think it would make any difference what the case was, I think we'd win. If conditions were wrong, I think we'd lose automatically. (Laughter)

Anyway, I think it can be done. I don't think it's utopian at all. I think it could be very much simpler if it were done this way. The only trouble is that the legal departments of various countries have vested interests and I think the governments have vested interests. I think this will take some doing to get around. But it's not utopian. I think this could be done in 50 years, 20 years from now quite easily. That's my feeling.

MODERATOR GREEN: Assistant Commissioner Schneider, do you have a comment?

JOHN H. SCHNEIDER: I did have a comment, but first I'd like to point out that in regard to the EEC and the European patent, the U. S. applicant may not have accessibility. However, the route to access for the U. S. applicant might be found through our adherence to the PCT. Failure of the U. S. to adhere to the PCT could result in the U. S. applicant being even further from access to the European patent. Furthermore the possibility of having available a route to the European patent, which the PCT potentially presents, may not be available to the U. S. again in the near future or even ever. Therefore when evaluating ratification of the PCT it would be in the best interest of the U. S. applicant to weigh fairly this particular advantage among others that adherence to PCT might offer.

MODERATOR GREEN: You're saying, if you can't lick them, join them. Any other comments?

MR. RABINOW: May I ask a question? If there is a European patent, do you think they would exclude us or force us to get an individual patent? Do you think that we could not take advantage of it?

MR. SCHNEIDER: It is a possibility that we may not have access.

MR. RABINOW: In other words, we'd have to go the old route in individual countries?

MR. SCHNEIDER: Yes, we still have the Paris Union. I'd like to point out further that it was the result of a proposal presented by the delegation of the United States of America to the Executive Committee of the International Paris Union that eventually led to the PCT. We were actually out in the forefront on the concept, so backing out of it now doesn't seem to be compatible with our previous recommendations.

DIRECTOR HARRIS: Is that a very formal commitment? Are we committed to it in precisely this way?

MR. SCHNEIDER: No, not necessarily, but one might question why we were the ones who proposed the broad concepts initially and then dropped it by the wayside as the thing began to gel. While we may be in agreement with the broad concepts I'm not saying that we have to buy a treaty which is not acceptable to us. We should continue to try to shape the document so that it is fully acceptable to us.

DIRECTOR HARRIS: I was just curious whether we actually proposed that they prepare a formal treaty, or if we merely suggested that they develop some medium, according to a certain rationale, on which to base further discussion.

MR. SCHNEIDER: It was a proposal presented by the delegation of the United States and on that proposal the Executive Committee of the International Paris Union recommended that the Director of BIRPI urgently undertake a study of solutions tending to reduce the duplication of effort both for applicants and for national patent offices in consultation with outside experts to be invited by BIRPI, having due regard for the efforts of other international organizations.

MR. BECHT: Commissioner Schneider, does the Patent Office consider PCT to be a stepping stone or would you anticipate a like period of time between the next action as compared with the Paris Convention and endeavors here? I think that's really the question. I don't think anyone is disagreeing with the problem. It's a question of time.

MR. SCHNEIDER: Well, I think as we view it generally, if we bypass this opportunity, it could be a long time before we have a similar opportunity again.

MODERATOR GREEN: Dr. Behrman.

DR. BEHRMAN: What were the problems in Chapter II in getting it

put into the same sort of thing as Chapter I, and is this the next step? Is this sort of the basis for formal discussion?

MR. SCHNEIDER: Are you addressing that to me? I would like to defer to Mr. Brennan.

MR. BRENNAN: This dichotomy between Chapter I and Chapter II was the result essentially of recommendations made to the Patent Office by people in the Bar who saw many dangers in having in addition to the search of Phase I the examination under Phase II. As you probably know, Phase II adds to Phase I an additional five months of decision time and it provides for an examination which indicates in the opinion of the examining authority whether the invention is novel, involves an inventive step, and is capable of industrial use.

As a result of this we have not been giving too much attention to Phase II within the last two years. We've looked at the Treaty but we have looked at it with the feeling, perhaps subconsciously, that the United States is not going to adhere to Phase II. There is a provision in the Treaty which allows us to reserve with respect to Phase II and presently we contemplate that this is what we will do.

I think the Commissioner was somewhat surprised about a month ago at the AIA meeting when someone asked him, "Why?" People from industry saw this as an additional five months' decision time and they thought there might be some attraction to it. Since then, other people have raised this question. Dr. Behrman did not. And we are now in a position where we are thinking that we should really look at Phase II, not that we would consider adhering immediately to Phase II but if it becomes evident after five or six years of operation under the treaty that there are certain attractions to Phase II that would make it desirable for us to adhere—if we get playback from industry and innovators that they want Phase II—then we want to be in a position to drop our reservations.

Of course, the only way we can do this is to look very closely at Phase II during this period to make sure that it is molded to a shape consistent with our national law and practices. And then if the time comes, we will be able to drop the reservation. So there is no plan now to adhere to Phase II, but we do want to look at it very closely to make sure it's in the best shape possible so that if we do change our minds on this we will be able to drop the reservation.

DR. BEHRMAN: Isn't Phase II really the step that Mr. Rabinow was talking about in terms of reaching a regional patent? Isn't that the next step?

MR. BRENNAN: Well, it may be the next step towards such a patent.

If PCT goes well, I think you will find that a businessman with a patent for the same invention who has claims that are drafted in PCT style reading exactly the same in six or seven countries is some day going to turn to his patent attorney and say, "How come those German claims don't cover exactly the same as the U. S. and the French and the Belgian? I'd like to license this thing on a worldwide basis and know that my coverage is the same in all these countries since it is the same invention and it has the same claims." And I think if enough of these industrialists get together and complain to their house counsel or the attorneys who are servicing them, and they in turn go to their governments that there will be a tendency to harmonize the patents on a more or less uniform interpretation.

I'm talking from my own viewpoint which is not a Patent Office viewpoint—it's not an official position, it's just my personal feeling that this is the way it is going to develop. We're not maybe going to go out and get another treaty to do something more—someone said osmosis, and I think this is what is going to happen. I think we'll just sort of osmose into a universal patent that really isn't a universal patent because it's a whole group of different patents, but they all read the same in different languages and they all mean more or less the same thing. I think we will have come a long way when we get there.

MODERATOR GREEN: Can I throw in one myself? At lunch Dr. Muller asked me—he said, "Looking on this as a first step, we have found first-to-file so successful in Europe, why doesn't America come along next with the first-to-file?" Is this a fair statement?

DR. MULLER: Well, not exactly, but it may serve your purpose. (Laughter)

MODERATOR GREEN: Let me say that my response to him was that I thought this was something that would not be acceptable in this country; that we had a whole system of publication, research, development of invention, disclosure built upon the fact that the patent goes to the first to invent who relies on this fact; further that interference is not the onerous burden that some people think it is. I'd like to know whether this is a fair statement or not, or whether I misadvised him. Does anyone see—

MR. WOODWARD: I can tell you why I think first-to-file won't go here for at least another 20 years. When you ask a company about some change in the patent law like first-to-file, you first get to the public relations department because when someone asks questions, then they refer them to the director of research. Usually the director of research is on the offensive platoon, psychologically speaking. He's not on the defensive platoon, and the patent attorney does much more business

with the offensive platoon I mean in hours per day, than with the defensive one although that depends a little bit on the company. And it usually happens that the defensive platoon are hard-headed people you can get along with anyway even though you allow no news releases, but you have to baby the offensive platoon, because they are your top talent in many erudite things and you don't want to lose them. So you have to be very careful of your top man in the offensive platoon. You usually let him speak for the company on matters of patent law.

Now his point of view is that no matter how sloppy his people are about writing things down or remembering what they did when, he doesn't want them to lose any rights. And he's not worried so much as to what can be retrieved by his opposite number in another company who is equally sloppy, because that's the problem of the defensive platoon and that doesn't bother him. (Laughter) And you are always going to get the offensive platoon on this question for at least the next 20 years, and they don't want first-to-file.

MR. RABINOW: John, may I make a comment on this because I am heavily involved. First of all, the European system doesn't work very well. This is fiction, with all due respect. I will quote the research director of Zenith—Mr. Adler who just won the award as being the inventor of the year—and Bob says that when he worked in Germany—I think he's German or Austrian—he said he once had a good invention. He tells the story that he couldn't talk to his family, he couldn't talk to his co-workers in the laboratory, he kept his mouth absolutely shut because he had a good invention. It wasn't a trivial one. He got the thing written quietly and got the patent filed. Then and only then could he talk to his staff. Now, he may be exaggerating, but I don't think so—Bob Adler is not the exaggerating type. I worked for the government for 16 years, my own company for 10, and Control Data for 6 years. I've worked as a consultant for the largest companies in America—RCA, Univac, Cutler-Hammer, and many others. And I can tell you, from my experience, in America we are not afraid to talk to anyone. You get an invention—it may be great, it may not be great—maybe a magnetic clutch that may be worth millions—I made \$26,000—or it may be a reading machine that is now copied by everybody, it may be a watch regulator which made me a personal fortune of a quarter of a million dollars. You're never afraid to talk to anybody. You go to strangers, you go to your co-workers, you go to your competitors. We take competitors through the plant. IBM is a very violent competitor of Control Data. I would take the research director of IBM without the slightest hesitation through the plant. There may

be a new idea I won't tell him about, not because I'm afraid he'll steal it but because I don't want IBM to make a similar device. In other words, I would like them not to start working on it yet. (Laughter) But, generally speaking and I speak from experience on this, you can show anybody anything, knowing that unless they are out-and-out crooks, unless they steal all the records, they will lose any case that goes to court. I have notes, my staff has notes, we have memos to my boss, we have so many documents we can always go to court and show what happened.

We have had cases of interference with IBM and others, We open the books to each other and usually it is settled without going to court—I have never had to go to court on an interference yet. Interferences are a pain in the neck, but they are not so tragic. The fact of the matter is that in America this leads to great development of technology at a much higher rate because when you have a brilliant idea you cover yourself by talking to people, in fact the more people you talk to the safer you are because they are witnesses for you.

But this is not true in Europe. I would be damned if I would take an idea which I consider valuable for Control Data and tell it to my whole staff knowing that somebody will quit tomorrow and work for my competitors. This happens all the time. I'll be damned if I would talk to them before I filed, which means I would file a half-baked, rushed disclosure which is not yet thought through, which has not yet been discussed with my peers. In Europe they are afraid to talk. I've talked to many people from Europe and they all tell me that they talk only to very, very intimate friends whom they can really trust. They will never dare to make a public announcement of an invention before it is filed or before they can talk to somebody. I think that the thing does not work well. The patent system works well from the patent office's point of view. It makes things much easier for the patent office but it isn't good for technology and I think the American system works infinitely better. And today we are the leaders in technology in many ways and this wasn't always so. I think it is probably because our patent system is so wide open and so safe.

MODERATOR GREEN: I think this is the essence of what I tried to say—he's done it ten times better.

MR. RABINOW: And also in ten times as many words as you would use. (Laughter)

MODERATOR GREEN: It is now 4:30. Is there anyone who wants to ventilate something we haven't covered?

DR. MULLER: I only want to say that I entirely disagree. (Laughter)

MR. NIELSEN: I'd like to ask permission to leave. I've got to catch a plane and I understand the traffic here is miserable and I'm leaving a little after five.

MODERATOR GREEN: You'd better move out. Thank you for your contribution. It was very worthwhile.

MR. NIELSEN: Thank you very much for inviting me. Glad to have met you, gentlemen.

MODERATOR GREEN: In an effort to try to extract the essence of this I had hoped that as we went from topic to topic to summary, we'd proceed without violent disagreement. Apparently that was O.K. but let me see if I can, in general terms, say where we stand. It would seem that this group looks on PCT as not a panacea, not a very important development. They also don't see it as a disaster. I would say many, if not most, say, well, we can live with it, we think it's worth an experiment. There's another group, of which Jack is a member, which says we can live with it but we'd rather not. We think it's cumbersome, expensive, not necessarily in our best interests. We would rather work a little longer for something simpler and perhaps better tuned to our needs.

MR. RABINOW: Mr. Robbins said it much better.

MODERATOR GREEN: Well, all right. Is this a distillation of where we come out today?

MR. ADAMS: Well, I think your statement is a little more pessimistic than his, his and mine, and maybe a couple of others'. (Laughter)

MODERATOR GREEN: You mean my statement—we can live with it, it's worth an experiment?

MR. ADAMS: "We don't think it is very important but we can put up with it." I think "We think it's not perfect but we'll sure use it" was nearer what I was trying to say.

MR. ROBINSON: Do you think it is worth trying? That's different from being able to put up with it.

MR. RABINOW: Yes, nobody says it's not important. I think it's important. I think it's certainly going to be very interesting to watch.

MR. WOODWARD: There's one little advantage that hasn't been mentioned here that is peculiar to America under the present system. If you file abroad in the 18-month publication countries, your patents come out first in German, in Swedish, and so forth and so on, and people write in to you and say you've got a case that came out on such and so, would you send us an English translation. We will do the same for you on ours. You go through the unseemly system of looking at French and German and whatnot translations of American documents

and translating them back into English. Under the PCT they will be published first in the original language on about the same time schedule. This will save a lot of trouble.

MODERATOR GREEN: To go back to my comments as corrected. There are a substantial number here who think it is important and it should be tried. Lou, it's time to conclude.

DIRECTOR HARRIS: Thank you, John. Thank you, fellow discussants and fellow participants. The exchanges have been most informative. The information surfaced here today will be very helpful in guiding the Institute's research in this area. And I am sure it will be most useful to the decision makers. I want to thank particularly those of you who have come from great distances to be here. I want to assure you that we are going to maintain the confidentiality of the transcript until you have had an opportunity to edit your remarks. The information will then be submitted to the Commissioner and also be published. Our Clinic stands adjourned. Thank you very much.

APPENDIX

OUTLINE OF PCT CLINIC

The Institute is engaged in legal and economic studies on the role of industrial-intellectual property protection in the promotion of international trade and development. Special attention is being given to existing and proposed national and supranational legislative and treaty arrangements. In view of the desirability for a deeper investigation of the proposed Patent Cooperation Treaty, the Institute plans to examine the latest (July 11, 1969) draft of the Treaty through three coordinated mechanisms: (1) a one-day Clinic of persons experienced in innovation; (2) an analysis of responses to a mail questionnaire; and (3) a series of personal interviews. This memorandum is addressed to the first item—the one-day Clinic.

The Institute has selected a group of innovators with special knowledge about the problems of patents and innovation here and abroad. These personnel include (1) inventors, (2) economists, (3) research administrators, (4) company executives, (5) attorneys and (6) representatives of the federal government. They are being invited to meet at the Institute headquarters to consider the short and long term impacts of the proposed Patent Cooperation Treaty. Since the Commissioner of Patents has asked for information designed to uncover any unrecognized flaws or obstacles by the end of this year, it is useful to hold the meeting in November. This time will provide an opportunity for recording the views of the Clinic participants, reflecting on information supplied and organizing the knowledge for publication, including submission to the Commissioner.

Each participant is being supplied a copy of the latest version of the Treaty and related explanatory material in advance of the meeting and is asked to consider whether its features, if accepted, would prove advantageous to our economic growth. There are several questions which have been raised by patent experts and others which merit discussion. These include—How would U.S. adherence to the Treaty

- (a) Affect international licensing of patents and related technology?
- (b) Affect expenses of U.S. inventors and companies seeking patent protection abroad?
- (c) Affect the procedural matters involved in obtaining patent protection abroad?
- (d) Affect protection abroad for U.S. inventors and firms?
- (e) Affect the flow of foreign applications to the U.S. Patent Office?

The participants will, without doubt, wish to discuss other aspects of the Treaty. One, which some authorities feel should influence U.S. authorities toward acceptance, is the extension of time for filing in other countries from 12 to 20 months after filing at home. The significance of this feature in the context of the entire Treaty merits examination. In an article in the July 21, 1969 issue of *International Commerce*, the Commissioner of Patents stated "Our Patent Office is concerned about the impact upon U.S. practice of certain provisions of the draft relating to timing of the various steps involved in the filing procedure, . . ."

To consider the rationale behind the provisions of the Treaty and the implications for U.S. interests, the participants may wish to direct the foregoing general questions to Articles in the latest draft. The following are suggested questions and explanatory material.

I

At present foreign patent applications are usually filed by the following procedure:

- (1) An application is filed in the applicant's home Patent Office.
- (2) Within 12 months of this filing, individual applications are sent to the foreign countries where patents are desired with translations where necessary and with the respective filing fees.

Under PCT the following alternative procedure is proposed:

- (1) A regular national application is filed in the applicant's home (country of his residence or nationality) Patent Office.
- (2) Within 12 months of this filing, an "international application" (Article 3) is filed in the home Patent Office in a language acceptable to the searching authority (in the U.S. it would be English). At the same time, the other countries in which patents are desired must be designated (Article 4).
- (3) Upon receipt of a search report (Article 18) based on the international application, the applicant may file with the International Bureau, which administers the Treaty, an amendment of the claims of the international application (Article 19).
- (4) Within 20 months of the original filing, the applicant sends a copy of the international application (in translation where necessary) to the Patent Office of each of the designated countries together with the respective national filing fee (Article 22).

QUESTIONS

1. How will the alternative procedure proposed by PCT
 - (a) Affect your expenses in obtaining patent protection abroad?
 - (b) Affect procedural difficulties for you in obtaining patent protection abroad?
 - (c) Affect your foreign filing activities?
2. Assuming both the present and proposed PCT procedures are available, which one would you use for obtaining foreign patent protection?

II

Under the procedure proposed by PCT, it is contemplated that international applications would be searched by one of five agencies: the United States, West German, Japanese and Russian Patent Offices and the IIB (Hague Institute). The international application (including any amendment of the claims as a result of the search report) and a copy of the search report listing the prior art found, would be communicated to the Patent Offices of the designated countries. If any of these Offices are examining Offices, the usual examination for patentability would be made (with the "head start" provided by the international search report) and there might also be a further search. In a non-examining Office, the search report would presumably be placed in the file and the patent granted.

QUESTION

What effect would you consider that this procedure, particularly in the non-examining Offices, would have on the role of patents in assisting your commercial operations in the respective countries?

III

Chapter II of PCT (which is optional) provides for an international patentability examination (novelty, inventive step, industrial applicability) in addition to the international search of Chapter I.

QUESTION

Since, at the present time, the standards of patentability are different in various countries, the advisory opinion of one of the international examining agencies might be different from the opinion of an examining Patent Office in one of the designated countries. How might this affect your use of Chapter II if this Chapter were included in the Treaty?

IV

QUESTION

Assuming that the cost of filing through PCT is greater than present costs (due to transmittal, international and designation fees as well as national filing fees), would you nevertheless use the PCT route in order to obtain the benefits of PCT?

V

In addition to PCT, consideration is now being given to an EEC patent (as well as to different patents in other European countries based on the filing and prosecution of a single application, e.g. Nordic Plan). Under the EEC plan (including Belgium, France, West Germany, Italy, Luxembourg, Netherlands) a patent will be granted which will be effective in all six Common Market countries and involve provisions governing matters arising after grant. PCT deals only with part of the pre-grant procedures and the grant and subsequent practice remain under national jurisdiction.

QUESTION

If the EEC patent would become available, what effect would this have on your utilization of the PCT procedure if PCT became operative too?

Innovators Examine Proposed Patent Cooperation Treaty*

JOHN C. GREEN** AND CHARLES M. LEEDOM, JR.***

INTRODUCTION

THE PTC RESEARCH INSTITUTE'S SERIES of coordinated studies of the proposed Patent Cooperation Treaty are designed to produce information relevant to the effects of acceptance and implementation of the Treaty should the U.S. government follow that course. Such information will be helpful to U.S. participants who will be weighing the many provisions contained in the Treaty in the forthcoming international Conference. This survey is one element in the Institute's comprehensive examination, the results of which will be found in *IDEA* and will be discussed at the Annual Public Conference in Washington, D.C., June 4th and 5th.

* In the development of the questionnaire for the study reported here, the authors benefited from the advice of S. Delvalle Goldsmith, Langner, Parry, Card and Langner; L. James Harris, Director of The PTC Research Institute; and various individuals in the U.S. Patent Office.

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*** Mr. Leedom, who participated in the consolidation and analysis of the replies for the purpose of this report, is a Patent Examiner in the U.S. Patent Office.

The Institute's previous assessments of economic effects of industrial property decisions have always taken into account the special experience of the members of the patent profession. In addition, the Institute has consciously sought to broaden that base of knowledge by enlisting the help of innovators—that is, respondents concerned with the scientific, engineering, and business actions which are influenced by patents and which, in turn, influence decisions with respect to the patent process. This principle was followed in the present survey. A list of 200 experienced innovators was developed, including inventors, research administrators, and company executives. They were sent a questionnaire (see Appendix) designed to elicit information on four general areas which have been the subject of discussion and debate. These are: Costs, Procedural Aspects, Impact on the U.S. Patent System, and Impact on International Business Transactions, including Licensing.

We were confident that the persons approached understood the patent system and its relation to invention, research, production and sales well enough to comprehend the import of the questions and to provide useful answers. The responses show that this belief was well founded. This is an interim report to disclose early information. It will be revised as additional materials, which are still being received, are evaluated. However, the strong response to date permits this tabulation and report on how many expert respondents view major elements of the proposed Treaty.

COSTS

At present when foreign patent applications are contemplated, the first case is filed in the applicant's home Patent Office. Within 12 months of this filing, individual applications are filed in the foreign countries where patents are desired, with translations where necessary and with the respective national filing fees. Under PCT, an alternate procedure will be available involving filing in the applicant's home Patent Office as before, followed in 12 months by the filing of an "international application" (Article 3) in the home Patent Office. A "record" copy is sent to the International Bureau. This application must be in a language acceptable to an international searching authority, which in the U.S. would be the U.S. Patent Office; therefore the language would be English. At this time the foreign countries in which patents are desired would be designated. Upon receipt of a search report based on the international application, the applicant would file

an amendment of the claims of the international application (Article 19) with the International Bureau, which administers the Treaty. The applicant would finally send within 20 months of the original filing a copy of the international application (with a translation where necessary) to the Patent Offices of the designated countries together with the respective national filing fees (Article 22). A reputed advantage of this procedure is that applicants would have an additional eight months in which to determine the commercial usefulness of their inventions before they are required to bear the expense of foreign filing. Thus some cases would be "weeded out" as more was learned about their actual value.

When informed of the foregoing procedure, 36 percent of those responding to the survey felt that PCT would cause an increase in their expenses for foreign filing, while 38 percent saw a decrease. Thus, taken as a whole, the survey failed to evidence a clear position on cost on the part of the respondents. However, when the survey results were subdivided, a difference developed between innovators who replied directly and those who looked to their patent counsel in preparing their responses. The latter group predominantly estimated cost increase while the former predominantly anticipated a decrease. This same division between attorneys and inventors existed throughout the responses. Innovators tended to be optimistic about the effects of the Treaty, while many patent attorneys tended to see the Treaty as ineffective or actually harmful. In terms of total effect on foreign filing activities, most respondents (58 percent) saw no substantial change while roughly one-fourth saw an increase in their activities. Here again there was a split between inventors and attorneys. Inventors generally expect to increase their activities while only 14 percent of the attorneys expect to do so.

Despite the pessimism over cost savings, over three-fifths of all respondents indicated that they would use PCT. This fact is surprising since the adoption of PCT will not preclude the old method of direct filing. One is led to conclude that cost will not be an important factor in the acceptance and use of PCT.

PROCEDURAL ASPECTS

Great interest has been expressed by both domestic experts and foreign practitioners in the extension of time for filing in other countries to 12 to 20 months after filing at home. (See Harris and Finn, "International Industrial Property Transactions: Views and

Experience of Foreign Experts," *IDEA*, Volume 13, Number 4, page 529 at 547). However, nearly one-half of all respondents said that the extension of time would not strongly affect their use of PCT, the most frequent reason being that an additional eight months was still not sufficient to allow a determination of commercial usefulness. Nearly three-fourths of all research executives and representatives of medium-sized firms believed that the eight months would make no difference to them, while only one-half of all representatives of large firms felt this way. Only speculation can suggest why large firms feel that the additional eight months would be more useful to them than do smaller firms.

Certainly there are many instances in which small firms equal or surpass large firms in moving an invention through development, testing, and production to successful introduction. Perhaps the answer lies in the frequency of foreign filing and in the methods employed by large and small firms in deciding when and where to file. The large company, with its research and development division and patent counsel, can be expected to generate a greater number of patentable inventions than a small firm. Further, the larger company may be in a better position to exploit these inventions abroad, either by sale or licensing or through manufacture by an affiliate. The smaller company, with fewer inventions, has less international experience and has not devised internal management methods for deciding promptly which inventions merit overseas protection.

One representative of a firm with extensive overseas experience observed that foreign cases fall into two groups: (1) Those in which the company is reasonably sure that foreign protection is necessary and potentially valuable and (2) those in which they do not have enough facts upon which to base an intelligent judgment. He then went on to state that usually in the latter situation, the information needed does not develop promptly enough to make the additional eight months significant in arriving at a sophisticated decision. Thus his company, while large, came to the same conclusion with respect to the value of the extension as did the representatives of smaller companies.

It is clear that the "cost savings" argument set forth by the proponents of the Treaty is simply not accepted by a large number of American innovators working closely with the patent system. They were similarly unwilling to accept the argument that the Treaty will result in a more complex filing procedure. Seventy-six percent of all respondents said that they expect PCT will either simplify foreign filing procedure or have little effect. It must be concluded that the

American innovator is basically unimpressed with the likelihood of either cost savings or increased procedural difficulties.

A more controversial section of PCT (Chapter II) would provide for an optional international patentability examination (novelty, inventive step, industrial applicability) in addition to the international search (Chapter I of PCT). Since standards of patentability are different in various countries, the advisory opinion of one of the international examining agencies might also be different from the opinion of an examining patent office in one of the countries designated by the applicant.

This was pointed out to the respondents. Nevertheless a majority indicated that they would seek such an examination if Chapter II were adopted and implemented. The responses indicate that numerous persons concerned with the acquisition of patents in other countries see value in a preliminary examination. Such a finding is not consistent with prior information, much of which was furnished by the U.S. patent profession, which questions the wisdom of U.S. adoption of Chapter II at this time. The authors feel this departure from earlier views merits additional survey work to determine whether there are significant differences in the attitudes of patent professionals and those they represent.

In addition to PCT, consideration is now being given to an EEC plan (as well as different patents in other European countries based on the filing and prosecution of a single application, i.e., a European plan). Under the EEC plan a single patent will be granted which will be effective in all six Common Market countries (Belgium, France, West Germany, Italy, Luxembourg, Netherlands) and involve provisions governing matters arising after grant. PCT deals with only part of the pre-grant procedures; the grant and subsequent practice remain under national jurisdiction. In response to our query as to the use of the EEC system in preference to PCT (assuming that both are adopted), a clear majority of those responding indicated that they would use PCT. The question involved the assumption that both plans would be available (although EEC may not in fact be directly accessible to foreign inventors) and yet most would still use PCT. Once more, patent attorneys disagreed with the majority of other respondents in that attorneys would overwhelmingly favor the EEC plan. This could be based on their belief that once protection is obtained in all of Western Europe no further benefit could be obtained under PCT.

Thus, while the plans are not necessarily mutually exclusive it would

appear that the possibility of obtaining a single European patent is of greater consequence to patent attorneys than are the more modest advantages of PCT.

IMPACT ON U.S. PATENT SYSTEM

To discover the possible impact of PCT on U.S. patent practice each respondent was asked to assume that, as a result of U.S. adoption of the Treaty, there was an increase in foreign applications filed in the U.S. Patent Office resulting in some increase in the workload for the Office; that there was some additional production or importation of goods covered by such patents; and that a larger number of U.S. patents were controlled by foreigners. In spite of such assumptions, consistently 70 percent or more saw no change in their present practice of seeking patent protection in the United States or in other countries or in any other part of their operations. The proper conclusion is clear. This potential result of PCT simply does not represent either a great threat or a benefit to the American patent system. This belief may prove to be wrong but is, nevertheless, clearly the position of those responding to the Institute's survey.

A more controversial provision is Article 11 (3) of the draft Treaty. At present, the original filing of a patent application in one country and a subsequent filing of a corresponding application in another country within 12 months have only the effect that the second application will have the benefit of the filing date of the first application for priority purposes. Under Article 11 (3) of the Treaty draft, the second application will not only have the benefit of the original filing date but will also have the same status in all respects as an application actually filed on the same date in the U.S. One of the effects of Article 11 (3) is that the one-year grace period provided by U.S. law would, for a foreign applicant who files his international application first, run back from the filing date of the international application rather than from his actual filing date in the U.S. In other words, a foreign applicant would have the privilege of publishing his invention one year prior to his international filing date and would not be restricted to the one-year period preceding his U.S. filing date.

Thus, in view of the complaints of foreign applicants that they do not get the same benefit from the year-of-grace provision as U.S. applicants do, the respondents were asked if they would be in favor of granting this benefit to foreign inventors. Roughly 50 percent were in favor of granting the privilege; however, inventors as a group were much less enthusiastic, with only one-third in favor of granting this

benefit to foreign inventors. The reasons stated were primarily political, and in one instance it was based on the belief that certain Eastern European countries were already exploiting U.S. inventors.

Another effect of Article 11 (3) would be to establish the international filing date as the effective date of a United States patent issued to a foreign inventor, and used as prior art against another U.S. application. However, Article 27 (5) limits the effect of Article 11 (3) to the extent that national law rather than Article 11 (3) would determine the effective date of an international application for prior art purposes as distinguished from priority purposes.

In the U.S. the *In re Hilmer* decision clearly stated that the foreign priority date could not be used for prior art purposes. If the Treaty is enacted without Article 27 (5), the effect of Article 11 (3) would be to overturn *In re Hilmer*. (See text of the address delivered by William E. Schuyler, Jr., U.S. Commissioner of Patents, before the French Federation of Industries at the International Chamber of Commerce, March 19, 1970). The respondents were asked if in their experience references had been cited against one of their patents which would have barred its issue if the reference had been effective as of its foreign priority date. The vast majority answered in the negative; however a few did indicate that they would have lost valuable rights and these few questioned the wisdom of accepting Article 11 (3) for this reason.

IMPACT ON INTERNATIONAL BUSINESS, INCLUDING LICENSING

Under the procedure proposed by PCT, it is contemplated that international applications would be searched by one of five agencies: the United States, West German, Japanese and Russian Patent Offices and the IIB (Hague Institute). The international application (including any amendment of the claim as a result of the search report) and a copy of the search report listing the prior art found would be communicated to the Patent Offices of the designated countries. If any of these offices are examining offices, the usual examination for patentability would be made (with the "head start" provided by the international search report) and there might also be a further search. In a non-examining office, the search report would presumably be placed in the file and the patent granted.

Our experts were simply unable to agree on the effect of this procedure on their operations. Nearly one-fifth of all those replying said they were unable to determine what effect it would have, while

the rest were fairly evenly divided between those who saw a benefit to their commercial operations and those who did not.

The last question asked what, if any, changes were expected in each respondent's international transactions assuming PCT were in effect. Only 10 percent predicted a change in their operations. The expected change in one case involved greater reliance on patent protection and less reliance on licensing know-how. Another respondent predicted seeking broader patent protection and commercial application. However, by far the largest number of respondents indicated that they foresaw no alteration in their present international transactions.

FINDINGS

Nearly three years have passed since the first version of the proposed Treaty was published. During the meetings to revise the several drafts many questions and dissents were considered and language was modified to accommodate the points raised. These accommodations produced the current version which, while reasonably acceptable to most U.S. interests, does not appear to have substantial advantages or disadvantages. Certainly the "sample" of innovators responding to this questionnaire are neither disturbed nor enthusiastic. Three items of information developed illustrate the above observation:

- (1) The "cost savings" or "increased costs" which have been debated vigorously are not a significant factor to the men who make, administer or finance inventions. They do not see the financial aspects as influencing their decisions to any degree. This is logical when one recognizes that a company or individual with a commercially significant invention can be expected to seek protection where a potential market exists and where he can hope to obtain substantial rewards either through overseas manufacture, sale or licensing of the patent. The prospect of such reward will weigh far more heavily on his decisions than the slight financial differences, plus or minus, which would come about if the Treaty goes into effect.
- (2) The extension of time for filing from 12 to 20 months is less important than earlier supposed. In the past many have argued that the one feature of the Treaty which makes it valuable to U.S. firms is the eight-month extension over current practice which permits a more careful decision on the value of overseas filing. However, those surveyed in this

study were less impressed. Many indicated that they would have little more factual information upon which to base decisions in a 20-month period than at present. This, as pointed out earlier, may reflect the fact that most of the innovators responding to this questionnaire were individuals or medium-sized firms. Perhaps such persons or companies do not have the management techniques which are used by major firms to appraise the value of their invention in terms of overseas protection.

- (3) The modifications in procedure contemplated did not generate much enthusiasm either. The respondents saw them largely as changes from accepted procedures without embodying significant improvements.

This "lukewarm" evaluation of the claimed advantages of the Treaty does not mean that innovators consider it to be without value. On balance, they may be said to be in favor, but do not see it as providing real savings, simplifying procedures or achieving stronger patents. Perhaps the most significant aspect of the proposed Treaty is that its acceptance would constitute a step along the road to more harmonization of the U.S. patent system with those of other nations. This, as will be recalled, was a major recommendation of President Johnson's Commission on the Patent System. They recommended also that:

... the ultimate goal in the protection of inventions should be the establishment of a universal patent, respected throughout the world, issued in the light of, and inventive over, all of the prior art of the world, and obtained quickly and inexpensively on a single application, but only in return for a genuine contribution to the progress of the useful arts. (*Report of the President's Commission on the Patent System*, page 55.)

One might speculate that if PCT is accepted and proves reasonably satisfactory there will be future drafts designed to move further toward the goal expressed by the Presidential Commission.

APPENDIX

QUESTIONNAIRE

Costs

I

At present foreign patent applications are usually filed by the following procedure:

1. An application is filed in the applicant's home Patent Office.
2. Within 12 months of this filing, individual applications are filed in the foreign countries where patents are desired with translations where necessary and with the respective national filing fees.

Under PCT the following alternative procedure is proposed:

1. A regular national application is filed in the applicant's home Patent Office (country of his residence or nationality).
2. Within 12 months of this filing, an "international application" (Article 3) is filed in the home Patent Office in a language acceptable to an international searching authority (in the U.S. the searching authority would be the U.S. Patent Office, and the language would be English). At the same time, the other countries in which patents are desired must be designated (Article 4)
3. Upon receipt of a search report (Article 18) based on the international application, the applicant may file with an International Bureau, which administers the Treaty, an amendment of the claims of the international application (Article 19).
4. Within 20 months of the original filing, the applicant sends a copy of the international application (with a translation where necessary) to the Patent Offices of the designated countries together with the respective national filing fees (Article 22).

QUESTIONS

How will the alternative procedure proposed by PCT

- (a) Affect your expenses in obtaining patent protection abroad?
- (b) Affect your foreign filing activities?

II

QUESTION

Assuming that the cost of filing through PCT is greater than present costs (due to transmittal, international and designation fees as well as national filing fees), would you nevertheless use the PCT route in order to obtain the benefits of PCT?

Procedural Aspects

III

QUESTIONS

Bearing in mind the explanatory material set forth in item I of this Questionnaire—

- (a) Would the extension of time for filing in other countries from 12 to 20 months after filing at home strongly influence your utilization of PCT?

- (b) How would the proposed PCT affect procedural difficulties for you in obtaining patent protection abroad?

IV

Chapter II of PCT (which is optional) provides for an international patentability examination (novelty, inventive step, industrial applicability) in addition to the international search (Chapter I of PCT). Since, at the present time, the standards of patentability are different in different countries, the advisory opinion of one of the international examining agencies might be different from the opinion of an examining Patent Office in one of the designated countries.

QUESTION

How might this affect your use of Chapter II if this Chapter were included in the Treaty?

V

In addition to PCT, consideration is now being given to an EEC plan (as well as to different patents in other European countries based on the filing and prosecution of a single application, i.e. a European plan). Under the EEC plan a single patent will be granted which will be effective in all six Common Market countries (Belgium, France, West Germany, Italy, Luxembourg, Netherlands) and involve provisions governing matters arising after grant. PCT deals only with part of the pre-grant procedures; the grant and subsequent practice remain under national jurisdiction.

QUESTION

If the EEC and European patent plans would become available, what effect would this have on your utilization of the PCT procedure if PCT became operative too?

Impact on U.S. Patent System

VI

QUESTIONS

If a result of U.S. adoption of the Treaty should be an increase in foreign applications that would be filed in the United States Patent Office and this resulted in some increase in the workload for the Office, some additional production or importation of goods covered by such patents, and a larger number of U.S. patents controlled by foreigners—would any of these results modify

- (a) Your practices in seeking patent protection in the United States?
- (b) Your practices in seeking patent protection in other countries?
- (c) Any other feature of your operations?

VII

At present, the original filing of a patent application in one country and a subsequent filing of a corresponding application in another country within 12 months has the effect only that the second application will have the benefit of the *filing date* of the first application for priority purposes. Under Article 11 (3) of the Treaty draft, the second application will not only have the benefit of the original filing date but will also have the same status in all respects as an application actually filed on the same date in the U.S. However, Article 27 (5) provides that national law, rather than Article 11 (3), will determine the effective date of an international application for prior art purposes as distinguished from priority purposes.

QUESTIONS

- (a) One of the effects of Article 11 (3) is that the one-year grace period provided by U.S. law would, for a foreign applicant who files his international application first, run back from the filing date of the international application rather than from his actual filing date in the U.S. In view of the complaints of foreign applicants that they do not get the same benefit from the year of grace provision as U.S. applicants do, would you be in favor of this provision of PCT which would give this benefit to the foreign applicant?
- (b) Perhaps you have been issued one or more U.S. patents over foreign references or in fields where foreign activity paralleled your own work. If such has been the case, could you advise whether citation of a foreign invention as prior art, using the filing date abroad, would have resulted in a limitation or denial of a claim or claims in your U.S. patent?

Impact on International Business, Including Licensing

VIII

Under the procedure proposed by PCT, it is contemplated that international applications would be searched by one of five agencies: the United States, West German, Japanese and Russian Patent Offices and the IIB (Hague Institute). The international application (including any amendment of the claims as a result of the search report), and a copy of the search report listing the prior art found, would be communicated to the Patent Offices of the designated countries. If any of these Offices are examining Offices, the usual examination for patentability would be made (with the "head start" provided by the international search report) and there might also be a further search. In a non-examining Office, the search report would presumably be placed in the file and the patent granted.

QUESTIONS

- (a) What effect would you consider that this procedure with respect to the international search (pursuant to Chapter I of PCT), particularly in the non-examining Offices, would have on the role of patents in assisting your commercial operations in the respective countries?

- (b) What effect would you consider that the additional procedure with respect to an international patentability examination (see explanatory material set forth in item IV of this Questionnaire concerning Chapter II of PCT) particularly in the non-examining Offices, would have on the role of patents in assisting your commercial operations in the respective countries?

VIII

QUESTION

Assuming PCT were in effect—would you conduct your international transactions, especially those relating to licensing or sale of patents, know-how, etc., differently than at present? If so, please explain.

FORUM

Although the primary purpose of *IDEA* is to communicate the research work of the Institute, it also serves as an educational vehicle for the exchange of informed opinion. The positions taken by the authors of papers and notes in this section are not necessarily those of the Institute. It is hoped that the material published in this section will stimulate researchers to undertake further study of the issues.

International Patent Systems: Aims, Principles, Means

P. O. LANGBALLE*

SYNOPSIS

THIS ARTICLE CONSIDERS the question of whether it would be possible or desirable to combine (1) the International *Application* Procedure defined in the proposed Patent Cooperation Treaty (BIRPI documents PCT/DC/1-5) with (2) the International (European) *Granting* Procedure proposed in the European Patent Convention drafted by the working parties appointed by the governments of the EEC countries.

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BACKGROUND

PROMOTION OF INDUSTRIAL DEVELOPMENT as a means for improving the standard of living of their populations is the basic aim of patent legislation in all countries.

Many countries have recently revised and modernized their patent laws, and others are preparing more or less fundamental changes, but today the most significant feature is no doubt the inter-governmental initiatives for preparing conventions, treaties and agreements providing for the setting up of international patent systems.

The preparation of such instruments as the draft Patent Cooperation Treaty (PCT) providing for an international patent application system, and the draft European Patent Convention (EPC) for the granting of European patents has naturally been assigned to groups of experts appointed by the governments of the sponsoring states, but the ultimate success or failure of these initiatives will obviously depend on the final ratification of the proposals.

It would, of course, be premature to forecast anything about the chances of ratification by a reasonable number of countries, the more so because many important principles and details of the proposals are still under debate. But it would not be unreasonable—and it may indeed be helpful—to consider some of the political and practical aspects which may have a decisive influence on the ultimate result.

From a political point of view it may well be questioned if the advantages offered by the proposed systems will adequately compensate for the necessary concessions and commitments. More particularly, as regards the European countries, it may be asked if it should really be necessary or expedient to envisage the ratification of two international patent systems such as the PCT and the EPC, both purporting to provide for simplification and economy by avoiding duplication of effort at the national level: Would it not be possible and preferable to have one system comprising one international application procedure (of which the European patent application would be a specific feature) and one international granting procedure limited to the countries which would adhere to the EPC?

From a practical and economical point of view it may be asked if it is necessary or desirable to envisage the setting up of an elaborate European Patent Office for the processing of the particular kind of international applications referred to as European patent applications, thereby providing for precisely such duplication of effort (at the

international level) which each of the two systems purports to avoid (at the national level) ?

It would seem that these rather fundamental questions ought to be considered before the final drafting of the two conventions is completed.

Now, it is an indisputable fact that the political issues as regards both the PCT and the EPC differ considerably from one country to another. As regards the PCT there is one situation in the four countries which expect to become "Authorities" (Searching and/or Preliminary Examining Authorities): Germany, Japan, the Soviet Union, and the USA. The advantages offered by the PCT to the citizens of those countries are obvious and need not be restated or elaborated here: Their home applications which would be filed as international applications would be processed by their own national patent offices. There would be quite a different situation in the presumably vast majority of other countries whose citizens would have to depend on one of the said Authorities (or the IIB) for a considerable part of the processing of their applications. It remains to be seen to what extent it will be possible to reconcile this difference (not to say conflict) of interests. In any case, it cannot—and should not—be concealed that strong national interests are closely associated with the *means* envisaged for the operation of the proposed system.

As far as the EPC is concerned, we are again faced with conflicting interests (and here it is correct to say *conflicting*), i.e. the interests attached to the location of the European Patent Office. For obvious reasons Germany attaches the greatest importance to the choice of Munich as "the European Patent Capital" and for similar and equally obvious reasons the Netherlands argues that it should be The Hague. Luxembourg is also a candidate, although the arguments in its favor are perhaps less obvious. Many other countries will probably be reluctant to express any preference, although some of them may have misgivings in regard to a potential dominance of the European patent system by a powerful industrial country. There are many other aspects of conflicting political (and professional) interests which may arise in due course, but these would appear to be the most significant ones.

We are thus faced with a series of problems—political, psychological and professional—which will almost certainly affect the outcome of the precious and admirable work which has so far been invested in the preparation of drafts for international patent systems. The question therefore arises: What can we do about it? Let us try to face it and see if we could approach a reasonable and generally acceptable solution.

ONE GENERAL CONVENTION INCLUDING TWO (OR MORE)
SUB-CONVENTIONS.

Would this be possible—practically and politically? *Practically*, yes. *Politically*, maybe—and maybe not.

From a practical point of view there could hardly be any serious obstacles to amendments of the two draft conventions so as to provide for one international application procedure common to the “PCT-Route” (resulting in a plurality of national applications) and to the applications for European patents to be granted by the European Patent Office (including the grant of unitary EEC patents through the special arrangement provided for in Article 8 of the EPC).

In fact, in their present form, the two proposals PCT and EPC both comprise the following general principles:

- (1) They both relate to international procedures, and both have substantially the same aims (PCT/DC/1, par. 3-7), more particularly they both purport to avoid duplication of effort;
- (2) They both provide for an international novelty search by the International Patent Institute of The Hague although
 - (a) The PCT envisages that this Institute should preferably be one of several International Searching Authorities, whereas
 - (b) The EPC provides that this Institute should make all novelty searches for the European Patent Office;
- (3) They both provide for examination in regard to patentability based on substantially the same criteria (novelty, non-obviousness and industrial applicability) although
 - (a) The PCT provides (Phase II) that this examination shall be *preliminary* and *optional*, whereas
 - (b) The EPC provides that this examination shall be *final* and *compulsory*.

Bearing these similarities and differences in mind, it would seem that the necessary and sufficient requirements for incorporating the two systems into one General Convention would be:

- (1) To substitute the PCT procedure for the application procedure pertaining to European patent applications;
- (2) To provide that Member States adhering to the special EPC arrangement should be bound by Chapter II of the PCT, and that the European Patent Office should be assimilated to an elected Office under the PCT;

- (3) To provide (in the PCT) that the International Patent Institute of The Hague shall be Searching and Examining Authority in respect of all applications for European patents.

It will be observed that although Chapter V, Articles 117 to 123 of the EPC do in fact provide for a certain coordination of the PCT and EPC procedures, these provisions are confined to the establishment of some kind of link between the two otherwise completely independent systems, designed on the one hand to enable an *international* application under the PCT to take the effect of a *European* application (to be subsequently *fully processed* by the European Patent Office) and, on the other hand, to enable a *European* patent application to be used as a basis for an *international* application under the PCT. Thus, although the declared aim of the EPC is to facilitate the *granting* procedure in respect of European patents, it assumes the institution of its own elaborate European application procedure before the European Patent Office.

The practical and economical advantages of the proposed combination of the two systems into one General Convention, the structure of which would be comparable to that of the Paris Convention would be twofold:

- (1) There would be *one set of rules* governing all kinds of international patent applications and hence no duplication of effort.
- (2) The dimensions and functions of the European Patent Office could be substantially reduced.

From a political point of view, on the other hand, there will surely be many objections, and they will naturally be raised by the countries whose ambitions to play a dominant part as PCT Authorities and as "EPC Patent Capital" are at stake. However, even under the two systems as at present envisaged, these conflicting interests are still prevailing, and whether or not such political discrepancies would be more pronounced under the proposed "One-Convention-System" is a question which it may well be worth while to consider.

However this may be—and the forthcoming discussions at the Diplomatic Conference in Washington may perhaps throw some light on this matter—there are still the interests of the remaining countries, which are neither candidates for a PCT Authority nor for the EPC Patent Capital, to be considered. More particularly, as regards some of these countries which envisage adhering to both the PCT and the EPC and which have already stated their preference for a centralized

searching authority (the International Patent Institute), would it be unreasonable to expect that such countries would prefer the simplified solution of the "One-Convention-System"? Surely these countries, when faced with the question of the location of the European Patent Office, could hardly wish to have the European patent system dominated either by Munich or The Hague. Would it not be more attractive to such countries to envisage the location of a comparatively small, inexpensive and yet efficient European Patent Office in a neutral country like Luxembourg which, at the patent level, would be the European equivalent to Washington D.C. which was selected as an extraterritorial capital of the United States precisely to avoid giving preference to any of the then existing States?

Let us not forget that we are dealing here with "the shape of things to come" and that the modern approach to research of the future is to start with the ideal at which we are aiming and to devise ways and means for attaining it rather than with an extrapolation of the present.

A Multiple Patent Proposal

HAROLD L. MARQUIS*

INTRODUCTION

THE UNITED STATES PATENT SYSTEM grants a patent to the first inventor even though he may not be the first to file a patent application.¹ A complex interference procedure has been established to determine priority between two or more persons who claim the same patentable invention.² Priority is awarded to the inventor who is the first to conceive the invention and reduce it to practice.³ However, the party who is the first to conceive, but not the first to reduce to practice, is awarded priority if he is "diligent in working to obtain his later-achieved reduction to practice continuously from a time just before his opponent's conception until his reduction to practice."⁴

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¹ Patents, 35 U.S.C. § 102 (g) (1964).

² Rules of Practice in Patent Cases, 37 C.F.R. §§ 1.201-286 (1967). (Hereinafter cited as Patent Office Rule —, which is standard patent practice usage).

³ Patents, 35 U.S.C. § 102 (g) (1964).

⁴ Floyd H. and Maurice A. Crews, "Introduction to Interference Law and Practice," *JPOS*, Vol. 46 (1964), p. 755 at p. 762.

Conception refers to "the complete performance of the mental part of the inventive act,"⁵ while reduction to practice is "proving by demonstration the practical usefulness of the invention."⁶ The inventions are presumed to have been made in the chronological order of the filing dates of the patent applications,⁷ which means that the junior party (the last to file) must prove he made the invention prior to the filing date or any earlier proven invention date of the senior party. The question of priority of invention is determined by the Board of Patent Interferences (three examiners),⁸ with a right of appeal to the Court of Customs and Patent Appeals⁹ or, at the election of either party, by a suit in the appropriate district court.¹⁰ Interference procedure is similar to civil trial procedure except that the proceedings are usually conducted by correspondence and the witnesses do not testify in the presence of the Board of Patent Interferences, but rather by deposition on oral examination¹¹ with a right of cross-examination.¹² It is the purpose of this article to analyze various patent priority systems and to propose a new solution.

CRITICISM OF INTERFERENCE PROCEDURE

Criticism of the patent interference system¹³ culminated in the proposals of the President's Commission on the Patent System¹⁴ and in the Patent Reform Act of 1967¹⁵ (unenacted) to replace the

⁵ *Townsend v. Smith*, 36 F.2d 292, 295 (C.C.P.A. 1929).

⁶ *Crews and Crews*, *supra* note 4, at p. 768.

⁷ Patent Office Rule 257.

⁸ Patents, 35 U.S.C. § 135(a) (1964).

⁹ Patents, 35 U.S.C. § 141 (1964).

¹⁰ Patents, 35 U.S.C. § 146 (1964).

¹¹ The testimony of witnesses is taken by deposition on oral examination unless the parties agree to use affidavits or stipulations as to testimony. Patent Office Rule 272.

¹² Patent Office Rule 273.

¹³ A number of articles in recent years have criticized the patent interference system and suggested reforms. See, e.g., *Crews & Crews*, *supra* note 4; Daniel V. De Simone, James B. Gambrell, and Charles F. Gareau, "Characteristics of Interference Practice," *JPOS*, Vol. 45 (1963), p. 503; George E. Frost, "Some Possibilities and Limitations of Patent Interference 'Reform,'" *PTC J. Res. & Ed. (IDEA)*, Vol. 7, No. 2 (Summer 1963), p. 162; Stephen D. Kahn, "The First-to-File Priority System: Possibilities and Problems," *IDEA*, Vol. 12, Nos. 2-3 (Summer-Fall 1968), p. 944.

¹⁴ *Report of the President's Commission on the Patent System* (Washington, D.C.: G.P.O. 1966), p. 5.

¹⁵ S. 1042, 90th Cong., 1st Sess. (1967); H.R. 5924, 90th Cong., 1st Sess. (1967). These identical bills were introduced by the Administration in both houses on

present interference system with a first-to-file system. Under a first-to-file system, "when two or more persons separately apply for a patent on the same invention, the patent would issue to the one who is FIRST TO FILE his application."¹⁶ The President's Commission was critical of interference procedure on grounds it is expensive to the parties, results in delays in the issuance of patents, and is no more equitable than a first-to-file system.¹⁷

Cost studies have demonstrated that interferences can be expensive to the parties involved. The American Society of Inventors estimated that the average cost for an interference was about \$5,000 per party.¹⁸ In contrast, a survey of a small sample of universities and medium-sized and small-sized firms reported a cost range of from \$300 to \$40,000, with a majority of the interferences costing less than \$5,000 per party.¹⁹ As with other types of litigation, the cost varies depending upon the stage at which the litigation is terminated. Interferences in which testimony is taken can be very expensive,²⁰ while the costs may be low if a party relies upon his filing date. Small firms and independent inventors are less able to bear the high cost of interferences than the large corporations.

A statistical study by De Simone, Gambrell and Gareau of interference proceedings during the 1950-60 decade disclosed that the average time from the declaration of an interference to its termination was nearly one and one-half years.²¹ The average duration ranged from about 15 months for interferences in which no testimony was taken to about two and one-half years when testimony was taken.²² There have been instances of delay of a decade or more in the issuance of a patent due to interference proceedings.²³ The delay problem becomes acute

the same day.

¹⁶ *Supra* note 14, at p. 5.

¹⁷ *Id.*, at p. 6.

¹⁸ *Hearings on Patent Law Revision Before the Subcommittee on Patents, Trademarks and Copyrights of the Senate Committee on the Judiciary*, 90th Cong., 1st Sess., pt. 1, at p. 291 (1967) [hereinafter cited as *1967 Senate Hearings*].

¹⁹ Henry Van Arsdale, "Mistaken Assumptions on the High Cost of Interference," *IDEA*, Vol. 12, No. 4 (Winter 1968-1969), p. 1099 at p. 1104.

²⁰ Kahn, *supra* note 13, at p. 958.

²¹ De Simone, Gambrell & Gareau [hereinafter cited as De Simone *et al.*], *supra* note 13, at p. 524 (Table 1.10b; based on a random sample).

²² *Id.*, at p. 526 (Table 1.11a; based on a random sample).

²³ George E. Frost, "The Patent System and the Modern Economy," *Senate Study No. 2*, 84th Cong., 1st Sess., p. 67 (1957). The issuance of the patent on the automatic choke for automobile engines was delayed for over 20 years by interference proceedings. *Hearings on the American Patent System Before the Subcommittee on Patents, Trademarks, and Copyrights of the Senate Committee on the Judiciary*, 84th Cong., 1st Sess., p. 287 (1956).

when the delay caused by interferences is added on to the delay involved in the examination of patent applications.²⁴ The delay caused by interferences is not only expensive to the parties, but results in an unsettled industrial situation²⁵ which smaller firms are less able to withstand. The cost and delay involved in interferences is partially attributable to the complexity of interference procedure.²⁶

Interference procedure has been criticized as being rigid and inflexible,²⁷ which may prevent the "true" first inventor from obtaining a patent. Each party to an interference must have proper support in his patent application to make the interference "count" as a claim.²⁸ There have been horrible examples of parties who have lost interferences because of their failure to meet trivial language in the "count."²⁹

Testimony in interferences is taken by deposition on oral examination or, if the parties agree, by affidavit.³⁰ Consequently, the Board of Patent Interferences make their decision on the basis of a transcript³¹ without the benefit of seeing or hearing the witnesses. The law attempts to compensate for this deficiency³² by requiring as a positive rule that the testimony of the inventor be corroborated by independent first-hand testimony of other witnesses on all elements of proof.³³ The corroboration rule applies both to the oral testimony of the inventor and any physical exhibits on which he testifies.³⁴ Except as to conception, the corroborating testimony cannot rely upon the inventor's notebooks or communications as they are regarded as self-serving.³⁵ The rule is especially onerous because general corrobora-

²⁴ Kahn, *supra* note 13, at p. 957. A random sample of interference proceedings disclosed that the average time between the filing date of the senior party and the termination date of the interference was in excess of five years. De Simone *et al.*, *supra* note 13, at p. 525. (Table 1.10c.)

²⁵ Maurice A. Crews, "Interference Practice and the New Rules," *JPOS*, Vol. 48 (1966), p. 411 at p. 415.

²⁶ See Patent Office Rules 201-286. The interference procedure is about as complex as trial procedure. There would appear to be less justification because interference procedure is concerned with only one issue—priority of invention.

²⁷ Frost, *supra* note 13, at p. 176.

²⁸ Patent Office Rule 203.

²⁹ Frost, *supra* note 13, at p. 170.

³⁰ Patent Office Rule 272.

³¹ Patent Office Rules 253-59, 271-78.

³² See Kahn, *supra* note 13, at pp. 958-62 for a thorough discussion of this problem.

³³ *George v. Karsel* 111 F.2d 148 (C.C.P.A. 1940); *Weber v. Good*, 129 USPQ 32 (Patent Office Board of Patent Interferences 1960).

³⁴ Crews & Crews, *supra* note 4, at p. 767.

³⁵ *Senkus v. Johnston*, 166 F.2d 597, 599 (C.C.P.A. 1948); Crews & Crews, *supra*

tion testimony is not sufficient,³⁶ but the testimony must be a complete factual report based on physical observation of all acts of invention.³⁷ If an inventor hopes to prove an invention date prior to his filing date, he must bring others into his full confidence in the course of making an invention.³⁸ All details of the invention must be explained to them,³⁹ preferably recorded, signed and dated by the inventor and his witnesses. Some inventors are reluctant to disclose their inventions to others prior to filing a patent application⁴⁰ and may fail to prepare adequate records of inventorship. Kahn commented that "The rule of corroboration establishes a rigid bar likely to trap only the innocent, independent inventor who does not have the help and advice or the particular knowledge that is available to the corporate employee and would be known by anyone intent on falsifying evidence."⁴¹

The statistical study by De Simone *et al.*⁴² indicates that the parties have not encountered the difficulty of proof as was commonly thought. The parties were able to prove conception in over 80 percent, reduction to practice in nearly 50 percent and diligence in about 10 percent of the cases terminated by a priority judgment in which these concepts were in issue.⁴³ The conception date proved was the same date as alleged in over 40 percent of the cases, with an additional 28 percent of the parties proving a conception date within 90 days of the one alleged.⁴⁴ The reduction to practice date proved was the same date as alleged in approximately 45 percent of the cases with 25 percent proving a reduction to practice date within 90 days of the one alleged.⁴⁵ This study does not break down the success on the basis of different arts (*e.g.*, mechanical and chemical); one would expect that the success rate was lower in the chemical field. These statistics do not include the parties who do not attempt to prove an earlier invention date, a portion of whom are dissuaded by the corroboration rule.

note 4, at p. 790.

³⁶ Crews & Crews, *supra* note 4, at p. 768.

³⁷ 2 Wikstrom, *Patent Interference Practice* § 12.08 [8] at p. 1428 (1965).

³⁸ Crews & Crews, *supra* note 4, at p. 757.

³⁹ *Id.*

⁴⁰ *Id.*, at p. 758.

⁴¹ Kahn, *supra* note 13, at p. 962. The Court of Customs and Patent Appeals seems to be relaxing the corroboration rule a bit, *See Berry v. Webb*, 412 F.2d 261 (C.C.P.A. 1969).

⁴² De Simone *et al.*, *supra* note 13.

⁴³ *Id.*, at p. 570 (Table 4.8; based on a random sample).

⁴⁴ *Id.*, at p. 571 (Table 4.9; based on a random sample).

⁴⁵ *Id.* (Table 4.10; based on a random sample).

One complaint commonly voiced against interference proceedings is that the rules permit the senior parties to win a much larger percentage of interferences than they deserve to win. According to the De Simone *et al.* study, the junior parties won only 27 percent of the priority judgments.⁴⁶ Statistics of this sort have given credence to the charge, but a further breakdown paints a different picture. The junior parties won about 45 percent of the priority judgments in interferences where testimony was taken.⁴⁷ This difference is not surprising as the early stage of interference proceedings are designed to determine if the junior party has a *prima facie* claim to an earlier invention date.⁴⁸ Indeed, the junior party cannot take an interference to the testimony stage unless he can overcome the senior party's filing date.⁴⁹ Since each party is informed of his opponent's evidence prior to the testimony stages, he is not likely to spend money in taking testimony unless he believes his evidence is sufficient to establish priority. In some instances a party may take testimony in an interference involving a commercially important invention on the outside chance of winning, or to improve his bargaining position in license negotiations, or to delay the issuance of the patent so he can continue marketing the product for a time without infringing.

The De Simone *et al.* study reveals that senior parties are only slightly more successful than junior parties in proving conception and reduction to practice dates.⁵⁰ This comparison has to be tempered by

⁴⁶ *Id.*, at p. 521 (Table 1.6; based on all interferences declared).

⁴⁷ *Id.* (Table 1.8; based on all interferences declared).

⁴⁸ Kahn, *supra* note 13, at p. 955.

⁴⁹ Each party to an interference is required to file a preliminary statement setting forth the claimed invention dates and supporting facts. Patent Office Rule 215. If the junior party fails to overcome the filing date of the senior party, judgment will be entered against the junior party without taking any testimony. Patent Office Rule 225.

⁵⁰ DeSimone *et al.*, *supra* note 13, at p. 570 (Table 4.8; based on a random sample). The junior parties proved conception in 77% of the two party cases in which it was in issue compared with 86% for the senior parties. The junior parties proved reduction to practice in 47% of the cases in which it was in issue compared with 54% for the senior parties. None of the senior parties proved diligence, while 13% of the junior parties were successful in cases where this was in issue. The junior and senior parties had nearly identical success in proving the same conception date as alleged. The junior parties were able to prove the same conception date alleged or one within 90 days thereof in 72% of the cases, while the senior parties were successful in 68% of the cases. The senior parties proved the same reduction to practice date as alleged in 55% of the cases compared to 42% for the junior parties. The junior parties proved the same reduction to practice date as alleged or one within 90 days thereof in 69% of the cases, while the senior parties were successful in 75%.

the higher percentage of interferences either lost or abandoned by junior parties prior to taking testimony.⁵¹

Kahn has correctly observed that abolishing the interference procedure for a first-to-file system would deprive over one thousand first inventors per decade of patents they deserve,⁵² assuming that the present procedure is fairly accurate in determining who is the first inventor. While the statistics on interferences dispel some of the myths about interferences, they cannot answer the basic questions of the fairness of the first inventor concept and whether the interference procedure should be modified or abolished.

It is interesting that there has been so much controversy about interferences since only about one percent of the patent applications filed become involved in interferences.⁵³ There are approximately 500 interferences declared per year,⁵⁴ which is a small amount of litigation considering the number of patents issued⁵⁵ and the commercial importance of the patent system. However, the significance of interferences to society should not be measured by the small number declared, but by the number of commercially important inventions involved.⁵⁶ It has been suggested that a higher percentage of important inventions become involved in litigated interferences,⁵⁷ which may explain the controversy over the system.

POSSIBILITIES OF MODIFYING INTERFERENCE PROCEDURE

The Patent Office has modified some of its rules and policies in recent years in an effort to limit the number of interferences where the junior party's claim is weak. It instituted a policy in 1964 of not

⁵¹ Senior parties win about 72% of the priority judgments rendered in interferences. *Id.*, at p. 521 (Table 1.6; based on all interferences).

⁵² Kahn, *supra* note 13, at p. 956.

⁵³ 1967 Senate Hearings 118 (Testimony of the Acting Under Secretary of Commerce.) The percentage for the 1956-62 period was nearly identical to that prevailing after 1962. De Simone, *et al.*, *supra* note 13, at p. 516 (Table 1.3; based on all interferences declared).

⁵⁴ Hearings on General Revision of the Patent Laws Before Subcommittee No. 3 of the House Committee on the Judiciary, 90th Cong., 2d Sess., ser. 11, pt. 2, at p. 601 (1968) [hereinafter cited as 1967-1968 House Hearings, pt. 2]. (Testimony of Commissioner of Patents).

⁵⁵ Utility patents are currently being issued at the rate of nearly 70,000 per year. Patent Office, U.S. Dep't of Commerce, *Official Gazette* (1969) (weekly publication containing abstracts of all patents issued that week).

⁵⁶ 1967-68 House Hearings, pt. 1, at p. 319. (Testimony of representative of Patent, Trademark, and Copyright Law Section of the ABA.)

⁵⁷ *Id.*

declaring an interference between applications involving inventions of a simple nature where there is a difference of more than three months in filing dates or for more complex inventions where the filing date difference is more than six months, other than in exceptional situations.⁵⁸ The practical significance of not declaring an interference between conflicting patent applications is that a patent is issued to the senior party. While this policy reduces the interferences that would otherwise be declared between patent applications, it has resulted in an increase in the number of interferences between applications and patents,⁵⁹ as the junior party has a right to provoke an interference within one year from the issuance of the patent.⁶⁰ Nevertheless, the patented invention enters the public domain earlier under this policy than if the issuance had to await the outcome of an interference. As the junior party cannot delay the issuance of a patent to the senior party by participating in the interference, he is less inclined to provoke an interference unless he has a good chance to win. In order to relieve a patentee of the burden of going through an interference with a junior party applicant who does not have a justiciable case,⁶¹ the Patent Office promulgated Rule 204 (c).⁶² Under this rule, before an interference will be declared between a patent and an application with a filing date more than three months subsequent to the patent, the applicant must file affidavits by himself and at least one corroborating witness setting out facts *prima facie* entitling him to an award of priority.⁶³ If the applicant's filing date is subsequent to the patentee's filing date by three months or less, the applicant need only file an affidavit that he made the invention before the filing date of the patentee.⁶⁴ This rule also tends to discourage an applicant from provoking an interference with a patent unless he has a good case.

There have been numerous proposals to speed the issuance of patents involved in interferences. Frost recommended issuing patents to all the parties involved in an interference immediately after a

⁵⁸ Patent Office, U.S. Dep't of Commerce, *Manual of Patent Examining Procedure* § 1101.01 (3d ed. 1961, rev. 1969).

⁵⁹ Crews, *supra* note 25. The junior party must file an affidavit under Patent Office Rule 204 that he can overcome the filing date of the patentee before an interference is declared.

⁶⁰ Patents, 35 U.S.C. § 135 (b) (1964).

⁶¹ *Supra* note 25.

⁶² Patent Office Rule 204 (c).

⁶³ If the affidavits do not provide a sufficient basis for overcoming the patentee's filing date, the Board is to render a summary judgment against the applicant. Patent Office Rule 228.

⁶⁴ Patent Office Rule 240 (b).

decision on interference motions, with the question of priority to be decided later.⁶⁵ The date of decision on interference motions was selected for the issuance of patents because many interferences are terminated prior to this time. This approach would minimize the hardship caused by delays in the issuance of patents, but might cause confusion through the issuance of conflicting patents. Priority among these patents would still need to be determined by conventional interference procedure.

Many years ago a patent attorney suggested that a patent be issued as a matter of course to the first-to-file a patent application, the patent to be contingent upon litigation in district court if the junior party could convince the Patent Office by affidavits and exhibits that he had completed the invention prior to the senior party's filing date.⁶⁶ Not only would this litigation be expensive and result in delay, but the period of uncertainty over patent rights would remain. In response to the Johnson Administration's first-to-file plan, the Philadelphia Patent Law Association proposed that a patent should be issued to the first-to-file, but would permit a junior party to provoke an interference within one year of the issuance of the patent to the first-to-file.⁶⁷ A bill backed by the patent section of the American Bar Association contained a similar proposal, but reduced the period for provoking an interference to six months from the publication of an allowed application.⁶⁸ The Administration opposed this proposal as presented on grounds that there would be no more incentive to file promptly than under the present system,⁶⁹ but succumbing to a strong attack on its first-to-file plan substituted a "modified first-to-file" plan incorporating the ABA proposal.⁷⁰ The "modified first-to-file" label is a misnomer since interference proceedings were to be retained. In spite of the

⁶⁵ Frost, *supra* note 23, pp. 68-69.

⁶⁶ James A. Watson, "Defects of Interference Practice and a Proposed Remedy," *IDEA*, Vol. 11, No. 3 (Fall 1967), p. 449 at pp. 456-57. (Written prior to 1929, but published posthumously.)

⁶⁷ 1967 *Senate Hearings* at pp. 265-66.

⁶⁸ S. 2597, 90th Cong., 1st Sess. § 137 (1967); H.R. 13951, 90th Cong., 1st Sess. § 137 (1967) (identical bills). These bills were backed by the ABA, but were not enacted 1967-68 *House Hearings*, pt. 2, at p. 425.

⁶⁹ 1967-68 *House Hearings*, pt. 2, at p. 523. (Testimony of Commissioner of Patents.)

⁷⁰ *Id.*, at p. 524. Under the "modified first-to-file" proposal, an interference would be declared only when the junior party's filing date was within one year of that of the senior party. In addition, a party could only obtain the benefit of an invention date which is "no earlier than 1 year prior to his earliest public act or earliest effective filing date, whichever came first." *Id.* These provisions were designed to encourage early filing of patent applications.

proposed compromise, no patent reform legislation was enacted. Enactment of the "modified first-to-file" system should reduce the number of interferences, as the onus of initiating an interference would be on the junior party. Unfortunately, any inequities inherent in the interference system would remain.

Earlier filing of patent applications would be encouraged and the number of interferences reduced by limiting the period prior to filing in which a party could obtain the benefit of earlier proven conception and reduction to practice dates. If a party were only granted the benefit of a conception date that was no more than one year prior to his filing date, either a significant percentage of the present interferences would be eliminated or inventors would file their applications earlier.⁷¹ In addition, a senior party with a filing date nearly one year prior to the junior party would have an easy time winning an interference.⁷² A bill introduced by Senators Dodd and Ribicoff⁷³ adopted a proposal of the American Chemical Society⁷⁴ that a party be limited to reliance upon conception and reduction to practice dates not more than two years prior to his filing date. The Administration accepted this approach as part of its "modified first-to-file" plan, but reduced the period to one year.⁷⁵ The American Chemical Society believed that one year was too short a period because of the long development time required for many inventions.⁷⁶ Of course, a year limitation would apply equally to all parties, and hence should not be productive of many inequities. As a part of its "modified first-to-file" plan, the Administration proposed that a party not be granted the benefit of a conception or reduction to practice date that was more than one year prior to his earliest "public act."⁷⁷ These "public acts"

⁷¹ According to a statistical study of interferences declared during the 1950-60 decade, only 13% of the junior parties and 46% of the senior parties alleged conception dates within one year of their filing dates, while 31% of the junior parties and 68% of the senior parties alleged reduction to practice within the one-year period. De Simone *et al.*, *supra* note 13, at pp. 579-80 (Tables 4.19-4.20; based on random sample). A portion, but not all, of those interferences involving a party alleging a conception date more than a year prior to his filing date would be eliminated by such a limitation. The percentage would likely be reduced by adopting such a system, as inventors would be stimulated to file their applications within one year of conception.

⁷² 1967-68 *House Hearings*, pt. 2, at p. 599. (Testimony of Commissioner of Patents.)

⁷³ S. 1691, 90th Cong., 1st Sess., § 135 (e) (1967); H.R. 7454, 90th Cong., 1st Sess., § 135 (e) (1967). (Identical unenacted bills.)

⁷⁴ 1968 *Senate Hearings*, p. 531.

⁷⁵ 1967-68 *House Hearings*, pt. 2, at p. 524.

⁷⁶ 1968 *Senate Hearings*, p. 531.

⁷⁷ 1967-68 *House Hearings*, pt. 2, at p. 524. The Administration also proposed

include public use, sale and publication anywhere in the world. Thus, under the Administration's "modified first-to-file" plan, a party to an interference could only obtain the benefit of a conception or reduction to practice date that was no more than one year prior to the earlier of his filing date or first public act. Enactment of this plan would stimulate early filing, but might not greatly reduce the number of interferences or their complexity.

One study of the Patent Office recommended awarding priority to the first inventor to reduce his invention to practice (either actual or constructive), but not permit a party to prove reduction to practice more than two years prior to his filing date.⁷⁸ This approach would eliminate the need to prove diligence in the few cases where it is an issue. Diligence is difficult to prove and involves costly testimony. Adopting this proposal, but reducing this period to one year would be a significant move to encourage earlier filing of patent applications and would tend to reduce the number of interferences and simplify the remaining interferences.

As a part of the "modified first-to-file" proposal, the Administration proposed that interferences should be declared only where the junior party's filing date is within one year of the senior party's date.⁷⁹ Enactment of this proposal would eliminate from 25 to 31 percent of the interferences presently declared, since 69⁸⁰ to 75⁸¹ percent of the interferences are between applications with filing dates less than one year apart. This large amount of a reduction in the number of interferences might not be achieved as inventors would be spurred to file patent applications earlier. Nevertheless, the rule seems desirable in that it would eliminate some interferences and encourage diligence in filing.

that a party to an interference be required to prove diligence from the conception date they rely upon until the earliest filing date or "public act." *Id.* Under present law only a party who is the first to conceive, but is not the first to reduce to practice, needs to prove diligence. Patents, 35 U.S.C. § 102(g) (1964). He must prove diligence from "a time just before his opponent's conception until his reduction to practice." Crews & Crews, *supra* note 4, at p. 762. While this proposal would stimulate earlier filing, it would further complicate interference proceedings.

⁷⁸ Subcommittee on Patents, Trademarks, and Copyrights of the Senate Committee on the Judiciary, *1961-62 Management Survey of the U.S. Patent Office*, 87th Cong., 2d Sess., p. 57 (Comm. Print 1962). (Report prepared for Department of Commerce by a task force headed by former FTC Commissioner Kintner.)

⁷⁹ 1967-68 *House Hearings*, pt. 2, at p. 524.

⁸⁰ De Simone *et al.*, *supra* note 13, at p. 540. (Table 2.3b; based on random sample of interferences declared during the 1950-60 decade.)

⁸¹ 1967-68 *House Hearings*, pt. 2, at p. 599. (Testimony of Commissioner of Patents.) (Based on interferences declared in the mid-1960's).

In order to cut expenses, Bierman proposed that evidence be submitted by affidavit rather than by deposition on oral examination.⁸² Since the Board of Patent Interferences neither sees nor hears the witnesses, depositions may not provide a much better basis for judging credibility of witnesses than affidavits.⁸³ While an adverse party has a right of cross-examination in the taking of a deposition, he may be less inclined to exercise the right than in court litigation because of the expense and its reduced impact on the Board who neither sees nor hears the witnesses testify. A change to the use of affidavits need not be a final bar to cross-examination if the party who loses before the Board retains the present right to a trial before the district court where the right to cross-examination can be exercised in the presence of the decision-making body.⁸⁴ One other approach to the elimination of the deposition and also of the corroboration rule is for the Patent Office to use hearing examiners to hear witnesses testify and render an initial decision.⁸⁵ Any party dissatisfied with the initial decision could appeal to the Board and then to the courts as with decisions by other administrative agencies. Statistical information on the extent of cross-examination in the taking of depositions and its impact upon the Board's decisions would aid in evaluating those proposals.

Closely related to the manner of submitting evidence to the Board of Patent Interferences is the procedure established for review of Board decisions. A party dissatisfied with a Board decision may, at his option, either appeal to the Court of Customs and Patent Appeals⁸⁶ or institute a civil action in district court.⁸⁷ The Court of Customs and Patent Appeals is limited to reviewing the evidence produced before

⁸² Harry C. Bierman, "Simplified Interference Practice," *IDEA*, Vol. 11, No. 3 (Fall 1967), p. 345 at 349. Evidence may be submitted by affidavit under the present rules with the consent of both parties. Patent Office Rule 272 (c).

⁸³ See Kahn, *supra* note 13, at pp. 961-62. The authors of a study of the Patent Office thought that a change to the use of affidavits in place of depositions should be viewed with caution because of the value of cross-examination in developing facts. *Supra* note 78, p. 59.

⁸⁴ Patents, 35 U.S.C. § 141, 146 (1964).

⁸⁵ Federal administrative agencies are authorized to use hearing examiners, *Government Organization and Employees*, 5 U.S.C. § 3105 (Supp. IV, 1965-68). The hearing examiner may render either an initial or recommended decision. Administrative Procedure Act § 8, 5 U.S.C. § 557 (Supp. IV, 1965-68). This is a technical distinction, as the Board has "all the powers which it would have in making the initial decision." *Id.*

⁸⁶ Patents, 35 U.S.C. § 141 (1964).

⁸⁷ *Id.*, § 146. If appellant appeals to the Court of Customs and Patent Appeals, the adverse party may demand that the appellant institute the proceeding in the appropriate district court. *Id.*, § 141.

the Patent Office,⁸⁸ while the parties are permitted to introduce any relevant and competent evidence in the district court even though the evidence was not submitted to the Patent Office.⁸⁹ Interference procedure before the Board could be improved and greater uniformity in decisions obtained if a dissatisfied party did not have alternative routes of review available.⁹⁰ There would be less objection to the use of affidavits before the Board if review were before the district court where the credibility of the affiant could be adequately tested. On the other hand, if review were limited to appeal on the record to the Court of Customs and Patent Appeals, there is greater need for an adequate method of testing credibility of witnesses before the Board. Requiring the witnesses to testify before the Board would increase the cost of interferences. The use of affidavits is not justifiable if review is limited to appeal on the record to the Court of Customs and Patent Appeals because the parties would not have the right of cross-examination at any time. Limiting review to the Court of Customs and Patent Appeals may be justified if the Patent Office uses hearing examiners in interferences. The procedure of the Administrative Procedure Act could be followed by granting the Board discretion either to review on the record or permit the introduction of evidence.⁹¹ This discretion would permit the Board to accept the decisions of examiners in whom they had confidence, but to decide a case on the merits when they had doubts about the examiner's decision.⁹²

While the basic complaints of expense, delay and inequitable results can be reduced by modifying the interference system, they cannot be eliminated by modification as they are inherent in litigation systems. Recognition of this central fact has prompted proposals to abolish the interference system in favor of a first-to-file system.⁹³

⁸⁸ *Id.*, § 144 (1964).

⁸⁹ *Id.*, § 146.

⁹⁰ Kahn, *supra* note 13, at p. 963. Limiting review to appeal to the Court of Customs and Patent Appeals should reduce delay. Delays occur because a party can bring suit in the district court where new evidence may be introduced. In a study of the patent system, Frost suggested that decisions of the Board of Patent Interferences be reviewed on the record by the appropriate court of appeals as decisions of the FTC and other administrative agencies are reviewed. Frost, *supra* note 23, p. 69. However, the Court of Customs and Patent Appeals may be able to do a better job because of their expertise.

⁹¹ Administrative Procedure Act § 8, 5 U.S.C. § 557 (Supp. IV, 1965-68), the Board would have "all the powers which it would have in making the initial decision except as it may limit the issues on notice or by rule." *Id.*

⁹² See Davis, *Cases on Administrative Law* 210 (1965 ed.).

⁹³ *Supra* note 14, at p. 6.

FIRST-TO-FILE SYSTEM

In response to the 1966 Report of the President's Commission on the Patent System, the Johnson Administration sponsored the Patent Reform Act of 1967 (unenacted), which would have abolished the present interference procedure in favor of a first-to-file system.⁹⁴ The first-to-file proposal provoked the most severe criticism from the Patent Bar and industry of any provision of the Patent Reform Act.⁹⁵

The President's Commission asserted that a first-to-file system would "encourage prompt disclosure of newly discovered technology."⁹⁶ By its very nature a first-to-file system encourages inventors to race to the Patent Office in the filing of patent applications immediately upon completion of the invention.⁹⁷ The large companies may have a greater advantage over independent inventors and small firms in such a race than under the present interference system.⁹⁸ Patent attorneys would be under considerable pressure from inventors to file their applications immediately and could incur liability for delay. The emphasis upon haste in filing would certainly have an adverse effect upon the quality of patents and the extent of the disclosure. Consequently, the first-to-file system as presented may place too great a premium upon early filing of patent applications.

To ensure prompt dissemination of information disclosed in patent

⁹⁴ S. 1042, 90th Cong., 1st Sess., § 102 (b) (1967); H.R. 5924, 90th Cong., 1st Sess., § 102 (b) (1967) (identical bills). Section 102 (b) provides that a person shall not be entitled to a patent if "the subject matter sought to be patented was disclosed in a published United States application, or United States patent, having an effective filing date on or before that of the application for patent for the subject matter sought to be patented unless such application for patent is filed by the same applicant and is filed prior to the publication date of such prior published United States application."

⁹⁵ See, e.g., S. Delvalle Goldsmith, "The United States Patent System: Has It Come to the End of the Line?," *IDEA*, Vol. 11, No. 3 (Fall 1967), p. 333.

⁹⁶ *Supra* note 14, at p. 6.

⁹⁷ There is a race to the Patent Office in countries with a first-to-file system. Goldsmith, *supra* note 95, at p. 336. In a survey of executives of several medium-sized companies, conducted by The PTC Research Institute, the majority thought that patent applications would be filed earlier under a first-to-file system. Medium-sized companies in this survey were defined as employing not more than 1,000 persons, but having annual sales of at least \$1 million. Firms with recent experience in patent ownership were picked for the survey. Irving H. Siegel and Gideon Schmuckler, "Executive Views on Presidential Commission's Patent Recommendations: Medium-Sized Companies," *IDEA*, Vol. 12, No. 1 (Spring 1968), p. 617 at p. 620.

⁹⁸ See *Hearings on Patent Law Revision Before the Subcomm. on Patents, Trademarks, and Copyrights of the Senate Comm. on the Judiciary*, 90th Cong., 2d Sess., pt. 2, at p. 530 (1968).

applications, the Patent Reform Act required that pending applications be published within 18 to 24 months of their earliest filing date.⁹⁹ Present law requires the Patent Office to keep patent applications secret until the patent is issued,¹⁰⁰ which may be several years after the filing of the application. Earlier publication enables the scientific community to build upon the inventor's advance and avoid duplication of effort. Competitors learn of the inventor's rights at an earlier date, which aids them in making business decisions.

While a first-to-file system would result in earlier filing and publication of patent applications, firms would likely tighten security precautions prior to filing due to increased fear of derivation of their invention.¹⁰¹ Although the inventor would have a cause of action against the derivator, he may be less likely to learn of the derivation than under the present system where an interference would automatically be declared. However, an inventor would be more inclined to discuss his invention after filing an application under a first-to-file system because priority is decided solely on the basis of filing dates.

The President's Commission believed that a first-to-file system would "substitute for the delays and expense of interference proceedings a fair and inexpensive means by which an inventor can establish priority."¹⁰² The Commission argued that it was as "equitable to grant a patent to the first-to-file as to the one who wins an interference" because the "first to file is more apt to be the inventor who first appreciated the worth of the invention and promptly acted to make the invention available to the public."¹⁰³ While the first-to-file is obviously the least expensive system possible, it may not be as fair as the interference system. Of course, inventors could adjust to this system as they have to the interference system.¹⁰⁴

Goldsmith suggested that the first-to-file system is equitable because

⁹⁹ S. 1042, 90th Cong., 1st Sess., § 123(a) (1967); H.R. 5924, 90th Cong., 1st Sess., § 123(a) (1967) (identical bills).

¹⁰⁰ Patents, 35 U.S.C. § 122 (1964).

¹⁰¹ In a survey of executives of several medium-sized companies, the majority indicated that companies would tighten security precautions if a first-to-file system were adopted. Siegel and Schmuckler, *supra* note 97, at p. 619. Adoption of a first-to-file system would likely result in inventors being more reluctant to discuss their inventions with customers and investors prior to filing a patent application. Donald Banner, "The Recent Proposal to Change the United States Patent System," *Ohio State Law Journal*, Vol. 29 (1968), p. 873 at p. 878.

¹⁰² *Supra* note 14, at p. 6.

¹⁰³ *Id.*

¹⁰⁴ Independent inventors and corporate laboratories have adjusted to the interference system by maintaining records of conception and reduction to practice and securing corroboration of them.

scientific priority is decided on a first-to-file basis since priority is generally accorded by scientific publications on the basis of the date of receipt of the article.¹⁰⁵ However, the scientific journals are not organized to conduct interference proceedings, so that the date of receipt is the simplest method to decide priority. Furthermore, the granting of patent rights should be more seriously regarded because large sums of money are often at stake.

From a practical standpoint, the United States presently has a first-to-file system as to inventions made abroad, whether by foreigners or citizens,¹⁰⁶ since such applicants are limited to their foreign filing dates in establishing a date of invention in interferences.¹⁰⁷ Regardless of whether the present interference system is maintained or a first-to-file system adopted, this type of discrimination should not be perpetuated.

One survey indicated that inventors, research administrators and company executives thought that a first-to-file system would have a negative effect upon innovation.¹⁰⁸ While it is nearly impossible to estimate its effect, it is conceivable that it may have a positive or neutral effect because firms may respond by filing patent applications earlier.

The President's Commission also supported a first-to-file system because it would "bring U.S. practice into harmony with that prevailing in almost all other industrial nations."¹⁰⁹ While harmonization of the priority systems of the various countries advances patent cooperation, harmonization in several other areas is of greater importance.¹¹⁰

The first-to-file system is the least expensive and time-consuming method of resolving priority conflicts. Adoption of this system should minimize the uncertainty about ownership of patent rights. The first-to-file system would be especially attractive if the inequities of the race to the Patent Office could be significantly reduced.

¹⁰⁵ Harry Goldsmith, "Why Not a First-to-File System?," *JPOS*, Vol. 49 (1967), p. 699 at p. 702.

¹⁰⁶ *Id.* at 700.

¹⁰⁷ Patents, 35 U.S.C. § 104 (1964). The administration finally proposed that foreign applicants should be permitted to establish a conception date prior to their filing date as part of the "modified first-to-file" proposal. *1967-68 House Hearings*, pt. 2, at p. 524.

¹⁰⁸ John C. Green, "Early Information on the Institute's Study of the President's Commission Report," *IDEA*, Vol. 11, No. 4 (Winter 1967-1968), p. 459 at p. 465.

¹⁰⁹ *Supra* note 14, at p. 6.

¹¹⁰ For example, the harmonization of the subject matter that is patentable and cooperation in patent searches would seem to be more pressing.

As an additional incentive for early filing of patent applications, the Patent Reform Act¹¹¹ adopted the Presidential Commission's¹¹² recommendation for the abolition of the grace period. An inventor is not barred under present law from obtaining a patent on his invention even though "the invention was patented or described in a printed publication in this or a foreign country or in public use or on sale in this country" unless such act occurred more than one year prior to the filing date of his patent application.¹¹³ This provision creates a one-year grace period during which the inventor, or anyone else, may publish or test the commercial feasibility of his invention through public use or sale without the inventor losing his patent rights. The grace period saves many inventors the expense of filing patent applications on inventions that are not commercially feasible. Kahn estimated that the grace period may reduce the number of patent applications filed by 100,000 per year because many inventions are not commercially feasible.¹¹⁴ Public knowledge, sale, public use, or "disclosure in tangible form" prior to the filing of a patent application would constitute a bar to obtaining a patent under the Patent Reform Act.¹¹⁵ The abolition of the grace period would produce harsh results, particularly on small firms and independent inventors. For example, an inventor would be barred from obtaining a patent by public use or sale occurring a few days before filing the patent application through the carelessness of his own employees. Certainly inventors would be more secretive about their inventions prior to filing and more inclined to file before adequate testing, resulting in an increase in the number of hastily prepared patent applications.

As a substitute for the grace period, the Patent Reform Act authorized the filing of a preliminary application as soon as the invention was conceived.¹¹⁶ The Act provided that the filing date of the preliminary application would be the effective date in establishing priority if the invention were adequately described. Authorizing preliminary applications would result in the hasty preparation of large numbers of applications on unproductive inventions, flooding the Patent Office. In some cases the application would be carefully

¹¹¹ S. 1042, 90th Cong., 1st Sess., § 102 (a) (1967); H.R. 5924, 90th Cong., 1st Sess., § 102 (a) (1967).

¹¹² *Supra* note 14, at p. 6.

¹¹³ Patents, 35 U.S.C. § 102 (b) (1964).

¹¹⁴ Kahn, *supra* note 13, at p. 947.

¹¹⁵ S. 1042, 90th Cong., 1st Sess., § 102 (a) (1967); H.R. 5924, 90th Cong., 1st Sess., § 102 (a) (1967).

¹¹⁶ S. 1042, 90th Cong., 1st Sess., § 111 (c) (1967); H.R. 5924, 90th Cong., 1st Sess., § 111 (c) (1967).

prepared by a patent attorney to insure that the disclosure was adequate to establish the filing date, but adding to the inventor's expense. Unfortunately, without the preliminary application, completely abolishing the grace period as to the inventor's acts would often produce harsh results.

In the face of vigorous criticism, the Administration abandoned its proposal to abolish the grace period at the same time it abandoned its original first-to-file proposal.¹¹⁷ The preliminary application proposal was likewise abandoned as it was intended as merely a substitute for the grace period.

MODIFICATION OF THE FIRST-TO-FILE SYSTEM

The most serious inequity resulting from the first-to-file system is that an applicant may develop an invention independently at great expense, but lose all rights to use his invention because another inventor files first. While the early filing of patent applications should be encouraged, the first-to-file system may provide too large a premium in granting exclusive rights. A similar inequity is inherent in the interference system because an inventor loses all rights to his invention if another inventor proves he made the same invention a few days earlier. Under both systems an inventor, who makes his invention independently at great expense shortly after the first inventor, loses all rights if the first inventor files first. The harshness of the interference system is often ameliorated because the parties frequently enter into a cross-licensing agreement prior to final judgment.¹¹⁸ There is considerable business pressure on the parties to settle an interference because the delay and uncertainty about the outcome is unsettling to the commercial development of an invention. This extensive cross-

¹¹⁷ 1967 Senate Hearings p. 525. (Testimony of Commissioner of Patents.)

¹¹⁸ The parties may grant cross-licenses with one of them conceding priority in the interference or the proceedings may be continued to the award of priority. There are probably more instances of cross-licenses with the interference being continued. Uncertainty about the outcome of the interference and the financial gain from receiving royalties under the licenses makes parties reluctant to utilize a different method of determining priority (*e.g.*, arbitration or negotiation). Only a small percentage of interferences are dissolved by agreement and an unknown percentage of these do not include the granting of a license. *See De Simone et al.*, *supra* note 13, at p. 536 (Table 1.16d). In order to make it more difficult for applicants and owners to use an interference settlement to secretly violate the anti-trust laws, legislation was enacted in 1962 requiring all agreements between the parties, which were made in connection with an interference, to be filed with the Patent Office. Patents, 35 U.S.C. § 135(c) (1964); H.R. Rep. No. 1983, 87th Cong., 2d Sess. 1 (1962). While these records are a complete source for an em-

licensing of important inventions involved in interferences tends to decrease the monopoly inherent in the patent system. There would be less incentive for an applicant to grant a license under a first-to-file system as there would be no uncertainty about which applicant will obtain the patent rights once the filing dates are known. Thus, a first-to-file system would likely result in reduced competition among firms producing patented products. The author became concerned with the patent priority system because it seemed that the first-to-file system might be modified to minimize the inherent inequities in a race situation and yet maintain the competitive features of the present system.

The inequity of the first-to-file system is not in the granting of a patent to the first to file, as he deserves a premium for his early disclosure, but rather the loss of all rights by the second to file who has developed his invention independently at about the same time. This inequity can be eliminated only by granting certain rights to the second to file, while retaining the patent grant for the first to file. An inventor who makes his invention independently of the first to file should be awarded no rights unless he files a patent application within a limited period (*e.g.*, one year) after the first to file. Filing a patent application not only indicates an interest in exploiting the invention, but delineates the scope of the rights of the subsequent applicant and is evidence that the invention was made independently.

Shop Right

Rabinow proposed that the harshness of the first-to-file system could be minimized by awarding a nonexclusive, nontransferable, royalty free license to the second to file, provided he files within a limited time and can prove he is the first inventor.¹¹⁹ It was envisioned that either

pirical study of cross-licensing in interferences, the records are not generally available to the public.

The Hearings on Administered Prices, held in the early 1960's before Senator Kefauver's subcommittee, provide a wealth of source material on patent licenses that otherwise would have been unavailable. *Hearings on Administered Prices Before the Subcomm. on Antitrust and Monopoly of the Senate Committee on the Judiciary*, 86th Cong., 1st & 2d Sess., pts. 14-26 (1959-60). Among the important drugs cross-licensed in the 1950's to settle interferences are the corticosteroids prednisone, prednisolone and triamcinolone derivatives; and the antibiotics procaine penicillin, benzathine penicillin and tetracycline. The author has no reason to believe that cross-licensing practices in other research oriented industries are significantly different.

¹¹⁹ 1967-68 House Hearings, pt. 1, at p. 216. (Testimony of J. Rabinow, Vice President, Control Data Corporation.)

the inventor or his employer at the time the invention was made would have the license.¹²⁰ Since the license is nontransferable, this approach is discriminatory against the inventor who is either not interested in personally manufacturing the invention or is unable to obtain financial backing. This discrimination could be eliminated by granting a transferable, nonexclusive, royalty free license to the second to file. Nevertheless, this change does not remove the inequity of the second to invent and file losing all rights, even though he made the invention independently at great expense and at about the same time as the first to invent and file.

Since this proposal is based upon the second to file being permitted to prove he is the first inventor, proceedings for deciding this question are needed. Rabinow proposed a limited interference to decide this question when two or more inventors file on the same invention within a year of each other.¹²¹ As in present interferences, this prior party would have the burden of proving he was the first inventor. Retention of the interference would reduce the derivation possibilities that are present in a first-to-file system. Since 69 to 75 percent of the interferences are between applications having filing dates within one year of each other,¹²² this system would not greatly reduce the number of proceedings, but they should be less complex and expensive. More competition would be preserved by this system than the first-to-file system, as the first inventor who is second to file is also granted a right to exploit the invention. As cross-licensing frequently occurs in the present interference system, the main advantages of Rabinow's proposal are the earlier establishment of the rights of the first to file and the reduction in the number and complexity of interference proceedings.

Prior Use

In an effort to salvage its first-to-file proposal, the Administration suggested a modification so that anyone who had commenced commercial manufacture, use or sale in the United States, or had made "substantial preparations for the practice of the invention" prior to the earlier date of either the filing or the first public act of the patentee would have a prior use right to continue practicing the invention.¹²³ This right of prior use is similar to the intervening

¹²⁰ Jacob Rabinow, "The Anti-Inventor Report of the President's Commission on the Patent System," *IDEA*, Vol. 11, No. 1 (Spring 1967), p. 47 at p. 52.

¹²¹ *Id.*

¹²² See notes 80 and 81 *supra*.

¹²³ 1967-68 *House Hearings*, pt. 2, at p. 525. (Testimony of Commissioner of Patents.)

rights frequently involved in connection with broadened reissue patents.¹²⁴ Since the Administration proposal did not require the prior user to file a patent application, the prior user would have to establish his right by litigation. Although this litigation would sometimes be expensive and complex, it should not be too onerous to the prior user as he would be commercially exploiting the invention. While adoption of this proposal would eliminate some of the harshness of the first-to-file system, the inequity to the inventor who had independently developed an invention at great expense, but could not establish prior use, would remain.

Multiple Patent Grant

One intriguing solution to the priority problem is to grant a patent to both the first to file and any other inventor who files an application claiming the same subject matter within a limited period (*e.g.*, one year) of the first to file. A one-year limitation would bar from 25 to 31 percent of the conflicting applications filed under the multiple patent system if the present filing practices of applicants were continued.¹²⁵ The relationship between the filing dates of junior and senior applicants may not be significantly changed by a multiple patent system because of the strong incentive for all inventors to file early.

The simplest type of multiple patent system would be to grant a patent to all inventors filing within one year of the first to file, regardless of conception and reduction to practice dates. This approach would provide an ideal setting for any potential derivator to obtain a patent as he would not be brought to task in an interference. As the patent of the first to file is likely to issue first, any question about derivation of the invention by the first to file can best be resolved by subsequent litigation. Although derivation questions as to subsequent applicants can also be settled in this way, it would be desirable to minimize the risk of derivation by further limiting the rights of subsequent applicants. The derivation potential would be decreased if the subsequent applicants were required to prove either conception or reduction to practice prior to the filing date of the first to file. In order to simplify the issues and reduce the risk of derivation, it may be preferable to ignore conception and require the subsequent

¹²⁴ See Goldsmith, *supra* note 105, at p. 711. The Court may permit a manufacturer to continue making and selling anything patented by the reissue patent unless it also infringes a claim in the original patent. Patents, 35 U.S.C. § 252 (1964).

¹²⁵ See notes 80 and 81 *supra*.

applicants to prove prior reduction to practice. If a subsequent applicant has not reduced his invention to practice prior to the filing date of the first to file, the probability of his conception date being chronologically close to the conception date of the first to file is reduced.

How should the reduction to practice issue be determined? The cost and delay factors inherent in interference procedure indicate that a simpler procedure is needed. One possibility would be to establish a procedure similar to that provided under Rule 131.¹²⁶ Under such a procedure, the patent or patent application of the first to file would be cited against any subsequent applicant claiming the same subject matter. Since the subsequent applicant knows the relevant date is no more than one year prior to his filing date, there may be little reason to maintain the secrecy of the filing date of the first to file. The subject matter in common could be identified by the examiner either following the procedure of Rule 203¹²⁷ in suggesting claims to the subsequent applicant or simply by identifying the claims in the subsequent application that involve common subject matter. The subsequent applicant would then have an opportunity to file affidavits showing facts sufficient to establish reduction to practice prior to the filing date of the first to file. Exhibits of the records or drawings should be required or their absence satisfactorily explained as is required by Rule 131. Admittedly, depositions, with a right of cross-examination, are superior to affidavits in ascertaining the truth, but are more expensive and time-consuming. If the subsequent applicant is successful in proving reduction to practice prior to the filing date of the first to file, then he should be issued a patent. If he should fail in his proof, then the examiner must decide which claims, if any, in the application can be allowed because they do not contain subject matter in common with the first to file.

Because the commercial rights of the first to file are diluted by granting a second patent, it may be desirable to require that copies of the affidavits and exhibits be sent to the first to file and to permit him to file a brief opposing the grant of a patent to the junior party. While this departure from a pure *ex parte* procedure should not appreciably increase delay and cost, it may improve the quality of decisions and reduce the chances of subsequent litigation. In the interest of establishing a streamlined procedure, the first to file should not be permitted to introduce evidence unless he raises a derivation question. If

¹²⁶ Patent Office Rule 131.

¹²⁷ Patent Office Rule 203.

these proceedings should become glutted with derivation issues raised by the first to file for delay purposes, raising the issue can be limited to subsequent litigation. While the senior party would not want his commercial rights diluted by granting a second patent, he would be under less pressure to oppose the junior party than in an interference where his own right to produce under the patent is at stake. Nevertheless, he could offer some opposition by filing a brief at a relatively low cost. Filing a brief should not bar a subsequent court attack by the first to file as the commercial importance of the invention will often not be established at the time of the Patent Office proceedings.

Abolishing the one-year grace period for publication, public use, or sale prior to filing¹²⁸ would unreasonably limit the public testing of the product under the multiple patent system.¹²⁹ If the grace period were abolished, a subsequent applicant should not be barred by any public acts occurring after the filing date of the first to file. Otherwise, the first applicant could bar subsequent applicants simply by making his invention public immediately upon filing. Public testing prior to filing could be permitted by establishing a one-year personal grace period.¹³⁰ Under a personal grace period an applicant would not be barred by his own public acts within the period, but would be barred by any public acts of third parties, other than with his consent, occurring prior to his filing. In effect, the personal grace period would convert the multiple patent system into a first-to-make-public system, as the first inventor would be inclined to make his invention public immediately upon completion in order to bar other inventors. More orderly disclosure of inventions would likely occur if the one-year grace period were retained under the multiple patent system. Derivation problems would be reduced by the statutory prohibition that an applicant is not entitled to a patent if his invention was publicly known or used prior to his invention.¹³¹ If this issue were raised, the applicant would have to prove by a Rule 131¹³² affidavit that he made the invention prior to any public act of another party. The grace period would only permit him to swear back of a public act occurring within one year prior to his filing date.

Retention of the statutory prohibition of public knowledge or use prior to invention by the applicant would seem to convert the multiple patent system into a first-to-make-public system. The first inventor

¹²⁸ Patents, 35 U.S.C. § 102 (b) (1964).

¹²⁹ See Kahn, *supra* note 13, at pp. 947-49.

¹³⁰ See *id.*, at pp. 949-50 for a discussion of the impact of a personal grace period, coupled with a first-to-file system.

¹³¹ Patents, 35 U.S.C. § 102 (a) (1964).

could bar subsequent inventors simply by publishing his invention immediately after it is conceived. Many inventors would be reluctant to publish at this time for fear that the invention may not be perfected. Premature publication might aid a competitor working on the same problem. Even though publication would bar subsequent inventors, it may not be undesirable as the scientific information would be disseminated earlier. Furthermore, the invention would usually enter the public domain earlier as the inventor would have only one year from his publication date in which to file a patent application. Once the invention is reduced to practice, the requirement that a subsequent applicant must file within one year of the first to file provides a powerful incentive for early filing. Once an application is filed there is no advantage in publication, as subsequent applicants have to swear back of the first filing date anyway. An inventor might wish to publish at the time his invention was reduced to practice and delay filing for a year in order to test his invention and postpone incurring patent prosecution costs. Publication would be nearly tantamount to filing a patent application. Inventors could be encouraged to file a patent application in lieu of publication by requiring a subsequent applicant to prove reduction to practice prior to the first filing date while permitting an applicant to swear back of a publication by showing either prior reduction to practice or prior conception coupled with due diligence.¹³³

Under a multiple patent system the public should be informed of the existence of two or more patents with conflicting subject matter. A search for conflicting applications and patents, similar to the present interference search,¹³⁴ should be conducted by the examiner prior to issuing any patent. If a subsequent applicant claiming conflicting subject matter is able to prove he is also entitled to a patent, a notation of the conflict should be included in or attached to all the conflicting patents. The conflicting claims should be listed in this notation.

What rights would each patentee have under a multiple patent system? The conflicting patents would block each other unless each

¹³² Patent Office Rule 131.

¹³³ An applicant can now swear back of certain references by showing either "reduction to practice prior to the effective date of the reference, or conception prior to the effective date of the reference coupled with due diligence from said date to a subsequent reduction to practice or to the filing of the application." Patent Office Rule 131 (b).

¹³⁴ Patent Office, U.S. Dep't of Commerce, *Manual of Patent Examining Procedure* § 1101.01 (c) (3d ed. 1961 rev. 1969).

patentee and his licensees could practice the invention within the scope of the claims of their respective patent without infringing the other patents granted. The multiple patentees would have the same right as joint owners of a patent to "make, use or sell the patented invention without the consent of and without accounting to the other owners."¹³⁵ Indeed, the multiple patentees would in effect own the overlapping subject matter as joint owners. Each multiple patentee would have exclusive rights to any claimed subject matter which was not in conflict. This system would create problems in determining whether a patentee was practicing exclusively within the scope of his claims and not infringing any separate claim of another patent; but this determination should not be any more difficult than present infringement questions. Furthermore, this issue would be avoided altogether if the invention were not being commercially exploited. This issue would also be avoided if the patents were cross-licensed, which would likely occur frequently because of doubt about the scope of the claims and the desire of each patentee to exploit features of all the conflicting patents.

Because the conflict between patent applications would be determined in the Patent Office, the conflicting patents would frequently be issued on the same day. If they were not issued on the same date, the later issued patent should expire on the same day as the first patent as to overlapping subject matter in order to avoid any extension of the patent monopoly.

Infringement litigation involving only the separate subject matter of any of the multiple patents would obviously not require the joinder of the owners of the other multiple patents. Since the courts have treated co-owners of a patent as indispensable parties in infringement litigation,¹³⁶ they might apply this rule to the owners of multiple patents where the infringement litigation involves common subject matter. The courts should decide whether the multiple owners are indispensable parties or not on a case-by-case basis by weighing the factors added to Federal Rule of Civil Procedure 19(b) in 1966.¹³⁷ If the multiple

¹³⁵ Patents, 35 U.S.C. § 262 (1964).

¹³⁶ *Switzer Bros. v. Byrne*, 242 F.2d 909 (6th Cir. 1957); *Hurd v. Sheffield Steel Corp.*, 181 F.2d 269 (8th Cir. 1950).

¹³⁷ Fed. R. Civ. P. 19(b). These factors were taken from cases. Notes of Advisory Committee on Rules, 28 U.S.C. at pp. 2017-19 (Supp. IV, 1965-68). There was apparently no intention to overrule any cases by the revision of the rule. 3A J. Moore, *Federal Practice*, ¶ 19.05[1], at 2206 (2d ed. 1969). Nevertheless, courts may be less inclined to hold that a party is indispensable if he cannot be made a party because of limitation upon service of process or other reasons. Notes of Advisory Committee on Rules, *supra*.

patent owners should be treated as indispensable parties, the owner of one patent should be permitted to join the owners of the other patents as involuntary plaintiffs in infringement litigation involving common subject matter.¹³⁸ Without such joinder, the owner of a multiple patent might not be able to enforce his rights. Unfortunately, the courts have refused to permit involuntary joinder of a co-owner in infringement litigation.¹³⁹ While the courts may eventually permit joinder in such cases, legislative solutions should be explored in enacting any multiple patent system.

CONCLUSION

Under the proposed multiple patent system, a patent would be granted to the first to file and any subsequent applicant who files within one year of the first to file and proves reduction to practice prior to that date. The present one-year grace period should be retained to permit the public testing of an invention prior to filing a patent application.

Many of the advantages of a first-to-file system would likewise accrue from the multiple patent system. Time-consuming and expensive interferences would be eliminated with patent rights being determined nearly as expeditiously and inexpensively as under the first-to-file system. While there would still be a premium on early filing, it should not precipitate a hasty race to the Patent Office. This premium should be adequate to "encourage prompt disclosure of newly discovered technology."¹⁴⁰

The multiple patent system minimizes the inequities present in both the first-to-file and first-to-invent system. Under the present system, an inventor may lose all rights to an invention simply because someone else *invented* it a few days earlier. Both inventors would receive a patent under the multiple patent system if the subsequent applicant filed within one year of the first to file and could prove

¹³⁸ 3A J. Moore, *Federal Practice*, ¶ 19.06, at 2218 (2d ed. 1969). Prof. Moore advocates an extension of the doctrine that an exclusive licensee may join the patent owners as an involuntary plaintiff in infringement litigation to other types of cases. See *Perkins v. Standard Oil Co. of Cal.*, 29 F.R.D. 16 (D. Ore. 1961), *aff'd*, 347 F.2d 379 (9th Cir. 1965) for a case following his suggestion.

¹³⁹ *Rainbow Rubber Co. v. Holtite Mfg. Co.*, 20 F. Supp. 913 (D. Md. 1937). Greater use of compulsory joinder would seem to be authorized by Fed. R. Civ. P. 19. If a party refused to join in litigation, "he may be made a defendant, or, in a proper case, an involuntary plaintiff." Fed. R. Civ. P. 19.

¹⁴⁰ *Supra* note 14, at p. 6.

reduction to practice prior to the first filing date. An inventor can lose all rights to an invention under the first-to-file system simply because another inventor *files* a few days earlier. This would not happen under the multiple patent system unless the subsequent applicant filed more than one year after the first to file. Determination of the single inventor who is to receive a patent under either the present system or a first-to-file system tends to be arbitrary. It is more equitable to grant patents to both inventors who make their inventions at about the same time and file timely patent applications than to grant a patent to only one. Under these circumstances both inventors probably "appreciated the worth of the invention and promptly acted to make the invention available to the public."¹⁴¹

More competition would be fostered by awarding a patent to all the inventors who file and invent within a given time period than by granting a patent to only one inventor. While cross-licensing under the present system tends to foster competition, the multiple patent system would accomplish this directly with less cost and delay. The first-to-file system may be the most anticompetitive of the three systems, as there would be little reason for the applicant with the earliest filing date to grant a license to a later applicant. Firms interested in the invention would be in a good bargaining position under the multiple patent system, as they could negotiate with two parties for a license.

While the author is enthusiastic about the multiple patent system, he concedes that it is not a perfect system and may indeed have serious undetected defects. Nevertheless, the author believes it is worthy of serious study.

¹⁴¹ *Id.*

REVIEWS AND ANNOTATIONS

Recently Published or Reported Material Relating to the Research Institute's Work

Beier, F. K., "Letter from the Federal Republic of Germany," *The Trademark Reporter*, Vol. 59 (July 1969), p. 485.

Blaustein, P. H., "Planning for Maximum Depreciation by Proper Treatment of Patent Acquisitions," *Journal of Taxation*, Vol. 31 (December 1969), p. 340.

Blaustein, Paul H., "Patent Depreciation in New Corporate Formations and Acquisitions," *Journal of the Patent Office Society*, Vol. 52, No. 2 (February 1970), p. 109.

"Depreciation of patents and the accompanying tax deduction for high technology companies may be of substantial value and, particularly in the cases of newly formed corporations and in corporate acquisitions, this deduction should not be lost by default. An attempt will be made herein to survey the case law considerations related to patent-tax depreciation in order to aid the understanding of the variables which must be considered in a comprehensive tax planning program."

Bryan, Roland T., "Pre-Trial Discovery in Interferences," *Journal*

of the Patent Office Society, Vol. 52, No. 1 (January 1970), p. 54.

"In order to consider the question in its broadest scope one must look at the present status of the law and then the public policy considerations that provide the inputs to shape future legislation and Patent Office procedure."

Cochran, S. William, "Historical Review of Fraud in Patent Procurement: The Standards and Procedures for Doing Business Before the Patent Office," *Journal of the Patent Office Society*, Vol. 52, No. 2 (February 1970), p. 71.

"In summation, it can be said that it has been clear from the time of the *Hazel Atlas* and *Precision Instrument* cases that the protection of the public from fraud in patent procurement has been viewed by the Supreme Court as a matter of considerable significance. The matter goes beyond the protection of the interests of any particular litigant, the public stake is paramount, and the sanction of patent invalidity may be imposed even though the party urging fraud has been negligent. The more recent developments in the *Walker* and *Cyan-*

amid decisions have increased interest in patent procurement fraud and have created areas of concern for patent applicants, patent practitioners, and the Patent Office. This concern has led to the formation of a joint Bar-Patent Office discussion group which, in a series of meetings, has attempted to hammer out a series of guide lines for practitioners spelling out their minimum duties to avoid fraud and inequitable conduct. Draft guidelines are under discussion, and while agreement has not been reached as to the precise language to be used, it is hoped that they can be published at an early date for comment by all those interested."

Cohen, S., "Primitive Copyright," *American Bar Association Journal*, Vol. 55 (December 1969), p. 1144.

"Copyright Law and Its Relevance to CATV: Can an Old Dog Be Taught New Tricks?" *Buffalo Law Review*, Vol. 19 (Fall 1969), p. 65.

"Copyright Law and Mechanical Reproduction for Educational Purposes," *West Virginia Law Review*, Vol. 71 (April-June 1969), p. 347.

Crisman, Thomas L., and Robert P. Taylor, "Vending an Old Combination: A Patent Misuse-

Antitrust Problem," *Journal of the Patent Office Society*, Vol. 51, No. 10 (October 1969), p. 649.

"Assume, however, that an automobile manufacturer has improved and patented the carburetor he installs in his unpatented cars but lacks either the facility or the economic motivation to market carburetors by themselves. In selling only automobiles, he has arguably violated the antitrust laws by forcing those who desire the advantage of his improved carburetor to purchase an entire vehicle. On the other hand, since few would dispute the desirability of encouraging research to improve products, it seems self-evident that no penalty should be imposed simply for incorporating a patented improvement into an unpatented machine.

"Only a few scattered cases have given recognition to these opposing concepts and they provide little guidance for the seller of such a product. It is the purpose of this Note, therefore, to focus more clearly on the problem of patented parts and sub-assemblies in unpatented machines and to suggest some criteria for resolving it."

De Jonghe, Thomas G., "When Is Commercial Use a 102(b) Bar?" *Journal of the Patent Office Society*, Vol. 51, No. 11 (November 1969), p. 706.

"A number of court decisions

applying 35 USC 102(b) hold that commercial use of an invention, even though the use is not truly accessible to the public at large, is a bar which prevents a subsequent original inventor from obtaining a valid patent on the same invention. Upon analysis, this does not appear to be desirable in view of the goal of the patent system, namely, promotion of scientific progress in the United States.

"An analysis of the facts of some of the early landmark cases and consideration of the pronouncements in some of the better reasoned cases leads to and supports an interpretation of 35 USC 102(b) which is more in accord with the reason for the patent system in the United States.

"The conclusion developed herein with respect to the 102(b) use bar emphasizes promptly making the invention truly accessible to the public at large, so that improvements upon the invention may be made."

Dodds, L. B., "After *Lear v. Adkins*—What?" *Journal of the Patent Office Society*, Vol. 51, No. 10 (October 1969), p. 621.

"The recent decision of the Supreme Court in *Lear, Inc. v. Adkins* (6/16/69—U.S.—, 162 USPQ 1) has produced rather violent reverberations and an interest among members of the Patent Bar. This note examines the

rationale of the Court's principal holdings, certain of which represent substantial departures from what were considered to be long-established principles of Patent Law."

Ebb, Lawrence F., "Common Market Anticartel Law and Trademark and Patent License Agreements," *U.C.L.A. Law Review*, Vol. 16 (April 1969), p. 545.

"Educator and the Copyright Law," *Copyright Law Symposium (ASCAP)*, Vol. 17 (1969), p. 24.

Eggert, Paul H., "Uses, New Uses and Chemical Patents—A Proposal," *Journal of the Patent Office Society*, Vol. 51, No. 12 (December 1969), p. 768.

"It is apparent that a re-examination of some current doctrines and policies relating to chemical patents is warranted because of the growing economic importance of chemical process and compound patents, the current interest in patent reform, and the strong feelings aroused between the opposing CCPA factions.

"This discussion of chemical patents will include an examination of the general situation exemplified by the two recent CCPA cases, which were rightly decided, though for the wrong reasons. Then a legislative change will be proposed and discussed."

Fugate, Wilbur L., Edgar E. Barton, Marcus A. Hollabaugh and L. A. Glick, "Registrability of Surnames as Trademarks in Western Europe," *The Trademark Reporter*, Vol. 59 (August 1969), p. 573.

Godenhielm, Berndt, "Letter from Scandinavia," *Industrial Property* (October 1969), p. 281.

"Since my last 'Letter' (see *Industrial Property*, 1967, p. 317), the new Nordic Patent Laws, 1967, have come into force with effect from January 1, 1968. It might therefore be of interest to see what has transpired from experience of the amended legislation. However, there is an important exception to the enforcement of the new Laws. Chapter III of the Laws, containing the provisions regarding 'Nordic Patent Applications,' will not enter into force until a special decree to that effect has been issued. Today it seems very uncertain whether that ever will happen. The international development of patent law will perhaps make the Nordic patent application system, if not superfluous at least undesirable or unnecessary. In Denmark, in particular, and I believe also in Norway, there has been much opposition to the Nordic patent application system, the opponents thinking it more suitable to wait for a European patent system or for the putting into operation of the Patent Co-

operation Treaty (PCT) project."

Goldsmith, S. D., "Proposed International Patent Cooperation Treaty," *American Bar Association Journal*, Vol. 55 (October 1969), p. 955.

Groves, David M., "Potential Liability for Patent Attorneys under Section 11 of the Securities Act of 1933," *Journal of the Patent Office Society*, Vol. 52, No. 1 (January 1970), p. 16.

"The purpose of this Article is to discuss the significance to patent attorneys of Section 11 of the Securities Act of 1933 and to point out recent developments which indicate increased liability for patent attorneys in the future. Of necessity, a partial sketch of the Securities Act of 1933 will be presented accompanied by recent developments in securities law. Then will follow a discussion of the areas of potential liability for patent attorneys under Section 11 of the 1933 Act, based primarily on administrative determinations of the Securities and Exchange Commission. . . ."

Gustafson, Torsten, "Summary of the 1968 Annual Report of the Swedish Patent Office," *Industrial Property* (October 1969), p. 289.

"A new Patent Law came into force on January 1, 1968. It is based on a report made in col-

laboration with the other Nordic countries which have also introduced essentially the same patent legislation. This Law involves a number of new departures in the treatment of patent applications. Among these are: the opportunity now afforded for patents to be granted for chemical compounds with the exception, for the time being, of those involving foodstuffs and pharmaceuticals; the disclosure of patent applications still pending after a lapse of 18 months from the date of priority; the opportunity to request the results of the examination from another country undertaking an examination as to novelty; the widening of the novelty rule; the adjustment of running days; and new rules for patents of addition. The changes in the working routines that have resulted have had a considerable effect on the work of the Patent Office during the year."

Hay, L. E., "Administration of the Reporting Requirements of Patent Rights Clauses in Air Force Contracts," *Air Force JAG Law Review*, Vol. 11 (Summer 1969), p. 304.

Hewitt, Lester L., "The New Use Patent," *Journal of the Patent Office Society*, Vol. 51, No. 10 (October 1969), p. 634.

"... While it is difficult to ascertain all the factors contributing to this limited protection for

new use inventions it is submitted that there are several primary reasons. First, the new use of a known patented invention was not literally within the purview of any of the four statutory categories of invention as set out in the 1836 Patent Act. Second, the new use of a known device or compound which is structurally identical to the prior art device or compound makes the determination of patentability in view of the prior art a more arduous task. And finally, the courts suffered under the misconception that a prior patentee would lose a part of his existing patent monopoly if the new use patent were granted."

Heyman, T. V., "Patent Licensing and the Antitrust Laws—A Reappraisal at the Close of the Decade," *Antitrust Bulletin*, Vol. 14 (Fall 1969), p. 537.

Hyde, Edward R., "Most Favored Licensee Provision," *Journal of the Patent Office Society*, Vol. 51, No. 12 (December 1969), p. 802.

"The prospective non-exclusive licensee will want to provide against a future competitive disadvantage resulting from a subsequent licensee receiving a more favorable license. Of course, if the licensor is a competitor the licensee is already at a competitive disadvantage, but this must be accepted. A customary clause found in non-exclusive licenses is

the most favored licensee provision which serves to give the licensee the right to adopt more favorable terms that the licensor may grant to subsequent licensees. This paper will consider various aspects of such provisions."

- Kastenmeier, R. W., "Revision Revisited," *Bulletin of the Copyright Society of the U.S.A.*, Vol. 16 (June 1969), p. 269.
- Kegan, Esther O., "Central American Convention for the Protection of Industrial Property (Trademarks, etc.)," *The Trademark Reporter*, Vol. 59 (July 1969), p. 481.
- Kins, Juris, "Dissipation of Patent Misuse," *Journal of the Patent Office Society*, Vol. 51, No. 12 (December 1969), p. 790.
- "While it seems that the courts are willing to find misuse when the patentee is guilty of impropriety in regard to his patent, it also appears that courts are aware of the harsh nature of the doctrine and are just as willing to find that the misuse has been abandoned and that its consequences have been dissipated. The purpose of this comment is to examine when and how the courts are willing to find that misuse and its consequences have dissipated."
- Körner, E., "Territorial Protection of Industrial Property Rights under the Aspect of Article 85 of the Rome Treaty Prohibiting Restrictive Trade Practices," *New York University Journal of International Law & Politics*, Vol. 2 (Spring 1969), p. 35.
- Latman, A., "Fifteen Years after Mazer v. Stein: A Brief Perspective," *Bulletin of the Copyright Society of the U.S.A.*, Vol. 16 (June 1969), p. 278.
- Lignac, A. M., "Comparative Foreign Patent Procedure," *The International Lawyer*, Vol. 3 (July 1969), p. 810.
- Maksarev, Y. E., "The Role of Employees' Inventions in the USSR," *Industrial Property* (October 1969), p. 285.
- "The question of employees' inventions has been acquiring ever greater importance with the development of technology. An invention requires for its creation an increasing volume of resources, equipment and work performed by auxiliary personnel. The sphere of activities of individual inventors becomes narrower, while the share of inventions created by employees using the means, material and labor resources of organizations in the process of fulfilling their normal working functions increases.
- "Moreover, the importance of employees' inventions is also growing because of the fact that

inventions created in the course of fulfilling normal working functions have a greater chance of being utilized as they are the kind of inventions that solve the problems facing the organization."

McKie, Edward F., Jr., "An Analysis of the Proposed Patent Law Revision Legislation from the Point of View of the Private Practitioner," *Journal of the Patent Office Society*, Vol. 51, No. 12 (December 1969), p. 757.

"... I suggest that the mere enumeration of some of the major changes which have been expressed above, make it evident that S. 2756 would create more sweeping changes in the American patent system than any revision of the patent law within our lifetime. In fact, I think one would have to go back at least to 1864 and the Revised Statutes, to find equally general changes in the American patent system.

"It is my belief that the changes of S. 2756 are generally supported by the Bar. I know that I personally am very strongly in favor of these changes, because I believe the patent system will be substantially improved over the years if these changes are enacted."

Meller, Michael N., "A New Look in Foreign Patent Practice, or a Treaty of Versailles," *Journal of the Patent Office Society*, Vol. 51,

No. 11 (November 1969), p. 689.

"The avowed purpose of the Patent Cooperation Treaty is basically twofold:

"a) Provide *applicants* an extra eight months in addition to the present priority year to make their decisions regarding foreign filings; and

"b) Give national *Patent Offices* a head-start with examination efforts by having foreign applications arrive in those offices with an International Search.

"These purposes, noble ones, with both parties having their *quid pro quo*, no one can find any fault with. But the problem of legally implementing and meshing these purposes into the present systems even after three drafts, remains when viewed in light of U. S. Law."

"Misappropriation of Trade Symbols — Synthesis of Public and Private Priorities," *Utah Law Review* (June 1969), p. 552.

More, D. M., "U. S. Anti-trust Laws and Territorial Provisions in Licensing Foreign Patents and Knowhow for Foreign Use," *Record of the Association of the Bar of the City of New York*, Vol. 24 (November 1969), p. 512.

Orenbuch, L., "The First Inventor and Actual Reduction to Practice," *Journal of the Patent Office Society*, Vol. 51 (November 1969), p. 742.

"Reflections on the Problems of Parody-Infringement," *Copyright Law Symposium (ASCAP)*, Vol. 17 (1969), p. 133.

Rembar, Charles, "Xenophilia in Congress: Ad Interim Copyright and the Manufacturing Clause," *Columbia Law Review*, Vol. 47 (June 1969), p. 914.

Riegert, R. A., "Max Planck Institute for Foreign and International Patent, Copyright, and Unfair Competition Law," *The International Lawyer*, Vol. 3 (July 1969), p. 797.

Romero, Ricardo, "The Central American Convention for the Protection of Industrial Property and the American Exporter," *The Trademark Reporter*, Vol. 59 (July 1969), p. 476.

"Royalties without Copyright: Proposals for a Payments Agreement between the United States and the Soviet Union," *Copyright Law Symposium (ASCAP)*, Vol. 17 (1969), p. 51.

Santen, J. V., "Letters Patent: A Legal Tool of the Successful Franchisor," *Chicago Bar Record*, Vol. 51 (December 1969), p. 131.

Soltysinski, S. J., "New Forms of Protection for Intellectual Property in the Soviet Union and Czechoslovakia," *Modern Law Review*, Vol. 32 (July 1969), p. 408.

"Some Copyright Aspects of New Art: Pop Goes the Easel," *Boston College Industrial & Commercial Law Review*, Vol. 10 (Summer 1969), p. 993.

"Sound Recordings, Records and Copyright: Aftermath of Sears and Compco," *Albany Law Review*, Vol. 33 (Winter 1969), p. 371.

Spencer, R., "Retrieval of Programming Technology for Patent Purposes," *Journal of the Patent Office Society*, Vol. 52, No. 2 (February 1970), p. 125.

"In conclusion, and to summarize the present situation, it will be apparent that some means for searching software is needed whether or not the programs themselves are patentable. The problem is apparent to individuals and organizations outside the patent field. It goes without saying that duplication of effort in this area would be very costly. Any meaningful effort may well represent a compromise which falls far below the development of a perfect system. All that we can hope for at the present time is the development of a search facility for software which is on a par with existing facilities in other subject matter areas. As we all know the volume of pertinent reference material is growing very rapidly. Now is the time to act. Prompt cooperative effort on an international basis will expe-

dite the creation and development of a search and classification system for software. Such effort will lower the overall cost which may be required and will make the results of searches in various patent offices more uniform."

Stern, Richard H., "A Future Look at Patent Fraud and Antitrust Laws," *Journal of the Patent Office Society*, Vol. 52, No. 1 (January 1970), p. 3.

"The topic assigned to me by your chairman involves the interface between patent rights and antitrust liabilities. He has asked me to try to predict and chart out for you the future location of a part of this boundary layer. First, I will point out some antitrust consequences of the fraudulent procurement or use of patents. Second, I will discuss recent antitrust trends in the area of restrictive limitations in patent licensing agreements, with particular attention to field-of-use restrictions."

"Trade Secret Protection of Non-technical Competitive Information," *Iowa Law Review*, Vol. 54 (June 1969), p. 1164.

"Trademarks — Their Early History," *The Trademark Reporter*, Vol. 59 (August 1969), p. 551.

Tuxen, E. P., "The Activities of the Danish Patent Office in 1968," *Industrial Property* (October

1969), p. 288.

"The problems of the Danish Patent Office are—as is the case with patent offices in most other countries where patents are granted after a novelty search and subsequent prosecution—the steadily increasing number and the evergrowing complexity of incoming patent applications.

"The year 1968 was marked by the advent of the new Danish Patent Law, which came into force on January 1, 1968, and which in several respects involves changes in the existing organization and procedure. The Law has given rise to a prosecution routine which in many ways is more complicated than the previous one and has introduced a new organization, since the former Patent Board—composed of two legal experts and 16 technical experts and having the power to decide in each individual case whether a patent should be granted or not—has been abolished, and the grant of patents is decided in the first instance by the Patent Office under the responsibility of its Director. This change does, of course, make heavier demands on the examiner."

Wells, C. C., and W. H. Riggins, "Public Use and Sale as a Bar to Obtaining a Patent and Its Application to Government Activities," *American University Law Review*, Vol. 18 (December 1969), p. 43.

NOTES

Latest on Fourteenth Annual Public Conference

The Fourteenth Annual Public Conference will take place on June 4th and 5th, 1970. The Conference will present and discuss the research of the Institute and important current issues relating to industrial property today, in the company, the government and the market. It will examine industrial property as it is used for technological advance in companies and for "positive competition" in markets among companies and internationally. Special attention will be given by the staff and outside experts to reducing costs of patent litigation; to the types and extent of use of patent license limitations; and to anticompetitive restraints and restrictions in franchise agreements.

INDUSTRIAL PROPERTY TODAY: THE COMPANY, THE GOVERNMENT AND THE MARKET

THURSDAY, JUNE 4, 1970

- 9:00 a.m. Opening Remarks
- 9:30 a.m. A. COMPANY FRONTIERS
Moderator: Theodore L. Bowes, General Patent Counsel, Westinghouse Electric Corporation
1. *Protection of Computer Programs*
Research Institute Contributor: Herbert R. Koller
(For other affiliations of Conference Participants from the Research Institute, see end of program)
Invited Discussants: Martin A. Goetz, Vice President, Applied Data Research; Carl Hammer, Director, Computer Sciences, UNIVAC
 2. *Executive Decision-Making*
Research Institute Contributors: Wallace R. Johnston, Irving H. Siegel
Invited Discussants: Robert Klamman, Attorney, Caplin & Drysdale; (second discussant to be announced)
 3. Panel Discussion and Question Period

12:15 p.m. LUNCHEON (Speaker to be announced)

1:30 to B. LITIGATION AND REGULATION

5:30 p.m. Moderator: George E. Frost, Director, Patent Section, General Motors Corporation

1. *Cost of Enforcement of Industrial Property Rights*

Research Institute Contributors: L. James Harris, Catherine K. Berrett, Frederic B. Schramm

Invited Discussants: John W. Malley, Attorney, Cushman, Darby & Cushman; Francis C. Browne, Attorney, Browne, Beveridge & De Grandi

2. *Antitrust—Unfair Competition*

a. Franchising, Trade Secrets and Other Interactions

Research Institute Contributor: Richard T. Dole, Jr.

b. Patent Licensing Limitations

Research Institute Contributors: S. Chesterfield Oppenheim, John C. Scott

Invited Discussants (for both a & b): Sigmund Timberg, Specialist in Antitrust and International Law; Lawrence I. Wood, Vice President, General Electric Co.

3. Panel Discussion and Question Period

7:30 p.m. RECEPTION, DINNER HONORING CHARLES STARK DRAPER, the recipient for 1969 of the CHARLES F. KETTERING AWARD

FRIDAY, JUNE 5, 1970

9:00 a.m. to C. INSTRUMENTS OF COMPETITION

12:30 p.m. Moderator: John H. Schneider, Assistant Commissioner of Patents, U.S. Patent Office

1. *Trademark Economics*

Research Institute Contributor: Joseph M. Lightman

Invited Discussants: Harry Ansorge, Trademark Attorney, E. R. Squibb and Sons, Inc.; Stuart P. Greene, Trademark Attorney, American Home Products Corporation

2. *International Industrial Property Arrangements*
Research Institute Contributors: John C. Green,
Robert B. Bangs, Dennis I. Meyer
Invited Discussants: Foreign experts attending
the Diplomatic Conference for the Proposed
Patent Cooperation Treaty (PCT) (to be an-
nounced)
3. Panel Discussion and Question Period

CONFERENCE PARTICIPANTS FROM THE PTC RESEARCH INSTITUTE

Robert B. Bangs, Economist, U.S. Department of Commerce

Catherine K. Berrett, Financial Economist, Securities & Exchange Com-
mission

Theodore L. Bowes, Advisory Council, The PTC Research Institute;
General Patent Counsel, Westinghouse Electric Corporation

Richard T. Dole, Jr., Associate Professor of Law, University of Iowa

John C. Green, Scientific Communications and Research Consultant

L. James Harris, Director, The PTC Research Institute; Professor of Law,
The National Law Center, The George Washington University

Wallace R. Johnston, Thomas Alva Edison Fellow

Herbert R. Koller, Technical Program Director, American Society for
Information Science

Joseph M. Lightman, International Economist, Foreign Business Practices
Division, Office of Commercial and Financial Policy, U.S. Department
of Commerce

Dennis I. Meyer, Attorney, Baker & McKenzie

S. Chesterfield Oppenheim, Adviser on Research, The PTC Research In-
stitute; Professor Emeritus of Law, University of Michigan

Frederic B. Schramm, Patent Attorney

John C. Scott, Attorney, Rowley & Scott

Institute's Special Environmental Conference Stresses Industrial Property, Innovation and Competition

The Institute's Special Conference of Invited Experts on "Air and Water Depollution: Roles of Industrial Property, Innovation and Competition" took place on March 31 at the Shoreham Hotel in Washington, D.C. Concentrating on the role of the legal and economic incentive systems, the Conference speakers and panel of experts contributed significant hard information not previously available to many of the attendees. Unusual interest was evidenced in the influence of industrial property systems and antitrust factors involved in

sanctioning cooperation among private parties.

The meeting demonstrated the potential of the Special Conference for topics of national, or international, importance, as an educational tool to teach experts about fields, neighboring on their specialties, with which they may not be familiar. The proceedings are being edited for early publication. The following program lists the speakers and panel. A number of experts from various disciplines were in attendance as observers.

Welcome

L. James Harris
Director, The PTC Research Institute
Professor of Law, The National Law Center
The George Washington University

Introductory Remarks

Conference Chairman
Milton Harris
Chairman, Board of Directors
American Chemical Society

AIR POLLUTION

State of knowledge and technical directions of solution

Charles M. Heinen
Chief, Emission Control & Chemical Development, Chrysler Corporation

Cross-questioning and comment by Panel of Experts

Incentives and deterrents of industrial property with respect to technologically innovative solutions

Andrew L. Gaboriault
General Patent Counsel
Mobil Oil Corporation

Cross-questioning and comment by Panel of Experts
General Discussion

WATER POLLUTION

State of knowledge and technical directions of solution

James M. Shackelford
Physical Science Administrator
Federal Water Pollution Control Administration
U. S. Department of the Interior

Cross-questioning and comment by Panel of Experts

LUNCHEON

Motion Picture—"Fuel to the Fire"

Speaker—Giles S. Rich
Judge, U. S. Court of Customs and Patent Appeals

AFTERNOON SESSION WATER POLLUTION (cont'd)

Incentives and deterrents of industrial property with respect to technologically innovative solutions

W. M. Yates
Director, Patent Department
The Dow Chemical Company

General Discussion

Antitrust Factors Involved in Sanctioning Joint or Cooperative Activities Among Private Parties

George P. Lamb
Lee, Toomey & Kent
Barry Grossman
Assistant Chief, Evaluation Section
Antitrust Division
U. S. Department of Justice

Cross-questioning and comment by Panel of Experts

General Discussion

PANEL OF EXPERTS

Miles O. Colwell
Vice President, ALCOA

Henry Depping
Litigation Section
U. S. Department of Justice

John C. Green
Project Leader
The PTC Research Institute

Lawrence R. Hafstad
Chairman, Committee on Undersea Warfare
National Academy of Sciences

Arthur B. Hanson
Hanson, O'Brien, Birney and Stickle

Milton B. Lee
Patent Counsel
Union Oil Company of California

Daniel MacDougall
Director, Research and Development
Chemagro Corporation

S. Chesterfield Oppenheim
Adviser on Research
The PTC Research Institute

Vincent J. Schaefer
Director of Atmospheric Sciences Research
Center, State University of New York

John Schneider
Assistant Commissioner
U. S. Patent Office

Arthur A. Schoen
Chief, Pollution Control Branch, Division
of Operational Safety, U. S. Atomic Energy
Commission

Irving H. Siegel
Consultant
The PTC Research Institute

Robert R. Werner
Assistant Director, Civil Works for
Comprehensive Planning
Department of the Army
Office of the Chief of Engineers

Institute Clinic Reports Series Inaugurated

As a special service to our members we are now distributing advance reports of the Institute's Clinics. This new series, *Institute Clinic Reports*, was inaugurated because of the timeliness and widespread interest in the subjects examined. The instructive exchanges which take place during the Clinics, limited to relatively small groups of invited experts from a range of relevant specialties, are proving their value in encouraging new insights and approaches.

Living Inventors' Accomplishments Recorded in New Institute Film

The Institute is pleased to announce that the motion picture "Living Archives of Inventors," recording the inventive insights of outstanding creative minds, is being filmed in May at the Smithsonian Institution.

Sponsored jointly by the Institute and the Smithsonian, this is the first of a series of one-hour films planned by the Institute to provide clear and memorable impressions of outstanding living inventors portraying the circumstances under which their inventions originated and were applied. The film series will underscore the relation of the industrial property systems to the pro-

tection and marketing of products of the mind.

The five outstanding inventors who are participating in the film are Robert Adler, J. Presper Eckert, Jr., Jack Rabinow, Richard Walton and Vladimir Zworykin. Several representatives of the Smithsonian Institution and the Institute are also taking part.

It is contemplated that this film program will afford an opportunity for researchers, students, professional people, business administrators and the general public to examine firsthand the techniques employed by recognized creative individuals

and give these creative people an opportunity to contact and react to other outstanding creative minds. The series will serve three major purposes: (1) make available an educational instrument for universities, television, business, etc., (2) provide living archives for posterity, and (3) honor leading creative people in a unique way during their lifetimes. In these ways, the nation will become better acquainted with the accomplishments of outstanding creative minds, and we will develop a vivid autobiographical record of technological pioneers for future and enduring reference.

Stanley D. Stookey Named 1969 Inventor of the Year

Dr. Stanley D. Stookey, Director of Fundamental Chemical Research in the Technical Staffs Division of Corning Glass Works and inventor of photosensitive glasses and PYRO-CERAM (R) brand glass-ceramics, and co-inventor of photochromic glasses that darken reversibly in sunlight, has been named 1969 Inventor of the Year. Recipients of The PTC Research Institute's Inventor of the Year Awards in past years included: Chester F. Carlson, 1964; Samuel Ruben, 1965; Gordon K. Teal, 1966; Robert Adler, 1967; and Jay W. Forrester, 1968.

President Lloyd H. Elliott of The George Washington University presented the Award to Dr. Stookey at a reception in his honor held on Thursday, April 16, 1970, at the

Mayflower Hotel, in Washington, D.C.

A native of Hay Springs, Nebraska, Dr. Stookey was graduated magna cum laude from Coe College, Iowa, in 1936. He received his master's degree in chemistry from Lafayette College in 1937 and a doctorate in physical chemistry from Massachusetts Institute of Technology in 1940. He was awarded an honorary D.Sc. degree from Coe College in 1963.

Dr. Stookey joined Corning Glass Works in 1940 as a research chemist, in 1950 was named a senior research associate in chemistry, in 1955 was appointed manager, and in 1963 named director of Fundamental Chemical Research.

He was awarded the S. B. Meyer

Award of the American Ceramic Society in 1950 and, with Dr. Robert H. Dalton of Corning, received the John Price Wetherill Award of the Franklin Institute in 1953 for discoveries in the field of photosensitive glasses. He was presented the Coe College Alumni Award of Merit in 1955, and received the Ross Coffin Purdy Award of the American Ceramic Society for the author who made the most valuable contribution to ceramic technical literature in 1960.

Dr. Stookey was awarded his second John Price Wetherill Award

in 1962 for his invention of PYRO-CERAM (R) brand glass-ceramics. The same year he received the "Golden Plate Award" of the Academy of Achievement at San Diego, California, and in January 1964 the Toledo Award of the American Ceramic Society.

He is author of numerous scientific papers and technical articles. He is a member of Sigma Xi, American Chemical Society, British Society of Glass Technology, and a Fellow of the American Ceramic Society and of the American Institute of Chemists.

Empirical Study of Limitations in Domestic Patent and Know-How Licensing: A Preliminary Report

S. CHESTERFIELD OPPENHEIM* AND JOHN C. SCOTT**

THIS PRELIMINARY REPORT has the sole purpose of presenting a summation of the factual findings based on the data gathered to date in the responses to the project questionnaire.

WHY THIS EMPIRICAL STUDY?

THIS PROJECT IS PART of the Institute's continuing investigations of licensing operations involving industrial property rights by American companies in the United States and abroad. Professor Jack N. Behrman of the Institute's Research Staff conducted Institute

* Adviser on Research, The PTC Research Institute; formerly Professor of Law, University of Michigan.

** Research Associate, The PTC Research Institute; Rowley and Scott, Washington, D. C.

empirical studies on foreign licensing by United States companies and foreign companies licensing in the United States. Other members of the Research Staff, Messrs. Robert B. Bangs and Joseph M. Lightman, have also conducted empirical studies on patent, trademark, and know-how licensing.

The present project was announced in February, 1969, as a factual study of various types of patent and know-how license limitations and royalty practices used by large and small companies within the United States.

Why was this particular study undertaken? The short answer is that it was designed to fill a vacuum in this kind of empirical data. The Institute took note that in the records of litigated cases and opinions of the courts, as well as in the vast literature on the legal, economic and business aspects of patent licensing, only a modicum of factual data existed with respect to patent and know-how licensing limitations.

The Institute was thus convinced of the urgent need for the empirical data contemplated by this current project as a basis for legal and economic analysis far more significant and useful than the analysis of case law and the abstract and speculative opinions and commentaries which have dominated the literature on this subject.

We were further impressed by the shortcomings of the conventional case-by-case judicial decision-making process in patent licensing cases, based wholly on the facts of the particular litigation. The records of those cases are barren of data on patent licensing in particular industries as a whole. As Judge Learned Hand observed in his opinion in *Cheyney Brothers v. Doris Silk Company*, 35 F. 2d 279 (2d Cir. 1929):

. . . We must judge upon records prepared by litigants, which do not contain all that may be relevant to the issues, for they cannot disclose conditions of the industry, or of others that may be involved.
. . . Our vision is inevitably contracted, and the whole horizon may contain much that may comprise a very different picture.

We hope the empirical data gathered in this study will enlarge the vision of the heretofore dimly seen horizon of patent and know-how licensing limitations. We hope the factual findings will be useful to the courts, government officials in the executive and legislative branches, business executives, the patent Bar, and the larger public interested in technological and commercial innovation. It is hoped the factual findings will contribute to a better understanding of the factors to be considered in balancing the public interest and private rights in this significant area of national concern.

THE NATURE AND CONTENT OF PLANNED SUBSEQUENT REPORT

A subsequent report is planned for publication after the Institute's Conference scheduled for October 29, 1970. The authors will then evaluate the implications drawn from the empirical data and any additional data subsequently received from respondents to the questionnaire.

We will also seek to place the factual findings in the context of existing judicial decisions on patent policies relevant to the specific categories of subject matter covered in the survey. We will also refer to pronouncements and proposals in government reports and documents, and in public statements of government officials (relevant to patent and know-how licensing limitations covered in the Institute's project questionnaire) which are addressed to the ongoing process of accommodation of the exclusive private rights of the patent grant to the public interest in preventing and correcting licensing practices deemed to constitute patent misuse.

The authors hope that this subsequent report will make the factual data in this preliminary report more meaningful and will aid readers in making their own evaluation of the pros and cons of current controversial issues in areas where court decisions have not yet clarified whether or not certain types of patent and know-how licensing limitations are within the legally permissible boundaries of the grant of the patented invention or protectible trade secrets of the licensor.

THE QUESTIONNAIRE DESIGN

Data as to the frequency of specific licensing practices are more meaningful when accompanied by like information with respect to other closely related or alternative licensing provisions. Moreover, the economic and competitive impact of such provisions can be evaluated only in the light of the economic motives that prompted them. These requirements of a useful survey were combined with the optimum size and the patent-activity data needed to assign appropriate weight to each response into a questionnaire of more than 60 questions. To accommodate the busy respondent, the Institute designed a multiple-choice questionnaire that, by making liberal use of tables or charts, combined multiples of related queries into a single question answerable by the insertion of marks in a few appropriate boxes. (Questionnaire is appended)

In the multiple-choice format, respondents were asked to designate categories of frequency—categories identified by the words "always,"

"usually," "often," "occasionally," "seldom," and "never." The import of a designation "always" or "never" is obvious. For each of the other four options, the questionnaire assigned a range of percentages: To "usually" was assigned the range above 60% but less than 100%; to "often" was assigned 30 to 60%; "occasionally," 10 to 30%; and "seldom," below 10%.

Each table or chart providing spaces for multiple-choice answers to a series of questions was designed to deal with a particular class of patent-licensing provision. Since it was not possible, however, to anticipate and list every conceivable provision that might fall within that category, each table or chart lists the three or four most common forms of provision and then provides a space labeled "other," in which the patent owner was asked to identify briefly any other type of arrangement he may use and then to designate the frequency of its use. This attempt to build in flexibility was most revealing; only one or two such designations were made in the responses—an encouraging indication of the comprehensiveness of the questions listed.

THE POPULATION SAMPLED

This questionnaire was sent in two mailings to 1,500 corporations. The 1,000 companies that received the initial mailing were selected as follows: The first 200 on *Fortune's* list of the 500 largest industrials; the ten largest employers in each of 18 basic industries; 220 companies selected by pulling every ninth corporation on the New York Stock Exchange list; 200 selected by picking every third corporation on the American Stock Exchange list; and 200 chosen by picking every fifth company whose stock is traded over the counter. For the second mailing of 500, the selection was made as follows: The remaining 120 on the *Fortune* 500 list (that is, those remaining after the selection of the first 380 companies for the initial mailing); and 380 companies selected at random from the New York Stock Exchange list and the American Stock Exchange list. In the selection of companies from the stock exchange lists, banks, insurance companies, brokerage houses, and other service agencies not relevant to ownership of patent portfolios were eliminated. The second mailing was made because almost 27% (21 of 78) of the responses to the first mailing came from companies reporting no patent ownership or no patent-licensing activity. To date our total number of replies are 163, 58 of which are from companies that do not engage in patent licensing.

SOME GENERAL OBSERVATIONS ON THE
RESPONSES TO THE QUESTIONNAIRE

Completed questionnaires were received from 105 patent-owning and licensing corporations with annual sales ranging from \$800,000 to \$14 billion, with patent portfolios covering from 1 to 14,000 inventions, and with annual patent-licensing royalties totaling as high as \$15 million. Of the firms responding, 32 had sales of over \$1 billion in 1968, 17 had annual sales from \$500 million to \$1 billion, 32 had annual sales of from \$100 million to \$500 million, and 21 had annual sales below \$100 million.¹ Thirty-six own more than 700 patents, and 10 have outstanding licenses covering more than 700; 35 own between 200 and 700 patents and 9 license that many; 28 own between 50 and 200 patents and 24 license that many; and 5 own fewer than 50 patents, although 55 license fewer than 50.²

Domestic licensing of unpatented trade secrets and other technology or know-how was reported by 76 of the 105 respondents. Of the 76, 47 said that know-how is "always" or "usually" licensed in conjunction with patent licensing. Fourteen said that is "often" the case; 15 said it happens "occasionally" or "seldom"; but no one said his know-how licensing is "never" coincident with patent licensing. With only minor exceptions reported by three or four companies, each respondent's know-how licensing practices are identical to its patent-licensing practices.

As might be expected, the most common form of payment exacted from patent licensees is royalties. A total of 89 respondents (86%) said royalties are "always" or "usually" the mode of payment (20 of those exacted in addition to an initial fixed fee). And 64 reported that the royalties are "always" or "usually" based on a percentage of the licensee's sales. However, a fixed sum per unit of sale or production (as contrasted with a percentage of dollar sales) is "always" used by 4 respondents, "usually" by 12, "often" by 16, and "occasionally" by 32.

THE LICENSING PRACTICES REPORTED

Half (52) of the respondents reported a policy of refusing to license some patents, and most of these (37 of the 52) gave reasons either

¹ Three respondents did not answer the question relating to annual sales.

² One respondent did not answer the question relating to number of patents owned, and seven did not answer the question relating to the number licensed.

impliedly or obviously and candidly based on a desire to exclude or avoid competition during the period of the exclusive rights of the patent grant. They "prefer to practice our inventions ourselves" or want "defensive protection" or just simply "don't want competition." Two said their purpose is to protect the heavy investment they have made in market development, and three related their policy to the new, developmental state of the market involved, which made it difficult to place a value on a license or at least advisable to await further market development before licensing. One replied that a licensee would have to cut prices to enter the market for the patented product and that advice of counsel against attempting first-sale price control led to the decision not to license. Two respondents described a policy of refusing to license whenever they themselves are capable of supplying the entire demand; and two others, phrasing it somewhat differently, said their no-license policies apply whenever the market is too small to support other producers.

On the other hand, the number of patents actually withheld is not large. While 14 of the 52 respondents who acknowledged a no-license policy did not specify the number of patents affected (those 14 held 22,307 patents), the other 37 reported that the policy applies to only 2,741, or about 5.2%, of the 51,075 patents they control. Only one patent owner said he applies the policy to all his patents (and therefore, of course, had no licensing practices to report), and only six others apply it to more than 15% of their patents.

Apparently an overwhelming majority of the patent-licensing arrangements reported on are nonexclusive. Only 7 respondents said their domestic licenses now in force are "always" or "usually" exclusive. Another 16 said they "often" or "occasionally" use exclusive licenses. But 52 said they "seldom" license exclusively, and 26 said they "never" do so.³

In response to a question about their nonexclusive licenses, 69 of the respondents said they "always" or "usually" include in their license a "most favored nation" clause guaranteeing to the licensee that his royalties and other considerations will not exceed those paid by any other licensee. Only two of the companies that indicated they do not use "most favored nation" clauses reported that they nevertheless always use uniform royalty provisions. Those who responded to an inquiry about their reasons for not exacting uniform royalties gave a variety of business or economic explanations for discriminating among licensees. The reason given most frequently (by 12 respondents) is a

³ Two respondents failed to respond to this question.

desire to assist a first or early licensee charged with the task of pioneering or developing a new product or process. Next in order of frequency (8 respondents) is adjustment of royalty rate to give credit for other considerations supplied by the licensee—cross-licensing, settlement of litigation, or supplying technology or testing. Five respondents said they vary royalty rate with field-of-use involved; 4 take into consideration the size of the licensee; and 3 act on the basis of the value or price of the product in which the licensee uses the invention. Respondents often pointed out that there are so many variations and combinations of all of these motivating factors that uniform royalty rates would create serious injustices.

Package Licensing

Package licensing, in the sense of writing a licensing agreement that covers more than one patent, is commonplace. Only 9 respondents said none of their license agreements cover more than one patent. Almost three-fourths (73) of the respondents said their licensing agreements “usually,” “often,” or “occasionally” cover two or more patents. Yet only 11 of the 83 companies that answered the question reported that their licensees are not “always” free to select and take a license under individual patents of the “package.” Six other respondents indicated that, while licensees are free to choose fewer than all the patents, the royalty rate is based solely or primarily on the dominant patent or patents and no reduction is granted for elimination of subordinate patents from the package. Of the 11 companies that acknowledged a policy of licensing certain patents only in package, four justified their policy by reporting that the patents are so closely related to, and dependent upon, each other that it is impossible to use them individually. The same situation may have been described in different terms by two respondents who said their policy has developed simply because no one has ever asked for anything less than the whole package of patents. Two other respondents explained that they follow a compulsory package-licensing policy only when the primary subject of the license is know-how and the royalty rate is based upon the importance of the technology communicated rather than upon the value of the related patents.

Companies that do license packages of patents but also permit licensees to select fewer than all the elements of the package were asked to indicate the factors they weigh in determining the royalty rate for individual patents. The responses are somewhat difficult to

tabulate, however, since a variety of terms were used to describe what appear to be identical, or at least very closely related, factors or considerations—i.e., “economic value,” “savings available to licensee,” and “potential profits.” Some of the more specifically identifiable factors reported are the relative importance of the individual patents, i.e., whether they are basic or improvement patents (17 respondents); the certainty of the patent’s validity (10 respondents); the scope of the patent claims (9 respondents); the ease with which the patented invention can be avoided (7 respondents); and the remaining life of the patent (3 respondents).

First-Sale Price Fixing

As far as the respondents to the Institute’s questionnaire are concerned, patentee’s control of first-sale price is virtually nonexistent. Only two companies said they ever use a provision fixing the licensee’s first-sale price, and both use it “seldom.” Where royalty is based on sales price, both explained, control of first-sale price is “important to guaranteeing reasonable royalty.” Only four of the responses otherwise sufficiently complete to be tabulated failed to answer the question about first-sale price.

Grant-Back Provisions

Grant-back provisions are, on the other hand, quite common. Only 16 respondents said they “never” use grant-back clauses of any kind, although 54 respondents reported the use of grant-back provisions requiring only nonexclusive licenses.⁴ Generally the companies using exclusive-license and assignment grants-back find it necessary to use them only “occasionally” or “seldom.” Only one company said it “always” requires an assignment grant-back (of specified existing patents); one said it “usually” requires assignment grants-back (of all improvement patents); and one said it “often” requires assignment grants-back (again, of improvement patents). Of the 26 respondents

⁴ Of these 54, 35 answered our chart-form question fully, definitely stating that they “never” require exclusive-license or assignment grants-back. The other 19 acknowledged use of nonexclusive-license grant-back provisions without marking the portion of the chart relating to exclusive-license and assignment grants-back. In view of the wording of the question and the nature of the chart used, it would appear that these incomplete answers are intended to indicate that the respondents did not use exclusive-license or assignment grants-back.

reporting use of assignment grant-back provisions, 19 said they are used "seldom." Among those using exclusive-license grants-back, only three said they "always" include such a provision in the license (two asking for all improvement patents and one asking for all patents subsequently acquired by the licensee). Eight of the companies using exclusive-license grant-back provisions find it "usually" necessary to insert such a requirement, but 31 (54%) said they "seldom" (less than 10% of the time) use such licensing provisions.

As might be expected, improvement patents are the most common type of patents covered by grant-back provisions, accounting for 44.7% of existing grant-back provisions identified by the respondents. Specified existing patents are covered by 34.6% of the grant-back arrangements, and the remaining 20.7% cover all new patents subsequently acquired by the licensee. A few respondents pointed out that a grant-back of existing patents is nothing but a cross-licensing arrangement or exchange of patents. But only three companies that answered this inquiry engage in such exchanges without also having some true grant-back arrangements covering either improvement patents or all new patents subsequently obtained by the licensee.

In response to a request for the reasons for requiring grant-back commitments, 34 respondents stated that these are measures of self-protection—that the licensor who wants to stay in the market in competition with his licensees must protect himself against (1) the licensee's development of improvements that give him a significant competitive edge and (2) the development of improvements that may not only drop the licensor completely out of the market in a sales sense but even prevent him from engaging in further developmental work. Five respondents were interested in receiving all improvements for the purpose of keeping all other licensees competitive in the market, and three others said their purpose is to promote a free exchange of information and technology in the industry (not counting one who said grants-back are not so much a company policy as a generally accepted practice of its industry). In justification of grants-back in general, 13 respondents made the observation that the licensor has some rights in this regard because it is his patent and know-how that put the licensee in a position to develop improvements and that stimulate invention; three of these indicated that they use grant-back provisions only when the licensing of the patent is accompanied by a furnishing of know-how and technical assistance. Four of them reported requiring grant-back only for a limited period of time—i.e., during the early development period in the specific field of technology.

Field-of-Use Licensing

Field-of-use licensing, like grant-back requirements, is in widespread use. While 76% (80 of 105) of the respondents indicated that they never place any restrictions upon the quantity of activity engaged in by their licensees under the patent, and 70% (74 of 105) stated they never granted domestic territorial licenses, 29% (30 of 105) said they never engage in field-of-use licensing. Of the 67 companies that reported engaging in field-of-use licensing, 47 (70%) license use of the invention in conjunction with some designated product, process or apparatus; 44 (65.7%) use provisions permitting utilization of the invention for only some designated purpose, such as industrial, commercial, or home consumption; 37 (55%) license use of the patent in a specified industry or industries; and 21 (31%) license use of the patent in a specified stage of production—i.e., research, manufacturing, product testing, or the like. Only three of the respondents said they “always” give field-of-use licenses, and each identified the type of license as being one authorizing use of the patent only in conjunction with a specified product, process, or apparatus. On the other hand, almost three-fourths (73%) of the responses indicated that field-of-use licensing is used only “occasionally” (10 to 30% of the time) or “seldom” (less than 10% of the time).

In connection with the field-of-use inquiry, the question seeking reasons for using this type of license yielded a rich variety of explanations. Some respondents said they did so to increase their royalty income, to help them “police” their patents, or to test the utility of their invention in a particular field while they collected information on which to base a decision as to general licensing policy. Others granted field-of-use licenses because they could not determine the value of their patents in other fields not embodied in the license or because the licensees themselves demanded exclusivity in their respective fields. Still others (nine of them) stated that they wanted to maintain exclusivity for themselves in their own particular fields of endeavor. Indeed three respondents insisted that ability to grant field-of-use licenses is the motivating factor that induced them to adopt a licensing policy. But the most frequent explanation for granting licenses of these types is the needs or capabilities of the licensee; 32 of the respondents said they granted patent licenses designed to fit the licensee’s needs or to conform to his production or marketing capability, and this explanation is frequently accompanied by the observation that this licensing procedure enables the licensor to hold down the royalty rate charged each licensee.

Territorial Licensing

Licensees' needs and capabilities are also the most frequent explanation given by respondents for territorial licensing practices. Five respondents said they tailored their territorial grants to the licensee's wishes, and four of these reported that the amount of the royalty paid was significantly affected by the scope of the territory granted. However, three said they granted territorial licenses for the purpose of maintaining exclusivity for themselves in particular areas, and three more said they did so to prevent "overlapping" of licensee-manufacturers and overcapacity in specific geographical areas.⁵

Actually, 70% of those responding said they never use territorial restrictions of any kind, and almost half of the others said they use territorial licenses only "seldom" or less than 10% of the time. A geographical limit on manufacturing activity is somewhat more common than a geographical limit on actual sales.

Quantity Limitations

Licenses granting the right to use the patented invention up to a certain quantity of use or production appear to be less common among the respondents than do territorial licenses, for 76% of the respondents said they never limit licensees' production. The most common type of quantity limit (identified by 12 respondents) puts a ceiling on the units of production the licensee can achieve by use of the patent. Most of the other affirmative responses (7) said the limit is based upon the number of producing machines permitted the licensee.

Five of the respondents said the provisions are related to the needs or desires of the licensee—particularly his desire to minimize the royalty. Three respondents reported that their purpose is to maintain exclusivity for themselves for the balance of the market, and two said their quantitative licenses were granted for the purpose of conducting a limited test of the invention's usefulness.

THE IRRELEVANCE OF COMPANY SIZE

The only characteristics of the responses received by the Institute that seem to fluctuate with the respondent's volume of sales or size of

⁵ Many respondents who reported field-of-use, territorial or quantitative licensing gave no reason for the practice.

its patent portfolio are the completeness and clarity of the answers given. Except for a few minor areas where the tabulations are so small that the percentages are not meaningful, the various licensing practices seem to be about as prevalent in one size classification of corporation as in another. For example, of the 52 respondents who indicated they never require exclusive-license or assignment grants-back, 12 come from the 19 respondents whose annual sales are below \$100 million; 15 come from the 31 companies whose sales range from \$100 million to \$500 million; 11 fall in the category of 17 companies with annual sales from \$500 million to \$1 billion; and 14 are among the 32 companies with annual gross sales in excess of \$1 billion.

Field-of-use licensing appears to be practiced less frequently by companies with annual sales ranging from \$100 million to \$500 million than by companies in the other size classifications. Almost half (15 out of 34) of that group reported they "never" use field-of-use licensing, whereas only 6 of the 20 companies taking in less than \$100 million annually, 3 of the 17 companies in the \$500 million to \$1 billion class, and 3 of the 32 companies receiving over \$1 billion annually made such a report. Similarly, use of quantitative and territorial licensing appears to be slightly, but perhaps not significantly, lower among smaller corporations. Of the 32 companies over \$1 billion in annual sales, 16 said they "never" engage in quantitative licensing and 19 said they "never" use territorial licenses. Of the next smaller grouping (\$500 million to \$1 billion) 14 of the 17 said "never" on quantitative licenses, and 9 said "never" on territorial licensing. In the \$100 million to \$500 million group, 29 of the 34 said they "never" license quantitatively, and 21 said they "never" license territorially. Among those companies in the final and smallest classification, 14 of the 20 said "never" on quantitative licensing and 13 said "never" on territories.

THE CHARACTERISTICS IN COMMON AMONG SPECIFIC INDUSTRIES

Six basic industries are represented by as many as five or more respondents in the questionnaires completed and returned to the Institute to date, and in each of them the answers generally follow the overall pattern. All of the 14 petroleum and chemical producers who participated in the survey said they "usually" or "often" license their patents in packages, but only one said its licensees are not "always" free to take a license under an individual patent. On the other hand, 11 of them reported that they do refuse to license some of their

domestic patents. Producers of electrical and electronic equipment also accounted for 14 of the responses; only half of them said they refuse to license some of their domestic patents. Package licensing of patents is less common among these producers (one said it "always" licenses in packages, and 4 said they "often" do, but 8 reported package licensing of less than 30% of their patents) and again only 1 company said its licensees are not "always" free to select individual patents for separate licensing.

Among the 9 companies whose principal activity was identified as the production and fabrication of basic metals, 5 said they do sometimes refuse to license some of their United States patents, and 5 said they "often" or "usually" license their patents in packages, although none of them reported a compulsory package-licensing policy. "Consumer products" manufacturers accounted for another 9 responses, and again 5 reported a policy of refusing to license some United States patents. Eight of the 9 said they use package licenses less than 30% of the time, but 2 did indicate that their licensees are not "always" free to take a license under individual patents.

The pharmaceutical manufacturing industry accounted for 6 of the answers, and some of those were submitted by corporations that listed pharmaceuticals second, third, or lower in the sequence in which they identified their corporate activities. Five of these companies said they do refuse to license some of their United States patents. Two of the 6 said they "never" license patents in packages, and each of the other 4 said their licensees are "always" free to license individual patents. With respect to quantitative and territorial licensing, not a single pharmaceutical producer indicated any use at all of this type of licensing practice.

With the few exceptions set out in the preceding three paragraphs, the answers supplied by the members of specific industries followed generally the pattern of the responses received on all questionnaires.

APPENDIX

THE PTC RESEARCH INSTITUTE OF
THE GEORGE WASHINGTON UNIVERSITY

WASHINGTON, D. C. 20006

QUESTIONNAIRE ON LIMITATIONS IN DOMESTIC (U. S.) PATENT
AND KNOW-HOW LICENSING(Replies will be kept strictly *confidential*)1. General Background Information

- (a) Nature of company's business: _____
- (b) Volume of annual sales for 1968 or last fiscal year (give dates): _____
- (c) Number of U. S. patents owned by company: _____
Does this number include patents owned by subsidiaries: Yes _____ No _____
- (d) How many (percent) of your currently owned U. S. patents have been derived from your own R&D _____%; purchased from others _____%; procured through grant-back commitments from your licensees _____%.
- (e) Number of U. S. patents licensed from others:
(i) Through field licenses in which patents are not identified (please make broad estimate): _____
(ii) Through licenses in which the licensed patents can be identified: _____
- (f) Amount of annual royalties paid to others for license of U. S. patents: \$ _____

2. Patent Licensing Policy—In General

- (a) Number of *owned* U. S. patents licensed to others: _____
(i) Through field licenses in which patents are not identified (please make broad estimate): _____
(ii) Through licenses in which the licensed patents can be identified: _____
- (b) Number of U. S. patents on which company has obtained sublicensing rights from others: _____
- (c) Amount of royalties received annually on U. S. patents licensed to others: \$ _____
- (d) Does the company refuse to license any of its owned U. S. patents? Yes _____ No _____
- (e) If yes, indicate how many _____ and explain reasons: _____
- (f) Does company engage in domestic licensing of unpatented trade secrets and other technology (know-how)? Yes _____ No _____

- (b) If you have answered in 3 (a) that your licensees pay royalties, indicate how frequently the following formulae are used to measure royalties, with or without sliding scale:

	Patents						Know-How					
	Always	Usually	Often	Occasionally	Seldom	Never	Always	Usually	Often	Occasionally	Seldom	Never
Percentage of Licensee's Sales												
Fixed Fee per Unit of Sale or Production												
Fixed Fee per Week, Month, Year												
Other (specify)												

- (c) Indicate how frequently your own granted domestic licenses now in force are exclusive:

Always _____
 Usually _____
 Often _____

Occasionally _____
 Seldom _____
 Never _____

- (d) Indicate how frequently your present nonexclusive domestic licensees are guaranteed that their fees, royalties and other considerations will never exceed those paid by "most favored licensee":

Always _____
 Usually _____
 Often _____

Occasionally _____
 Seldom _____
 Never _____

- (e) If you do not *always* charge a uniform royalty, explain your reasons for the variations: _____

4. Package Licensing

- (a) Indicate how frequently you have licensed, in domestic agreements now in force, two or more patents or classes of know-how as a package:

Always _____
 Usually _____
 Often _____

Occasionally _____
 Seldom _____
 Never _____

- (b) If you engage in package licensing, is the licensee free to take a license under individual patents of the package? Yes _____ No _____

(c) If your answer to 4 (b) is "yes", indicate the factors you weigh in determining the royalty rate for individual patents (e.g., the qualitative value of the patent): _____

(d) If your answer to 4 (b) is "no", state the reasons for this policy: _____

5. Grant-Back Commitments

Indicate how frequently your domestic licensing agreements now in force contain the following grant-back commitments by your licensees.

	Nonexclusive Lic.						Exclusive Lic.						Assignment					
	Always	Usually	Often	Occasionally	Seldom	Never	Always	Usually	Often	Occasionally	Seldom	Never	Always	Usually	Often	Occasionally	Seldom	Never
Specified existing patents																		
All improvement patents																		
All new patents																		

If you have not answered "never" in all three categories, please explain in general your reasons for requiring grant-back commitments: _____

6. Types of Limitations

(a) First Sale Price—Indicate frequency with which your domestic licensing agreements now in force permit you to fix your licensee's first sale price: (please check below)

	Patents	Know-How
Always	_____	_____
Usually	_____	_____
Often	_____	_____
Occasionally	_____	_____
Seldom	_____	_____
Never	_____	_____

If you have not answered "never" in both columns, please explain in general your reasons for retaining control of first sale price: _____

- (b) **Field-of-Use and Field**—Indicate frequency with which your domestic licensing agreements now in force license the following:

	Patents						Know-How					
	Always	Usually	Often	Occasionally	Seldom	Never	Always	Usually	Often	Occasionally	Seldom	Never
Use of patented product or process for specified field or fields (i.e., industrial, commercial, home consumption)												
specified industry or industries												
specified stage of production (i.e., research, manufacturing, product testing)												
use in conjunction with specified product, process, or apparatus												
Other (specify)												

If you have not answered "never" in both columns, please explain in general your reasons for so licensing your patents: _____

- (c) **Quantity and Territorial Provisions**—Indicate frequency with which your domestic licensing agreements now in force impose the following:

	Patents						Know-How					
	Always	Usually	Often	Occasionally	Seldom	Never	Always	Usually	Often	Occasionally	Seldom	Never
<u>Quantity Limitations</u>												
Units of production achieved by use of patent												
Number of manufacturing employees permitted licensee												
Number of producing machines permitted licensee												
Number of man hours or machine hours of production permitted												
Number of times a process or structure may be used												
Other (specify)												
<u>Territorial Limitations</u>												
Use or manufacturing limited to specified geographical area												
Sales limited to specified geographical area												
Other (specify)												

If you have not answered "never" in all categories, please explain in general your reasons for including the limitations: _____

Trade Secrets: Report of an Institute Clinic

INTRODUCTION

THE PTC RESEARCH INSTITUTE held a Clinic on Trade Secrets on February 25, 1970, at its headquarters on the campus of The George Washington University. As in earlier instances, such as the Patent Cooperation Treaty Clinic already reported in *IDEA*, Vol. 14, No. 1 (Spring 1970), a small invited group participated. This group included knowledgeable persons in industry, government, and the academic world. The list of participants follows, and the object of the exercise is described in the Appendix, "Outline of Trade Secrets Clinic."

The Moderator of the Trade Secrets Clinic was Irving H. Siegel, a Principal Consultant to The PTC Research Institute and an economist on the staff of the W. E. Upjohn Institute for Employment Research. The Clinic was opened by L. James Harris, Director of The PTC

Research Institute. It was organized around four principal contributions by Jon Rogeberg, Merck & Company; William C. Becker, B. F. Goodrich Company; Walter Henderson, U.S. Department of Defense; and S. Chesterfield Oppenheim, Adviser on Research to The PTC Research Institute. These principal statements and the discussion that they engender comprise the bulk of the Proceedings which are reported below.

Clinic Participants

Roland A. Anderson	—Assistant General Counsel for Patents, U.S. Atomic Energy Commission
George J. Bair	—Director, Technical Staff Services, Corning Glass Works
Ernest H. Beck	—Assistant Chief Patent Counsel, E. I. du Pont de Nemours & Company
William C. Becker	—Counsel, The B. F. Goodrich Company
K. Robert Bedell	—Assistant Technical Director, National Distillers and Chemical Corporation
P. F. Casella	—Director, Patents and Licensing, Hooker Chemical Corporation
Horace B. Cooke	—Special Consultant, The PTC Research Institute
Timothy J. Curtin, Jr.	—Corporate Security Officer, Geigy Chemical Corporation
William K. Fulton	—Manager of Security, Lederle Laboratories Division, American Cyanamid Company
John C. Green	—Project Leader, International Trade and Development Studies, The PTC Research Institute; Scientific Communications and Research Consultant, Washington, D. C.
L. James Harris	—Director, The PTC Research Institute; Professor of Law, The National Law Center, The George Washington University
Walter Henderson	—Project Officer, Office of the Assistant Secretary of Defense, U.S. Department of Defense

- | | |
|---------------------------|--|
| Roger R. Horton | —Assistant Director, Patents and Licenses Department, Atlas Chemical Industries, Inc. |
| Wallace R. Johnston | —Thomas Alva Edison Fellow, The PTC Research Institute |
| Joseph M. Lightman | —Research Associate, The PTC Research Institute; International Economist, Foreign Business Practices Division, U.S. Department of Commerce |
| Joseph W. Lucca | —Staff Counsel, Bristol-Myers Company |
| G. F. Magdeburger | —Patent Attorney, Chevron Research Company |
| S. Chesterfield Oppenheim | —Adviser on Research, The PTC Research Institute; formerly Professor of Law, University of Michigan |
| Joseph C. Redmond, Jr. | —Managing Patent Attorney, Fishkill Patent Operations, IBM Corporation |
| Jon Rogeberg | —Manager, Corporate Security Services; Merck & Company, Inc. |
| Irving H. Siegel | —Consultant, The PTC Research Institute; Staff Member, W. E. Upjohn Institute for Employment Research |
| James E. Toomey | —Patent Counsel, Kaiser Aluminum & Chemical Corporation |

The Proceedings of the Clinic

DIRECTOR L. JAMES HARRIS: Welcome to the Trade Secrets Clinic of The PTC Research Institute of The George Washington University. This Clinic is one of several events that have been scheduled to mark the twentieth anniversary of the signing of the Charter of the Institute, the Charter that made the Institute an integral part of the University. We have designated the period from the fall of 1969 to August 3, 1970 as the Charter Vicennial Year. It was on August 3, 1950 that the Declaration of Trust was signed by Cloyd H. Marvin, President of the University at that time, and Henry P. Erwin, Secretary of the Board of Trustees.

As part of the Vicennial celebration, the Institute has already held a Clinic on the Patent Cooperation Treaty (November 1969) and has arranged for another, on Unfair Trade Practices Relating to Industrial-Intellectual Property (April 1970). Other events have also been scheduled in the spirit of this Vicennial Year, such as the Special Conference of Invited Experts on Air and Water Depollution: Roles of Industrial Property, Innovation and Competition, held at the end of March.

The Clinic is intended as a research tool for the disclosure of problems, for diagnosis, and for the prescription of practical remedies. It is an instrument of mutual instruction for all participants. Operating under academic aegis, we hope that the discussion will be frank and free—in the interest of maximum mutual benefit and of maximum public usefulness of the edited Proceedings, which will appear in *IDEA*.

The principal contributions that will serve as the foci of today's discussion deal with managerial, legal, and public issues concerning trade secrets. A more detailed description of the exercise is provided in the "Outline," which was sent to you with your invitation and which will be included as an Appendix to the published Proceedings.

Incidentally, we originally planned only three contributions, but Professor Oppenheim has volunteered a fourth.

Dr. Siegel, the Moderator of this Clinic, will now call on the first of the main contributors.

IRVING H. SIEGEL

Before hearing from the four main speakers of the day, I should like to mention that by bringing you to the Institute today, Dr. Harris and I hope to advance a research program on which he and I have collaborated for several years while also engaged in other activities. One of the fruits of our joint effort is a paper that some of you may have seen in *IDEA*, Volume 10, Number 3 (Fall 1966), on "Trade Secrets in the Context of Positive Competition." Since this room will serve as a library again after you go home, I might mention that this paper has been reprinted in a volume that I see on a shelf before me—*Nurturing New Ideas: Legal Rights and Economic Roles*, edited by Dr. Harris and published in 1969 by the Bureau of National Affairs.

As you know, the protection of trade secrets derives largely from common law and equity, rather than explicit statutes. Since the classical case of *Peabody v. Norfolk* (1865), the discussion of trade secrets has centered on three concepts: property, contracts, and confidence. More recent court decisions have helped to sharpen definitisms, to discriminate circumstances, and to provide guiding principles. Rules of conduct for employers and employees and the liability for trade-secret disclosure and for related breaches of confidence are distilled in Sections 757 and 758 of the *Restatement of Torts* and in Sections 395 and 396 of the *Restatement of the Law of Agency*, which are frequently cited.

Since the company, the individual firm, is necessarily a key site at which trade secrets are located and at which contests of property, contracts, and confidence arise, we turn first to Jon Rogeberg, of Merck & Company, for his contribution to this Clinic.

Company Management of Trade Secrets

JON ROGEBERG

Gentlemen—My name is Jon Rogeberg and I am Manager of Corporate Security Services at Merck & Company, Inc. I have been asked to start this Clinic with a few words on company management of trade secrets.

As perhaps most of you know, Merck & Company is a manufacturer of pharmaceutical chemicals and pharmaceutical products. Our field is very competitive, and very much research is oriented to new products. It can indeed be said that research is the lifeblood of our business. I believe that we have one of the largest research budgets of a single drug company in the world.

Our concern with the protection of proprietary information did not come about in a vacuum. It evolved rather in the wake of two well-known cases of information theft, perhaps better known as industrial espionage. I am referring to the *Robert S. Aries* and *Lehel Telek* cases which involved carefully planned, deliberate efforts to misappropriate proprietary technological information of Merck & Company. Both cases are almost classical in character, and the *Aries* case is perhaps the most publicized industrial espionage case on record, although Mr. Fulton from Lederle Laboratories may disagree.

Rather than attempt to present my general views with respect to the protection of proprietary information, I thought it might be better to discuss what our experiences have been at Merck and what we have done, rightly or wrongly, to deal with the problem.

Like many innovative companies today, we have recognized the importance of putting our personnel on notice that much of what they see and hear in the course of their employment is the company's intellectual property. All new hirees are now required to sign our "Conditions of Employment" statement, which incorporates a nondisclosure agreement. This agreement, which is signed by the new employee, provides that certain proprietary company data are not to be divulged outside the company during and after employment. It also generally stipulates that any inventions or discoveries made by an employee on company time and at company expense become the property of the company, and any patent rights must therefore be assigned to Merck & Company. We also require employees who leave the company to sign a termination statement that serves as a reminder of the continuing obligation not to divulge Merck proprietary

information. It is our feeling that both of these statements would prove useful instruments in a court of law should it be necessary to demonstrate to the court that ample notice of confidentiality has been given the employee. Our lawyers have informed us that courts have increasingly held that there must be such notice to the employee.

The two measures I have just discussed are in use in many companies and represent nothing new. Where perhaps we have gone a little further is with regard to the protection of written information internally. Some six years ago we instituted a document control program which we feel has proven a very useful weapon in the defense of trade secrets. While we go on the premise that all company information is company property and should be protected, we recognize that certain information requires more than the usual protection. We have, therefore, established two categories of information which require special safeguards, Critical and Restricted. Restricted is our basic category, while Critical is used sparingly. Under our program, Critical distribution is required if a document contains "information that is complete enough to be substantially useful to a competitor and which, if disclosed, would be detrimental to the company's interest." The Restricted category is used when a document contains "valuable data not otherwise available to our competitors but which does not represent a comprehensive or conclusive segment of information." Both categories require special handling as to preparation, transmittal, accountability and custody.

Needless to say, the Critical and Restricted stamps mean nothing by themselves. The value lies in the special care and handling required when they are placed on a document. The basic difference between the two categories with reference to handling is that a Critical document requires formal accountability, that is to say that all recipients become individually accountable for their copies and must receipt for them to our central accountability file. Individual accountability is also a part of the Restricted procedure, but on a less formal and decentralized basis. Once a year we take an inventory of all Critical documents. Common to both categories are copy control, transmittal via specified gum-sealed and tape-sealed security envelopes, and storage in approved security files under key control.

It is our experience that our vulnerability to information theft is greatest after hours, and we have therefore attached great importance to the quality of locks and locking mechanisms on file cabinets. We now have standard criteria throughout the company for file cabinets used to house Critical and Restricted documents, which include specifications for locking mechanisms and proprietary lock codes. A

key control system has been established to maintain accountability on all keys which are nonrepeating.

Under our document control program, the originators of a document select the category of controlled distribution, if any, to be used, since it is our belief that only they can assess the value of documents. The procedure does provide, however, that departments may establish guidelines as to types of information to be marked Critical or Restricted. While there has certainly been misunderstanding and some abuse of the procedure, it has been our experience that the categories have been used properly and when required in the vast majority of cases. The principle of "need to know," and the idea of who needs the document rather than who gets it, are the paramount guides.

Our document control program is far from perfect and certainly does not represent the whole answer to the problem of document security. We have, however, found it to be a valuable security measure which, along with a number of other related protective measures, has made a significant contribution to the protection of our proprietary information.

At this point, I shall be happy to answer any specific questions that you may have regarding the workings of our document control program and our security measures in this area generally. Thank you.

MODERATOR SIEGEL: Thank you, Jon. Now, we turn to William Becker for the second contribution of today's session. He has been asked to expand our horizons beyond the company's walls.

Legal Status of Trade Secrets

WILLIAM C. BECKER

My topic today is the current Legal Status of Trade Secrets with subtopics concerning state or federal statutes and antitrust developments.

There are hundreds of trade secret cases decided every year and it is difficult to synthesize these cases into any trendline or cohesive picture.

I will first sketch the major considerations involving the legality of trade secrets without specific reference to case law. This is possible since there appears to be consensus on generalized rules. Then, I will follow with four or five selected subtopics.

I do think there is a trend to greater reliance on trade secret protection rather than patent protection. There is a whole field of law, of course, on the differences between trade secrets and patents, but I would call your attention to an article by J. J. Mahon, Jr. (*Journal of the Patent Office Society*, August 1968, p. 536) which compares trade secrets and patents and which states that (based upon a survey), in suits to enforce patent rights, plaintiff wins 29 percent of the time, whereas in suits to protect or enjoin the use of trade secrets, plaintiffs win 47 percent of the time. In addition, the author notes that proof and discovery in a trade secret case may and probably will be easier than that in a patent case.

The law of trade secrets is the walking of an equitable tightrope between major conflicting and socially desirable interests. As the Court said in the *Du Pont-American Potash* case:

Among the substantial and conflicting policies at play in this situation are the protection of employers' rights in their trade secrets on the one hand, versus the right of the individual to exploit his talents, use matters of general knowledge, and pursue his calling without undue hindrance from a prior employer on the other. The law recognizes that trade secrets are entitled to reasonable protection regardless of the supporting legal label. Reasonable legal protection tends to encourage, as here, substantial expenditures to find or improve ways and means of accomplishing commercial and industrial goals. The protection of such efforts when translated into trade secrets tends to encourage such efforts and the result is beneficial to the employer and presumably to society. However, it is hard to ask a man to work in a trade secret area and thereby circumscribe his possible future liberty of action and the use of his knowledge and skills which are inextricably interwoven with his knowledge of trade secrets. (*E. I. du Pont de Nemours and Co. v. American Potash and Chemical Corp.* 200 A. 2d 428, 437 (Del. Superior Ct., 1964).)

There are similar statements in nearly every trade secret case. In fact, the one thing that is endemic to trade secret cases are paragraphs of high-flown rhetoric concerning the conflict between the interests of the parties.

See *Plant Industries Inc. v. Coleman*, 287 F. Supp. 636 (C. D. Cal. 1968), quoting an article of Julian O. von Kalinowski in *Virginia Law Review*, Vol. 47, p. 583 at 599:

Protection should be afforded when, and only when, the information in question has value in the sense that it affords the plaintiff (i. e. ex-employer) a competitive advantage over competitors who do not

know of it (i. e. the trade secret), and where the granting of such protection *will not unduly hamstring the ex-employee in the practice of his occupation or profession*. This simple balancing process will invariably protect all of the pertinent interests—those of the former employer, of the former employee, and of the public.” (Emphasis added) (640)

With this kind of basis, courts can and do go off in every conceivable direction. Simply stated, the law of trade secrets is dependent upon the individual fact situation. If the situation is flagrant enough on either side, the court will find a reason to decide in favor of the innocent, or the less guilty, party. As an example, I have not read a single case involving an employee who had been fired, although in theory, I see no reason why the obligation of confidentiality imposed upon the employee should be altered by the circumstances of his leaving his employment.

No paper on trade secrets is complete unless the *Restatement of Torts* is quoted. Therefore:

A trade secret may consist of any formula, pattern, device or compilation of information which is used in one's business and which gives him an opportunity to obtain an advantage over competitors who do not know or use it. It may be a formula for a chemical compound, a process of manufacturing, treating or preserving materials, a pattern for a machine or other device, or a list of customers. (*Restatement of Torts*, Section 757, Comment (b), 1939.)

In addition, the statement from the 1969 *Patent Law Annual*, pages 17 and 18, seems particularly helpful here:

There is not much to be gained from an extended philosophical discussion of whether trade secret protection is based upon a concept of “property” or of wrongful conduct. One thing is clear. Overwhelmingly, trade secret cases arise out of some sort of misconduct: theft, bribery, breach of an express or implied contract, violation of a confidence consciously entered into or implicit in a relationship such as that of employer and employee. In marginal cases, liability may be predicated upon knowingly taking advantage of the wrongful acts of others, or occasionally of mistaken or inadvertent disclosure—cases, in other words, where one uses or further discloses the information with full knowledge that it is not publicly available and was not intended to be made available to him.

In consequence, *no protection will be given where the trade secret is the subject of independent discovery or discovery through examination or analysis of publicly available materials or products*, where it is *acquired through legitimate channels* such as disclosure without any express or implied restriction, where the user or discloser is under no obligation to refrain from use or disclosure as, for instance, where the information is deemed to be part of the acquired general knowledge and skill of an ex-employee. (Emphasis added)

In summary, the elements of a trade secret case are (1) the existence of a trade secret which is specific and can be convincingly proved (for some of the difficulties here, see *E. W. Bliss Company v. Struthers-Dunn, Inc.*, 291 F. Supp. 390, S.D. Ia., 1968); (2) disclosure to the defendant under some element of trust or confidence; and (3) use to the injury of the plaintiff.

Once you have said the above, the rest is detail and every detail can change the result.

It is my feeling, based upon our experience and my reading of cases, that the kind of relief normally granted in a trade secret case involving former employees is frequently inadequate to protect trade secrets. The injunction against continued use, with or without damages, won't do the job. There are cases in which the employee simply *cannot* go to work for the new employer *without divulging real trade secrets learned in confidence*. I think this was true in our case (*B. F. Goodrich Company v. Wohlgemuth*, 192 N.E. 2d 99 (Ct. App. Ohio 1963)). I think it was also true in *DuPont v. Potash*.

In *Wohlgemuth*, the Common Pleas Court refused to prohibit the defendant's working for the new employer. In *DuPont v. Potash* the court granted a temporary injunction prohibiting the defendant from working for the new employer in the specific location where the trade secret information would be used. This case was never tried on the permanent injunction. In the *Bliss* case, the lower court issued a temporary restraining order to prohibit the employees from working for the new employer, but this was reversed by the 8th Circuit, (408 F.2d 1108), refusing to allow trade secret protection to rise to the level accorded a covenant not to compete. In *Allis-Chalmers Manufacturing Co. v. Continental Aviation and Engineering Corp.*, 255 F. Supp. 645, (E. D. Mich. 1966), there was also a lower court temporary injunction to keep the employee from working for the new employer.

I have yet to see the case where, absent a covenant not to compete, the employee will be permanently enjoined from working for a competitor. There have been *temporary* injunctions; I have seen *no final* injunction.

There are some very specific findings by courts that the defendant would *have to use* the trade secrets in performing duties for his new employer. Even with this kind of finding, we find no permanent order keeping the employee from going to work. This reluctance on the part of courts to enter an order restraining other employment, even admitting that any other relief is futile, is or should be impetus for the rethinking of the entire matter of the covenant not to compete and its place in selected employment contracts.

I was asked to comment on the antitrust laws and their influence upon the law of trade secrets.

An article in the 1969 *Patent Law Annual* (page 15, *et seq.*) discusses this subject generally and concludes that there is little or no law with reference to this subject and apparently none at the Supreme Court level. What law there is seems to keep the two fields of concern separated. However, the author, Professor Stedman, believes that there is little reason to expect that the broad leeway accorded trade secrets owners without delving to any extent into antitrust considerations will continue.

One may say, with reasonable certainty, that one may not extend a monopoly beyond the scope of patent; for example, see *Morton Salt v. G. S. Suppiger Co.*, 314 U.S. 488 (1942), in which the court found an illegal extension of a patent in a situation where, with a patent on a salt machine, the patent holder sought to require the purchase of salt pills with the patent license. See also *Zenith Radio Corp. v. Hazeltine Research, Inc.* (23 L.Ed. 129, 1969). It is clear (see Donald F. Turner, *IDEA*, Vol. 10, Conference Number 1966, p. 32 *et seq.*) that combinations for patent pools, cross-licensing, and the like may run afoul of the antitrust law. In any event, it appears, at this time, that conditions imposed on the sale of trade secret information with restrictions on price, field of use, geographical territory, et cetera, could very well be held invalid because of the possibility that the restriction might extend protection beyond valid trade secrets protection.

I call attention specifically to the case of *United States v. Imperial Chemical Industries*, 254 F. Supp. 685 (S. D. N.Y. 1966), in which the court considered the problem of license restrictions on a licensee with reference to information developed by the licensee; and *A & E Plastik Pak Co. v. Monsanto Co.*, 396 F.2d 710 (9th Cir. 1968), in which the court held restraints on competition valid where the restraints appeared to be a normal adjunct to a trade secret agreement. The court quoted with approval from an article by David R. McDonald in *Michigan Law Review*, Vol. 62 (1964), p. 351, as follows:

... "so long as restraints are imposed solely upon those know-how licensees who have not discovered and cannot easily obtain the technology for themselves, the restraints should be valid, if reasonable. To the uninitiated licensee, at least, the know-how which is granted is figuratively a type of 'property,' and the restraints imposed on him are less burdensome than the competitive disability posed by his unfamiliarity with the secret techniques." (355)

... "the license itself, like a patent license, is a partial release of (a) monopoly position rather than the imposition of an additional restraint upon trade and commerce in the products made by the use of the know-how." (358)

The court went on to say:

The critical question in an antitrust context is whether the restriction may fairly be said to be ancillary to a commercially supportable licensing arrangement, or whether the licensing scheme is a sham set up for the purpose of controlling competition while avoiding the consequences of the antitrust laws. (715)

I have been also asked to comment on state and federal laws with reference to their effect. There is an article summarizing the law on this subject in *IDEA*, Vol. 9, No. 4 (Winter 1965-66), p. 587, by John P. Sutton.

Suffice it to say that current state acts in about six or seven states deal, so far as I know, *exclusively* with state criminal law. The problems with respect to these laws have to do with the kinds of questions particularly pertinent to criminal law—for example, whether or not intent is needed, the definition of tangible and nontangible property, et cetera. These acts do not give rise to private suits. The problem is that the statutes attempt to handle the movement of ideas and concepts by using language which is more adapted to tangible property. In addition, the whole problem of intent, due process, et cetera, comes into play, particularly with regard to a second employer who legitimately gets a trade secret and might, possibly, be prosecuted.

There is currently a bill proposed to the Congress to change the law of trade secrets, particularly as it applies to employer-employee situations requiring assignment of developments. (H.R. 15512) This proposed bill is designed to compensate employees for inventions and trade secret development as defined in the Act. There is not sufficient time here to explore all of the aspects of this Act. Suffice to say that it imposes obligations upon the employer which he clearly now does not have and provides for the scheduled reimbursement of employees who make proposals for technical improvement. This bill should certainly be followed closely.

A great deal of hue and cry has been raised with reference to what is now known as the *Sears-Compco* theory (*Sears, Roebuck & Co. v. Stiffel Co.*, 376 U.S. 225 (1964)), and *Compco Corp. v. DayBrite Lighting, Inc.*, 376 U. S. 234 (1964). Both cases dealt with the question of whether or not there is federal patent pre-emption which would prohibit a state from protecting patentable ideas. In both cases, a design patent was held invalid and the lower courts held that, despite that fact, there was unfair competition (Illinois law) in copying a lamp design and a light fixture design. (There was no finding of any attempt to palm off goods of one manufacturer as those

of another nor had the design of the goods taken on a secondary meaning.)

The Supreme Court reversed, holding that, since the design patent failed, the public generally had the right to the use of any information which was in the public domain. It might appear that these cases could have a devastating effect on the law of trade secrets. In fact, *Winston Research Corp. v. Minnesota Mining & Mfg. Co.*, 350 F.2d 134 (9th Cir. 1965) held that *Sears*:

... precludes judicial recognition of a legally protectible interest in the secrecy of industrial information as such, as distinguished from an interest in the integrity of confidential employer-employee relationships. (138)

Incidentally, if *Winston* is right, there may be various state laws with reference to unfair competition or with reference to the protection of trade secret information which may be in conflict with U. S. patent laws and, therefore, unconstitutional. (See Sutton, *id.*, p. 603.) As indicated, *Sears* and *Compco* are not trade secret cases. *Winston*, despite the quote, did protect trade secrets with a two-year injunction.

For another look at the *Sears-Compco* reasoning, see *Lear v. Adkins*, 23 L.Ed. 2d 610 (1969), in which the Supreme Court sent back to the State Court of California the question of the extent to which state law would protect information not patentable. A particularly frightening but conceivably prophetic statement is found in *Lear* where, in dissent, Justices Black, Warren, and Douglas said:

One who makes a discovery may, of course, keep it secret if he wishes, but private arrangements under which self-styled "inventors" do not keep their discoveries secret, but rather disclose them, in return for contractual payments, run counter to the plan of our patent laws, which tightly regulate the kind of inventions that may be protected and the manner in which they may be protected. The national policy expressed in the patent laws, favoring free competition and narrowly limiting monopoly, cannot be frustrated by private agreements among individuals, with or without the approval of the State. (627) (Emphasis added)

Milton Handler, writing on antitrust developments in the *Cornell Law Review*, Vol. 55, No. 2 (January 1970), was quite critical of the above quoted *Lear* dissent.

Particular attention is invited to the case of *Painton & Company, Ltd. v. Bourns, Inc.*, 164 USPQ 595 (S.D.N.Y. 1970), in which the court, construing a contract involving drawings, instructions and engineering assistance said:

This court's enforcement of such an agreement would be contrary to our national patent law and policy, *Lear v. Adkins*, *supra*. Our patent policy of strict regulation of inventions would be undercut if inventors could enforce agreements for compensation for alleged secret ideas without being required to submit those ideas to the Patent Office, and, thereby, eventually have the ideas disclosed to the public. (596)

This would seem to be following the *Lear* dissent quoted above.

I would call attention specifically to *Servo Corp. v. General Electric Co.*, 337 F. 2d 716 (4th Cir. 1964) in which the court *refused to extend the Sears doctrine* since *Servo* was an unjust enrichment situation arising out of breach of a confidential relationship.

However, there is *some* sentiment which would argue that the entire law of trade secrets should be reconsidered in light of the possible effect of the federal pre-emption doctrine. Specifically, see Martin J. Adelman, *Journal of the Patent Office Society* (October 1967), p. 713. His argument is, simply, that insofar as trade secrets are patentable and are not patented, or if no patent is applied for, they conflict with patent laws and their protection should not be permitted. Adelman particularly objects to the fact that the trade secrets are not kept secret but are, in fact, widely disclosed to employees, licensees, et cetera. And now, of course, *Lear* and *Painton*.

A couple of final items that concern me:

I have seen two cases, *Plant Industries v. Coleman*, 287 F. Supp. 636 (C. D. Cal. 1968) and *Wexler v. Greenberg*, 160 A. 2d 430 (S. Ct. Pa. 1960) in which the courts seek to make a distinction between the protection of trade secret information *developed* by an employee by his own efforts and that information which is *disclosed to him*. In *Greenberg* (with no written agreement of any type), the court enunciated the doctrine and permitted the continued use of trade secrets developed by the employee. In *Coleman*, the court seemed to approve the rule and distinction of *Greenberg*, but then found that the information had been disclosed and was, therefore, protectible. *Winston* rejects the *Greenberg* distinction. It has always been my view that the law makes no such distinction. The confidential relationship between an employer and an employee gives rise to the obligation of secrecy, whether or not the information was developed by the employee.

The last item in this paper is the problem of estoppel. I call your attention particularly to *Scott Paper Co. v. Marcalus Mfg. Co., Inc.*, 326 U.S. 249 (1945). In this case, the question was whether an assignor of a patent was estopped from attacking the patent in an

infringement action. The court held he was *not* estopped because of the public interest in the public use, and disclosure of information overrode estoppel. Justice Frankfurter vigorously dissented.

In *Lear v. Adkins* the court again turned to the problem of estoppel and once again refused to recognize estoppel urged against a licensee again holding that the interest in the public generally to the free use of information outweighed any competing arguments of estoppel. The court, considering the conflict, said:

The uncertain status of licensee estoppel in the case law is a product of judicial efforts to accommodate the *competing demands of the common law of contracts and the federal law of patents*. On the one hand, the law of contracts forbids a purchaser to repudiate his promises simply because he later becomes dissatisfied with the bargain he has made. On the other hand, federal law requires that all ideas in general circulation be dedicated to the common good unless they are protected by a valid patent. (Emphasis added) (621)

Surely the equities of the licensor do not weigh very heavily when they are balanced against the important public interest in permitting full and free competition in the use of ideas which are in reality a part of the public domain. (623)

I might end this paper on a hopeful note with a quotation frequently used. The court in *Franke v. Wiltschek*, 209 F.2d 493 (2d Cir. 1953):

At the outset of their Restatement of this subject, the distinguished authors made an acute observation on the trend of the law which has since been often quoted. They said: "But the tendency of the law, both legislative and common, has been in the direction of enforcing increasingly higher standards of fairness or commercial morality in trade. The tendency still persists. . . . The present case surely is not one where we are disposed to attempt to reverse the trend." (499-500)

And, if there is such a trend, neither would I.

MODERATOR SIEGEL: Thanks, Mr. Becker. Now we ask Walter Henderson to guide us through the difficult terrain of ASPR. Although the Procurement Regulation does not speak of trade secrets explicitly, it does refer to proprietary technical data, which companies zealously wish to protect—and thereby hangs this tale.

Government Protection and Release of Information: The Public Interest

WALTER HENDERSON

I regard it an honor to have been asked to take part in the proceedings of The PTC Research Institute of The George Washington University. The studies of the Institute parallel in many ways our preoccupation in the Department of Defense with significant issues involving the acquisition, utilization, and protection of information.

I hope that I have assumed correctly, in the light of the Moderator's remarks, that my participation in today's Clinic reflects your interest in the government's position on the issues in question, and more particularly, the position of the Department of Defense in those issues.

The functions and activities of the Department of Defense are manifold, and they all depend upon the availability of information, and the ability to use it. We depend upon information in the formulation of policy, and in the execution of it. It is essential for scientific research and engineering, for sound fiscal control, for internal administration, for intelligence and security, for coordination of international programs, for military operational planning, and for the effective acquisition, management, and support of our manpower and materiel requirements.

With all of that, it is difficult to say where our need for information begins, and where it ends. But it must surely be apparent that the interest of the Defense agencies in the protection and release of information goes far beyond that of any individual citizen, any industrial or commercial concern, any educational institution, and—I venture to say—beyond that even of other agencies of the government, save only the Congress itself, in the exercise of its power to provide for the common defense.

Although my discussion today centers largely about Department of Defense policy as it affects the treatment of industrial and intellectual properties, I offer the foregoing with the thought that our fuller understanding of those policies would profit from a better appreciation on the part of all of us for the larger scope of the government's interest in all forms of information, and its usage in the national interest.

Inasmuch as this Clinic is concerned principally with the subject of "trade secrets," giving particular emphasis to questions of ethical

standards, I shall direct my formal comments to that area, leaving for the discussion period any specific questions you might have on peripheral subjects, such as patent policy, or matters within the purview of the Invention Secrecy Act.

Standards for the protection and release of information by the Department of Defense, like any policy formulated and applied for the purpose of governing and regulating complex relationships, are the result of conflicting interests. As such, they represent in most cases a compromise solution toward reconciliation of those interests.

Public policy, of course, attempts to reach a suitable balance between opposing interests. But in government—certainly in the Department of Defense—the problem is further complicated by the fact that opposing interests weighed in one context take on different values placed in some other context with which we may be equally concerned.

If this seems abstract, let me advance to the specific.

In addressing the subject of industrial and scientific information, and the treatment of the intangible property interests which may vest in it, there are at least two contexts in which Department of Defense policy is pertinent:

First, there are interests in information as it relates to the logistics and procurement functions of the Defense mission.

Second, there are interests in information simply as it represents the yield of a sizeable investment of talent and resources, and a valuable store of scientific and technical knowledge.

Let us begin with the first. In the management of its logistical and procurement functions, the Department of Defense generates, buys, stores, maintains, and distributes an enormous amount of information. Frequently, private firms or individuals are sources of that information.

Much of it, particularly information of a technical nature, is put to use in a great many ways. It is used internally by the Department to perform research and development, design approval, quality control, maintenance and repair, training of personnel, cataloging, standardization, inventory management, and still other functions. It is used externally by the Department, too. Most importantly, it is frequently the only basis on which the government can solicit competitive bids and proposals for materiel and services. The rule of competitive procurement, as everyone knows, is a statutory requirement binding on the Department of Defense, and a matter of considerable controversy in the recent past. To discharge its duty under the law, it is essential that the Department of Defense have the information it needs, and to

the maximum extent possible, have the right to use it free of restrictions.

Unfortunately, restrictions do arise to encumber the government's use of information. One source of those restrictions are what is known in the common law as "trade secrets." And it is inevitable that information originating in the private industrial and scientific community will embody, or in some way involve, trade secrets. I hardly need instruct this group on the meaning of the term, nor on the body of law surrounding it. Professor S. Chesterfield Oppenheim, at one time associated with this university and an adviser to The PTC Research Institute, is an acknowledged authority in the field.

However, reluctant as I am to rely on my accuracy of recall (such as it is), permit me a brief recitation of the definition as it appears in the *Restatement of Torts*:

A trade secret may consist of any formula, pattern, device or compilation of information which is used in one's business, and which gives him an opportunity to obtain an advantage over competitors who do not know or use it. It may be a formula for a chemical compound, a process of manufacturing, treating or preserving materials, a pattern for a machine or other device, or a list of customers.

To this definition, Professor Oppenheim, in his casebook on *Unfair Trade Practices*, adds the note that, "A trade secret may relate to production and distribution of goods or other business operations." This is an interesting note from the standpoint of DOD policy, and we'll come back to it.

Returning to the significance of trade secrets, and to put the problem squarely in focus, the Department of Defense *needs* information pursuant to its logistical and procurement functions; and, when it does, that need is not the least diminished by the fact that somebody's trade secret is involved.

We are confounded only by the law:

What with the Fifth Amendment protection against taking of property by the government without due process *and* just compensation, we are constrained not to trifle with peoples' trade secrets without some convenient means of satisfying the constitutional requirement. As you know, the government some time ago accommodated itself by enactment of the Tucker Act (28 U.S.C. 1491), which waives the right of sovereign immunity to permit suit against the United States for breach of contract, and certain other cases not sounding in tort. But the unauthorized use or disclosure of a trade secret, as luck would have it, sounds in tort.

Congress in its wisdom has seen fit to enact a statute providing a similar remedy (28 U.S.C. 1498) which leaves the way clear for the government to infringe patents and copyrights free of the threat of injunction, and to permit its contractors, with the government's authorization and consent, to do likewise. Thus far, however, no such relief has been provided to facilitate the government's ready use of a trade secret let alone compel its disclosure, without the owner's permission. And seldom is such permission casually bestowed. Indeed experience shows that owners of trade secrets tend to be, not surprisingly, secretive.

In a statute (10 U.S.C. 2386) which permits the government to "acquire" patents and copyrights, Congress did throw in "designs, processes, and manufacturing data." This does cover most trade secrets. But it confers no authority for the government to compel anyone to disclose a trade secret unwillingly. Nor does it permit the government to violate any confidence imposed on its disclosure. The Comptroller General has told us in firm tones, for example, that we can't include proprietary data in bid solicitations without the originator's prior consent (see B-143711, decided December 22, 1960). In fact, federal law imposes a criminal penalty on any U. S. government employee guilty of unauthorized disclosure of a trade secret (18 U.S.C. 1905).

In short, if the government wants knowledge of a trade secret, or the right to use it, it must bargain first, and successfully at that. And experience also shows that owners of trade secrets tend to bargain hard.

The effect of all this is that the government is left with no alternative but to work out elaborate policies and procedures for acquiring trade secrets, when it needs them, on a contractual basis. The pertinent policies and procedures are spelled out in some particularity, for the most part in Section IX, Part 2, of the Armed Services Procurement Regulation (ASPR). From its genesis in 1955 as a modest, simple paragraph, it has grown over the years to the present rather extensive coverage. It is a bit lengthy to permit of treatment in detail within the time available here. However, a few points deserve brief mention.

First, we have been talking quite a bit about "trade secrets." ASPR doesn't. In fact, an expert on trade secrets reading ASPR Section IX, Part 2, might well conclude that its drafters really didn't have in mind using its language and guidance for the purpose of contractually acquiring trade secrets. He would be partially right. The ASPR approach doesn't attempt to capture trade secrets, *per se*. It attempts

simply to spell out the government's minimum essential requirement for "data," without regard to trade secrets, and to obtain for the government an equitable distribution of rights to its use. Briefly, it works this way:

Data which the contractor is required to deliver is listed in the contract on a form, like an order blank. The clause prescribed by ASPR is also made a part of the contract. The clause operates to determine the rights which the government acquires in the data listed on the requirements list. Under the terms of the clause, the government agrees that data pertaining to items, components, and processes developed at *private expense* (here is where the trade secrets come in), and delivered to the government marked with a legend prescribed by the clause, will not be disclosed outside the government, nor be used by the government itself for manufacture, without permission of the originator of the data, except in certain specified situations.

I called attention earlier to the *Restatement of Torts*, which contemplates that a "list of customers" would constitute a trade secret, and to Professor Oppenheim's mention that trade secrets may relate to the "distribution of goods or other business operations." Under Section IX, Part 2 of ASPR, only technical data,—that is, drawings, specifications, and the like—are protectible. The reason for excluding nontechnical data from the body of protectible subject matter under this provision of ASPR is unknown to me. To my knowledge, it is the source of no particular problem in our procurement of such data. Nevertheless, I would be interested in the rationale, if there is one, as to why ASPR has traditionally stopped somewhat short of treating the full scope of subject matter contemplated by the common law.

Earlier, I adverted to the problem of balancing relative interests when the values they represent are subject to differences in context or approach. Until now I've talked about relative interests of the government on one side, and the industrial and scientific community on the other, in the context of their relationship as a buyer and a seller. In many ways, the interests of these two are inherently in conflict with one another. The buyer seeks maximum accessibility to information in the interest of broadening the competitive base. The seller seeks the minimum accessibility to information in which he enjoys some exclusivity of knowledge in order to advance his own position against the competition in the marketplace.

But now, let's look for a moment at information in the other context—as a source of the useful and valuable knowledge which it represents. In this context, the interests of the government on the one hand, and of the scientific and industrial community on the other, are

still opposed to one another. But their relative interests have shifted. In fact, they have exactly reversed! Government, the custodian of a considerable store of new scientific information stretching across the whole span of defense research and engineering and mindful of the importance of technology in maintaining military and economic superiority in this unsettled world seeks to maintain prudent controls over its availability. In contrast, the scientific and industrial community, on its side, hungrily seeks out solutions to their research and engineering problems from amongst the voluminous reports, documents, files, and memory banks which represent the repository of Defense-sponsored information.

Here, the government finds itself in an ambivalent situation. While careful to preserve our national security, it must and does recognize also the potential benefit to our own economic and technological progress through programs of effectively disseminating scientific and technical information. And so, once more, government and industry must collaborate in finding a suitable balance which accommodates both objectives.

Recognizing the urgent need in our society to be able to manage and handle this growing store of scientific information, the Federal Council for Science and Technology, in 1962, established the Committee on Science Information. Under its charter, the Committee was directed to examine the interrelationships of existing information services, both in and outside of government, and to establish standards for and coordination of such services within government. In an amendment to its charter in 1964, the organization was renamed the Committee on Scientific and Technical Information (COSATI). It was directed to develop among the Executive agencies a coordinated but decentralized technical information system for use by scientific and engineering professionals. In addition, it was to review the adequacy of existing technical information programs, and to develop new and improved programs as needed to better meet the requirements of Executive agencies, and to facilitate the national and international interchange of scientific and technical information.

In the years since, COSATI has made some notable accomplishments. I might cite just a few. First, there has been established a Clearinghouse for Scientific and Technical Information, a central repository where government reports and similar documents are made available to the public. Through the support and auspices of COSATI, the Information Analysis Center concept has been expanded. These centers, geographically dispersed, repackage various kinds of information for special audiences. Some 120 of such centers are now carried in

the COSATI directory. Under the sponsorship of COSATI, a number of significant studies have been conducted and reported. One, for example, which may be of interest to The PTC Research Institute is entitled *The Copyright Law as it Relates to National Information Systems and National Programs*. Finally, COSATI has developed a training program for potential users of information systems. In cooperation with the Office of Education, pertinent training films are being produced. Lecture materials are already available.

In the entire field of policy concerning the public interest in government information—particularly scientific and technical information—probably no problem is more complex than that of resolving the conflicting objectives of, on the one hand, protecting such information in the interest of national security, and on the other, disseminating it in the interest of broadening its utilization for the good of society. At the present time, the Department of Defense is actively considering various actions relative to the security classifications of research and engineering information in order to assure a correct balance between these two objectives.

I could hardly conclude my presentation on this subject without some reference to PL 89-487—the so-called Freedom of Information Act. Its enactment by Congress in 1966 had as its purpose the establishment of a “general philosophy of full agency disclosure unless information is exempted under clearly delineated statutory language” (S. Rept. 813, 89th Cong., 1st Sess., 1965).

Reflected in the Act is the concern on the part of our legislators to provide sound policies governing the availability of government records and documents. But the legislative history of the Act reflects, too, how complex is the search for rules by which to achieve the fullest responsible disclosure of information, while preserving the delicate balance of all interests involved. The Act provides a court procedure by which citizens and the press may obtain information if withheld contrary to the intent of the law. Undoubtedly, we will see that procedure invoked many times in the years to come, with the courts along the way weighing again and again the conflicting interests involved. Many questions will revolve around interpretation of the nine exemptions afforded by the statute to the disclosure rule. The fourth of these nine exemptions is of particular interest to this group. As defined by the statute, it embodies

Trade secrets and commercial or financial information obtained from a person and privileged or confidential. (5 U. S. C. 522 (b) (4))

The language should afford all that is necessary to enable agencies to continue extending their protection to trade secrets disclosed to the government in confidence and technical data subject to limited rights in compliance with ASPR.

I would like to conclude with one last thought. I referred at the outset of this presentation to the very considerable interest which the government has in all forms of information, and in its usage. The government's interest is really the public's interest. And in government's stewardship for the public, it must never lose sight of the fact that ours is essentially an open society. Free access by the public to information in the government's custody is the general rule. We start at that baseline, and from it, define those areas where the public's interest is best served by restrictions on the availability of information. Our security policy proceeds on that theory. And our policies concerning the handling of information which affects the intellectual property rights of each individual citizen proceeds on the same theory. Respect for those rights is, after all, in the long-term best interests of all of us.

MODERATOR SIEGEL: Thank you, Walter Henderson, for your illuminating comments on ASPR and other provisions for the procurement of defense systems and equipment.

At this juncture, I wish to refer to a recent case that has stirred some interest today. Mr. Toomey advises that the citation for *Painton and Co. v. Bourns, Inc.* is 68 Civil Reports 3834, in the U.S. District Court, Southern District, decided February 4, 1970 by Judge Constance Baker Motley.

Now, we come to the fourth key input to this Clinic on Trade Secrets. I call upon the man whom we fondly know as "Oppie" and who has been teacher to so many of you. Professor Oppenheim.

Sherman Act Suits Involving Trade Secrets

S. CHESTERFIELD OPPENHEIM

I am focussing on questions which involve the interaction of unfair competition or unfair trade practice law and the antitrust laws, particularly the Sherman Act, related to misappropriation of trade secrets. These questions have emerged in recent years and may be of

greater significance as time goes on. The principal question to which I am addressing this discussion is whether a company, whose employees have been enticed or lured away by a competitive company, can obtain an injunction and recover treble damages in a Sherman Act suit based on the theory of a combination or conspiracy in unreasonable restraint of trade.

In a trade secret context we usually think of a corporate raid of key technical employees where more than one employee is lured into the employ of a competitive company, which may be either a well established enterprise or a newly created competitor.

Preliminarily we should mention that among the remedies available for redress of Sherman Act violations is the private suit for injunctive relief, which is usually accompanied by a prayer for treble damages. The cases I shall discuss are such private antitrust suits. In the 1960's such suits arose in the federal courts. Bill Becker was quite right in saying that, when one discusses trade secret litigated cases, the factual variants must be carefully noted. I shall therefore attempt to specify the salient facts in each of the cases to which I make reference.

In dealing with these factual situations, it is essential to keep in mind the basic distinction in antitrust law between individual or unilateral conduct of a single corporate entity or a single individual and concerted action of two or more persons or entities. Section 1 of the Sherman Act prohibits a combination or conspiracy in unreasonable restraint of interstate trade or commerce. Hence, Section 1 requires a plurality of actors for its violation—at least two persons acting in concert. This creates the element of a combination or conspiracy.

If only one competitive company is the actor inducing the switching of employees from the rival company, this falls under Section 2 of the Sherman Act prohibiting "any person" from monopolizing or attempting to monopolize any part of interstate commerce in a defined relevant market. Section 2 has been interpreted by the United States Supreme Court to require proof of monopoly power—the power, even though not actually exercised, to control market prices or to exclude competition. (See the recent monopolization Supreme Court case, *United States v. Grinnell Corp.*, 384 U. S. 563 (1966). Such proof can generally be adduced only if the luring company is dominant in the relevant market for the goods or services and has a predominant share of that market. An attempt to monopolize requires additional proof of a specific intent to accomplish the unlawful monopolization. A competitive company long established may be exposed to such proof but a

newly created rival company presumably would generally not present such a dangerous probability.

Let us now turn to facts of the private suits involving Sherman Act charges to see whether the above distinctions have been observed and the extent to which the alleged offenses involved confidential subject matter ordinarily protectible as trade secrets or other confidential information safeguarded at common law or in courts of equity.

In *Atlantic Heel Co. v. Allied Heel Co.* (284 F. 2d 879 (1st Cir. 1960)), the court held it was a per se violation of Section 1 of the Sherman Act to engage in a conspiracy to destroy a competitor by the following alleged unlawful means: Proselyting key employees; misappropriation of trade secrets; intentional false statements regarding plaintiff's financial condition; interference with plaintiff's source of raw materials; visits to plaintiff's plant to disrupt work.

The plaintiff company had a substantial share of the leather heels market and the enticed employees were key personnel. The Court of Appeals held that a cause of action was stated. It may well be startling to an antitrust law specialist that the court held that the allegations, if proved, would constitute a per se violation of Section 1 of the Sherman Act as a conspiracy to destroy a competitor by means inimical to the free flow of interstate trade and not within the area of fair and honest competition.

To date the United States Supreme Court has condemned as illegal per se violations of Section 1 of the Sherman Act agreements which have no other purpose than the stifling of competition. These are agreements among competitors to fix prices, control production, allocate markets or customers, and group boycotts. *Atlantic Heel* is far removed from such practices which by nature and character are inherently suppressive of competition. Citing *Klor's, Inc. v. Broadway-Hale Stores, Inc.* (359 U. S. 207 (1959)), the *Atlantic Heel* court said there was no need to prove public injury or the unreasonableness of the restraint.

The court approved its earlier 1930 rationale in *Mitchell Woodbury Corp. v. Albert Pick Barth* (41 F. 2d 148 (1st Cir. 1930)), *aff'd* 57 F. 2d 97 (1st Cir. 1932), where a dominant defendant company was charged with enticing trusted employees of the plaintiff. The employees were alleged to have had access to confidential information while in the employ of the plaintiff and to have solicited customers of the plaintiff in behalf of the defendant before leaving the plaintiff's employment. The court held that allegations of a conspiracy with intent to suppress interstate commerce unreasonably and to destroy the plaintiff was a violation of Section 1 of the Sherman Act and

remanded the case for trial. In *Atlantic Heel* the court considered *Pick Barth* as also within the area of an illegal per se violation and approved that rationale.

On appeal in *Pick Barth* the court's opinion affirming the judgment for the plaintiff sustained the reasoning as well as the conclusions reached by the district court. The tenor of the entire opinion supports the illegal per se conspiracy approach the *Atlantic Heel* First Circuit opinion also approved.

In *Perryton Wholesale, Inc. v. Pioneer Distributing Co.* (353 F. 2d 618 (10th Cir. 1965), cert. denied 383 U. S. 945 (1966)), the court granted an injunction, and treble damages of about \$98,000 were recovered in a Section 1 Sherman Act suit. The plaintiff, Pioneer, had a dominant market position as a rack jobber furnishing retailers with racks for display of goods in Western Kansas and Eastern Colorado. The defendant was a rack jobber competing with Pioneer at one time in only one Kansas town. Some knowledge and skill are required in the racking of the goods, and the training of route salesmen, who solicit new accounts, is considered important. Several Perryton employees switched to Pioneer. One of them became a sales manager for Perryton; another became a Perryton supervisor, and a third was an experienced salesman. Altogether, five employees left Pioneer for Perryton.

The court held there was a violation of Section 1 of the Sherman Act by conspiratorial conduct involving unfair means. The court ruled that a substantial effect on interstate commerce was not essential if the restraint is unreasonable. The court supported findings that the defendant successfully induced the trained and trusted employees to change their employment and bring with them the customers, routes, and business methods of their former employer, thus causing plaintiff loss of business and the burden of training new personnel.

In *Vogue Instrument Co. v. Lem Instruments Corp., et al.* (40 Fed. Rules Decisions 497 (S.D.N.Y. 1966)), the District Court denied a motion to dismiss a complaint charging violations of both Sections 1 and 2 of the Sherman Act. Three former employees of a company acquired by the plaintiff formed a new competitive company. It was alleged that they solicited business from the purchased firm's customers; caused employees to leave the other company; caused a principal customer to break his contract and transfer his business to the new firm by inducement of defendant's unreasonably low prices; disparaged the competitive firm; appropriated drawings, customer information, and other trade secrets; and that all of this conduct was to the end of destroying the other firm and its ability to compete. The

individual defendants were key employees of the plaintiff's acquired company. One was production manager, another was the chief designer, and the third was a key consultant. The business involved manufacture of brakes, clutches and other components used in space vehicles.

In denying the motion to dismiss, the court nevertheless expressed reservations reflected in the following comments:

... The case scarcely conveys to "the expert feel of lawyers" . . . a sense of striking, or even familiar, Sherman Act implications . . . and the "restraints" alleged are a garden variety of unfair competitive practices reachable, and normally reached, under state rather than federal law.

The most recent case in this series is *Metal Lubricants Co. v. Engineered Lubricants Co.* (284 F. Supp. 483 (D. Mo. 1968)). The court held that four employees of the plaintiff who agreed to and did engage in a business in competition with their former employer did not violate Section 1 of the Sherman Act.

The plaintiff dealt in custom-made lubricating oils and compounds for machine metal work, involving cutting, grinding, and drilling applications. Sales of this segment of plaintiff's business in its St. Louis division depended on quality of service, visits by salesmen to the customer's plant to determine the customer's needs, and several years of training of the sales force. One defendant was a commission salesman for plaintiff for six years, and the others were part of plaintiff's sales staff. The creation of the defendant as a new competitive company was preceded by dissatisfaction with the plaintiff's St. Louis division.

The plaintiff charged a conspiracy and breach of fiduciary obligation. The court concluded that plaintiff failed to prove substantial misappropriation of confidential information and hence there were no protectible trade secrets. It found that the knowledge of the former employees regarding the market, identity of customers, and personal contacts were not within the category of protectible confidential information. Most of the information, including the working ingredients of a product, were in the defendants' heads and part of their general knowledge.

On the Sherman Act charge, the court said that in the *Perryton*, *Atlantic Heel* and *Pick Barth* cases, discussed *supra*, there was a conspiracy with unfair competition. But in the case before it, the court said no such elements existed and there was no unreasonable restraint of trade. On the contrary, competition was fostered by the creation of the new defendant company.

The Court of Appeals affirmed (412 F. 2d 426 (8th Cir. 1969)). The court agreed with the court below that there was lack of proof of both wrongful appropriation of trade secrets and a conspiracy to eliminate the former employer from competition. Missouri cases were cited holding that employees may agree among themselves to compete with their former employer on termination of their employment, absent a valid covenant not to compete or breach of confidential relationship.

Referring to the *Perryton* and *Atlantic Heel* cases *supra*, the court said that "resolution of the Sherman Act issues here does not turn upon the fact that in the above cases the raid of a corporation's key employee was made by *an established concern* with intent to disrupt and ruin the competitor's standing." (Emphasis by the court.)

We can now attempt to pull together the threads of some kind of synthesis in this novel area where the conventional remedies for redress of unfair trade practices intersect with Sherman Act antitrust concepts and private suits thereunder for injunctive relief and treble damages.¹

First, I would call attention to the package of unfair trade practices alleged in the cases I discussed which go beyond the narrow category of trade secrets with which the discussion in this Clinic is primarily concerned. (For the spectrum see Oppenheim, "The Judicial Process in Unfair Competition Law," *IDEA*, Volume 2, Conference Number 1958, p. 116.)

Second, there was a plurality of actors charged as defendants in each of the cases discussed. The recent decision of the Supreme Court in *Albrecht v. Herald Co.* (390 U.S. 145 (1968)), is believed by some commentators to expand the reach of the combination concept under the Sherman Act. Generally, combination and conspiracy are used interchangeably in Section 1 Sherman Act cases. In my view there is no tenable basis for the application to unfair trade practice factual situations of the automatic and oversimplified illegal per se rule to Section 1 conspiracy charges, as was done in the First Circuit *Atlantic Heel* case, *supra*. As previously stated *supra*, that type of case is a far cry from the kinds of agreements among competitors the Supreme Court has condemned as conclusively and inherently suppressive of competition and without any redeeming virtue.

¹ *Georgia Law Review*, Vol. 2, (1968), p. 372. While I generally concur in the author's concern with respect to ill-considered application of the Sherman Act to traditional competitive torts, I do not regard the single corporate concept as necessarily the crux of the rationale at issue.

The cases I have discussed are especially appropriate for an extended Rule of Reason inquiry into all of the relevant facts and circumstances before a determination of either the reasonableness or unreasonableness of the restraint is made. Indeed, the factual situations in cases I have discussed are more appropriate for determining whether the restraints alleged are reasonably ancillary to a main lawful objective, such as preserving the competition of an established competitive firm or the potential competition of a new entry of a competitive company. What weight should be given to the fact that either the plaintiff company or defendant company has a dominant position in the relevant market? or that the defendant is a newly created enterprise seeking a share of the market in the relevant product or service? These and other factors are pertinent to whether the restraint tends to promote or to stifle competition.

Third, so far as trade secrets are concerned, the entire body of law on that subject reveals the difficulty of applying the principles in 4 *Restatement of Torts*, Sections 757, 758. For example, the business of making components for space vehicles in *Vogue Instrument, supra*, may involve technical information of a higher dignity than the knowledge required for rack jobber salesmen in *Perryton Wholesale, supra*. Beyond the trade secrets, the factual variables in other alleged tortious conduct, such as disparagement and interference with contractual relations, are not readily resolved. (See Oppenheim, *Unfair Trade Practices* (2d.ed. 1965), Chs. 5 and 10.)

I share the concern expressed by Mr. Boone in his article (*supra* note 1) that the courts should exercise care in granting relief under the Sherman Act in the competitive tort cases here discussed. I believe that in a corporate raid of key employees of a competitive concern, issues such as wrongful appropriation of trade secrets or other tortious practices and the element of conspiracy between the enticing company and the former employees of its competitor do not apply in the case of conduct of a single company. If the acts in question are attributable solely to the enticing company as a single entity, the general rule that a corporation cannot be held guilty of conspiring with its officers, agents and employees applies. (See *Nelson Radio & Supply Co. v. Motorola, Inc.*, 200 F. 2d 911 (5th Cir. 1952).) But in the cases discussed, the defendant company was not the sole actor in inducing a switch of the former employees of the competitor. The enticed employees actively participated with the enticing company in conduct that may be appropriately characterized as concerted or conspiratorial.

I am aware of the danger of overexpanding the implied conspiracy doctrine, once described by Justice Jackson as "loose practice" for an

“elastic” and “sprawling” conspiracy doctrine. (Concurring opinion in *Krulevitch v. United States*, 336 U.S. 440 (1949).) Yet if each of the enticed employees knew that his switch of employment to the competitor company contemplated joint action of his other enticed fellow employees and the enticing company, this may well be deemed beyond mere conscious parallel conduct by independent decision-making of each one of the actors and within the area of conduct stemming from an agreement or conspiracy (See those distinctions as explained in *Theatre Enterprises, Inc. v. Paramount Film Distributing Corp.*, 346 U.S. 537 (1954).)

It seems to me that it is immaterial whether the switching employees acted concertedly prior to or after their termination of employment with their former employer. So long as their joint action is aimed at the end purpose of a breach of confidential relationship or other proven tortious conduct, the collusive acts go beyond mere individual vertical employer-employee relationships with the former or new employer² and drift into a horizontal conspiracy.

What I have said is not intended to voice approval of substituting Sherman Act sanctions for the well established competitive torts. Unfair competition doctrine has moved within its own orbit of remedies since the privilege to compete fairly in a private business was recognized in 1415 in *The Schoolmaster's Case*. Likewise, restraint-of-trade doctrines are also deeply rooted in common law to preserve competition, and the antitrust laws are statutory extensions of that policy. But unfair competition and antitrust doctrines are not always mutually exclusive. They may overlap, as demonstrated in the cases we have analyzed. It then becomes the duty of the courts to exercise caution in making a proper accommodation of these two bodies of law so that the antitrust policy of maintaining competition does not come into undue conflict with the goal of unfair competition doctrine aimed at regulating the plane of competitive rivalry by curbing unprivileged tortious conduct.

MODERATOR SIEGEL: Thank you very much, Oppie. According to the procedure we are following, we shall continue to devote about five minutes to clarifying and amplifying questions.

ERNEST H. BECK: Beck, Du Pont. I'm interested in what I think you characterized as a border-line conspiracy situation. Let's say we have

² For a perceptive opinion distinguishing the vertical manufacturer-distributor or dealer relationship and the preservation of the manufacturer's unilateral right to terminate a distributor and resort to direct dealing with customers, see *B & B Oil & Chemical Co. v. Franklin Oil Co.* (293 F. Supp. 1316 (E.D. Mich. 1968) (per Judge Talbot Smith).)

Company A, which is large and has a whole variety of operations. Company B has many operations, some in common with Company A. Company B has an employee who is a specialist in an operation which is in common with the kind of operation practiced by Company A. Company A solicits and hires this employee from Company B. The employee from Company B doesn't know precisely where he's going to fit into Company A. But, when he gets there, he's put into this directly competing operation in which he has special knowledge. Is it your view that this sort of a fact situation may be sufficient to establish a conspiracy?

PROFESSOR OPPENHEIM: I doubt it. If one can assume that only Company A actively solicits and hires this one employee from Company B, and that later the enticed employee fits into a slot in which he is a specialist in an operation competitive with Company B, it would be a distortion of the conspiracy concept to charge Company A with conspiracy. There was no preconceived purpose to hire away the employee by inducing a breach of trade secret confidentiality.

MR. BECK: This assumes that the mobile employee did not know in advance what he was going into. If he had known, if there had been a prior discussion, would you expect a different result?

PROFESSOR OPPENHEIM: Yes. There is no more than the enticement of one individual, rather than a corporate raid on the competitive company's technical specialists. But if, prior to the switch, Company A and the employee had agreed on the purpose of placing the employee in the competing specialized job, that might possibly be considered concerted action or conspiratorial conduct.

In the office machines industry, for example, especially computers, we know there have been raids by one corporation on trained personnel—programmers or other technical employees—of a competitor. I would distinguish situations where multiple employees are enticed away. There may be overt acts prior to the switch occurring while the enticed employees are still in the employ of the former employer. If each of the various enticed employees is aware and has knowledge that the objective of the enticing company and among themselves is to accomplish a raid on key employees, that may be more than mere conscious parallel conduct and may involve the element of conspiracy. It is like a chain reaction. Each one knows what the others plan to do and all are aiming at the same end result. They may no longer be in a position to claim that each one acted independently and individually. I referred to this distinction when I cited the Supreme Court *Theatre Enterprises* case in my main discussion.

MR. BECK: Are you ruling out conspiracy between the prospective new employer and an individual existing employee?

PROFESSOR OPPENHEIM: I think that's the strongest case for ruling out conspiracy. If the situation is limited to a prospective new employer and an individual employee of the other employer, that would be a vertical and bilateral relationship between one company, acting on its own, and the individual employee. I think that, if the courts ever get to the point of holding that, where a particular company had induced an employee to make the change and to fill a particular slot and therefore that constitutes a conspiracy, we would have gone a long way toward preventing mobility of technical employees. I think that's going too far.

HORACE B. COOKE: Oppie, you wouldn't apply the same rule if the employee of Company B comes to Company A. If I'm an expert and have knowledge in this field, and you are working in the field, I can bring you my knowledge and training. Here, the solicitation is made by the employee of B; he solicits employment by A. Now what do you think?

PROFESSOR OPPENHEIM: In an active solicitation of new employment by the expert employee himself, I am inclined to think that the question is whether there is a breach of a fiduciary trade secret relationship, rather than an antitrust application of conspiracy. In other words, I can't see any horizontal element of combination or conspiracy. It seems to me that is a typical case where the employee is actively soliciting new employment giving the competitive company reason to believe he is going to bring with him trade secret information. Obviously, you have a question of fact. Does the employee come to the competitor and say, "I am an expert in this field and I am equipped by years of experience to do a lot of good for your company?" What does that infer? It's a question of fact whether he is actively inducing employment to disclose trade secret information to his new employer in breach of confidence. On the other hand, he may merely be bringing valuable experience and information to the new company without any violation of trade secrets.

MR. COOKE: Just to complicate the question, we might assume that this employee is a member of the patent department—

PROFESSOR OPPENHEIM: Well, then you have the circumstantial presumption of trade secret information and liability for breach of confidence.

PETER F. CASELLA: Peter Casella, Hooker. Oppie, did you touch on the case in which there is only one company in existence and three key employees, during coffee break, decide to branch off and start their

own competitive company? Did you consider a case touching on that situation?

PROFESSOR OPPENHEIM: The cases I discussed do not involve that. The fact that three key employees decide to start a competitive company against the one company in existence is a factual situation of a different complexion. We know that, in the Boston area in the electronics field, we have had many cases of former employees starting a competing enterprise. Of course, if there is a valid covenant not to compete for a reasonable period of say, one year, and a reasonable geographic area, the employer may have an action on that covenant. In the absence of such a covenant, the mere fact that several employees decide to launch a competitive business should not be the basis for an injunction on the theory of an antitrust conspiracy. That would defeat the public policy of preserving actual or potential competition.

The collective decision of the several employees may be sparked by one of them who has the idea of starting a competitive business. He may tell the others he can raise the capital and may persuade them to become partners or to incorporate the competing firm. I would be concerned that, since they are technically trained in their present employment, there may be a charge of conspiring to form a new enterprise to the injury of their present employer. Technically, they would be acting in concert prior to the formation of the new company, but I hope the courts would not go astray in oversimplifying this as a combination or conspiracy in violation of the Sherman Act. Once three employees get together to plan the new enterprise, it can be argued that they have acted collusively, instead of individually. One of them could entice the others, and all of them would have the common purpose of creating a competitive company. The court might say that the employee who started the ball rolling was the architect of what ultimately is a conspiratorial arrangement. But suppose each employee independently had the idea of starting a competitive firm and each one went to the others and made the same sort of proposal. Would that refute the concerted action?

What I am concerned about is that the antitrust laws should not become the basis for aborting a genuine objective of starting a competing enterprise. This would be even worse if the court should apply the *per se* illegal Sherman Act violation rule to such a situation. That would be a complete distortion of the basis for such a ruling. At the least, the court should apply a Rule of Reason and inquire into all of the surrounding facts and circumstances. On the face of the situation Mr. Casella stated, I would say that, apart from enforcing a valid covenant not to compete, the former employees should be free to

engage in a competing business. That's what competition is supposed to make legally permissible.

Moreover, I am concerned about using antitrust law to displace the traditional tort remedies under the unfair trade practices doctrines. Sometimes, antitrust overreaches and gets into areas not intended by the antitrust laws. It may then boomerang and, if the antitrust laws are used to destroy mobility of former employees who decide to go into a competing business as entrepreneurs, the pendulum will have to swing back to preserve freedom of employees to start a new competing business. I would stick to the law of unfair competition to deal with situations like these. If there is misappropriation of trade secrets by the employees, the case should be decided on that ground and not on antitrust policy grounds.

JOSEPH C. REDMOND, JR.: Could I call attention to the other side of the coin—the affirmative defense by a former employee or a company formed by former employees of antitrust violation by the former company? In other words, say that I leave and go to another company for personal reasons and I am sued for appropriating trade secrets. Could I assert an affirmative defense of antitrust violation?

PROFESSOR OPPENHEIM: We have that problem too, where antitrust is set up as a defense. You might even say this may involve misuse of trade secret rights, like misuse of patent rights. I think this difficulty is going to show its head more and more. I didn't go into the licensee situations, where you have a package of different problems, such as the question of to what extent your know-how remains protected.

MR. BECK: What was the reference, Professor, to Justice White's enlargement on the conspiracy doctrine—in what case?

PROFESSOR OPPENHEIM: *Albrecht v. The Herald Company*, 390 U.S. 145 (1968).

K. ROBERT BEDELL: Bob Bedell, U.S.I. Did I hear correctly, Professor, when you said that if information is readily assembled from memory infringement is not involved?

PROFESSOR OPPENHEIM: The Missouri Federal District Court said so in the *Metal Lubricants* case regarding the employees' knowledge of the market, identity of customers, and personal contacts.

MR. BEDELL: Including engineering know-how and all the things that we get into in developing a process?

PROFESSOR OPPENHEIM: Apart from the *Metal Lubricants* case, I thought that trade secrets include customer lists.

MODERATOR SIEGEL: Trade secrets are often held to include lists, do they not?

PROFESSOR OPPENHEIM: If it's a customer list case, some courts have said so—and California has had many such cases. But I can't see reliance on memory for the kind of art that is involved in highly technical data. That's stretching general knowledge or subjective skill all out of shape.

MR. BEDELL: That could be a real danger, as in the case of *American Potash* referred to by the Du Pont man. People with engineering know-how that they've developed in setting up a plant and so forth—all that is in your memory—could join a competitor.

PROFESSOR OPPENHEIM: As a matter of fact, the *Perryton* case was one in which rack jobbers and salesmen on the route were stacking shelves with Campbell soups. There, it might be a little harder to say that you can't carry away that kind of a skill in your head. Racking up shelves and getting orders, however, are matters which do not seem to involve much by way of trade secrets; yet this is one of the cases, the *Perryton* case, in which the plaintiff made the grade in getting an injunction against the defendant. It seems to me that this isn't a sound case.

MR. BEDELL: Let's hope that 1968 case is not repeated, then.

WILLIAM K. FULTON: In a case with which I'm familiar, Judge Friendly held that taking out anything committed to memory couldn't be prosecuted as a criminal violation. He left it very clear that the matter could be handled in a trade secret suit. I liked the way he phrased it that the information was "taken out in the recesses of a thievish mind."

PROFESSOR OPPENHEIM: Yes, and also I say it's storage, just like in a computer. If you can store information in your brain lobes, I don't see the difference between doing so and storing in a computer, do you? (Laughter) You know, some people have a good memory storage compartment, and that helps.

MR. BEDELL: Somebody else was talking earlier about the *Aries* case. Wasn't that a case involving memory in some degree?

MODERATOR SIEGEL: Samuel Slater, we should also recall, brought a lot of British technology over in his head. As Mr. Henderson is especially aware, problems relating to confidentiality may arise when competing bidders have recourse to a common pool of outside technical consultants.

PROFESSOR OPPENHEIM: What about the person with a photographic memory? Are you going to let him off the hook? (Laughter) Suppose he can remember all he sees? (Laughter)

MODERATOR SIEGEL: I'd like at this point to revert to the discussion of our four principal contributors. The first speaker, you will recall, was Jon Rogeberg of Merck, who talked to us about company

management of trade secrets. Let us return to a more intensive examination of some of the ideas he developed.

ROGER R. HORTON: This is Roger Horton. I'd like to ask Jon a couple of questions. You've indicated that the disclosure agreement that Merck uses made a requirement that certain data not be divulged. Is there any effort made to specify such data at the time the employee comes on board?

MR. ROGEBERG: In rather broad terms—again, I am not a member of the legal staff and I am not myself an attorney—let me give you a layman's answer. I think our legal staff recognizes certain dangers in being too specific as to the types of information not to be divulged. Because of court decisions which have held the plaintiff to the letter of the agreement, there has been an avoidance of very specific terminology.

MR. HORTON: Do you refer to your classifications?

MR. ROGEBERG: No, we do not. Because the existence of this document-control program in no way implies that other company information, falling outside the scope of the program, is not also company property.

MR. HORTON: Now, I seem to recall—I can't cite any cases—but I seem to recall something in the books to the effect that you have to do something to show that the information was secret in order to try to protect it. And, of course, you have done so in your document-control program, but you don't have a reference in your employee agreement, I gather.

MR. ROGEBERG: I don't fully understand your point.

MR. HORTON: Well, you've already answered my question really. You said that in your employee agreement you don't specify any particular types of information that are secret. You rely on your document-control program for that.

MR. ROGEBERG: Of course, we do refer to information which is obtained in the course of a person's employment without specifying precisely the kinds of information. In other words, we're telling employees that certain broad categories of information are company property.

MR. HORTON: You mentioned you had a termination statement. Now, is that a statement made to the employee?

MR. ROGEBERG: That is a statement which is read by the employee, and signed.

MR. HORTON: And signed. Suppose he refuses to sign?

MR. ROGEBERG: I knew you were going to ask that, and I can't answer it. I'm not aware of an instance in which this actually

happened. (Laughter) I'm sure it will happen, if it hasn't already. And I don't think that there's any way that we could force or compel anybody.

MR. HENDERSON: Did you cover unsolicited proposals? Do you know what I mean by an unsolicited proposal?

MR. ROGEBERG: Not necessarily—

MR. HENDERSON: I refer to ideas submitted with the intention of interesting a prospective purchaser or licensee. Let us say some private individual outside your company comes to you and says that he knows you are in the business of such and such, and he has an idea that you might evaluate, that he might be interested in licensing for your use.

MR. ROGEBERG: Well, that would really fall into a different arena, if I understand your question correctly. We're talking mainly about protecting company information from the would-be disloyal employee.

MR. HENDERSON: Yes, but this other situation generally touches on company liability arising out of alleged misappropriation.

MR. ROGEBERG: Our document-control program does not address itself to that type of situation.

G. F. MAGDEBURGER: Mr. Moderator, I'd like to ask a question here. Jon, you mentioned that all of your employees as a condition of their employment signed this confidential agreement. I assume that that includes your invention assignment agreement also. It's all in one package. Now, how far do you extend that? You say to all employees. Do you really mean that?

MR. ROGEBERG: Yes, I mean that.

MR. MAGDEBURGER: Janitors?

MR. ROGEBERG: Yes.

MR. MAGDEBURGER: And you have no trouble with the unions?

MR. ROGEBERG: Oh, we have troubles with the unions. (Laughter)

MR. MAGDEBURGER: Not on that score. (Laughter)

MR. ROGEBERG: Let me point out one thing to you. I'm glad you raised that. When this agreement was instituted it applied to new hires from a certain date. It was not introduced retroactively.

MR. MAGDEBURGER: We follow a policy of restricted application of our invention agreements. And, as a matter of fact, we don't have our classified personnel, our lab technicians, sign these disclosure agreements and invention assignments. Sometimes, you get a very smart technician in the laboratory who comes up with an invention and you either have to pay him off in a private deal for an assignment, or you have to promote him pretty fast to bring him into the unclassified area which is not represented by unions so that he can sign the agreements.

DIRECTOR HARRIS: How do you classify your documents? Do you have a committee classify your documents?

MR. MAGDEBURGER: Well, we've gone through this course on a policy basis recently, and have defined various classes of "confidential" information. We have three categories of confidentiality which fit fairly closely to what he was talking about.

MODERATOR SIEGEL: In other words, one of the three is "unclassified" in effect?

MR. MAGDEBURGER: No. I mean restricted, confidential, and—in spite of the Department of Defense—classified. Now, the classified quote "authorized distribution only," is the most guarded form. It is our critical classification.

MODERATOR SIEGEL: That's available only on a need-to-know basis?

MR. MAGDEBURGER: Absolutely. Yes.

DIRECTOR HARRIS: Who decides this?

MR. MAGDEBURGER: This is decided by the manager or the vice president responsible for that area of technology.

DIRECTOR HARRIS: For each document?

MR. MAGDEBURGER: For each class of material.

MODERATOR SIEGEL: For the top classification.

MR. MAGDEBURGER: Right. Now, we have, for instance, correspondence and reports dealing with know-how in respect to which we have contractual secrecy obligations. Of course, all correspondence in that category is labeled "contract confidential," which is a subdivision of the general class of "confidential."

DIRECTOR HARRIS: And you have an annual review?

MR. MAGDEBURGER: Annual or as soon after annual as you can get around to it. (Laughter).

DIRECTOR HARRIS: Do the documents go out of confidentiality rapidly? Do you find that they remain classified? How long—

MR. MAGDEBURGER: At the time of review you usually downgrade. Something that has been categorized "Classified—Authorized distribution only" after January 1, 1970 becomes then merely "confidential."

MODERATOR SIEGEL: Do you sign for documents in all classes?

MR. MAGDEBURGER: No, only in this one classification, which is the most sensitive classification.

MODERATOR SIEGEL: And this document control system is centralized?

MR. MAGDEBURGER: It's a corporate control.

MODERATOR SIEGEL: It's not by an individual or department?

MR. MAGDEBURGER: No.

MODERATOR SIEGEL: In all of the discussion, I keep wondering about

new employees, new college graduates particularly, who are coming into maturity in an atmosphere in which confidentiality seems to be rather unimportant because it's more than a four-letter word. (Laughter) How do you indoctrinate, civilize, induct a generation which has been raised in permissiveness? Can companies maintain anything like confidentiality when, say, a youth can break into a selective service office and destroy draft records with impunity?

DIRECTOR HARRIS: Do you have any observations on this matter, Mr. Lucca?

JOSEPH W. LUCCA: I have just a comment. The problem seems to be akin to what we have had in the past, though differently oriented. You have a company program which takes account of the law of trade secrets, but invariably somebody will violate the procedure, as in the case of Lederle and as in the case of Merck. The company system is violated in the same way that the selective service office is violated, and you have to have provisions to redress these wrongs. I think that's the way I would interpret your question and answer it. Surely, all youth has not gone completely down the drain. Those who engage in these kinds of violations will have to be treated in the same manner as people have been in the past.

MODERATOR SIEGEL: But even in a more important sense, how can we discourage violation? I think this is the more constructive and more difficult aspect of this problem. In a certain sense, the sanctions and constraints which in more stable times are imposed upon people in the whole course of their maturation may now have to be imposed by the first employer or the military. Does not the first or early employer have a special burden nowadays in encouraging young employees to protect trade secrets?

GEORGE J. BAIR: I have an opinion on that. In the first place, not all young new employees are rioters or sign carriers. But we do have to face the fact today, that you cannot expect blind acceptance by this group of all company policies and procedures. We should be willing and able to explain the reason for these regulations and why they are important to them. If we cannot give satisfactory explanations, we had better change the regulations.

MODERATOR SIEGEL: Have you had experience of this sort?

MR. BAIR: We have not experienced any troubles. We had a moratorium activity planned by some of our scientists last November. They sent out a notice that there was to be a meeting at noon in our Auditorium on Moratorium Day. We contacted the leaders and gave permission for the meeting but explained that as the research laboratory was private property, no outsiders would be allowed on the

platform or on the premises. We also expressed a concern that they could not control the meeting. They acted surprised that we were concerned and they kept the meeting well organized. There was plenty of discussion, as much in favor of the conduct of the Vietnam war as against. We believe now that the meeting was probably a good thing. There has been no follow-up. I believe our counsel to the meeting leaders was well accepted and followed.

MODERATOR SIEGEL: In a sense, this gets close to another issue—the relative loyalties to profession and to company. In discussing relative loyalties, we now must add attachment to one's age group.

MR. BAIR: Both company loyalties and professional loyalties are very important to employees and to their careers. Individual desire for technical recognition by both the company and associates is primary with research and development people.

MODERATOR SIEGEL: I was wondering about company recognition.

MR. HENDERSON: The young don't relate to the profit motive, do they?

MR. BAIR: Oh, yes, they do.

VOICE: They soon became part of the establishment. (Laughter)

MR. ROGEBERG: I'd like to make a comment. I agree with everything that's been said, but I would like to add that at some point you have to have enforcement of your policy.

VOICE: It's better to do everything possible to avoid the need for that.

MR. ROGEBERG: Yes, and that's why I prefaced my statement by saying that I agree with everything that has been said.

MR. FULTON: There might be an answer to that question. In our procedure—for each individual, department head, and section head, and in training of new employees—we cover these points. As far as exempt employees are concerned, we have an orientation day for new personnel, an all-day session in which different people speak to the class. This procedure, we hope, will encourage support of policies covering trade secrets.

DIRECTOR HARRIS: Do you have any special problems with respect to labor unions? (Laughter)

MR. FULTON: As far as trade secrets are concerned, our bargaining group does not sign an employment agreement—everyone else does except the hourly payroll. I've never been able to explain why. I see no reason why they shouldn't sign such an agreement. As for technicians (we have a particular situation with our technicians). They were part of a separate unit and then decertified. We still haven't decided what to do in the employment contract regarding them. There is

nothing in the union contract on an employee agreement, and, to me, this has always been a big, open loophole. Happily, we have never had any problems with the members of the bargaining group. Instead, our problems have been with the Ph. D. and other experienced scientists.

MODERATOR SIEGEL: Let me add one thing here before I forget it. Mr. Magdebuerger, you talked about the ambitious and capable technical aide, the subprofessional in your company. Has the company thought of extending coverage to him, as Mr. Rogeberg's company has? You objected to very broad coverage including janitors, but the answer to your particular problem might well lie in a minor or trivial extension of coverage to include laboratory technicians. Why isn't that possibility taken up?

MR. MAGDEBURGER: I believe this matter has a historical basis, as I recall; and, I think, Mr. Cooke can elaborate from his experience, too, in the petroleum industry. I remember when all employees were required to sign assignment and nondisclosure agreements, and, if my memory serves me correctly, the issue was raised in a union negotiation in Texas. Specifically, a laboratory technician in an analytical group had developed some type of analytical apparatus, quite minor, but certainly of significance in her mind. The company did nothing with it, treating it as a matter of routine. Through a lack of communication, the company was unaware of her desire to have the "invention" released to her for her own exploitation. Her complaint was that she had signed the assignment agreement and the company just sat on her invention and didn't do anything about it. This situation became one of the grievance points that were raised, and the union took the position that if the company was going to extract inventions involving the mental faculty of these employees as a condition of employment, then their wage scales should be proportionately increased. Rather than meet the issue head on, the company decided to restrict the classes of employees who would be expected to execute invention assignment agreements as a condition of employment. The reasoning behind this decision was that no substantial inventions were developed by personnel other than research and management professionals. So it's historical, I think.

MODERATOR SIEGEL: Yes, it is the fewness of cases that apparently makes the gaps in coverage tolerable.

TIMOTHY J. CURTIN, JR.: Curtin, Geigy. We've concentrated a good bit on documents that are in motion around a company, and on the various problems of the company, but I wonder how much concern is put on the research notebooks themselves, within companies. How much control is exercised over them, and in the microfilming of them?

I found that, in my company, once or twice a year we bundle up all the research notebooks and send them to an outside company to microfilm, with very little control exercised over the procedure.

MODERATOR SIEGEL: Just to augment that observation a bit, how about the problem of mere inhouse duplication of notebook material even apart from microfilming? I mean, that you're not even sure, after a while, that you have what amounts to the standard source, the original or definitive version of an experiment or finding.

MR. CURTIN: We have made an effort to place duplicating machines in strategic locations under the control of one or two individuals who handle all the actual duplication and maintain records. We lock the places up at night and limit off-hours use to one or two machines.

MR. HORTON: I was curious as to what do you do about waste paper? This is a real problem.

MODERATOR SIEGEL: Do you have burn-bags?

MR. CURTIN: Well, at our pharmaceutical plant in Suffern, New York, we burn everything. We have installed an incinerator at that location. Every scrap of paper is burned at that plant. At the other locations we try to shred. We encourage as much shredding as we can.

MR. FULTON: Another method we use is to burn everything in the plant in a large incinerator. We have, in key areas, locked the confidential wastebaskets, which are collected by members of our own security force. These are just in the key areas, like the administration building and the key areas of research. We use these baskets for our very confidential documents. The lesser materials—tons every day—are collected by our own people, not outsiders, in our normal trash collection procedure.

MODERATOR SIEGEL: Do you have a classification system for papers per se, rather than as parts of documents?

MR. FULTON: We don't classify papers at all. Actually, we have a procedure for classification of formal laboratory reports, everything from a project report right up through summaries of the year, and it covers all formal documents.

PROFESSOR OPPENHEIM: In connection with your system, what happens when a restricted or critical document so classified by the author and approved by the head of the department goes to a highly trained research man in that department who questions the designation, protesting that only certain portions are restricted or critical. Do you have any internal procedures to resolve that kind of a dispute, or do you say to this man that the decision has been made by the author of the document, and that's final?

MR. ROGEBERG: That's it. The classification stands, whether you like it or not.

PROFESSOR OPPENHEIM: Then you don't avert some difficulty later if he leaves employment and says he never considered that document as within the realm of real trade secret information. Suppose he says, it's just a part of my general experience and knowledge and I can take that with me.

MR. ROGEBERG: I don't think that they view it quite in that context, you see, because the program was designed as an internal security measure rather than as a guide for employees to carry certain information away with them from Company A to Company B.

MODERATOR SIEGEL: But you could easily have this situation and other abuses of classification. Having worked with scientific people for a number of years of my life, I'm aware of the jealous rivalries that often exist among people on the way up. I suspect that you may even have what might be called "spite classifications," with people deliberately putting labels on documents in order to upgrade them and limit their general circulation and availability to colleagues with high clearance or rank. Those of you who contribute to professional journals know how papers often get delayed in the referral processes simply because they are sent to people who have a personal interest in outcome. I mean that the referees are not completely neutral, despite what people often like to say and believe about scientific types. When papers are rejected after long delay, rivals in effect are alienating the authors' trade secrets. Aren't such questions real in industry too!

MR. ROGEBERG: Oh, yes. Beyond that, the designation has become a status symbol, purely and simply.

MODERATOR SIEGEL: It is good to have critical labels on your material?

MR. ROGEBERG: And then there are those people who, I suppose, without giving the matter much thought, expect the value of the system to lie in the critical or restricted stamp itself. They proceed to leave the paper on the desk, believing that, somehow, this critical stamp protects the material.

MR. CURTIN: I just want to clarify one point in your system, John. Is the material sent through the company mail in normal course, and are the envelopes distinguishable? You said that certain envelopes—

MR. ROGEBERG: We have tried very hard, of course, to come up with an envelope which is neutral in appearance to an outsider but which is distinguishable by the trained insider. Suppose that a plain manila envelope, which is gum-sealed or tape-sealed and is used once, bears just the name of the recipient and his location in the upper left hand

corner. When an envelope of this appearance arrives in a mail room, we could set up a rule that it cannot be opened by a mail clerk or even a secretary, unless she's been specifically authorized.

MR. CURTIN: I just wonder if, in this type of situation, since the greatest danger seems to come from someone inside the company, if the envelope itself wouldn't be a flag to somebody who's actively looking for information.

MR. ROGEBERG: I would agree.

MR. FULTON: This brings up—you mentioned a flag—a fundamental problem in the whole business of classifying documents and handling them. Marking does flag the documents more than it would if it weren't marked at all. From a real security standpoint, there is a question as to whether marking helps you. Maybe one of the reasons it's done is that once a document does get lost or is mishandled you may establish your proof more easily in a court of law later. I have never forgotten a bit of advice contained in a letter in my file written by one of the masterminds in international espionage in the pharmaceutical industry. He instructed one of his subordinates in another company under the same ownership not to mark any document confidential because doing so only calls attention to it. Here's a guy who really knows.

MR. ROGEBERG: I agree with Bill, but I would also say in defense of the classification system that it isn't the stamp itself that means anything. It is the handling, the method of handling, which the stamp calls for that is important. For instance, a critical document or a restricted document at Merck and Company by definition has to be stored in an approved security file. And it has to be in that file when you go home at night. It must not be left on the desk anywhere.

MODERATOR SIEGEL: And you can't take it home.

MR. ROGEBERG: Well, you can take it home, but you have custodial responsibility for it. Anyway it calls for a certain type of locking mechanism, it calls for a certain type of key, and it calls for key accountability.

MR. CASELLA: Are there any advocates within the room of the "totally confused system" rather than the "totally systematic system" with respect to managing trade secrets? I raise this question because it seems possible, if one obtained the log of critical documents from the proper person on your staff, to have complete access to the most critical documents in Merck all in one place at one time. Now, we in my company haven't arrived at that system, although we've been considering that. It would be absolutely impossible under the system that we maintain—which is none—(laughter) (with respect to keeping logs or

lists of documents marked confidential) to find all of the critical documents even if you wanted them, and I'm just wondering what the experience in the room is on this point. We're in the throes of trying to decide what to do here on this very question. Now, with respect to government contracts, of course, we just have to follow the outlined procedure. I'm talking about our own proprietary information.

MR. HENDERSON: You're talking about classified material, aren't you?

MR. CASELLA: Yes, about logs or lists of a critical technical information, important to our profit plan.

DIRECTOR HARRIS: You're not saying, are you, that the government operation is confused?

MR. CASELLA: Oh, no, no— (Laughter)

DIRECTOR HARRIS: That's good and bad, because if our system for defense documents is confusing to us, it would be just as confusing to our enemies. (Laughter)

MR. CASELLA: I just wondered what the experience in the room is with respect to nongovernment documents.

MODERATOR SIEGEL: Let me make a remark here. I think what we have to consider all the time is the usefulness and the utilization of information. We do not compile information in order to keep it secret. We compile it in order to use it. I'm saying that the difficulty in a typical company arises not so much from the inability of the Russians to get the material, but still worse, from the inability of proper employees to get the material. (Laughter) I think this is the core difficulty of a completely decentralized or haphazard system. Whenever you have decentralized arrangements, you are in effect diffusing information about information. This is a very interesting kind of thing for philosophers, managers, and writers of mystery stories. For running a business, however, the only reason you should want a decentralized procedure for controlling the flow of information is to control what you already know about, not what you don't know about. A haphazard system's difficulty is that a company doesn't even know what information it has, so its officials can't even know if they should want to control this information. Control of information means not simply storage but possession of an inventory and of means of retrieval, transmission, and selective disclosure.

MR. CASELLA: Well, suppose the criticalness of information isn't highlighted and that individuals have access on a need-to-know basis. That is, the information is just disseminated to those who need the information without any special designation or ritual handling. If you can compile the information all in one place for the purpose of

determining criticalness, you certainly can compile it with respect, say, to sources of technical information and without categorizing it as to its criticalness.

MODERATOR SIEGEL: I'd like to make a prediction. A company will change such a procedure as soon as it has one important case of breach.

VOICE: I'll reinforce that statement.

MR. CASELLA: What will be the best result, though? Has there been experience in the room? May not a lack of system produce a minimum number of breaches as against a very elaborate system producing a large number of breaches?

MODERATOR SIEGEL: Mr. Toomey, did you have something to say on that point?

MR. TOOMEY: When the day comes that you seek to enforce a trade secret, you'll find that you have the sympathy of the court to a far greater degree if you have consistently followed a policy of marking as classified those documents which include your trade secrets.

MR. FULTON: In the requirements for establishing a trade secret, one of the elements is that steps are taken to protect the information as a trade secret. That step is one of the five elements in the definition of a trade secret. Another element bears on security precautions taken.

MODERATOR SIEGEL: Mr. Johnston, as a Business Administration candidate, do you have something to ask of us?

WALLACE R. JOHNSTON: Yes, I have two questions. Number one, for Chevron. Do you have the status problem that Merck mentions in the application of classification stamps? Is the information critical or is one trying to impress one's peers by putting the highest possible rating on it?

MR. MAGDEBURGER: I'm sure you're talking about human nature—

MODERATOR SIEGEL: Do you have human nature in your company, too? (Laughter)

MR. MAGDEBURGER: To the extent at least that we have the same situation.

MR. JOHNSTON: The second question relates to the cost of the elaborate systems, which seems phenomenal. But then, of course, you have to weigh cost against gains or do you actually weigh it against the potential losses? Do you explicitly consider the potential cost when you establish these systems? The cost, I think, tends to snowball. You may pile control on control where possibly you don't need it.

MODERATOR SIEGEL: Yes, the control of information has an economic side, and managers have to consider costs and benefits there, too.

PROFESSOR OPPENHEIM: I have an addendum to what has been said about a system versus a non-system. I wonder if it might be useful to refer to Section 758 of the Restatement of Torts, which is very heavily relied on by the courts and which deals with the innocent discovery of a secret and the effect of subsequent notice or a change of position. As I see it, from the standpoint of what happens in courts, any company which doesn't have a system will have problems in measuring up to what the court thinks is the minimum essential due diligence on the part of the company to serve notice. There has been very little law under Section 758, which says: "One who learns another's trade secret from a third person without notice that it is a secret and that the third person's disclosure is a breach of duty to the other, or who learns the secret through a mistake without notice of the secrecy and the mistake (a) is not liable to the other for a disclosure or use of the secret prior to receipt of such notice." Bill Becker brought out before, the importance of serving due notice of the confidentiality of some document, whether you call it restricted, or critical, or whatnot. And the failure to take steps to do this may cause difficulties—for example, after a person leaves the employment. (I was surprised to find that Goodrich doesn't require any covenant not to compete—I suppose the idea is that ultimately you have to fall back on protective trade secrets anyway.)

But here's a person who gets a secret from someone who says "I never had notice of this being in the realm of confidentiality." In the absence of any notice, the person uses the information—he invests some money and changes his position. He does so in good faith, he paid value; and he will not be held liable unless there's evidence that he had reason to know, and did know, he was using a trade secret or that he failed to inquire to the extent of determining that the information was not a trade secret. Have you folks had problems of that sort? A question of lack of notice or mistaken disclosure, or something of that sort, without identifying the information as secret?

MR. MAGDEBURGER: Well, I'll make one comment. I don't think that we are consciously trying to protect trade secrets as a property right or a liability here. We are trying instead to protect the business knowledge or confidential information of the corporation from getting out. I like to regard confidential information and trade secrets as not being necessarily the same. You are putting the employee on notice. In a large corporation you have many employees. Reports, research results, are quite often transmitted through a lot of people, who may see an interesting idea or fact. To them—who are not close to the project—an interesting point may seem good material for a cocktail conversation, such as "There was something interesting I read the other day—."

MODERATOR SIEGEL: Still worse, they may even think the idea was their own.

MR. MAGDEBURGER: Sometimes that happens, too, but generally a very critical fact or observation often leaks out. You're putting somebody—the employees, even management—on notice that certain information is critical and confidential and should not be prematurely disclosed; they'll get to know about it when it's a finished project; but, in the meantime, they're merely being shown progress in the research area, and to keep their mouths shut, in effect. If it didn't have a classification flag, an item would just be taken as an ordinary bit of correspondence, an interesting observation that might properly be talked about. Yes, we've had instances of such premature leaks.

DIRECTOR HARRIS: When does your patent department get involved generally? When a case comes up? Do you have any procedure for—

MR. MAGDEBURGER: Well, generally, our patent department is consulted, affixes the stamp and dictates the category—

MODERATOR SIEGEL: You mean the department operates a classification process?

MR. MAGDEBURGER: Yes.

MODERATOR SIEGEL: That's for a document. Does it also do so with respect to ongoing research outputs?

MR. MAGDEBURGER: That's correct.

MR. BAIR: How do you do this? Do you see every document that's generated?

MR. MAGDEBURGER: No. Projects—from the standpoint of projects.

MODERATOR SIEGEL: Do you take the advice of the project leader? Is this the idea?

MR. MAGDEBURGER: We're fairly close in that respect.

MODERATOR SIEGEL: There's a routine reportage of—

MR. MAGDEBURGER: You see, we're thinking primarily of invention, of getting our patent position established as soon as possible. To that extent, we're informed of new research results close to the point of inception.

DIRECTOR HARRIS: Then you're thinking of the property, protecting the property both inside and outside the plant.

MR. MAGDEBURGER: Right.

MR. CASELLA: I want to clarify a point. I do not want to leave the thought that our company doesn't have a procedure. We have a very elaborate procedure. I was talking about *a* company that may not have a procedure. We have a rather elaborate procedure. (Laughter)

PROFESSOR OPPENHEIM: I'm glad to hear you say that, Pete. I was going to ask you for a job with your company.

MR. CASELLA: We are evaluating whether we should have a centralized documentation, a log book of all confidential documents. The experience on that question would guide us. Incidentally, I could describe our procedure, if you would like to hear it.

MODERATOR SIEGEL: I'm glad you put a hooker in for Hooker. (Laughter) You may be interested in this observation on decentralized procedure. There is often a need to know of a technical sort, not necessarily in terms of the company but of a project. At a certain stage in the work, it may be very useful for people in Department A or in project A to know that a certain problem has already come up in Department B or in Project B, so there is no point in, say, putting additional or new mathematical, physical or chemical capability into solving the same company problem over and over again. Yes, we know the advantages of serendipity, duplication, et cetera, but we also need to save some money, to control cost. If you have a decentralized system, is it not more difficult usually to keep people advised, to apprise them that there is something like cumulative company experience, to put them in touch with each other? In a company like IBM, I, as an occasional outside consultant, could sometimes serve a useful role in making people aware that Department A was doing what Department B was also doing or was interested in doing. In connection with the control of documents, this kind of role also is a very important and useful one if you have any kind of centralization. I'm not saying this coordinating function is *the* reason for centralization. But I do feel this is an additional consideration in Mr. Johnston's problem of costs and benefits. If you're going to endure costs, you want to maximize benefits. Right? (Laughter) And if you have certain benefits in view, you want to minimize the costs of getting them. Attention must be paid to all of the purposes that are, or could be, served by a classification system that is either centralized or decentralized. I pointed out earlier that the use of information is far more important to the company than its mere denial of use to the wrong people within the company and to outsiders. Sure, you can destroy a company through failure to deny this information, but the important thing is for you to enhance your own company's position through constructive and productive use.

MR. CASELLA: I think it's necessary to define the kind of confidential information you're talking about in order to determine what dissemination or cross-fertilization there should be. As we have been talking here, within the framework of trade secrets, you could include a customer list. A business study concerning the acquisition of a company could also fall within the same category. The research and

development activities in the central research department, even the scientific part, could give rise to trade secrets. The specific operation of a commercial process at certain temperatures and with certain catalysts could merit protection on a need-to-know basis.

Well, in our company, if there is a specific plant making a product which is important to the profit plan of a particular division, it becomes the responsibility of the local management to decide what part of that process should be maintained confidential and secret and to apply the usual mechanisms for data control. Now, with respect to acquisition studies, where the actual performance of a company on the stock market may be affected, the information is kept confidential and limited to the people making those studies. We haven't found it necessary to put the people with the plant process information in touch with the people having the acquisition information. So it becomes essential to define what kind of confidential information you're talking about in the first place. The character of the information determines the need for cross-fertilization or centralization.

MR. HORTON: One small question for Mr. Rogeberg. He mentions that the critical document, when it comes in, is to be opened only by the addressee, and not by his secretary. I'm curious to know who typed the document in the first place—

MR. ROGEBERG: Unless the secretary is so authorized.

MR. HORTON: You can have your secretary authorized?

MR. ROGEBERG: Yes. We want this authorization to be the prerogative of each recipient of critical and restricted documents. As far as the secretary typing the document in the first place is concerned, well, we're back again to basics. Certainly, we cannot protect information from people who have to see it in the course of their work; and we feel that if we can limit it to those people we've really accomplished something.

MR. HORTON: One entirely different question. Several times we've mentioned agreements with employees respecting secrecy of information. Now, these tend to be combined with patent agreements; and, with respect to patent agreements, we went into the problem of unions. But, if we don't have a patent agreement, then we don't have the secrecy agreement, as long as they're together. Well, have any of us given consideration to eliminating the secrecy provisions from the patent agreements and relying on common law rights, which after all are quite substantial—

MODERATOR SIEGEL: Or possibly having two documents?

MR. HORTON: Yes, but I think you would avoid the problem of having too many people under different rules.

MR. CASELLA: I can address myself to that question. We have three documents, two of which I brought along. One is an employee agreement, Form A, which is for the exempt employees technically trained—the technical service. It has both an invention assignment obligation and a secrecy obligation. We have a Form B, which is just secrecy. This form is used for all non-unionized employees, who are not required to sign Form A. The secretaries sign Form B on secrecy; we have no right to try to take away inventions if they are not in a position really to invent. Now, with respect to the union situation, the largest one that we're dealing with has recognized a very fundamental and important point, that the security of the jobs for union members is in part dependent upon their maintaining the proprietary position for the company, that members will lose jobs if secrets are taken out of town to competitors. The result is that we have had the cooperation of certain of our unions.

MR. HENDERSON: I've heard a lot of comments touching on areas that I'm interested in. We talked about document control, and I'm interested in knowing whether, in practice, R&D and manufacturing companies "code" technical documents like drawings, specifications and so on, with relation to project or department. Apparently, there is frequently some difficulty in finding out just where particular items are developed by our contractors. Is it possible, for example, to determine easily whether a particular item was developed under a contractor's independent R&D program?

MODERATOR SIEGEL: The real question is detail or specificity. Are items identified not only with respect to department but also according to project and sponsorship?

MR. BEDELL: Bedell from U.S.I. The common practice in our company is that any drawing that goes out has a stamp on it as the property of U.S. Industrial Chemicals, and is not to be used except as authorized.

MR. HENDERSON: My next question is this: Who sets the management control system up and who does the auditing and tracking? The budget people who are funding the various projects of the company? Your directors of research?

MODERATOR SIEGEL: Do you have experience in the Atomic Energy Commission on this matter, Mr. Anderson?

ROLAND A. ANDERSON: We do. All our contractors have to identify contract work by project or contract number, and that practice is carried through from the top of the research department right on down to the project manager and engineers. I'm sure you'd find that in DOD they do the same thing to the extent that they can and must do so for accounting purposes. GAO auditors go in and if they don't find a

project or contract number, or if they do not find project numbers on a lot of things that we paid for, we are held accountable for it and have to answer for it.

MR. HENDERSON: So the answer is, it's done only if it's a requirement.

MR. ANDERSON: If companies do government contract work, it's a requirement. And I don't know of any company that doesn't keep its own project numbers, because it also has to account to its budgetary people as to whether Project A is doing this and Project B is doing that. Accounts have to be kept even within house. I think it's common practice to have budgetary identification if for no other reason than for company charges. Also, for technical reasons, companies do this so that they can keep the documentation on a particular project separate from another.

MR. FULTON: Here's a concrete example of how we do it: The distribution sheet that goes on every formal laboratory report shows in the very first line the project number and project title; it goes on to show the volume, year, page number, and copy number; so there has to be strict accountability.

MR. HENDERSON: O.K., good. Another question has to do with transfusion or diffusion of information. I'm talking about protection against compromise of private information. In the classical situation, a hard charging R&D outfit will come into some military department which has a published qualitative material requirement. There is considerable talk back and forth between engineers—not lawyers or contract negotiators, but technical people who get together and talk about solutions. The military engineer is working on a project, the contractor's engineer will come in, and they'll start talking about problems and solutions; whereupon the government engineer sits down and writes a "spec" around the thing they've discussed and goes out on the street with it. Industry must have this problem too. When I was with a private company in an engineering job, my colleagues very often didn't even recognize that there might be a legal problem involved. They were transfusing information among various people, which would seem to me to raise some questions of company liability. Do these protective procedures that you have worked out cover this situation?

MR. FULTON: Some information really has to be transferred and hazarded in that situation.

MR. CASELLA: I think that your question presumes that all information is confidential or important to keep secret for the proper plan of a company. But only a small part of it has to be guarded in our

company, that which is designated by local management. So it doesn't become a problem to go out and talk to a vendor about this or that unless it's a confidential matter, which is a small percentage of all transactions.

MR. HENDERSON: Every company with a manufacturing operation buys most of its plant equipment from somebody else.

MODERATOR SIEGEL: Mr. Bair, would your company, which is not chemical to the extent of so many of the others here, have pertinent experience with any of these problems?

MR. BAIR: I tend to go with motherhood in something like this. There is a certain degree of ethics that one has to have in business. A purchasing agent who knowingly passes along confidential information to a competing vendor is certainly being unethical.

MR. HENDERSON: But this doesn't touch on the formality of control procedures.

MR. BAIR: In some cases, non-disclosure agreements are used.

MODERATOR SIEGEL: Is there another question?

PROFESSOR OPPENHEIM: I want to be a little bit of a catalytic agent, if I may. Since this is a knowledgeable group and the discussion so informative, I want to open up the question of the relation of patent protection to trade secrets—with the implications of the dictum in *Lear v. Adkins* (395 U.S. 654 (1969)) and what's going to happen with *Compco* and *Sears*. When I started teaching patent and antitrust law, I used to tell my students the first article I ever came across, in an educational journal, indicated that a basic initial decision must be made between the alternatives of going the patent route and going the trade secret route. Of course, if you go the trade secret route, you take your chances on discovery by fair means. Here, we are talking about trade secret protection. My question is, and it will open up a Pandora's box, I suppose, are we talking about a subject matter in all these elaborate systems (or nonsystems) that over a period of years will go through a process of attrition at a point where one will wonder about all this discussion about trade secret protection. May the Supreme Court get to the point of watering down trade secret protection so much that we'll be forced into patented invention only?

MODERATOR SIEGEL: This is a case in which it is the Moderator who says, "I'm glad you asked that question," and strangely means it—because we are helped to break off discussion of one topic and go on to the second. Mr. Becker, the opportunity to re-enter your field is here. Would you care to comment upon Professor Oppenheim's remarks?

PROFESSOR OPPENHEIM: Don't burn up on re-entry. (Laughter)

MODERATOR SIEGEL: No, we will shield them from that. (Laughter)

MR. BECKER: Well, I don't know what comment is appropriate given the confusion that seems to exist in the light of the *Sears* and the *Lear* language; and, even in the *Lear* decision itself, the court, in sending the case back to California, said that it wanted a determination of the question of whether, and to what extent, the state may protect the owners of unpatented inventions. I don't know where we are on this question, and I don't know how the courts or anyone is going to decide what is an unpatentable invention so as to get it back into the area of trade secrets. The literature and the comments that I've read don't go further than to say that those things which are patentable should not be allowed trade secret protection. That leads to some type of subjective evaluation at some point in time as to whether or not they're patentable. I think there's some confusion here. I'd be interested if Mr. Toomey now wants to read from *Bourns* as to what the District Court in New York is saying this month.

MR. TOOMEY: This case arose from a trade secret license. A California corporation licensed a British corporation, and after expiration of the license the British corporation continued to manufacture and use the trade secret. An attempt was made to enjoin the British corporation.

VOICE: Which law was in control—U.S., British?

MR. TOOMEY: This is clear from the decision.

(1) It is undisputed that model Nos. 224, 3010, 3052, and 3053 embody features that are covered by British Patent No. 923,607. In *Lear, Inc. v. Adkins*, 395 U. S. 653, 162 USPQ 1 (1969), the Court held that a licensee is not estopped from contesting the validity of the patent and (more importantly for this case) that once a patent issues, regardless of what was the intention of the contracting parties, the patentee-licensor may not enforce its trade secret claims. *Lear* at 672-4, 162 USPQ at 8-10. Thus, regardless of the construction of the 1962 contract under California law, California courts must obey the dictates of the Supremacy Clause, follow federal law, and refuse to enforce defendant's trade secrets in respect to those models covered by a patent.

(2) Pursuant to Paragraph 6 of the 1962 contract, Painton agreed to pay royalties on models for which no patent application had been or would be made. Painton is not required, however, to make any future payments. This court's enforcement of such an agreement would be contrary to our national patent law and policy, *Lear v. Adkins, supra*. Our patent policy of strict regulation of inventions would be undercut if inventors could enforce agreements for compensation for alleged secret ideas without being required to submit those ideas to the Patent Office, and, thereby, eventually have the ideas disclosed to the public. Furthermore, patent policy (reaffirmed by the holding in *Lear* that estoppel will not be a bar to challenging the validity of a patent, *Lear* at 655-71, 162 USPQ at 2-8) which allows compensation only for ideas which rise to the level

of invention would be further undermined by the enforcement of such a contract, since compensation would be awarded for non-inventions. And if this court were to hold that before a state could enforce a trade secrets contract, the ideas must be found to be an invention as prescribed by the rigid requirements of federal patent law, inventors would be able to circumvent "the manner in which (inventions) may be protected." *Lear*, at 667. Inventors would be encouraged to avoid filing applications altogether and contract for long licensing arrangements. The severely restricted area which the Supreme Court left open to applicable State law would become a yawning abyss. Fewer patent applications would be made. The Patent Office would soon have a less accurate view of the state of the art in a particular field. And state courts, rather than the Patent Office, would become the initial triers of whether a discovery is an invention.

For these reasons, this court holds that federal patent law requires an inventor to submit his ideas to the Patent Office before he can compel consideration for the use of his idea. The Court, however, does not decide whether under California law an inventor, if he makes a patent application, can be compensated for this disclosure before the patent has issued. *Lear, Inc. v. Adkins*, *supra*, at 676-7, 162 USPQ at 9-10. That question is not before this court.

The Court goes on to say "Pursuant to Paragraph 6 of the 1962 contract, Painton agreed to pay royalties on models for which no patent application had been or would be made." (The Court refers again to *Lear*.) "That question is not before this court." That is the essence of the decision.

PROFESSOR OPPENHEIM: In other words, with Warren off the Supreme Court, Black and Douglas have let loose a dictum in *Lear v. Adkins* which is apparently working up a gale.

VOICE: Warren wasn't on that court—

PROFESSOR OPPENHEIM: He's off now, so you have Black and Douglas still sitting with a dictum that they announced now going hog wild.

VOICE: It's Miss Motley. I'm talking about the dictum that started Judge Motley's thinking. After all this is the source. You've seen dicta converted into rules of law without much thought.

VOICE: Is that case being appealed?

MR. TOOMEY: Perhaps the moral of this is that you should not entrust a lady with a secret. (Laughter)

Tom Arnold brought this case to the attention of several of us with the comment that it could have a material effect on all obligations of confidence of employees and all know-how licenses. If followed as fully as Judge Motley indicates she would follow it, it destroys the capacity ever to tie the money for a research and development contract to the use of the results of that contract, save only with respect to patentable inventions.

DIRECTOR HARRIS: There are some who have interpreted *Sears-Compco*, and the dissenting opinion in *Adkins*, to mean that if it isn't under Section 101—if it isn't a patentable composition, process, machine, manufacture—only then could it be protected as a trade secret. But if it's one of those, it's got to be protected as a patent. That's in line with what she appears to be saying.

MR. COOKE: The Listerine people are still paying hundreds of thousands of dollars for the Listerine formula.

PROFESSOR OPPENHEIM: But I don't think that's quite it. As I understand it, it goes beyond that. In the light of *Lear v. Adkins*, despite everything that's been said by the Patent Bar and teachers of law for decades, when know-how may be much more important than a patented invention, will know-how still be protected? I'm asking if the dictum in *Lear v. Adkins* doesn't suggest that, if you have a patented invention and you have a lot of know-how which may be more important than the patented invention, you're still going to be under the gun in regard to what you can do with that know-how.

DIRECTOR HARRIS: Is it a combination? Is it a composition? If it is, it can be protected only by patent.

PROFESSOR OPPENHEIM: No, I'm talking about an unpatentable trade secret or know-how.

DIRECTOR HARRIS: How could you tell?

MODERATOR SIEGEL: You couldn't tell.

DIRECTOR HARRIS: How could you tell unless, as Judge Motley appears to say, you went to the Patent Office and tried to patent it?

MR. CASELLA: If it doesn't fall into one of the statutory classes for patentability—

DIRECTOR HARRIS: Then you could have a trade secret. If it doesn't fall into those classes according to this interpretation.

PROFESSOR OPPENHEIM: It looks to me as if you're making the Patent Office examiner not only someone who decides whether it is patentable subject matter but also who decides whether you've got some subsisting trade secret or know-how that you can protect. He's the one who could either package it in or leave it out. And if he leaves it out, where does it stand?

MODERATOR SIEGEL: Mr. Redmond, do you want to get your word in edgewise?

MR. REDMOND: There is legislation, I think, pending to remove the effect of *Lear v. Adkins*, and Mr. Wilson of the Department of Justice has made these remarks in Chicago: "We would therefore support a modified version of Section 301 which would permit the states to protect inventors' rights in their ideas provided that those ideas are in

fact secret, and in fact valuable. We believe it should also be made clear that such a modified section 301 does not overrule the *Sears-Compro* and *Lear v. Adkins* case." It seems anyway that the Department of Justice is—

MODERATOR SIEGEL: Working to overcome that?

MR. REDMOND: Yes.

MR. CASELLA: That's the McClellan Bill, Section 301 of the McClellan Bill.

MR. REDMOND: Yes, the Department of Justice is supporting it. They are not asking for the statutory standard of unobviousness to be applied. You know, trade secret law never did rely on unobviousness. You could have a trade secret that was obvious as long as it was secret and valuable. And it seems here as though that's what the Department of Justice is saying, that as long as the idea is in fact secret and valuable, regardless of its novelty, protection would be available in the state courts as a trade secret.

MODERATOR SIEGEL: Mr. Fulton, do you want to get your side-paddle into the stream?

MR. FULTON: A perfect example of one element that is absolutely essential as a part of a license and which has been adjudicated to be unpatentable is provided by is the microorganisms required in the manufacture of an antibiotic. The antibiotic itself can be subject to a patent, the process can be subject to a patent but the essential thing necessary to make the process work—namely, the microorganism—is unpatentable.

MR. TOOMEY: This is just a District Court decision.

MODERATOR SIEGEL: Any further observations?

MR. REDMOND: I would say the problem Judge Motley points out—with trade secret law—that nobody would file patent applications hasn't been the case. With trade secret law, as we know it, hundreds of thousands of patent applications are filed and the Patent Office can't get them all processed. I don't think the Patent Office could handle the additional trade secret applications.

MR. TOOMEY: You'd have to change the standard of invention to an impractical degree. Even the British standard of mere technical novelty would not protect the majority of trade secrets.

MR. BECK: It seems to me that the philosophy here behind this decision and the dissent in *Lear* goes along this line: If a thing is not patented, it ought to be fair game and be freely available; no one should be able to control it; it should be disseminated freely without any restrictions. I feel that if in a case in which the information is truly a trade secret, one cannot receive compensation for licensing

trade secrets, then we are going to get the opposite of the intended result of promoting dissemination of technical information. We are going to get a reluctance to license trade secret information and more of a tendency to keep it inhouse.

DIRECTOR HARRIS: Do you license your trade secret information very much?

MR. BECK: Oh, yes. A great deal.

DIRECTOR HARRIS: Isn't there a general tendency to assign trade secrets rather than to license them?

MR. BECK: It depends upon the situation.

DIRECTOR HARRIS: How do you maintain secrecy? How do you handle the problems of control after the secret is divulged?

MR. BECK: If you sold it—

DIRECTOR HARRIS: No, if you licensed it.

MR. BECK: Oh, licensing. Just the usual contractual commitments of the licensee.

MODERATOR SIEGEL: Do trade secrets tend to be associated with patents? I mean, are they often parallel?

MR. BECK: Sometimes.

MODERATOR SIEGEL: But not always. I mean, you can have an independent licensable package of trade secrets?

MR. BECK: Oh, yes.

MR. HENDERSON: Don't they usually include technical advice too?

MR. BECK: Very often in a patent agreement you've got a provision like that.

MR. HENDERSON: I mean, trade secret matters.

MR. BECK: Yes, usually it is necessary to supplement the written terms.

PROFESSOR OPPENHEIM: You might furnish manuals.

MR. BECK: Yes.

MR. HENDERSON: One legal question. As a practical matter, is it pretty difficult to carry one of those things off without a good deal of transfusion or leakage?

MR. BECK: It depends upon the subject matter, but normally I think the answer is yes.

PROFESSOR OPPENHEIM: You know, Lou Harris said something that I think is very pertinent, but he now creates a dilemma by saying that if a thing isn't patentable, then trade secrets aren't being stressed as much. What he said was, and I think I agree, that underlying this kind of a rationalization of result is a social policy idea—namely, the dissemination of information and the opening of the market for knowledge. This is what underlies this. That's why I'm sort of fearful

about it because I think it'll tend in that direction if it keeps on without some kind of legislative solution. In other words, the courts, today, like to look for some redeeming social value of some kind. Sometimes we call the result judicial legislation, but whatever the name, the result is some kind of undermining of what we now consider to be the conventional basis for trade secret protection. For example, Mr. McLaren, head of the Antitrust Division, wants to take us in another direction. McLaren has said after *Lear v. Adkins* that the Antitrust Division will approach patent license limitations with respect to know-how in the same way as it approaches limitations for the patentable inventions. Thus, we should look at know-how limitations in licenses the same way as we do for patentable subject matter. But the idea of coalescing the two in that way means that you can't identify more specifically the know-how and say that the know-how itself is something quite different from the licensing of a patented invention.

MR. BECK: The thing that troubles me is that if this type of thinking prevails, what incentive is left the possessor of trade secret information to make it available to others? If he can't get any money for it, why should he make it available?

MR. CASELLA: That doesn't necessarily preclude getting money for your information. You have the show-how; you certainly can sell the manuals; you can help start up the operation; you can give technical assistance. You can charge money for all these things, and this only talks about one aspect.

MR. BEDELL: But isn't that know-how, though? You're selling know-how. All those manuals are know-how. There's no patent protection. It's a physical thing.

MODERATOR SIEGEL: You can't rent the information, you can only sell it.

MR. BECK: Apparently, you can't sell it on a deferred-payment basis because this court said it was improper to collect fees beyond issue of the patent. I gather that was the ruling.

MR. TOOMEY: "Patent policy which allows compensation only for ideas which rise to the level of invention would be further undermined by the enforcement of such a contract (this is a contract for the right to use trade secrets) since compensation would be awarded for noninvention." It's got to be inventive.

MODERATOR SIEGEL: Trade secret use contracts might be undermined, but trade secret sales would not be.

MR. TOOMEY: I don't think the ruling distinguishes between types of transaction.

MR. BECK: But this is a sale here.

MR. COOKE: Suppose I go to your company and I say that I have this wonderful idea, that it's a secret. I will give you this information, license you to use it as freely as you like. You will pay me \$250,000 now and if and when I get a patent you will start paying me royalties at 5 cents a barrel or whatever the rate is on that patent. Do you regard this case as knocking that arrangement out? What would they do about the \$250,000? The \$250,000 is paid; would you get it back?

MR. TOOMEY: I think you could get it back under the law of the *Painton* case.

MODERATOR SIEGEL: Wouldn't common law still apply?

PROFESSOR OPPENHEIM: Look, it isn't a question of pushing a panic button. I'm not suggesting a panic. What I'm saying is that if you look in perspective on the evolution of judicial interpretations of the Constitution, the patent statutes, or copyright law, you've got to look at it from the standpoint of a time continuum at the end of which there might be a considerable erosion of rights; but by that time you get accustomed to another world of things. In other words, just as the patentees today know that the use of the first sale price limitation in a license under the GE doctrine is a very narrow rule, they're living with it, but there was a time they were living with a lot of different rights. In time, you get accustomed to a new order of things and then, all of a sudden, you wake up and it's like, as Justice Sutherland said many years ago, the little bird pecking away—take a woodpecker—at a stone, not a tree. You know that in the course of a hundred years or a thousand years it's going to erode a lot. And we always think of what's going to happen within our lifetime; but what we must also think about is what's going to happen within more than our lifetime, what's going to happen over a period of a hundred years.

MR. MAGDEBURGER: Let's carry this dilemma a little further here. I mean this indicates that the patent right all of a sudden becomes sacrosanct and something high and mighty. But now you've got the Justice Department setting up a patent section—

VOICE: Antipatent section? (Laughter)

MR. MAGDEBURGER: That's not the title. The avowed purpose seems nevertheless to be that of attacking the uses of patents and various licensing practices. Well, if you have a patent, what you can do with it now is one thing; but the direction in which the courts and government are going means that you are not likely to get your full share.

PROFESSOR OPPENHEIM: A double-barrelled affair.

MR. MAGDEBURGER: Yes.

PROFESSOR OPPENHEIM: You see, the Department of Justice has been trying to get into questions of patent validity. Judge Gasch in the

District Court here put a little crimp in that. Lately, the Department has tried to question the patent law doctrine of equivalents. Now, you see you have a two-level attack. You have developments questioning some of the conventional, well-established patent law doctrines; and, at the same time, you have this upsurge of trying to reduce the value of the trade secret protection through this means. And I think eventually we shall come to the point of a boomerang because of loss of incentives and the other adverse effects.

Another thing that impresses me is this assumption—the inarticulate major premise—that a trade secret is something in perpetuity, which as we know is just nonsense. In other words, you'll have that trade secret only so long as you can prevent its discovery by fair means. Also, we know that no matter how elaborate the protective systems are, there is rapid obsolescence—the perennial gale of destruction by innovation, in Schumpeter's view. And the same is true of a trade secret.

I'd like to ask you gentlemen who are so experienced and sophisticated in this, isn't it true that even though you talk about protection of documents, whether you call them restricted or critical, the corporation is aware that a lot of this trade secret protection you now have may have rapid obsolescence. Perhaps we're always faced with that destructiveness which is the creative part of competition to keep open the streams of incentives. You try to find something to displace what you have now so that your trade secret can go down the drain along with your patented invention.

For years, my students have always thought that when you have a patent you don't have competition, and I have had to get across, with all the vigor I could command, the fact that you have competition in patented inventions. You have interchangeability, reasonable changeability of patented products, and sometimes even more than that. And they used to think that once you got a patent you had a little island of monopolistic immunity for the 17 years, so I'd say "Well, gentlemen, how many basic inventions can you think of?" I'd have to tell them that most of the progress in invention is made through improvement patents. Then, once in a while, you get the great break-through of something basic—like Xerography.

MODERATOR SIEGEL: Thank you, Oppie. This decision casts a new light on the remarks that Mr. Becker made at the beginning of his presentation on the *JPOS* article of August 1968, which showed a good record for plaintiffs in trade secrets cases as opposed to patent cases.

DIRECTOR HARRIS: If the federal unfair competition bill is enacted, would it not provide some relief here? Has the bill been reintroduced, Oppie, the bill in the form of an amendment to Section 34 (a) of the

Trademark Act of 1946? It stems from the Lindsay Bill.

PROFESSOR OPPENHEIM: The Lindsay Bill was mostly addressed to the deceptive practices like the present Uniform Deceptive Practices Act. It doesn't really touch on this, does it?

DIRECTOR HARRIS: The bill I mean was, I believe, introduced by Senator McClellan, and Section 7 specifically refers to wrongful disclosure and misappropriation of trade secrets.

PROFESSOR OPPENHEIM: Incidentally, I think you gentlemen might be interested in the *IDEA* Conference issue of 1968, which reports a discussion of the interaction of unfair competition and antitrust. Rudolf Callmann was the one who asked whether *Compco-Sears*—this is prior to *Lear v. Adkins*—was going to dilute trade secret protection. Doerfer, in the 1967 *Harvard Law Review*, has an excellent article in which he comes to the conclusion that *Compco-Sears* does not undermine trade secret protection or should not do so. Of course, the *Lear v. Adkins* dictum requires that whole article to be revalued. The reason I opened this up is I'd like to ask you gentlemen when you go back to your corporations, will you ask: Are we going to revalue what we're going to do about our trade secret protection by these systems, or should we wait and see what happens to that *Lear* dictum beyond what Judge Motley decided (in *Painton v. Bourns*)? How do you react to something like this? Do you regard it as an immediate counseling problem, or do you regard it as requiring watchful waiting?

MR. TOOMEY: May I quote Tom Arnold after he finished quoting from the decision here? He says "If that"—referring to what I just read—"does not bring every industrialist to the most energetic lobbying effort to perfect in the now-pending Title 35 a repeal of both *Lear* and the entire concept of preemption, then we as a people are surely incapable of effective self-government."

PROFESSOR OPPENHEIM: But let me ask you, just for my own illumination, why does he think we have to get rid of *Lear* lock, stock, and barrel? Aren't we more interested in zeroing in on this particular aspect of *Lear*—namely the dictum about the relation of trade secrets and patents, because I think efforts aimed at restoring the license estoppel are not going to be very fruitful.

MR. TOOMEY: I would agree.

PROFESSOR OPPENHEIM: It seems to me it has to be more narrow—otherwise the impression will be created of a return to the good old days when a patent licensee was fully estopped to contest the validity of the licensed patent, without even the antitrust restrictions that later crept in, such as price-fixing provisions and so on.

DIRECTOR HARRIS: These two pieces of proposed legislation, Section 301 of S. 2756 and the McClellan Bill stemming from the old Lindsay Bill, are still being actively supported. So there are legislative proposals *in esse*.

MR. BECK: But those proposals, as I understand them, would not reverse *Lear*. What they would do is cut out the preemption that is suggested—.

PROFESSOR OPPENHEIM: Exactly.

MR. BECK: I think we're painting with a broad brush here. Maybe you'd like to get rid of the *Lear* thing too.

DIRECTOR HARRIS: It would be quite an accomplishment just to bring the trade secret law back to center.

MR. BEDELL: I wonder if I could ask the group about secrecy agreements, in case one desires to sell a license. If you want to enter into a secrecy agreement, and this *Lear* case stands, a secrecy agreement may not be any good if a licensor only has trade secrets. One question that has come up in our company is the length of secrecy agreements—the number of years involved. We always have a standard term of about ten years. Is that a reasonable number for secrecy agreements? What is the policy of the companies represented here?

MR. MAGDEBURGER: Are you taking or giving? (Laughter)

MR. BEDELL: The person you're selling to wants the agreement, say, for two years, or something like that. What is a reasonable term for a secrecy agreement?

MR. HORTON: Well, is there any theoretical reason why it has to be anything less than infinite?

MODERATOR SIEGEL: Do trade secrets tend to have a long life in the chemical field, in terms of what Oppie said before, an opportunity for discovery by fair means?

MR. HORTON: I think that's a different question. But if the idea still remains a secret there is no reason it can't be protected.

MODERATOR SIEGEL: True, but if a man knew that technically there is no need for an infinite life—

MR. BEDELL: Usually, 99 percent of the time, this is the case.

MR. BAIR: In light of the attacks on trade secrets, I think it would be well to put a specific termination date on an employee's agreement to hold information confidential after leaving the company.

MR. HORTON: Don't you tie up your employees for life? We don't, but most companies do.

PROFESSOR OPPENHEIM: The term has to be ancillary to the continuation of the legal basis for the trade secret. I mean, you can go for life, but as soon as that secret is gone, why, then, the supporting agreement is gone.

MODERATOR SIEGEL: In the case of covenants, you pointed out, Oppie, the chances of support by a court would be reduced by failure to specify a term.

PROFESSOR OPPENHEIM: Well, that's not quite the same. Here you're selling something, but you are not saying you can't compete, or you are saying you can't use this information. You're not really saying that others can't compete by creating some competing enterprise. You can't compete with this trade secret information. Infringing competition is all you're talking about.

MR. BEDELL: Let's take an example—you're trying to sell a license, let's say for a trade secret, and you don't want to give away any know-how, but you have to give a certain amount of information to encourage buying of the license. We all face these things.

MR. MAGDEBURGER: You can get a quick answer from your neighbor there from American Cy, when he's licensing you and letting you use his microorganisms. Now what's the cut-off? I'll bet that it would be infinite.

MR. TOOMEY: I was going to say, forgetting the law of this *Painton* case, the term depends on the status of that trade secret or that subject matter after ten years. For a dress design, ten years would be unreasonably long.

MR. BEDELL: You're saying that it depends on the value of that trade secret.

PROFESSOR OPPENHEIM: Trade secret protection has to have an ancillary aspect. You can protect it as long as it's a trade secret. Once your trade secret is gone, it's not ancillary to anything that's protectible. Incidentally, on the District Court matter, don't forget this. Sure, we were talking about a District Court decision but the thing that the Bar always worries about, the antitrust Bar, your patent Bar and so on, is will the Supreme Court get its hands on this case? In other words, sometimes you might want to say to this party who lost, stay lost for the time being, don't appeal, because if it gets up to the Supreme Court, it will be deadlier than it is now.

MR. COOKE: Oppie, I think we can expect some marked confusion anyway if it gets up to Judge Friendly on appeal. I want to read a quotation from Judge Friendly's dissent in this case. He said, "While I would therefore reverse the judgment for the defendants, it does not follow that one should be entered for the plaintiffs." (Laughter)

MODERATOR SIEGEL: Are there other questions that you would like to address to Mr. Becker? Is there any point in pursuing further the matter of covenants?

PROFESSOR OPPENHEIM: No, the only thing I had in mind on the covenant is what Bill Becker said on the relief aspect. Would it not cause some corporations to reassess their policy and get into covenants not to compete after employment, provided you keep within a reasonable area and reasonable time. But what are the opposing considerations there, to have or not to have a reasonable covenant not to compete?

MR. BECKER: Well, I would guess the major consideration is today's hiring problem. Another reason that I've heard articulated is that, in a company such as ours, we really haven't had very many trade secret problems. We've had only a couple, in all of our years, that compelled us to go to court. We've always been able to solve these difficulties in some other fashion, so I guess that, for those few times in which the matter comes up, covenants haven't been, for us at least, worth the additional problem that you confront in hiring practices today. I think the covenant not to compete may cause some real misgivings for young employees if they read at all the documents that they sign at the inception of employment.

MR. CASELLA: Is there not a question as to whether a covenant not to compete is even possible? By a covenant not to compete you're saying, for instance, that I, as a chemist, working in the Hooker Chemical Corporation on oxidation chemistry, can be asked to agree not to take the job at Du Pont in oxidation chemistry?

PROFESSOR OPPENHEIM: No, no. This means not to compete in a competitive enterprise.

MR. CASELLA: But I'm a chemist, an oxidation chemist.

PROFESSOR OPPENHEIM: Well, the usual covenant not to compete after termination of employment covers as I understand it, what happens when the employee goes to the other company under the inhibition of revealing confidential information or trade secrets given to him in confidence with the understanding of secrecy. I'm talking about this employee setting himself up in a competing business, a practice so common today, and competing with his former employer in the same line of business. That's the kind of a covenant that I'm thinking about right now.

MR. BECKER: Well I was thinking of the broader one, Professor, of not being able to take competitive employment with another company.

MR. CASELLA: That would be unenforceable.

MR. BECKER: I'm not sure it's unenforceable.

MR. CASELLA: For what length of time? Forever?

MR. BECKER: No, of course not.

PROFESSOR OPPENHEIM: Courts generally have a very jaundiced attitude toward covenants not to compete that relate to the employee. It is the covenant accompanying the sale of a business with the seller agreeing not to compete that's given much more benign treatment. Courts are tough on trying to tie up an employee in any way, insofar as moving to another company is concerned. But I'm saying that there are judicial precedents for enforcing a reasonable—like one-year—covenant not to compete when an employee sets up a competing enterprise. Suppose in the Boston area, someone has been employed as a chemist, as a key person, and he goes out and creates a new concern of his own. I'd say the year limitation is usually considered to be reasonable. Once you go beyond a year or so, you're in trouble.

MR. BECKER: I think the key is to try to tailor the agreement. One of the arguments against having such covenants, of course, is that, if you're going to have effective covenants not to compete, you have to do a tremendous amount of work because each one of them really ought to be tailored. For example, if you have a salesman, you may say that he can't call on those customers that he has called on for you, rather than that he just can't sell chemical products. You have to limit the covenant to the protection which is valid for you. I think if you do that—I could be wrong—the covenant can be made effective.

PROFESSOR OPPENHEIM: But you don't need a legislative bill for genuine trade secrets situations. You might for customer lists, but even there you can't go out and actively solicit the old customers, using knowledge of which names came to you through customers. The courts do split on that issue because they don't consider customer lists of the same dignity as technical trade secret matter in some technology.

MR. TOOMEY: Another practical consideration arises in a large corporation of 500, 5,000, or many thousand employees. If you want to amend the agreement by inserting a covenant not to compete, you can have some pretty troublesome personnel problems, as well as the administrative problem that you encounter when you try to get 500 or 5,000 or still more documents signed in a matter of a few weeks.

PROFESSOR OPPENHEIM: Of course, not all employees are going to rush out and start new enterprises, but it's interesting.

MR. CASELLA: I'd like to add a little practical experience. You can have an employment agreement that might include a six months' covenant not to compete and then change it to eliminate that covenant; but you'd still have personnel problems in respect to signing.

PROFESSOR OPPENHEIM: That all depends on whether you have a sellers' or buyers' market. You wouldn't have much leverage unless you do have a sellers' market.

MR. BECKER: I don't want to give up on this thing completely. For example, I think that there are companies (my understanding is that auto companies do this), which pay bonuses, for example, on a five-year basis. That is, the bonus you get this year is due and payable to you one-fifth this year, and so forth, for five years. If you go to work for a competitor, you lose the bonus. Pensions are frequently limited that way. There are various uses of the covenant not to compete, not just in the employment contract, but also in bonus provisions, pension provisions, and so forth, that might be valuable.

MR. COOKE: Actually, some of those agreements don't use the word competition. They say if the person engages in any activity against the interests of this particular employment.

MR. BECKER: Well, all right.

MR. MAGDEBURGER: But usually there is a consideration for that.

MODERATOR SIEGEL: Mr. Beck?

MR. BECK: I'd like to go back, if I may, to a point that Roger Horton made which I think bears generally on this subject. I believe he said that his company does not enjoin its employees to secrecy in perpetuity. Do you feel free to tell us, Roger, what words you use to avoid this situation?

MR. HORTON: Well, our agreement is somewhat unusual in that our employees are obliged to keep information secret only for a period of five years from the time they leave. This provision has presented some problems when we've entered into agreements with other people about receiving information. I always have to get some sort of a clause in the contract permitting us to continue this agreement.

MR. CASELLA: Is the rate of obsolescence of the technology so fast that the term doesn't make any difference? Is that the guiding principle?

MR. HORTON: I don't know whether I'd want this published, but it's because it has always been that way. (Laughter)

PROFESSOR OPPENHEIM: You do get the paradoxical situation in which a person put under a secrecy contract or subject to disclosure in confidence, is enjoined from using the information even though the secret itself has expired by discovery. It has some rationality where this particular person is so important for what he's accumulated over the years, and his ability to engage successfully in competitive enterprise is injurious to the rival firm. This is the kind of case where the court may say, "You are the one who is saddled with a trade secret confidence and you're different from the general public. Anybody else can use the secret but you can't." And that problem arises also after a patent issues, for example, where there is a disclosure and somebody

has been working in that art, but the person who had a prior trade secret contractual relation can't make use of any of that information.

MR. HORTON: Getting back for a minute to our agreement, I'm sure that the five year period did get in originally because we wanted to have something we thought we could enforce, and we thought this would be a reasonable time limit. Our agreement is perhaps unusual in that it is liberal on trade secrets, but very restrictive on patents. The company has the right to any patentable invention an employee makes regardless of field. We have this provision because we have some people whose business is to try to develop new things for us. We combine it with a liberal release policy. An employee can get a release in a field ahead of time if he wants, say, to work in lawn mowers or something else at home. He could get a release for lawn mowers even before he made any inventions.

MODERATOR SIEGEL: Mr. Beck?

MR. BECK: May I change the subject slightly? I would like to hear some discussion on what constitutes sufficient consideration of an employer for an employee in a secrecy agreement even assuming one where he is not tied down in perpetuity—what makes sufficient consideration?

MR. HORTON: We have had patent agreements come in from other companies when an employee has been hired—and I remember one that had a quarter of his salary. Now, I certainly didn't think that was enough. We've had others that have come in with three-quarters of their salary—well that's getting closer. But somebody here mentioned a full salary for a year. I would think that would stand up.

MR. BECK: In a secrecy agreement with your employee, I assume that to support the agreement you recite some kind of consideration, and not just a recitation of open-ended employment with no term.

VOICE: Well, the employee can terminate.

MR. BECK: But isn't that simply an agreement to agree about the term of employment?

MR. HORTON: Well, it's not an agreement on term of employment, but it's an agreement on distribution of rights while he is employed. However, the secrecy requirement exists even without agreement. And with no agreement, you've got an obligation.

MR. BECK: Right. And that's the point I was making earlier. Maybe it's better just to rely on that fact than to put in a secrecy clause.

MR. HORTON: Incidentally, if you are interested in these things, the National Industrial Conference Board, I think, has made a collection of agreements, and there's a big book you can borrow from them.

MR. MAGDEBURGER: The National Research Institute—

MR. BECK: Is that it?

MR. MAGDEBURGER: Yes.

DIRECTOR HARRIS: Mr. Beck, are you suggesting the inadequacy of the usual consideration and the advisability of not entering into a formal contract?

MR. BECK: A contract to keep an employer's secret a secret could be a problem. At least, I've seen a decision which said that an agreement not to divulge secret information based solely on employment without other consideration was insufficient under contract law and that you go back to the common law.

PROFESSOR OPPENHEIM: It's not an illusory promise—you suggested that it might be an illusory promise—it might be bilateral on the benefit-detriment theory, where one person gets the employment, which is the benefit he gets, and the detriment is that he puts himself under secrecy. I think it would be considered a truly bilateral arrangement, a promise for a promise—a promise to employ with termination at the will of each party and a promise to keep something secret.

MR. COOKE: I remember a case in a Pittsburgh company, but not Gulf. Years ago, one of their research men came up with a very valuable invention which the company proceeded to develop quite quickly. It was an improvement on something else, and the company went right into business. We hit the depression, and the employee, like a lot of other people, within a very short time after he made this invention was let out, let go. The patent counsel for that company had taken the position that in his opinion no employment contract was any good; he said he could drive a horse and cart through any one that was ever written. So there was no contract, no written contract. But here was a man who at least was supposed to get something for this invention, like future advancement or continued employment. Anyway, he was fired; and, of course he started right away to make a fuss. Well, the company relented before the man actually filed suit, and they made a settlement. Unfortunately, nobody else would ever hire the man again. Here is a case in which a man expects to receive a reward in the way of continued employment and advancement for making an invention, yet he is one of those people fired. He said, then that invention doesn't belong to the company because the consideration for it is gone.

MR. TOOMEY: One practical consideration justifying use of a contract arises when an employee refuses to assign an invention or to keep it secret. With the contract you merely ask for specific performance in contrast to the detailed proof which is necessary to support such an

action in the absence of a contract. The contract makes the litigation far simpler.

MR. HORTON: Well, that's for inventions. But that wouldn't necessarily apply for trade secrets.

MR. TOOMEY: It should be helpful to show your policy of secrecy included the particular subject matter in question.

MR. COOKE: I should have mentioned, but I didn't remember at first, that what really happened was that the inventor refused to assign the patent application. It's one of the hardest things in the world to get a man to put his signature on any kind of a document.

MR. MAGDEBURGER: Mr. Moderator, I'd like to get some comments as to what legal restrictions can reasonably be put on a departing employee as far as his future employment is concerned. Now, maybe that's a very broad question. But the employee who leaves you and is going to be employed in a like discipline—in another company—is saturated, of course, with your confidential information. The decisions of the courts will hold that you cannot deny him the right to practice his professional skills. Query: What are his professional skills vis-à-vis the company's confidential rights? Now is there some way to protect the company? We talked about trade secrets, but now we enter the sphere of confidential proprietary property of the company. This property is quite valuable, but the employee is going into a competing business. Are there any ground rules?

MR. HORTON: That's a big question, and I don't know how you really can answer it.

MR. BECKER: That's true particularly, I think, if an employee has worked for a long time, maybe from the beginning of his professional career, on a relatively narrow subject. That man is almost totally tied up; it seems to me to be practically impossible to extricate his proper skills from those which belong to the company. In the *DuPont-American Potash* kind of case, as I read it, a fellow had worked for ten or 12 years, or something like that, in the development of a particular process.

MR. MAGDEBURGER: There the problem is quite well defined. O.K., the man is a chemical engineer.

MR. BECKER: I guess he argued that he was going to use his own skills.

MR. BECK: Yes, but the fact situation, I think, made it pretty clear that in the operation for which he was hired, it would be impossible for him to sit by and watch his new employer make mistakes. Since he had knowledge from his previous employment, he could remedy those mistakes. He couldn't legally do so, yet he would practically have to.

MR. MAGDEBURGER: Well, suppose you have a technological breakthrough, a rapidly expanding technology, and this individual is a physicist or a mathematician who started just out of college to become quite expert in this new technology. Is he in fact at that point practicing his profession or is he using the company's confidential information or trade secrets?

MR. BECKER: You know, the only answer I've ever been able to give on that is the old one. It depends on the fact situation. I think that there are facts in each of these instances which give you the clue. I think that the circumstances surrounding a person's leaving and the nature of his future employment give you some clue as to what is being sought, perhaps not even by the employee but by the new employer. I think that was the fact situation in *American Potash*. The company was hiring a person to run a plant, a specific kind of plant for which he was specifically employed. In our space-suit case, for example, this person was the head of our space-suit development program. There were only three or four space-suit companies in existence at that time, and the new employer had just received a contract for development by the government. The employer interviewed only this person. I think that the circumstances led to a conclusion that the employer was perhaps not only interested in his managerial skills.

MR. BECK: There was this kind of factor in the *American Potash* case too. Here was DuPont with the only going operation of this kind. Potash wanted to make an operation of like kind but had not yet built the plant. Potash advertised for somebody skilled in making the same product—advertised in the very city in which the DuPont plant was located and in which this man was working. These facts represented added evidence.

MODERATOR SIEGEL: Mr. Redmond?

MR. REDMOND: I can't give you precise definitions. There is, however, the textbook, *The Law of Trade Secrets*, by A. E. Turner, which describes particular skills versus general skills. As I recall that text, a man going to another company where the job is similar throughout the market would be exercising general skills. The companies know as much as their competition; likewise, the man in a particular job would not know any more than his counterpart at another company, so he could go to such a job on the basis of his general skills. But now should the man go to a job that's unique, that's more than the ordinary, such a job would probably require the exercise of particular skills which he acquired from a former employer. The Maryland case of *Hendski Company* also gives a good description of particular skills versus general skills.

DIRECTOR HARRIS: Maybe the subject is all a man knows. He got out of college and went directly into a particular department. This skill is all he has mastered. He knows nothing else for vocational purposes; he can't make a living at anything else. What do you do in that case?

MR. COOKE: What if in his first employment, a man comes up with an idea he thinks is very fine and his supervisor says no, we don't like that, that wouldn't work, forget it. The man gets disgruntled and leaves, taking the idea to a second employer. What about that situation, which was described I think, in the old *Alchlor* case, if you go back that far.

DIRECTOR HARRIS: I suppose this case might be an exception. In other words, there's a generalized rule, but there are exceptions—perhaps as in this example.

MODERATOR SIEGEL: Are there not cases of this sort in which the employee is paid off, given what amounts to the discounted income that he would be willing to forgo in order to work thereafter in other employment? In principle, you can do this.

DIRECTOR HARRIS: Yes, this is sometimes done. The employer might give a man three-quarters of his salary with the understanding that the employee will not work for a limited period for any employer in a specific field.

MR. MAGDEBURGER: Actually, this procedure has some semblance of practicality. In the case I brought up, the effort of the negotiation was to define the sensitive or the critical area of technology and come to an agreement to keep the employee out of that area for a given period. That's about as close as you get.

MR. BECKER: Well, I think that kind of agreement should not be overlooked. As a matter of fact, it seems to me that most of these problems in the workaday world are handled by common sense arrangements. In our company, for example, we don't want to buy a law suit. I think that we would look a long time at a letter from a former employer—in fact I know we've done this—of one of our employees saying that he had worked in some specific field, that he possesses trade secrets in that field, and that he should not work for us in the same field. We have bent over backwards to put the employee some place else, and we have had success on the other side of the same fence, so that this is the way in which we frequently reach agreement.

MR. CASELLA: In the workaday world, as we call it, we make consulting agreements with certain key people who leave.

MODERATOR SIEGEL: For how many years? For one year?

MR. CASELLA: No, we have a renewal.

MODERATOR SIEGEL: Even though the man leaves for another company?

MR. CASELLA: In that particular area that we wish to preserve.

MODERATOR SIEGEL: And the man is not serving two masters, presumably?

MR. CASELLA: Hopefully. It's pretty difficult—

PROFESSOR OPPENHEIM: Incidentally, you might be interested in two cases that get into an adjacent area of a no-switch-of-employees agreement between members of an industry. One of them is *Union Circulation Co. v. Federal Trade Commission*, 241 F. 2d 652 (2d Cir. 1957). Magazine subscription agencies agreed not to employ persons who had been engaged by another agency during the past year (whether or not the agency was a party to the agreement). This agreement was held not to be illegal per se but, because of its potential effect on competition, it was held an unreasonable restraint of trade within the Sherman Act. The case arose under Section 5 of the Federal Trade Commission Act.

The other case is *Nichols v. Spencer International Press*, 371 F. 2d 332 (7th Cir. 1967). There the court held that a no-switching agreement by publishers not to employ a former employee of any employer until six months after termination of his employment could violate the antitrust laws, but it was a question for the jury.

These cases may have relevance to an industry where switching of employees is prevalent due to great mobility of employees and the practice of corporate raiding. The industry members who are competitors and agree on no-switching of employees would be getting into a situation which might invite the kiss of death from an antitrust standpoint. The agreement could well be a per se illegal antitrust violation. It's like a mutual-aid agreement—you don't entice my employees and I won't entice your employees. If the big eight or nine computer companies got together on that basis—and this is just fictional supposition because their attorneys are too sophisticated on antitrust to allow it—the action would surely be condemned as a Sherman Act violation.

MODERATOR SIEGEL: They'd rather switch than fight. (Laughter)

PROFESSOR OPPENHEIM: Yes.

MODERATOR SIEGEL: Well, Mr. Lucca?

MR. LUCCA: Isn't the thread running through trade secrets violation an unconscionable action on the part of one or the other parties? Mr. Becker stated that you must look at the facts—and naturally you must—but we should look at this criterion, i.e. unconscionable activity, as a general guide. That would be the criterion that I would use.

MODERATOR SIEGEL: Well, I think that when Mr. Becker says "the facts," he means the whole context—not merely the objective facts but even the nature of the behavior. One can impute motives to people according to what they do.

MR. BECKER: Right.

MR. LUCCA: This matter of imputation is one of the stickiest problems in the whole area of trade secrets underlying much of the litigation.

MR. HORTON: Wasn't it in Mr. Becker's space-suit case (which, if I remember correctly, Goodrich lost) that the employee said openly that ethics had its price?

MR. BECKER: I would like at least to indicate that there is some difference of opinion as to whether we lost or won. (Laughter). This is why I made some comments about remedies. We won to the extent that we got and we have an injunctive order which has been renewed each year against this employee; this order prevents him from the disclosure of a listed group of trade secrets. To that extent we were successful. To the extent of seeking to prevent his employment by a new employer, either generally or specifically, in the space-suit department, we lost. As you stated, defendant did say that about ethics, and his remark seemed to impress the judges on the court of appeals, anyway.

MR. CURTIN: I understand there is a case before the courts in White Plains at the present time relating to a stolen computer tape on which an IBM customer list was set forth. I wonder if Mr. Redmond is familiar with that.

MR. REDMOND: No, I'm not. There is another case pending that involves the departure of 66 employees to start a competing firm. I'm not familiar with the other case at all.

PROFESSOR OPPENHEIM: Here's a very late article, January 1969, page 459; maybe you haven't seen it, in the *Business Lawyer*, by a man named Redmond. (Laughter). I know he didn't want to cite himself, but he had very good coverage of trade secrets in that article. Instead of conclusions, he suggests guidelines that, I think, take into account all of the ethical, legal, social, and economic considerations.

MODERATOR SIEGEL: I take it that the stealing of a tape which contains a customers list would be treated very much the same as the stealing of a list itself, would it not?

MR. CURTIN: I think so, yes. Apparently this tape was offered to a number of competitors of IBM.

MODERATOR SIEGEL: The interesting thing to me is the easy replicability of the information. The same is also true about any list that can

be photographed, for example. I'm curious as to whether the fact that the list was on computer tape makes the theft any exception.

MR. CURTIN: That's why I raised the point. I wondered if Mr. Redmond could discuss it.

MR. REDMOND: No, I'm sorry. In fact I'm embarrassed to say I don't know whether it could be considered an exception.

MODERATOR SIEGEL: You see what happened while he was away? (Laughter)

MR. REDMOND: I was so concerned with the 66 employee case that I haven't been able to follow all litigation.

MODERATOR SIEGEL: The loss of the 66 people—does that touch on the point Mr. Magdeburger raised earlier? He wasn't talking about a mass migration. (Laughter). What protection do you really have?

MR. REDMOND: Well, that is the reason why I suggested monitoring to Mr. Becker. He thought that the injunction per se didn't go far enough. So I was suggesting that alternative. Am I answering the question?

MODERATOR SIEGEL: Yes.

MR. REDMOND: Monitoring seems the best protection you have. I don't know whether that helps you much or not. You've got to approach the whole situation positively, of course. This means that your employees are first assumed to be honorable or you wouldn't have hired them. If they do start to depart with your trade secrets, with your proprietary information, then maybe it's a question of management, bad management. You really haven't done your job, so the question is to find out what the employee problem is and to develop employee loyalty. The Norton Company in Massachusetts apparently doesn't have agreements. Mr. Anderson, would you care to comment?

MR. ANDERSON: The company has no agreements as respects patents, or inventions, or loyalty. It relies upon the integrity of the individual, and it maintains that no departing employee ever stole an invention or a trade secret. Whether this is still the practice, I do not know. It was the practice when we negotiated a contract with the company a few years ago.

PROFESSOR OPPENHEIM: Where is that company?

MR. ANDERSON: Worcester, Massachusetts.

PROFESSOR OPPENHEIM: I thought it was in Shangri-la for a moment. (Laughter)

MR. ANDERSON: We have been dealing today with negative approaches. I think we ought to emphasize a little bit more the positive approaches. What do you do when a new fellow comes? How do you indoctrinate him to get esprit de corps? He's coming into the company,

he's making a career of this job. I think oftentimes we look at the job merely in terms of salary. I think that we are losing in our business endeavors because of size. We fail to emphasize the personal feeling that everyone is working on a team, for a company, for the United States. We're all in one "basket."

PROFESSOR OPPENHEIM: Roland, that's true. How large is this Norton Company? How many employees?

MR. ANDERSON: I judge it has a few thousand people.

MR. ROGEBERG: We take the positive approach, we really do. We have indoctrination programs.

MODERATOR SIEGEL: As Mr. Johnston, our Thomas Alva Edison Fellow, will agree, the imaginative management of people—what we are calling the positive approach—has an importance for organizations that is hard to overestimate. It is being honored increasingly in the proliferating literature, which bristles with new vocabulary featuring staff motivation, involvement, creativity, fulfillment, and so forth. Of course, many of the new ideas in organization and personnel administration that have been suggested in recent years are now going to be tested for real in a period of economic retrenchment. Loyalty to the company and self-development are easier to cultivate in good times than in bad, when company horizons may narrow, when bonuses and perquisites may vanish, and when layoffs may become necessary. The company that can maintain employee morale under stress is the company more likely to protect its trade secrets in general, in all seasons.

DIRECTOR HARRIS: Irv, in that regard, the method used at the time of entering into these contracts might be employed as a means to inspire and motivate these employees—in other words, to let them know about company policy and management, what the company is doing for them as people, how they can work together in the company as a team.

MODERATOR SIEGEL: In this connection, I'd like to recall an occasion I had to address the New Jersey Patent Bar Association—in the fall of 1966. One of the topics that commanded special attention was the maintenance and enhancement of employee loyalty as manifested in the honoring of patent agreements. I insisted that an employee who just comes to a job may resent being asked to waive rights, or to become subject to vague penalties, when he does not yet know of his benefits—his tenure, the prospect of continuity of employment, salary progression, and so forth. We hear much nowadays about "sensitivity" in dealings with minority employees. The same notion is important in any managerial context involving people, without regard to race.

Mr. Anderson is right to stress the positive, the creation and maintenance of good morale as a basis for all company-staff relations. The timing of the signing of waivers and the discriminating limitation of this requirement to the pertinent staff categories are matters that demand managerial sensitivity.

MR. BAIR: At what time do you think an employee should be asked to sign a patent agreement?

MODERATOR SIEGEL: I should dislike to come to a personnel office and be given a whole sheaf of papers to read and sign, especially agreements that concentrate on company rights and ignore mine.

MR. BAIR: I think he should be requested to sign before he is hired.

MODERATOR SIEGEL: You could even sign weeks later and in different contexts—on your own project, in your own department, when you have already joined your fellows.

MR. BAIR: What do you say when he asks you "Why didn't you tell me about this when you hired me?"

MODERATOR SIEGEL: Oh, he's very unlikely within a week to have really gotten that good in your company.

MR. BAIR: I think he should be informed of this during the interview.

MODERATOR SIEGEL: Maybe he should be informed in the post-hiring indoctrination, in the new employee orientation, but I think the opportunity should develop naturally.

MR. HORTON: What we try to do is inform him before he leaves his old job so that he knows what is to be expected.

MODERATOR SIEGEL: He should know what'll be expected, but don't hit him with legalisms and fine print too soon. I mean, don't insist on your pound of flesh before he knows what it is he is supposed to get in return. Establish rapport, make him feel part of the company.

DIRECTOR HARRIS: Time, gentlemen, time!

MODERATOR SIEGEL: We come to the end of a long day that has passed too soon. To summarize would be to geld, if not needlessly to gild. You were treated to four excellent talks, one of which is a bonus. You heard first from Mr. Rogeberg on the company management of trade secrets, then from Mr. Becker on the legal status of trade secrets, from Mr. Henderson on the public interest as represented by the Department of Defense, and from Professor Oppenheim on the relationship of the Sherman Act to the misappropriation of trade secrets.

The gems you have garnered no doubt are many, and you may have less difficulty retrieving them from your own notes than I do from my already inscrutable jottings. But you heard first how one major company attempts to classify and control documents; and the

discussion dealt, among other things, with problems of centralization and decentralization and with the overriding importance of good employer-employee relations. The variability and criticality of the facts pertaining to each case were stressed by Mr. Becker; these variations frustrate the search for simple rules and for single guides to trade secret protection under law. He commended our attention to some new literature and to some recent cases decided after *Sears-Compco*. He dwelt on *Lear v. Adkins* and *Painton v. Bourns*. He noted the adequacy of the material on state legislation already published in *IDEA*. Being forced by us to look at ASPR from our point of view, Mr. Henderson discovered a great secret of his trade—that technical data, in which the Department of Defense so heavily trades, is a term which includes trade secrets. From his talk it is clear that complex material production involving contractors cannot nowadays proceed very far without the parallel production of proprietary information—without its generation, processing, distribution, storage, and retrieval. The last formal presentation of the day, by Professor Oppenheim, treated several trade secrets cases involving Section 1 and Section 2 of the Sherman Act.

Thank you, gentlemen, for your papers and for the discussion—the reward for which will be the richness of the published record. Farewell and Godspeed.

DIRECTOR HARRIS: On behalf of the Institute and in closing this Trade Secrets Clinic, I also want to thank the speakers and the discussants. The proceedings will be published as soon as possible after you return your edited papers and remarks. The meeting stands adjourned.

A P P E N D I X

OUTLINE OF TRADE SECRETS CLINIC

The Institute's research studies endeavor to collect and analyze information relating to invention, innovation and to the major issues in the field of protection of industrial-intellectual property. One of the most significant issues in this field concerns the role and management of trade secrets. Accordingly, the Institute plans a one-day Clinic addressed to the following aspects of the subject: Policy, planning and procedures, safeguards against employee "raiding," the role of ethical standards and company regulations, the proper release of technical information in scientific reports, and the protection available through litigation. The Clinic will focus on management experience and opinion and deal with actual company situations. Ideas on appropriate action in particular instances will be exchanged.

In view of the scope of the Clinic, the participants will be drawn from various disciplines; among these are attorneys (including patent specialists), inventors, economists, company executives, research administrators, government officials and educators. They will meet at the Institute's headquarters. Three key discussants will first present short papers on topics relating to trade secrets. These papers, which highlight leading problems, will serve as the basis for the ensuing exchange among participants in the Clinic. One paper will concentrate on company management of trade secrets, including the establishment of procedures for regulating the relations between employers and employees and the distribution of technical information. Another will deal with the legal status of trade secrets in the light of decided cases, recent changes in public statutes, and antitrust developments. The third paper will focus on the public interest—the proper protection and release of government and private information, the movement of technical personnel, et cetera. The establishment and maintenance of ethical standards will arise in all three contexts.

After each paper is presented, a few minutes will be allowed for cross-questioning and comment to clarify some points made by the speaker. The principal discussion, however, will take place after all three papers have been presented. The discussion periods will follow the same order as the principal papers and will take up most of the day.

The maximum benefit of the Clinic will be derived from maximum interchange among participants. Experts will be sharing experience, opinions, and insights. Since all the participants are experts, it is hoped that the exchanges will be free and uninhibited. The quality of the proceedings that will result from the Clinic will be in direct proportion to the efforts of the participants themselves. After the Clinic a suitable report will be prepared for *IDEA*, the journal of The PTC Research Institute. An opportunity will be provided for the editing of the contributions of the participants to this report.

The Institute has been developing the Clinic as a research tool for diagnosis, instruction, and remedy. It is intended to deal in depth with frontier problems and is designed to surface otherwise inaccessible information. It complements other tools of research and education developed by the Institute: The Annual Conferences; Special Conferences of Invited Experts on selected topics of national or international importance; a journal (*IDEA*); digests of findings of Institute projects; booklets for young people on the industrial-intellectual property systems; and papers prepared by awardees of the four honors conferred annually by the Institute (Kettering, Inventor of the Year, Distinguished Government Service, and Patent Office Society Student Awards). In 1969 a volume of papers derived from *IDEA*, *Nurturing New Ideas: Legal Rights and Economic Roles*, was published by the Bureau of National Affairs.

Licensing As a Means of Penetrating Foreign Markets*

DAVID B. ZENOFF**

INTRODUCTION

THERE ARE COMPELLING REASONS to re-evaluate companies' attitudes toward and use of the foreign license. Thousands of firms may be foregoing handsome revenues by failing to exploit commercially their by-product R&D. The market is great: Developing countries demand an expanded volume of technology transfers from the industrial nations; Western Europe, Canada, the United States and Japan constitute vast markets for each other's know-how; all nations with fears and anxieties about excessive inflows of foreign equity would prefer to import technology without paying the price of foreign ownership; and, licensing frequently can provide a higher rate of return on

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investment and even larger cash inflows than exports or foreign investments.

After a study of 43 American licensing companies which represent a cross-section of companies engaged in foreign licensing,¹ it appears that foreign licensing is an underrated and underutilized method of foreign market expansion. It is true that the United States as a whole earns approximately \$1 billion annually in foreign licensing royalty income, and numerous American firms have large portfolios of such agreements in effect. Yet most companies interested in foreign markets treat licensing as only a marginal activity with unexciting income potential and their approach to managing licensing usually reflects this attitude. There are many companies which should re-examine their foreign licensing perspectives and policies with the idea of using the license as a more dynamic marketing tool.

NATURE OF COMPANIES' INVOLVEMENT IN FOREIGN LICENSING

American companies have derived a steadily increasing amount of royalties and fees from foreign licensing. The growth of these revenues (summarized in Table 1) compares favorably with the rise in dividend income flowing back from U.S. investments abroad and with the increase in the country's export sales. In absolute terms the royalty and fee total is approximately one-third the size of dividend income and only a small fraction (between 3-5 percent) of export sales.

TABLE 1

RECEIPTS BY U. S. COMPANIES FROM EXPORTS, DIVIDENDS FROM FOREIGN AFFILIATES, AND ROYALTIES AND FEES FROM ALL FOREIGN LICENSEES, 1960-1968.

(Millions of Dollars)

	1960	1961	1962	1963	1964	1965	1966	1967	1968
Exports	20,575	20,962	21,672	23,345	26,489	27,478	30,320	31,534	34,413
Dividends	2,355	2,768	3,050	3,059	3,670	3,963	4,045	4,518	4,985
Royalties & Fees	650	707	836	933	1,057	1,259	1,378	1,488	1,629*
(Royalties)					565	666	709	786	990

Source: U.S. Department of Commerce.

* Royalties from non-affiliated licensees estimated.

¹ The Appendix contains a summary of the characteristics of the companies studied. The project encompassed 3214 foreign licensing agreements, which accounted for \$114.9 million in royalty revenue in 1967.

Geographically, foreign licensing activity closely parallels the patterns of United States trade and direct investment. The first column in Table 2 summarizes the location of foreign licensees included in this study, and column II, the source of royalty income for the United States. The relative importance of Canada, Japan, the United Kingdom, and the European Economic Community can be noted. These countries are also the most important recipients of the capital and goods which the United States has exported since the end of World War II. These relationships can be observed in columns III and IV of Table 2 which compare the geographical locations of the primary recipients of U.S. private direct investment and exports with the location of foreign licensees and foreign sources of royalty income. The most important discrepancy in the importance of the respective areas for U.S. licensing, investment, and exports occurs in Japan, which until recently had not been receptive to U.S. direct investment but has been an important trading partner and consumer of American technology. With this exception, licensing fits into the overall pattern of the U.S. commercial involvement with foreign countries.

TABLE 2

GEOGRAPHICAL PATTERN OF U. S. COMPANIES' FOREIGN LICENSING ACTIVITY
COMPARED TO DIRECT FOREIGN INVESTMENT AND EXPORTS, 1967

Area	I % of Total No. of Licenses Among Companies in Sample ^b	II % of Total Royalties Received by U.S. Firms ^a	III % of Total Book-Value of Direct Foreign In- vestment in Each Area ^a	IV % of Total Exports to Each Area ^c
United Kingdom	9	17	10	6
EEC	26	31	15	17
Other W. Europe	11	6	6	7
Latin America	8	12	18	14
Japan	15	10	2	11
Eastern Europe	nil	nil	nil	nil
Canada	10	12	32	27
Rest of World	20	11	17	17
Total	100%	100%	100%	100%

Sources: ^a U.S. Department of Commerce;

^b 3214 licenses studied by author;

^c International Monetary Fund.

Viewed more closely at the level of the individual firm, foreign licensing is typically a small activity for most companies. This is depicted in Table 3, which presents the number of foreign licenses in effect for the U.S. companies studied, and shows that about two-thirds of the firms surveyed have 30 or fewer agreements in which they are licensors,² and by Table 4 which points out that about 60

TABLE 3

NUMBER OF FOREIGN LICENSING AGREEMENTS IN EFFECT
FOR 42 U. S. COMPANIES, 1967

Number of Licenses in Effect	Percent of Companies Within Range
1-10	42.9
11-20	11.9
21-30	11.9
31-40	9.5
41-100	7.1
101-200	4.8
201-500	9.5
More than 500	2.4
	Total 100.0

TABLE 4

FOREIGN ROYALTY INCOME RECEIVED BY 41 U. S. COMPANIES, 1967

Royalties Received per Company	Percent of Companies Within Range
Up to \$100,000	24.5
\$100,001 to \$500,000	26.8
\$500,001 to \$1,000,000	12.2
\$1,000,001 to \$2,000,000	12.2
\$2,000,001 to \$3,000,000	7.3
\$3,000,001 to \$4,000,000	7.3
\$4,000,001 to \$10,000,000	2.4
\$10,000,001 to \$35,000,000	7.3
	Total 100.0

² These data are corroborated by a recent National Industrial Conference Board study of 191 companies. Among firms in their sample, 64% had 24 or fewer agreements. See Enid Lovell, *Appraising Foreign Licensing Performance*. National Industrial Conference Board, Business Policy #128, 1969.

percent of these companies derive less than \$1 million annually in foreign royalty income. For the entire group of U.S. firms studied, foreign royalties were only .34 of 1 percent of corporate sales, and 3.4 percent of profits before taxes.

THE HIGHLY INVOLVED LICENSORS

Among the companies studied, 15 earned \$1 million or more in 1967 as royalties from foreign licenses. As a group, these 15 firms, which might be categorized as "highly involved" in foreign licensing, accounted for \$97.6 million of the total \$114.9 million of royalties received by the entire group of 43 licensors which were studied. The relatively small sample size and the possibility of bias in the data because *all* of the firms studied were engaged in licensing make it impossible to generalize about the distinguishing characteristics of the companies which were highly involved in foreign licensing, or to explain the relationship between the amount of licensing income and company characteristics. From a comparison of the 15 major licensors with the 28 other licensors which earned less than \$1 million in royalty income, the major licensors appear to be distinctive in three respects:

- (1) They are more closely grouped into the chemical, electrical machinery, paper and allied products industries than are the other firms;
- (2) The highly involved companies tended to commit relatively more funds (as a percentage of their total sales) to R&D than the other licensors:
- (3) A larger percentage of the highly involved licensors were those whose sales exceeded \$500 million compared to the other firms.

To study further the possible relationships between various corporate characteristics and the amount of foreign licensing income received, several multiple regression equations were computed based on data from this study. The inquiry focused on the possible relationships between (1) the *relative* importance of foreign royalties to a firm (royalties/corporate sales) and such variables as corporate size, R&D commitment, and involvement in foreign equity operations; and (2) the *absolute* amount of royalties received and such company characteristics as corporate size and R&D expenditures.

In the former case, the *relative* importance of foreign royalty income was hypothesized to be greatest for small companies which lacked the capital and management resources to expand into foreign markets through direct investment and sizeable export activity. It was

also posited that a firm's R&D commitment (R&D expenditures/corporate sales) would affect its relative involvement in licensing, insofar as the control of a body of technology is requisite for licensing. The bases for these tentative hypotheses are shown in Tables 5 and 6.

TABLE 5

RELATIVE IMPORTANCE OF FOREIGN ROYALTY INCOME TO 40
U. S. COMPANIES OF VARIOUS SIZES, 1967

Company Size (sales)	Importance of Foreign Royalty Income (royalties/total company sales)	Number of Companies
Up to \$10 million	.14	6
\$10,000,001 to \$65,000,000	.016	5
\$65,000,001 to \$150,000,000	.009	8
\$150,000,001 to \$500,000,000	.0013	6
\$500,000,001 to \$1,000,000,000	.0014	6
\$1,000,000,001 and larger	.0036	9
Average for all companies	.003	Total 40

TABLE 6

RELATIVE IMPORTANCE OF FOREIGN ROYALTY INCOME TO 34
U. S. COMPANIES WITH VARIOUS DEGREES OF R&D COMMITMENT, 1967

R&D Commitment (as % of total sales)	Importance of Foreign Royalties (royalties/total sales)	Number of Companies
Less than 2	.00086	9
2 and less than 4	.00107	7
4 and less than 6	.00607	8
6 and less than 10	.00395	4
10 and above	.00671	6
Average for all companies	.00308	Total 34

This area of inquiry provided no statistical basis to support the hypothesis that the relative importance of foreign royalties was a function of corporate size, R&D commitment, or involvement in foreign equity operations. This result confirmed an impression which is discussed later in this paper, that foreign licensing has not been used

as a deliberate marketing device and appears for most companies to be a residual type of activity.

In terms of establishing the relationships between the *absolute* amount of royalty receipts and various corporate characteristics, a significant and positive correlation was found between 1967 licensing income received by 34 companies and the amount of funds spent on R&D. This result is shown below in the regression equation in which the amount of royalties received (\$ Royalties) is the dependent variable and corporate sales (corp. sales) and the amount of R&D expenditures (\$ R&D) are the independent variables.

$$\begin{aligned} \$ \text{ Royalties} &= \$23,241 + 0.00091 (\text{corp. sales}) + 0.037 (\$ \text{ R\&D}) \\ R^2 &= 0.6126 \end{aligned}$$

The *t* values indicate that \$ R&D is significant at the 0.001 level and that corporate sales as an explanatory variable approaches significance. The constant term is not significant. The literature on licensing practices is limited, but the observed importance of R&D expenditures and corporate size is consistent with others' explanations.³

An interesting result of the investigation is an indication of the *size* of annual royalty receipts. While an "average" royalty figure for each license in 43 companies is not a meaningful measure, estimates can be made on the following basis: Roughly two-thirds of the firms reported that a relatively small number of their foreign licenses accounted for a comparatively large percentage of their royalty receipts. Using these data, it was possible to estimate that the average annual royalty received from the smallest 75 percent of the foreign licenses in effect during 1967 was \$9700, whereas the average income from the largest licenses was \$133,800.

An important aspect of the size of foreign royalties is the contrast between licensing income received from affiliated⁴ and non-affiliated licensees. Approximately eight of every ten companies studied which had foreign subsidiaries licensed at least some of them. Of the 3,214 agreements covered in this study, 14 percent were with foreign affiliates. From the available data, it is estimated that about 55 percent of all royalty receipts were from affiliated licensees. Hence, we might

³ See, for example, Enid Lovell, *supra* note; John Jurecky, "Surveys Report U.S. Firms' Views on Licensing Agreements, German Readiness to Conclude Still More," *International Commerce* (April 8, 1968); Vincent Travaglini, "Licensing U.S. Know-How Abroad Is Increasing," *International Commerce* (July 25, 1966); Jack Behrman, "Licensing Abroad Under Patents, Trademarks and Know-How By U.S. Companies," *IDEA*, Vol. 2, No. 2 (June 1958); *66 Months of New Foreign Business Activity in U.S. Firms*, Booz, Allen and Hamilton (New York: 1966).

⁴ An "affiliated" foreign firm is one in which a licensor owned any amount of the equity.

intimate that the average royalty from an affiliated foreign licensee is approximately *seven and one-half* times larger than that received from a non-affiliated licensee.

There may be several explanations given for the disparity in royalty size between affiliated and non-affiliated foreign licensees. Numerous companies were found to offer non-affiliated firms only their relatively unimportant technology, whereas foreign subsidiaries were given the commercially important processes and products. In addition, licenses were often granted to cover technology transfers to subsidiaries to minimize United States taxation on the transfer of technology abroad, to facilitate the inflow of funds from affiliates located in countries with exchange controls, and to comply with the "arms length" requirements of Section 482 of the United States Internal Revenue Code in transactions with foreign affiliates.

EXECUTIVES' VIEWS ON LICENSING NON-AFFILIATED FOREIGN COMPANIES

With the foregoing aggregated data for background, it is possible to examine with more insight the broad patterns of foreign licensing activity and inquire into the policies and procedures of individual companies engaged in this activity.

From interviews with licensing managers and from information provided from self-administered questionnaires returned by about 50 licensors, it appears that there are five prevalent interrelated views on the basic role of licensing non-affiliated foreign companies:

- (1) Licensing, especially by relatively small American firms, is viewed as a source of prestige for the licensors. Through licenses their know-how, products, and trademarks are used around the world, often by the best known, large corporations.
- (2) A license is frequently used as the means to obtain future access to foreign-controlled technology. Companies will grant licenses for the use of their industrial property rights to obtain reciprocal rights from foreigners and to enhance their chances of obtaining such licenses in the future when the parties' roles are reversed.
- (3) The amount of royalty income received from most foreign licenses is expected to be small—partly because what is licensed may not be viewed as having commercial significance to the licensor and partly because the licensor's compensation is

only a small percentage of the foreign sales of the licensed property.

- (4) The revenue from most foreign licenses is considered to be "windfall" income to the licensor because the licensed technology or products were not originally intended to produce royalty income. The industrial property may have been designed for internal use, such as a part of a manufacturing process, or for incorporation into products which the company manufactures for resale.
- (5) Companies generally are reluctant to license technology which they believe has significant commercial potential. Most executives believe that if the sales potential is large, it should be exploited by their own firms rather than by licensees. By directly entering foreign markets, companies normally anticipate earning larger profits than by licensing others to use it.

One conclusion resulting from these five attitudes is that the expectation that foreign royalties will be small is frequently a self-fulfilling prophecy. Licensing is not usually considered as an alternative method of foreign market entry when top level corporate strategy is formulated. In fact, licensing is often viewed as a distant third choice behind exporting and foreign investment. Respondents in the study indicated that more than one-half of the time, a license is negotiated only after a prospective *licensee* has taken the initiative to bring the parties together. It is generally true that companies possessing technology do little more to generate new foreign licenses than to make known their new processes and products in articles and news releases written for technical journals.

HOW LICENSING DECISIONS ARE REACHED

Given the widespread view of foreign licensing as an activity with low incremental costs and only marginal importance to the licensor, it is not surprising that relatively little analysis is given to the question of whether to grant licenses to prospective licensees. Normally a rough calculation is made of the potential royalty income to be generated by a prospective license in one typical year, or during the first few years of an agreement, and a few estimates are made of the out-of-pocket costs of becoming involved in an agreement. If a licensor expects to recover his out-of-pocket costs through receipt of a cash down-payment when an agreement is signed, then usually no further cost calculations or economic considerations are made.

If a down-payment is neither sought nor anticipated, a licensor may subtract from the expected income a few highly visible out-of-pocket costs expected during the early years of a new agreement. The resulting figure, often termed "profit," is then used as the basis for making a decision. Companies may compare projected "profit" with a rule of thumb standard—such as \$10,000 per year—or they may decide more intuitively if a projected stream of royalty income will be large enough to warrant proceeding with a new license.

Licensing managers acknowledge that several aspects of licensing activity can result in costs to their companies, but few of the costs associated with licensing are included in the analysis of a prospective license. As depicted in Table 7, those costs which are more frequently included in licensing evaluations are: Training a licensee, transferring

TABLE 7

A COMPARISON OF THE COSTS INCURRED BY 43 U. S. COMPANIES
AS A RESULT OF FOREIGN LICENSING ACTIVITY* WITH THE COSTS
WHICH ARE INCLUDED BY THESE COMPANIES IN THEIR APPRAISAL OF
PROSPECTIVE LICENSES

Type of Cost	Number of Companies That Incur the Costs	Percent of Companies Incurring Costs Which Include Them in Evaluation of Prospective Licenses
Correspondence with licensees to answer technical, managerial and legal inquiries	42	33
Negotiation of license contract	41	51
Appraisal of prospective licensees	39	31
Maintenance of licensor staff	39	29
Assistance to licensee in use of know-how	39	80
Transmission of technical data to licensee	37	86
Entertainment of visiting licensee representatives	35	26
Periodic training and updating of licensee	35	71
Policing of licensee	34	21
Legal expenses to maintain patents, etc.	30	37
R&D activities to modify technology to fit licensee requirements	24	63
Arbitration of disputes and renegotiation of contracts	20	20
Advertising to support licensee sales	6	83

* As Licensors.

technology to the licensee, adapting products or processes to meet a licensee's requirements, and promotions to enhance the market value of what is licensed. The decision to include these costs instead of most of the others incurred in licensing is based on three reasons: They are readily identifiable, they are regarded as out-of-pocket and therefore appropriately charged off against projected royalty income, and they often form the basis for calculating the fees charged to licensees for reimbursement of special expenses incurred by the licensor. Many of the costs of licensing *not* included in the evaluation of a prospective license are those which cannot readily be identified or measured by licensing managers or those which are considered too inconsequential for consideration in an analysis.

Only two types of remuneration from foreign licensing are normally taken into account: projected cash royalties and the receipt of equity in licensees. Few companies attempt to forecast the profits they might earn from exporting to their licensees, the benefits to be accrued from visiting licensees' plants or deriving information about licensees' markets, or gaining experience with licensees who might become partners or distributors of a licensor's other products. Potential export revenues are ignored even though many licenses lead to export opportunities for licensors which far surpass the value of the stream of royalties received over the life of an agreement. In these cases the failure to forecast export revenues associated with a license could lead to an erroneous decision to forego a prospective agreement whose royalty potential was believed to be low, but whose overall income generating capability was high.

The use of a payback standard as a rule of thumb (such as \$10,000 per year) as the primary method of determining the acceptability of a prospective license (1) ignores the differences in the time value of the various inflows and outflows of funds associated with a license over its life, (2) can be based on an erroneous assumption that the relationships between the costs and benefits associated with each new license will be identical to previous agreements (some of which were negotiated years before), and (3) does not enhance the ability of a decision-maker to compare meaningfully licensing with direct investment and exporting to determine the best means of penetrating a foreign market. (Among the companies studied, only one-fifth regularly attempted to compare licensing with other methods of foreign market entry as a part of their decision process.)

AREAS FOR MANAGEMENT ATTENTION

As alluded to earlier in this paper, there are vast opportunities for international licensing of industrial property. The existence of national differences in technology levels gives rise to commercial opportunities to transfer know-how to countries which need it. The choice of a transfer mechanism will be determined largely by the characteristics of technology, the owners' objectives and resources, the size and overall attractiveness of markets for specific technology, recipient nations' attitudes and policies towards various types of foreign commercial presence, and the degree of competition between suppliers and consumers of technology.

Within this setting each company must appraise the nature of foreign demand for its know-how and decide on the best strategy for competing in international markets. In several situations licensing may represent the most suitable means for the sale of a company's technology. These situations can be summarized briefly:

- (1) When a foreign market is too small to warrant local manufacture or exporting;
- (2) When a national market is closed to imports and/or direct investment by foreigners;
- (3) When a foreign market is presently unsuitable for local manufacture and closed to imports but is expected to become attractive to local manufacture in the future. In this case, licensing can provide an initial base of operations and a means of exploring market potential;
- (4) When a firm does not possess the capital or management resources required to exploit a foreign opportunity by exporting or direct investment;
- (5) When the nature of a company's industrial property is such that a higher rate of return on investment and larger profits will be derived from licensing than from other methods of market penetration;
- (6) When otherwise unexploitable by-product technology is possessed, licensing can provide means of producing income from the property;
- (7) When a firm can beneficially enter into an exchange of industrial property with a foreign company through a cross-license agreement which may be superior to two conventional sale and purchase agreements for the same technology.

The variety of opportunities for international licensing suggests the

need for developing a licensing *program* which is tailored to meet each company's objectives, resources, technology, and market opportunities. Based on the earlier review of existing licensing practices, three broad recommendations can be made for companies which have opportunities to license:

- (1) Licensing should be included in the basic planning and market evaluation phases for international operations;
- (2) Licensing should receive the same quality of management that is provided other facets of an international marketing program;
- (3) Suitable approaches should be developed to evaluate prospective licenses in relation to other means of gaining entry to a foreign market.

Licensing can be incorporated into company planning and the formulation of strategy at two important junctures: (1) When decisions are made on the allocation of resources to research and development activity, and (2) when plans are developed for penetrating foreign markets.

The expected end-uses of corporate R&D programs will dictate the objectives of the program, the size of capital investment in research, and the type of development work undertaken. Apparently, when R&D is being planned, most companies do not consider licensing as one of the sales devices which can be used for new products and processes. Few licensing executives systematically communicate to R&D managers their suggestions for product modifications or for basic product development which would be particularly suitable for foreign licensing. Furthermore, R&D managers generally fail to inform licensing executives of new technology and product developments which might have value in a licensing program. To make licensing more effective in many companies and to ensure profitable exploitation of a company's technology and industrial property, close and continuous communication should be maintained between the licensing and R&D functions.

As a means of entry to foreign markets, licensing can be considered early in the formulation of basic marketing strategy for all products and processes believed to be suitable for licensing. When a firm has determined that opportunities exist to earn profits through licensing, it should energetically attempt to *sell* its know-how abroad, rather than half-heartedly advertising it and waiting for prospective licensees to identify themselves. In a similar sense, after a contract has been signed, licensors are often in a position to assist their licensee on a variety of technical and managerial problems which are *not* within the

framework of the license contract. Assistance to licensees can have potential payoffs to both parties through increased licensee sales and profitability and in turn, through larger royalty payments and greater mutual trust and goodwill.

A successful program of international licensing must of necessity be based upon a suitable program for evaluating prospective foreign markets, licensees, and contractual terms. Opportunities must be identified and effectively communicated to all relevant executives to ensure proper consideration of the marketing, financial, and technical characteristics of a situation. Most companies today acknowledge the advantages of effective internal communications, but few firms have taken steps to improve internal communication, and only a small number of companies are now adequately structured to evaluate fully foreign licensing opportunities.

A necessary ingredient in the framework for evaluating prospective foreign licenses is a comprehensive measurement of the value of projected relevant marginal costs and benefits associated with a given opportunity. In many cases, companies will find it too costly to make detailed analyses of *pro forma* variable expenses arising from licensing activity. In these instances, licensors can rely on a set of up-to-date standard costs to approximate the expected marginal costs of a new project.

In the evaluation of benefits which might result from new licensing possibilities, it is important to include *all* of the potentially significant benefits. Frequently, the export revenues associated with a license or the stream of dividends resulting from equity participation in a licensee will far surpass the value of royalties from a license. Many benefits from licensing cannot readily be reduced to a dollar value for purposes of evaluation. However, if they are explicitly identified and analyzed as part of the overall evaluation, they are likely to influence the final determination of whether or not to proceed with a specific proposal.

Licensing agreements can then be *compared* with alternative methods of penetrating foreign markets to ascertain their relative profitability potential. The difficulties for management of projecting the inflows and outflows of funds associated with foreign licenses, export activity, and investments are considerable—which preclude many firms from even attempting to make comprehensive comparisons. However, those firms which persist in trying to estimate the outcome of foreign operations usually find that the data generated are very useful in decision-making and that the discipline of making careful evaluations and forecasts provides a variety of useful insights to management about

international opportunities, problems, and appropriate strategies.

The gains from a well-conceived and effectively managed program of international licensing can be significant and lasting. Only three companies among the 43 firms studied had comprehensive programs of foreign licensing with aggressive sales of technology and products, but these three alone derived fully *50 percent* of the total foreign royalty income earned by the entire group. The disadvantages and risks to a licensor which are associated with delegating licensing to a second or third-class status among marketing approaches and of making poor choices of foreign licensees or incorrect decisions to proceed with inherently unprofitable agreements can have far-reaching effects on companies' immediate profitability in terms of losses, revenues foregone, and, over the longer term, exclusion from attractive foreign markets.

APPENDIX

SUMMARY OF THE CHARACTERISTICS OF 43 UNITED STATES LICENSING COMPANIES STUDIED, 1967

SIC Classifications	No. of Companies
20	1
24	3
26	4
28	11
29	1
30	2
32	4
34	4
35	2
36	4
37	2
39	2
50	1
73	1

Annual R&D Expenditures As % of Corporate Sales	No. of Companies
1% or less	8
more than 1 to 2	4
more than 2 to 3	2
more than 3 to 4	4
more than 4 to 5	5
more than 5 to 9	5
more than 9	7

Overall range of R&D as % of Sales: 1-25%

Total Corporate Sales	No. of Companies
\$10 million or less	6
\$10,000,001 to \$50 million	4
\$50,000,001 to \$100 million	5
\$100,000,001 to \$200 million	6
\$200,000,001 to \$500 million	5
\$500,000,001 to \$750 million	3
\$750,000,001 to \$1 billion	3
more than \$1 billion	10

Overall Range of Size of Total Corporate Sales:
\$1.6 million—\$8 billion.

Number of Foreign Subsidiaries Owned	No. of Companies
0	12
1 to 5	7
6 to 10	9
11 to 15	4
16 to 20	3
21 to 25	1
26 to 30	1
more than 30	6

Overall Range of Number of Foreign Subsidiaries Owned: 0-46.

Income From Foreign Subsidiaries As % of Total Corporate Income	No. of Companies
0	16
1 to 5	8
6 to 10	2
11 to 15	4
16 to 20	1
21 to 25	0
26 to 30	3

Overall Range of Foreign Income As a % of Total Income: 0-30%.

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Genus, Species and the Patent Law*

JULES E. GOLDBERG

INTRODUCTION

MANY VEXING PROBLEMS regarding genus and species have confronted the U.S. patent applicant whose invention resides in the chemical field. Two recurring problems involve the questions of (1) adequacy of supporting disclosure¹ and (2) antedating prior art references.^{2, 3}

* This paper was submitted by the author in partial fulfillment of the requirements for the degree of Juris Doctor at Seton Hall University School of Law. He is at present a Registered Patent Agent with the firm of Hubbell, Cohen & Stiefel, New York.

¹ 35 U.S.C. 112.

² In *In re Stempel*, 241 F. 2d 755, 113 USPQ 77 (CCPA 1958), the court defined a reference:

What is a "reference"? It is nothing more than a patent or publication cited to show that all or part of the invention for which a patent is sought was in the prior art, either more than a year before the filing date to which the applicant is entitled, in which case it is a "statutory bar" and cannot be sworn back of, or before the date of invention. When a reference is not a statutory bar, Rule 181 provides a procedure by which the applicant is permitted to show, if he can, that his date of invention was earlier than the date of the reference.

³ For a thorough discussion of prior art see V. Woodcock, "What is Prior Art," Ch. 3, p. 87-221 in *The Law of Chemical, Metallurgical and Pharmaceutical Patents*, (H. Forman Ed., Central Book Co., 1967).

A typical example of a genus which can present such difficulties is "lower alkyl." The first question presented by such a genus is, of course, what are the metes and bounds of the genus itself? That is to say, what is the maximum number of carbon atoms a species can contain and still be classified within the genus "lower alkyl"?

Let us assume that the genus is restricted to lower alkyl groups having from one to six carbon atoms. Even with such a limitation, many possible species exist which would fall within the genus. Thus, the inventor could have in mind both linear alkyls and branched alkyls. With the latter subgenus, the number of combinations increases greatly. Assuming the inventor wishes to claim this latter genus, the patent draftsman must decide how many individual species must be disclosed in the application to adequately support the claim to the genus. This question frequently arises and unfortunately the only definite answer which can be given is, "the more the better."

Let us further assume that the desired generic coverage is more limited, e.g., linear lower alkyls having one to six carbon atoms and that species containing one carbon, four carbons and six carbons are disclosed in the specification. Suppose further that the examiner cites a reference disclosing one of the following: (1) the four carbon atom species; (2) the five carbon atom species; or (3) both the four and five carbon atom species. Assuming that the reference can be antedated, as by "swearing back," the question arises as to what must our inventor show in terms of prior preparation of specific species within the claimed genus in order to overcome each of the references.

The foregoing are but a few of the difficulties which arise in the genus-species area. In recent years, judicial construction has significantly clarified many of these problems. This discussion will examine the development and the current status of the patent law regarding this complex area of patent practice.

THE PROBLEM OF THE UNSUPPORTED GENUS

As a hypothetical situation, let us assume that the applicant has disclosed species A, B, and C and the claims are directed to the genus of A, B, C, D, E, and F.

The question that arises in this situation is whether the disclosure of the three species is sufficient to support a claim to the genus. As the court indicated in *In re Steenbock*,⁴ the number of species required to

⁴ 83 F. 2d 912, 30 USPQ 45 (CCPA 1946). See also *In re Shokal*, Devlin and Winkler, 242 F. 2d 771, 113 USPQ 283 (CCPA 1957) and *In re Kyrides*, 159 F. 2d 1019, 73 USPQ 61 (CCPA 1947).

support a given genus depends on the nature of the genus. Generally, the naming of one member of a generic group is not, in itself, an adequate basis for a claim to the entire group. However, it may not be necessary to enumerate a plurality of species if the genus is sufficiently identified by other appropriate language.⁵ The question of what constitutes "other appropriate language" depends on the circumstances of the particular case.⁶ Thus, if the claimed group involves compounds radically different from each other, it probably would not be sufficient to broadly identify the group and identify one or two compounds in it. For example, identifying the group "azo dyestuffs" and then disclosing only a few species would not be sufficient to support a claim to "azo dyestuffs." If, however, the group were small and closely related, e.g., alkali metals, the naming of the group may well be sufficient, since no significant disclosure would be added by further specifying of the well-known members of the group.⁷

This raises a particularly interesting situation with respect to interferences. Suppose the count is to a genus and that each of the parties has disclosed one or more species. In such a case, the right of priority would go to the party who first discovered a species.⁸ However, the winning party can obtain the genus claim only if his application has sufficient disclosure to support the genus.⁹ The reason for this is that while possession of a single species before another is considered sufficient to show priority, it is not necessarily sufficient to show possession of the claimed genus.

Thus, one of the major problems confronting the chemical inventor is to decide how many species should be prepared in order to provide the desired breadth of coverage in the patent application. Usually, it is not practical to prepare all of the compounds which the patent attorney would like disclosed. Consequently, the usual situation is a compromise between the inventor and the patent attorney as to the number of compounds disclosed in the application.

Moreover, the case law provides little help in this situation, since even on the most detailed analysis, one invariably reaches the same conclusion: The more species disclosed in the specification, the better the support for the genus.

⁵ *In re Dreshfield*, 110 F. 2d 225, 45 USPQ 36 (CCPA 1940).

⁶ *Id.* 45 USPQ at 41.

⁷ *In re Grimme, Keil and Schmitz*, 274 F. 2d 949, 124 USPQ 131 (CCPA 1960).

⁸ *Kyrides v. Andersen, Grenquist and Ball*, 121 F. 2d 514, 50 USPQ 131 (CCPA 1941).

⁹ *In re Kyrides*, *supra* note 4.

THE PROBLEM OF THE "KILLING" REFERENCE

The court in *Steenbock*¹⁰ further held that while a single species may not be sufficient to support a claim to the genus, the disclosure of a single species in a reference does in fact anticipate the genus.

The question now arises as to what the applicant can do, when confronted with such a situation, to overcome the reference. Several possibilities present themselves depending upon the issue or publication date of the reference and upon where the invention was made.

*More Than One Year Between the Issue or Publication
Date of the Reference and Applicant's Filing Date*

Where the reference issue or publication date is more than one year prior to the applicant's filing date, there is a statutory bar present under 35 U.S.C. 102(b) and the reference cannot be overcome by antedating. This can be particularly troublesome in situations involving CIP applications containing claims to a genus where the parent case disclosed one or more species and where foreign applications corresponding to the parent case have issued more than one year prior to the filing of the CIP. In *In re Ruscetta and Jenny*,¹¹ the CCPA upheld the examiner's position that applicants' issued British patent, which disclosed a single species, constituted a statutory bar to the expanded genus claimed in the CIP.

One reason why the *Ruscetta* decision is particularly troublesome is that it is the general practice to file foreign and U. S. applications within 12 months of each other in order to take advantage of the priority afforded by the international convention. (See 35 U.S.C. 119.) Consider a U. S. applicant. It frequently happens that such an applicant will discover, after the U. S. filing, that the scope of the invention is somewhat broader than originally contemplated and disclosed in his first U. S. application, and thus a CIP directed to a broader genus is filed.¹² The prosecution time in many foreign countries is substantially less than that in the U. S. Also, some countries make all applications available to the public after a relatively short period of time. For example, in West Germany and the Netherlands, patent applications are made available to the public 18

¹⁰ *In re Steenbock*, *supra* note 4.

¹¹ 255 F. 2d 687, 118 USPQ 101 (CCPA 1958).

¹² See, for example, *Fijitsu Ltd. v. Sprague Electric Co.*, 264 F. Supp. 930, 153 USPQ 168 (S.D.N.Y. 1967). *Ex parte Julius*, 154 USPQ 485 (P.O. Bd. App. 1967).

months after the application date. The general practice is to file Convention applications just within the one year priority time limit. In such a situation, the U. S. applicant must file his CIP within about two and one-half years of the filing of the U. S. parent application, inasmuch as, after the period, the *Russetta* doctrine will come into operation as a result of the foreign publication.

Note that the foreign applicant whose priority date is his filing date in a country that makes the application public after 18 months faces an even greater dilemma, inasmuch as he would have only about six months from the filing date of the U. S. parent application (assuming it was filed within the one-year priority period) to file a CIP.

*Less Than One Year Between the Issue or Publication
Date of the Reference and Applicant's Filing Date*

If the date of the reference is within one year of the filing date of the application, then the reference may be antedated, as by a showing under Rule 131,¹³ since a statutory bar would not be present. The question then arises as to what the affidavit must show in order to overcome the reference.

In *Ex parte Fryling*,¹⁴ the appealed claims called for a generic series of monomers, designated for convenience B₁, B₂, B₃, . . . et cetera. The reference cited disclosed species B₃ and a Rule 75 affidavit (now a Rule 131 affidavit) was submitted showing completion of B₁ prior to the effective date of the reference. Here, however, the Board concluded that inasmuch as the affidavit was not directed to the same species as the reference, it would not serve to overcome the reference. A second affidavit was submitted showing that B₃ had been conceived but not reduced to practice prior to the effective filing date of the reference. The Board held that the combination of the first and second affidavits did overcome the reference inasmuch as the combined affidavits showed completion of a generic invention prior to the effective date of the reference.

¹³ 37 C.F.R. 1.131. This rule, insofar as applicable here, reads:

When any claim of an application is rejected on reference to a domestic patent which shows or describes but does not claim the rejected invention, . . . and the applicant shall make oath or declaration to facts showing completion of the invention in this country before the filing date of the application on which the domestic patent issued, . . . then the patent shall not bar grant of a patent to the applicant, . . .

(Emphasis added.)

¹⁴ *Ex parte Fryling*, 175 USPQ 9 (P.O. Bd. App. 1947).

The Board in *Ex parte Burt*¹⁵ appeared to liberalize the *Fryling* criteria. In this case the applicant, in order to support generic claims, filed a Rule 75 affidavit showing completion of the same species disclosed by the reference before the effective date of the reference. The Board of Appeals reversed the examiner, holding that it was not the purpose of a Rule 75 affidavit to show that the invention as claimed had been reduced to practice prior to the effective date of the reference. Rather, it is sufficient if the affidavit shows that as much as the claimed invention as is taught by the reference was reduced to practice by the appellant prior to the date of the reference.

The question was apparently laid to rest (at least it was thought so at the time) by the decision in *In re Stempel*.¹⁶ In that case, applicant's U. S. application contained a generic claim to certain isopropyl benzenes, which claim was rejected on a reference having an effective date less than one year prior to applicant's filing date. The reference disclosed a species falling within applicant's generic claim. Applicant filed a Rule 131 affidavit which showed reduction to practice of the species of the reference prior to its effective date. Notwithstanding their decision to the contrary in *Ex parte Burt*,¹⁷ the Patent Office Board of Appeals held that it was well settled that a showing under rule 131 establishing priority as to a common species is not necessarily sufficient to obtain allowance of a generic claim.

The CCPA reversed the Board, deciding that not only was this construction of the rule too literal, but also, it was not in accord with the past practice of the Patent Office. Thus the court held that the affidavit had only to show the species of the reference in order to remove the reference.¹⁸

Note, however, that shortly thereafter, the CCPA, in *Ruscetta*¹⁹ clearly limited *Stempel* to those situations wherein the effective date of the reference and the filing date were less than one year apart.

The Combination-Genus-Species Distinction

The case of *In re Tanczyn*,²⁰ further clarified and, as so often happens with such clarification, also limited the *Stempel* holding. In

¹⁵ 89 USPQ 186 (P.O. Bd. App. 1950).

¹⁶ *Supra* note 2.

¹⁷ *Supra* note 16. See also *Ex parte Clark*, 60 USPQ 72, 73, (P.O. Bd. App. 1943).

¹⁸ See also *In re Blake and Hammann*, 358 F. 2d 750, 149 USPQ 217 (CCPA 1966).

¹⁹ *In re Ruscetta and Jenny*, *supra* note 11.

²⁰ *In re Tanczyn*, 347 F. 2d 830, 146 USPQ 298 (CCPA 1965).

Tanczyn, the applicant filed a U. S. application claiming a steel composition containing both nitrogen and molybdenum. The examiner rejected the claim on the combination of a reference which disclosed steel plus molybdenum (but no nitrogen) and a second reference which disclosed steel plus nitrogen (but no molybdenum). Applicant submitted a Rule 131 affidavit showing reduction to practice of the teaching of the second reference (steel plus nitrogen) however, not showing possession of his own claimed invention (steel plus nitrogen plus molybdenum). The court held that the affidavit did *not* dispose of the second reference, inasmuch as it did not show that applicant possessed his invention prior to the effective date of the reference. Thus, the CCPA stated, at 146 *USPQ* 301:

The primary consideration is whether, in addition to showing what the reference shows, the affidavit also establishes possession of either the *whole* invention claimed or something falling *within* the claim, in the sense that the claim as a whole reads on it. (Court's emphasis.)

Thus arises one of the major distinctions between the genus-species situation, i.e., X or Y, and one involving an improvement, i.e., X + Q, in that in the former, possession of a species (X) is construed as possession of the genus invention, i.e., X or Y, whereas in the latter, possession of X alone cannot give one possession of the invention (X + Q).

It is not always necessary, however, in order to establish "possession of the whole invention" to demonstrate that the embodiment or species disclosed by the reference was "possessed" by the applicant prior to the effective date of the reference. Thus, in the *Hostettler* case,²¹ the claim on appeal was directed to a process for producing a polymer by reacting a compound having one or more reactive groups A with a compound having one or more reactive groups B in the presence of catalyst X. The cited reference disclosed the reaction of two compounds in the presence of catalyst X, each of the compounds being polyfunctional with respect to the reactive group. Applicants submitted a Rule 131 affidavit establishing that they had carried out the reaction with the respective *mono*-functional compounds prior to the effective date of the reference. Both the examiner and the Board of Appeals concluded that the affidavit was not effective since it neither showed the reaction of the species which the reference disclosed, nor did it show possession of the claimed invention, i.e., producing polymers by reacting mono- or poly-functional compounds.

²¹ *In re Hostettler and Cox* 356 F. 2d 562, 148 *USPQ* 514 (CCPA 1966).

The CCPA reversed, holding that applicants had shown that they had discovered that catalyst X was suitable for reacting compounds having reactive groups A and B and that one of ordinary skill in the art would know that the catalyst would operate independently of the number of reactive groups. The court stated that applicants should not be required to submit facts under Rule 131 showing that they reduced to practice that which is obvious in addition to those facts offered as showing a completion of the invention, for the purpose of overcoming a reference.

Shortly after the *Hostettler* decision, the CCPA further clarified its position regarding Rule 131 showings in *In re Clark*.²² In that case, the applicant submitted a Rule 131 affidavit which showed reduction to practice of species A and B of the genus A, B and C. The reference, however, disclosed species C. The Patent Office contended that the affidavit was insufficient since it did not directly antedate the species of the reference. The CCPA reiterated the rule that a proper showing can overcome a reference which discloses a species within a generic claim, even though completion of that species prior to the effective date of the reference is not shown. Although the CCPA decided that the appellants' showing in this specific case was not sufficient, it did clearly state that the Patent Office position as to Rule 131 was incorrect and enunciated the correct rule as follows:

The rule for antedating references is not limited to fact situations where the inventor can show priority as to the identical compounds described in the references. . . . In an appropriate case an applicant should not be prevented from obtaining a patent to an invention where a compound described in a reference would have been obvious to one of ordinary skill in the art in view of what the affiant proves was completed with respect to the invention prior to the effective date of the reference. This is particularly true where the inventor had already appreciated that the invention was generic in nature from his works on diverse species and was endeavoring to determine by reasonable diligence the precise scope of the invention . . . antedating affidavits must contain facts showing a completion of the invention commensurate with the extent of the invention as shown in the reference, whether or not it be a showing of the identical disclosure of the reference.²³

The CCPA further indicated that where the affidavit would persuade one of ordinary skill in the art to a reasonable certainty that the applicant possessed so much of the invention as to encompass the reference disclosure, the showing was sufficient to antedate the reference. The court even went so far as to indicate that in an appropriate

²² 356 F. 2d, 987, 148 USPQ 665 (CCPA 1966).

²³ *Id.* at 145 USPQ 669.

case, a single species could be sufficient to antedate indirectly a *different* species of a reference.²⁴

Judge Almond, in a concurring opinion in the *Clarke* case noted that a "commensurate" showing must include a showing of a common utility or property which would serve to link together the compounds prepared prior to the effective date of the reference in order to evidence "possession" of the compounds by the applicant.²⁵

It would appear from the foregoing that the requirements for antedating a prior art reference have undergone some degree of liberalization over the years.

Today, to antedate a reference, it is necessary only to show, prior to the effective date of the reference, possession of either (1) the same species as disclosed in the reference or (2) one or more species (not including the species of the reference) sufficient to delineate a group in which the reference species obviously would be included, coupled with knowledge of a common characteristic or property possessed by each species in the group. Showing (2) is essentially tantamount to showing possession of the genus prior to the effective date of the reference.

The Problem When the Invention Is Made Abroad

While the *Clarke* decision has greatly clarified the problems of antedating references for U. S. applicants, the law is somewhat more indefinite as regards applicants whose inventions were made abroad, inasmuch as they are prohibited, except in certain circumstances, from submitting Rule 131 affidavits.²⁶ How can such an applicant antedate a reference? A foreign applicant can, of course, rely on a Convention priority date.²⁷ But considering the genus-species situation, the question again arises as to what the priority document must show in order to antedate the reference.

²⁴ This situation occurred in *In re Fano*, 392 F. 2d 280, 157 USPQ 192 (CCPA, 1968).

²⁵ See also *In re Rainer, Hilton, Redding, Sloan and Stewart*, 390 F. 2d 771, 156 USPQ 334 (CCPA 1968), and *In re Fong*, 288 F. 2d 932, 129 USPQ 264 (CCPA 1961).

²⁶ 35 U.S.C. 104. An applicant cannot establish a date of invention by reference to acts in a foreign country unless the invention was made by a person, civil or military, while domiciled in the United States and serving in a foreign country in connection with operations by or on behalf of the United States.

²⁷ 35 U.S.C. 119.

This question was recently considered in *In re Ziegler, et al.*²⁸ This case involved a situation wherein a CIP containing a broadened genus claim was filed, and the priority document on which the U.S. patent case was based disclosed the species of the reference. The Patent Office contended that, even so, the priority document failed to show that the applicants were in possession of the generic invention claimed in their U. S. CIP. The CCPA overruled the Patent Office, holding that the logic of the *Stempel* case was clearly applicable and that the Convention application gave a right of priority of invention as to everything pertinent that the references showed as of a date prior to the effective date of those references. This holding is of particular importance in situations where, as described previously, the reference to be antedated is the applicant's published foreign case.

If, however, a priority document does not exist, it may still be possible for such an applicant to antedate the reference even though he cannot prove *acts of invention* abroad, by showing that the reference patentee derived his own invention, or disclosure of applicant's invention, from the applicant. Thus, it would appear that a foreign applicant may circumscribe 34 U.S.C. 104, at least to some extent, by submitting affidavits of such derivation.²⁹ Proof of such derivation is applicable in situations wherein the claims are rejected under 35 U.S.C. 102 (e) which requires that (1) the application for the reference patent must have been by one who is legally "another" and (2) the filing date must be "before the invention . . . by the applicant. . . ." If it can be shown that the 102 (e) reference patentee obtained knowledge of the applicant's invention from him, and thereafter described it, he necessarily filed the application after the applicant's invention date. *In re Land and Rogers*,³⁰ the CCPA specifically held that "evidence of such a state of facts, (of derivation) whatever its form, must be considered."³¹ See also the cases of *Blout and Rogers*³¹ and *Limieux*.³²

CONCLUSION

The CCPA over the past 10 to 15 years has resolved many of the problems which arise regarding patentability in the genus-species

²⁸ *In re Ziegler, Breil, Holzkamp and Martin*, 347 F. 2d 642, 146 USPQ 76 (CCPA 1965).

²⁹ *In re Land and Rogers*, 368 F. 2d 866, 151 USPQ 621 (CCPA 1966).

³⁰ *Id.* 151 USPQ at 683.

³¹ *In re Blout and Rogers*, 333 F. 2d 928, 142 USPQ 173 (CCPA 1964).

³² *Ex parte Limieux*, 115 USPQ 148 (P.O. Bd. App. 1957).

situation and has greatly clarified many of the questions which applicants encountered. Still remaining, however, are the questions arising in the situation where the invention is made abroad.

Thus it would appear that the major expansion of this body of law should come in the area of foreign priority and proof of derivation of invention, inasmuch as 135 U.S.C. 104 will most likely still be operative for some time to come.³³ Thus, it seems likely that the *Ziegler et al.* and *Land and Rogers* rulings could be further extended to encompass the more liberal concepts of *In re Clarke* and *In re Hostettler et al.* In a situation, for example, wherein the Convention application does not disclose the exact species of the reference but the reference species clearly would be obvious to the skilled art worker in view of the disclosure of the Convention application, then the Convention application should suffice to antedate the reference as to a claim to a genus.

Or, in the derivation situation, it should be sufficient to show that the information given by the applicant to the reference patentee, while not identical with the disclosure thereof, would have made such disclosure obvious so that clearly applicant also possessed the knowledge prior to the reference patentee.

Clearly, such decisions would tend to make the law more equitable towards those whose inventions are made abroad.

³³ S. 2756, 91st Cong., 1st Sess. § 104 (1969). Although it was initially intended to delete § 104 from the new patent bill, it was decided to retain this section. See 115 Cong. Rec. 8954 (daily ed., Aug. 1, 1969—Remarks of Senator McClellan).

Coerced Package Licensing and Royalties: Patent Misuse^{*}

ALBERT B. KIMBALL, JR.

INTRODUCTION

THE SUPREME COURT HELD in *Zenith Radio Corp. v. Hazeltine Research Inc.*,¹ that "conditioning the grant of a patent license upon payment of royalties on products which do not use the teachings of the patent" is patent misuse,² reinstating the District Court's injunction against Hazeltine's conditioning the grant of a license upon payment of royalties on the manufacture of apparatus not covered by such

* This paper was prepared by the author in partial fulfillment of the requirements of a course in patent, trademark and copyright law while a graduate student in The National Law Center of The George Washington University. Mr. Kimball is presently associated with the firm of Pravel, Wilson & Matthews, Houston, Texas.

¹ 161 USPQ 577.

² *Id.* at p. 591.

patent.³ However, no relevant criteria to be considered in determining the presence of "conditioning" or coercion during the licensing negotiations were given.

The purpose of this paper is to examine prior case law where coercion or conditioning has been argued or alleged to exist in two patent licensing situations, the first being in formation of a package license covering a plurality of patents, and the second being the determination of a royalty structure for a package of patents. Some conclusions and suggestions regarding acceptable as well as possibly dangerous licensing techniques will then be made.

The cases dealing with coerced package licensing will be discussed first, and next the cases involving license agreements requiring payment of royalties without respect to whether the claims of the patents are being infringed by the licensed apparatus. The term "percentage sales" will be used as a descriptive label to refer to this latter situation, although the cases in this area have dealt with agreements which called for lump-sum payments (as in *Zenith v. Hazeltine*) by licensee as well as payment based on a percentage of licensee's sales.

CASES HOLDING NO COERCED PACKAGE LICENSING

The Circuit cases holding no coerced package licensing do so for one or more of the following reasons: The purported infringer has failed to introduce any evidence of coercion to support his affirmative defense of misuse; the allegedly coerced licensee has in actuality insisted upon a package license; there were other licenses in effect for less than the entire package; the licensor proved that he is willing to negotiate licenses for less than the entire package; it was shown that it is commercially desirable to utilize the entire package; and finally, it was impossible to produce a commercially acceptable device which does not infringe each patent in the package.

Lack of Evidence

In *Automatic Radio v. Hazeltine*,⁴ the only factual support for the alleged refusal of Hazeltine to grant licenses for less than Hazeltine's

³ 144 USPQ 381. On remand from the Supreme Court, Zenith has apparently withdrawn its request for this portion of the injunction. See opinion of the Court of Appeals for the Seventh Circuit, 418 F. 2d 21, at p. 23.

⁴ 85 USPQ 378.

standard package was an affidavit which the court held to be insufficient because it was made on the basis of information and belief, rather than on personal knowledge. No allegation was made that Automatic Radio had sought a license under less than Hazeltine's entire package.

Similarly, in *Hensley Equipment Company v. Esco Corp.*,⁵ the Court of Appeals for the Fifth Circuit indicated that there was no evidence that the licensee had been "coerced into unwillingly accepting any of the patents in the package," and therefore refused to decide the case on the issue of coerced package licensing, finding misuse on the basis of sales limitations imposed by licensee upon licensor.

Two cases from the Seventh Circuit, *Apex Electrical Manufacturing Co. v. Altorfer Bros. Co.*⁶ and *Hazeltine Research, Inc. v. Avco*⁷ have refused to find misuse due to coerced package licensing, on the basis that the defendant raising the misuse issue failed to bring forth evidence to prove his affirmative defense of coercion.

The Eighth Circuit, in *Sbicca-Del-Mac v. Milius Shoe Co.*,⁸ refused to find misuse, stating that there was no evidence that licensee had expressed any desire to obtain the license under less than the entire package, or of similar requests by other manufacturers which were refused by licensor.

The Tenth Circuit in *McCullough Tool Co. v. Well Surveys, Inc.*⁹ has similarly indicated that defendant infringer failed to prove coercion and consequent misuse, indicating that suitable evidence of coercion might consist of "a request by a prospective licensee for a license under less than all of the patents and a refusal by the licensor to grant such a license,"¹⁰ citing *Automatic Radio v. Hazeltine*¹¹ as authority.

Licensee Requests Package

In *Shea v. Blaw-Knox Co.*¹² the Seventh Circuit refused to find misuse on the basis of coerced package licensing, indicating that the evidence established that the additional patent in the package was

⁵ 155 USPQ 183.

⁶ 111 USPQ 320.

⁷ 107 USPQ 187.

⁸ 63 USPQ 249.

⁹ 145 USPQ 6.

¹⁰ *Id.* at p. 27.

¹¹ *Supra* note 4.

¹² 156 USPQ 481.

included in the license at the request of licensee.¹³

In *Hensley Equipment Co. v. Esco Corp.*,¹⁴ the Fifth Circuit indicated that the package license formed at licensee's request would have been acceptable, except for a provision restricting sales by the licensor to authorized dealers of the licensee, which sales limitations were held to be misuse by the licensor.

Other Licenses for Less Than Package

In *Apex v. Altorfer*,¹⁵ patentee proved that no coerced package licensing existed due to the existence of other licenses which included smaller packages of patents than the entire package.

Offer by Licensor of Licenses of Less Than Entire Package

The *Apex v. Altorfer*¹⁶ case also relied upon patentee's expressed willingness to grant a license under less than the entire package, as does another Seventh Circuit case, *Shea v. Blaw-Knox*.¹⁷

In *Sbicca-Del-Max v. Milius Shoe Co.*,¹⁸ where a corporation owning a package of patents relating to shoe manufacturing machinery was formed to settle infringement litigation, the package license agreement alleged to be coercive provided on its face that licensee could have a license "of the contract patents or any of them."

In *McCullough Tool Co. v. Well Surveys, Inc.*,¹⁹ the Tenth Circuit refused to find misuse due to coerced package licensing, and relied upon a lower court finding that the patentee, Well Surveys, was "willing to grant licenses" on the patents of its package "individually or collectively" upon negotiated reasonable terms.²⁰ The court indicated that coercion and misuse might occur where the licensor had refused requested licenses under less than all the patents; and on a subsequent

¹³ *Id.* at p. 483.

¹⁴ *Supra* note 5.

¹⁵ *Supra* note 6; this opinion had been handed down overruling the District Court holding of misuse, 105 USPQ 94, at the time that the District Court in *American Securit v. Shatterproof Glass*, note 33 *infra*, 114 USPQ 259 cited the District Court holding as authority that coerced package licensing was a misuse.

¹⁶ *Supra* note 6.

¹⁷ *Supra* note 12.

¹⁸ *Supra* note 8.

¹⁹ *Supra* note 9.

²⁰ *Id.* at p. 27.

hearing of a case stemming from the litigation,²¹ reiterated that McCullough had failed to show an unreasonable refusal by Well Surveys to grant a license under the particular patent being infringed.

In *Baker-Cammack Hosiery Mills, Inc. v. Davis Co.*,²² the Fourth Circuit refused to find coerced package licensing, one of the reasons being that the patentee offered various packages of patents according to the particular type or types of stockings the licensee desired to produce. Additionally, there was evidence that patentee had expressed a willingness to negotiate licenses at reasonable royalty rates under any of its patents, apparently instituting this practice after the Supreme Court had handed down *United States v. Paramount Pictures, Inc.*,²³ an antitrust prosecution dealing with copyright block-booking practices.

Commercial Desirability of Package

In the *Baker-Cammack*²⁴ case, the Fourth Circuit discussed the six patents, relating to manufacture of stockings allegedly coercively packaged, and affirmed the District Court finding that the patents were in actuality "complementary" rather than "competitive,"²⁵ because the entire package of patents was necessary to produce a complete product line of stockings.

Commercial Necessity of Package

In *International Manufacturing Co., Inc. v. Landon Inc.*,²⁶ the Ninth Circuit refused to accept an argument that coerced package licensing existed in a package formed by cross-licensing to overcome the problem of blocking, or interlocking, patents. No commercially acceptable device could be made without infringing both patents in the package, so the patentees entered into a pooling and cross-licensing agreement. The Ninth Circuit distinguished the case from the *American Securit* case²⁷ on the basis that in *American Securit*,

²¹ 158 USPQ 81.

²² 85 USPQ 94.

²³ 334 U.S. 131 (1948).

²⁴ *Supra* note 22.

²⁵ *Id.* at p. 111; see also p. 98 *et seq.* thereof for discussion of the subject matter of the individual patents in the package.

²⁶ 142 USPQ 421.

²⁷ *Infra* note 33.

prospective licensees were compelled to accept patents as part of the package which were drawn to alternative methods of making sheet glass, so that a manufacturer desiring to use one method would be required to accept, as part of the package of patents in the license, other patents that it did not intend to practice; whereas in the *International Manufacturing* case, it was necessary to infringe both patents in the package²⁸ in order to produce a commercially acceptable device.

CASES HOLDING COERCED PACKAGE LICENSING

The course of the negotiations between Zenith and Hazeltine giving rise to the misuse aspect of their litigation must be set forth in some detail²⁹ in order to gain an insight into impermissible package licensing negotiation techniques.

Zenith was a non-exclusive licensee for a five-year term under Hazeltine's package license. In 1959, Hazeltine requested that the license be renewed for five years at a rate of \$50,000 per year. Zenith refused to accept this condition, since it apparently felt that it did not infringe any of the patents.

Hazeltine thereupon asserted that Zenith's monochrome television infringed at least four patents in Hazeltine's package. They also made an alternative proposal to license Zenith under the Hazeltine monochrome patents according to the following plan: Any one patent in the package will be licensed for 50 percent of the standard royalty rate; any two patents would be available for licensing at the rate of 80 percent of the standard rate; and any three or more patents would be available at 100 percent of the standard rate, with Hazeltine reserving the right to sue Zenith for infringement of any patents not licensed, thus precluding an implied license to practice under the remainder of the package. Zenith refused this offer and Hazeltine thereupon instituted an infringement suit against Zenith.

The above rates would apply regardless of the commercial value of the patent under which Zenith wished to accept a license. The record is silent as to whether Hazeltine had ever made any estimation of the commercial significance of each of the individual patents in the pool, although Hazeltine's attorneys, during the course of the litigation, stated that most of the patents in the package were "insignificant."³⁰

²⁸ The defendants raising the misuse defense were making a device which infringed both patents in the package, 142 USPQ 427.

²⁹ Extracted from District Court opinion, *supra* note 3.

³⁰ 144 USPQ 381 at p. 397.

During pre-trial discovery, Hazeltine informed Zenith that Zenith was infringing nine patents and the claims in one pending application of Hazeltine's color television package and again tendered the original standard package license, which Zenith refused.

Later, during pre-trial, Hazeltine offered Zenith three alternative licenses. The first was a license under nine color television patents, which Hazeltine contended that Zenith infringed, for a sum of \$435,000 per year. Second, Zenith could obtain a license under all of Hazeltine's color television patents and applications for an added \$65,000 per year, or a sum of \$500,000. Third, Zenith could obtain a license under Hazeltine's color as well as monochrome television patents for the smaller sum of \$150,000.

Zenith refused, contending that the above offers were an obvious attempt to coerce Zenith to take a package license it did not want or need, since Zenith would be clearly at a competitive disadvantage in the industry by being forced to pay \$435,000 per year for the patents it was allegedly using in its color television receivers; whereas RCA, one of its competitors, was paying only \$150,000 per year to Hazeltine under the standard package license.

Subsequently, Hazeltine offered a third group of alternative licenses to Zenith, which were basically the same as the second offer, at somewhat different rates. A license under the nine patents allegedly infringed by Zenith could be had for \$275,000 per year; a license under all Hazeltine's color television patents could be obtained for an additional \$25,000; a license under all of Hazeltine's present and future color television patents would require payment of \$310,000 per year, \$10,000 more than the license for all present color television patents; or, Zenith could obtain the license under all of Hazeltine's color and monochrome patents for \$200,000 per year, \$50,000 more than under the second offer.

The Seventh Circuit³¹ affirmed the District Court holding that this coercion amounted to misuse of the patents in the package, affirming the award of \$150,000 as treble damages for such misuse, saying that the economic coercion employed here was indistinguishable from American Securit's³² outright refusal to license less than the entire package.

³¹ 156 USPQ 229; the 50%-80%-100% provision was upheld as reasonable by the Seventh Circuit based upon commercial realities. Only three Hazeltine patents were in widespread use at the time. The provision was regarded by the Court of Appeals as designed to save the licensee money if he did not desire to use all three patents. In fact, eight licensees had taken a license under only one patent.

³² *Infra* note 33.

In *American Securit Co. v. Shatterproof Glass Corp., Inc.*³³ patentee (American Securit) and certain other corporations had settled an antitrust prosecution by the Justice Department with a consent decree, providing in part that no license agreement be entered into requiring that any of the patents in the pool the antitrust defendants had formed be licensed on condition that licenses under other patents in the pool be accepted by licensee; and, should a prospective licensee and patentee fail to agree on a reasonable royalty, the District Court in which the antitrust litigation was held was empowered to fix a reasonable royalty.

Shatterproof initiated negotiations with American Securit for a license under four patents of the package, and was refused, and after Shatterproof had commenced manufacture of plate glass utilizing the patents, American Securit sued Shatterproof for infringement. Shatterproof defended on the basis that coerced package licensing was patent misuse, and succeeded on this basis. The following evidence was in the record as proof of coercion: stipulated correspondence that "plaintiff has consistently refused to license individual patents in the package";³⁴ and an affirmative statement by an officer of patentee corporation, "we do not grant a license on that [less than package] basis."³⁵ During the course of the negotiations, American Securit did offer a license of less than the entire package of patents at the same standard royalty rate as the entire package, but the Third Circuit accepted the District Court's treatment of this as a "mere catalyst to compel Shatterproof to accept the entire package."³⁶

COERCED ROYALTY PROVISIONS

The *Zenith v. Hazeltine* type of patent misuse discussed by the Supreme Court arises when the patentee coerces or conditions the payment of royalties regardless of whether the licensee infringes the claims of the patents in the package. Since the claims define the scope of the exclusionary grant being waived by the patentee in the license agreement, it should be understood that infringement of the claims is apparently what the Supreme Court meant when it held that conditioning the payment of royalties on devices which do not *use the teachings* of the patent is misuse.

³³ 122 USPQ 167.

³⁴ *Id.* at p. 172; District Court 114 USPQ 259 at p. 263.

³⁵ *Id.* at p. 172.

³⁶ 114 USPQ 259 at p. 263.

Cases Holding No Coerced Royalty Provisions

In *Automatic Radio v. Hazeltine*,⁸⁷ the Supreme Court held that a royalty provision calling for a percentage of licensee's sales was not a per se patent misuse. In so holding the Court relied upon the District Court's characterization of this provision as a "convenient mode of operation designed by the parties to avoid the necessity of determining whether each type of petitioner's [licensee's] product embodies any of the numerous Hazeltine patents."⁸⁸ As noted previously, there was no evidence in the record of the case reflecting coercion on the part of Hazeltine in the formation of this license agreement.

In *Hazeltine v. Admiral*,⁸⁹ the Seventh Circuit refused to hold patent misuse by a license measuring royalties on total sales including products not covered by the licensed patents, relying on *Automatic Radio*, *supra*. In *Apex v. Altorfer*,⁴⁰ the royalty rate was a set amount regardless of whether one, two, or three patents comprised the subject matter of the license.

In *Muth v. J. W. Speaker*,⁴¹ a 5 percent royalty on each device sold, apparently irrespective of whether or not the device infringed a patent somewhat limited in scope, was upheld. The Seventh Circuit correctly noted that in addition to buying peace from infringement litigation, which itself was sufficient consideration to support the requirement for such payment, the licensor had transferred his entire inventory to the licensee, and cancelled a prior distributorship agreement as further consideration to support the licensee's promise to pay.

In *Plastic Contact Lens v. Butterfield*,⁴² a license agreement using a percentage of licensee's sales as royalty was upheld by the Ninth Circuit on authority of *Automatic Radio* in view of a contention by licensor that such a scheme was utilized for the purposes of simplified accounting, even though the trial court ruled that licensor had produced no evidence to support such contention.

In *McCullough Tool Co. v. Well Surveys, Inc.*,⁴³ a percentage sales royalty rate was upheld on the basis of the absence of coercion in formation of the license agreement. Both parties conceded that the operations upon which royalty payments were based included operations under expired as well as existing patents, but the Tenth Circuit

⁸⁷ *Supra* note 4.

⁸⁸ *Supra* note 4 at p. 380.

⁸⁹ 86 USPQ 289.

⁴⁰ *Supra* note 6.

⁴¹ 120 USPQ 207.

⁴² 151 USPQ 83.

⁴³ *Supra* note 9.

correctly distinguished this situation from *Brulotte v. Thys*,⁴⁴ where all of the patents in the package had expired.

In *Well Surveys, Inc. v. Perfo-Log, Inc.*,⁴⁵ a similar percentage sales provision covering a package of patents, some of which had expired during the period between formation of the license and litigation, was upheld against the attack that the provision in and of itself constituted coercion, since as previously noted, Well Surveys had expressed willingness to license under any or all of the patents in the package.

In *Acitelli-Standard Concrete Wall, Inc. v. Rocform Corp.*,⁴⁶ misuse was held by the Sixth Circuit in a non-exclusive package license agreement whose payment terms did not decrease upon expiration of a basic patent in the package. The District Court⁴⁷ held that the expiration of the basic patent substantially devaluated "the consideration for the grant of the license," and failure to adjust the royalty at such time was misuse. The Circuit Court construed the District Court's holding as follows: "plaintiff-appellant employed the patent in suit so as to coerce (or attempt to coerce) this defendant to purchase the Rocform system and thus to purchase other patents and unpatented materials and services,"⁴⁸ although the Seventh Circuit itself pointed out that the infringing defendant had not signed a license, and the District Court explicitly stated that no coerced package licensing had been established⁴⁹ and consequently there was no basis in the case for inferring coercion.

The court correctly indicated that a licensee in a suit for royalties under a license he has voluntarily signed must show coercion with respect to himself to escape liability; whereas a defendant in an infringement suit need not show that he himself was coerced, but may prove coercion of others in order to show misuse by coercion. If the court had realized that in order to escape liability for infringement by reason of misuse due to coercion, the infringer must show misuse by coercion with respect to *someone*, perhaps they would have perceived the illogic of their ruling, pointed out in the dissent:⁵⁰ The patent conceded to be valid and infringed is unenforceable due to misuse caused by coercion when there was no basis in the record to find coercion.

⁴⁴ 143 USPQ 264.

⁴⁵ 158 USPQ 119.

⁴⁶ 151 USPQ 305.

⁴⁷ 143 USPQ 405.

⁴⁸ *Supra* note 46 at p. 307.

⁴⁹ *Id.* at p. 414.

⁵⁰ *Supra* note 46 at p. 308.

In *Glen Manufacturing, Inc. v. Perfect Fit Industries*,⁵¹ the District Court refused to allow application of the *Automatic Radio v. Hazeltine* rule in a license of a single patent requiring a payment of ten cents for each toilet tank cover manufactured, irrespective of whether or not the cover was within the scope of the patent, distinguishing the case from *Automatic Radio* in that there, due to the large package of patents and complex technical subject matter, an "exception to the general rule required a strict, limited royalty structure"⁵² was permitted and percentage sales royalties were allowed, whereas in the present situation the court found that it could be readily determined whether or not the tank covers were or were not covered by the patent.⁵³ Since the license agreement required royalties on each item regardless of whether it was covered by the patent and had the effect of lessening competition, presumably with respect to cost, on unpatented toilet tank covers, misuse was found.

On appeal,⁵⁴ after *Zenith v. Hazeltine* had been handed down, the Second Circuit remanded the case to the District Court for a determination of the issue of misuse according to whether the provision in question was conditioned or coerced by the licensor, in effect overruling the District Court's limited application of the *Automatic Radio* rule, and indicating that among relevant criteria to be considered were, "whether the provision was bargained for or imposed and whether the licensee had made 'protestations' which were overriding."⁵⁵

CONCLUSION

Package Licensing

The most relevant consideration to be kept in mind by a patentee contemplating package licensing is the subject matter of the individual patents in the package.

If there are several patents which would be infringed by manufacture, use or sale of a commercially acceptable product, as in the

⁵¹ 161 USPQ 408; see also 161 USPQ 688.

⁵² 161 USPQ 690.

⁵³ 161 USPQ 410; Correspondence regarding a license with another licensee of the same patent indicates this may not actually be the case, see *Glen Mfg., Inc. v. Fulton Industries*, 159 USPQ 610, at p. 611.

⁵⁴ 164 USPQ 257.

⁵⁵ *Id.* at p. 258; the District Court had held no evidence of bad faith or coercion had been shown, 161 USPQ 689.

International Manufacturing case, a package composed of the complementary or blocking patents is permissible, practical, and highly desirable, allowing the subject matter of the patents to be utilized. A license under less than the entire package would be unsatisfactory to all parties due to the uncertainty it would create. The licensee under the partial package could not produce, sell or use the commercially acceptable end products without infringing the remainder of the patents of the package, and in effect would have purchased little except freedom from infringement suit under the portion of the package. The licensor would not be certain whether the license under a portion of the package constituted an implied license to practice under the remainder of the package unless he had specifically negated the possibility of an implied license by inserting a provision in the license that no such implied license was contemplated.

If there are patents which are mutually exclusive, or competing, as was apparently the case in *American Securit*, it is clear after the *Zenith* and *American Securit* cases that a license including such a group of patents will be permissible only upon willing acquiescence by the licensee or mutual agreement of the licensor and licensee. Further, in view of the possibility of future disagreement and/or litigation between the parties, the licensor must consider during the entire negotiation process that it is entirely possible that the negotiation may undergo judicial scrutiny in order to determine the presence or absence of coercion or conditioning.

If the patents in the group are of the type comprising a basic, original, or highly important patent and ancillary improvement patents, determination of the blocking or competing nature of the patents must be made. The conceptual basis for the *Zenith* decision was the use of an individual patent as leverage to condition or coerce undesired patents into the package,⁵⁶ and this will apply equally as well to situations where the licensee is required to accept a license under unwanted improvements as it does to unwanted competing patents. However, if the only suitable device which could be produced required practice of the basic patent and an ancillary improvement patent, analysis on the basis of blocking patents is applicable.

If the package is formed comprising a basic or dominant patent and ancillary, later issued patents, another possible problem which may arise is attack of the license due to the license rate continuing at the same rate after expiration of the dominant patent, which problem will be discussed below.

⁵⁶ 161 USPQ 592.

In view of the reliance by the courts upon the copyright blockbooking cases for guidance in this area, it should be noted at this point that the analogy between patents and copyrights with respect to using one patent or copyright as a lever to compel acceptance of the package stands up only with respect to the situation of competing patents as in *American Securit*. A copyright package owner requiring that a licensee take several unwanted films, such as "Nancy Drew Trouble Shooter" and "Gorilla Man" to be able to exhibit the film he desires, "Casablanca,"⁵⁷ can be analogized to a requirement to accept a license under two alternative methods of making glass, one desirable and the other undesirable. However, the above general copyright analogy cannot be contorted to cover the blocking patent situation.

Due to the difference between the rights granted under a copyright and under a patent, a first copyright owner generally cannot prevent a second copyright owner from enjoying the benefits of his copyright; whereas a first patentee can prevent another patentee from infringing the first patent. The analogy of the relation between two blocking patents and copyrights in the copyright law is to that of a derivative copyright owner being required to obtain the earlier copyright owner's permission in order to include the earlier copyrighted work in the derivative copyrighted work.

Royalty Provisions

The *Zenith v. Hazeltine*⁵⁸ and *American Securit*⁵⁹ cases make it clear that a patentee may no longer give a prospective licensee a "take it or leave it" package offer, or employ economic coercion to force licensee acceptance of an undesired package, and the *Zenith* case bars conditioning a license on the payments of royalties on unpatented apparatus.

The theory underlying the *Zenith* case is that a highly desirable patent in a package may not be used as "leverage" to garner a percentage of licensee's sales as a royalty⁶⁰ in exactly the same manner that it cannot be used to "tie-in" and gain commitments from the licensee with respect to unpatented goods. It is thus apparent that licensor should not approach negotiations on using the most desirable patent in the package as a "lever" during the negotiations, and should avoid anything which might give this impression.

⁵⁷ *United States v. Loew's Inc.*, 371 U.S. 38.

⁵⁸ *Supra* note 1.

⁵⁹ *Supra* note 33.

⁶⁰ *Supra* note 56.

There are several unanswered questions remaining regarding royalty provisions in patent licensing. First, to what extent and on what basis should the royalty rates for the final package differ from the royalty rates offered or requested by the licensor for the original package? Second, under what conditions may the royalty be based upon some other royalty basis than solely upon licensee's production which infringes patents in the package? Third, must the license have adjustable royalty provisions to reduce the royalty as individual patents in the package expire?

Regarding the first question, general conclusions are of very little help absent a factual situation in which they can be applied, and there is very little case law in this area.⁶¹ It should be noted that the *Zenith-Hazeltine* misuse was based upon an analysis by the District Court and the Circuit Court of the "economic coercion" by Hazeltine in the negotiations. Thus, a licensor in negotiations must be aware that the royalty rates offered during negotiations for a license may be scrutinized at some future time.

If a non-exclusive license is being agreed upon, which under hornbook patent law is no more than a covenant not to sue, it would seem to be permissible to require a licensee to make the same payment in return for a promise not to sue upon a first number of causes of action as for promising not to prosecute a somewhat larger number of causes of action when caused by the same activity of the defendant. However, the "leverage" analysis used by the Supreme Court in *Zenith* must be kept in mind when framing such an agreement, and a license should never be granted if the smaller group of patents or the patent is used as "leverage" to require the identical royalty rate as for the larger package. In view of *Zenith v. Hazeltine*, a request for a larger royalty on a smaller package than the original package will be highly suspect.

With respect to the second question, in view of the *Automatic Radio*⁶² and *Glen Manufacturing*⁶³ cases, the licensor and licensee may agree to royalty provisions upon any basis that is mutually convenient with respect to licensing any patent or package of patents, so long as the agreement is truly mutually convenient and not imposed by the licensor against the licensee's protestations. In addition to any situation where the parties themselves deem it mutually convenient,

⁶¹ There are cases holding no reduction in royalty is required when a portion of the package has been held invalid. See *Magnus Harmonica v. Harmonic Reed*, 106 USPQ 266.

⁶² *Supra* note 4.

⁶³ *Supra* note 53.

there are three situations where such a provision would seem to be both desirable and convenient.

The first is the *Automatic Radio*-type situation, where the package is of such size that examination of the product of the licensee with respect to whether the claims in each patent in the package are infringed would render administration of the package wasteful in terms of time and money, and thus economically unfeasible.

A second area where it is highly feasible and acceptable to agree to a percentage sales royalty is due to the complexity of the patent, as in the *Plastic Lens v. Butterfield*⁶⁴ case, where the subject matter of the patent was contact lenses, and the claims were directed to the radius of curvature of the lenses, a situation where determining if the lenses produced infringed the claims in the patent would often be a close question. In this situation, the practical answer lies in the payment of a flat rate on each lens produced, or alternatively a percentage of licensee's sales, perhaps even taking into account the fact that a certain estimated percentage of the licensee's production may not infringe the claims of the patent, and framing the amount of royalty accordingly.

The *Glen Manufacturing v. Fulton* case⁶⁵ and the *Butterfield*⁶⁶ case exemplify the third situation, where there is difficulty in determining whether the licensee's apparatus infringes the patent's claims. This may also be the case in situations similar to the *Glen Manufacturing v. Perfect Fit Industries*⁶⁷ case, since the simpler the device or the more crowded the art is, the more complex the claims become and thus the more difficult it becomes to determine whether the device made under the license actually infringes the claims.

The final area of uncertainty regarding package license royalty rates is whether the royalty rate must be adjusted as the patents in the package expire. Reliance on *Brulotte*⁶⁸ in this area is misguided, since in that case all the patents in the package had expired while royalty payments were still required.

It is important to note that the Supreme Court has interpreted *Brulotte* in the *Zenith* case as "articulating in a particularized context the principle that a patentee may not use the power of his patent to levy a charge for making, using, or selling products not within the reach" of the patent grant,⁶⁹ and in that same *Zenith* case has stated

⁶⁴ *Supra* note 42.

⁶⁵ 159 USPQ 610, see note 53 *supra*.

⁶⁶ *Supra* note 42.

⁶⁷ *Supra* notes 51 and 53.

⁶⁸ *Supra* note 44.

⁶⁹ *Supra* note 56.

that the leverage of one patent cannot be used to coerce acceptance of an undesired package or royalty structure. Thus, the permissibility or not of such a royalty structure must be determined after an analysis of the composition of the package and the course of the negotiations leading to the formation of the package. If there is no coercion in establishing the royalty provision, the use of the patent as "leverage" to require payment for use of expired patents or unpatented goods has not been shown, and the fixed royalty provision for the life of the package license is acceptable.

The holdings of the Sixth Circuit in *Acitelli*⁷⁰ and the Tenth Circuit in the *McCullough*⁷¹ and *Perfo-Log*⁷² cases are reconcilable on the basis that in the latter cases, no coercion was shown, while the Sixth Circuit felt that coercion was shown.

However, as the Tenth Circuit indicated in the *Perfo-Log* case, the *Acitelli* case can be interpreted as holding that a package license of an expiring basic patent and ancillary improvements which does not adjust the royalty rate upon expiration of the basic patent is per se misuse. If this was the basis for the Sixth Circuit's decision, the use of "leverage" theory by the Supreme Court in the *Zenith* case, as well as *Automatic Radio* holding no per se misuse by package licensing, indicates that the Tenth Circuit was correct in analyzing the *Perfo-Log* case on the basis of presence or absence of coercion, rather than following *Acitelli* and holding per se misuse.

The uncertainty in this area as evidenced by the conflicting interpretations of substantially similar packages comprising a basic patent and ancillary improvements should serve as a warning to licensors of a package containing a basic patent and ancillary improvements to be certain to avoid anything which could later appear to be use of "leverage" during the negotiation of a license agreement.

⁷⁰ 143 USPQ 405.

⁷¹ *Supra* note 9.

⁷² *Supra* note 45.

NOTES

Institute Publishes Monograph on Environmental Pollution

The Institute is pleased to announce the recent publication of its monograph on the complete edited proceedings of the Special Conference of Invited Experts on "Air and Water Depollution: Roles of Industrial Property, Innovation and Competition" which was held March 31 in Washington, D. C.

Concentrating on the roles of the economic and legal incentive systems for invention and innovation, the Special Conference speakers, panel of experts, and specialists invited as observers contribute significant information not previously available on two major areas of concern in the current national crisis in environmental contamination.

The monograph deals with the new roles of industrial property in technically based organizations seeking to meet the changing en-

vironmental needs of the country, and the position of the inventor in relation to such organizations. It also covers key factors involved in coordination among government, industry, and universities and cooperation between managers and technical men.

Emphasis is placed on the contributions of the patent and other industrial property systems and antitrust factors involved in sanctioning cooperation among private parties. Special attention is directed to air and water depollution solutions within the technological competence of the private entrepreneur.

Copies of the monograph may be ordered from The PTC Research Institute, The George Washington University, Washington, D. C. 20016. The price is \$5 per copy for members of the Institute and \$7.50 for nonmembers.

Institute's Fourteenth Annual Conference Announced

"Industrial Property in Today's Competitive Setting" is the theme of the Institute's fourteenth annual Conference to be held on Thursday, October 29, 1970 at the Shoreham Hotel, Washington, D.C.

The Conference starts at 8:45 a.m. and will continue until 5:45 p.m., with the Kettering Award luncheon at 12:10 p.m. The Conference fee, including luncheon, is \$60.00.

The proceedings of the Conference will *not* be published. Publi-

cation will be limited only to selected papers. The moderators of the various sessions are John H. Schneider, Assistant Commissioner of Patents, U.S. Patent Office; Theodore L. Bowes, General Patent Counsel, Westinghouse Electric Corporation; and George E. Frost, Director, Patent Section, General Motors Corporation. Charles Stark Draper, Kettering Award recipient for 1969, will be the luncheon speaker.

The Conference is by invitation. The program follows:

INDUSTRIAL PROPERTY IN TODAY'S COMPETITIVE SETTING

- A. COMPUTER PROGRAM PROTECTION
- B. TRADEMARKS IN WORLD MARKETS
- C. MANAGING TECHNOLOGY AND ENFORCING RIGHTS
 - 1. *Company Innovation*
 - 2. *International Industrial Property Arrangements*
- LUNCHEON: KETTERING AWARD ADDRESS
 - 3. *Costs of Litigation: A Survey*
 - 4. *Adjudication Barometer: Preliminary Findings*
- D. ANTITRUST AND UNFAIR COMPETITION
 - 1. *Patent Licensing Limitations*
 - 2. *Franchising and Trade Secrets*

In each part of the Conference reports will be presented by one or more members of the Institute's Staff, and papers will be given by Invited Contributors. The presentations will be followed by Panel

Discussion and questions from the floor.

The members of the Institute's Research Staff reporting on empirical studies are: Terry M. Chuppe, Richard T. Dole, Jr., John C.

Green, L. James Harris, Wallace R. Johnston, Herbert R. Koller, Joseph M. Lightman, S. Chesterfield Oppenheim, Frederic B. Schramm, John C. Scott, and Irving H. Siegel. Among the Invited Contributors are Harry Ansorge, Trademark Attorney, E. R. Squibb and Sons, Inc.; Francis C. Browne, Attorney, Browne, Beveridge & De Grandi; Martin A. Goetz, Vice President,

Applied Data Research; Stuart P. Greene, Trademark Attorney, American Home Products Corporation; Carl Hammer, Director, Computer Sciences, UNIVAC; John W. Malley, Attorney, Cushman, Darby & Cushman; Sigmund Timberg, Specialist in Antitrust and International Law; and Lawrence I. Wood, Vice President, General Electric Company.

Romani Appointed Edison Fellow

Paul N. Romani of Washington, D.C. has been awarded the Thomas Alva Edison Fellowship for the year 1970-71. Given annually for graduate study in the patent and related systems, the Fellowship is sponsored by the Thomas Alva Edison Foundation, with special assistance by the McGraw Foundation. Mr. Romani's doctoral research will be conducted under the guidance of a member of the Research

Staff of the Institute.

Mr. Romani received his bachelor and master's degrees in Business Administration from The George Washington University in 1967 and 1968 respectively. He was a Teaching Fellow for two years in the Data Processing Department of the University, and during the Summer of 1970 was a consultant to President Nixon's Advisory Council on Management Improvements.

The PTC Research Institute: Accomplishments and Future Prospects

THE YEAR 1970 MARKS THE 20TH ANNIVERSARY of the signing of the Declaration of Trust establishing The PTC Research Institute. It is, accordingly, a timely occasion for inviting the attention of the various publics served by the Institute to consider achievements and prospects.

HISTORY

The history of the Institute goes back to February 15, 1949, when the American Patent Law Association, by resolution at its stated meeting and subsequently by referendum vote, recognized the need for creation of an independent organization under university auspices to carry out objective research and education in the field of the patent and related systems. The George Washington University agreed to undertake establishment of such an organization, and this step was endorsed by the American Bar Association and by 15 of the 18 city and state patent law associations.

The Institute represented the first university attempt at a comprehensive study of the nature and value of the patent, trademark, copyright and related systems. It has devoted itself throughout its history to (a) development and analysis of factual information; (b) establishment of forums and other media for the exchange and interplay of relevant dialogue, at all levels; and (c) the dissemination of the results obtained. It remains unique in its position, accomplishments, and competence for this work.

Three letters recently received indicate the high regard in which the Institute is widely held:

I believe The PTC Research Institute is the foremost progressive exponent of our American patent system, and I am impressed with the work reported in IDEA.

(Samuel Ruben, Independent Inventor, April 8, 1970)

I want to congratulate you on the latest issue of IDEA, Summer of 1969. My offhand reaction is that it is the finest and most constructive and helpful patent journal that I have ever seen. . . . You and the Admiral are entitled to the respect and gratitude of the entire patent profession.

(Charles M. Hogan, General Patent Counsel, Avco Corporation, November 14, 1969)

We at RCA Corporation find that the work done by The PTC Research Institute is indeed deserving of our increased support. . . . I think Mr. L. J. Harris should be commended on the consistent quality of the research work being carried out by his group.

(J. V. Regan, Staff Vice President, Patent Operations, RCA, December 8, 1969)

These statements constitute but a small sample of such commendations.

THE NEED

Many Americans subscribe to a belief, often questioned, that the patent and related systems have been one of the main channels through which the United States has advanced steadily to a position of technological leadership. This common belief is that the systems also have fostered inventive resourcefulness, the development of technical know-how, the investment of risk capital, and scientific research—and thus have contributed to a progressively higher standard of living.

Doubts have been reflected in the literature and in the hearings, investigations, and reports of the various branches of government. The doubters have asked: How, if at all, have these systems contributed to the welfare of Americans? Do they provide important employment opportunities? Are the creative incentives of the systems indispensable, and are the rewards adequate for scientists, inventors, and authors? How do the systems influence the large and small industrialist or businessman to invest risk capital in new enterprises and to help his company or industry grow?

Out of these uncertainties and the gaps in knowledge the need for the Institute arises. Furthermore, the answers to such questions are illusive, and they cannot be given once for all in a dynamic, evolving economy. The major work of the Institute is diagnosis. Its primary purpose is to ascertain how the systems are functioning and to make the facts available to citizens in objective reports. These facts could, and sometimes have, become the bases for sound, remedial action.

SOME INTERESTING FINDINGS

In keeping with the foregoing objectives, the research and educational activities of the Institute are now concerned with the following areas:

- (1) *Individual* (e.g., from the standpoint of creativity, incentives, etc.)
- (2) *Industrial* (e.g., from the standpoint of economic growth, research and development activity, diversification of firms, intercompany relations, executive decision-making, and anti-trust)
- (3) *Governmental* (e.g., from the standpoint of legislation, administrative regulations and procedures, terms of contracts with private firms, judicial actions, and taxation)
- (4) *Public* (e.g., from the standpoint of the general state of opinion or knowledge, as reflected in polls and news media)
- (5) *International* (e.g., from the standpoint of foreign collaborations, transfer of technical data, etc.)
- (6) *Other Economic, Legal, and Social Aspects*

The many volumes of the Institute's journal, *IDEA*, begun in 1957, record the results of Institute research. Only a few examples can be given here:

In an early exploratory study the Institute considered various techniques for arriving at the value of the patent system. Many values were

reported to be involved, both public and private, and most of these were not precisely measurable.

The study concluded that, instead of trying to evaluate the patent system by statistical measurement, building-block data such as case studies of particular companies or industries in which patents had been important to the growth or development of the business would illustrate the roles of the patent system. Since then, a number of case studies have been made, primarily of small businesses. These case studies have indicated that patents and related industrial property become strategic, particularly as the company grows enough to become market-conscious, in developing new businesses and new products. In the light of these early studies, the Institute is now seeking to assess the roles of patents in management decisions by means of depth interviews with corporate officials.

The case studies of the role of patents in small business or industrial units examined three diverse industries at a time. The first trilogy consisted of a mature industry reputed to be "monopoloid" and technologically stable but recently approaching a new technological frontier (iron and steel) ; a young industry which has spent all of its life on the technological frontier (electronics) ; and a specialization service industry which has arisen between the producer and the producer's customers (custom heat-treating) . Following these, three other industries growing through the medium of "small business" were investigated—aluminum fabrication, fabricated plastics products, and scientific and other instruments.

Very early in the Institute's operation, it became clear that a wide difference of opinion existed concerning the extent to which patents once issued were later actually used. Estimates of used patents ranged from one to ten percent. Institute researchers statistically investigated a scientifically selected sample of patents and provided the first accurate idea concerning patent use. The showed that, in general 50 to 60 percent of all patents issued were actually used productively some time before their expiration. The precise ratio differs, of course, with various classes of patents, for assigned patents as against those unassigned.

Interesting spin-offs of this work include the findings that patented inventions that are used generally come into use at a very early date, even before the patent application is filed; that about one-third of patented inventions become obsolete due to newer inventions; that once a patent is used, it generally remains in use beyond the 17-year period; and that the smaller corporations generally use their patented inventions more extensively than the large corporations.

The initial work on patent use led to a number of studies regarding: (a) inducements to invention; (b) the relative productivity of independent versus salaried inventors; (c) the relation between inventor compensation and creative output; and (d) productivity of government versus private investment in industrial research. This group of Institute studies represents a pioneer contribution in the application of statistical methods to measurement in the industrial property field.

Another bellwether study, on deterrents to invention for national defense, indicated that patentees prefer to deal with industry. Inventors say they have found that negotiations with federal defense agencies result in smaller returns, red tape, and indifference.

The Institute has also engaged in an extensive study of the licensing of patents and related industrial property internationally. The Research Staff sought information on the amount of foreign trading relationships, and particularly about the foreign licensing of American companies and their operations abroad through subsidiaries or joint ventures. This was another Institute study which supplied facts in an area heretofore considered principally in terms of opinion.

The study showed that the transfer of assets represented by patents, trademarks, and know-how provided the basis of much of the post-World War II expansion of American companies into Europe and Latin America. More than half of the companies questioned ranked royalty returns as the most important motive for licensing. The study described clearly the pattern of this type of international trade and the considerations motivating American business firms to go abroad in this way.

Another important subject studied concerned effects of antitrust decrees involving patents. Research Staff members explored monopoly and antimonopoly aspects of certain antitrust decrees. The *Besser* (concerning the concrete block-making machine industry), the *Vehicular Parking*, and the *Technicolor* decrees were analyzed in depth. These studies have shown that the relationship between patent positions and antitrust situations is highly complex. Decrees intended to break down antitrust positions by compulsory patent licensing and similar procedures were found *not* to be the effective solutions some had conceived them to be.

The Institute has also studied the technical rules governing the income taxation of proceeds from invention and from business negotiations dealing with patents and related property. It gave attention not only to the prevailing law but to the actual experience of inventors and others under the law. Individual inventors have often been ignorant of their tax rights. Large corporations, on the other hand, have been found generally to be aware of tax aspects of their transactions.

CURRENT ISSUES

Research proposed for the Institute may be classified into several types. One relates to technical functions of the patent and related systems. The research in this field is of particular relevance to the Patent Bar since it deals with matters related to day-to-day practice. These include possible applications of computer technology to information retrieval or search technique in the U. S. Patent Office, possible modifications of fees charged to process patent applications, and techniques to make the validity of patents more secure.

Another set of questions relates to the comparative performance of industrial property systems, both domestic and foreign. The Institute has been exploring various aspects of the relative efficiency of the U.S. and foreign systems, and has published a number of reports on findings.

A third type of research involves ways in which industrial property is actually used as a business asset. This research considers the role of patents in business strategy, the uses made of results produced by development programs, the constructive employment of technical knowledge for improving the economic development of individual businesses, and the innovation of technical knowledge as it becomes available. It considers the uses made of patents and related property owned by corporations, the problems of licensing policy both in the United States and abroad, the civilian use of techniques developed in military or space R&D, the offensive versus defensive use of industrial property in modern business strategy, and other issues touching on business policy.

How corporations reward their inventors is another topic of active Institute inquiry. It is commonplace that research has become less an individual than a group activity, that the relative number of independent inventors has diminished while the number of employed inventors has increased. Research of the Institute has indicated that, despite these trends, issued patents are still attributable in major part to individual efforts, even when the inventor may be a member of a research team.

Research on the international aspects of industrial property is becoming more intensive and systematic. This attention is demanded by changes in the role of conglomerates and multinational corporations, the growth of the European Common Market, the development of common markets in Latin America, and the adoption of new international arrangements, such as the Patent Cooperation Treaty.

CURRENT RESEARCH ACTIVITIES

That serious problems and controversies will continue to arise and may proliferate is inevitable in a dynamic free economy. Now more than ever, the unique value, the competencies and the experience of the Institute are needed for deliberate and forward objective inquiry. Many proposals for changing our system have recently been made—for example, in the Report of the President's Commission on the Patent System. Proposals have also emerged for new international arrangements, for "harmonization" of national patent systems, for further limitations of patent licensing on antitrust grounds, and for restricting the use of trademarks and the protection of trade secrets. All of these are the subjects of major Institute research projects, current as well as already completed. Other continuing major projects include studies relating to taxation of industrial property, the patentability of computer programs, and the cost of enforcement of industrial property rights.

The Institute has also undertaken to compile continuing data on patent and related adjudications. This pilot "Barometer" may lead to periodic publication of adjudication lists of decisions, with thumbnail information, relating to patents, trade secrets, trademarks, copyrights, etc.

In cooperation with the Smithsonian Institution the Institute is also organizing a film series on "Living Archives of Inventors." The object of the series is to provide clear and memorable impressions of outstanding living inventors, including the circumstances in which their inventions originated and were applied. Each session will bring together five outstanding inventors and representatives from relevant specialties for a full day in Washington. The discussions are to be taped and, after editing, transferred to motion pictures of approximately an hour's showing time. The first session of this series was held on May 7, 1970. Participating inventors were Dr. Robert Adler, Dr. J. Presper Eckert, Jr., Mr. Jack Rabinow, Mr. Richard Walton, and Dr. Vladimir Zworykin.

DISSEMINATION OF STUDIES AND INFORMATION

Once research has been completed, the results are made known to the pertinent audiences. A comprehensive publication and information program is a major adjunct to the Institute's research efforts. Since the Institute went into operation in 1954, it has done the following in the

interest of effective dissemination of study findings and other pertinent information:

- (1) Developed a comprehensive publication program, including *IDEA*, the Institute's quarterly journal of research and education, a *Bulletin*, *Digests*, *Current Reports to Members*, *Guides to Institute Research*, *News Notes*, etc.
- (2) Conducted fourteen Annual Public Conferences and published the proceedings in separate numbers of *IDEA*.
- (3) Established a diversified educational program, consisting of lecture series, motion pictures, booklets addressed to young people, the *Thomas Alva Edison Fellowship*, the *Patent Office Society Student Award*, etc.
- (4) Maintained liaison with other organizations interested in industrial property and related problems in the U.S. and foreign countries.
- (5) Established a series of Clinics dealing with specific problems of special and timely importance and including selected experts from industry, government, and the Bar. These Clinics have related to Computer Software Protection, the Proposed Patent Cooperation Treaty, Trade Secrets, and Unfair Trade Practices Relating to Industrial-Intellectual Property. The results of these Clinics are being regularly reported in *IDEA* and are also made available to our membership in advance of such publication.
- (6) Established Special Conferences of Invited Experts to deal with selected topics of national and international importance. The Institute's Conference on "Air and Water Depollution: The Role of Industrial Property, Innovation and Competition," held on March 31, 1970, proved a most successful event.

Other programs of the Institute on behalf of industrial and intellectual property include:

- (7) Annual presentation of the *Charles F. Kettering Award* for outstanding contributions in research, education, and public service in the field of industrial and intellectual property.
- (8) Annual presentation of the *Inventor of the Year Award* to honor a journeyman or professional inventor who has made significant patented contributions even though he may not have come to wide public notice.

- (9) Annual presentation of the *Founders' Day Award for Distinguished Government Service* to honor an individual for highly meritorious accomplishments in the industrial-intellectual property field while in government service.
- (10) Conduct of a Patron Program to honor prominent lawyers, inventors, and executives for achievements in the field of industrial and intellectual property. The individuals so honored make substantial gifts in support of the Institute.
- (11) Establishment of Area Committees to maintain grass-roots contact and to spread information and guidance to school systems and other local organizations.
- (12) Development of a diversified and growing membership of individuals, firms, companies, foundations, and associations in every state of the nation, and abroad. Members and subscribers to the Institute's publications are located in more than 30 foreign countries.

The Advisory Council occupies an important place in the formulation and execution of the Research Institute's programs. The Council has consisted of men distinguished for their contributions to industrial-intellectual property as executives, inventors, research directors, educators, judges, and lawyers. Among the members of the Council in the past years have been Charles F. Kettering, David Sarnoff, Vannevar Bush, Cyrus Ching, Learned Hand, Glenn Seaborg, Chester Carlson, John Connor, Games Slayter, Edward Weidlein, John W. Davis, and John Olin.

THE NEXT 20 YEARS

An area of research for the future in which the potential appears good is the comparative study of national industrial property systems. Information on actual experience of different systems is needed. The Institute, as previously noted, has already conducted inquiries into foreign industrial property systems.

A good deal remains to be done in analyzing more completely the role of industrial property in international trade. Our foreign licensing study has been laying a good factual basis for this work, but many questions remain unanswered, particularly graduation from licensing activity to actual operation of foreign subsidiaries or joint ventures with foreign partners. Tax considerations in comparative operating costs are known to be important in decisions concerning private investment abroad.

Non-tariff barriers to trade, about which there is little precise informa-

tion, are also important in foreign investment. Frequently, American companies go abroad with subsidiaries as the most practical way to penetrate foreign markets. They might prefer to keep manufacturing operations in the United States and simply export completed products, but foreign countries, anxious to speed their own industrialization, often insist on local facilities and enforce this insistence with subtle non-tariff barriers. While national aspirations and the means employed for advancement are only indirectly related to international trade and to uses of industrial property, many interconnections need to be explored.

Another area in which considerably more work might usefully be accomplished relates to the R&D process and to the manner in which decisions in R&D are made. With the rapidly mounting outlay in R&D, both by the government and industry, we need to develop measures of the relationship between input of R&D and the amount, form, and use of industrial property emerging. More information is needed on the management of patent portfolios in the individual firms and on licensing decisions. The Institute has already engaged in exploratory studies in this general area.

A broad subject of particular interest to economists, business executives, and government officials is the role of technology in the structure of competition within industry. Reports and papers by the Institute have indicated that the relation of business technology to business competition involves much more than industrial property, but that industrial property and know-how play a very important role in this area.

Another topic for research relates to techniques by which the validity of issued patents could be improved and by which cases could be expedited through the Patent Office. A related problem to which a great deal of importance attaches is an extension of the Institute's study of how to reduce the time and expense of patent litigation. Important, too, is the individual inventor and his problems. We need to know more about what motivates the inventor and, if he is employed, we need to know more about how he fits into the organization. We also need to know more about how invention is related to the size of company. We need to trace the life cycle of particular patented inventions to shed more light on use, the changes in economic value, and the relationship to subsequent technical developments. Also, the Institute's studies on trademarks and on know-how should be enlarged. We must also pay increasing attention to copyrights.

The Institute has made considerable progress over the years in establishing a pattern of activities to contribute toward the accomplishment of objectives stated in its Declaration of Trust.

From the very outset, several concepts have been basic to the Institute's research plan. Studies were to be factually supported and wherever possible, appropriate statistical methods were to be employed. Projects were also to be interdisciplinary in nature so as to bring to bear the diverse viewpoints and training of the various specialties. The projects were to be as dispassionate as the objectivity of the researchers and their advisers could make them. A hallmark of the Institute's work was to be its design in the broad public interest. The Institute's research program from the beginning has been conceived within a broad frame of reference. The object has been to explore not only the technical operation of the patent and related systems but also their broad economic, social, industrial, and technological implications.

Our pioneering research in the patent and related systems has proven how opinion can differ from fact. Inventors are not groups but individuals, fascinating men and women. Patents are not shelved, but used again and again, and although public attention is commonly directed to patent policies of large corporations, small corporations often take special advantage of patents to strengthen their market position during their early stages of development. Our accumulating experience and growing capability for determining how the systems for promoting creativity are actually performing and for giving the citizens of the country the facts is our exciting prospect as we enter our third decade.

Comparative Income Roles of U.S. Industrial Property Rights Licensed Abroad

JOSEPH M. LIGHTMAN*

INTRODUCTION

THE PTC RESEARCH INSTITUTE'S CURRENT FOCUS on international licensing is prompted by the growing interest of U.S. firms in licensing aspects of their overall foreign marketing programs. Increasing net inflows from licensing in the U.S. balance of payments context is an equally important facet of the Institute's research project. Our present studies are intended to provide insights into the international licensing income picture where interpretive data have been particularly tenuous.

Our article on "Compensation Patterns in U.S. Foreign Licensing" in the previous issue of *IDEA*¹ deals with royalty rates and other payment bases used by a selected cross-section of U.S. manufacturing firms in licensing patents, trademarks, and know-how abroad. Precise information on geographic sources of U.S. firms' foreign licensing income is also provided. Commentary received by the Institute since publication of that

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¹ Vol. 14, No. 1 (Spring 1970), pp. 1-25.

article indicates that the subject research results offer new dimensions relative to international licensing compensation not heretofore publicly available.

The latest phase of our current project deals with the relative importance to U.S. industries of patents, trademarks, industrial designs, know-how,² and copyrights as income earners abroad—i.e., the subject of this article. In recent years, material has been published by the U.S. Department of Commerce, annually, on royalties and related licensing and management fees received by U. S. firms from their direct foreign investments.³ The Organization for Economic Cooperation and Development (OECD) has also published information on countries' "Technological Balance of Payments" including U.S. receipts from use of industrial property rights abroad.⁴ Annual reports of many U.S. companies show an item in the "assets" column of their balance sheet for industrial property rights (unnamed) or for "Goodwill, Patents, Trademarks, etc." In none of these primary sources, nor others of a secondary nature from private organizations that were researched, is there any indication of components of the total receipts that may be attributable to specific earnings from patents, trademarks, or any other type of intellectual property rights.

The U. S. Department of Commerce, which compiles and publishes the more up-to-date licensing receipt figures, does not require companies to provide any breakdown of them by "type of property right" sources. Breakdowns are required by amounts received from direct investment sources as (a) "Royalties, license fees and rentals"⁵ and (b) "Management fees and service charges." Within these two categories no further specificity is required as to amounts received from royalties, flat fees, assignments, or rental payments. The only further requirement on respondents is to specify geographic regional source of the reported figures. Regarding receipts from non-affiliates, firms are not required to report receipts in (b), above; reporting is required only of receipts in (a).

The PTC Research Institute, thus, has undertaken a research project in this phase of its international licensing study to identify the specific

² In this article the term "know-how" encompasses trade secrets and other forms of unpatented technology subject to licensing, assignment or sales by our respondents.

³ Appears in annual article on "The International Investment Position of the U.S.; Developments in (year)," usually in the October issue of *Survey of Current Business*.

⁴ "The Research and Development Effort in Western Europe, North America and The Soviet Union" (OECD, Paris: 1965), pp. 51-5; p. 74.

⁵ For explanation of "rentals," see note "d" in Table 3.

roles of U.S.-owned intellectual property rights abroad as income earners. A related purpose of this project is to provide some quantitative estimates of U.S. royalty income from licensing abroad that may be attributable each to patents, trademarks, designs, know-how and copy-rights.

EXTENUATING FACTORS

To many U.S. owners, the full value of their intellectual property rights abroad extends considerably beyond the royalty income they generate. Such values may be based on broader calculated marketing advantages such as reinforcement of foreign trading positions, forestalling of competition, establishment of bargaining leverage for technical information and services, and support of export sales through local maintenance and servicing. While the purpose of this study is to evaluate interrelationships of such rights as basic income earners, care has been taken to keep this subject in its proper perspective.

It is therefore believed desirable in the context of this article to sketch briefly a broader picture of those factors which, when taken together with licensing and sales for income, may constitute the more complete measure to their U. S. owners of the value of industrial property rights abroad. While the more salient factors have already been mentioned, there are others, perhaps less obvious, but equally as important to many firms.

It is to be noted that a great deal of technical information and know-how is interchanged abroad in group contexts without specific payment. This may take place at international conferences or under pre-arranged procedures between private trade, professional and managerial associations.

"Package deals"—where technology and patented inventions are included as part of foreign purchases of complete plants from U. S. sources—involve another aspect of U. S.-owned industrial property values not fully measurable in income earnings. Steel, chemical, and electronics plants account for most of those that have been sold abroad. Such sales embody use of the U. S. technology and patents for which no separate payment calculations have been made or estimated by many of the U. S. sellers.

Also to be considered are cross-licensing deals for exchanges, rather than outright purchases and sales of technology and licenses. In a number of industrialized countries where technical innovation has reached a high degree of sophistication, U. S. firms may be reluctant to sell

and license technology outright in various industries, such as electronics, aircraft, plastics, photography, and chemical technologies. U. S. firms may be concerned about the use of their technology sold abroad in competition with their own products in world markets. In dealings with the Japanese, for example, a number of U. S. firms are reportedly willing to license patents and technology only in return for comparable Japanese industrial property rights. Cross-licensing, rather than purchase and sale agreements for outright monetary compensation, are the more acceptable method to these firms of doing business with the Japanese.⁶

The following considerations are also offered regarding the earnings role of patents and trademarks in their overall value measurements.

There may be a considerable time lag between issuance of a patent abroad and its role as an income earner to the U.S. owner, where he uses it essentially for licensing purposes. Its "unproductive" earning period, however, will not necessarily obviate its value during that time if its earnings potential remains apparent.⁷ The value of trademarks to most firms is inherent in the goodwill and reputation they convey to the public, at home as well as abroad. Trademarks are not generally licensed separately for income earning purposes as such. They are usually licensed in combination with patents and/or technical know-how. Most firms in the Institute's licensing studies, however, have had little difficulty in assessing the specific role of trademarks, for royalty calculation and comparative earnings purposes, within their foreign licensing operations.

The use of inventors' certificates by U. S. firms abroad is inconsequential when compared to patents. Although little, if any, earnings therefrom are realized, it is nevertheless desirable to mention this form of recognition offered by certain countries. Where U. S. firms have inventors' certificates, they may constitute a form of industrial property right that has value, even though not necessarily providing remittable income earnings.

Inventors' certificates are used extensively in the Soviet Union, and, on a lesser scale, in Bulgaria, Poland, Rumania, and Algeria. They embody no proprietary rights in inventions as do patents.⁸ Compensation is

⁶ For a list of some of these U.S. firms, see article "Japan: Now the Imitator Shows the Way," in *Business Week* (May 16, 1970), p. 92.

⁷ The fact that a patent can be licensed is one of its most important attributes, or perhaps the most important of them. As pointed out in the "Report of the Attorney General's National Committee to Study the Antitrust Laws" (1955):

The simple grant of a patent license—like the simple assignment of a patent—poses no antitrust problems. Indeed the right to grant such licenses is one of the major elements of value in the patent itself. (p. 231).

⁸ For a detailed study on this subject, see article "Inventors' Certificates and Industrial Property Rights" in *IDEA*, Vol. 11, No. 2 (Summer 1967) pp. 133-50.

derived from a schedule of fees based on the State's use of the invention. Payment may also be in non-cash benefits such as job promotions, better housing, vacations, etc. It is seldom a form of recognition sought by U. S. nationals since the invention must be turned over to the State, the cash payments are usually not convertible to dollars, and the non-cash awards are not generally suitable to foreign interests. Inventors' certificates are sought mostly by domestic inventors as a convenient form of payment for inventions accepted and used by the State. However, there are occasions where U. S. firms may find it desirable to seek inventors' certificates, particularly in fields where patent protection is not practicable and this may be the only form of recognition feasible,⁹ even though receipts, if any, in dollar payments may be negligible. There is also growing international awareness of the inventors' certificate system, as exemplified by recent changes in the "Paris Union" Convention for the Protection of Industrial Property recognizing applications for such certificates as bases for the one-year right of priority.¹⁰

The basic problem, therefore, in studying income earning roles of intellectual property rights, is not to distort such roles for complete value measurement purposes. But, even though income earnings may serve only as a partial measurement of value, they are nevertheless a quantifiable and useful indicator of the importance of such rights to those who use them in international trade. To those who acquire such rights abroad primarily for licensing, assignment, and/or sales income purposes, the earnings measurement, of course, becomes a major value indicator.

DESCRIPTION OF THE SURVEY AND QUESTIONNAIRE

Since this survey is intended as a companion to that on "Compensation Patterns in U. S. Foreign Licensing,"¹¹ our latest questionnaire was sent to those firms in our earlier sampling base, in addition to certain others that had expressed a direct interest in our findings—about 70 firms in total. As in the earlier survey, we established five categories of industries for mailing purposes. These are listed below:

- (1) Aerospace and electronics (including communications and electrical equipment, and other closely related fields) ;

⁹ All countries with inventors' certificates systems have patent systems. However, in some instances (such as pharmaceutical processes in the Soviet Union), only inventors' certificates, not patents, are obtainable on inventions.

¹⁰ Amendment to Article 4, at Stockholm Revision Conference, 1967. (*Supra* note 8, pp 144-5.)

¹¹ *Supra* note 1.

- (2) Industrial machinery (including generators, machine tools and other heavy machinery and equipment) ;
- (3) Metals, chemicals and other materials (including primary and fabricated metals, rubber products, building and construction materials) ;
- (4) Consumer-type products (including household goods, softwear and other textile products) ; and
- (5) A miscellaneous category (including such industries as laboratory supplies, precision and scientific instruments, medical equipment and photographic supplies and equipment) .

The 25 usable responses we received are our sampling base for this phase of the survey.¹²

Again, the questionnaire was designed to expedite response by a person familiar with the subject matter without extensive record searching. It actually consisted of a chart, listing in the left hand column on separate lines, "Patents," "Trademarks," "Industrial Designs," "Unpatented Technology (know-how and trade secrets)," and "Copyrights." The recipient firm was asked to indicate with respect to its total foreign licensing royalty income (specified as 100%) the percentage sub-totals accounted for by each of these types of intellectual property rights. The same breakdowns were sought for total income received from their assignment and sales (100%) and from other direct income to be specified (100%) from their use abroad. No dollar value figures were requested; only percentages. No time frame was designated in the questionnaire, nor were the respondents asked to specify a particular period for the figures they reported. It was left to the recipient firms to report figures typifying their experiences in recent years.

COMPARATIVE ANALYSIS OF FINDINGS BY INDUSTRIAL SECTORS

All 25 respondents reported receipts of royalties from licensing of industrial property rights abroad, as indicated in Table 1. Only two reported receipts from copyright royalties. Since this survey was directed to industrial manufacturers who use copyrights incidentally to protect rights in their technical printed matter, this negligible finding on

¹² For sampling purposes, we consider this a usable return based on the 70 firms surveyed. From past experiences of this and other research organizations seeking voluntary information through questionnaires, our 28% response is believed satisfactory.

TABLE 1
COMPARATIVE IMPORTANCE OF INDUSTRIAL PROPERTY RIGHTS AS ROYALTY INCOME EARNERS ABROAD
 (By average percentages for sampling base in selected industries)^a

Industries	Number of Firms Reporting	Calculated Average Percent of Foreign Licensing Royalty Income Accounted for by:				
		Patents	Trade-marks	Designs	Know-How	Copy-rights
Aerospace and Electronics	4	39	3	11	47	0
Industrial Machinery	8	52	4	12	32	0
Metals and Chemicals	4	55	0	0	45	0
Lighter Industrial and Precision Equipment	4	67	7	18	8	0
Miscellaneous	5	52	3	10	33	2
(Building materials, textile products, plastics, conglomerate operations)	—					
	25					
						100%
						100%
						100%
						100%
						100%

^a Percentages are shown in Table 3 (see note c) for overall 25-firm sampling base, as distinct from five industry category breakdowns.

copyrights was expected. The item was included in our questionnaire only to secure completeness in reporting.

Only six of the respondents reported receipt of income from foreign assignments or sales of industrial property rights. As to other types of income, only one firm submitted a report. It identified receipts in the form of "equity" for use of such rights abroad.

Calculated average percentages based on the reported information showed patents to be the major foreign licensing royalty income earners but, not in all five, only four, of the industries surveyed (industrial machinery; metals and chemicals; lighter industrial and precision equipment; and miscellaneous¹³). In the fifth industry (aerospace and electronics), know-how licensing accounted for major receipts from foreign royalty income (see Table 1).

In the industrial machinery, metals and chemicals, and miscellaneous industries, the ratios between patent and know-how royalty income ranged from 1.2 to 1 to 1.6 to 1. In the lighter industrial and precision equipment industry, patents were by far the major foreign royalty income earners; the ratio between patent and know-how income being about 8.4 to 1.

Industrial designs were the next most important foreign royalty earners. In the miscellaneous, aerospace and electronics, industrial machinery, and lighter industrial and precision equipment industries, they accounted for 10, 11, 12, and 18%, respectively, of their totals (see Table 1). The metals and chemicals industry respondents reported no design or trademark licensing income, as such, from abroad.

Trademarks were the least important foreign royalty earners for their U. S. owners, ranging from 3 to 7% in each of the four industry categories where licensed abroad.

Although only six firms reported information on industrial property rights assigned or sold, the results were quite revealing. No consistent pattern was evident among the respondents (see Table 2). In two industry categories (industrial machinery and lighter industrial and precision equipment) know-how accounted, by far, for the greater percentage of income from such transactions. Designs assumed the major position in aerospace and electronics. In the miscellaneous category, the only reporting firm, a conglomerate, noted patents as the major income source in assignments and sales. Patents played a much lesser role in the other industries, as did trademarks.

¹³ This category of industries included 5 firms—2 in textiles and carpeting, 1 in building materials, 1 in plastic containers and the other a conglomerate in metals and chemicals, capital machinery, electrical control systems, fire fighting and automotive parts.

TABLE 2
COMPARATIVE IMPORTANCE OF INDUSTRIAL PROPERTY RIGHTS' ASSIGNMENT
AND/OR SALES INCOME FROM ABROAD
(By average percentages as reported by six firms in selected industries)

Industries	Number of firms Reporting	Calculated Average Percent of Foreign Income from Assignment and/or Sales Accounted for by:				
		Patents	Trade- marks	Designs	Know- How	Copy- rights
Aerospace and Electronics Industrial Machinery Lighter Industrial and Precision Equipment Miscellaneous (Building materials, textile products, plastics, conglomerate operations)	2	0	0	60	40	0
	1	10	10	0	80	0
	2	13	12	25	50	0
	1	90	0	0	10	0
	6					
						Total
						100%
						100%
						100%
						100%

INTRA-COMPANY PATTERNS

The above findings are based on calculated averages reflecting the general situation for each of five industry categories rather than for any particular firm. The following information elaborates on our findings on a case-by-case basis:

(1) Aerospace and Electronics (4 firms)

One firm reported that 100% of its foreign royalty income was accounted for by patents. Another stated that 95% of such income originated from know-how and 5% from patents. Neither of these firms reported receipts of income from assignments or sales of industrial property rights.

A third firm stated that most of its foreign licensing contracts were for know-how (60% of total royalty income) and design licensing (40%). Any licensing royalties from patents or trademarks were "incidental." Of its total income from assignments and sales, 60% was accounted for by designs and 40% by know-how.

The fourth firm reported that 50% of its foreign royalty income originated from patents, 10% from trademarks, 5% from industrial designs, and 35% from know-how. It explained that:

. . . the percentages listed could differ between developing and developed countries. In developing countries, technology is the major factor in licensing. On the other hand, in industrialized countries, the patent rights appear to play the most important role.

Licensing income from copyrights, reported by this firm, was "negligible." Assignments or sales of all such property rights were also reported as "negligible."

(2) Industrial Machinery (8 firms)

Four firms reported that between 90 and 100% of total foreign royalty income originated with patents, but qualified this by stating that the figure also included some know-how licensing for which no separate percentage could be stated. One of these firms estimated this latter figure at about 10%. Three additional firms had the opposite experience. They estimated receipts from foreign know-how licensing at 70, 80, and 95%, respectively. Receipts from patent licensing were 10, 10 and 5% and trademarks, 20, 10, and 0%, respectively.

The eighth firm reported foreign royalty income only from industrial designs. It had no income from any other form of intellectual property right, attributing "100%" to that from designs.

Only one of the eight firms reported income from assignment or sales, attributing 80% to know-how, and 10% each to patents and trademarks. The firm also reported receipt of "equity" in the same percentage distribution for licensing foreign use of the above rights.

(3) Metals and Chemicals (4 firms)

Patent and know-how licensing were the only sources of royalty income for those of our respondents in this industry. Typical of their situation was that for the respondent who reported:

... essentially all of our income from abroad for use of intangible property rights by independent parties results from royalties for the licensing of patents, or patents and know-how. Of these two categories, the major part of the royalty income is from patent licensing.

(4) Lighter Industrial and Precision Equipment (4 firms)

Two firms reported that patents accounted for about 70% of their total foreign royalty income. One also attributed 28% of its total to trademarks and allocated some know-how revenue to the patent total; 100% of its total receipts from sales of industrial property rights abroad were accounted for by know-how. The other firm did no trademark licensing. It attributed 20% of its remaining total revenue to designs and 10% to know-how. It had no sales or assignments.

A third firm specified 50% of its total foreign royalty income to be from design licensing and 25% each from patent and know-how licensing. From its assignment and sales of such rights abroad, 50% of total income was accounted for by designs and 25% each by patents and trademarks.

The fourth firm explained that in its completed questionnaire:

... we indicate that all of our income (100%) from intangible property rights is derived from licensing royalties for patents. Lest we mislead you, we would like to advise that most of the agreements also provide for licensing of technical information and trademarks. However, we have been unable to allocate what proportion of the royalties obtained under these agreements can be assigned to trademarks and technical information.

(5) Miscellaneous (5 firms)

One of the respondent firms in carpeting and textiles noted that half of its foreign royalty revenue came from patents and the other half from know-how. The other reported 70% from patents and 30% from designs. A building materials firm reported that 98% of its total royalty income was divided evenly between patents and know-how, with the remaining 2% attributable to trademark licensing. A plastic container manufacturer attributed half of its total foreign royalty income to know-how, 20% to design and 10% each to patent, trademark, and copyright licensing. The respondent conglomerate firm, active in metals and chemicals, capital machinery, electrical control systems, fire fighting and automotive parts production, attributed 84% of royalty income to patents, 15% to know-how and 1% to trademarks. It also reported that patents accounted for 90% and know-how for 10% of its total foreign assignments and sales earnings.

EXTRAPOLATION OF FINDINGS TO U. S. GOVERNMENT PUBLISHED STATISTICS

Commerce Department's published figures on total U. S. royalties received from direct investment and non-affiliated sources abroad for the years 1965 through 1969 appear in Table 3 (columns 1 through 3).

The PTC Research Institute has no indication whatsoever how its sampling base of 25 companies compares, company or industry-wise, with the 1000 plus firms universe used by that agency. Nor, is it known how many, or if any, firms appear in both universes. The source of information on the Commerce statistics is that which the agency publishes and clarifies to the public. No information can be given out by that agency on the identity of its respondents because of the confidentiality rules under which the data is collected. Also, as previously noted, such respondents are not required to break down their reported royalty receipts by type of property right from which generated.

Recognizing this lack of information on possible relationships between the Institute's and Commerce Department's sources, the Institute nevertheless sought to extrapolate its findings to Commerce Department's statistics. It was felt that overall percentages developed by the Institute from its sampling base, when applied to the Commerce statistics, might be useful to those engaged in licensing studies in providing them with some basis for quantitative comparisons of foreign earning roles of U.S.-owned intellectual property rights. It is hoped that the Institute's figures shown in the last five columns of Table 3 may serve this purpose,

TABLE 3
COMPARATIVE EARNING ROLES OF INDUSTRIAL PROPERTY RIGHTS LICENSED ABROAD EXTRAPOLATED BY
THE PTC RESEARCH INSTITUTE TO U.S. PUBLISHED STATISTICS ON FOREIGN LICENSING RECEIPTS
(Millions of dollars)

Year	Royalties, License Fees and Rentals ^d from:		Total	PTC Research Institute Calculated Sub-Totals by Type of Licensed Rights ^e				
	Direct Investment ^a	Non-Affiliates ^b	(100%)	Patents (52.61%)	Trademarks (3.52%)	Designs (11.52%)	Know-How (31.91%)	Copyrights (0.44%)
1965	325	335	660	347	23	76	211	3
1966	362	353	715	376	25	83	228	3
1967	438	406	844	444	30	97	269	4
1968	540	456	996	524	34	115	319	4
1969	641	510	1151	606	40	133	367	5

^a From *Survey of Current Business*, published by Commerce Department, Office of Business Economics. Figures appear in the Table on "Direct-Investment Receipts of Royalties and Fees, by Areas and Major Industries, (year)," in annual article (October issue) on "The International Investment Position of the U.S.; Developments in (year)." Statistics on "Management fees and service charges" also appearing in referenced Commerce Department table not included in this PTC Research Institute comparative table since the Institute's survey concerned royalty earnings, rather than related income such as that from management and services.

^b Provided by Commerce Department, Office of Business Economics. Not published as separate figures; appear in Table 1 on "U.S. International Transactions" together with other receipts shown in line 9 as "Other private services," in article on "The U.S. Balance of Payments" in *Survey of Current Business* (March, June, September, and December issues).

^c Calculated (and extrapolated to U.S. government statistics) by The PTC Research Institute from percentages developed in its research on 25-firm sampling base. Figures are rounded.

^d Figures available from Commerce Department explained in notes "a" and "b" above include receipts from rentals of tangible property rights; no break-outs of such rental receipts are available, but they are believed to constitute a very small percentage of total figures shown in first three columns of this table.

despite the limitations and "heroic" projections under which they were calculated.

The Institute developed an overall average percentage royalty earning for each of the intellectual property rights licensed abroad by the respondents in its sampling base. The total foreign royalty income role for these firms, taken as 100%, averaged 52.61% for patents, 3.52% for trademarks, 11.52% for designs, 31.91% for know-how and 0.44% for copyrights. Since these percentages were based on experiences by the respondents in recent years, they were extrapolated to Commerce's statistics for each of the years 1965 through 1969.

CONCLUSIONS

Royalties derived by U. S. manufacturing firm respondents from licensing of their industrial property rights abroad were attributable for the most part to patents and know-how. The highly consistent pattern of responses relative to the combined percentages of these two forms of industrial property rights was not surprising. Total percentages per company of patent and know-how royalty income ranged primarily from 70 to 100% of total royalty income for most respondents. But, on the question of percentage income attributable individually to patents and to know-how, little consistency was apparent on a company-by-company basis, even in the same industry. Responses ranged from 50 to 100%, individually for patents to the same figures individually for know-how.

We appreciate respondents' efforts to provide specific percentages of royalty income breakouts, particularly from patents and from know-how. These are difficult figures to compile given the fact that patents and know-how are seldom licensed separately. The same also applies to trademarks which are generally licensed in combination with other industrial property rights.

Industrial designs played a fairly important role in respondents' foreign royalty income. A number of firms reported incomes from this source to be about 20% of their royalty totals, some as high as 40 and 50% and one at 100%. Trademarks played a much lesser role, usually ranging less than 10% of the total foreign earnings, although one firm reported 20% and another 28%.

Only six of our respondents reported income percentage breakdowns for assignments or sales, indicating that this source of income is relatively inconsequential when compared with that from licensing. Patents and trademarks generally formed the lesser sources of revenue in assignment

and sale transactions. Designs and know-how were the principal forms of rights so transacted.

Foreign income from licensing, sales and assignments of copyrights by our respondents was negligible. This form of property right is obviously not an important income earner for industrial manufacturers.

Although foreign royalty receipts and those from assignments and sales transactions may not serve as the full measure of value to U. S. firms of foreign owned industrial property rights, they are nevertheless the major quantifiable factor in the various indicators that may be used for overall value determination. The PTC Research Institute, therefore, has sought to develop comprehensive knowledge on foreign income earning roles of industrial property rights in intra-industry, as well as intra-company contexts.

The Institute has also considered such earning roles in relation to U.S. government published statistics on balance of payments, even though there is no information on the relationship of its sampling base for percentages to the Department of Commerce's universe for compiling quantitative receipts. Overall percentages that the Institute has developed indicate generally that patents account for a little over half of total U. S. royalty receipts; know-how, a little less than a third; designs about 12%; trademarks, about 3½%; and copyrights, less than ½ of 1%. When applied to U. S. government receipt statistics (as shown in Table 3) the calculated results may prove particularly interesting to those engaged in licensing income studies.

Just as in the earlier companion article on royalty rates and geographic sources, this article has endeavored to provide new insights into U. S. foreign licensing for the business, legal and economic professions.

Taxation of the Foreign Licensor in Germany

CHRISTOPH J. C. BELLSTEDT*

INTRODUCTION

THE LICENSING OF TECHNICAL KNOWLEDGE by foreign companies has been an important factor in Germany's post-war development. A hiatus in research other than that with a direct military significance during the pre-war period, the emigration of uncounted thousands of intellectuals to Western countries, predominantly the United States, and the lack of sufficient capitalization and tax incentives required for broad-scale research activities made Germany heavily dependent on foreign technology. Its inflow has thus never been impeded by protective legislation. Only the tax laws, as well as domestic and European Economic Community (EEC) anticartel regulations have an impact on the foreign licensor and the German licensee.

The foreign licensor who is not engaged in a trade or business in Germany through a permanent establishment is exposed only to a 25 percent income tax, the 1 percent property tax, and an 11 percent turnover tax. The impact of the income tax and often also of the property tax

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EDITOR'S NOTE: This article is the sixth report in a series of studies being conducted by John F. Creed and Dennis I. Meyer, members of the Research Staff of The PTC Research Institute, dealing with the taxation of the foreign licensor in certain selected non-U.S. jurisdictions. The series naturally breaks down into three study groupings:

- 1. Australia, Canada, United Kingdom, South Africa and India.*
- 2. The Common Market countries.*
- 3. Japan.*

At a later time other non-U.S. jurisdictions will be included in the series.

While the studies are involved principally with income taxation,

has been eliminated through tax conventions. As a practical matter, therefore, the turnover tax is the only tax that remains to be considered in many cases. With respect to United States corporate licensors who are licensing their German subsidiaries, the payment of royalties may, however, have an effect on the German tax treatment of dividends paid to the United States parent company.

INCOME TAX

The income tax on individuals and partners of a partnership,¹ as well as the corporate income tax,² are imposed if either of two situations exist, namely (a) if the residence, the usual place of abode, the corporate seat or the head office of the taxpayer is located in Germany; or (b) if the revenues originate from Germany. Alternative (a) is called "unlimited taxability." In that case the taxpayer is subject to the German income tax on his world-wide income. Alternative (b) is called "limited taxability" because the right to tax is limited to specific revenues from German sources, provided that the revenue in question is

¹ §§ 1 and 15 No. 2 *Einkommensteuergesetz* (EStG)—Income Tax Law of December 12, 1969.

² §§ 1 and 2 *Körperschaftsteuergesetz* (KStG)—Corporation Income Tax Law of October 13, 1969.

other taxes are also covered where they have a material impact on the foreign licensor. Particular attention is paid to the taxation of U.S. licensors in the various jurisdictions, and in this connection an analysis of the pertinent U.S. double taxation treaties comes into play.

The studies are being undertaken by men who, through training and experience, are tax experts in the respective jurisdictions. In presenting their studies, they strive to walk the path between undue technicality and over-simplification.

The first report in the series, "Taxation of the Foreign Licensor in Australia" prepared by John K. Connor, was published in Volume 8, Number 1 (Spring 1964) of IDEA. The second in the series, "Taxation of the Foreign Licensor in Canada" by Hubert J. Stitt and John A. Gamble, appeared in Volume 8, Number 2 (Summer 1964). The third, "Taxation of the Foreign Licensor in the United Kingdom" by Malcolm J. F. Palmer, was published in Volume 9, Number 3 (Fall 1965). The fourth in the series, "Taxation of Foreign Licensors in Italy" by Peter C. Alegi, appeared in Volume 12, Number 1 (Spring 1968). The fifth, "Taxation of the Foreign Licensor in South Africa," by Pearce E. Rood, was published in Volume 13, Number 2 (Summer 1969).

among those enumerated in Section 49 EStG.³ This latter provision also applies to foreign (nonresident) corporations.⁴

Royalties in General

In the case of a foreign individual, partnership or corporation receiving royalties from Germany, alternative (b), limited taxability, would apply. Royalties for patents, trademarks, copyrights and other industrial property rights paid by a German resident, partnership or corporation to a nonresident licensor are covered by Section 49 (1) No. 6 EStG in connection with Section 21 (1) No. 3 EStG, and therefore subject to the German income tax,⁵ unless a tax convention provides otherwise. As noted later, know-how is not considered a "right" for purposes of Section 49 (1) No. 6 EStG. This presupposes that the licensed rights in question are either registered in Germany or used within a domestic business entity. Hence, the tax also applies to royalties for unregistered rights,⁶ as well as registered rights.

If property is licensed but not domestically registered, its utilization within a domestic business establishment is thus required. Whether the products manufactured under license are sold within or outside Germany is irrelevant. But the income tax does not apply if royalties are paid for the use of foreign trademarks outside of Germany or if the German licensee uses the licensed property rights in a foreign permanent establishment.⁷

The application of Section 49 (1) No. 6 EStG to foreign corporations had posed a theoretical problem in view of a peculiarity of the German income tax. Contrary to the vast concept of "income" as defined by Section 61 (a) of the Internal Revenue Code of the United States, the German income tax is levied only on the seven sources of income enumerated in Section 2 (3) EStG, among which is "income from trade or business." In the case of a corporation, all income is regarded as income from a trade or business regardless of the actual source.⁸ Since

³ § 1 (2) EStG.

⁴ § 2 (1) and § 6 KStG; *Bundesfinanzhof* (BFH)—Federal Tax Court, decision of November 30, 1966, *Bundessteuerblatt* (BStBl) (1967), III, p. 400.

⁵ Hohensee-Bellstedt, *Die Besteuerung international verflochtener Gesellschaften* (2nd ed., 1970), pp. 18, 246-247; Knoppe, *Die Besteuerung der Lizenz- und Know-how-Verträge* (1964), pp. 32 *et seq.*, 40, 47.

⁶ § 50a (4) b EStG; Herrmann-Heuer, *Kommentar zur Einkommensteuer und Körperschaftsteuer*, § 49 EStG annot. 48 and 51 (1969).

⁷ Herrmann-Heuer, *supra* note 6, § 49 EStG annot. 51 (1969).

⁸ § 16 *Körperschaftsteuer-Durchführungsverordnung* (KStDV)—Corporation Income Tax Regulations.

income from a trade or business of a foreign corporation from German sources can only be taxed in Germany if and to the extent that such foreign corporation generates said income through a permanent establishment or a permanent representative in Germany,⁹ the view had been taken that royalties received by a foreign corporation, being income from a trade or business, could not be taxed in Germany in the absence of a permanent establishment or a permanent representative of the foreign corporation in Germany. Obviously, this view would have resulted in undercutting the concept of limited taxability of Section 49 EStG altogether, leaving all income from German sources other than from a permanent establishment tax-free.

The undesirability of this result lead to the so-called "isolated view" that was developed by the courts¹⁰ which looks upon the income only rather than on its recipient. Once the income category "royalties" is isolated from the recipient "corporation," the rule that corporations can have income only from a trade or business¹¹ becomes irrelevant and the right to tax such royalties under Section 49 (1) No. 6 EStG is reestablished.

Although the "isolated view" concept was first espoused in the late 1920's, its maturity does not protect it from reconsideration. One authority¹² bluntly states that the imposition of the income tax on royalties paid to a foreign corporation is not covered by the law. There are also other critics.¹³ As discussed in the following section, this

⁹ § 49 (1) No. 2 EStG.

¹⁰ Mersmann, *Die Ertragsbesteuerung inländischer Betriebstätten und Tochtergesellschaften ausländischer Kapitalgesellschaften* (1966), p. 32; *Reichsfinanzhof* (RFH)—Supreme Tax Court, decision of February 7, 1929, *Reichssteuerblatt* (RStBl) (1929), p. 193; of March 12, 1936, RStBl (1936), p. 968; of August 5, 1936, RStBl (1936), p. 1132; BFH of January 20, 1959, BStBl (1959), III, p. 133; *Finanzgericht* (FG)—Tax Court Baden-Württemberg, of December 2, 1969, *Entscheidungen der Finanzgerichte* (EFG) (1970), p. 168. Cf. also Vogel, "Die Auswirkungen der Abkommen zur Vermeidung der Doppelbesteuerung auf das innerstaatliche Steuerrecht," *Der Betrieb* (1959), p. 32; Debatin, "Die beschränkte Steuerpflicht bei der Einkommen- und Körperschaftsteuer," *Der Betriebs-Berater* (1960), p. 1015; Debatin, "Internationale Steueraspekte in der deutschen höchstgerichtlichen Rechtsprechung," *Deutsche Steuer-Zeitung* (A) (1966), p. 167; Debatin, "Die Bestimmung der Einkunftsart bei der beschränkten Steuerpflicht," *Der Betrieb* (1961), pp. 785 *et seq.*; Grieger, Note in *Aussenwirtschaftsdienst des Betriebs-Beraters* (AWD) (1959), p. 87.

¹¹ Which anyway applies to domestic corporations only, cf. the reference to taxpayers to whom the German Commercial Code applies in § 16 KStDV, *supra* note 8.

¹² Niedner, *Lizenz- und Know-how-Vergütungen an ausländische Unternehmen*, AWD (1968), pp. 429 *et seq.*

¹³ Hüpper, "Zur beschränkten ESt-Pflicht von Einkünften aus 'know-how' und

criticism had fruitful results insofar as royalties for know-how are concerned.

Royalties for Know-How

Section 49 (1) No. 6 EStG imposes a tax on income from leasing (as defined in Section 21 EStG) received by nonresidents, provided that the subject matter of the contract is real estate, assets or "rights" located in Germany or registered in a domestic register or used by a domestic business entity. Section 21 (1) No. 3 EStG refers to know-how as "industrial experience." It is recognized that industrial experience or "know-how" is not a "right"¹⁴ and that royalties for know-how are, therefore, not covered by Section 49 (1) No. 6 EStG.

The tax administration¹⁵ agreed but imposed the tax by authority of Section 49 (1) No. 3 EStG that subjects to limited taxability income from "independent labor performed or exploited in Germany." This view had been rejected by legal commentators who note that a corporation, as distinct from a physical person, cannot possibly perform "independent labor," a term used by the code for the liberal professions.¹⁶

In 1965, the Tax Court of Düsseldorf joined the critics and held that know-how can only be developed and hence licensed by a business entity which by definition cannot perform "independent labor" so that royalties for know-how are income from a trade or business which is tax-free in the absence of a German permanent establishment of the licensor.¹⁷ In this decision, the Tax Court pierced the "isolated view" concept and in fact looked to the foreign recipient. In March 1970 the Federal Tax Court upheld the Düsseldorf decision¹⁸ and rejected the view of the tax administration that know-how royalties are income from "independent labor" if the recipient is a foreign corporation. The court qualified the isolated view concept in that "due regard must be given to the recipient if this is necessary for the qualification of the income in question."

Patentüberlassung nach § 49 EStG," *Der Betrieb* (1964), pp. 1530-1534; van der Velde, "Sind Einkünfte aus der Überlassung betrieblicher Erfahrungen (know-how) beschränkt steuerpflichtig?," *Der Betrieb* (1959), pp. 1205 *et seq.*

¹⁴ Debatin, *Der Betriebs-Berater* (1960), *supra* note 10, p. 1018; Knoppe, *supra* note 5, p. 70; van der Velde, *supra* note 13, p. 1206.

¹⁵ Ordinance of the State of Hessen of December 24, 1958, *Der Betrieb* (1959) p. 361; Debatin, *Der Betriebs-Berater* (1960), *supra* note 10, p. 1018.

¹⁶ Knoppe, *supra* note 5, pp. 67-70; van der Velde, *supra* note 13; Hüpper, *supra* note 13.

¹⁷ *Finanzgericht (FG)*—Tax Court Düsseldorf of July 21, 1965, EFG (1966), p. 82.

¹⁸ BFH of March 4, 1970, BStBl (1970), II, p. 428.

The Federal Tax Court further refused to tax the know-how royalties under Section 49 (1) No. 6 EStG on grounds different from those of the tax administration. The administration did not apply Section 49 (1) No. 6 EStG because know-how does not constitute a "right"; the Federal Tax Court, however, referred to the definition of the term "income from leasing" in Section 21 (1) No. 3 EStG that includes royalties both from "rights" and from know-how but which presupposes that such know-how is granted to the licensee "for a limited period of time." In the case under review, a British corporation had agreed to communicate to a German company "technical, practical and commercial information and knowledge." In the view of the Federal Tax Court which is shared by the authors cited above, the utilization of such information and know-how is not susceptible to time limitation despite the fact that the underlying contract could be terminated. It could be added that a time limitation imposed on the utilization of unprotected know-how would also infringe German anticartel laws.¹⁹

In summary, royalties for know-how are tax-free if paid to a foreign corporation, whereas royalties for other industrial property rights are taxable regardless of the recipient.

Royalties to a Foreign Parent Corporation

In a 1960 decision the Tax Court of Freiburg held that there is no general assumption to the effect that license agreements between related companies must be entered into for a consideration.²⁰ The court argued that within a group of related companies industrial property rights may in principle be used free of charge. This view is at variance with business practice and also contradicts basic rules of taxation. It is usual and indeed required by the tax laws that all transactions between related taxpayers be consummated on an arm's length basis that requires an adequate compensation for any benefits received, tangible or intangible. Valuable trademarks, patents, copyrights or know-how may thus not be granted under a royalty-free arrangement.²¹ As a practical matter, the payment of an adequate royalty by the German subsidiary to its foreign

¹⁹ In another decision of March 4, 1970, concerning know-how licensed by a U.S. corporation to a German company, the Federal Tax Court held that the royalties were tax-free as a matter of national law because the license agreement did not put a time limitation on the licensee's right to use the technical knowledge made available to him. See BFH of March 4, 1970, *Deutsches Steuerrecht* (DStR) (1970), p. 469.

²⁰ EFG (1962), p. 315.

²¹ See Knoppe, *supra* note 5, p. 74, with further references; Reuter, "Die An-

parent company had never been questioned in principle and the Freiburg Tax Court decision is not applied in practice.

On the other hand, based on the authority of Section 6 (1) KStG that provides for the taxation of so-called hidden profit distributions, a payment to the parent-licensor will not be recognized as a royalty payment in its entirety to the extent that the royalty rate exceeds the normal rate. The excessive part of the payment is considered income to the licensee and is treated as a "dividend" paid to the parent-licensor in a concealed fashion. The tax result of such an allocation of income amounts to a total tax of some 90 percent (corporate income tax, trade tax, property tax and dividend withholding tax).

The difficulty then is to determine the proper royalty rate in the parent-subsidiary arrangement. A number of factors are involved such as the value of the trademark (a famous vs. an unknown mark) or of the patent (exploitability, remaining life) involved, as well as business usage within the particular trade. "The lower the better" is the safe rule as regards the German licensee. This may present a problem, however, to the foreign licensor, for example, the United States parent-licensor who is subject to the standards of Section 482 and the regulations promulgated thereunder.

Withholding Tax

Royalties for the utilization or the right to utilize copyrights, industrial property rights and know-how paid to a nonresident recipient are taxed by way of a 25 percent withholding tax.²² Losses from other operations in Germany may not be offset against the royalty income.²³ Should the licensee fail to deduct and pay the proper withholding tax, then the licensee becomes liable for the tax.²⁴

Business Expense

Royalties paid to a foreign licensor may be deducted as a business expense by the German licensee. This also applies where the payor is a

erkennung von Dienstleistungen und Überlassung immaterieller Werte zwischen Muttergesellschaften und ihren Tochtergesellschaften im Ausland . . .," *LIVa Cahiers de Droit Fiscal International* (1969), II, pp. 3 *et seq.* Hohensee-Bellstedt, *supra* note 5, p. 247.

²² § 50a (4), b EStG.

²³ § 50 (2) EStG.

²⁴ § 50a (5) EStG.

subsidiary of the licensor provided, of course, that the royalty rate is fair and reasonable.²⁵

PROPERTY TAX

The distinction between unlimited and limited taxability also applies to the property tax (net wealth tax). Nonresident persons or corporations are subject to the property tax only on their so-called "domestic property."²⁶ The term "domestic property"²⁷ includes "inventions and petty patents which are registered in a domestic book or register."²⁸ In other words, if the subject matter of the license is a German patent, then the property tax becomes payable with respect to royalties.

Domestic property further encompasses "other property made available, in particular leased to, a domestic business entity."²⁹ According to the Federal Tax Court, this section of the Valuation Law is a catch-all provision which subjects to tax also "unregistered inventions and apart therefrom all other intangible assets, such as know-how,³⁰ made available to a domestic enterprise."³¹ The specific case dealt with a copyright license, but its importance lies in the *obiter dictum* that refers to know-how and all other intangible assets. The Federal Tax Court repealed the judgment of the Administrative Court of Berlin which held that unregistered inventions were not subject to tax.³² The Federal Tax Court decision does not appear to be in conformity with the Valuation Law.³³ The decision is, however, applied by the tax administration in those rare cases where the property tax is not waived by a tax convention.

The property tax rate is 1 percent³⁴ of the net value of the royalties accruing to the licensor if such net value exceeds DM 2,000.³⁵ The value of the royalties is determined on the first of January of any calendar year by capitalizing the royalties to be received in the future on the basis of

²⁵ Reuter, *supra* note 21, II, p. 3; Rasch, "Beratungskosten an ausländische Konzerngesellschaften," *Der Betriebs-Berater* (1963), pp. 1094 *et seq.*

²⁶ §§ 2, 7 No. 2 *Vermögenssteuergesetz* (VStG)—Property Tax Law.

²⁷ As defined in § 121 *Bewertungsgesetz* (BewG)—Valuation Law.

²⁸ § 121 (2) No. 4 BewG.

²⁹ § 121 (2) No. 5 BewG.

³⁰ The court uses the English word "know-how" in its decision.

³¹ BFH of January 29, 1965, BStBl (1965), III, p. 219.

³² EFG (1963), p. 46.

³³ See Bellstedt, Note in AWD (1965), p. 179; Hohensee-Bellstedt, *supra* note 5, p. 49.

³⁴ § 8 VStG.

³⁵ § 6a VStG.

the facts known on the assessment date. In capitalizing the annual royalties, an interest factor of 5.5 percent is used; the total assessment value may not exceed a maximum of 18 times the annual value of the royalties³⁶ but is usually much less depending on the term of the agreement.

Since the amount of royalties to be collected in the future is uncertain, the annual value of the royalties must be estimated³⁷ and may not exceed 1/18 of the value of the licensed patent or other right.³⁸ In practice, the term of the license agreement or, in the absence thereof, the remaining life of the patent, the payment history under the agreement, and the turnover of the licensee with regard to the licensed product are factors taken into account in valuing the royalties. From the gross value so established, there may be deducted all business expenses, liabilities, taxes (including the property tax) and otherwise "economically connected" with the royalties to arrive at the net worth thereof.³⁹

TURNOVER TAX

The Old and the New Tax

Effective January 1, 1968, Germany abandoned the old "cascade" tax and introduced the so-called "value-added" tax.⁴⁰ Most of the changes of the turnover tax system resulting from the new law do not affect the foreign licensor except for the increase in the tax rate from 4 percent to 11 percent.

Under both the old and the new tax, domestic deliveries or other domestic performances were and are subject to the tax. Performances comprise actions as well as omissions and "tolerations."⁴¹ Thus, the foreign licensor who "tolerates" the exploitation of a German industrial property right by a German enterprise is considered to render a domestic performance and hence, the consideration for such toleration, that is the royalties, are subject to the tax.

³⁶ § 13 (1) BewG.

³⁷ § 15 (3) BewG.

³⁸ § 16 (1) BewG.

³⁹ §§ 118, 121 (3) BewG.

⁴⁰ See the bilingual edition of the new turnover tax: Schmidt-Döser-Bellstedt, *Das Mehrwertsteuergesetz*—Added Value Tax Law, English-German Text With Short Introduction (Cologne: Verlag Dr. Otto Schmidt KG, 1967; Commerce Clearing House, Inc. 1967).

⁴¹ See § 3 (8) *Mehrwertsteuergesetz* (MWStG)—Added Value Tax Law. (The correct title of this law is really *Umsatzsteuergesetz 1967*—Turnover Tax Law of 1967).

Industrial Property Rights

Patents, copyrights, and trademarks can be either transferred or licensed to the user. In the case of a transfer or sale,⁴² the taxable performance occurs in the country where the patent is registered.⁴³ So the sale is taxable if a German patent is concerned and tax-free if a foreign patent is sold. If patents registered in several countries are sold, then the consideration must be segregated into a taxable portion for the German patent and a nontaxable portion for the remainder.⁴⁴

In the case of a mere license arrangement, the transfer of rights to the licensee is disregarded and emphasis is put on the toleration by the licensor of the exploitation of the protected rights. In some cases the absence of any exploitation by the licensor is predominant, rather than the toleration of an exploitation by the licensee (exclusive vs. nonexclusive licenses). Under the turnover tax, both cases are treated alike. The toleration occurs in that territory where the tolerated action (exploitation) occurs,⁴⁵ and the omission occurs in the territory where the omitting party could have acted.⁴⁶ It follows that royalties for both exclusive and nonexclusive rights to use German industrial property rights attract the 11 percent tax.

If a German licensee is granted the right to manufacture in Germany and to sell both within and outside of Germany, then only the "domestic" portion of the royalty payment is taxable, i.e., the manufacture and sale in Germany, whereas that portion attributable to foreign sales is not taxable.⁴⁷ This rule of long standing which enjoyed the approval of the tax administration⁴⁸ had only recently been confirmed by the Federal Tax Court⁴⁹ which held that one-half of the royalties allocable to the foreign sales are subject to the tax because the goods so exported were

⁴² Under German law, only patents can be sold to a third party (§ 9 *Patentgesetz*—Patent Act), whereas copyrights cannot (§ 29 *Urheberrechtsgesetz*—Copyright Act) and trademarks can only be sold along with the business entity to which they belong (§ 8 (1) *Warenzeichengesetz*—Trademark Act).

⁴³ BFH of November 26, 1953, BStBl (1954), III, p. 63; BFH of February 26, 1959, BStBl (1959), III, p. 225.

⁴⁴ BFH of February 26, 1959, *supra* note 43.

⁴⁵ RFH of September 28, 1944, Kartei UStG, § 1 No. 1 R. 2; BFH of March 10, 1966, BStBl (1966), III, p. 302; of September 26, 1968, BStBl (1969), II, p. 58.

⁴⁶ See § 3 (10) MWSStG.

⁴⁷ Knoppe, *supra* note 5, p. 141; Haver-Mailänder, *Lizenzvergabe durch deutsche Unternehmer in das Ausland* (1967), p. 154.

⁴⁸ Ordinance of the District Tax Office (OFD), Hamburg, of June 10, 1964, *Der Betrieb* (1964), p. 936; Rädler-Raupach, *Deutsche Steuern bei Auslandsbeziehungen* (1966), p. 141.

⁴⁹ BFH of July 17, 1969, BStBl (1969), II, p. 693.

manufactured in Germany; the remaining half of the royalties referable to the export sale is tax-free.

Know-How

It is obvious that one cannot tolerate the exploitation of a right in Germany in the absence of a right which enjoys protection in Germany. It is, therefore, a rule of long standing that the turnover tax applies only to royalties paid for the exploitation of patents, trademarks, petty patents or other industrial property rights which are registered in Germany or which otherwise enjoy the protection of the German laws.⁵⁰ It follows *e contrario* that royalties for know-how are turnover tax-free.⁵¹

Know-how consists of technical or other knowledge developed by the foreign licensor, written down by way of formulas, descriptions, reports, drawings, or otherwise, and communicated to the licensee. The subject matter of know-how is not normally capable of enjoying industrial property right protection, nor does it normally enjoy it. Know-how consists of technical secrets the disclosure of which is the material factor under a license agreement.⁵² Such disclosure usually occurs in writing and hence the place of performance is considered to be identical with the location of the licensor. Only where the know-how is communicated to the German user by personnel of the foreign licensor physically present in Germany, rather than by mail or some other similar delivery, would the foreign licensor be considered to render, in person, services in Germany that would attract the tax to the extent that the royalties are paid for such services.

Difficulties arise in many cases where a license agreement provides for both the granting of a patent license and the communication of know-how to the licensee. It had been the practice of the tax administration to ascertain, with the aid of both parties involved, the portion of the royalties attributable to the patents on the one hand (taxable) and to the know-how on the other (tax-free) and to tax the foreign licensor only on the former. This segregation was, of course, easier to accomplish in the rare cases where special royalty rates were provided for in the license agreement for each item.

⁵⁰ Mathiak, "Ort der Leistung bei urheberrechtlichen und patentrechtlichen Leistungen, insbesondere bei Auslandsbeteiligung," *Umsatzsteuer-Rundschau* (1970), pp. 209-214 with further references.

⁵¹ See note 50; BFH of March 11, 1954, BStBl (1954), III, p. 152.

⁵² See Mathiak, *supra* note 50.

The above approach, although still valid in principle, has recently been questioned by the Federal Tax Court which held that know-how which is technically related to the patent or patents licensed is not susceptible to a tax treatment different from that attributable to the patent royalties since "as a rule of experience" know-how of this nature is granted only as incidental to the patents so that its tax fate is subordinate to that of the patent royalties.⁵³ This decision, right or wrong as it may be, brings an end to the favorable tax treatment which know-how royalties previously enjoyed in many cases. In the future, the burden of proof will be on the taxpayer to show that the know-how is absolutely unrelated with, and distinct from, the technical realm of the patent. Only where the agreement is confined to the licensing of know-how does the old tax treatment still prevail.

Tax Base, Tax Rate, Assessment

The turnover tax is based on accrued consideration,⁵⁴ hence, on the royalties accrued during any one tax reporting period.⁵⁵ The tax is not part of the tax base. The tax rate is 11 percent.⁵⁶ In the event the last annual taxable turnover plus the tax thereon did not exceed DM 60,000, then the tax rate is 4 percent of the tax base increased by the tax thereon.⁵⁷ This section of the law reintroduces the old cascade tax for so-called small entrepreneurs, measured by their domestic turnover. This section may well apply to a number of foreign licensors whose total royalty receipts from Germany do not exceed DM 60,000. It is important to realize that taxation under the 4 percent rule may have disadvantages both to the licensor and to the licensee (no prior tax deduction) and that taxpayers therefore tend to opt for the application of the general rules, including the 11 percent tax.⁵⁸

The turnover tax law provides for rather stringent invoicing, accounting, and reporting mechanisms. Upon demand by the domestic licensee, the foreign licensor must issue detailed invoices to the licensee showing, along with other items, both the royalty and the tax.⁵⁹ These invoices may be substituted by credit notes issued by the licensee. The licensee

⁵³ BFH of July 17, 1969, BStBl (1969), II, p. 693.

⁵⁴ § 10 (1) MWStG.

⁵⁵ § 13 (1) No. 1 (a) MWStG. The tax is reported on a monthly basis, § 18 (2) MWStG, and the final tax is computed on the annual return, § 18 (1) MWStG.

⁵⁶ § 12 (1) MWStG.

⁵⁷ § 19 MWStG.

⁵⁸ This option is granted by § 19 (4) MWStG.

⁵⁹ § 14 (1) MWStG.

would show the amount of royalties accrued and would add thereto the tax of 11 percent and would pay both amounts over to the licensor. It is the sole obligation of the licensor to pay the amount of tax so collected to the German tax authorities.

The licensee is not burdened by paying the licensor both the royalty and the tax thereon because the licensee may deduct the amount of tax so paid from his own tax obligation or obtain a refund, respectively, if he owes the government a lesser amount of, or no turnover tax (so-called prior tax deduction).⁶⁰

The foreign licensor is assessed annually on the basis of tax returns filed by him. The appointment of a domestic representative for handling the filing and assessment matters is in many cases necessary.⁶¹

CUSTOMS DUTIES

Licensing may have customs duty repercussions. If a foreign—non-EEC—licensor grants a trademark license to a domestic licensee who in turn imports products from the licensor or any company related to the licensor bearing the trademark so licensed, then the royalties paid are added to the customs value of the products so imported.⁶²

IMPACT OF TAX CONVENTIONS

Income Tax

Germany has entered into 25 tax conventions that cover all Western European countries, the United States, Canada, and Japan, to mention a few.

Exemption Granted

In most of its tax conventions, including the treaty with the United States,⁶³ Germany has waived the right to tax royalties accruing to a person or corporation of the other contracting state. The right to tax

⁶⁰ § 15 MWStG.

⁶¹ § 89 *Reichsabgabenordnung*.

⁶² § 21 *Wertzollordnung*.

⁶³ Convention Between the Federal Republic of Germany and the United States of America for the Avoidance of Double Taxation with Respect to Taxes on Income and to Certain Other Taxes, As Amended in 1965, Art. VIII.

royalties is reserved to the country of the licensor's domicile. Only where the licensed property is effectively connected with a German permanent establishment of the foreign licensor do the tax conventions reserve Germany's right to tax the royalties as part of the income of the permanent establishment.⁶⁴

Only a few conventions provide for the right of the licensee's country to levy the withholding tax, usually at a reduced rate. This is so with regard to the treaties between Germany and Argentina (15 percent),⁶⁵ Canada (15 percent),⁶⁶ Ceylon (German rate 12.875 percent),⁶⁷ India (25 percent plus surtax),⁶⁸ Iran (10 percent), Israel (5 percent),⁶⁹ Japan (10 percent),⁷⁰ Luxedbourg (5 percent),⁷¹ Spain (5 percent),⁷² and Thailand (5 per cent for copyright royalties and 15 percent for other royalties).⁷³ Most of the tax treaties further provide that the rules applicable to royalties are also applicable to income from the sale of the industrial property rights.

In order to permit the German licensee to pay the royalty without deducting the normal 25 percent withholding tax, the licensor must file a written exemption application with the competent German tax office on a special form, whereupon the licensee would obtain an exemption certificate.⁷⁴

While exempting royalties from the tax of the licensee's country, the tax conventions also emphasize the principle that royalty rates must be normal and at arm's length. To the extent the royalties are excessive, the tax authorities of the licensee's country may allocate the excessive amounts to the income of the licensor and tax them accordingly.

Royalties to United States Licensors

The tax convention between the United States and Germany prior to its amendment in 1965 was interpreted by the German tax authorities to

⁶⁴ Cf. for example the tax treaties with Canada, Art. VIII (5); Luxembourg, Art. 15 (5); U.S.A., Art. VIII (4).

⁶⁵ Art. 12 (1).

⁶⁶ Art. VIII (2), except for copyrights.

⁶⁷ Art. VII (2), except for copyrights.

⁶⁸ Art. XVI (1).

⁶⁹ Art. 14 (2), except for copyrights.

⁷⁰ Art. 12 (2).

⁷¹ Art. 15 (2).

⁷² Art. 12 (2).

⁷³ Art. 12 (2).

⁷⁴ § 73h *Einkommensteuer—Durchführungsverordnung*—Income Tax Regulations; Joint Ruling of the State Tax Authorities of October 30, 1968, BSStBl (1968), I, p. 1184.

the effect that royalties for "intangible know-how" were not exempt from the German income tax. The exemption of Article VIII of the Convention was granted only to royalties for registered industrial property rights and for "tangible" know-how, such as samples and demonstration pieces.⁷⁵ In the Memorandum of Understanding to the Protocol of September 17, 1965, amending the 1954 Convention, Germany reserved the right to maintain its peculiar interpretation of the old Article VIII for all royalties which had accrued until December 31, 1962. Now, and too late indeed to aid many, the Federal Tax Court disagreed with the administration and exempted royalties for all kinds of know-how under the 1954 version of the treaty as well.⁷⁶

The new Article VIII of the United States-German Tax Treaty applicable since 1963 now explicitly excludes know-how royalties from the tax. It provides in Sections (2) and (3):

- (2) Royalties derived by a resident or corporation or other entity of the United States shall be exempt from tax by the Federal Republic.
- (3) The term "royalties," as used in this article,
 - (a) means any royalties, rentals or other amounts paid as consideration for the use of, or the right to use, copyrights, artistic or scientific works (including motion picture films or tapes for radio or television broadcasting), patents, designs, plans, secret processes or formulas, trademarks, or other like property or rights, or for industrial, commercial or scientific equipment, or for knowledge experience or skill (know-how) and
 - (b) shall include gains derived from the alienation of any right or property giving rise to such royalties.

Effect on Dividend Taxation to the United States Licensor

The United States-German Tax Convention in its amended version of 1965, is distinct from all other German tax conventions in that it creates a peculiar situation with regard to the effect royalty payments may have on dividend taxation. Article VI of the treaty provides that the German dividend withholding tax on dividends paid to a United States parent company shall be increased from 15 to 25 percent on that portion of any dividends that are deemed to have been reinvested in the paying German subsidiary.

Pursuant to the official German interpretation of Article VI of the 1965 treaty, the term "reinvestment" also includes the granting of

⁷⁵ See Korn-Dietz, *Doppelbesteuerung*, U.S.A., Art. VIII annot. 1 (1968).

⁷⁶ BFH of March 4, 1970, DStR (1970), p 469 (see *supra* note 19).

licenses to the German subsidiary-licensee.⁷⁷ It is hardly conceivable how this interpretation could be upheld in view of the language of the tax convention which deals with investments, rather than with agreements for the exchange of property based on a reasonable consideration.⁷⁸ Through leasing or licensing, the German subsidiary is not acquiring investment assets at the expense of the United States parent; it is not augmenting its financial potentiality. On the contrary, it assumes an obligation to pay royalties. This assumed obligation is equal to the value of the property rights licensed to it. Consequently, an investment does not occur, provided that the royalties are not below a fair and reasonable level. Furthermore, the Regulations are silent on the method of valuating the "investment" in the case of a license.⁷⁹

It remains to be seen whether a United States taxpayer affected by this German interpretation of the new treaty will take the issue to the Treasury Department of the United States pursuant to Article XVII of the treaty claiming to have been adversely affected by an action taken by the German tax authorities in applying the convention.

Property Tax

The property tax usually follows the income tax. Germany's right to tax domestic property of foreigners ceases to exist where a tax convention so provides.⁸⁰

A large number of the tax treaties entered into by Germany also cover the property tax.⁸¹ With regard to royalties, these treaties either expressly provide that only the country of the licensor may levy this tax or the treaties state in a catch-all provision that with regard to any kind of income or property not otherwise dealt with by the treaty, only the country of the recipient or owner, respectively, shall have the right to tax.⁸² This results in an exemption of the foreign licensor from the

⁷⁷ Joint Ruling of the State Tax Authorities of June 3, 1966, BStBl (1966), II, p. 143, sub A No. 4 (3).

⁷⁸ See the controversy on this subject matter between Bellstedt, "Reinvestitionen' nach dem neuen deutsch-amerikanischen Doppelbesteuerungsabkommen," AWD (1966), pp. 363-364, and Debatin, "Wertungen und Auslegungen zum revidierten deutsch-amerikanischen Doppelbesteuerungsabkommen," AWD (1966), pp. 413-419 (416-418); see also Hohensee-Bellstedt, *supra* note 5, pp. 236-238.

⁷⁹ See *supra* note 77.

⁸⁰ § 9 No. 2 *Steueranpassungsgesetz*.

⁸¹ See the tax treaties with Argentina, Austria, Belgium, Ceylon, Denmark, Finland, France, Great Britain, Greece, Ireland, Italy, Japan, Luxembourg, Netherlands, Norway, Spain, Sweden, Switzerland, Thailand, and the U.S.A.

⁸² See, e.g., Art. XIV A (4) of the U.S.-German Tax Convention.

German property tax on royalties. The exemption is granted regardless of whether a property tax is actually levied by the home country of the licensor.⁸³

In the situation where there is no special royalty clause or catch-all provision in a tax treaty,⁸⁴ or where the property tax is not covered by the treaty in the first place,⁸⁵ the general rules of taxation apply.⁸⁶

⁸³ Hohensee-Bellstedt, *supra* note 5, p. 48; BFH of July 7, 1967, BStBl (1967), III, p. 588 (concerning Sweden).

⁸⁴ *Cf.* the tax treaty between Germany and Argentina.

⁸⁵ *Cf.* the tax treaty between Germany and the United Arab Republic.

⁸⁶ See Hohensee-Bellstedt, *supra* note 5, p. 16.

Unfair Trade Practices Relating to Industrial-Intellectual Property

INTRODUCTION

The CLINIC ON UNFAIR TRADE PRACTICES held on April 29, 1970 is a natural sequel to the Clinic on Trade Secrets reported in *IDEA* Volume 14, Number 2 (Summer 1970). Both are part of the Institute's continuing Clinic series held at the headquarters of the Institute in Washington, D. C.

A small group of invited experts from industry, government, and education participated. Moderator of the Clinic was S. Chesterfield Oppenheim, Adviser on Research of The PTC Research Institute and former Professor of Law, the University of Michigan. The Clinic was opened by L. James Harris, Director of the Institute. It was organized around three principal contributions by Albert C. Johnston, Senior Partner of Keith, Johnston & Isner, George D. Cary, Deputy Register of Copyrights, U.S. Copyright Office, and Professor Oppenheim. These principal statements and the discussion that they engendered comprise the bulk of the Proceedings which are reported below. A list of Clinic participants follows:

Andrew B. Beveridge	—Senior Partner, Browne, Beveridge and DeGrandi
George D. Cary	—Deputy Register of Copyrights, U.S. Copyright Office
Horace B. Cooke	—Special Consultant, The PTC Research Institute
Paul M. Craig	—Senior Partner, Craig, Antonelli, Stewart & Hill
William H. Dyczko	—Senior Counsel, RCA Records
John C. Green	—Project Leader, International Trade and Development Studies, The PTC Research Institute; Scientific Communications and Research Consultant, Washington, D.C.
L. James Harris	—Director, The PTC Research Institute; Professor of Law, The National Law Center, The George Washington University
Albert C. Johnston	—Senior Partner, Keith, Johnston & Isner
Wallace R. Johnston	—Thomas Alva Edison Fellow, The PTC Research Institute
Edward F. McKie	—Partner, Birch, Swindler, McKie & Beckett
Frank L. Neuhauser	—Patent Attorney, General Electric Company
Helen W. Nies	—Partner, Pattishall, McAuliffe & Hofstetter
S. Chesterfield Oppenheim	—Adviser on Research, The PTC Research Institute; formerly Professor of Law, University of Michigan
Hiram P. Settle, Jr.	—Partner, Cullen, Settle, Sloman & Cantor
Carrington Shields	—Attorney, Lee, Toomey & Kent
Richard C. Steinmetz	—Attorney, Allen-Bradley Company
Clyde F. Willian	—Attorney, Hume, Clement, Hume & Lee, Ltd.

Proceedings of the Clinic

DIRECTOR L. JAMES HARRIS: On behalf of The PTC Research Institute of The George Washington University, I want to welcome you to the Clinic on Unfair Trade. For those of you who haven't attended our previous clinics, the purpose of the Clinic is to develop a more effective instrument of communication. Our Clinic concept is intended to bring together experts to speak to experts, packaging this hard material, and sending it to interested publics—and, incidentally, without any effort, time, or expense on the recipients' part we seek to deal in depth with frontier problems, to develop generally inaccessible information, and to make a record that we can use for additional research of the Institute.

To accomplish this purpose, we invite a team of leading specialists representing a range of disciplines. They are selected for their position and for their experience. What we're attempting to do is to diagnose the problem, to instruct, and, if possible, to remedy. To do so we must let our hair down. Of course, we don't want any company secrets, but we've got to tell ourselves the facts and there's got to be a maximum of trust among professionals. We hold these deliberations in confidence. The proceedings will be published only after the participants have had an opportunity to edit their remarks.

We find that this kind of frank and open discussion is best accomplished under the aegis of an educational institution, such as the Research Institute within the University. The Institute undertakes this type of Clinic as part of its research function and as part of its work in the public interest.

This Clinic was preceded by a Clinic on Trade Secrets. This Clinic, spotlighting misappropriation, is a natural sequel. The subjects of these two clinics are very timely or, in current terminology, "relevant" in view of increasing employee mobility; increasing loyalty of employees to their discipline and decreasing tie to company; decreasing respect for the "establishment" by young people; technological explosion, making it more difficult to sort skill from secrets; increasing national and international competition, greater number of companies, employees, and products on

the market; increasing technological information transfer to developing countries; attitude of the courts in *Sears-Compco*, *Lear v. Adkins*, and other cases; decreasing respect for law and order in certain quarters; problems of community service and hard core employment with which companies are now involved; changing patterns of federal contracting for goods and services; opportunities for ethical underpinnings in engineering and other kinds of education; and the need to plan for diversification and conversion to new products in defense-oriented companies.

The format of the clinics, of course, depends on the subject under consideration. In *Unfair Trade*, we will commence with Albert Johnston—when he arrives. He will talk on trade secrets versus patent protection. A brief period for cross-questioning to clarify the points made by each speaker will follow each of the three scheduled speakers. Since you haven't received the papers, before the speaker introduces the subject, you will be given this opportunity to clarify. The second paper was to be presented by Professor Burrus on recent developments in cases involving the effects of *Sears* and *Compco*. Unfortunately, Professor Burrus is ill; we have just received word that he will not be able to participate. The third paper will be given by George Cary on recordings. All of the Clinic participants will thereafter engage in a free discussion. The Moderator-Commentator, whom you all know, is Professor Oppenheim, Adviser on Research to the Institute and former Professor of Law, University of Michigan. A former super-professor of law of The George Washington University for 25 years, and an internationally recognized authority on antitrust and unfair trade practice law, he is universally admired and known to all of us as Oppie.

This is the 20th anniversary of the signing of the Declaration of Trust of the Institute—you must have noticed the signs to that effect as you walked in. This is our Charter Vicennial Celebration. As a result of a resolution and referendum of the American Patent Law Association, the University undertook the establishment of this Institute back in 1950. The President of the University, then Cloyd Heck Marvin, signed the Declaration of Trust on August 3rd, 1950.

Luncheon will be served at 12 o'clock in the Adam's Rib restaurant on the ground floor of this building. That means we will probably recess at 11:45 and recommence at 1:15. The luncheon will not be taped and we don't want to lose too much valuable information. We'll want to bring that back to the Clinic. The Clinic will run until 5:00 p.m. If you wish to speak, please raise your hand and the Moderator will recognize you. In order to make a good tape recording of the Clinic, please identify yourself before speaking. This procedure is essential for an accurate

transcription, but keep it informal so that we don't lose spontaneity. Professor Oppenheim.

S. CHESTERFIELD OPPENHEIM

Mr. Director. What we are trying to cover today is an interchange of ideas on certain major topics involving, to a great extent, the interaction of unfair competition and patent law and copyright law, as reflected in recent judicial decisions and legislative proposals. All of you know that the unfair competition doctrine has expanded from what was originally a misrepresentation approach, a narrow "passing off" which was later expanded to other forms of misrepresentation. Then came the *International News* case, 248 U.S. 215 (1918) which some heralded as a milestone, introducing the concept of misappropriation. Of course, that might beg the question. If there is appropriation of values which may equitably belong to another—that is a misappropriation. However, if it is privileged conduct, it is fair competition.

Unfair competition is really a branch of the law of business torts—business wrongs. If there is any vitality in *International News* doctrine, it is considered to mean that, in addition to misrepresentation, the law of unfair competition will protect against a misappropriation of the efforts, labors, expenditures, of others, and commercial utilization of those values in a way which we consider to be unfair. Edward Rogers, one of the notable authorities in the trademark and unfair competition fields, years ago asked in one of his discussions with students, how would you define unfair competition? Various definitions were offered and finally one student spoke up and said, "It's just a bag of dirty tricks." Mr. Rogers thought that was just about as good a definition as one could formulate. It's like trying to define invention, for example.

I think that we are witnessing right now a tug-of-war between marking out the scope of protectible interests, in the patent and the copyright fields, in trade secrets, and unfair competition either primarily through the judicial process or primarily through the legislative process. But judges usually have the last say. When legislation is enacted, we know that it can't always be drafted in such explicit terms that there's no room for interpretation. So we do have the intervention of the judicial process

for construction of the statutes and on this the courts have the final say. The Supreme Court, for example, has the final say on what the Constitution means. A little bit of judicial legislation is thrown in at times—I think maybe more than a little bit.

Various federal legislative proposals are relevant to our discussion. Recommendation 22 of the President's Commission proposed a "rule of reason" approach to patent license limitations. There is a section in the pending McClellan Bill to amend Section 43(a) of the Lanham Act by setting forth various unfair practices deemed actionable in interstate or foreign commerce. There are proposals for copyright revision. The courts ultimately will be the tribunals to interpret such legislation if it is enacted.

In 1958, I had the privilege of writing a paper on "The Judicial Process in Unfair Competition Law" as my Kettering Award address which was published in Volume 2 Conference Supplement (1958) of *IDEA*. At that time I expressed the hope that a judicial rule of reason approach could reconcile effectively the different conflicting interests in unfair competition cases and offer more promise than legislation. We have to have some legislation, but, as I said, the courts finally tell us what the statutes mean. But as of 1970, I might well have second thoughts on my advocacy of primary reliance on the judicial process. I think that recent judicial decisions and the developments that we're going to talk about today may make one wonder whether you can always have a public interest resolution of conflicting interests through the judicial process. We have conflicts between federal law and state laws. Is there federal supremacy or federal preemption? How much intrusion on state court jurisdiction will result from federal court decisions, particularly Supreme Court decisions, as in *Compco* and *Sears* and *Lear v. Adkins*. These are the kinds of questions we're faced with this morning.

At this point I should tell you that we had invited Professor Bernie Burrus of Georgetown University Law School to tell us about developments in the courts since *Compco* and *Sears*. His wife called me this morning to say he has laryngitis and will not be able to be with us. Professor Burrus teaches Unfair Trade Practices and Antitrust Law and is held in high repute in these fields.

Albert Johnston, who was scheduled to be our first principal discussant, is on a delayed flight from New York City but we expect him shortly.

DIRECTOR HARRIS: In the meantime, Oppie, why don't we have some of your thoughts on *Compco* and *Sears*? They should be very interesting.

PROFESSOR OPPENHEIM: Well, I'll try some off the cuff comments.

One of the major questions, of course, which hasn't been fully settled, is whether *Compco* and *Sears* explicitly or in effect overrules the *International News* case. This was answered in the affirmative by the ruling of the court in the *Paladin* case, *C.B.S. v. De Costa*, 377 F. 2d 315 (1st Cir. 1967), which held that the *Compco* and *Sears* case does bar relief under state law for misappropriation of a character, like *Paladin*. So, the court ended up by saying that if the *Paladin* card, "Have Gun, Will Travel," with the insignia of *Paladin's* gun in a holster, had been copyrighted, that might have come under copyright protection. We'll be asking George Cary about that case later when he discusses certain copyright problems. Professor Walter Derenberg is convinced that the *Paladin* ruling that *International News* is no longer authoritative is a judicial misreading of *Compco* and *Sears* and that there are other decisions since *Compco* and *Sears* which make it clear that *International News* still has vitality. (See Derenberg, "Proposed Federal Legislation on Unfair Competition" in The PTC Research Institute's *Nurturing New Ideas*, pp. 343-348 (1969).)

There may be confusion in *Compco* and *Sears* between the copying of functional features of a non-patented article, and copying of a collocation of non-functional features which acquire secondary meaning. I think it is interesting to point out that *Compco* really wasn't a case of first impression in a literal sense. Prior to *Compco* and *Sears*, we had the famous *Singer Sewing Machine* case, *Singer Mfg. Co. v. June Mfg. Co.*, 163 U.S. 169 (1896). I'm just trying to see if my association recalls will work all right on this subject. The question in that case was whether the name "Singer" had become a generic designation for a type of sewing machine and had fallen into the public domain free for the use of all others. The *Singer* case shows that the fact that there originally was patent protection on the machine, and the patent expires, does not necessarily mean that you can have an absolute right in continuation of a name of the product which has become generic. However, *Singer* was entitled to some remedial relief to avoid confusion as to source, to distinguish *Singer's* manufacture from that of another company using the word "Singer" in its generic connotation.

And then, of course, came the famous aspirin case. The word "aspirin" fell into the public domain as the generic name of that drug. But the case that comes closest and I think is really a parallel to *Compco* and *Sears*, is *Kellogg v. National Biscuit Company*, 305 U.S. 111 (1938), where Justice Brandeis, writing for the Court, held that the pillow-shaped form of the shredded wheat biscuit was functional and therefore free for use by any competitor of National Biscuit.

I remember being at the Kellogg plant in the summer of 1922 when Kellogg was experimenting with the pillow-shaped biscuit. Kellogg was trying to get a shredded wheat biscuit to become pillow shaped and also to heat evenly to avoid burning. It took a few years after that for Kellogg to launch the product on the market, and of course the suit was later brought by National Biscuit Company. There you have a classic example, at least from the standpoint of a decision based on the functional features of the biscuit. The other side claimed that the features were non-functional, but there was evidence both ways. Certain features were claimed to be also important for the packaging of the product to prevent breakage.

In the absence of a patent, functional features, namely, those which are essential to the production and commercial use of the product, or its marketing, are open to free copying, provided there's no patent protection. There may be a design patent, which of course would provide that much protection. There may be a trademark, which also would be protectible even after the patent had expired, if the mark is not generic.

Professor Derenberg and Rudolf Callmann, as you know, are vigorous supporters of the expansive concept of trademark protection, and I may say that I find myself quite sympathetic to that. I think the Lanham Act was designed to expand protection of trademarks beyond what existed before. Derenberg thinks that one great threat of *Compco* and *Sears* may be the failure of a proper reconciliation of permissible copying of the article itself—product simulation—while preserving relief where there are additional acts of unfair competition, such as misrepresentation of source or misappropriation. You recall that the Supreme Court in *Compco* and *Sears* said that the state law couldn't stop this copying of the product per se, the simulation of the product, but, of course, if the law of the state prohibits passing off, then you could have relief against confusion of the source.

There's one thing that I think is very attractive about the *INS* doctrine and that is, basically it's an unjust enrichment doctrine. I am against giving a competitor a "free ride" on his rival's labor and expenditures. If we have a private competitive enterprise system, it seems to me that, on balance, we have to prevent someone riding on the back of another who has created something, even if it isn't patentable, and has expended great efforts and money to bring it to the point of commercial feasibility and marketing. I don't like a "free ride" on something not already in the public domain.

I also think that one of the difficulties about this whole area is this loose use of the word "monopoly." In an antitrust context we know that

under Section 2 of the Sherman Act, monopolization first requires proof of monopoly power. We know monopoly there means an honest-to-goodness kind of power to control the market price and to exclude competitors from the market. That is truly a foreclosure of competition. And if there's an intent or deliberate purpose to maintain a monopoly, then we have a monopolization. If there's an attempt to monopolize, you must prove a subjective intent.

That's a far cry, it seems to me, from what I have called differential advantages and disadvantages possessed by persons or business firms. I think that not only our private enterprise system, but communism and socialism, involve differential personal and commercial advantages and disadvantages.

These differential advantages a business or a person possesses obviously mean that in a competitive system rivals are correspondingly placed under differential disadvantages. Yet it would be fallacious to brand the differential advantages as "monopolistic" in, let us say, an antitrust sense. A patent grant, to be sure, gives the patentee for a limited time exclusive rights—the right to exclude all others from practising the patented invention except under a license from the patentee. But even that so-called temporary "legal monopoly" of a patent grant does not totally exclude competition. Apart from an occasional basic patented invention, there is competition between patented improvements in products and processes. So in a real sense, many patents involve temporary differential advantages with competition among reasonably interchangeable substitutes. Likewise, there are competitive substitutes for various copyrighted works and for products differentiated by trademarks or secondary meaning trade names. Trade secrets also do not totally block out competition and hence are not "monopolies" in an antitrust sense.

This is to me a very revealing concept. It teaches that we should avoid the misuse of the word "monopoly" in an antitrust context when we are really dealing with differential advantages of some persons or business competitors which, after all, are not perpetual.

Let me first cite some examples of what I mean in personal talents or status. Caruso, and Bing Crosby and Frank Sinatra were apparently born with vocal cords which produce voices none of us could hope to emulate successfully. These are little exclusivities of talents. Think about star performers on TV, a Bob Hope, a Jack Benny, a Jackie Gleason, a Red Skelton. Each one of them has certain differential advantages as comedians, don't they? Marcel Marceau, the famous mime, is considered a genius in that art. But that does not give him a "monopoly" on mimicry. Red Skelton and Jackie Gleason are also excellent mimics.

Turning next to commercial differential advantages in business, I think that the law of unfair competition is suffused with examples of differential commercial advantages in the marketplace. The trademark "Coca-Cola" is a prime example. That beverage got off to a great headstart. To this day some consumers think that its flavor can't be duplicated in other "cola" beverages. But Coca-Cola does not have a monopoly in the antitrust sense. There is the trademark "Pepsi-Cola" and many other cola beverages and the "uncola" 7-Up beverage.

These are all differential competitive advantages in the marketplace which are interests deserving of legal protection through the judicial process of balancing the equities between competitors and non-competitors. In *Compco* and *Sears* and in *Lear v. Adkins*, there's a common thread of the idea that the antitrust laws, the patent laws, copyright laws and trademark laws all have the common purpose of promoting and maintaining competition. But, as we have said, even the exclusiveness of the patent grant, or the prohibitions on infringing copyrighted works through copying or on infringement of trademarks, as well as remedies against misappropriation of trade secrets, do not create the kinds of monopoly power deemed illegal under the antitrust laws. In sum, our economic society is studded with little exclusivities which are not incompatible with a competitive order.

When I was employed by the Kellogg Company of Battle Creek, Michigan many years ago, I could go through the entire plant except the flavor extract room. That formula was a trade secret. It was under lock and key and under guard, because the thought was that no one was going to be able to imitate the flavor of the Kellogg corn flakes. When Post Toasties came out, it really wasn't exactly the same flavor. That's a differential advantage, but we have a lot of other dry cereals today with different flavors. Kellogg itself has a diversity of dry cereal products.

Schumpeter, the famous economist, referred to the perennial gale of creative destruction. By that he meant that things are always being outmoded, obsoleted, and with our technology today that's more true than ever. When we come to a discussion of trade secrets I hope someone will comment on the rate of obsolescence of trade secrets. We might have a study some day to find out how long trade secrets really last. What kind of trade secret is it? Trade secrets are also not complete "monopolies" because there is constant competition in trade secrets possessed and protected by individual companies.

At the recent PTC Research Institute's Trade Secret Clinic, I was talking about Sherman Act cases involving trade secrets and corporate raids of key employees of a competitive company. One case involved rack

jobbers. I couldn't see a heck of a lot of trade secret knowledge about how to rack up Campbells Soup on an A & P or Safeway shelf. And yet, the court had to decide whether training salesmen to rack products on shelves of the store is a kind of differential advantage that's a trade secret and has value deserving of legal protection. Of course, the problem today is not racking them up; it's finding the shelf space to rack the products. That, too, is a differential competitive advantage for a chain store supermarket with greater shelf space than the small independent "pop and mamma" store. I'm going to stop now and hope that some of you will start discussing *Compco* and *Sears* as you analyze the effect of those cases.

HELEN W. NIES: I have a question, on whether you think—to the group, and you particularly—what effect the *Sears* and *Compco* case had on state trademark laws. Do you think there is any vitality left in state registration?

PROFESSOR OPPENHEIM: I think that the proposed federal unfair competition bill, as Derenberg sees it, and Callmann would agree, is a manifestation of what you're talking about. In other words, with *Erie Railroad v. Tompkins*, came a "checkerboard," as some thought, of state court decisions on unfair competition-multistate actions. *Compco* and *Sears*, it seems to me, might develop a more insistent demand for a federal unfair competition law. This is why I said that I'm having second thoughts. I think as of today I wouldn't be so sure of myself in saying that legislation is not to be preferred to the judicial process. I think a federal unfair competition statute today would carry more persuasiveness in view of what's happened in *Compco* and *Sears*, which may preempt a great area of what was considered proper state legislation on trademarks and state court suits to protect trademarks and to prevent other forms of unfair competition. But I'm hoping that Derenberg is right in saying that, while it looks as if *Sears* and *Compco* might be sweeping away state law protection and intruding to a great extent on jurisdiction of state courts, maybe the federal courts will exercise restraint in not thinking that *Compco* and *Sears* means a conquest in the federal field under the federal supremacy and preemption doctrines.

MRS. NIES: When federal law moves in, it supplants state laws.

PROFESSOR OPPENHEIM: It does. Professor Derenberg's article to which I referred earlier reviewed cases since *Compco* and *Sears*. The net effect of it is to show that the courts are alert to the danger of proceeding too far with federal preemption. He cites a number of cases to show that. Then he comes to the *Paladin* case I mentioned earlier. He criticizes the ruling very vigorously and also thinks that matters were made worse by

the court's suggestion concerning copyright registration of Paladin's card. George, I wonder what you think about the copyright aspect.

GEORGE D. CARY: As I remember it, in the *Paladin* case, the court felt that he had in effect published the cards without any copyright notice on them. Therefore, they were in the public domain. But, query: if the cards had been protected, would that protect the character Paladin? As I remember, all he had on the card was his name, and "Have Gun Will Travel," contact Paladin, and telephone number, or address. I fail to see whether this would have done him any real good. But one aspect of that case that did impress me was that the court came out very strongly to indicate—incidentally, it's probably the only case that has ever gone that far—that it was possible to protect a character by copyright. Characters have, under the law of copyright, more or less been considered stock creations and therefore not subject to protection. Although Learned Hand, in one case, did indicate that it wasn't impossible to protect a character in an unusual situation such as Shakespeare's creation of Malvolio and Falstaff which were very outstanding characters. They were the very essence of the play, and perhaps in that situation you might find the character was protected. But, outside of that one reference, until you got to the *Paladin* case, characters per se were not thought to be protected. But, going back to *Paladin*, I don't see that there is any real indication that a copyright on the card would have done Paladin any good.

PROFESSOR OPPENHEIM: Does the Office take a position on copyright protection of characters?

MR. CARY: I don't know that anybody's tried to copyright any characters per se. They usually will copyright a play or other dramatic work and of course try to argue in court that the play contains a protected character. The motion picture, "The Maltese Falcon," included the character Sam Spade, for example, which the court held not to be subject to copyright, but we just don't get any applications for characters, per se.

FRANK L. NEUHAUSER: Oppie, I'd like to get back to Mrs. Nies' question on state trademarks. I have not reread *Sears* and *Compco* recently. It is not my recollection, however, that they necessarily would downgrade the value of state trademarks, because they left completely open the labeling aspect of which trademarks would be one. I would not think state trademarks would be materially weakened, per se, by the *Sears* and *Compco* cases. I'm not sure how much I want state trademarks, just as a broad proposition, but I wouldn't be deterred, at least this is my reaction, by the *Sears* and *Compco* cases.

DIRECTOR HARRIS: Wasn't the thrust of the cases in the direction of federal copyright and patent preemption?

MRS. NIES: Yes, I think so.

DIRECTOR HARRIS:—rather than on trademark vitiating?

MRS. NIES: It was my thought in reading the case again that it did have the effect of vitiating many or all state registrations, even though this particular question wasn't involved in the case at all. The question I have in my mind is, what is the value of a state registration where someone has a prior federal registration and then someone else adopts and registers the same mark in a state where the federal registrant is not using that mark? What possible value could that state registration have? The decisions show that as someone moves into a state under a federal registration they're entitled to preclude use within that state of a similar mark. Does it make any difference if that mark is registered in the state? To me, *Compco* and *Sears* says, No, the state registration has no effect, because federal law is there.

PROFESSOR OPPENHEIM: Well, there might be a qualification on that, Helen. For example, this might make relevant the *Mogen David* case decided by the CCPA in 1967, *Mogen David Wine Corporation* (372 F. 2d 539), which I'm sure you are familiar with. In that case, there was a configuration of a decanter wine bottle, and it had developed secondary meaning. The court held that therefore it was registrable under the Lanham Act even though the configuration also complied with the design patent law. The court said that it was a case of first impression and that both trademark registration and design patent may subsist at the same time. It would be immaterial whether you got the design patent first or whether you registered your mark first. This, to me, has this implication. The court, in that case, made it very plain that when we talk about *Compco* and *Sears*, and patent and copyright protection, we shouldn't lose sight of differences in what was intended in the federal laws, like the Lanham Act, with respect to trademark rights. We know trademark rights stem from common law, from adoption and use, and the mark can, of course, also be further fortified with registration and resulting remedial advantages. But the court made it clear that it thought that *Compco* and *Sears* shouldn't be so quickly generalized into a fear of preemption of state trademark protection, or that the federal registration of a mark is itself preemptive. The court said that the trademark rights, for example, don't extend the patent monopoly. Expiration of a design patent might give anybody an absolute right to copy the configuration of a bottle. I'm inclined to think, as Mr. Neuhauser indicated, that we haven't seen the demise of state trademark

protection. I think you're raising the question of whether there's been a dilution of the scope of protection of trademarks under state law. Perhaps state trademark registration hasn't been too effective anyway.

MRS. NIES: No.

PROFESSOR OPPENHEIM: I suppose that's why some would like to see a uniform state trademark registration statute.

MRS. NIES: But as a practical matter in advising a client whether they should get state registrations, it would be helpful if we did have a statement of some kind by a court on whether it does have any validity independent of your federal registration.

PROFESSOR OPPENHEIM: Certainly. My own feeling would be, if I were asked to advise on that, I would certainly counsel to go ahead full steam with the idea that the preemption and the supremacy concept in *Sears* and *Compco* would not necessarily drastically cut down the scope of state law protection. In *Compco* and *Sears* there was product simulation and I hope that the Supreme Court will confine it to that kind of a case where the court is satisfied that you're trying to prevent competition in copying the product itself, a Chinese copy or a colorable simulation thereof. I'm hopeful that the Supreme Court is not going to allow outright or gross passing off practices with confusion of source. That can be avoided by requiring distinguishing matter.

MR. CARY: A question, which may tie in with Mrs. Nies' inquiry: to show my ignorance about trademarks, I will only suggest this. There are quite a few cases in the copyright field since *Sears* and *Compco*, which indicate that the courts are not always going to buy the *Sears* and *Compco* doctrine, at least in the copyright area where there has been a complete appropriation of the work itself. One example that occurs to me was that somebody reproduced a record of a reporter's comments with respect to the assassination of President Kennedy, as I recall, and one of the defenses was that *Sears* and *Compco* applied and there was no protection here. However, the court said that *Sears* and *Compco* did not apply where the thing that is appropriated is the entire substance of the matter—in other words, the record of the man's voice. There have been other cases along the same lines, so I wonder whether the doctrine might be applicable to trademarks, too. I just ask you the question—I don't know.

ANDREW B. BEVERIDGE: George, didn't you have some cases on architect's plans in the copyright area? This would be getting into the functional feature, somewhat like the patent side—you have a structure built from the plan, but the plans are copyrighted, and I believe that they reflect the doctrine there.

MR. CARY: In *Woods v. Skene*, I think it was a Massachusetts case.

PROFESSOR OPPENHEIM: Anyone else? I think it might also be helpful to refer to Walter Derenberg's article in The PTC Research Institute's volume *Nurturing New Ideas*, pp. 343-348 (1969). For example, he cites one case in which the court said it did not read *Sears and Compco* "as striking down or intended to strike down all state laws of unfair competition in all cases and for all purposes."

An Illinois court held to the same effect with respect to trade secrets. A Pennsylvania court said it didn't consider the famous early decision in *INS* overruled by *Sears and Compco*. So, up to the *Paladin* case, which Derenberg also cites, it seems there is a belief that the federal courts and state courts aren't going to tumble into a complete federal preemption doctrine.

In the evolution of judicial doctrines, one of the difficulties is simplistic over-generalization. Of course, everyone knows that you can't protect ideas as such, but when you have them embodied in something, there may be legal protection. As Justice Frankfurter said, trademarks are great symbols that impregnate the market with the association of a particular source, and they then become valuable assets. The *Compco* and *Sears* opinions appear to state over-simplifications. The partial dissent of Justice Black in *Lear v. Adkins*, which will be discussed later, contains another over-simplification. Federal policy favors open competition in ideas, and things in the public domain should be free for people to share. But the initial question is what is in the public domain?

MR. CARY: Quoted with approbation.

CLYDE F. WILLIAN: Doesn't it get down to this—that on the present Court, Black and Douglas interpret the *Sears-Compco* cases in a broad philosophical way, and they intend it in a broad philosophical way. And I think that is best illustrated in *Lear-Adkins* when you compare the majority opinion versus Black's statement there. For example, on the question of pre-patent royalties, Harlan says we haven't decided that question yet. As I recall, Black says we did decide that; we put that to rest in the *Sears-Compco* cases. So I think your remark—about if the composition of the court changes we may very well see a difference of attitude in interpretation of those cases—is very well taken. As you and I have talked about a couple of times, we've already seen at least one court take heed of Black's attitude in the *Painton-Bourns* case, and I understand we're going to discuss that.

PROFESSOR OPPENHEIM: Oh, indeed, indeed. Any other comments?

WILLIAM H. DYCZKO: We in the record industry, of course, have been faced with *Sears-Compco*. Our product is non-patented, not copyrighta-

ble today. But, in addition to the case that George Cary mentioned, in pursuing pirates, unauthorized duplicators, we've been successful since *Sears and Compco* in both New York and California in overcoming this defense—that's the stock defense that all the pirates use, they just point to *Sears-Compco*. We have in the California state court of last resort a decision¹ now that there is a civil action by a record company producer despite the maintained defense of *Sears and Compco*. I don't know—I think there's some movement to try to get the question to the Supreme Court. I don't know how successful they will be. But there's a parallel action in California. We were successful in getting a criminal statute passed, but it's not being enforced by the enforcement authorities because an association of tape duplicators, some of them defendants in the civil action, have sued the Los Angeles city attorney and the Los Angeles County District Attorney to enjoin enforcement on the grounds, among others, that the criminal act is unconstitutional.² That's going to be argued before a three-judge federal court in the next month or so.³

But, I think the significance on the civil side is that during the pendency of this order to enjoin enforcement of the criminal act, the California Supreme Court refuses to review an opinion of the Appellate Court sustaining injunctions that we have obtained against pirates, some of whom are plaintiffs in the criminal—in the Declaratory Judgment Act. So our theory is—I think George and you have alluded to it—that this is not product simulation at all—this is an appropriation of the very product itself. It's just plain theft, the record industry feels, to use a colloquialism, it's certainly unjust enrichment, and at least in New York and California and one or two other states, the courts have listened to us.

You have a paradox in the record industry—our whole business is built around one section of the copyright act—one needs a mechanical copyright license and yet our product is not copyrightable. We have another paradox. A record is not deemed to be a copy of any copyrighted musical work which is embodied in it, yet a piracy of one of these records constitutes an infringement of the musical work. We have to rely on the unfair competition aspect. We're hoping to correct that if they ever pass the omnibus copyright revision, but I guess that's just a matter of hope

¹ *Capitol Records, Inc. v. Richard W. Erickson et al.*, 2 Cal. App. 3d 526, 82 Cal. Reporter 798. On June 15, 1970 the Supreme Court of the United States denied the petition for *certiorari*. This should dispose of any question about civil liability as against *Sears and Compco* in the California courts, and as a practical matter, in the federal courts, in California.

² *Tape Industries Association of America, et al., v. Evelle J. Younger, et al.*, United States District Court, Central District of California, No. 68-1938-AAH.

³ Oral argument has been completed, subsequent briefs filed, and presently the decision of the three-judge court is being awaited.

springing eternal. However, with respect to post *Sears* and *Compco* cases even though we are in the non-patented, non-copyrightable area, we've been encouraged. There's only one court in the land that you mentioned, a state court in Chicago, Illinois, in which we were refused relief—and when I say we, I'm talking about members of the industry, not necessarily my own company, in each case. In Illinois a judge in a lower court denied a preliminary injunction on the ground the record is not copyrighted, this after we had gone through all of the prior history in New York and California, suggesting he see some persuasive authority there, but he just went off on the proposition that there is no copyright in a record, so we are in the process of appealing.

DIRECTOR HARRIS: May I ask a question, Mr. Chairman?

PROFESSOR OPPENHEIM: Oh, yes, indeed.

DIRECTOR HARRIS: Previous to *Sears* and *Compco*, did you have a good deal of success in protecting against record duplication on the basis of misappropriation?

MR. DYCZKO: Yes.

DIRECTOR HARRIS: Around the country?

MR. DYCZKO: One of the first cases, around 1909, was right after the copyright act was passed, and relief was granted on a broad misappropriation theory really anticipating, I think, the *International News* case. It was later overruled. We ran into some problems, but essentially New York and California, being two of the greater entertainment jurisdictions, have been sympathetic to the problem.

DIRECTOR HARRIS: Even after *Sears* and *Compco*?

MR. DYCZKO: Even after. Yes, very definitely. Before and after; some of the significant cases were before *Sears* and *Compco*. You see, we have another practice in this industry—known as cover records, which are entirely legal, they're what you gentlemen in trademarks and patents might call imitations, but, what happens, for example, when we have a hit with Elvis Presley, or an underground group, such as Jefferson Airplane, some other record company will get its own artist and do the same tune and perhaps even try to come close to the original arrangement. But this is an acknowledged practice. If somebody gets a hit, everybody climbs on it, but there's no passing off, there's no simulation, no confusion about the artist—they're just trying to capitalize on the current popularity of the selection, or style, or "sound."

DIRECTOR HARRIS: So it's not misappropriation.

MR. DYCZKO: That's right if you are referring to piracy. But "cover records" are a perfectly acceptable practice in the industry. We distinguish what we call cover, which you might call imitation, from appropri-

ating the very thing itself, which is what the record pirates are doing. They're just taking someone else's recording and grinding out copies of it.

PROFESSOR OPPENHEIM: Mr. Craig is an expert in the international area. From a comparative point of view, if there is a broad concept of unfair competition, like in German law, don't you have more of a rule of reason against the per se approach, analogous to what we have in the antitrust field?

PAUL M. CRAIG, JR.: Well, I think the difference is basically—and I profess total ignorance of the actual statutory provisions in European laws—the difference between civil and common law is: in civil law, you have a statutory enactment which sets forth a broad principle and it is interpreted as applied to the facts; whereas in common law, statutory enactments tend to be very difficult bills that provide exceptions, and so forth, but which leave little room for interpretation. I think the basic problem in this whole area is the collision between the systems of federal and state laws in areas where you can make out a federal jurisdiction. Today, if you get into unfair competition, you can always try to say it involves a question of patent, trademark, copyright, or antitrust—and, even though it might be primarily one of tort, business tort, as you correctly call it, the minute you can bring it into some twilight zone where federal jurisdiction is exclusive, I think you are going to find difficulties between the two systems of law. And I think it won't make any difference what the composition of the Supreme Court is going to be, they will always set forth a preemptive jurisdiction in the federal area. And the only question is, how far are they going to extend the federal area through the twilight zone where two different issues might be involved and where the federal jurisdiction is appealed to primarily to avoid the state jurisdiction. This is going to be the area that has to be thrashed out. Of course, the Supreme Court is also not blind to the realities of the business development today and to the fact that the effective size of the states is shrinking with expanding technology. There is nothing today that is not tainted with interstate commerce. So, I think, this is the problem that we are faced with, and I'm quite in agreement with you that it would be desirable that we spell out, on a federal level, the unfair competition that ought to be enforced, be it by *Erie Railroad* or in some other way. I think if you don't, you can always say that the fact that somebody brings a suit involves a Section 2 approach to the business methods and then you are right back at the collision course between state and federal systems, and I have no doubt the Supreme Court will always, if they find a bonafide defense, say that the federal

jurisdiction has supremacy. I think we've got to spell it out more clearly on the federal level if we want to get anywhere.

PROFESSOR OPPENHEIM: It is interesting, for example, how the pendulum swings. *Swift v. Tyson* prevailed for a hundred years; then it was overruled in a Justice Brandeis opinion, and then we got *Erie Railroad v. Tompkins*, which generally applies state law. From what you say, Paul, I think that it may well be true that a federal law of unfair competition may be needed. As I said, I feel a little differently about my position in 1958 than I do today. If we're wrong in expressing the hope that the courts will reconcile *Sears v. Compco*, and the legitimate protectible interests in preventing misappropriation, then it seems to me, pressures will be building up until we get federal legislation. Because this is the beauty of our system. It's like checks and balances; where the judicial branch is unresponsive to what is considered by the business community to be indispensable for protection of private values, then they appeal to Congress for relief. I'm inclined to think that now a much better case can be made for some redefining of the federal area of jurisdiction; in other words, stopping this conquest of federal preemption and supremacy. In antitrust we have that problem all the time.

There's an excellent monograph written by one of my former students at Michigan, John Flynn, Professor of Law at the University of Utah, entitled "Federalism and State Antitrust Legislation" (*Michigan Legal Publications*, 1964). This is a depth analysis of the problem of the collision between federal and state laws and it presents an interesting picture. I think we're saying the same thing here, Paul. We also have the problem of pendent jurisdiction, which is another phase of this same problem, where you have a federal right like a patent or a registered Lanham Act trademark or a copyright, and then you have the pendent, unfair competition count. So it seems to me, we may be witnessing a development which may end up in federal legislation.

MR. CRAIG: Well, I think, if I may say one other thing, it seems to me that the areas that are staked for exclusive federal jurisdiction ought to be relied upon. It deals with the collision problem today. It seems to me that if there is need for remedial legislation, it ought to be tried there first, to take care of the very critical need of particular industries—recording industries and so forth—where we can change the copyright laws or anything else, rather than to stake out completely new laws. Then you're going to get into the question, is this going to pass Congress. If you take the garment industry, where they have had the theory many, many years that it ought to be open to all, you can argue the beneficial results from such policies. So, I think, trying to take a new tack by a new

law may not be the most effective way of achieving the desired aims; rather it would be better to amend the acts that exist today.

PROFESSOR OPPENHEIM: I just want to make one more comment and then we'll take pleasure in introducing Mr. Johnston, and that is, you might make a note of what happened in connection with state fair trade acts. You know that after 45 states had enacted fair trade laws legalizing contractual resale price maintenance, there was a setback by the Supreme Court in a decision which made those laws inoperative against non-signers, *Schwegmann Bros. v. Calvert Distillers Corp.*, 341 U.S. 384 (1951). I think Justice Frankfurter's opinion in that case has great relevance as an analogy to what we have here. The pressure grew until Congress enacted the federal McGuire Amendment giving effect to fair trade contracts where they exist in states where the goods are resold. Congress felt it couldn't have the temerity of saying that our federal system will defeat the public policy of 45 states with fair trade statutory enactments. So there's a good example of what happened when federal law preempted state laws. This is a question that's controversial. The McGuire Amendment at least leaves some of the state fair trade laws very effective, as in New York and California. Now, Al Johnston, we are very happy to greet you, welcome you. You're a great example of saying better late than never.

Knowing that you were in transit from New York, we shifted over to *Sears* and *Compco* and now we can come back to what we originally planned as our introductory discussion in one of the most intriguing areas, namely, the question of the alternative of trade secret protection versus patent protection. What's happening to the scope of protection of trade secrets and know-how in relation to patents, the effect of the dictum in the *Lear v. Adkins* dissenting opinion of Justice Black, and then *Painton v. Bourns*. On that basis, this is really a most important question at the moment. We know it's elementary Hornbook law that trade secrets is a branch of law of unfair competition and in certain circumstances may also be protected by a patent. But the question is, what is happening now? Is it sound public policy to have two systems, patent laws as basic protection, with trade secret and know-how coexisting peacefully with patents? Some of the critics say that if trade secrets encourage non-disclosure, then maybe some of these developments questioning the scope of trade secret protection have a sound basis for public policy.

Now I have the honor and pleasure of calling on Al Johnston. As everyone knows, I never miss a chance to claim a star former student. Al had plenty of positive force when he was in my law classes and I can

recall him standing up and holding forth and sometimes making me wonder whether I did all my homework. So, Al, I've already told them what you're going to talk about—trade secrets versus patents and all the implications. I'm very, very happy to have you here with us.

ALBERT C. JOHNSTON

Thank you, Oppie. I'm very sorry. Air traffic control had me in the air for two hours this morning.

Certainly, I can't pretend to be any expert in these fields, and all I can try to do is hopefully to contribute some thoughts on the matter, as I've been exposed to a good bit of it. I haven't had an opportunity to prepare any organized paper, due to the crush of other affairs. I have tried to review some of the considerations which struck me as being extremely vital in the *Lear-Adkins* decision and in the dissent of that decision, and to bring to mind the kinds of things that are affected.

As a general conclusion, I might make a broad statement that in both the area of trade secrets and patents, if *Lear v. Adkins* is read for what it seems to be saying and in that regard is to be the guidepost of future determinations, then there is no remedy for resulting problems, short of legislation. This, I believe, is an inevitable consequence of the very broad doctrine called federal patent policy, that is enunciated as the foundation for the court's holdings. This stated that federal patent law policy is equally present in the majority opinion as it is in the minority opinion. The only difference between the opinions that I perceive is that the three dissenting justices would immediately have had the court declare that there could be no enforcement of a contract to pay for the use of ideas while they were still secret before being patented, because of an overriding federal policy; whereas the majority took the position that that was an important issue that had to be determined by the lower court before they would pass judgment on it. But in order to take that very position, the majority seems to have adopted as a starting premise that there is an overriding federal policy against the rewarding of persons by contract for ideas or inventions that are not patentable. The majority applied that overriding policy concept in order to vitiate those portions of the contract between *Lear* and *Adkins* that called for *Lear* to

pay Adkins on its use of his work after a patent was granted, in the period before any adjudication of the validity of the patent.

Probably the starting point of the *Lear* problem was the *Compco-Sears* decision. Whatever may be the origins, it is my impression that the *Lear* opinion reflects an overriding desire by the Supreme Court to strike down anything by way of what they regard as anticompetitive forces, whether by contract or by patent—anything that would prevent one competitor, or even a company not in a competitive relationship, from copying and producing for the public economic weal works that one may or may not have any right to use under the ordinary concepts of common law.

If there was ever a case where the court reached far in order to find a way to get at this striking down process, it seems to me that *Lear v. Adkins* is such a case. Here was a case where a man of apparently acknowledged extraordinary talent as an inventor was engaged to bring a company that was in trouble competitively in the gyroscope field into a position where it could meet the exacting demands of modern aviation in its product. He did it, according to the opinion of the court; he brought the company into an improved product or improved production techniques, one or both, that enabled it to fulfill the need. Before he did it, he had a contract that the company would pay him for his ideas or inventions—irrespective of whether or not they were patentable. The contract that ultimately evolved, after a very loose initial contract, amounted in effect to saying, yes, the company would pay him for all the uses of his ideas and any inventions and what not. As far as the relationship between the company and Adkins was concerned, it didn't matter whether or not there was to be a patent, but if there was a patent and, if, in the attempt to enforce that patent so as to maintain Lear's competitive or preferred position, Lear were not able to enforce the rights that the patent purported to give, namely, of excluding other people, then at that point payment should cease as to the thing affected. That was made clear; it was to be this specific thing, whatever it was. So the contract said, I Adkins, will serve you, Lear, and give you my creativeness; you may use it, you agree that you will pay me. The only condition on which you will not pay me is if you don't use it or if, after a patent is granted on it, in case one ever is, that patent is not enforceable against a third party. Then you can cease the payment.

This is a very rational and a very necessary kind of a contract in order to induce creative activity by creative people who have strong bargaining powers, as evidently Mr. Adkins did vis-à-vis Lear. Now let's think of that contract. It's made. At some point in the course of it, a smart patent

lawyer for Lear makes a search and discovers what he claims or what Lear claims to anticipate the invention of a patent application pending on behalf of Adkins. And by the way, this patent application really has nothing to do with the price of cheese as it concerns what Adkins did for Lear, as to whether or not he performed his part of the contract. It only has to do with whether or not Lear is going to be in a position to exclude third parties in the future. So this enterprising person for Lear says in effect to Adkins, your patent application is anticipated, so we're not going to pay you, and so you have only a lawsuit after the patent is issued.

As of 10 or 20 years ago, I don't believe there is a person in this room who would have dreamed that anything applied to that case other than the traditional common law obligation of a taking company to pay the giving party for the use of his work as agreed. I would say, as to that particular contract, that the common law concept of contract liability would by everyone be thought to extend all the way to what it says, which was that the time for stopping to pay would be when a patent had been held invalid. It didn't provide for Lear to contest the validity. So the issue before the Supreme Court wasn't really licensee estoppel, in the sense of patent enforcement against a licensee, but was whether you are going to enforce a contract to pay for the use of creative works where invalidity of a patent for the work was only a condition subsequent that could terminate the obligation to pay. The court really went out of its way to grab this as a vehicle to rule on estoppel. They did that apparently because they wanted to do what in the earlier *McGregor* case, Justice Frankfurter suggested when he said that the Court ought to give the doctrine of license estoppel a decent public burial. Apparently, they thought this was the vehicle to do it. But in order to reach estoppel here, they had to ignore the contract itself, because the contract imposed a clear obligation to pay.

I personally have no quarrel with the basic notion that the licensee estoppel doctrine should not be applied—that it was outmoded and perhaps wrong from the standpoint of the public interest that can be very readily expressed as arising under the patent statute. But the court had to go farther than that in deciding the *Lear* case. It talked about estoppel because the Supreme Court in California had mentioned estoppel; yet as I read the situation, estoppel had been mentioned in the California court only as a secondary explanation—as another reason why Lear wasn't in a position to argue about whether their operation was or wasn't under the contract.

Anyhow, they went to estoppel and threw out estoppel. So far, so good.

But then they went a second step, which was to vitiate the contract after the point when the patent issued on the theory that although the contract called for payment up to the point of the patent being found invalid, nevertheless public policy required that if it turned out to be invalid the contract couldn't require payment from the time the patent was published. The theory that underlies that has to be that the very publication of the subject matter of the patent throws that matter in the public domain and prevents enforcement of a contract to pay for uses of it, unless a court later on is going to hold the patent valid. That is a vitiation, in many respects, of the doctrine of presumed validity of the patent; it presumes a public domain status of the subject matter, even as concerning a private contract to the contrary, just because it happens to have been published as a part of the patent process.

There, I think, the court has taken a fundamental position. In Justice Harlan's opinion you can even find implications that the declared federal patent policy, or policy of unrestricted competition, is almost a constitutional thing. And yet, it's attributed to enactment of the Sherman Act. So it's a very peculiar situation. It's as if we were going back to the old constitutional case where it was held that the steam boat activity on the Hudson River was subject to the interstate commerce clause, and not to state regulation. But, here it goes deeper, because we have a statute, the Sherman Act, being given effect in the reasoning of the court as a kind of quasi-constitutional doctrine which, by retroactive action, puts strong limitations on the constitutional patent doctrine in such a way as to cut that down, and even cut down the common law of contracts, to such extent as the subject matter may be something that the court says doesn't fit the existing patent law. This of course could open a tremendous Pandora's box in the future as to federal and state jurisdiction.

I would say that the third issue of the case, namely whether or not there could be payment for uses of Adkin's work prior to the issuance of the patent, is just an extension of the same fundamental principle that the court adopted in order to get to the second step, namely, that there wouldn't be liability from the date of the publication of the patent if the patent ultimately was found not valid. This all means to me, without much question, however startling it may seem or actually is when you reason it out, that the opinion of Judge Motley, rendered in February in the *Painton* case in New York, is not nearly so far off base in terms of the doctrine of the *Lear-Adkins* decision as most people in the Bar—prima facie—regard it to be. Judge Motley said, after going through some recounting of the holding of *Lear*, that "for these reasons this court holds that federal patent law requires an inventor to submit his ideas to the

Patent Office before he can compel consideration for the use of his idea.” I’d say that she was justified in reaching that conclusion by logical analysis of what Justice Harlan said, with the sole exception that Justice Harlan stood on the fence as it related to the pre-issue, pre-publication point of the patent—threw it back to the California court. But it seems to me that what he was saying about the overriding federal patent policy and its existence giving a reason to throw the pre-patent issue back for a finding in the state court, almost amounts to a ruling as broad as Judge Motley’s.

If this be true—let’s say even if it isn’t true—it seems to me we’re in a Pandora’s box that has to be corrected by legislation. If it were true, of course the need for legislation is even more clear. I don’t believe that businessmen, lawyers, my clients, can know what they can do and what they cannot do under this type of legal regime.

We have many many things in the area of trade secrets that constitute know-how; it’s awfully hard to generalize know-how. But there are three different types of things that are very significant, that I know of from experience in working with agreements.

One type involves, for example, the accumulated production know-how of a company, as to how to make a widget that will sell well at low cost. If a company wanting to enter the widget field can make a deal with my client who has the know-how and get hold of that know-how, that company is immediately in the business. Therefore, being able to buy that know-how is an extremely important thing if it can be achieved. It’s an important loss to the developer of it to give it up, if he’s going to give it up to create a direct competitor. It’s a tremendous gain to the newcomer to have it. Consequently, we have a tremendous number of know-how agreements of that nature that exist between American companies and particularly foreign companies that may not have been up to date with the American trend of competition, which enable these foreign companies that aren’t going to be very directly competitive with the American developer to put themselves immediately into a highly economic production of an important product—to wit, the widget.

I don’t pretend to know what is the overall value of these contracts that exist. I do know that I personally must have negotiated at least half a dozen or a dozen of them in the last 10 or 15 years, and the values of those have been many hundreds of thousands of dollars. That type of thing isn’t even susceptible to patent protection. And yet it’s an accumulation of what the courts are calling ideas, some one or more of which, or some pieces of which, might at some time or other have been made the

subject of a patent if somebody had wanted to spend the money or try to keep other people out of such a thing.

Another type of so-called know-how or trade secrets arises where you have highly skilled persons either as consultants or as employees of companies, who will develop valuable ideas or valuable cures for problems—many even short of having been commercially used, but developed in a course of attempted reaching of a goal. These things sometimes never get anywhere in terms of practical or economic importance, but sometimes they are the important link to getting to the end point. Problems arise as to whether they may be protected at the stage before they become important. At that stage they aren't really very significant as patent matter, because nobody's proved that they are worth enough to spend the time or the money on patent rights or to have the government fiddling with issuing patents for them. So this is the kind of thing to which the courts have traditionally given strong protection under principles of equity; it goes back to the old case, I believe Oppie talked about it, back in the Twenties—when Justice Holmes said the offense was in the breach of the confidence and not in the protection of a property right. What's the name of the case, Oppie?

PROFESSOR OPPENHEIM: *DuPont de Nemours Powder Co. v. Masland*, 244 U.S. 100 (1917).

MR. JOHNSTON: The concept of the breach of the confidential obligation has been the fundamental by which the courts have given very strong protection to trade secrets, when they've been taken either by a breach of the relationship by someone to whom they were disclosed in confidence or by a trusted employee walking off with them in any other fashion. The courts have enforced this as a matter of equity.

I can find no distinction between the subject matter of that type of equitable claim and what the court in *Lear v. Adkins* is talking about as being subject to federal patent policy. And yet it seems ridiculous to suppose that ideas of that nature, or in that nascent stage, are going to be the subject, broadly speaking, of patent policy. It just isn't feasible.

Then, of course, there is a third type of situation, where a trade secret is an important part of an actual commercial operation. It may be a composition; the Coca-Cola formula is a good example. Or, how to make a piece of equipment that is important to a process, or some key reaction that is important to a process—something that can be kept to oneself and yet becomes a very vital part of a commercial operation. Now this too will very strongly be protected by the courts, traditionally, on equitable principles. It may or may not become the subject of a patent, depending upon whether or not the interests are such and the nature of the matter

is such that it makes sense to get a patent and expect to be able to enforce it.

So it seems to me that there is no remedy for the problems of *Lear v. Adkins* short of some legislation that would draw lines that would in effect say that it goes too far to project this notion of an overriding federal patent policy into the lives of human beings at the point where they are making contracts with each other as to their creative efforts or the fruits of those efforts. And apropos of that conclusion, I am sure you are all aware that there are presently pending proposals to bring into patent revision legislation sections that would hopefully vitiate the impact of the *Lear-Adkins* doctrine by in effect negating the notion of a preemption of state law or of common law of trade secrets and confidential relationships, and so forth, by reason of the enactment of the patent law.

PROFESSOR OPPENHEIM: Are you referring to Senator Scott's legislative proposal?

MR. JOHNSTON: Yes, the Scott bill. And, perhaps you're familiar with it.

PROFESSOR OPPENHEIM: Well, Al, I see you haven't lost one bit of your A quality. I had to always give you A's. I can't give you anything less for what you said now. I think it's a very penetrating analysis. I don't think I ever understood that case as well as I do now in the light of your analysis of *Lear v. Adkins*, particularly where the majority rationale itself might be just as damaging as the Justice Black dictum.

MR. JOHNSTON: I have no doubt. The only difference I see is that Justice Black would immediately dispose of the pre-patent question, whereas the majority threw it back because they thought it was so important that it ought to be on the fence until the state courts act.

Afternoon Session

PROFESSOR OPPENHEIM: Al, I'm opening the way for you to complete whatever you want to say.

MR. JOHNSTON: Well, Oppie, I think I've talked quite enough on the subject, but I thought there was one sideline consideration that I failed to mention earlier and that is this, that in the *Lear-Adkins* case both the

jury and the California Supreme Court had held that Lear had used two things that were created by Adkins and so did the Supreme Court at page 655 of its opinion. And Lear had agreed to pay for the use of these things by contract. Yet the Supreme Court holds, and clearly so as to the "patent period," that an overriding federal policy requires that the obligations of that contract be vitiated in that regard. The point that I wanted to mention is, this might be considered to raise a question as to whether the Supreme Court has given adequate heed to the Fifth Amendment as it relates to the taking of property rights for public purpose. The public purpose is a purpose expressed by the Supreme Court, and the property right is a contract right which, at least heretofore, has been regarded as a perfectly valid and enforceable obligation. I just thought I'd toss in that little sideline for whatever it's worth.

PROFESSOR OPPENHEIM: Woudn't that perhaps also come up in connection with impairment of the obligation of a contract?

MR. JOHNSTON: I would think so.

PROFESSOR OPPENHEIM: Are you saying that the property right is in the trade secret or confidential information?

MR. JOHNSTON: Well, as to this particular case, it could be said that it is in the contract which gave a right to compensation for the use of the secret or whatever it may be called.

PROFESSOR OPPENHEIM: Which involves property interest?

MR. JOHNSTON: Yes.

DIRECTOR HARRIS: Well, isn't this support for Justice Douglas' position? As I understand it, he is of the opinion that if trade secrets are considered property rights, they are a type of right that could be preempted by the patent law since Section 261 of the 1952 Act states that "patents shall have the attributes of personal property."

MR. JOHNSTON: Well, my thought wasn't so much to the point of whether or not the trade secret or the invention, unpatented or patented, was itself the property right as that in this situation there was a contractual obligation to pay for the turning over of that and the use of it and actually the *Lear-Adkins* case did not at all hang on the attempted enforcement of a patent right. There was no element of an attempted enforcement of a patent right involved in the *Lear* case, only an attempted enforcement of a contract right.

MR. CARY: Al, are you saying that the contract right was in effect a property right?

MR. JOHNSTON: Well, this is the question that I raise: Is it not a protectible property right that cannot be taken at least without due process of law or without just compensation, for public purpose? And

yet, in a very broad theoretical and actual sense the declared reason for the taking or vitiation of that right in *Lear* is for a public purpose declared by the Supreme Court.

MR. CRAIG: I wonder whether the view taken this morning may not also be an overgeneralization because I'm afraid that, in the *Lear* case, to some extent, the problem arise that the know-how was tied up with the patent. I think that this does not necessarily mean that an agreement which provides for know-how only, which is the proper material for know-how, could be held invalid, nor do I think that an agreement which says "we pay so much for know-how and so much for royalties" would necessarily fall under the *Lear* doctrine. I think the trouble always stems from the fact that a lot of these agreements don't differentiate between payment for know-how and payment for the patent royalty. And I just feel that I don't think that the Supreme Court has yet held that trade secrets can be preempted by the Patent Act as it exists and I doubt that they would at this point.

DIRECTOR HARRIS: You mean patentable trade secrets?

MR. CRAIG: Well, I don't think patentable—I would say that I would like to differentiate between trade secrets and patentable subject matter. There are certain things, as we heard this morning, and I quite agree, that are trade secrets that properly fall within the category of trade secrets. Now I would say that what I'm afraid of is anyone who tries to use this approach and tries to use it as a subterfuge to get around some other provision, by calling something that ought to be a patent a trade secret, is going to be in difficulty. I think manufacturing know-how—I think certain methods of doing business—things of that sort, are properly trade secrets which are not patentable. I see no reason why they cannot be protected by an agreement. What I have done always is to separate the know-how agreements from the patent agreements because I've always felt the two should not be mixed together, and I'm not sure that this situation would have arisen had that been done in the *Lear* case. But in the *Lear* case, the problem was that it was tied up with a patent and it said that they would pay the royalties as long as the patent was valid, thereby really putting all the know-how payments on a patent claim, so to speak—a kind of a nebulous arrangement as far as I could see. I don't know the specific language of the agreement, but if you read the decision—in effect that's what *Lear* agreed to do—to pay as long as the patent was valid, you really base it completely on the patent validity.

PROFESSOR OPPENHEIM: Frank?

MR. NEUHAUSER: This brings us a little bit back to the *Painton-Bourns* case. In Paul's view you could still have protection of trade secrets. I

think Judge Motley has gone all out, but I differ a little bit from Al here in that I do not think the Motley decision is representative of the future. It seems to me that this is "way-out" case which has ignored reality and I have some hope—I hope it is not only wishful thinking—that the Court of Appeals will set her straight. One of the things that leads me to feel this way is that the lower courts did not buy *Sears* and *Compco* to the extreme they could have. In fact, they tried to encompass it quite a bit and there are decisions in substantial number after *Sears* and *Compco* protecting against unfair competition, whereas if they'd gone the Motley way they could well have said "This just throws out everything." I don't personally feel that the lower courts are going to go Judge Motley's way and I do hope, Al, that the Court of Appeals will see fit to reverse this one and I assume it's getting there. May I ask you a question on this? I'm just curious. The New York Patent Law Association, for example, considered an amicus brief if there is an appeal, and I can't conceive of the loser taking this one lying down without appealing.

MR. JOHNSTON: I don't know the answer to that, Frank.

PROFESSOR OPPENHEIM: Well, I know the answer to one thing, and that is, we have the benefit of having here Clyde Willian, who is going to be counsel for Bourns. Clyde, I'm sure everybody is eagerly awaiting your comments.

MR. WILLIAN: All I hope is, you're right! We got into the *Bourns* case just after the decision came down. Obviously, it's an extremely fascinating situation. I don't want to get into what I think the future of it is, because I don't think it's proper since it's a pending case and I am now one of the counsel of record. But I will give you a little background and where it stands right now. As the case stands right now, it's unappealable. It is a multiple-issue situation in which the court decided—well, I'll simplify it saying two out of the three claims, the third claim being a patent claim. Now, if you read that decision, her first grounds for holding against Bourns was the public policy question that she claims has been decided in *Lear-Adkins*. Her second point was straight contract interpretation. We have moved under Rule 54 (b) asking the court to enter an order directing that the decision, as to the decided issues, be made final and therefore appealable. Houston Kenyon who was brought in after the decision came down, as we were, and his co-counsel, who is not a member of the Patent Bar, have gone along with us in asking the court to enter that order. Originally, there was some slight difference of opinion as to the wording of the order in that we were asking that there be an injunction for the period of the appeal to keep the trade secrets

from being disclosed to the public. At first they didn't buy that but they've come around now.

Even with that agreement between the parties, Judge Motley has held this close to a month. The matter came up on a regular motion call in the Southern District but Judge Motley was not sitting that day—therefore it was referred to her for decision. My local counsel went over with Houston to the court and talked to the law clerk and the law clerk indicated a great deal of reluctance to put this matter in appealable condition. Whether or not that reflected the views of the court, I don't know—she has held it for quite a long time.

You know, I had thought that *Bourns* was probably the first of its kind—the so-called case of first impression—and that it created a tremendous uproar, you can imagine, in the Bar. Bill Connor and I between us have had numerous telephone calls and inquiries from various attorneys and business executives, people calling in from all points of the country saying “Don't let this thing die! You've got to do something about it.” Oh, one point that I did forget—her decision on the public policy question was entirely *sui sponte*. There was not one word suggesting this approach in any of the briefs that were filed.

PROFESSOR OPPENHEIM: Or the record.

MR. WILLIAN: The case was decided on cross motions for summary judgment. It went up strictly on a contract interpretation matter and the court held it for what I would consider a fairly long time—several months after hearing. I understand that that court normally disposes of matters of this type much more promptly. But anyway, what I was getting to, was—I had just sort of thought that the *Bourns* case might be one of its kind and the other day, in just thumbing through some books I found a case called *Winston Research v. Minnesota Mining*. It surprises me that when it came down in 1965—a Ninth Circuit decision—it didn't precipitate the uproar the *Bourns* case has. Maybe it's because the language is dicta, but anyway, it's right on point, as far as what we're discussing here today, and I'll just read a little bit because it states it certainly a lot better than I can rephrase it. It says:

An additional argument is sometimes made in favor of protecting confidential but unpatented matter from disclosure, but we think the rationale of *Sears Roebuck v. Stiffel Company* precludes us from giving it weight. We refer to the contention that the results of research and development must be accorded reasonable protection from disclosure or private investment in such activities will be inhibited and progress will be slowed with a consequent loss to both employers and the public. The patent laws, it is argued, do not afford adequate protection because excessive time is required to process a patent application and because a high standard of inven-

tion must be met to obtain a patent, or at least sustain a patent once issued. However, we are satisfied that the rationale of *Sears* precludes judicial recognition of a legally protectible interest in the secrecy of industrial information as such.

PROFESSOR OPPENHEIM: What's the citation, Clyde?

MR. WILLIAN: 350 F. 2d 134. *Winston Research Corporation v. Minnesota Mining*. Now, that case came down long before *Lear-Adkins*—right after the *Sears* case and here's a court taking a view somewhat similar to Judge Motley. Now, I'd like to ask you—the group—this question: We talk about remedial legislation—that may be the way things are going to have to go, I can't say, I hope that the Second Circuit will set Judge Motley right—but in any event, as I understand Douglas and Black, they are really saying that there's more than just the patent statute or the antitrust statute, but that the constitutional provision regarding patents is a limitation. It's more than an enabling clause. Well, if I'm correct in their interpretation, how can Congress pass a law that overrides the Constitution?

MR. JOHNSTON: I would try to answer that only in this respect, that so far as *Lear* is concerned, they don't speak in terms of the constitutional origin of the doctrine but they speak in terms of the Sherman Act having imposed a restriction upon the traditional patent doctrine.

MR. WILLIAN: Yes I agree with you.

MR. JOHNSTON: Now, if that can be taken literally, it seems to me to imply a kind of judicially grafted doctrine attached to the Sherman Act concept. I do agree, I think, with your suggestion in this respect: that if you follow *Compco* and *Sears* to the logical bottom, it would seem that the bottom of that doctrine is to the effect that because of the patent clause of the Constitution there somehow came about an exclusive congressional power to deal with things in the idea field, even though the Constitution doesn't say that this is an exclusive power of Congress. Now, if that turned out to be the ultimate ruling of the courts, then it would seem to me to have to follow that everything in the idea area would have to be protected by congressional enactment or not at all.

And, this raises the interesting question, as a corollary, as to the possibility that by very extensive revision of the patent laws, of the related laws, one might be able to deal with these problems directly under Article 1, Section 8 of the Constitution rather than indirectly by trying to, or more directly, perhaps, in one sense, by trying to negate the direct effect of *Sears Compco* and *Lear*. And apropos of that I was told, without really knowing, that current copyright revision would deal with the common law copyright concept as well as the registration copyright concept, whereas current patent law revision would deal only with

patents in the usual sense that we've known—and leave the rest of it completely to common law concepts.

PROFESSOR OPPENHEIM: We can go to the headwaters on that and ask George Cary about his reaction to that suggestion.

MR. CARY: Well, I think Al is essentially correct on that. I just want to throw in this comment in regard to Clyde Willian's reading of Douglas and Black. I think this to a great extent is pretty much what Judge Hand said in his dissent in the *Capitol Records* case, where he felt that the Constitution applied *ex proprio vigore*—that you didn't have to look at the copyright act—he was talking, of course, about the limitations—the limited times problem. But he felt very strongly, I think, in that opinion, very much the same way you interpret Douglas and Black here. Of course, that was a dissent and it didn't count.

PROFESSOR OPPENHEIM: Frank?

MR. NEUHAUSER: This may be a digression from our broad subject matter, but he raised this constitutional provision and it has frequently, I guess continually, puzzled me how the Supreme Court, particularly Justices Douglas and Black, seem to read into Article I, Section 8 vis-à-vis patents that there's a constitutional standard of patentability and yet they don't seem to read the same constitutional standard when it comes to copyrights. I wonder, George, whether you have comment?

MR. CARY: Well, I've always been amazed about this and the only way I can reconcile it is that when you analyze the type of protection you get by patents and the type of protection you get by copyrights, patents represent a much more all-inclusive type of exclusive right, as it were, whereas copyright really is much more limited I think—in other words, you can prevent somebody from copying your work—you're unable to prevent them from using your product or creating the same product if they don't copy your work, so there is considerably less of a monopoly, if you want to call it that, which I think is improper in view of what was said before. But this is about the only way I can rationalize it. The courts do take that into consideration.

MR. NEUHAUSER: It's visceral, rather than philosophical, I suppose?

MR. CARY: That's right.

PROFESSOR OPPENHEIM: Well, may I suggest the construction of an argument which might have relevance in the *Bourns* appeal. I think there is a policy question here. The constitutional purpose that should be considered is that when a patent is issued, it is conditioned by a public purpose, but the conditioning of a public purpose goes only to the point that when a patent issues, you can claim no more than the invention as described in the specifications and claims. If you go beyond

that, then you are interfering with competition and the competition should be deemed privileged.

Then you have other problems—to what extent is that competitive privilege hemmed in by some other consideration? This concept of a patent being conditioned by public purpose arose long before the 1890 Sherman Act. In the early cases, in the early 1830's, the Supreme Court said that same thing. This PTC Research Institute was established to study the patent, trademark and copyright systems. You have three systems of law. One is the patent laws, pursuant to the constitutional provision, to promote progress of science and useful arts. If it isn't promoted because of patent misuse by a tying clause or other misuse, that's one thing. What the Sherman Act did was to produce the problem of accommodating the patent laws and the antitrust laws, and we have another package of problems, still going on. How is this accommodation going to take place?

Then you go to the trademark area and you either have common law prior to legislation or you have the Lanham Act. Again accommodation has to be made between the basic concepts of trademarks, which really is a branch of the law of unfair competition, and the antitrust laws. Then you have the doctrine of unfair competition law and copyright law, as you say, George, has its own built-in limitations, too. So, it seems to me that we get off the trail if the courts should confuse these different public policies. In other words, I used to say when I taught the subject—you have the public policy of trademark laws, you have the public policy of unfair competition, and any statutory extensions thereof, and you have the public policy of the competitive enterprise system. You have various public policies and the real underlying problem is, how do you reconcile them?

In the appeal in *Bourns*, it seems to me this ought to be emphasized, that the court is still faced with the problem of accommodation of patent and trade secret protection and there's nothing in *Lear v. Adkins* which should preclude trade secret protection. For example, this morning I talked about the *Mogen David* case, where the CCPA made the very point that trademark and design patent rights may coexist. We don't have collisions here necessarily; we have supplementations, we have multiple rights. You can have design patent rights, you can have a trademark registration right. So, they're not mutually exclusive.

MR. WILLIAN: I would like to clarify the record. I don't want it to be understood that I agree with any inference by Douglas and Black that there is a constitutional standard of patentability. Long before the *Bourns* case—I think just as part of my basic training in patents, I read

the Constitution and to me it's just an enabling clause. I think their constitutional limitation argument is designed to achieve their own personal philosophies—antipatent philosophies—as a matter of fact, and I hopefully think the rest of the Justices don't go along with that attitude.

PROFESSOR OPPENHEIM: Right. Remember Justice Holmes said in the *Northern Securities* case, the Sherman Act says nothing about competition, doesn't mention competition. You can say, analogously, that the Constitution says nothing about competition or the private competitive enterprise system, and unless the Court introduces the idea that the competitive enterprise system is a constitutionally based system, then you have to determine to what extent it is a common law problem, or a statutory problem.

DIRECTOR HARRIS: In the *Bourns* case, could the judge not be going as far as Black would like to go—despite the fact that people seem to think she's gone all the way. Does she make a distinction? She says, submit it to the Patent Office, let them decide if it's patentable or not. Black would probably say all trade secrets contracts were out, as he appears to be saying in his dissenting *Adkins* opinion. Now, does *Bourns* go that far—or does it go beyond *Adkins*? She says, submit it to the Patent Office. If the Patent Office decides it is patentable, it receives protection. If the Patent Office says it is not patentable subject matter, then could you still get protection if you meet common law trade secret standards? Is there that distinction in the *Bourns* opinion?

MR. JOHNSTON: It seems to me that, practically speaking, it becomes a distinction without a difference as it relates to the trade secret as such. I believe that what Judge Motley is speaking of—before submitting ideas to the Patent Office—what the opinion is really saying is that unless it is submitted to the Patent Office and has the imprimature of approval by the Patent Office then it is outside the jurisdiction of the courts to enforce. If that's the correct interpretation of what's being said, then it seems to me to sweep aside all those things that might be regarded as submittable to the Patent Office, from all forms of protection in the court, unless they have not only been submitted but also been granted as a patent right.

DIRECTOR HARRIS: And if the Patent Office decides that it is not patentable subject matter—you say, even if it meets the standards for trade secrets, it can't be protected as such?

MR. JOHNSTON: That seems to be the implication.

MR. CRAIG: This argument, I think, is fallacious in only one way. If the Patent Office finds it to be not patentable, then it can't be a trade

secret in the sense that we recognize trade secrets, because it's either known or obvious, and if it is so, how can it be a trade secret.

DIRECTOR HARRIS: How does that follow?

MR. CRAIG: Because, if the Patent Office rejects the patent application under Section 102 or 103, it means that it is known already or it is obvious. If this is so, then I don't think it is properly of the type that is a trade secret. But I think there are certain areas where you cannot really properly apply for a patent—ingredients in a perfume, for instance, things of that sort, where patent protection would be meaningless, and I think it's in those areas where protection must be safeguarded to really uphold the property right in the area of the trade secret as it is properly recognized. If you make the question of whether a trade secret can be enforced dependent on the rejection by the Patent Office, I think you open yourself up to the argument that no longer can there be a trade secret because you have acquiesced in the holding of the Patent Office that it is either patentable or is not patentable, i.e., that it is not new, but is already known.

MR. JOHNSTON: It seems to me that that's completely contradictory to the long history of cases having to do with the law of trade secrets, and also with one of the basic premises that is expressed often about patents, namely, that the inventor is given the opportunity to apply for a patent and thus make his invention public, and if he is not allowed the protection he thinks he ought to have he still has the right to preserve that subject matter in secrecy and gain such benefit as he may from the fact that it is secret. We have great numbers of litigation cases where trade secrets are protected, that the courts expressly find fall short of the requirements that would apply to patentable subject matter, and the criteria that go into litigation over trade secrets are not at all the criteria of patentability—they are fundamentally whether or not there was a confidential relationship, whether or not there was novelty of some kind in the subject matter, and not absolute novelty in the patentable sense but novelty as it relates to the understanding and the benefit of the parties to the litigation, and whether or not there was a taking, and once the court finds that those elements are present, generally speaking, relief will be granted against the taking.

MR. CRAIG: I agree with you wholeheartedly. I completely agree, and I'm aware of it. I'm just saying that there is the pitfall in predicating the protection of trade secrets on the rejection by the Patent Office because you open yourself up to the further objection once the Patent Office rejects the application, by saying, well you haven't really had anything. To that effect I would rather see the protection of the trade secret

maintained regardless of any question of patentability submission to the Patent Office or not, because if you make it dependent on the rejection by the Patent Office as a preliminary test, you're going to find that that which you are trying to avoid, you're inviting directly, because then the Supreme Court is going to come in and say, gentlemen, you have in effect admitted that under the patent system there is nothing to be protected, what are you trying to do? You're trying to extend a property right into an area which ought to be in the public domain. I think this is the very great danger if we go that route. This is the only thing I'm trying to bring out.

DIRECTOR HARRIS: Well, it's impractical too—you'd have to have three or four patent offices to handle the amount of work you'd get under those circumstances.

PROFESSOR OPPENHEIM: Frank?

MR. NEUHAUSER: I read the Motley decision the same as Al does, however, that what she's saying is you have to go to the Patent Office and your sole rights are there, and if the Patent Office turns you down, you have no place to go. Whether or not there is a trade secret residual wouldn't concern her because she wouldn't protect that trade secret in any form.

PROFESSOR OPPENHEIM: That's the great fear. I might put on the table what I think is a perceptive article which the court cited in *Lear v. Adkins* and therefore it becomes important. The article is by Adelman, on "Trade Secrets and Federal Preemption," 49 *JPOS* 713 (1967). Here are four of Adelman's propositions on which I'd like to have some discussion.

First, if the inventor does not apply for a patent on a potentially protectible invention within Section 101 of the Patent Code and elects to put the secret to commercial use (usually through disclosure in confidence to employees and licensees), then the trade secret should *not* be protected against those who violate confidence.

Second, if *not* put to commercial use, then the trade secret should be protected within the scope of common law and state law protection.

Third, as to all classes of trade secrets not patentable under Section 101, the usual law of trade secrets should apply the Adelman thesis.

Fourth, secrets which are protectible under patent applications should be protected by trade secret law.

Now this raises a basic question that *Bourns* leaves unclarified. As Al Johnston just said, if *Bourns* means that you've got to go to the Patent Office and make a disclosure not only of what you think is within a valid patent claim, but you also have to package in any trade secret informa-

tion that you have so that a decision may be made as to whether it is patentable, then you may have no more trade secret rights. It seems to me this is what opens up the Pandora's box, because, if that's so, then what we have is really a situation where the *Restatement of Torts* on trade secrets may go down the drain and with it all of the conventional trade secret legal protection.

Stephen P. Ladas has an article on "Legal Protection of Know-how," published in *IDEA (PTC J. Res. & Ed.)*, Vol. 7, No. 4, p. 397. That was most revealing to me because we all know how difficult it is to define know-how. It seems to me that Ladas is quite precise on what he includes in know-how. For example, know-how may include information relating to a patented invention but not included in a patented specification, and it may include inventions capable of being patented but not patented. If you have some know-how which is related to the patented invention, then *Painton v. Bourns* might have real significance. Then it's up to you to make a disclosure or you might be guilty of fraud on the Patent Office since the Patent Office examiner is often at a great disadvantage in acquiring knowledge of prior art. The patented invention might be much less important than the know-how that comes later when you spend research and development money for things that aren't patentable, as, for example, the layout of your plant to carry on production; reducing cost of manufacture; adjustments to machines, things like that, where you know you have nothing that can be patentable, but you have very valuable information that isn't generally known or public.

As Paul Craig says, if you start getting into that area and say, "Well, I'd better go to the Patent Office now, in the light of the *Bourns* case, and cough up my boots on my trade secrets, "then you're going to be in trouble once you get a rejection of trade secret matter as not being patentable subject matter. And where is legal protection of know-how going to be—tooling, laying out plants, and all that? So, Ladas, I think, is right in saying that this know-how is often supplemental to a patentable invention. And then we raise a question, why should one who develops know-how which isn't published not be protected? And why shouldn't we say that once you disclose it in confidence, it's like a restricted circulation, not for general publication, and hence is still protectible? Clyde?

MR. WILLIAN: Your comments on the value of know-how and trade secrets vis-à-vis patents I think are very interesting. I personally feel at times that a situation like the *Bourns* decision may be the greatest thing that ever came down the pike, from a legislative viewpoint, for several reasons. I'm not convinced that the ordinary businessman is completely attuned as to the value of patents. A lot of them cannot relate patents in

terms of dollars to their daily operation. But you tell a businessman that his trade secrets—all the things that permit him to operate on a day-to-day basis—are going out the window, and he'll relate that immediately to the function of his business. If the patent system went out, I don't know whether that would cause too much of a stir in the business community as it would in the Patent Bar. But you tell the business world that the trade secrets are going out and I think that'll cause a heck of a hue and cry. The *Bourns* case alone has caused a substantial outcry from the business community.

PROFESSOR HARRIS: Which brings up another question. Are the trade secrets, the court talks about ideas, Judge Motley talks about ideas—is she including such things as customer lists and other confidential data used in the operation of a business? Is this being included? Is this what you mean is striking the businessman so hard, because his business secrets—the essence of his business uniqueness—are being challenged as well as his right to his confidential technical ideas?

MR. WILLIAN: Logically, I would think you have to. I can't draw that distinction intellectually between what is Section 101 subject matter and what isn't. Maybe the court would.

PROFESSOR OPPENHEIM: Al?

MR. JOHNSTON: There is great difficulty in drawing a logical distinction, but concerning the cases that have gone so far, it seems to me that the courts have had in mind not the type of thing that was last mentioned by Professor Harris, but rather the things that are in the nature of technical subject matter which makes the court think in terms of patents. Therefore I think that the suggestion as to how this might apply to the business trade secret type of information as distinguished from the technical trade secret is something that hasn't been reached yet.

I would like to go back and comment a little bit about the articles you mentioned, Oppie. It seems to me that Mr. Adelman is suggesting at one point that the doctrines lead to something that one might call a four-walls rule: That you keep your secret within your own four walls or you have none; that the minute you subject it to a contractual obligation and disclosure to a third party and bring it before the courts for enforcement, you won't get enforcement because it doesn't have the stature of a patent position; and anything less than that isn't going to be enforced under the doctrine of *Compco* and *Sears*.

Assuming that that were the doctrine, here is an example of what strange results it would reach: Just about a month ago I had to give some advice to a client—an American company that had a know-how contract with a foreign company wanting to build a plant for the production of chemicals following the plans of my client's plant. It just so happened

that one of the components of this plant had to do with a patented piece of equipment and process for which my client had taken a license from another company in the United States; and while getting the license for this piece of equipment they also got know-how from the other company as to how best to design it in terms of detail—what materials and what dimensions and the drawings to follow in building it. They had later made this contract with a foreign company to design a plant for them. The question to me was, can we give them the information about the way we have improved this piece of equipment without violating our obligations to the company from which we acquired the original license and know-how on this particular unit of the overall plant. I reluctantly had to come to the conclusion that they either had to withhold that know-how or make an arrangement with the company which had supplied them originally; then I was told that that company was also trying to compete for similar know-how selling jobs abroad, and they weren't likely to be willing to make a supplemental arrangement. It would follow that if the doctrine that we are supposing may be law actually becomes law, none of those contracts would be of any validity whatsoever. And it would seem also to follow logically that whoever had originally developed the equipment, and the know-how as to how to design it and use it best, would simply have to hold it within his four walls because otherwise he would not be able to dispose of it with any safety or expectation of protection.

PROFESSOR OPPENHEIM: Paul Craig?

MR. CRAIG: I wonder whether we shouldn't at this point of discussion also differentiate between the protection of trade secrets personal to the owner of the secret and the utilization of these trade secrets in connection with licensing others. I wonder what the views are of some of the gentlemen here as to the effect of the decisions we have discussed in protecting the trade secret as a property right if it is not used at all. Is it completely outlawed? Is it not enforceable on employees who are on a contractual obligation to maintain confidential certain information they receive? I don't think the decisions go that far, so that one really ought to differentiate between trade secrets which are personal to the owner and the use of trade secrets in licensing others. I think under the decisions, a distinction ought to be made in these discussions.

MR. JOHNSTON: That's what I tried to express by the four walls notion.

PROFESSOR OPPENHEIM: Clyde?

MR. WILLIAN: I might have to disagree with that if the decision like Judge Motley's becomes the law of the land, that you can make a distinction between the tortious taking of a trade secret by an employee and the breach of a contract by a trade secret licensee. I really don't see

philosophically that there is any difference. If there's no property right in a trade secret—to me, it doesn't make any difference whether you take it by breach of contract or whether you take it by tortious taking. If you can't enforce an express contract then I don't see how you can enforce an implied contract against an employee who steals your secret.

MR. JOHNSTON: Well, you can actually take *Lear*. That was a four-wall situation until the patent issued. Mr. Adkins was working for Lear under a contract that the ideas and inventions belonged to Adkins but would be licensed to Lear. Now the . . .

PROFESSOR OPPENHEIM: Non-exclusively, Al?

MR. JOHNSTON: Well, I'm not so sure—I don't know the details of that. But here the Supreme Court throws that issue back to the state court as to the period before the record indicates that the work was even published. So there's still a question, apparently, as to that four-wall situation.

PROFESSOR OPPENHEIM: Well, I'm inclined to go along with Clyde Willian's point for this reason: There's no point in talking about a trade secret as a property, right or interest, or whatever it is, or as once said, an unanalyzed expression of something that amounts ultimately to a breach of confidence, if it's going to be rendered sterile by saying as soon as the owner doesn't keep the trade secret to himself, it loses legal protection.

If you have a trade secret and particularly if you're willing to license it to others on a non-exclusive basis, then you're promoting progress of technical information. You're accomplishing the same basic purpose as the patent laws. In other words, you're opening the way to the use of technical information, technology, by not keeping it to yourself. Certainly we always thought it was a bad thing to have a willful suppression of a patented invention, and there are many cases where you can't make use of a patented invention because it isn't commercially ready for use. What I'm getting at is that it's ridiculous to me to say that there is a loss of public interest when you have a secret and you put it to commercial use. That's the very thing the public interest fosters. And even if you put it to commercial use with five licensees, you're doing a heck of a lot more for the public interest than saying, I alone will use the secret information.

The other thing is that the owner of a trade secret, like the owner of a patented invention, may not have the capital to exploit it. He can't use it himself, he doesn't have the means, he doesn't want to use it; he wants to get someone else to use it. It seems to me there's a great logical fallacy and a contradiction of the basic idea that if disclosure of a patented invention is a great thing and is basic to the patent system, then we ought to say that the use of confidential information on a limited basis is also in the public interest. But if there's a dichotomy between trade

secrets that you put to commercial use and those you don't, then you're getting into this terrible fallacy of saying that the public interest is damaged as soon as you put it to use, whereas we know from experience as businessmen it's just the other way around.

DIRECTOR HARRIS: Oppie, may I supplement your statement with an addendum—just a little addition. Our enterprise system is committed to competition. Here you have one system, patents, competing with another, trade secrets. If we assume that the greater utilization of technical information is in the public interest, why not use the probably larger returns to the businessman from increased utilization as the selecting mechanism? The businessman's choice of patent or trade secret would then be in the best interest of the public when he seeks to maximize utilization in his own best interest of doing more business.

PROFESSOR OPPENHEIM: Richard Stern, Chief, Patent Unit of the Department of Justice, recently delivered an address on "Antitrust Implications of *Lear v. Adkins*" (February 19, 1970) before the Philadelphia Patent Law Association to which I shall refer again later. Here let me give you one little insight into the difficulties that we run into when trying to define a trade secret. Stern points out that there is a "broad area of licensing know-how and other commercially valuable technical information which falls short of a trade secret," and here's where he mentions, "Tolerances for machine work, necessary degree of purity of chemical reagents, permissible temperature zones for processes, sources of supply for machinery or raw materials, methods of doing business." Are these putting apples and oranges in the same crate? Some of the above technical information I would say, and this group knows more than I do about it, could qualify for trade secrets, couldn't it?

MR. NEUHAUSER: So does the *Restatement of Torts* think so.

PROFESSOR OPPENHEIM: Tolerances for machine work, necessary degree of purity for chemical reagents, permissible temperature zones for processes, to me have high dignity potential for trade secrets. But I would be less sure about knowing the source of supply for raw materials, such as bauxite used in the aluminum industry. Someone knows it's in Timbuctoo, no one else knows it. Well, you can't keep that a trade secret very long because people now fly to Timbuctoo, you see it on a TV travelogue, and you know there's bauxite there. The natives boast about it. Methods of doing business raise a question, but the *Restatement of Torts* says anything which has commercial significance and gives you a competitive advantage over your competitors because they don't know about it is a trade secret. Well, maybe that's broader than some would like to tolerate. But you can see it is easy to get a little mixed up by

putting together in one crate apples and oranges, grapefruits and pineapples.

RICHARD C. STEINMETZ: I was only going to comment on your sources of material. This can be extremely critical, particularly if it's an isolated source which is peculiar to your project. I can see that as being critical—so I wouldn't exclude that.

PROFESSOR OPPENHEIM: Frank?

MR. NEUHAUSER: It strikes me as an ironic development in the *Lear* and *Painton* cases that, in effect, we're considering whether—at least in *Painton*—we're throwing out trade secrets entirely. Now, I have made no statistical analysis of this, but it is my impression that trade secrets over the last ten years have fared a lot better in the courts than have patents. I suspect that more people who have gone to court trying to protect trade secrets have won than have the patentees trying to sue on their patents. Yet trade secrets are the things they would throw out completely.

PROFESSOR OPPENHEIM: Any other comments? Would you like me to summarize, if some of you haven't read the article, Stern's position on the implications of *Lear v. Adkins*?

Do you think that might be helpful?

One implication mentioned by Stern is that public policy favors the invalidation of worthless patents. So now the Justice Department Anti-trust Division is not shying away and won't shy away from challenging patent validity, which it has been doing. Of course, you know, it got a little clipped in the *Glaxo* case, where Judge Gasch said the government can't challenge the validity of a patent collaterally for any reason except on allegations of fraudulent procurement under the Walker process decision of the Supreme Court.

The second Stern implication is that agreements to insulate a patent from legal challenge tend unreasonably to restrain trade in violation of the Sherman Act. The third Stern implication is that the logical implication of *Lear* is that public policy forbids enforcement of many contractual arrangements for control over unpatented matter such as trade secrets and know-how. The restraints permitted by a valid patent may well be Sherman Act violation if contracts cover unpatented matter.

Dick Stern is quite fair in saying that the implications of *Lear* are uncertain, for example, with respect to the levying of royalties for unpatented trade secrets and know-how. He says that issue is not reached by the majority of the Supreme Court in *Lear* but the Black dictum did so. Stern raises queries regarding the legality of prepatent-issuance royalty arrangements. Licenses are granted in patent applications, but as to royalty provisions, Stern thinks, there may be no valid distinction between pre-issuance and post-issuance. He thinks it is questionable that

a pre-issuance royalty agreement "will support a competitively significant restraint on the licensee." He also thinks that pre-issuance may be the other side of the coin of *Brulotte v. Thys*, namely, that if you can't collect royalties from unexpired patents, then query, how can you collect royalties on licenses under a patent application before the patent issues or if the patent never issues?

In all fairness I should point out that whether one agrees or disagrees with him, Dick Stern is a very able attorney who has the capacity for penetrating analysis of patent-antitrust problems. At the conclusion of his paper he refers to the statement in *Lear* of giving primacy to federal patent policy and then correctly states that

At the same time there is a policy worth fostering, of permitting and encouraging the rapid, economical and efficient dissemination of technology which does not rise to the inventive level. What trade-offs should be made in order to maximize the respective public interests served by these policies will call for more prolonged and patient analysis than anyone (including the Court in *Lear*) has yet made.

I think this is a fair way of emphasizing that *Lear v. Adkins* leaves many implications in an unclarified state. This is another question I'd like to ask the experts, namely, how about the concept of a sale of know-how, the sale of trade secret information as against licensing and royalty collection? Frank?

MR. NEUHAUSER: I think Stern can find his answer to his philosophic distinction between pre-issuance royalties and post-expiration payments as in *Brulotte v. Thys*, right in *Lear*, where they recognize there's a certain advantage that you get by having the information before it becomes public, which you do in pre-issuance royalty payments. This is many times the reason you take a license—you get a head start before it becomes available to the general public. Post-expiration royalties, for something you do after the expiration, is a horse of an entirely different color from the pre-issuance royalties.

PROFESSOR OPPENHEIM: Al?

MR. JOHNSTON: Oppie, I didn't, in my remarks earlier today, mean to say that a majority actually held the unpatented trade secret would fail of protection. But what I did mean to say was that, by the rationale on which the majority returned that issue to the lower court for determination, it appeared that they must regard the federal policy as the element that has to be determined. This itself constitutes a tremendous departure from past concepts of what constitutes a federal policy and how it has a play upon the common law principles that we all thought applied. And, apropos of that, the Court, the majority in *Lear*, under the section which

has to do with the question of enforcement of the contract obligation, states in these words: "At the core of this case, then, is the difficult question whether federal patent policy bars a state from enforcing a contract regulating access to an unpatented secret idea." Now notice, that quotation has no relationship whatsoever to whether it is patented or whether it has been published. It is unpatented. It is secret. And yet the Court throws that question back to the lower courts for determination.

PROFESSOR OPPENHEIM: Yes, very good.

MR. JOHNSTON: And it could not do this without having reached previously the conclusion that there is a paramount federal patent policy and that the courts somehow or other have to find out what is the dividing line of application of what the Supreme Court in this case calls the paramount federal patent policy, as it relates to the facts of the *Lear* case. Under our ordinary concepts that existed before, I don't believe any of us would ever even—ever dreamt—that the Supreme Court would take a position here stated to be at the core of this case. We would have thought that the Supreme Court would have said, "This is not a federal question. It's a contract law question involving an unpatented secret idea and it isn't for us to determine at all."

PROFESSOR OPPENHEIM: Yes.

MR. BEVERIDGE: Al, would you interpret that to mean that if I license somebody under a pending application, and a patent then issued, was litigated and held invalid, that the licensee could recover all of the license royalties from me?

MR. JOHNSTON: Not that particular holding, but because the holding that I alluded to before has to do with what treatment was going to be given to the idea before it was patented. Your question concerns what is the situation after it is patented, as I understand.

MR. BEVERIDGE: Well, I have a royalty payment while the application is pending, so it's not patented at that stage. And then it becomes patented, and I continue to pay royalties, and then. . .

MR. JOHNSTON: It seems to me that's right at the heart of *Lear v. Adkins*, that that's exactly the situation of *Lear v. Adkins*. The contract required payment before and after.

MR. BEVERIDGE: Can I recover?

MR. JOHNSTON: They held that it could not be recovered from the date of the patent if it should ultimately be held that the patent is invalid. They did not decide what was going to happen before it was patented, but threw the issue back to the state courts for determination as a matter of federal patent policy.

MR. WILLIAN: Excuse me. I didn't understand your question. I interpreted his question to mean, couldn't a licensee get a refund, which

I think is a different thing. *Lear* says, you can stop paying right now until we determine whether or not the patent is valid—to oversimplify *Lear*. There is no language in there about giving a refund for payments already made.

MR. JOHNSTON: I misunderstood the question. I agree with you, there is nothing in *Lear* that indicates any right to a refund. Unless I'm mistaken as to the usual course of decision, it usually is that the payments made under such contract aren't refundable, but that doesn't prove anything under the present status of the law, and particularly where you have, for example, an antitrust philosophy claiming that if you have an unenforceable contract that extracts things from another party, you may not only be liable for a refund but maybe for damages.

MR. BEVERIDGE: That was the analogy I was trying to get to.

MR. JOHNSTON: And I think, if you take current antitrust philosophies and project them to their ultimate end of logic, all this comes to the point that any contract by which one—particularly one competitor—imposes upon another anything other than complete freedom of competition is, particularly if it relates to the subject matter area of patents, going to be labeled antitrust unless you can ultimately sustain it as having been justified by a valid patent. This is the rather treacherous logical consequence of a lot of current antitrust positions.

PROFESSOR OPPENHEIM: What is the history of *Lear* under remand? Has anything happened? Does anybody know?

MR. JOHNSTON: I don't know.

MR. WILLIAN: As far as the refund goes, it would seem to me that that all depends on the vitality of the doctrine of presumption of validity. The patent is presumed valid until the court says otherwise, and therefore the licensee got his quid pro quo. Therefore there should be no refund. But the thing that bothers me is the situation that you raised this morning, that of the courts saying that you don't have to make payments during the time that the licensee is contesting the validity of the patent. I have difficulty reconciling on the one hand "Mr. Licensee, you don't have to pay," and on the other hand saying, "Mr. Licensee, you can't get back what you really didn't have to pay."

PROFESSOR OPPENHEIM: Does this make sense? There's a very impressive comment by White in his concurring opinion where he makes this statement in a footnote:

The court's opinion flatly proscribes recovery by Adkins of all royalties after the Adkins 1960 patent issued if *Lear* can prove patent invalidity. But recovery of pre-1960 royalties is left open by the Court apparently because pre-issuance and post-issuance royalties do not stand on the same footing under federal law. Such a

distinction may be valid and the pre-1960 royalties recoverable; but, if so, what of post-1960 royalties which are attributable to the head-start Lear obtained over the rest of the industry as a result of pre-issuance disclosure of Adkins' idea? Today's bar to collection of post-1960 royalties would seem to be inflexible, and yet those royalties arguably are recoverable to the extent they represent payment for the pre-1960 disclosure of Adkins; to that extent, they seem indistinguishable from the pre-1960 royalties, at least for the purposes of federal law.

Then he cites for comparison *Brulotte v. Thys*. I'd like to ask Al and the rest of you—what about this? If I followed some of you correctly, basically *Lear v. Adkins* was a case where the Court felt it was going to seize the opportunity it had to give a decent burial or an indecent burial, either one, to the licensee estoppel doctrine but it did so in a factual situation which involved jurisdictional questions relating to federal court relationships to state courts.

What might be the effect of changes in the composition of the Supreme Court, with Chief Justice Burger and the likelihood of the confirmation of the nomination of Judge Blackmun, so far as Justice White's objection to deciding the issue of whether federal or state law prevented collection of royalties reserved by the contract?

MR. BEVERIDGE: You mean like the *Hazeltine* package licensing decision? (Laughter)

PROFESSOR OPPENHEIM: Yes. They overruled that one.

MR. JOHNSTON: Well, Oppie, your wishful thinking as to the influence of changes in personnel on the Court I hope will come about. I might remark that the proposed Justice Blackmun is from a court, namely the 8th Circuit, where the last 17, I believe it is, or 18 patents before that court have been held invalid.

PROFESSOR OPPENHEIM: Paul?

MR. CRAIG: I just want to toss out, in line with what you said basically, I'm not so sure, apart from the dissent of Justices Black and Douglas, that the Court really meant to go so far. You've got to look at the background, how the case arose. It was a suit in a state court for recovery of royalties which were based on the validity of a patent. Now, the validity of a patent normally cannot be adjudicated in a state court, and therefore I think supremacy of the federal system came into play. I think the Court may have gone beyond what they intended to do, but what they have said, in my opinion, basically is—whenever you get something involving a patent, it's the federal law that controls.

I think the decision ought to be interpreted in the light of how it got up to the Supreme Court. It was a contract case, allegedly a contract involving a question of royalties due under the patent, and the contract,

unfortunately, specified they would pay as long as the patent is valid. There was licensee estoppel in the agreement, and the state courts have said: we are not concerned with it. I think at that point the Supreme Court said, "We'll take the case, and we'll tell them that when there is a patent involved, it involves federal supremacy, and besides, once and for all, we want to lay to rest the licensee estoppel doctrine." And I think this is all the Court has said in the case, apart from Justices Black and Douglas who have a philosophy which may be different.

PROFESSOR OPPENHEIM: That sounds very persuasive. What you're saying, I take it, is that suppose a case came up to the Supreme Court somehow or other, of a contract to pay for trade secrets. Don't call them royalties but certain sums for the use of a trade secret or know-how, and assume that there'll be no patentable know-how or trade secrets as admitted by the parties. Would that be an entirely different kind of case than *Lear v. Adkins*?

MR. CRAIG: Well, I think if you have a case where the parties A and B agreed that A transfer certain know-how in payment of X dollars, and then B says, "thanks for the information, but under the *Lear* doctrine I don't have to pay you anything," I would be very surprised if the Supreme Court is going to say there's a supremacy of federal theory, or whatever it may be called, saying that the contract, based on actual consideration is void, of course, unless you can show there was no consideration. . .

PROFESSOR OPPENHEIM: And it wouldn't make any difference whether it's a flat sum or royalty.

MR. CRAIG: Right. If it's a royalty, then they might look at the possibility of subterfuge, in some way. I'm always leery about. . .

PROFESSOR OPPENHEIM: Don't use the word "royalty"?

MR. CRAIG: Just paid a certain amount. But I do feel. . .

DIRECTOR HARRIS: Even for a trade secret. This involves a trade secret only.

MR. CRAIG: Well, I've always felt that the minute you use certain terms of art, you open yourself up.

DIRECTOR HARRIS: Confidential information?

MR. CRAIG: Well, whatever you want to call it. If they say, "we're willing to pay so much a year, or so much on the basis of our production, if we can use it" and you tie it up under the same rules as applicable to a trade secret agreement in the antitrust field, then, to be valid, it must be a trade secret and it must be limited to the items you manufacture under the trade secret. I think you've got to look at the whole field of the law in proper perspective. You're not only dealing with unfair competition

but you always have a real question of whether the know-how and trade secret agreement is enforceable under the antitrust law. I think if you get to that point, I don't think *Lear* is going to help it.

DIRECTOR HARRIS: Well, how else would you deal with your suppositional case than in contract terms?

MR. CRAIG: Well, I'm not saying contract terms—say, on the basis of a royalty based on production. I think the *Automatic Radio* case to the extent it's still alive is not applicable to trade secrets, and I think Professor Oppenheim will agree with me that a trade secret agreement which says "we're going to pay you on all our production" violates the antitrust law.

MR. JOHNSTON: Paul, I'd like to comment a little on your comments. For one thing, I think that the view you're expressing really is the issue that was put back to the lower courts in *Lear* for decision, and the main issue—as in the *Painton* case—points oppositely to what you have just been urging.

Another thing, I think that there's a mistake if you feel that the California courts couldn't decide the issue of validity and that that influenced the treatment of the *Lear* case in the Supreme Court. As a matter of fact, the *Lear* case was remanded to the California court and the opinion in *Lear* states that the California Supreme Court has yet to pass on the question of patentability in that clear and unequivocal manner which is so necessary. Now, obviously, the Supreme Court expects the California court to determine the question of validity in this contract dispute.

MR. CRAIG: Well, I appreciate that and I think the only question I have is whether state courts have jurisdiction at all to determine any issues of patents.

MR. JOHNSTON: Well, I think the answer to that is clear in *Lear*—that they do if it is collateral to a contract issue. They do not have the jurisdiction to enforce the patent rights, but that goes back to the point made earlier today that *Lear* isn't a case of attempted enforcement of a patent right. And for this reason, *Lear* is a sort of a back door way of getting at licensee estoppel. But there was no attempt to enforce a patent.

MR. CRAIG: Well, I agree with you that this is one of the reasons it went up to the Supreme Court—it was a back door approach to a know-how agreement tied to a patent, where you try not to enforce the patent but the contract, but unfortunately it tied into a patent in some way. I think that's what got up the ire of the Supreme Court.

MR. JOHNSTON: But it's a very usual and necessary type situation,

where the rights that were transferred to Lear were all of the workers' rights, whether or not they would become patented; if something did happen to become patented, therefore it was a part of the deal.

MR. CRAIG: But am I not correct in stating that Lear only agreed to pay as long as the patent was valid?

MR. JOHNSTON: The contract provided that the company would have an option to terminate as to the whole agreement, or as to a particular part of it affected, if a patent should be issued and it should be held invalid. That was merely an optional right to terminate their obligation to pay under certain future contingencies, none of which has yet been established to exist.

PROFESSOR OPPENHEIM: Well, suppose some claims were held valid and others invalid. Then what? Could you sever and say you owe me for royalty on trade secrets not related to those claims?

MR. JOHNSTON: It seems to me that involves the question of interpreting a clause in the contract that refers to a partial termination, and it may be that on evidence as to the intent of that clause of the contract one could say that on those claims which were invalid there was no longer any obligation to pay, and I would expect that to be the opinion.

PROFESSOR OPPENHEIM: Well, how about a drafting technique? Suppose in the light of this discussion, you are called upon to draft an agreement. You are very sensitive about what the impact of *Lear v Adkins* might be, so you decide to draft it with that case in mind. So you recite that you are the owner of certain subject matter, you state what it is you consider to be property rights of yours, whatever you want to call it—property interests, know-how, or trade secrets. Your patent counsel is convinced that all of the subject matter is not potentially patentable—that it wouldn't come under patentable subject matter (Section 101) or that it wouldn't meet the nonobvious test under Section 103; and then you keep on reciting an agreement for payment by the recipient for this know-how or trade secret subject matter that you disclose in confidence. Do you think you might escape some of the claws of the implications in *Lear*?

MR. JOHNSTON: It seems to me you are only putting a disparaging label on the work by the negative aspects of that supposition, and not really gaining anything as it relates to the underlying philosophy of the decision.

PROFESSOR OPPENHEIM: No, but I'm talking about reciting some of these things. On that there'd be pretty general agreement among the Patent Bar, namely, technical information which qualifies for trade

secret protection under the *Restatement of Torts* sections on trade secrets.

MR. JOHNSTON: All right—your question, then, really is contemplating that area of trade secrets that clearly is not within the framework of patent protection.

PROFESSOR OPPENHEIM: That's right, but. . .

MR. JOHNSTON: But nevertheless, clearly. . .

PROFESSOR OPPENHEIM: Clearly is trade secrets, yes.

MR. JOHNSTON: And you're not talking about a business method.

PROFESSOR OPPENHEIM: That's pretty much on the borderline.

MR. JOHNSTON: Then the question is whether these cases erect any obstacle to the potential validity of such an agreement.

PROFESSOR OPPENHEIM: Yes.

MR. JOHNSTON: Well, I certainly hope they don't.

PROFESSOR OPPENHEIM: In other words, you don't go to the Patent Office, but you were advised by counsel that this was far removed from any probability of patentability. You just didn't go down there, because we. . .

MR. JOHNSTON: Because it never entered anybody's mind that this could be. . .

PROFESSOR OPPENHEIM: Suppose a patent attorney looked the thing up and he was convinced that he had no chance of getting a patent issued.

MR. JOHNSTON: Well. . .

PROFESSOR OPPENHEIM: Judge Motley can't then say, you should have disclosed the trade secret subject matter for the Patent Office to decide whether it was or wasn't patentable.

DIRECTOR HARRIS: Who decides that? Who makes that decision?

PROFESSOR OPPENHEIM: Well, initially, your patent counsel.

MR. JOHNSTON: The only thing that I question is this, that that type of trade secret information, while valuable, is valuable primarily because of lead time—it isn't the kind of thing that can't be picked up by a lot of other people if they choose to spend the time and effort. Whereas the other type trade secrets, those that are more tricks of the trade or things which have been discovered but not made public and are very difficult to come upon, have, in a sense, a much higher order of quality. And this is what we recognize publicly—that other type that I mentioned approaches more nearly the thing that the patent act itself specifically authorizes to be protected. Now, it's ironic to me that there could be a doctrine validly drawing a line of distinction between these two things, that would make a difference legally, in the consequences of an agreement, when they are both equally in the secret status, both equally in the creative

proprietary area of human activity, both equally susceptible to contract, often having to be mixed together in a contract. In fact, I've known many contracts where they are mixed together indiscriminately. To draw that line would strike me as being a very unrealistic line. I agree with you that, as far as what seems to have been in the mind of judges so preoccupied with patents in these opinions, that there can be room for saying that they certainly haven't ruled out the enforceability of those contracts.

PROFESSOR OPPENHEIM: In other words, you seem to be saying that there may be a distinction where you have a very low grade trade secret—very far down the totem pole. Where you are so far removed from potential patentability the court would say that this is a very honest kind of recital.

MR. JOHNSTON: If *Lear* and *Painton* go as far as they may go on this question of unpatented trade secrets, then it's still arguable, I suppose, that they can't be said to go to the type of thing your question put, because anybody knows that those things aren't in the area of patents. Now, whether that argument. . .

PROFESSOR OPPENHEIM: But Judge Motley in *Bourns* couldn't put to the Patent Bar the all-or-nothing kind of thing, could she? Did she really say, this is all-or-nothing on patentability? In other words, was she saying that one could readily recognize that there are trade secrets of such a low value that you can't get a patent covering them?

MR. JOHNSTON: I don't think that the court in *Painton* or the court in *Lear* really put its mind to this other type of trade secret that your question contemplates. Therefore, it's always arguable that the cases have no application to that situation. But if you flip the doctrines that they are seemingly relying upon around into their logical extension, it seems to be that once an idea—and they use the word idea—once an idea has gotten into the contract area, or into publication—even (by patent or otherwise) any form of publication and any form of dissemination of the idea—the notion seems to be that then it becomes controlled by federal patent policy, and unless there's a law that says it's protected, it isn't. And if they go that far, then I would have to say even this would extend to your nuts and bolts.

PROFESSOR OPPENHEIM: Andy?

MR. BEVERIDGE: The situation you have been discussing is basically black or white, but if we hit into a gray area, and we very well know we will in some of these licensing and know-how situations, we not only start out with an initial handing over of information, but we can provide for a certain number of our employees to be present and working with these

licensees for a period of time. These people are on the site, and we may be erecting a plant, running it for a trial period, and then running it for initial production. So you have a situation that could continue over a long period of time and you wouldn't know whether you had any patentable ideas coming out of it or not. Assume at the beginning there were none, you as counsel or I as counsel would say the trade secret information that I'm handing over to you now is in my opinion not patentable and I would not recommend filing on it. But, of course, working out this thing over a period of months, maybe even years, a few ideas might develop. How do you protect against that?

PROFESSOR OPPENHEIM: Then we'd have to have a prospective operation, Andy. And you could say you're all right now in not disclosing information not patentable but you won't be all right later. If you do come across something stemming from this, it becomes patentable after you do more R&D.

MR. JOHNSTON: I would like to add just one other thing. There is one possible line that might be drawn in this whole area, if the courts choose to draw it. And that line would concern the point of publication. You see, the 1960 date in *Lear* that's stressed is the point of publication of patent. The court gave no weight to the fact that in the lower court they held that *Lear* took things that were beyond what the prior art showed. The court apparently assumed that the patent disclosed all that *Lear* continued to use. And the opinion talks about, uses an expression, referring to the publication of the work. If you use that as the dividing line, then you can maybe fall into patterns that resemble the copyright distinction—the common law of copyright and and statutory copyright, and let publication be the dividing line between the point of protectibility and the point of unprotectibility, without patent protection.

PROFESSOR OPPENHEIM: But then you can get a chill, because first of all it would knock the devil out of the confidentiality of a patent application and the lead time you get under the patent application.

MR. JOHNSTON: No, it wouldn't, Oppie, because if you're hanging on publication that wouldn't occur until the patent has been granted.

PROFESSOR OPPENHEIM: Oh, I see, you wouldn't knock out prepublication confidentiality before the patent issues.

MR. JOHNSTON: No, you wouldn't need to knock that out. You would, if you took publication as your line of demarcation, be able to logically enforce the prepublication obligations of the disclosure and contract.

PROFESSOR OPPENHEIM: But you have another problem. Publication of what? Because, if I understand correctly, you would say, yes, there was a publication, but there was a lot of art that was not touched upon, not really in public use, but not necessary to disclose to the Patent Office in

order to get the patent issued. Do you have that kind of a thing?

MR. JOHNSTON: Well, all right.

PROFESSOR OPPENHEIM: You may have some generic claims, or some combination claims. . .

MR. JOHNSTON: That logic would require holding that the concept of dedication—incidentally, dedication is a word used in the *Lear* opinion—the concept of dedication would apply only to what is published. It would apply logically, that if you had an agreement with a mixture of a patent license and know-how license, and if after the issuance of the patent the licensee chose not to pay, he might escape his patent liability by showing the patent invalid, but he still wouldn't be able to escape the liability for use of the know-how that was substantial and wasn't disclosed in the patent.

PROFESSOR OPPENHEIM: And doesn't come under a duty to disclose, under the *Walker Process* case rationale?

MR. JOHNSTON: Now that particular line of demarcation is the only one that to me makes any sense at all, but it isn't one that fits into the pattern of logic of the opinion of the *Lear* decision.

PROFESSOR OPPENHEIM: I now have the pleasure of calling on George Cary, Deputy Register of Copyrights, who's going to be talking to us about sound recordings from the standpoint of authors, performers and record companies, and taking into account the impact of the Supreme Court's *Fortnightly* case decision.

GEORGE D. CARY

Thank you, Oppie. I would only preface my remarks by saying that compared to the complexity of the subject that Al has been discussing, the one that I am to discuss is as transparent and clear as a gem of purest ray serene. I have entitled my remarks "Freebooters and Free Riders," which I think will give you an idea of what the contents are. I understand that my function here today is not to deliver a dissertation on the subject which reflects my own personal views, but is rather to serve as a catalytic agent producing a useful interaction of views of the experts assembled here. Consequently, I don't intend to engage in any comprehensive review of all the problems involved in this area, but instead merely hope to attempt to bring some of these into focus by summarizing

some of the more glaring unfair trade practices in the area. It is for you to discuss, or dissect, rather, the focussed image and shed the light of your own knowledge and experience thereon, so that, hopefully, you will have created a body of data and ideas that may serve to assist those remedying some of these problems.

Perhaps the most prevalent and costly unfair trade practice in the recording industry results from the process known as "bootlegging" or "pirating" of a record or tape, to which Bill Dyczko has already referred. Let it be said at the outset that this practice is not considered an infringement under the copyright law, as Bill has also indicated, except under one circumstance, namely, that where the pirate fails to pay to the proprietor the statutory two cents royalty for each composition which he produces. Should he not do so, then the copyright proprietor can at best recover triple damages, which would be six cents per composition, which is not likely to make any such effort effective or remunerative—and I'm talking about his action under the copyright law only. The net result is that in most cases federal copyright law is generally of little assistance in stopping this practice, so you have to look to other means.

Basically, the piracy problem is not a new one, although today it has reached a point, especially with the growing popularity of pre-recorded tapes, where it is of growing concern to the recording industry. So, by way of background, just let me briefly explain to you how these so-called pirates operate, and how their actions affect the various parties involved in a recording.

Some 12 to 15 years ago, when the 45 rpm single record was at the height of its popularity, particularly with teen-agers, the piracy problem bloomed exceedingly well. An enterprising individual looking for a fast buck could obtain a copy of the original record, run a tape from it, and take this tape to a record custom pressing service and order whatever number of copies he thought he could dispose of. Ironically, it often happened that the custom pressing company was a division or affiliate of the record company that had produced the original recording. At that time, the pirate also frequently produced or obtained from unauthorized sources exact reproductions of the original label and then affixed these to the custom pressed records. So, since the pirate did not have to incur the expenses involved in producing the record, such as a payment to the performer or performers, hiring of the musicians, arrangers, producers rental of a studio, and so forth—all of which may be considered by no means nominal expenses—it was possible for him to sell the bootlegged recordings either to unsuspecting or possibly conniving dealers or distributors at considerably lower prices than those normally paid. Testi-

mony before a Senate Committee in the early 1960s indicated that such actions had diverted some \$20 million from the legitimate music industry.

In 1962, the Congress, at the urging of the record industry, passed a law making it a criminal offense to produce and transport in interstate commerce counterfeit copies of the record labels. While this law undoubtedly made it more difficult for the pirate to do business, it may not be accurate to state that thereafter unauthorized records completely disappeared from the scene. There was still no criminal inhibition to deter the pirate from simply using labels of his own origin, so long as they did not amount to counterfeiting of the original.

In recent years, with the advent of 4-track and 8-track stereo tapes, which are usually used in your automobile, the pirate found it considerably less difficult to carry on his business. For one thing, the actual copying of tapes was less costly and a lot simpler to produce, probably, than making the records. The higher cost of the original tape cartridge produced a ready market for his unauthorized product. And, very frequently, the reproduction on these unauthorized tapes was of a higher order of fidelity than many of the bootlegged phonograph records.

Henry Brief, the Executive Director of the Recording Industry Association of America, which is the trade organization in this field, has estimated that in the year 1969 one out of every three pre-recorded tapes sold in this country was a pirated copy of the original. So, if you can realize that sales in this field amount to something over \$300,000,000, and one out of three of that was bootlegged, you get an idea that this was far far greater than the \$20 million that the Committee found was diverted from the legitimate music industry in the 1960s. Five times as much, roughly!

In February of this year, the trade press announced that the Recording Industry Association of America, which I will hereafter refer to as RIAA, had mounted a total war against tape pirating. According to these sources, one aim was to prepare a uniform law and urge its adoption by the various states, since only New York and California had any criminal laws against such piracy. Bill has already told us that the criminal law in California isn't very effective and is now being challenged on a constitutional basis. As a result of this approach, a committee of the Arizona legislature reported this last month on a bill that would make the unauthorized manufacture, wholesaling, and retailing of unauthorized tapes a criminal offense. As far as I know, this is the third state to take any action and hasn't quite completed it, unless you have some more up to date information than I do. Bill?

MR. DYCZKO: There is one other.

MR. CARY: There is? Which is it?

MR. DYCZKO: In Texas. It's pending. They're sympathetic.

MR. CARY: Another aim of the RIAA is to coordinate various legal battles against the pirates, to convince advertisers and manufacturers of tape equipment to cease ballyhooing their equipment for this type of use and to enlist other segments of the music industry in their war against the pirates.

One court case brought by a major tape producer against such a tape pirate is worthy of mention—I assume that this is the one that Bill has referred to earlier—which was *Capitol Records, Inc. v. Erickson*, doing business as Phoenix Tapes. In that case, the defendant reproduced tapes produced by Capitol Records, and on the label of the stereo cartridge listed the title and the performance and the names of the performing artists. In addition, it included this very interesting statement:

No relationship of any kind exists between Phoenix and the original recording company nor between this recording and the original recording artist. This tape is not produced under a license of any kind from the original company nor the recording artist(s) and neither the original recording company nor artist(s) receives a fee or royalty of any kind from Phoenix. Permission to produce this tape has not been sought nor obtained from any party whatsoever.

A very unusual type of admission! In that case, the defendant contended that its conduct was entirely permissible under the doctrine of the *Sears* and *Compco* cases under which theory a state court could not, under those cases enjoin the conduct on the theory of unfair competition or otherwise. The court, however, held that the statement on the cartridge, which I just read to you, did not of itself negate the possibility of a “palming off” or confusing the public, a matter which they left for the trial court to determine. And, in addition, the court did uphold a preliminary injunction on the ground that the defendant actually misappropriated plaintiff's entire product, and said that this result was not barred by *Sears* and *Compco*.

Perhaps stirred by this success, Capitol Records is reported to have begun the biggest crackdown on tape piracy when in March of this year it filed action in a California court against 44 companies and individuals charging illegal duplicating of their tapes.

On other ground, there has been set up an ad hoc committee of publishers, artists and recording companies which has proposed a rather novel legislative solution to this problem, and Congressman Burke of Massachusetts introduced it into the House on March 26 as H.R. 16687. The bill would require anyone engaged in the manufacture and sale of

records and tape recordings to secure from the U. S. government an identifying number which would be displayed on each of the products sold to the public. A stamp tax of \$5 is to be paid to the Internal Revenue Service and this would authorize the manufacturer to impress the number on his product, followed by the legend "United States Stamp Tax." Anyone manufacturing and selling records or tape recordings that did not bear an authorized number, or who made a false application for a number would be guilty of counterfeiting and subject to a fine of up to \$5000 and imprisonment of not less than five nor more than 25 years—pretty steep penalties!

Now, these bootlegging practices, it seems to me, affect adversely just about everybody who participates in the making of a recording. If the bootlegger is aware of the compulsory licensing provision and makes the payments due to the copyright proprietor, then he gets off the hook as far as the copyright proprietor is concerned. But the difficulty of that is that these types of operators are usually the "fly-by-night" types, and even if he made the payments it might be difficult, if not impossible, to ascertain whether the payment was really based upon the actual number of recordings manufactured. And, of course, if he didn't pay anything, then, obviously, the copyright proprietor is adversely affected by the failure to receive the entire amount of the royalties due him under the copyright law.

However, the recording company is obviously the principal loser, since the sales of the bootlegged product at a cut-rate price sufficiently dilutes the market for that recording at least to the extent of the number of the unauthorized recordings sold. Here again, I would refresh your mind—as Mr. Brief has stated—one out of every three recordings are of that type. In addition, companies in many instances lose good will value because sometimes the records or the tapes could be of an inferior quality and cast aspersions upon the validity, as it were, or the authenticity of the products of that particular record company.

Then we have the performing artist. He suffers a loss in royalties since in many instances the artist is paid by the recording company a certain percentage of the gross sales. So, if there isn't a percentage of gross sales to be paid, obviously he loses. The musicians, who play the music, are adversely affected because there is no payment by the bootleggers to what is known as the musician's trust fund, which is primarily a payment by the record company to the musicians under a contract with the American Federation of Musicians, I understand, which was set up as a way of providing pensions for the older musicians or those out of work.

So, bootleggers don't pay that and so the musicians are adversely affected.

Finally, Uncle Sam's Treasury Department is also affected because the bootleggers don't pay the excise taxes which the law requires to be paid on these manufactured records and tapes, since bootleggers are not about to provide such incriminating evidence.

There's another aspect of this particular unfair trade practice, which is a by-product of it, really, and this has to do with an interference with contractual relations. For example, in 1951 a recording of Verdi's *A Masked Ball* was issued by a firm called Classic Editions. The performance supposedly took place in Italy and the artists listed were either fictitious or unknown—that is, the artists listed on the record label. Irving Kolodin, of the *Saturday Review*, exposed the hoax by pointing out that this was actually a broadcast performance of the Metropolitan Opera made some four years previously. Two of the performers on this recording were Jan Peerce and Leonard Warren, both of whom were under contract with RCA. Maybe Bill might tell us whether there were any red faces at RCA after Mr. Kolodin revealed that the unauthorized recordings had been pressed by RCA's own custom pressing division! So, unwittingly, RCA had become involved in a breach of its own contract. I understand this was settled out of court by the company agreeing to withdraw the recording.

However, in 1950 there was, I think, a landmark court decision which involved the right of a recording company to enjoin "off-the-air" recordings of the Metropolitan Opera broadcasts, which we in the copyright field and in the record field call the *Metropolitan Opera* case. Although this was originally an action by the opera company to enjoin some recording outfit from taking these off-the-air recordings, Columbia Records participated in this later by joining itself as a plaintiff, and its reason was that it had an exclusive contract with the Opera Association to produce certain recordings of the Metropolitan Opera. So, its allegation was that this action by the defendant was an interference with its own contractual relations. Well, aside from the fact that the court held the defendants' acts to constitute unfair competition under the misappropriation doctrine, it also held that the conduct of the defendants "interfered with Columbia Records' enjoyment of the benefits of its exclusive contract as plainly as if the defendants had persuaded Metropolitan Opera to break its contract with Columbia Records by granting to them the privilege of recording Metropolitan Opera performances." Perhaps the summation of the court in that case is pertinent to our discussion here today:

The conclusion here reached is not an onslaught on the currents of competition; it does not impose shackles on the arteries of enterprise. It simply quarantines business conduct which is abhorrent to good conscience and the most elementary principles of law and equity.

Now, another form of unfair trade practice in the recording industry, which made the headlines some ten years or so ago and which gives an indication perhaps of returning in a different form, is that practice you've heard about as "payola." This is a phenomenon which historically is an outgrowth of the early-developed practice of song-plugging. In the music industry, exposure of the work is considered a prime objective. In the days when the sheet music dominated the industry, it was not uncommon for a Tin Pan Alley publisher to persuade a vaudeville star or a bandleader to "plug" certain of his compositions. When sheet music sales lost their dominance in the 30's, and it became evident that the preferred form of exposure was by means of spinning a disk in a broadcasting station, the "disk jockey" became the cynosure of the affections of record manufacturers. The nature of the exposure problem can be visualized when it is understood that in 1968, which is the most recent year that I could find any figures for, during that year approximately 126 single records and 78 L/Ps were issued each week, a total of well over 10,000 separate records for the entire year! Obviously, all of these could not be hits. So you can see there is a great possibility of competition for public acceptance.

The payola scandal that was uncovered in the early 60's is a matter of common knowledge and we don't have to repeat that here. But I would just like to read you a very brief excerpt from a report of the Special Subcommittee on Legislative Oversight of the House Committee on Interstate and Foreign Commerce, which went into that subject, and this is the quote I'd like to bring to your attention.

... there is considerable reason to believe that much of the music the public hears is played not because of broadcasters' judgment as to its quality, but because of its use. Broadcasting of music is a necessary ingredient in balanced programming. Enhancement of record sales or artist popularity that results incidentally is perfectly legitimate so long as balanced programming is the broadcaster's principal concern. It is when the broadcaster loses sight of his programming responsibilities and accepts the "promotion" role thrust on him by the record industry that the public interest is compromised.

As a result of that scandal and the investigations, the President approved, in 1960, an enactment which was designed inter-alia to promote the above-stated objective of "balanced programming." As far as the payola issue is concerned, the new law in effect required the

broadcaster, where any money, service or other valuable consideration was paid, directly or indirectly, to it, to announce the name of the person or organization furnishing the same as well as the fact that such contribution was made.

This new law, however, I point out, did not apply to the relationships of music publishers and songwriters with record company personnel and distributors, so that any payola in that area would have to be governed by the various bribery laws of the different states. Two practices which lend themselves to payola in this area should be mentioned in passing at this point. The first is the so-called "cut-in," which can be of different types. When the music publisher was the means of promoting exposure, it was not uncommon for a publisher to cut himself in on the songwriter's share of royalties by securing an agreement that he would be listed as one of the composers. Thus, as a publisher he would share in the recording royalties under the copyright law, and as a co-author he benefitted by obtaining a share of the performance royalties which the copyright law also authorized.

Today the shoe may be on a different foot. Record companies, now being the principal medium of promoting the exposure problem, frequently demand and receive from the publisher a "cut-in" as part of the price for recording a particular composition. I might add that it is now becoming more and more common for a famous artist to cut himself in in the same manner. Further, in the rising tide of conglomerate ownership of business organizations, it may be that a record company which owns a music publishing company or companies, will cut itself in the composition by taking a part ownership of the copyright.

The second aspect of payola in this area concerns the relationship of recording companies to their dealers. Recording companies frequently compete for exposure by offering a stated number of free records, known as "freebies," to their dealers for each stated number of purchases. One rather unusual example that I am aware of was one case where a record producer offered 300 singles for every 1000 purchased. So the recording company benefits by the supposed desire of the distributors to push the sales of that company's labels, and the dealer profits by selling the freebies and pocketing the entire sales amount as profit. The artist receives no royalty, however, on these freebies, nor does the publisher, and quite possibly the government fails to receive its excise tax on these freebies.

PROFESSOR OPPENHEIM: A lot of trading stamps, though.

MR. CARY: A somewhat different form of payola may be in the process of being uncovered now. In February of this year one Gerard W. Purcell,

a talent agent with offices in New York and Hollywood, alleged in an affidavit presented to the FCC that certain recording artists were being forced to pay "kickbacks" as a part of the price for obtaining an appearance on TV shows. The allegation was that the kickback was generally received from a record company but that the company usually deducted the amount of the kickback from the royalties due the performing artist. Thus, Mr. Purcell concluded, this in effect constituted a forced payola payment by the artist to the TV network or station. However, the TV station involved in this particular instance denied such kickbacks but did admit receiving some reimbursements from record companies which furnished the artist. However it contended that it had complied with the 1960 payola law by announcing that the artist appeared through the promotional consideration of the specified record company. As far as I am aware—and maybe Bill can throw further light on this—this matter is still under investigation and consideration by the FCC—I haven't heard that it has been concluded.

In concluding this area of the unfair trade practices, I'd like to mention two other areas which perhaps give us a little more uncertainty and doubt. In other words, these probably fall in the "gray" area which are neither black nor white. The first of these concerns a rather sizeable practice in a certain area by a few specialized record labels of reissuing on L/Ps some of the performances of the great voices of the past, such as Caruso or Schumann-Heink, whose original recorded performances may exist only on very old 78s or even in some instances even on the early wax cylinders. Here we have a situation where many record companies would probably not consider it economically feasible to reissue such recordings and the companies that do reissue these justify their actions as preserving for history the practically unobtainable voices of the past. However, in recent visits of music stores, I seem to note that the record companies are now bringing out more and more L/P reissues of these old 78 rpm performances of great artists back into circulation. It may well be that the so-called odd-ball labels are having some effect or it may be that the record companies are doing this to preserve their right to these old recordings—I don't know.

Another part of this gray area that I mentioned involves the same practice but with a somewhat different purpose and I refer here to the situation where a number of record buffs may gather together as a club and will have run off, say, 100 sets of certain old records, and they limit the distribution just to the members of their club, which is supposed to be a non-profit private organization. Usually in these cases the label itself has stamped on it "privately issued" or "not intended for sale" or some

such indication. However, it's also true that in certain areas several of these recordings do find themselves on dealers' shelves in some manner, so it's not exactly clear as to whether this is limited to the club members or whether they press more than the 100 copies they say they do. This is all in an area which to me is considerably gray.

I think those are the principal areas the recording industry would like to think about. Now, coming to the impact of the *Fortnightly* case, I should point out that in the practices I've just mentioned, the bootlegging, primarily, and the payola, you have an aspect of either immoral or improper or illegal conduct. However, in the *Fortnightly* case, you can't necessarily say that that is what exists because, really, there the situation was one which was produced by an interpretation of the court as regards a section of the copyright law. In effect, the Supreme Court there held that no compensable wrongful act existed when a CATV system received the transmitted signals from television stations that were as distant as 52 to 82 miles in most cases, and passed these signals along to the homes and television sets of its subscribers by means of cable. In that case, there was no credible, competent evidence that any of those signals could have been received on a commercial television set by means of a regular rooftop antenna. This is because the locale of this case was in Clarksburg, West Virginia, which is, if any of you know the area, quite mountainous and, as you know, the television signal does not go around or through a mountain. That is why the CATV system was in operation there. Although there are many who would agree with dissenting Justice Fortas when he said, ". . . the Court today abandons the teachings of precedent, including a precedent of this Court. . ." it is not my intent here today to joust with the Court with respect to an opinion that would appear to be more of a socio-economic desire to support the growth of a new communications media than it is a legal decision.

However, looked at even from the aspect of being a socio-economic opinion, I throw out to you for your consideration whether there are not a few elements of unfair competition involved there. In simplistic terms, one might contend that this is a case where the Court in effect, by legal fiat, authorized a "free ride." How did we get that conclusion? From the point of view of the copyright proprietor, it should be noted that this proprietor—and I'm talking here now primarily of the copyright proprietor of the product which you mostly see on television, namely, motion picture film—he commonly exploits his product by licensing a package of films to a TV station for exclusive showing for a specified number of times over a stated period of years. Thus a broadcaster in Clarksburg, for example, who had purchased such a package of film, could arrange his

advertising and programming secure in the knowledge that people in that area would not be exposed to the film or films until they were actually broadcast by him. But if the CATV system, by means of its "well-located antenna," as the Supreme Court described it, is able to bring the same film or films to Clarksburg from one of the other cities involved in the case, namely Pittsburgh, then it seems you could reasonably contend that the action of the CATV system is unfair both to the copyright proprietor and to the local broadcaster. It's unfair to the copyright proprietor, one could argue, because it adversely affects his property rights in his films, and it's unfair to the local broadcaster because if this practice is continued unabated, the possibility exists that his advertising income might be so diminished that the community could ultimately lose its local TV outlet. And if this happened, what would the CATV systems do?

Another arguable instance of unfair competition concerns the fact that, as Justice Fortas very properly pointed out, "The operations of CATV systems are based upon the use of other people's property." One can urge that serious doubts can be raised with respect to a doctrine that permits a commercial CATV system which is in business for money, not a non-profit operation, to enjoy a free ride with respect to program material for which the originating broadcaster pays a fee for the right to disseminate over his station. Thus, when one looks objectively at two different types of communication media which maintain the hope of making an honest profit by their competitive operations, and one of them is freed of the cost of the program while the other is not, it seems difficult not to consider this obviously discriminatory practice as unfair competition.

We may take a look, also, at another problem in this connection and that is the televising of professional sports contests. Under a law enacted by Congress in 1961 these sports organizations—and I'm referring here primarily to the professional baseball and football teams—are permitted to enter into exclusive contracts with television networks and to impose a blackout in an area where a contest is being performed. One might well understand the frustration of a television broadcaster who, because of the blackout restriction, may not broadcast a particular game and incidentally is so prevented from enhancing his advertising revenue because a great many people are not going to watch his other programs—they're going to watch the game if it is imported into that area by a CATV system from an area where the ball game is not being blacked out. Now this act of the CATV system, in importing the signals, doesn't appear to violate the law of 1961 that I referred to, but one may possess doubts about any

reasoning that affords the CATV system an unfair advantage over the broadcaster merely because of a technicality of the law.

Then, perhaps I should mention another type of unfair competition which has been alluded to by the FCC in its various orders relating to the regulation of CATV systems. Taking as a premise the intent of the Communications Act of 1934 that the public interest would be served by promoting the "larger and more effective use of radio"—and they include television in that—the FCC has for a number of years considered it in the public interest to promote the growth of independent UHF television stations. These stations are by no means as lucrative investments as the regular VHF stations, and they generally do not always find it possible to turn even a nominal buck. Yet they have to compete with the cable systems for audience and revenue, but while they are required to pay for the programming they broadcast, under *Fortnightly* the CATV system would be freed of copyright fees. So, if the FCC is correct in its desire to foster the growth of UHF stations, then one can point to the unfairness of requiring the UHF broadcaster to pay for his product while at the same time the CATV system can get a free ride merely by importing a program into its subscribers homes in that general vicinity.

Well, lest you think this is a pretty dark picture—maybe it isn't. It can reasonably be contended that the *Fortnightly* case is concerned only with what might be termed local signals and does not concern itself with the problem of importing distant signals. This problem, incidentally, may come up for a decision this fall in a case that's pending in the Southern District of New York. Columbia Broadcasting System is bringing an action against a CATV system for the importation of signals including the fact that, in certain areas, they are using microwave relays for transmission. The FCC had already, some years ago, announced its jurisdiction over microwave transmission. That, to the FCC, is broadcasting, so, in this *CBS* case, it is likely that the court will face the problem whether or not the use of microwave relays or the importation of a distant signal in effect puts the CATV system out of the exemption of the *Fortnightly* case. Even Justice Fortas in *Fortnightly* admitted that insofar as CATV operations are limited to a geographical area which the licensed broadcaster has the power to cover, the CATV might be considered little more than "cooperative antenna." But, he adds, this would not be so where a CATV system imports distant signals because, in his words, "In such a case the CATV is performing a function different from a simple antenna. . . ."

You see, in the *Fortnightly* case, the whole point of the majority opinion was that the CATV system was not performing a work under the

copyright law—it was receiving a work—it was nothing more than a passive antenna. But, as Justice Fortas points out, where you import signals from a distant area, then you're not performing a simple passive antenna function, because, to go on in his words, . . . "the antenna could not pick up the signals of the licensed broadcasters and enable CATV patrons to receive them in their homes."

Well, lest anyone obtain the impression that my remarks concerning *Fortnightly* have indicated in any way that CATV interests have always contended that they are entitled to a free ride, I'd like to rid them of this misconception here, because way back in August of 1966, when he appeared before the Senate Judiciary Committee on the Copyright Revision bill, Fred Ford, who was then President of the NCTA, which is the trade organization of the cable television industry, stated certain general principles that he thought might be the basis for a resolution of the problem. Among them, he said, was a willingness to consider the payment of license fees to import certain distant signals. In some cases he would urge that the fee would be payable under a compulsory license; in other cases, it would be a negotiated license. He also suggested that where the CATV system originated a program, copyright fees were in order. They always have maintained this—when they originate, they are required to pay copyright fees. In fact, numerous meetings between CATV interests and other involved parties extending over a period of several years were the subject of attempts to find a resolution of the issue on which all could agree, and although they finally did break down prior to agreement, it's surprising to note that they *almost* did reach an agreement. So, I think, lest you think I'm accusing the CATV people of being free riders in that sense, I think there was a good bit of evidence to indicate that they did try to resolve it—all parties did, as a matter of fact. I, myself, wish to doff my hat to all the parties because these negotiations went on for several years, and from what I could find out, were all in good faith, bona fide, and it's a pity, in effect that they came so near to, and yet so far from, agreement.

Well, because of this failure to reach agreement, Senator McClellan's subcommittee last December issued a report on a revision bill which included its own version of the solution of the CATV controversy, and perhaps I should close my remarks by briefly summarizing that proposal.

The Senate Subcommittee's provision permits cable television systems to obtain a compulsory license to retransmit a great deal of copyrighted programs without the necessity of having to seek permission to do so. First, all aural programs—that is radio programs—can be transmitted under this compulsory license. Then, too, the signals of all local TV

stations can be put on the system without permission. As a matter of fact, the FCC under its present order requires a CATV system to carry all local signals. Next, if the CATV system is located in an area which is not served by any TV station, then the CATV system can utilize all TV signals without regard to distance. In the top 50 markets, a CATV system can import distant signals so long as the total number of local signals plus the imports does not exceed those under this formula: 3 national network stations, 3 independent stations, and 1 educational station, which is known as the 3-3-1 formula. If we apply this formula to Washington, for example, or to New York, then it would be apparent that a CATV system could not import any signals because there are those seven types of stations in Washington and New York also. Now, in markets below the top 50, the formula is slightly different in that the number of independent stations is reduced to 2, so the formula is 3-2-1.

All these transmissions would be under a compulsory license and payment is based upon a stated percent of the gross receipts, which varies with the size of the system. And herein lies a bugaboo, because, under the bill, the copyright proprietors and the broadcasters, I understand, feel that the fees in the bill are so low as to warrant absolutely no giving in on that point. However, in certain areas the CATV system would be required to honor the exclusivity of the copyright proprietor. For example, if a CATV system in the top 50 markets received notice from a local station that it had exclusive rights to televise a motion picture in that area, the CATV system would have to black out that program coming from a distant station or be subject to the full infringement penalties of the bill. Now, if the CATV system is in an area below the top 50, it would have to honor the exclusivity of a similar kind to a local TV station only where the program had never before been broadcast in a syndicated showing by any station in the entire market. Finally, the CATV system would be required to black out a live professional sporting event originating from a distant station if no station in the CATV system's market area was authorized to broadcast it. Thus, if the Washington Redskins were playing the New York Giants in Washington, and the game was blacked out in Washington, a CATV system which might operate in the Washington area could not carry that signal.

Although perhaps some CATV interests may agree to this solution, there are others who won't, I'm sure. There is every likelihood that practically every other party would not—I'm referring here to copyright proprietors and the broadcasters. Consequently, it is perhaps too much to expect that the bill can be enacted in this Session of Congress. But whether one may like it or not, it would appear that CATV is going to

be around for quite some time, which means that ultimately some settlement of the problem will have to be reached. I would doubt whether it can be reached by judicial decision procedure. In some way it's got to be done legislatively. Perhaps those experts here may be able to take part in effecting such a settlement.

PROFESSOR OPPENHEIM: Thank you, George. That was said very effectively and illuminatingly. Well, we're now open for comments on that—any phase of what George Cary has covered.

DIRECTOR HARRIS: A point of clarification, Mr. Chairman. George, are you saying that despite no copyright violation by the CATV people their action is equivalent to an unfair trade practice?

MR. CARY: What I'm saying is the court said it was free, at least in the local area involved up to 80 miles. What I'm suggesting is that, just looking at it objectively and without regard to any copyright implication whatsoever, it seems that you could urge—I don't say that I do urge—I say that you could urge that there is the element of unfair competition, simply because you have two competing forms of communications media. One is required to pay for his product which he disseminates over the air, and the other is entitled, under the *Fortnightly* case, to receive this off the air, and he gets the free ride. This is the free ride doctrine when carried to its ultimate extent.

DIRECTOR HARRIS: But, since the court did say that CATV is entitled to the free ride . . .

MR. CARY: What I'm suggesting is, of course, inferentially the court decision is wrong in the first place, but leaving that aside, just looking at the issue itself, it seems you could argue that it is, in itself, unfair. Whether it would come under the unfair competition doctrine that a court would uphold is something else. You see, this particular decision didn't go into the unfair competition aspect at all, because the case was divided into separate areas, and the only thing that was decided by the District Court was the question of whether or not there was a copyright infringement.

DIRECTOR HARRIS: Right.

MR. CARY: And they agreed to hold the other issues, of which I think unfair competition was one, as a separate trial issue. Of course, I suppose now it will never be tried, but the court did not reach the unfair competition problem here. They were speaking only to the copyright aspect.

DIRECTOR HARRIS: Another question, George. Why do you think the courts are more generous in the copyright cases, with respect to misappropriation?

MR. CARY: It's a good question, and I don't know the answer, except that alluding to what I hinted earlier, for some reason the courts seem to have always treated copyright, I think, much more gently and protectively than they have patents. Perhaps, as I suggested, it may be because of the fact that the rights under copyright are considerably less restrictive in a sense than they are in the patent area. I once read somewhere, I believe, that somebody concluded in a brief survey of copyright cases, that copyright validity had been upheld in pretty nearly 75 to 80 percent of all copyright cases, and I'm sure you will agree with me that the percentage in the patent field is nowhere near that. But as to why, I can only suggest that in addition to the less restrictive nature of copyright, there may be a clue in the fact that the copyright decisions have primarily emanated from the Second Circuit, and one of the judges who has had, perhaps, at least a bearing on this is Judge Learned Hand. He has, of course, been an advocate of this type of proprietary rights and the other courts may have just followed him. I don't know.

DIRECTOR HARRIS: The case you cited, where the recording itself was appropriated, the court was most sympathetic.

MR. CARY: Well, there are a number of cases, I think I could dig up a dozen or more, at least, cases since *Sears* and *Compco*, in the copyright field; somebody mentioned the World's Fair, I believe, earlier, in which the courts have in effect said *Sears* and *Campco* does not apply where you appropriate the entire product. You're not copying—this goes beyond copying—this is appropriation.

DIRECTOR HARRIS: How do you distinguish that from any other kind of misappropriation?

MR. DYCZKO: Well, I don't know that copying is a misappropriation. Maybe it's only semantics, but what is happening, at least in the record field, you have a master recording which in effect is akin to a photographic negative. We all know that anybody can go out and take a picture from the same position that the original photographer occupied and come up with a negative exactly the same and there would be no copyright infringement. And remember, with recordings you're not even dealing with copyright. We don't have that protection that you gentlemen in patents and trademarks and the music publishers have. But what is happening in our situation is that the pirate is misappropriating—really stealing—our negative, if you will, and then, from that, making new copies or "prints."

You see, we in the record industry have been attempting to obtain copyright. Inevitably you talk about copyright because a component of the record is something that has previously been copyrighted, i.e., the

music; but the recording has an existence and a being quite independent of the copyrighted music embodied in it. It has the music, it has the performance of an artist, the creative services of the arranger, all brought together and blended by the record company along with its willingness to take financial risk. It is through the merging of these separate factors that the recording becomes an artistic creation.

That is what the record company puts together, and it creates an entirely new product. We've convinced the Copyright Office of this and the gentlemen of Congress in several ways, one of which was to take several different recordings of the song entitled "I Believe" and play them at the hearings. That these various recordings of the same song by different record companies with different artists unquestionably were different works of art presented the facts more convincingly than all the perorations of the record company executives and lawyers. The senators and representatives at the end of a couple of weeks were saying, we now begin to understand what you're talking about when you express the feeling that the record company does have a proprietary right, that it has created something.

So, to come back to your original question—and perhaps my photographic negative isn't the best analogy as it's the first one which came to mind—the pirates are not copying. Copying is perfectly valid in the record industry, but we don't call it copying. We call it "covering"—making a cover record. Let us say Bob Goulet, who is with Columbia, makes a recording of a new song, and it becomes a smash hit. The very next day 10 record companies will get their tenors, in many cases relatively unknown, and have them record the same song. There's no palming off; there's no misrepresentation. They will extol theirs in the advertisements, they will furnish the radio stations with their rendition of the same song, but here they're hoping that the fact that somebody has made it popular will help their own artist and help them to sell their version. That's what we call covering. It may be copying in the sense of the *Sears* and *Compco* lamp, but the industry accepts it. On the other hand the pirate, the bootlegger, is doing what George has just said—he'll go out and he'll get a record of ours or a tape, and then he'll proceed to make his "negative" from it and sell the very same recording we do.

DIRECTOR HARRIS: Couldn't the same thing be done with the lamp in the *Sears* case?

MR. DYCZKO: No, that doesn't happen as often. I wanted to get into that a bit. The statute—the only existing federal statute—is a 1962 counterfeiting statute. It's been utterly useless thus far for the record industry. As of six months ago, when I last checked with the FBI, there

had not been a single prosecution under it. The reason is obvious. The gravamen of the violation is not the fact of the pirating; the violation is the fact of counterfeiting a label or trademark. Well, we didn't really need that statute. We could proceed under the trademark law, under the Lanham Act. If they took an RCA label, they've infringed our trademark. We were very happy in those years when we got that statute, but it didn't really prove helpful, and the fact of non-enforcement means that no pirate has been silly enough to open himself up to a federal prosecution.

Our problem is that we have to proceed on state principles of unfair competition, and we've been in only four states. Many of the states don't even know what a master recording is, and I said earlier this morning, having gone through the misappropriation theory with one judge in a particular state, he finally denied an injunction on the ground that there was no copyright in the sound recording. We knew that. That was the point of our misappropriation argument. I guess most people are aware of the fact that there's no copyright in a sound recording. I think I can understand your question about. . .

DIRECTOR HARRIS: Excuse me. Let me ask you this. If in *Sears* and *Compco* there were an actual dubbing—as there would be in the case of an authorized duplication of a record, do you think that the decision of *Sears* and *Compco* would have been different?

MR. DYCZKO: Well, there couldn't have been a dubbing in our sense with the lamp, because—I don't know how they take a lamp that Sears made and then in effect grind out through electronic and technological processes several generations of children who are siblings of that very lamp. That's what's happening when they pirate a master recording.

PROFESSOR OPPENHEIM: You call that the matrix, by the way?

MR. DYCZKO: That's right. It goes under various names of matrix, master, master recording. I think, in a way, maybe my analogy with the photographic negative is not so bad after all. They've stolen our negative.

DIRECTOR HARRIS: You keep saying "stolen." So it's the stealing that's crucial here.

MR. DYCZKO: Well, we think it's stealing, and a lot of the judges call it by a more euphonious name, but I think they agree with us. They call it misappropriation. But we call it stealing only because we're trying to get a spate of criminal statutes around the country.

MR. JOHNSTON: I would like to comment a little on the question about copying versus *Sears-Compco*. It seems to me that in *Sears-Compco* the situation was a copying of the product, and there have been many cases

following the *Sears* doctrine where unquestionably you have a copy of the original product, for example, a molded article being purchased at the marketplace and a duplicate mold being made from one of the commercial products in order to produce a lower cost duplicate or substitute to sell in competition. And, certainly, *Sears* and *Compco* stands for the proposition that that is permissible. And yet you have a rather ironic twist sometimes occurring that's represented by a number of decisions, where, let us say, a competitor takes my client's molded product, makes a duplicate of it, in a sense, although usually a cheaper grade duplicate, by using a mold facsimili, but in advertising the product, shows a picture of my client's product rather than of his own. Just that one, relatively small—in terms of commercial significance—act of having misrepresented the picture as a picture of his product, where it was a picture of my client's product, will be enough to get him into the situation where he will be—

DIRECTOR HARRIS: You need an additional factor to establish unfair competition. It's misappropriation plus.

MR. DYCZKO: Yes. We can quote from many of the state court cases. This is a clear misappropriation of another person's property right, without compensation. And they find, basically, that we have to go back to that concept of copyright: Is it a God-given or government-given right or is it a property right? I guess we can't get involved in that one—but at least the courts are approaching it—those that have given us relief.

MR. JOHNSTON: Section 43 (a) of the Lanham Act is the usual basis for the type action I just mentioned, where the use of a falsely represented picture may be enough to create liability, and I say ironically, because very often the ordinary person would never know the difference between the picture of the original product and the picture of the mold duplicate.

DIRECTOR HARRIS: Perhaps that's why in the *Capitol Records v. Erickson* case you referred to, George, the company tried to avoid being charged with "palming off" by including the rather unusual statement on the cartridge.

MR. DYCZKO: That's precisely the purpose. The pirates seek and get legal advice. Fortunately for us, not all of them know the copyright law and unfair competition too well. Some of them have a smattering of copyright law, so far. They're getting better—our opponents are getting more sophisticated.

MR. CARY: In that connection, I might say that I often go back to the old statement of Justice Story, a hundred years ago, that copyright law is the metaphysics of the law. And I think it really does get very metaphysical. To go back to your question, Lou, about misappropriation and

copying—perhaps this may help you, although it does tend to confuse many other people, but you're more discerning than most people, so perhaps you might get it—I'm referring to a rather odd doctrine in the copyright law—it's odd in the sense that it seems to apply only to a certain limited category of works—namely, cartoon characters. As you know, there are several cases which, in effect, say that when you take a two-dimensional copyrighted cartoon character, let us say Snoopy, and you make a three-dimensional doll from that two-dimensional work, this goes beyond copying—you have infringed the copyright; but the reason they say you have infringed the copyright is that you have taken the complete essence of that particular copyrighted work and put it into a three-dimensional form. And it is the complete essence that is your appropriation, I think—in Bill's case of the records—you have taken a complete essence of this recording which has cost them a sizeable sum and you have misappropriated, whether you call it a negative or a master, or what.

PROFESSOR OPPENHEIM: Isn't that what happened years ago when Jack Benny came out so unfortunately in the parody of a copyrighted play?

MR. CARY: Well, that gets into the problem of whether parody is an infringement.

PROFESSOR OPPENHEIM: Well, isn't that the essence—where you're talking about the essence?

MR. CARY: Oh, in that case they did take the essence of the original work, whereas in the *Sid Caesar* case they did not.

MR. JOHNSTON: George, your comment, I think, might call for a collateral comment that would refer to the fact that, as I understand it, if I, as an architect, have a drawing or painting made of a house that I have designed, and someone chooses to reproduce my house, he isn't subject to the same doctrine that applies to the cartoon case, and this fact, I think, tends to answer a little bit a question put earlier—why is it that the copyrighted work somehow or other gets, by and large, much more favorable and easier treatment than the patent work. And I suspect that a great deal of it lies in the fact that the copyrighted work is regarded as something in contemplation, something to look at, something to read; whereas the patent-type work is regarded as a functional creation that is a little more obscure and gets mixed up in word problems because you have to define things—you can't just contemplate them. And so you just get automatically into the resistance of courts to give to the latter the same simple type of judgment factors that apply in the copyright field.

MR. CARY: Actually, copyright covers literary, dramatic, cultural, artistic types of works and people have been used to thinking over the

years that this is not a money-making field, that this is a non-profit field; whereas these machines, computers, typewriters that the patent people have come up with, the whole purpose of those is to make money by selling the machines. Well, it isn't quite exactly true, I don't think, because after all, the whole purpose of selling a book, statute, or whatever it is, is to make money out of it, so there is a profit motive in both forms of activity. So, I don't know whether your analogy there is quite accurate or not. To me, it still seems mysterious why the courts do this. I've never seen anybody satisfactorily analyze it.

MR. JOHNSTON: Well, another possibility is in the statutes themselves. To prove a copyright case all you need to prove is originality and that it was copied, and that you complied with the formalities—

PROFESSOR OPPENHEIM: Not much originality.

MR. JOHNSTON: And because of the human tendency of the courts not to supplant the judgment of someone else on artistic merit, you get a very broad range of judgment as to what constitutes originality. In the patent field, you have none of that because you have very obscure problems that go very deep—absolute novelty which is itself an extremely difficult thing to put your finger on, plus utility, plus this obscure concept of obviousness or not. It's amazing when you get into the litigation arena, how vastly less difficult it is to get over the problem of proving the case in copyright than it may be to establish the same case, virtually, on a patent foundation. I've experienced it.

MR. CARY: If I may make a facetious remark, Al, I wonder, and have wondered at times, whether one of the reasons the courts tend not to uphold patents as much as they do copyright is whether they aren't really basically getting back at the patentee for having put them through the ordeal of sitting for days and weeks, listening to all this complicated legalistic, mechanical jargon, and then in effect saying "fie on you."

PROFESSOR OPPENHEIM: Trading off sadism for masochism—.

MR. JOHNSTON: I've often wondered also, if one of the difficulties in the patent litigation is not that by the time the issue reaches a court, it appears to be a struggle between two competing companies, one of whom is going to appear to be a good person and the other a bad person. Inevitably, that occurs in litigation. And, it's virtually impossible for the human mind to project itself back to this theoretical thing of the day when the invention was born.

MR. CARY: Well, you have the same thing in copyright, because invariably, if you look at the cases, you will find that the courts must look upon the contending parties as being one wearing a white hat and one wearing a black hat. It's amazing how often you can find the courts

referring to a bare-faced infringer, for example, which is a term created by Judge Hand, and it's repeated time and again. They look upon the defendant in that case as a bare-faced infringer—he's the guy with the black hat. So, I don't know—this is still a mystery to me. I can't even answer Lou's question.

PROFESSOR OPPENHEIM: The ramifications of the subject matter we have discussed do not lend themselves to summarization. But at this point I shall try to synthesize a few basic principles which, in my view, may help to place in perspective certain implications of *Compco* and *Sears, Lear v. Adkins, Bourns* and the CATV *Fortnightly* case.

There is sometimes what is called an inarticulate major premise. I think there is one behind today's discussion, even though it may be hard to pin down.

Let's start with the basic premise that the purpose of the patent system is to encourage disclosure of technical knowledge. Likewise, the copyright system is designed to encourage diffusion of all writings of an author. *Sears, Compco* and *Lear* stress the national policy to promote free competition and hence to limit encroachments on the federal patent and copyright policy by private agreements or by extensions of unfair competition or misappropriation remedies in state courts.

There is no doubt that both the patent and copyright systems are designed to diffuse knowledge. The constitutional provision in Article I, Section 8, historically—and contrary to what some believed—used the words “useful arts” to refer to patents and “science” to refer to the literary arts—cultural or intellectual creations in that category.

Professor Bugbee of Gettysburg College has written a book on the historical background of this constitutional provision based on his original research. He throws great light on why the Founding Fathers adopted that provision without debate. Aside from the support of Franklin, Jefferson, Madison, it was clear that the infant United States needed the incentives to develop the industrial arts and to start an American cultural life. We thus needed artisans from abroad who would come to this country to develop useful arts and we needed authors and composers to enrich our cultural life. Obviously, the patent and copyright systems were regarded as the main source of private incentives by grant of limited time patents and copyrights.

But these goals were not deemed in conflict with common law protection of trademarks, remedies against unfair competition, or common law protection of trade secrets. Hence, the judicial process over the years was deemed adequate to reconcile the exclusive rights of patented inventions and copyrighted works with ideas embodied in unpatented trade secrets and trademarks. The legislative approach was for long

periods subordinated to the judicial process as the means of balancing these private interests with the public interest.

Now the interesting but puzzling aspect is that *Compco* and *Sears* and the implications of *Lear v. Adkins* seem to bring us full circle to the beginning of our discussion today—namely, a tug-of-war between the judicial and legislative processes. By that I mean, *Sears* and *Compco* placed federal preemption through patent and copyright legislation above state jurisdiction to redress misappropriation of unpatented trade secrets and to protect against unfair practices beyond mere copying of the functional features of a product, that is, product simulation in the absence of a valid design patent.

As I said this morning, one might wonder whether the pendulum has swung too far toward federal judicial supremacy which gives the federal courts—the Supreme Court finally—the last say as to how to balance conflicting private interests and the comparative equities involved. Hence, we are witnessing demands for congressional legislation to correct what is regarded as an imbalance, a loss of checks and balances.

The judicial process on the whole did a good job in balancing equities in the field of trademarks and tradenames. Many years ago Handler and Pickett showed that the so-called “monopoly” of trademarks had a very ghostly hue. Why? Because while the courts gave protection to invented words, they did not allow monopolizing of descriptive and generic terms which should be open to use by any person who needs to identify his product. At the same time the courts protected against confusion of source by passing-off practices.

But *Compco* and *Sears*, certain implications of *Lear v. Adkins*, the *Bourns* case and the *Fortnightly* case are evoking second thoughts. I personally agree with Justice Fortas’ dissent in *Fortnightly* that a CATV system infringes the exclusive right of the copyright owner to perform in public for profit and that “the task of caring for CATV is one for the Congress.”

As George Cary said, there may be a socio-economic interpretation of the copyright law. CATV, of course, does increase diffusion of programs but so does an antenna on the roof of an apartment house, but CATV subscribers pay a monthly fee for the cable hook-up and the CATV company makes profits from getting a “free ride” on the copyrighted works it picks up.

What seems to be happening is an oversimplification of the competitive concept as though competition were an absolute requirement in the public interest even when competitors or noncompetitors get a free ride on the labor, efforts and expenditures of another who produces a product or service of which he alone is the creator. As I pointed out this

morning, if *Compco* and *Sears* are definitively held to overrule the *INS* doctrine on which relief against various misappropriation practices can be granted, then this would also give competitors and noncompetitors a free ride on what equitably belongs to another—or as Rudolf Callmann stresses, allowing others to reap the fruits of what another has sown. Likewise, if *Lear* and *Bourns* should result in depriving owners of trade secrets of their equitable rights in trade secret and know-how information not made known to the public, there would be a further dilution of protectible interests and additional free rides for those who are allowed to poach upon creations of others.

Nothing in what I have said should be interpreted as meaning that the law should protect worthless or invalid patents. *Lear v. Adkins* is a sound decision so far as sending to its demise the licensee estoppel doctrine. Similarly, the courts should protect only genuine trade secrets and know-how, not spurious claims for protection of information not worthy of being classified as “secret.” My articles in patent-antitrust place me on record as being just as vigorous as the Antitrust Division in condemning genuine patent misuse and the abuse of patents in violation of the antitrust laws. But in that area I support patent license limitations which the courts have held to be reasonably ancillary to the exclusive rights of the patent grant. I also think that the same principle applies to valid trade secret rights.

But if the courts through the judicial process should be guilty of rationalizing results they want to reach because of some philosophical or sociological values, this gets into judicial legislation and usurps the function of the legislature as policy makers, within constitutional limits, of course.

Today’s discussion dealt in part with incentives—whether to invent and obtain patent protection, or to become an author of a copyrighted work, or to embody contributions in trademark symbols, trade secrets and known information and the like. But the incentives system of private enterprise—and bear in mind that patents and copyrights compete in various ways just as unpatented or unpatentable subject matters compete—cannot be fully preserved if the courts or Congress succumb to what was called by Judge Jerome Frank as a “monopoly-phobia.” This morning I suggested that this confuses “monopolies” in the antitrust sense with what are merely differential competitive advantages possessed by business firms and individuals. Those differential advantages should be rewarded if they are creations not in the public domain and they include much more than just patented inventions and copyrighted works. Hence, while mere ideas are free to all, the differential competitive

advantages (or advantages of noncompetitors as well) to which I refer are not mere ideas. They are embodied in identifiable creations of individuals and commercial enterprises. And none of them is apt to be a perpetual competitive advantage any more than a patent grant for 17 years or a copyright with one renewal for a total of 56 years confers perpetual exclusive advantages. Indeed, there is an anomaly in common law literary property, which is preserved until there is a general publication. Isn't that rather at odds with *Compco* and *Sears* in that uncopyrighted common law literary property material is protected without forcing the author to get copyright protection? Then why compel the owner of trade secrets, which are not published, to get patent protection?

But in the final analysis, none of the rights we have been talking about are perpetual. So why should the public policy of private competitive enterprise not protect as strongly against unfair practices by misappropriation of unpatented and uncopyrighted creations as the patent and copyright laws protect against infringements of those rights? And if that is a sound view, why should the federal preemption and supremacy doctrine deprive the states of their rightful role of enacting legislation and deprive state courts of their jurisdiction either under common law or state statutes to protect against the kinds of misappropriations we have been discussing today.

Accommodations must be made under our federal system between federal and state jurisdiction. Like accommodations must be made between the federal patent and copyright laws and the antitrust laws, trademark and trade secret laws and unfair competition law generally. These processes of accommodation are still being made and I suppose the process will always be an ongoing one.

MRS. NIES: I have a question. I seem to recall reading a CATV case in Alaska where there was a recording made of a broadcast in the States which was taken up to Alaska and broadcast, and this was considered a wrongful act. Was that a copyright case? Or was that misappropriation?

MR. CARY: No, that was purely a copyright case. My recollection is that this was a *Walt Disney* case where Walt Disney films, which were broadcast on TV, were copies in the state of Washington, I believe, on tape. And then the tape was taken to Alaska and shown on the screens in Alaska via CATV. The gravamen of the error there, as it were, was the actual copying of the off-the-air telecast of this particular motion picture film, whatever it was. So, in effect, his violation of the copyright law was that he copied Walt Disney's film in toto. So that was the wrong, not the dissemination in Alaska.

MRS. NIES: There was some language about whether or not it was a

performance, wasn't there? It was considered not a performance, or it didn't matter whether it was a performance.

MR. CARY: That's right. Under the *Fortnightly* doctrine, the dissemination of that in Alaska probably would not be considered as a performance because that was what *Fortnightly* held—that CATV did not perform. But the real, I think, the gist of the wrong there was the copying of a copyrighted motion picture.

MRS. NIES: So if this had been other material, other than a copyrighted picture, there would have been no cause of action.

MR. CARY: No cause of action, unless you get into the competition problems. It would hardly be likely in that case.

PROFESSOR OPPENHEIM: Any comments? You probably paid some tribute, you might say, to the CATV people who recognized that they would be getting a total free ride and were trying to compose their interest and have a fair resolution of it. Now they've had a free ride thrust upon them, haven't they?

MR. CARY: Well, in a sense, I think that a great many of them that I've talked with believe that the *Fortnightly* case is not the final answer. They feel that *Fortnightly* deals only with the local signals. And they're worried about the importation of distant signals—they're worried about program origination. They well know—at least they've admitted publicly—that if they originate programs that they're just as much liable to copyright royalties as a broadcaster. The importation of distant signals is something that they believe *Fortnightly* did not touch upon. I think you can argue that pretty well because in the case, as I indicated, the stations were located no more than 82 miles from Clarksburg—I think there were five or six stations—and I believe practically every one of the stations were in what the FCC calls the Grade B contour from the local Clarksburg TV station. So in effect, all of these stations being received, with perhaps one exception, were within the normal area of the broadcast power of the local station. So there are a great many of the CATV people who feel that the answer to the CATV problem is not *Fortnightly*. They need other legislation to authorize them to do many other things.

PROFESSOR OPPENHEIM: Well, in New York City, George, there are some tall buildings that are like mountains there. They create the problem, and that's one reason we have to allow the CATV people to pick up the signals because of the interference from the buildings, isn't that right?

MR. CARY: Right. And one of the unusual aspects of that is this: The FCC in its second or third report, in effect said that all CATV systems

are required to carry the local signals. Of course, in New York that's all they can carry under the contract they have with the city. But it's interesting, I think, that in New York, because of what you have indicated, without the CATV bringing the signals in, the people who live there cannot get a good signal in many instances, primarily in color TV. So CATV is performing a very valuable function, but if they are required to carry that local signal under the theory that they are within the range of New York City stations, in effect they are making their whole income from an operation that is living off the signals of the local broadcaster. They're required to do it so they have to. *Fortnightly* says they can do it for free but yet their whole income comes from their use of this free signal. A lot of them feel a little uneasy about this and that is why, I think, they are willing to go along with the provisions in the McClellan Bill, which would require them to pay a compulsory license for all forms of broadcasts, whether in the city or not.

MR. DYCZKO: George, have they expressed any opposition to royalties for public performance of sound recordings, as expressed in the Bill?

MR. CARY: The CATV people?

MR. DYCZKO: Right.

MR. CARY: Well, I've heard vague rumblings, but no real outspoken criticisms.

MR. CRAIG: I wonder whether the argument could not also be made that by bringing in these stations to people who could not see them otherwise, the transmissions of the broadcasts are actually beneficial because the advertising is distributed to a larger number of people so why are they hurting the local transmitting stations when they are not permitted to bring in any outside stations in an area like New York or Washington?

MR. CARY: This argument has been made and they have made it on numerous occasions. As a matter of fact, the original copyright bill which came before the House had in it a rather complex CATV provision, which would have, in effect, permitted all CATV systems to use without any cost whatsoever the signal in an area where the local television broadcaster could cover—that includes New York—any system where the local signal area was involved. But the House committee threw out that provision, not because of that but because there was a squabble on the floor of the House between the House Commerce Committee and the House Judiciary Committee, and the Commerce Committee said that the Judiciary Committee had no right to pass upon legislation that was regulatory in its nature. So Chairman Celler promptly yanked it out of the bill and said they'd come back to it later. Then it was decided

over in the Senate and they had the same problem there. This was one of the reasons why there's been such delay.

Senator McClellan wrote a letter to Chairman Magnusson of the Senate Commerce Committee, I think, last December in effect saying, here is our bill and here's how it's going to affect your committee. Won't you please look at it—maybe hold hearings—and do this in a short time so we can get moving on it. As far as I know, he never got a reply. They did, apparently, write to the FCC and ask for their comments. Just last month, I think, Dean Burch sent his letter to Senator Pastore, and in effect he was saying, well, we don't like the bill because it isn't flexible enough from the point of view of FCC regulations. We think it ought to have certain aspects that stick to copyright and leave commerce aspects to the FCC. So, the FCC doesn't like the bill, the composers don't like it, the broadcasters don't like it, and even a lot of the CATV people don't like it, so how can you expect a bill like that ever to get through?

PROFESSOR OPPENHEIM: Any other comments? I'd like to ask where does *Mazor v. Stein* stand now? Can you get multiple protection? I made a notation here of a Copyright Office regulation that provides that if a patent issues you can't get a copyright registration. Where does that stand now, George? Since a few courts have suggested that a patent expires earlier than a copyright, or if it's held invalid, you should be able to have multiple copyright protection. What about this multiple protection under two systems? Is there anything wrong with that? The *Mogen David* case held one could have design patent protection and trademark protection also.

MR. CARY: Well, there has never been a copyright case flatly deciding the issue. Away back in the early part of the century there was a case in which the court hinted that where design patent and copyright were both available with respect to the same work, you might be able to get both forms of protection, but when you went to court to claim your right, you could only sue under one cause of action. You have to elect. And since that case, no court has ever really decided that. Now the *Mazor v. Stein* case had that involved—this was one of the issues of overlap, design patent or copyright—but the court neatly sidestepped it and said they weren't going to get into that issue. So we still don't have any bearing on—

PROFESSOR OPPENHEIM: Since *Mazor*.

MR. CARY: Now on the copyright regulations you referred to, this is based on the old *Korzybski* case which was something like this. Count *Korzybski* who was a very famous mathematician, some years ago had a system which he devised for teaching Einstein's relativity theory. He

used a wooden board with a lot of holes in it, in which he stuck certain plugs onto which were tied strings, and they revolved on a pendulum-like basis. I saw this board once, but not being a mathematician I cannot tell you how that explains the Einstein theory. But at any rate, he copyrighted this particular board under Class I—a plastic work of a scientific nature. He at the same time went over to the Patent Office, apparently, and got a design patent on this. Then Underwood and Underwood, photographers, apparently photographed the object and he sued for copyright infringement. The court in effect said, well, at the time that he had filed his application in the Patent Office, which was after he had it copyrighted, and the patent issued, this was made public, so the whole work itself was made public and this vitiated his copyright so he had no copyright protection. When Underwood and Underwood photographed the object they didn't violate the copyright because the copyright was vitiated. So, it is on that case that we base our regulation—the whole theory is that if we find someone has gotten a design patent, for example, on a work which they submit to us, we take the position that, if the design patent is already issued, it's in the public domain and we don't register what is in the public domain.

PROFESSOR OPPENHEIM: Anything else? Well, all I can say for the Institute, and I know the Director joins me, is how much we appreciate your coming and how grateful we are for your contributions to this Clinic. I'm sure the interchange has been most illuminating to me and I hope you all feel that way about it.

DIRECTOR HARRIS: Thank you, Oppie. I want to thank the speakers and all the participants. We have all gained new knowledge from the insightful exchanges of the Clinic. As I said at the outset, we are developing the Clinic as an instrument of communication among the experts. This is in the nature of a "post doctoral" educational instrument. The Clinic is one of the major media we employ in carrying out our educational role as a Research Institute. You will receive your portion of the proceedings for editing. After you return your copy, we will edit for the benefit of the whole prior to publication in *IDEA*. The Clinic stands adjourned.

NOTES

Looking Forward

After twenty years as a chartered activity within The George Washington University, a decision has been reached to disassociate The PTC Research Institute from the University by June 30, 1972. The Institute was established in 1950 with the endorsement and cooperation of the American Patent Law Association, as expressed by resolution and referendum vote, recognizing the need for the creation of an organization to carry out objective research and education on invention, innovation, and in the field of the patent and related systems. The Advisory Council of the Institute and the administrative officers of the University agree that the time has come in the current educational and research atmosphere for the Institute to become independent.

A considerable number of factors have combined to produce this result. Perhaps the most important are (1) a growing academic policy which does not favor continuance of a supported institute operating in an area and discipline broader than that of any single individual school or faculty within the university, and (2) the general financial

situation, which has increased the difficulty of securing adequate financial support for all institutions within the academic field, due largely to greatly increased operating costs of all kinds.

The Institute has many accomplishments. Its activities fall under three headings: (1) a research program, (2) an information dissemination program, and (3) an honors and awards program. Its diversified research program utilizes a combination of educational and research disciplines and the results are based on facts and data gathered by the staff. These results are disseminated in publications such as a journal, *IDEA*, *Digests*, and *Guides to Research*. The Institute also conducts Conferences, Clinics, and Lecture Series. The honors and awards which it confers each year include the Charles F. Kettering Award, the Inventor of the Year Award, the Founders' Day Award for Distinguished Government Service, and the Patent Office Society Student Award.

Over the years, the Institute has benefited from the participation of the distinguished individuals who

have been associated with it. Among the members of its Advisory Council in the past years have been: Charles F. Kettering, David Sarnoff, Vannevar Bush, Cyrus Ching, Learned Hand, Glenn Seaborg, Chester Carlson, John Connor, Games Slayter, Edward Weidlein, John W. Davis, and John Olin. The present Chairman of the Council and Director Emeritus of the Institute, O. S. Colclough, served The George Washington University as Dean of the Law School, Dean of Faculties, and Acting President.

Recognized both nationally and internationally as unique in its position, accomplishments and competence in its field, the Institute plans to carry on and augment, as an independent non-profit organization, the type of significant activities it has been conducting in the past. The Institute welcomes the interest and support of individuals and organizations concerned with invention, innovation, and the industrial-intellectual property and related systems.

Fourteenth Annual Conference Well Received

The Institute's Fourteenth Annual Conference took place at the Shoreham Hotel in Washington, D.C. on October 29. The theme was "Industrial Property in Today's Competitive Setting." The Conference was by invitation and well attended. It brought together representatives from industry, education, and government. The Kettering Award Address entitled "Technology, Creativity and the Changing Social Environment," was delivered at the luncheon in his honor by Charles Stark Draper, renowned space scientist.

Moderators of the various sessions were John H. Schneider, Examiner-in-Chief and former Assistant Commissioner of Patents, U.S. Patent Office; Theodore L. Bowes, General Patent Counsel, Westinghouse Electric Corporation; and George E. Frost, Director, Patent Section, General Motors Corporation.

The presentations by the speakers sparked lively and informative discussion. Selected papers presented along with Dr. Draper's address, will be published shortly in the Conference issue of *IDEA*.

Institute Moves to New Quarters

The Institute moved in November to 2120 L Street, N.W., Washington, D.C. Future Institute Clinics will be held in the Conference Room of the new headquarters. The

Institute's *mailing address* will continue to be: The PTC Research Institute, The George Washington University, Washington, D.C. 20006.

Nominations Open for 1970 Inventor of the Year Award

Nominations for the 1970 Inventor of the Year Award are invited by The PTC Research Institute.

Members of the Research Institute and all other interested persons are asked to submit the names of candidates for consideration by the Awards Board. Submissions should include information which clearly identifies the candidate and contains sufficient evidence of his *character* and *contributions* to enable the Board to make an evaluation.

The Inventor of the Year

Award honors a journeyman or professional inventor who has made a significant patented invention or inventions even though he may not have had wide public notice. Presented annually, the Award provides the opportunity for recognition of the accomplishments of creative people.

Chester F. Carlson was named Inventor of the Year for 1964, Samuel Ruben for 1965, Gordon K. Teal for 1966, Robert Adler for 1967, Jay W. Forrester for 1968, and Stanley D. Stookey for 1969.

Institute Schedules Clinics on International Trademark Protection and on Joint Ventures Abroad

The Institute is pleased to announce that it has scheduled for early 1971 two Clinics in its continuing Clinic series. One, in January, will be on "International Trademark Protection: Private Interests and Public Programs." The other, in March, will cover "Joint Ventures Abroad: Industrial Property, Taxation, and Competition."

Both Clinics will be conducted at the Institute's headquarters in Washington, D.C. and will run for a full day.

The Institute in selecting and inviting a limited number of experts representing a range of disciplines relevant to the topics under consideration. The invitees will be supplied with pertinent background

materials before the meetings. The Clinics are intended to provide advanced professional training, as part of the Institute's continuing educational program, and to serve as a research tool by surfacing otherwise inaccessible information, providing new insights and approaches, and defining further productive areas for research. Transcripts of the Clinics will be published in subsequent issues of *IDEA*.

The proceedings of our most recent Clinic on Unfair Trade Prac-

tices Relating to Industrial-Intellectual Property appears in this issue of *IDEA*. Our Clinic on Trade Secrets was published in Volume 14, Number 2 (Summer 1970); The Patent Cooperation Treaty: Views of Informed Innovators, Volume 14, Number 1 (Spring 1970); Computer Software Protection, Volume 13, Number 3 (Fall 1969); and Statutory Requirements of Companies for Protection of Intellectual Creations, Volume 8, Number 4 (Winter 1964-65).

Innovators View Effect of Industrial Property on Depollution Technology

JOHN C. GREEN*

INTRODUCTION

IT IS RECOGNIZED THAT our "affluent society," which is based upon large-scale consumption of the products of industry and on transportation via the automobile, produces an undesirable by-product—air and water pollution. In this connection the *New York Times*¹ reports that private consumption in this country burns up some 40 percent of the world's natural resources. The result of this consumption is an amount of waste the world has never imagined—20 million tons of paper, 48 billion cans, and the like—all costing close to three billions a year to dispose of. Simply expressed—people produce pollution and prosperous people pollute phenomenally.

In the long run prosperity and population will continue to increase;

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¹ The *New York Times* (December 17, 1970).

therefore, the nation through its various institutions must look for other ways to preserve the natural environment. One such institution is The PTC Research Institute which has recognized that the establishment of corrective measures will require the flow of new and appropriate technology and that the creation of such technology must be encouraged. Recently, the Institute brought together a number of experts including government officials, economists, patent attorneys and industrial research administrators to explore the contribution of our industrial property system to the solution of these problems. The results of that meeting were reported in a special publication titled, "Air and Water Depollution: Roles of Industrial Property, Innovation and Competition."

CURRENT INQUIRY

The wealth of information revealed in that Special Conference confirmed the Institute's belief that national measures to cope with pollution must not overlook the role and contribution of privately generated technology. To verify and strengthen this finding the Research Institute decided to broaden the base of inquiry to encompass key innovators in our society. Accordingly, a questionnaire was prepared and mailed to approximately 100 competent² inventors and an equal number of industrial research administrators. One objective was to find out if measures under current consideration would have beneficial or adverse effects upon the flow of new air and water pollution control technology.

The design of the questionnaire followed three criteria. First, it had to be short and clear to encourage responses. Second, it had to be objective to make sure that no particular position was suggested or favored. And third, it should produce information useful to policy makers in both government and industry. It was decided that these criteria would be satisfied if each innovator were asked for

- (1) His personal experience in producing air and/or water pollution inventions;
- (2) Knowledge he might have with respect to acquisition of significant technology from others;
- (3) His views on existing and contemplated measures intended to accelerate the diffusion of technology; and

² Inventors who have made several patented and commercially successful inventions.

- (4) His suggestions on measures he felt would encourage innovation in the field of pollution control.

A sample questionnaire is appended. It produced an extremely high rate of response, nearly 40 percent, evidence of the interest of the nation's innovators in the problem and in the introduction of sound corrective measures.

Twenty-six inventions, in either the air or water pollution fields were claimed by the respondents. Research administrators noted 16 of them and inventors 10. The breakdown between "water" and "air" produced a similar division with 15 innovations indicated in the first category and 11 in the second.

WILLINGNESS TO LICENSE

The second question asked whether the invention was available for licensing. All inventors and virtually all the administrators from industry indicated that the inventions were available for licensing when the development work had been completed and suitable patent protection obtained. (The single exception did not flatly refuse to extend licenses, but placed a question mark in the place marked for response.)

Thus there is no significant difference between the willingness of inventors to license others and that of the companies which employ the research administrators. This is not surprising with respect to inventors since they often need entrepreneurs or manufacturers to assume the expensive and risky tasks of developing, producing and marketing their ideas. Research administrators, on the other hand, are employed by firms which finance the work as part of an overall plan to generate and introduce new products and processes. In the area of pollution it seems, however, that industry is generally receptive to licensing.

Another possibility is that most depollution inventions produced by industrial research laboratories are intended to alleviate, or to remedy, some pollution attendant upon the company's own activities. In such cases the installation and maintenance of the antipollution device constitutes an additional expense advancing manufacturing costs. If another firm should want to reduce its pollution by installing similar equipment the royalties they are prepared to pay become a desirable offset against these increased costs of doing business. This is a distinctly different situation from that faced by two or more manufacturers of competing products. In the latter situation the firm which finances research, development, production and marketing of a novel item may

be reluctant, with good reason, to provide its competitors with the fruits of its research by granting them a license to produce equivalent devices.

In the pollution field there are a combination of factors at work which make it relatively easy for those who need them to get licenses. The first is the fact, just described, that much of the private technology in this area was not developed for competitive purposes. The second is an awareness of the seriousness of the national problem which prompts serious and responsible management to contribute any useful information they may possess to the pool of knowledge for the benefit of all. Last, and related to the other factors, is recognition that a failure to act responsibly and constructively would surely impair the firm's public image—an intangible, but highly valued asset.

COMMERCIAL INTRODUCTION

The disparity between research administrators and independent inventors in advancing their conceptions which had gone into practical use, is worth noting. Eight of the 16 inventions originating in research laboratories have gone this route while only one of the 10 in the inventor group has achieved comparable success. It is often observed that numerous significant inventions come from people who are not closely associated with the industry to which their ideas are directed. This does not mean that such inventions proceed smoothly or promptly. The transition from patentable concept to a process or product calls for skills and resources not readily available to most independent inventors. For example, a simple product designed to filter waste products from a liquid will require extensive development, engineering, design, market testing and economic forecasting. After these steps have been completed the company executive must consider whether the anticipated return justifies the allocation of funds, production facilities and personnel needed to place the product on the market and bring it to the attention of potential customers. Since the independent inventor is outside the company structure he faces greater problems in these action areas than does the company's own research administrator. (The time span between conception and use is shortened also for "in-house" inventions if the invention is one which the company intends to apply in correction of pollution accompanying its own production.)

IMPEDIMENTS TO APPLICATION

Nine research administrators answered the group of questions designed to identify any difficulties faced. All nine reported no special

difficulty in developing the product or process or in obtaining suitable protection. The third part of this question was directed to difficulties in interesting purchasers or licensees. Two indicated that interest had been difficult to develop. On analysis it turned out that in one instance there were other and more economical processes available while in the other the invention was an "in-house" use which has been abandoned. Thus it would appear that purchasers and/or licensees exist for generally useful air or water depollution patents.

None of the inventors, who had perfected their protection via the procurement of patents, indicated any difficulties in interesting appropriate parties. Some observed that such actions were being deferred until the patents were available to help define the rights and responsibilities of the parties. These answers increased our interest in the next portion of the questionnaire which was directed to the action of the Commissioner of Patents to advance the Patent Office's examination of inventions relating to depollution. The speedy processing of the patent application is intended to make the technology known earlier and to move ahead any commercial negotiations between the inventor and interested parties.

AWARENESS OF ACCELERATED PATENT OFFICE ACTIONS

One-half of the research administrators and two-thirds of the inventors indicated that they had not known about the Commissioner's action. Since "blue ribbon" panels in both categories were the targets for the inquiry, it would appear that the Patent Office should consider special communication techniques for providing information to those citizens concerned with invention, research and engineering who are not registered patent attorneys.

The innovators' reactions to the significance of this "time collapsing" opportunity provided by the Commissioner, merits comment. The inventors and research administrators answered alike. Approximately 50 percent thought it was of some value; the other 50 percent were not impressed. Some administrators did not see particular advantage for industry but did point out that inventors might be assisted, as previously mentioned, by having a clear definition of the metes and bounds of the invention at an earlier time.

A few innovators noted that the Commissioner's proclamation may be a dangerous precedent. One perceptive respondent observed:

I feel such special treatment for a whole art is quite unfair to the rest of the inventive community. The Patent Office has ample power to take specific applications out of normal sequence and with this

I am in complete agreement, but I think it would be a dangerous precedent to give special privilege to whole arts because of political pressure. It may be air pollution today—it may be city rebuilding tomorrow, etc., etc. The difficulty with this approach is that some great invention that really starts a new art would be put back for years because it is not yet politically important. Under this new policy a great many unimportant and trivial inventions will undoubtedly get precedence over much more valuable ideas.

On balance it appears that the Patent Office's willingness to process depollution inventions more speedily has some merit but is not thought to be a significant method of attacking the nation's pollution problems. At the same time we must remember the statement quoted above that it would be unwise to repeat this technique whenever a social problem arises since to do so might delay the introduction of a major invention upon which a great new industry might be based.

WISDOM OF "COMPULSORY" LICENSING

There has been considerable controversy spanning many years about "compulsory licensing" of inventions. One school of thought believes that patents should be licensed to all comers in order to broaden competition and rapidly diffuse knowledge. The opposing school believes that the patent owner should be able to deny licenses to others or to license one, or more, selected organizations, if those courses are in his best economic interest.

The issue has surfaced again in the depollution field through the introduction in the last Congress of a bill (the National Air Quality Standards Act of 1970) which contained a section directed to the compulsory licensing of patents, trade secrets and technical know-how. (This section was revised and included in the bill when it was enacted into law. However there is some anticipation that such language will be modified in 1971.)

Apparently, the inclusion of such language in the original bill derived from an assumption that in the area of depollution the normal workings of the industrial property system need to be modified in order to ensure

- (1) A continuing flow of technological advancements;
- (2) Wide diffusion of this technology;
- (3) Prompt application of the technology to reduce or remedy pollution situations.

The men who make our nation's innovations are in an excellent position to evaluate this assumption. Accordingly, the questionnaire

contained two questions designed to provide pertinent, factual information.

The first asked if the innovator had any knowledge of significant patents or "know-how" in the depollution field for which it has been difficult or impossible to obtain a license. There were 22 "no" answers to this question and 4 "yes" answers. Let us look at the affirmative answers in some detail.

In the first case the respondent stated "The owner fully utilizes and supplies the market himself." This language is open to interpretation. However it is clear that if the market is satisfied by one firm's production it is probably a limited market and not of national importance. Further it is one which probably would not be attractive to additional participants.

The second described a method of treating wash water from tank car loadings adapted to a specific plant in a specific location.

The third referred to a license negotiation which broke down because the owner demanded "unreasonable royalties or geographical restrictions."

The fourth and last stated:

Broad coverage in a new area can make it extremely difficult to develop technology in that area since the development scientists and engineers feel that a license will not be available and tend to avoid that area.

Upon analysis the second and fourth responses drop out. The former because the invention is not one of general value and hence licensing, compulsory or otherwise, becomes unimportant. The latter is a philosophical observation based on a research administrator's thinking that an area in which someone else has pioneered and achieved a proprietary position is less attractive than one in which no such protection exists. Many "late comers" in the fields of electronics might disagree, but whether this is a good guide for selecting research projects or not, it doesn't describe a specific situation in which the firm needed depollution technology and couldn't obtain it.

The third respondent gives the single example of such a situation. He advised that the reason the technology was denied him was "unreasonable royalties or geographic restrictions." In other words, he and the owner of the technology couldn't agree on the terms of a mutually agreeable license. "Geographic limitations" might raise antitrust considerations, while "unreasonable royalties" depends upon which party finds them to be unreasonable.

Looked at in context, we have 1 innovator who claims that depollution technology was denied him through normal commercial channels;

3 who describe situations which aren't directly relevant and 22 who haven't been faced with such a problem. This single denial indicates that these innovators have little difficulty in obtaining access to needed technology.

The Institute considered the possibility that although depollution technology might be generally available through normal commercial channels—i.e., purchase or license—innovators might still see merit in compulsory licensing. Accordingly, a question directed to this situation was included for answer by all respondents.

The "inventor" category produced 1 unqualified "yes," 1 "on-the-fence" answer, 2 "yes" in the special cases where the inventors "cannot demonstrate reasonable diligence in putting the product on the market" and 35 "no's." The research administrators voted similarly; here there was 1 "yes" and 36 "no's."

It should be noted that the two inventors who proposed that compulsory licensing should be available in those cases where the patentee or patent owner failed to exert diligence in placing the product on the market described unusual situations. In fact their proposal is similar to the "working requirements" called for by some foreign countries to encourage local manufacture of the patented product. Such a provision is far less sweeping than compulsory licensing of all patents issued in the air and water depollution field.

Two quotations, from an inventor and a research administrator, respectively, merit quoting:

- (1) I hope that we don't find a place in our society and in our governmental system for compulsory licensing. The risks undertaken by a company in developing new products are so great that the added burdens of government threats will ultimately result in a decline in development.
- (2) If a company, corporation or individual held a vital patent that offered an economically and socially acceptable solution to pollution (or its control) and refused to license or permit its use, tremendous public pressure would probably be generated. Government coercion would not be needed to bring about capitulation. Management is becoming more sensitive to public feelings and desires. Compulsory licensing could inhibit and reduce the number of companies involved in seeking depollution innovations. Many would "sit back" and wait for someone else to find the solutions and then license the technology.

OTHER INCENTIVES

The last question invited the innovators to supply any ideas or suggestions they thought would provide further incentives in the depol-

lution field. The replies were numerous and varied. The only pattern that could be traced was a financial one. Many research administrators favored greater government support of research and development or the provision of tax incentives for activity in the field. Several inventors would like some type of fiscal subsidy in order to justify their interest or some cash award for valuable contributions.

SUMMATION

What has been learned from the Special Conference and questionnaire that is pertinent to current considerations of government and industry policy makers? First, it's clear that air and water depollution inventions are high priority items in the nation's laboratories and workshops. The fact that roughly one-third of the respondents have made air and/or water depollution inventions indicates that this is not a neglected field, but is one in which we can expect a flow of new ideas and methods.

The next finding is that innovators generally grant licenses to others with respect to depollution inventions and technology. The experts do not feel that there is need for legislation which would compel innovators to grant licenses to others with respect to depollution inventions and technology. Further, they are willing to disclose their own findings and diffuse their information to others via conventional royalty-bearing licenses.

Next the Commissioner of Patents directive to accelerate the examination of depollution inventions may be constructive, but is not especially significant. Two related observations worth stressing are:

- (1) Information of this nature isn't reaching the nation's innovators effectively. Therefore, additional communications methods merit consideration; and
- (2) Enlargement of the examination advancement procedures to encompass areas of social concern may hold back the introduction of major inventions of economic importance.

Another finding, based on the innovators reports, is that current technology transfer mechanisms are working reasonably well and that impediments, if any, are inconsiderable.

Last, the innovators believe that if the government wants to accelerate innovation devoted to improving the environment it should follow the pattern proven successful in other areas, i.e., support of qualified scientific and technical personnel to produce more technology and faster than can be expected by major reliance on private enterprise for

such support. The fields of defense, space and atomic energy have shown that government funds, wisely disbursed, can accelerate the volume and speed the diffusion of technology. Similar techniques can contribute to the preservation of our environment. At this time the press reports a surplus of highly trained, technically qualified people who are accustomed to working on problems of national importance. This is a resource which should not be overlooked as we undertake the task of preservation and recovery.

APPENDIX

THE PTC RESEARCH INSTITUTE THE GEORGE WASHINGTON UNIVERSITY

AIR AND WATER DEPOLLUTION QUESTIONNAIRE

1. Have you a patentable invention in the field of

Air Pollution	Yes _____	No _____
Water Pollution	Yes _____	No _____
2. If your answer to (1) is "Yes,"
 - a. Will you describe it briefly _____
 - b. Is the invention available for licensing to others?

Yes _____	No _____
-----------	----------
 - c. Has it gone into practical use?

Yes _____	No _____
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3. If your answer to (1) is "Yes," did you face any difficulties in
 - a. obtaining protection _____
 - b. developing the device or process _____
 - c. interesting purchasers or licensees _____
 Please explain. _____
4. Are you aware of an Order of the Commissioner of Patents which advances the examination of patent applications in the fields of air and/or water depollution?

Yes _____	No _____
-----------	----------
5. Do you feel that such special treatment is a valuable incentive? Please discuss. _____
6. Are you, or your organization, aware of significant patents and/or "know-how" for which it is difficult or impossible to obtain a license?

Yes _____	No _____
-----------	----------

 (If your answer is "Yes," will you please describe and indicate difficulties.) _____
7. If your answer to (6) is "Yes,"
 - a. Do you think that compulsory licensing would be a preferred method for achieving access to the technology?

Yes _____	No _____
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 Please give reasons. _____
 - b. If you do not prefer compulsory licensing, do you have an alternative suggestion which will better meet the need? _____
8. Do you have any additional comments or suggestions to make it easier to introduce air and water depollution innovations? _____

Economic Aspects of Trademarks in Franchising

JOSEPH M. LIGHTMAN*

INTRODUCTION

FRANCHISING AS A FORM OF BUSINESS ACTIVITY has had a phenomenal growth in the past 15 years. Its appeal to the individual with limited resources and experience as a means towards business ownership is evidenced by the growth of total U.S. franchise holders from about 50,000 in 1955 to between 600,000 and 700,000 in 1970. Today, there are about 1100 national franchisors whose franchisees' gross sales total about \$90 billion annually, up from \$2.5 billion annually for the franchising industry 15 years ago.

Franchising was prevalent well before the 1950's but never a significant factor in activities other than automobile dealerships, consumer petroleum product outlets, and soft drink bottling and distribution. During the past two decades, franchising has spread to a wide variety of

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fields, most notably the fast food industry, including restaurants, drive-ins, and carry-out shops. Other significant franchising fields include specialized automotive services, business aid services, educational products, maintenance and cleaning services, general merchandising stores, special clothing and shoe outlets, recreation, travel and entertainment services and auto-trailer rentals. Economists generally agree that within the next 10 years, the number of franchisees will total about 1 million.

As a form of licensing, franchising, of course, encompasses marketing and distribution, and, in many cases, elements of production operations. The franchisee, however, does more than sign up for a licensing arrangement. In effect, he ties himself into the franchisor's most valuable asset—his reputation. The franchisor, in his licensing package, offers rights more valuable than those to marketing, distribution and production know-how. He licenses rights to his trademarks and trade name, the focal points of his goodwill identification and symbols of his national reputation.

The PTC Research Institute is thus directing the current phase of its research project on economic implications of trademarks to franchising. Legal aspects of trademarks in franchising have been dealt with in other Institute research projects and have been the subject of extensive consideration in law journals and trade publications.

The Institute, in undertaking this research, is fully cognizant of the fact that rapid growth of franchising has attracted its share of unscrupulous, as well as naive operators. Franchising has been the subject of considerable attacks by federal and state regulatory agencies, and by legislators and Better Business Bureaus. Also, shakeouts and failures in the industry are now much in evidence. Nevertheless, gross sales by the franchising industry continue to account for about 9 percent of U.S. Gross National Product and there are indications that this rate will continue upward in the 1970's as the franchising industry expands with more efficiency and sophistication.¹

¹ Secretary of Commerce Maurice H. Stans, in an address before the annual meeting of the International Franchise Association, Miami, Florida, January 23, 1971, stated:

The franchising industry will share fully in all that lies ahead. Yours is one of the great growth industries of our American enterprise system, and in fact you have a particular place of distinction in U.S. business, especially during a time of expansion. By its very nature, franchising is growth in a package. It is opportunity by formula. The franchise is a unique contract in the American economy because no other business commitment carries with it so much assurance of training, supervision, promotion, quality control and product identification. To the hopeful entrepreneur, the franchise very often can be the difference between getting into the American enterprise system successfully or not getting in at all. For this reason, we have selected the franchising industry as a key element in the efforts we are making to open the doors of the American enterprise system to the minority people of America.

THE RESEARCH APPROACH

The Institute believes that an industry as thoroughly marketing oriented as franchising should be the subject of a study with respect to the economic role therein played by trademarks. It believes that more comprehensive knowledge than now exists is needed on this particular subject, including a better understanding of trademark values in franchising operations.

Since franchising encompasses a wide variety of industries, the Institute decided, as a first step, to test a selected cross section of franchisors before embarking on a broader research approach. They were sent a questionnaire the purpose of which was to determine from their replies:

- (a) Whether a broader inquiry would be useful;
- (b) What revisions therein would be necessary for such a broader inquiry;
- (c) What needed data would be available; and
- (d) What attitudes could be expected regarding meaningful responses to our questions.

DEFINITION FACTORS

Part of the problem in conducting this research project is defining the term "franchising" itself. In the political realm "franchise" still means the right to vote. Classically, however, in the commercial context, franchising involves a licensing arrangement wherein the owner of a product, service or method obtains distribution at the retail level through affiliated dealers. The latter is usually given exclusive rights within a specified geographical area to market the product, method or service under the franchisor's brand name.² In the franchising arrangement, the ultimate receiver of rights gives up certain options and freedom in business decisions that ordinarily would be available to a licensee of a "non-franchised" business.³

² The International Franchise Association, the major trade association in the field, defines franchising as "a continuing relationship in which the franchisor provides a licensed privilege to do business, plus assistance in organizing, training, merchandising, and management in return for a consideration from the franchisee." *Franchise Company Data for Equal Opportunity in Business*, published by U.S. Department of Commerce (July, 1969, p. VIII).

³ In trademark licensing operations not involving franchises, the licensor maintains rights of quality control over products bearing the licensed mark but with lesser controls over the licensee's other step by step activities involving sales of the branded products or services identified with the licensed mark.

Technically, today's franchisors in the U.S. include the auto manufacturers who have about 30,000 plus dealers, the petroleum companies who have franchised about 225,000 service stations, and soft drink manufacturers with many thousands of franchised bottlers in the U.S. and abroad. In these industries, however, franchising has been traditional. The real present-day meaning of franchising is related to its rapid inroads into many new types of business operations.⁴ The Institute thus focused its test questionnaire on selected firms in those industries with a significantly rapid growth in franchising.

THE TEST QUESTIONNAIRE

As previously noted, the primary purpose of our initial approach was not only to acquire substantive information, as such, but primarily to develop, by the sampling technique, optimum questions geared to the information desired and to feasible responses by the recipients.

The Institute selected 13 franchisors in eight industries to analyze as a test research sample on trademarks. (See table in Appendix A.) The industries are those which the Institute believes offer the best examples of both new and extensive franchising activity in recent years.

The franchisors received a four-part questionnaire. (Appendix B.) Part I asked for statistical data on their number of franchisees and gross sales value in 1969, and the number of U.S. product and service marks owned and licensed to their franchisees. Data was also sought on the number of franchisees they had abroad and the trademarks under which they were licensed. Information on selection, registration and promotion of trademarks in franchising operations was sought in Part II. A brief case history was also requested on one of the firm's trademarks, including its selection, promotion and contribution to the firm's franchising operations. In Part III, franchisors were asked about experiences with existing law in trademark activities; in Part IV, they were asked for specific data on trademark licensing and acquisitions. Included with the questionnaire was an appendix asking for quantitative value estimates of their trademarks and for cost estimates of enforcing trademark rights.

Since the food-service industry had the most significant growth, four

⁴ As *Business Week* points out, in the food-chain industry alone "franchising is replacing the mom-and-pop lunch counter. In a competitive, high-velocity economy, where marketing and advertising muscle means so much, the independent small businessman is scurrying under the franchisor's umbrella for safety. Franchise know-how obviously doesn't insure success. But an independent feels a lot safer tied into a national trademark than he would off by himself." (May 24, 1969, p. 146.)

franchisors, ranging from 13 to 3700 franchisees each, were selected. Two franchisors, in each of the business and educational services categories, also highly active, were selected. Only one firm in each of the other five industries was selected.

PRELIMINARY FINDINGS

The sampling approach, while designed primarily for procedural evaluation purposes, nevertheless elicited some interesting subject matter. Although far from conclusive, this material is nevertheless worthy of presentation and analysis in a preliminary report.

Basic Statistical Comparisons

An abstract of the salient statistics provided by the respondents appears in the table appended. The following information elaborates on this tabulation.

Food Services (Restaurants, Drive-ins, and Carry-out Operations)

Four firms were selected based on gross annual sales of their franchisees in 1969, ranging from \$400 million for the largest franchisor, to about \$1 million for the smallest.

The largest (identified as company A) reported 3700 U.S. and 400 foreign franchisees. It specified ownership of 30 U.S. product and service marks but noted that not all were automatically licensed for franchisees' use. Where the firm added new product marks to its franchising operation, it permitted existing franchisees to use such marks only after signing new operating agreements. It acquired 10, 16, and 18 new marks respectively, in 1967, '68 and '69. The firm's 400 franchisees had licenses to 10 marks abroad, including Guam, the Virgin Islands, Puerto Rico, Canada, Mexico, Spain, Iceland, Philippines and Panama.

The next representative franchisor (company B) reported 500 franchisees licensed to all of its 21 U.S. product and service marks. It acquired 2 new marks in 1967, 3 in 1968 and 2 in 1969. It reported no foreign franchising. The firm stated that its annual outlay for policing and maintaining its marks in 1969 was \$5,000.

The third selected franchisor (company C) reported 250 franchisees licensed to its 12 U.S. product and service marks. Two new U.S. marks were acquired in 1968, 3 in 1969 and 4 in 1970. The company reported 3 franchisees abroad using 7 of its marks in 4 countries. The fourth

franchisor (company D) at the smaller end of the scale had only 13 franchisees licensed to 2 of its U.S. service marks. One new mark was acquired in each year, 1968 and 1969.

Business Services (Bookkeeping, Income Tax Preparation and Secretarial Services.)

The larger of the two selected firms (company A) reported that its 1200 U.S. franchisees had about \$25 million in gross sales in 1969. They were licensed to use all of the firm's four U.S. service marks. The firm spent \$1,000 last year policing and maintaining these marks. It had no foreign operations.

The smaller firm had only 285 franchisees with \$12.5 million in sales. But, it reported ownership of 17 U.S. product marks all of which were licensed for use by the franchisees. It had acquired 4 marks in 1968 and 1 in 1969. The company had 6 foreign franchisees in about 15 countries licensed to the same number of marks. In 1969, it spent about \$1,250 policing and maintaining its U.S. and foreign marks.

Educational Services (Teaching, Modeling, Other Instructional Activities)

Each of the two selected companies was considered fairly typical of this segment of franchising. Their number of U.S. franchisees was about the same (40 for company A; 37 for company B), as were their gross sales in 1969 (between \$2 and \$2.5 million). Also, they each had only one U.S. service mark which was licensed; there was no overseas activity.

General Variety Stores

The representative franchisor in this segment reported 2,202 franchisees with gross sales of about 1500 million in 1969. The firm reported that it owned 30 U.S. product and service marks but that its franchisees were not necessarily licensed to use all of them. They were, of course, licensed to the franchisor's basic house mark. The firm reported no overseas operations.

Recreational Services (Campground, Playground and Related Facilities)

The selected franchisor reported 900 franchisees under agreement in the U.S., with 400 presently "operational." Total franchisees' sales in

1969 were \$15 million. The firm reported ownership of six U.S. service marks all of which were licensed to the franchisees. Twenty foreign franchisees were reported, all located in one country and licensed to the one mark the firm had registered there. Fifty thousand dollars was spent policing and maintaining the franchisor's U.S. trademarks in 1969.

Specialty Shoe Stores

This representative firm reported 50 U.S. franchisees with total gross sales of \$3.5 million in 1969, and licensed to its eight U.S. product marks. It reported no foreign operations.

Lawn and Garden Supplies and Services

This franchisor likewise reported 50 U.S. franchisees. All were licensed to use its five product and service marks in the U.S. Five new marks were applied for in 1969. There were no foreign operations reported.

Pre-Fabricated Homes

The selected firm reported 75 franchisees with total gross sales in 1969 of \$2 million. The franchisor specified ownership of only one product mark which it licensed to all franchisees.

Product and Service Mark Usage

While service, as distinct from manufacturing operations, may be predominant in the franchising industry, it is, nevertheless, interesting to note the great percentage of product marks that were reported registered, and in use, particularly by the food service firms. (See table appended.) Information provided by the representative firms indicates that product marks are highly important in their overall goodwill identification programs and as worthy of extensive investment as their basic house marks. Of the 138 marks reported for franchising operations, 99 were categorized as product and 39 as service marks.

As may be expected, the variety and shoe store franchisors, as well as those in food servicing, had the greater percentages of product marks in use. The two business service respondents reported opposite extremes; one reported 17 product and no service marks; the other, four service and no product marks—indicating very wide and highly diversified operations encompassed within their franchising activities.

Thirty-nine of the 138 U.S. marks used by the respondents were not registered. Twenty-five were product and 14 were service marks.

Trademark Values

As previously noted, the selected franchisors were asked to provide a brief case history of one of their trademarks with particular reference to the mark's selection, promotion and contribution to the firm's franchising operations. This case history, coupled with information requested in the questionnaire's appendix, was intended to serve as the basis for ascertaining "goodwill values" attributable by franchisors to the trademark aspects of their operations. Insights were also sought into the franchisors' trademark selection processes.

The Institute received a good variety of responses exemplifying economic values in basic house marks, as well as in those used for specific goods and services.

Said one firm of its house mark:

Needless to say the name made our business. Selected in 1939 to describe [the] . . . product being introduced, we had to be different to grow as we did. The name told our customers where they could find us. As product line was expanded, the marketing approach was altered accordingly and [the name] became the *place*, rather than the product. Now franchise more than 4,000 retail units in all 50 states and several foreign countries. Over the years we have spent many millions of dollars advertising and promoting the name.

The name is our biggest single asset. It has to be worth at least as much as our company is worth. We haven't set the sale price of the company.

Another firm said that its house mark:

. . . has become a national symbol of [its name] and its [product]. The value of the mark is immeasurable since without it people would not know what to expect when they walked in—[the name] is synonymous with [the product offered by the franchisee at his outlet].

A third franchisor with only one trademark registration noted that:

As a trademark our logo is instantly recognized and stands for the services we provide. The use of this logo has reduced the amount of advertising space needed to explain the company's services. This mark has been a major factor in the growth of our company and our number one position in our field. [The company valued this mark at \$2.5 million.]

Another franchisor noted, with respect to a particular mark, that it:

. . . is used on school, office, and correspondence stationery. This Trademark was derived as one of many private label merchandise lines made available to [the firm] as an intricate feature of the

quality and convenience image that [the firm's outlets] project to shoppers.

This Trademark name was selected since it is indicative of progress as well as quality. It is color co-ordinated so that all types of stationery that fall in this category have the same color label. Also, each type of item labeled has a character calling attention to that particular item's use. . . . This particular Trademark has contributed to the growth of our franchising program because [the firm] can promote a name that is not comparable in competitors' [outlets]. Customers must return again and again . . . for this favorite brand, since no other [outlet] has this brand.

This Trademark . . . is actually a "National Trademark" that creates an image of consistent quality with good customer acceptance; and this Trademark will continue to grow and become better established as we continue to promote this Trademark on monthly sale plans and in special . . . events.

This Trademark is registered and manufacturers who produce this merchandise for us cannot sell it to any other company.

As far as attaching a value, including goodwill, to this Trademark, we have no idea as to its monetary value.

There was no uniformity among respondents in procedures for selecting new trademarks. One firm noted that the basic selection responsibility was vested in a "marketing group" assisted by a "board" representing its franchisees. Others reported selection responsibilities assigned to independent trademark attorneys retained for this purpose. Still others indicated very pragmatic procedures whereby a franchisor firm might have its own in-house group do the selecting, or, as seen fit, have an outside firm or attorney handle the selection in a particular case.

Recapturing Franchised Trademarks

The respondents generally emphasized the "recapture" feature as the most important in their trademark licensing agreements with franchisees. Also stressed were the terms imposed on franchisees governing the specific marks and related symbols they could use and the conditions under which such use could be made.

Typical information provided to the Institute on this subject is exemplified by the respondent who stated that:

The Franchise Agreement gives the Franchisee the right to use our trademark in accord with certain descriptions contained in an attached schedule. Upon termination of the Franchise Agreement, the Franchisee agrees that all signs, etc. using the trademark become the property of the Franchisor who in turn agrees to pay for these signs, etc. for cost less depreciation. In addition, the Franchisee agrees upon termination to discontinue using the trademark, and the Franchisor has the right to charge a stipulated monthly fee for any continued use after such termination.

Trademarks and Wholly Owned Franchisor Outlets

As franchisors' marks have become more well known and profitably attractive in certain industries, a new trend has developed. The more successful franchisors, particularly in food services, have begun to buy up a number of the operating units of their franchisees. Their famous franchising marks are now appearing on their own company outlets. As indicated in the appended table, virtually all of the representative franchisors own some outlets outright. Some of these are "buy backs" and others are initially opened outlets by franchisors who, having seen the success generated by their name, style and reputation, now want the total retail profits therefrom, rather than a percentage royalty.⁵

CONCLUSIONS

The franchisor's basic asset is his reputation. In effect, his principal inducement to the potential franchisee is the goodwill projected by his valuable trade name and trademark rights. The logistics of the franchise package (i.e., the equipment, supplies, marketing assistance, inspection and other services) are peripheral to the main offer of attraction—that of the independent businessman tying himself into the franchisor's national reputation.

The Institute's questionnaire has served its purpose in developing a clearer picture of how best to maximize research efforts on this project. We are now in a better position to determine whether a broader survey is desired. The substantive replies received, although far from comprehensive or conclusive, nevertheless lend themselves to some preliminary conclusions.

The current growth of franchising is most apparent in service-oriented industries. While the respondent firms generally have more product than service marks in use, it is clear that the latter are the more valuable. In most instances, the basic house mark of these firms is categorized as a service mark. This trend is in contrast to earlier franchising operations that consisted primarily of automobile dealerships, petroleum product outlets and soft drink distribution, where products, rather than services, are basic. This, of course, is reflected in the predominant value of product marks within such franchising operations.

⁵ Other, less prevalent, reasons for "buy backs" are based on franchisors' desires to experiment in new marketing, pricing and product techniques, or to resell the franchise to a new dealer for such purposes as may be considered financially desirable.

Foreign trademark activity is comparatively small among the respondent firms, even among the few that reported overseas operations. Only one firm (in food services) reported any sizable operations abroad, as noted in the appended table. This should not be construed to mean that foreign parties are generally uninterested in doing business with U.S. franchisors. It suggests that those foreign parties who are impressed by U.S. franchisors' operations may be attracted by factors different from those governing interests of potential U.S. franchisees. To the latter, who are generally independent businessmen, the franchisor's national reputation symbolized by his trademarks and tradename are the principal attraction factors. Generally, foreign firms contacting U.S. franchisors about possible business ventures in their home countries are large established enterprises interested basically in U.S. franchising techniques and know-how, not necessarily U.S. trademarks and tradenames. Well-known U.S. franchising trademarks and tradenames may be a more important factor to potential franchisees in Canada, Mexico and a few closer Latin American countries.

In general product marketing, trademarks assume the role of "silent salesman," in new export markets, as the manufacturer's goods and advertising reach foreign shores even before he undertakes any intensive marketing program abroad. The franchising industry apparently does not lend itself as readily to this element of advance foreign market penetration. Nevertheless, as larger U.S. franchisors establish and expand foreign operations, their marks and names should eventually become most valuable assets abroad, as they are in the U.S.

Expansion is the essence of franchising. Trademark and tradename rights, while only one element in the picture, are basically the most important to the franchisor. The trademark and tradename serve not only as tools for identifying his services and products to the public but also as focal points for symbolizing the goodwill value of his operations to potential franchisees.

APPENDIX A

TRADEMARKS IN FRANCHISING—PRELIMINARY STATISTICAL PRESENTATION FROM SELECTED RESPONDENT FRANCHISORS' CASE HISTORIES

Industry and Selected Respondent ¹	Total Franchisees' Sales in 1969 (millions of \$)	U. S. Situation				Foreign Situation			
		No. of Franchisees	No. of Outlets Directly Owned	Trademarks in Use (Reg. and Nonreg.)			No. of Franchisees Abroad	Total Marks in Use ²	No. Countries Franchised
				Product	Service	Total			
Food Services									
Company A	\$400.0	3,700	12	25	5	30	400	10	10
" B	NA	500	50	10	11	21	—	—	—
" C	NA	250	155	10	2	12	3	7	4
" D	0.9	13	—	—	2	2	—	—	—
Business Services									
Company A	\$ 25.0	1,200	2,271	—	4	4	—	—	—
" B	12.5	285	1	17	—	17	6	15	15
Educational Services									
Company A	\$ 2.0	40	10	—	1	1	—	—	—
" B	2.5	37	5	—	1	1	—	—	—
Recreational Services	\$ 15.0	400	3	—	6	6	20	1	1
Variety Stores	\$500.0	2,202	6	25	5	30	—	—	—
Lawn and Garden Supplies and Services	NA	50	10	3	2	5	—	—	—
Shoe Stores	\$ 3.5	50	22	8	—	8	—	—	—
Pre-Fabricated Homes	\$ 2.0	75	—	1	—	1	—	—	—

¹ One case history was considered sufficient for presentation in the last five industry categories.

² Product and service marks.

APPENDIX B

THE PTC RESEARCH INSTITUTE
THE GEORGE WASHINGTON UNIVERSITY

QUESTIONNAIRE ON TRADEMARKS USED IN FRANCHISING

Part I. Statistical Data on Franchise Mark* Ownership and Usage

1. What type of business activity do you franchise (automotive products or services; trailer rentals; children's stores; food stores, restaurants, drive-ins; travel services; lawn and garden supplies and services, etc.)?

2. (a) About how many franchisees in the U. S. do you now have? _____
(b) About how many outlets do you own outright that are not franchised? _____
3. Do you franchise primarily on a national or regional basis in the U. S.?

If regional, in what parts of the country? _____

4. What was the total gross annual value of your franchisees' sales in 1969? _____
(estimate in round figures will suffice)
5. Please fill out the following chart regarding the number of marks your firm owns and licenses in its franchise operations.

	Product Marks	Service Marks	Total
(a) No. of marks you now have registered in U. S. Patent Office			
(b) No. of marks you use but do not yet have registered in U. S. Patent Office; either no application filed, or application pending			

Does each of your franchisees have a license to use all of the above marks in its operations? _____. If answer is no, please explain _____

* For purposes of this survey the term "trademark" refers to product and service marks as defined in the U. S. Trademark Law (15 USC 1127).

"Trademark" includes any word, name, symbol, or device or any combination thereof adopted and used by a manufacturer or merchant to identify his *goods* and distinguish them from those manufactured or sold by others.

"Service mark" means a mark used in the sale or advertising of *services* to identify the services of one person and distinguish them from the *services* of others.

6. Data on foreign operations, if any. Please fill out following chart.

(1) No. of franchisees abroad	(2) Countries of operations	(3) No. of Trademarks which you		(4) No. of Marks in Column (3) used by franchisee
		have registered in such countries	use but not registered in such countries	

- (a) On the average, about how many foreign registrations do you acquire for each mark you register in the U. S. ? _____
- (b) What are your more important considerations in deciding whether or not to acquire trademark protection abroad? _____
- _____

Part II. Data on Trademark Selection

7. (a) Describe briefly your procedure for selecting new trademarks.

(b) How many trademark registrations were issued to you in the U. S. in 1967? _____ in 1968? _____ and in 1969? _____.

8. Please write a brief case history of one of your company's trademarks, indicating how and why it was selected, how it has been promoted and protected, what value (including goodwill) you would assign to it, and how it has helped contribute to the growth of your company's franchising operations and to your company's present position in your industry. The mark need not be identified.

Part III. Experience with Existing Law

9. Would you describe briefly the major problems you have encountered regarding protection of your marks used in franchising because of possible deficiencies in existing law: in the U. S. ? _____

abroad? _____

10. Have you experienced any difficulties regarding the following problem areas? If so, please explain briefly.

(1) Lack of comprehensive reference sources for used but unregistered marks:

(2) Registration of marks by foreigners to the detriment of U. S. business interests:

(3) Lack of uniformity in classification among world trademark laws:

(4) Others:

11. Have you any suggestions for research in any aspect of the trademark field that you believe would be especially useful to you?

Part IV. Data on Trademark Licensing, Use and Acquisitions

12. Please describe with respect to trademarks those salient provisions (trademark use, recapture rights, etc.) generally included in your licensing agreements.

13. If your company bought or sold assets in the past five years that included trademarks, please fill out the following:

	In U. S.	Abroad
Total price of assets bought		
Price included for marks and value of goodwill		
Total price of assets sold		
Price included for marks and value of goodwill		

APPENDIX

We are highly desirous of obtaining specific information on trademark values and maintenance costs of franchisors. The following questions are designed for this purpose; while they may be difficult to answer, no body of information of this sort exists. Therefore, we are setting the questions forth as an appendix for your special consideration. The tabulated material may be highly valuable to you in comparing your activities with general practices.

- A. It is of great interest to the Institute to learn whether a franchisor firm can quantify economic value of marks used for the purpose of identifying the firm's services and in representing their reliability and quality. While we realize the difficulties of assigning dollar values to the "goodwill" in marks and their value as business assets, we would appreciate any estimate or approximation of such value that could be provided. Please indicate, if possible, the "goodwill" your firm attributes to its marks by placing estimated dollar figures (representing such goodwill) in the following boxes, and describe briefly the basis upon which such valuation was made.

	Value	Basis for Valuation
Your product marks		
Your service marks		

- B. What was your approximate total outlay (U. S. dollars, including estimated attorney fees) on franchise mark policing and maintenance in 1969 (opposition proceedings, infringement suits, cancellation proceedings, etc.)?

Outlay in U. S. _____ Outlay Abroad _____

Does the franchisee pay any of the above costs with respect to his particular territory of operations? _____. If so, please explain. _____

Taxation of Contingent Payments on the Sale of a Patent

DENNIS I. MEYER* AND ROBERT N. HICKEY**

INTRODUCTION

IT IS NOT TOO UNUSUAL that the United States Tax Court and the Commissioner of Internal Revenue, both reading the same section of the Code, reach opposite conclusions as to its meaning, both of which are justifiable. But, it is indeed a rare occurrence when the Commissioner disagrees with a Tax Court decision in his favor.¹ However, this phenomenon has occurred in the interpretation of section 1235 of the Internal Revenue Code of 1954.²

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¹ See Rev. Rul. 69-482, 1969 Int. Rev. Bull. No. 36, at p. 16.

² Section 1235 [1954 Code].

- (a) **GENERAL.**—A transfer (other than by gift, inheritance or devise) of property consisting of all substantial rights to a patent, or an undivided interest therein which includes a part of all such rights, by any holder shall be considered the sale or exchange of a capital asset held for more than six months, regardless of whether or not payments in consideration of such transfer are—
- (1) payable periodically over a period generally coterminous with the transferee's use of the patent, or
 - (2) contingent on the productivity, use, or disposition of the property transferred.
- (b) **"HOLDER" DEFINED.**—For purposes of this section, the term "holder"

ANALYSIS OF SECTION 1235

Section 1235 (a) in substance provides that a transfer other than by gift, inheritance or devise of property consisting of all substantial rights to a patent, or an undivided interest therein, by a holder shall be considered the sale or exchange of a capital asset held for more than six months, regardless of when and how the payments are made, and whether the patent was actually held for more than six months prior to its sale.

A "holder" is defined as either the inventor or a purchaser of a patent interest from an inventor for money or money's worth before reduction to practice.³ An invention is said to be reduced to actual practice when it has been tested and operated successfully under operating conditions.⁴ Excluded from this definition are the employer of the inventor⁵ and persons related to the inventor within the meaning of section 1235 (d).⁶

Basically, section 1235 (d) provides that section 1235 (a) shall not apply to any transaction, directly or indirectly between related persons as described in section 267 (b). In applying section 267 (b) and (c) for purposes of section 1235 (d) the phrase "25 percent or more" is substituted for the phrase "more than 50 percent" in section 267 (b). Moreover, under section 267 (c) the family of an individual is limited to his spouse, ancestors and lineal descendants.⁷ Three examples will illus-

means—

- (1) any individual whose efforts created such property, or
- (2) Any other individual who has acquired his interest in such property in exchange for consideration in money or money's worth paid to such creator prior to actual reduction to practice of the invention covered by the patent, if such individual is neither—
 - (A) the employer of such creator, nor
 - (B) related to such creator (within the meaning of subsection (d)).
- (c) **EFFECTIVE DATE.**—This section shall be applicable with regard to any amounts received, or payments made, pursuant to a transfer described in subsection (a) in any taxable year to which this subtitle applies, regardless of the taxable year in which such transfer occurred.
- (d) **RELATED PERSONS.**—Subsection (a) shall not apply to any transfer, directly or indirectly, between persons specified within any one of the paragraphs of section 267 (b); except that, in applying section 267 (b) and (c) for purposes of this section—
 - (1) The phrase "25 percent or more" shall be substituted for the phrase "more than 50 percent" each place it appears in section 267 (b), and
 - (2) paragraph (4) of section 267 (c) shall be treated as providing that the family of an individual shall include only his spouse, ancestors, and lineal descendants.
- (e) **CROSS REFERENCE.**—For special rule relating to nonresident aliens, see section 871 (a).

³ Int. Rev. Code of 1954, §1235 (b).

⁴ Treas. Reg. §1.1235-2 (e).

⁵ Treas. Reg. §1235 (b) (2) (A).

⁶ Treas. Reg. §1235 (b) (2) (B).

⁷ Related taxpayers are defined in section 267 (b) and (c) of the 1954 Code as follows:

- (b) **RELATIONSHIPS.**—The persons referred to in subsection (a) are
 - (1) Members of a family, as defined in subsection (c) (4);
 - (2) An individual and a corporation more than 50 percent in value of the outstanding stock of each of which is owned, directly or indirectly, by

trate the application of the above rules: (1) If individual Y owns 20 percent of the outstanding stock of a Corporation A, Corporation A is not a related person for the purposes of section 1235; (2) if, however, Y owns 20 percent of a Corporation A and his wife 6 percent, Corporation A is a related person; and (3) if Y owns 20 percent and his brother owns 20 percent of a Corporation A, Corporation A is not a related person since under section 1235 (d) only stock owned by Y's spouse, parents, children and grandchildren will be considered as constructively owned by Y.

Essentially, the statutory benefits provided by section 1235 are: (a) the rights need not be held for more than six months before transfer; (b) the mode of payment can be (i) periodical and coterminous with the use of the patent, or (ii) contingent on the productivity, use, or disposition of the patent rights transferred, (so-called royalty type payments); (c) all patent rights do not have to be transferred so long as all "substantial rights" are transferred;⁸ and (d) the transferor can

-
- or for such individual;
 - (3) Two corporations more than 50 percent in value of the outstanding stock of each of which is owned, directly or indirectly, by or for the same individual, if either one of such corporations, with respect to the taxable year of the corporation preceding the date of the sale or exchange was under the law applicable to such taxable year, a personal holding company or a foreign personal holding company.
 - (4) A grantor and a fiduciary of any trust;
 - (5) A fiduciary of a trust and a fiduciary of another trust, if the same person is a grantor of both trusts;
 - (6) A fiduciary of a trust and a beneficiary of such trust;
 - (7) A fiduciary of a trust and a beneficiary of another trust, if the same person is grantor of both trusts;
 - (8) A fiduciary of a trust and a corporation more than 50 percent in value of the outstanding stock of which is owned, directly or indirectly, by or for the trust or by or for a person who is a grantor of the trust; or
 - (9) A person and an organization to which section 501 (relating to certain educational and charitable organizations which are exempt from tax) applies and which is controlled directly or indirectly by such person or (if such person is an individual) by members of the family of such individual.
 - (c) CONSTRUCTIVE OWNERSHIP OF STOCK.—For purposes of determining, in applying subsection (b), the ownership of stock—
 - (1) Stock owned, directly or indirectly, by or for a corporation, partnership, estate, or trust shall be considered as being owned proportionately by or for its shareholders, partners, or beneficiaries;
 - (2) An individual shall be considered as owning the stock owned, directly or indirectly, by or for his family;
 - (3) An individual owning (otherwise than by the application of paragraph (2), any stock in a corporation shall be considered as owning the stock owned, directly or indirectly, by or for his partner;
 - (4) The family of an individual shall include only his brothers and sisters (whether by the whole or half blood), spouse, ancestors, and lineal descendants; and
 - (5) Stock constructively owned by a person by reason of the application of paragraph (1) shall, for the purpose of applying paragraph (1), (2), or (3), be treated as actually owned by such person, but stock constructively owned by an individual by reason of the application of paragraph (2) or (3) shall not be treated as owned by him for the purpose of again applying either of such paragraphs in order to make another the constructive owner of such stock.

⁸ The term "all substantial rights to a patent" means all rights (whether or not then held by the grantor) which are of value at the time the rights to the patent are transferred. If, in fact, the grant of rights is limited geographically within the country of issuance, limited in duration to a period of time less than the remaining life of the patent, or the rights are limited in use only in certain industries or trades which are less than all rights covered by the patent, which exist and have value at the time of grant; or which grants the grantee less than all the valuable

be in the "patent business" *i.e.*, an individual in the business of inventing or of financing inventors.⁹

Prior to the enactment of section 1235, only amateurs as distinguished from professional inventors could obtain capital gain treatment on the sale of a patent or invention since inventions by professionals were deemed to be property held primarily for sale to customers in the ordinary course of business and therefore were not capital assets.¹⁰

The regulations interpret these statutory benefits as applied to a number of questions.¹¹ A frequent problem arises in the employment relationship in determining whether payments received by an employee-inventor from his employer are in consideration of a patent transfer to the employer or whether the payments represent compensation for services rendered. In making such a determination the regulations provide that "consideration shall be given not only to all the facts and circumstances of the employment relationship, but also to whether the amount of such payments depends upon the production, sale or use by, or the value to, the employer of the patent rights transferred by the employee."¹² If it is determined that the payments are attributable to a transfer of patent rights, and all other requirements under section 1235 are met, such payments will be treated as proceeds derived from the sale of a patent.¹³

BACKGROUND OF SECTION 1235

Prior to the enactment of section 1235 in 1954, taxpayers had been for the most part successful in receiving capital gain treatment with respect to payments received from the transfer of patents where the payments were both periodical and dependent on the extent of use of the patent over the period of its life. In the *Edward C. Myers*¹⁴ case the

claims or inventions covered by the patent at the time of grant, the requirements of section 1235 will not be satisfied. (Treas. Reg. §1.1235-2 (b) (1) .)

Retention of rights which are not considered substantial include: (i) legal title for the purposes of securing performance or payment by the transferee; (ii) vendor's lien, or a forfeiture provision for nonperformance. (Treas. Reg. §1.1235-2 (b) (2) .)

See also Creed, Bangs, Driscoll, "Federal Taxation of the Inventor," *P.T.C. J. Res. & Ed.*, (IDEA), Vol. 2, No. 4 (December 1958), p. 505.

⁹ Treas. Reg. §1.1235-2 (d) (3) .

¹⁰ Harold T. Avery, 47 B.T.A. 538. (1942) .

¹¹ *E.g.*, payments for infringement, Treas. Reg. §1.1235-1 (c) (1) ; Payments to an employee, Treas. Reg. §1.1235-1 (c) (2) ; successive transfers, Treas. Reg. §1.1235-1 (c) (3) .

¹² Treas. Reg. §1.1235-1 (c) (2) .

¹³ *Id.*

¹⁴ 6 T.C. 258 (1946) .

Tax Court held that an exclusive license to manufacture, use and sell the patented articles for the full term of the patent, in return for a percentage of the sales price of the equipment embodying the invention, constituted the sale by the taxpayer of his invention, and since it was the sale of property which the taxpayer had held for more than the requisite statutory holding period and the invention was not property held primarily for sale to customers in the ordinary course of the petitioner's trade or business, there was a sale of a capital asset.¹⁵

The confusion over whether royalty type payments for the sale of a patent would be treated as gain from the sale of a capital asset was generated by the varying positions taken by the Commissioner with respect to the *Myers* case. In 1946, the Commissioner announced his acquiescence in the *Myers* holding.¹⁶ In 1950, however, the Commissioner withdrew his acquiescence and substituted a nonacquiescence.¹⁷

Consequently, in 1954, Congress decided to obviate the uncertainty caused by the Commissioner's nonacquiescence and to provide further incentive to inventors to contribute to the country's technological advancement, and therefore enacted section 1235 to the Code. Not to be outdone, the Commissioner in 1955 issued another ruling¹⁸ in which he announced that section 1235 would be applied to payments received in 1954 and subsequent years, but for taxable years beginning after May 1, 1950, and before January 1, 1954, he would continue to apply his 1950 ruling. To remedy this situation, Congress took further action in 1956 and amended section 117 of the 1939 Code and added a new subsection, (q), which in substance established the same rule for taxable years beginning after May 31, 1950, as was applicable under the 1954 Code. Finally, the Commissioner again reconsidered his position in 1958 and acquiesced in *Myers*.¹⁹

¹⁵ See Leonard Coplan, 28 T.C. 1189 (1957); Rose Marie Reid, 26 T.C. 622, 632 (1956); Roy J. Champayne, 26 T.C. 634, 646-647 (1956); Allen v. Werner, 190 F.2d 840 (5th Cir. 1951); Hofferbert v. Briggs, 178 F.2d 743, 744-745 (4th Cir. 1949).

¹⁶ 1946-1 Cum. Bull. 3.

¹⁷ 1950-1 Cum. Bull. 9, 10.

Further consideration has been given to the question as to whether the decision in the *Myers* case should be accepted as a precedent in the determination of income tax liabilities of other taxpayers with respect to contracts containing essentially the same provisions. . . .

The Bureau has reached the conclusion that where the owner of a patent enters into an agreement whereby, in consideration of the assignment of the patent, or the license of the exclusive right to make, use, and sell a patented article, the assignee or licensee agrees to pay to the assignor or licensor an amount measured by a fixed percentage of the selling price of the article so manufactured and sold, or amounts per unit based upon units manufactured or sold, or any other method measured by production, sale, or use either by assignee or licensee, or amounts payable periodically over a period generally coterminous with the transferee's use of the patent, such agreement, for income tax purposes, is to be regarded as providing for the payment of royalties taxable as ordinary income.

¹⁸ 1955-1 Cum. Bull. 97.

¹⁹ 1958-2 Cum. Bull. 6.

SCOPE OF SECTION 1235

The enactment of section 1235 has not ended the controversy over the taxation of royalty type payments received from the transfer of a patent. At issue is whether section 1235 prescribes the only set of circumstances in which capital gain treatment is provided for payment of patent interests that are periodical and extend over the period of patent use or are contingent on the use of the transferred patent right. On one side of the controversy is apparently the Tax Court with support from the legislative history of section 1235, and paradoxically, on the other, the Commissioner and the taxpayer, also supported by the legislative history of section 1235.

Section 1235 (a) speaks only of transactions by holders of patents. It is clear from the legislative history, however, that if the transferor does not qualify as a "holder" under subsection (b), while not receiving the benefits of section 1235, the transfer may still be eligible for capital gain treatment under section 1231 of the Code:

It is the intention of your committee that, if the mode of payment is as described in subsection (a), the sale of a patent by any "holder" must qualify under the section in order for such "holder" to obtain capital gains treatment. However, the benefits of this section are to be limited to those individuals and transfers qualifying under its terms. In enacting this section, for the specific purposes set forth in this report, your committee has no intention of affecting the operation of existing law in those areas without its scope. For example, the tax consequences of the sale of patents in years to which this section is inapplicable, or by individuals who fail to qualify as "holders," or by corporations, is to be governed by the provisions of existing law as if this section had not been enacted. Similarly, no inference is to be drawn from this section as to what constitutes a "sale or exchange" in other than the patent field. Benefits under the section are not available to nonresident aliens.²⁰

At face value, the legislative history also seems to indicate that if the mode of payment is as described in section 1235 (a) and the transferor is a holder, he *must* qualify under section 1235 in order to obtain capital gain treatment.²¹

At this point the Tax Court and the commissioner disagree on the scope of section 1235. Although the Tax Court was content to avoid the

²⁰ S. Rep. No. 1622, 83d Cong., 2d Sess. 441 (1954).

Under section 1231, the sale or exchange of a patent, which is depreciable property, used in the taxpayer's trade or business and held for more than six months may receive capital gain treatment provided that the sale or exchange is not between related persons as defined in section 1239. [sale between husband and wife or an individual and his 80% owned corporation.]

²¹ *Id.*

issue of the applicability of section 1235 to transfers by holders in 1957 and 1958,²² in 1966, it held, without discussion of the legislative history, that if a transfer by a holder does not qualify under section 1235, the transfer is governed by other provisions of the law, and in order to qualify for long-term capital gain treatment, the property rights in the invention must be held for more than six months prior to their sale.²³

In 1966, the Tax Court in the *Myron C. Poole* case²⁴ thoroughly reviewed the legislative history of section 1235 and reversed its earlier position. At issue in *Poole* was the transfer of patents by a holder to a non-related corporation within the meaning of section 1235 (d), but which in fact the transferor controlled, and the transfer by that corporation of a non-exclusive license to such patents to another corporation that was related to the transferor.

In holding that the royalty type payments were taxable as ordinary income, the court observed that in fact there was an indirect transfer of the patents to a related corporation and that section 1235 (d) applied to such indirect transfers. The importance of *Poole* is in the court's handling of the question—whether the taxpayer could obtain capital gain treatment outside of section 1235. The court, citing as authority the statement by Congress that a holder must qualify under section 1235 if payments are made as described in subsection (a), stated:

We also find unsound Poole's alternate contention that if section 1235 does not apply to the 1956 transfers, he is entitled under other provisions of law to capital gains treatment for the royalties paid in connection with such transfers. The legislative history with respect to section 1235 explains that a holder's recourse to prior case law is proper only when the transaction is not one described in section 1235 (a). In other words, if the payments for a patent are contingent upon productivity, use or disposition, or if they are payable periodically over a period generally coterminous with the transferee's use of the patent, section 1235 is the holder's exclusive provision for qualifying for capital gains treatment. Moreover, this interpretation of the effect of section 1235 is supported by an analysis of the effect of the provisions of the section. If a holder transfers a patent resulting in the payment of royalties in the manner described in section 1235 (a) to a related person, and if we were to hold that such a

²² In *Leonard Coplan*, 28 T.C. 1189 (1957) and *Herbert C. Johnson*, 30 T.C. 675 (1958), the taxpayer and Commissioner in both cases agreed that section 117 (q) of the 1939 Code [section 1235's 1939 Code equivalent] did not apply to the transfer of a patent by a holder to a related person in consideration of royalty type payments. Both courts concluded that the issue of section 117 (q)'s applicability was not before it and were content to decide the cases based on prior case law.

²³ *Max A. Burde*, 43 T.C. 252, 269 (1964).

²⁴ 46 T.C. 392 (1966).

transfer is entitled to capital gains treatment under another provision of law, we would be nullifying section 1235 (d). Since section 1235 (d) was included in the law, it must have been done for a purpose—the purpose of denying capital gains treatment to a holder's transfer to related persons when the payments are of the type described in section 1235 (a).²⁵

Poole is the last pronouncement of the Tax Court on this question and consequently, it must be concluded that as far as that court is concerned, section 1235 is the sole recourse of a *holder* for capital gain treatment if he transfers patent rights and receives periodical contingent payments as consideration.

The court in *Poole* by footnote pointed out that the Treasury's Regulations were inconsistent with its holding:

We are aware that section 1.1235-1 (b), Income Tax Regs., provides that if section 1235 does not apply because a transfer is made to a related person, the tax consequences of the transfer are to be determined under other provisions of law. If that section of the regulations is intended to imply that when a holder transfers a patent and receives payment in the manner described in section 1235 (a), such payments may qualify for capital gains treatment, the regulations must yield to the contrary legislative purpose.²⁶

The most recent judicial pronouncement in the sorted history of section 1235 is a district court decision, *Thompson v. United States*.²⁷ The issue, decided against the taxpayer, was whether he had transferred substantially all his rights in certain patents to a wholly owned corporation in return for royalty type payments. The taxpayer was a holder of certain patents and a non-holder of others. The court discussed the relevance of section 1235 and the *Poole* case, specifically focusing on whether capital gain treatment was available since section 1235 appeared to govern all alleged capital gain transfers of patents in exchange for "royalties" and the transfer in the instant case did not qualify under section 1235 (d) since it was between related persons.

The real issue, the court thought, was whether section 1235 prescribed the only set of circumstances in which capital gain treatment could be claimed for royalty type payments; in other words, will capital gain treatment be denied to non-holders and on *all* transfers to related persons.

²⁵ *Id.* at pp. 404-405.

²⁶ *Id.* at p. 404, n. 7. Treas. Reg. 1.1235-1 (b) is as follows:

(b) *Scope of Section 1235.* If a transfer is not one described in paragraph (a) of this section, section 1235 shall be disregarded in determining whether or not such transfer is the sale or exchange of a capital asset. For example, a transfer by a person other than a holder or a transfer by a holder to a related person is not governed by section 1235. The tax consequences of such transfers shall be determined under other provisions of the internal revenue laws.

²⁷ 70-1 USTC 82,792 (E.D.N.Y., Decided 12/31/69).

The court thought that *Poole* stood for the proposition that section 1235 did prescribe the only set of circumstances to obtain capital gain treatment for royalty type payments. Commenting on its analysis, the court stated:

It is difficult to resist the conclusion that the dictum in *Poole* is a valid reading of the statute's words, but the whole checkered and unfortunate history of this area of tax law counsels that it would be incautious to read section 1235 as intending a denial of capital gains treatment in all cases in which the consideration takes the royalty form unless the taxpayer can qualify as a "holder" and unless the transfer is to an unrelated person.²⁸

It is submitted that the district court's construction of *Poole* is not entirely accurate. *Poole* dealt only with the transfer of a patent for royalty type payments by a *holder*. If such is the case, the court found that section 1235 is the holder's only recourse for capital gains treatment. Nothing in *Poole*, especially in light of the relevant legislative history, forces a conclusion that section 1235 provides the only means for capital gain treatment of patent transfers for royalty type payments.²⁹

Poole was correct in reading the implications of Reg. 1.1235-1 (b) and in 1969, the Commissioner reaffirmed in Revenue Ruling 69-482³⁰ the position previously taken in the regulation. In that ruling the Commissioner was requested to advise whether the mere fact that a patent transfer for contingent amounts does not qualify for capital gain treatment under section 1235 prevents a holder from qualifying for such treatment under other provisions of the Code. The Commissioner concluded that capital gain treatment was available outside of section 1235 and the Reg. 1.1235-1 (b) was consistent with the legislative history pertaining to the adoption of section 1235.³¹ As viewed by the Commissioner, transfers of patent interests by a holder to a related

²⁸ *Id.* at pp. 82,800.

²⁹ S. Rep. No. 1622 states:

. . . In enacting this section, for the specific purposes set forth in this report, your committee has no intention of affecting the operation of existing law in those areas without its scope. For example, the tax consequences of the sale of patents in years to which this section is inapplicable, or by individuals who fail to qualify as "holders," or by corporations, is to be governed by the provisions of existing law as if this section had not been enacted. Similarly, no inference is to be drawn from this section as to what constitutes a "sale or exchange" in other than the patent field. Benefits under the section are not available to nonresident aliens.

(Emphasis added)

³⁰ 1969 Int. Rev. Bull. No. 36, at p. 16.

³¹ The Commissioner quoted the following portion of S. Rep. No. 1622:

. . . In enacting this section, for the specific purposes set forth in this report, your committee has no intention of affecting the operation of existing law in those areas without its scope. For example, the tax consequences of the sale of patents in years to which this section is inapplicable, or by individuals who fail to qualify as "holders," or by corporations, is to be governed by the provisions of existing law as if this section had not been enacted.

person are outside the scope of section 1235. This view finds some support in the legislative history; however, there is also support for *Poole's* interpretation of section 1235.

CONCLUSION

As evidenced from the discussion above, great confusion still exists with respect to the scope of section 1235. Both the Tax Court and the Commissioner appear to agree that a transfer by a non-holder of his interest in a patent, either for a lump sum consideration or royalty type payments, is outside the scope of section 1235 and the availability of capital gain treatment must be determined by reference to other provisions of the Code and prior case law.

The taxpayer, however, is placed in somewhat of a dilemma because of the differing views of the Tax Court and Commissioner on the question of whether section 1235 is the exclusive route to capital gain treatment for a holder of a patent receiving royalty type payments. For the present at least, a taxpayer-holder can rely on the regulations with respect to transfers to related persons. He should, however, be mindful that the Commissioner has changed his position in the past regarding the application of section 1235 and is certainly not precluded from such vascillations in the future. In light of *Poole*, the Commissioner could do so with the assurance that at least one forum, the Tax Court, would uphold the validity of a regulatory revision to the effect that section 1235 is the sole means of achieving capital gain treatment for a holder who desires to fashion a patent sale on a royalty type payment basis.

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Fraud Upon the Patent Office As a Violation of the Sherman Antitrust Law^{*}

NEIL A. SMITH

PREFACE

POSSESSION OF A PATENT SECURED BY A FRAUD upon the Patent Office coupled with the assertion of that patent grant to exclude others from making, using, or selling the patented invention within any part of trade or commerce may be monopolization or an attempt or a conspiracy to monopolize in violation of Section 2 of the Sherman Act. This paper examines the cases dealing with the concept of fraud on the Patent Office to determine the boundaries of a patent holder's conduct in the procurement of the patent and its subsequent enforcement which should be a violation of the antitrust laws.

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*An act concerning monopolies and dispensations with penal laws
and the forfeitures thereof.*

... be it declared and enacted by authority of this present parliament, That all monopolies, and all commissions, grants, licenses, charters and letters patents heretofore made or granted, or hereafter to be made or granted, to any person or persons, bodies politick or corporate whatsoever, of or for the sole buying, selling, making, working or using of any thing within this realm, are altogether contrary to the laws of this realm, and so are and shall be utterly void and of none effect, and in no wise to be put in use or execution.

That if any person shall be hindred, grieved, disturbed or disquieted, or his or their goods or chattels any way seized, attached, distrained, taken, carried away or detained, by occasion or pretext of any monopoly, and will sue to be relieved in or for any of the premisses; that then and in every such case, the same person may have his and their remedy by any action or actions to be grounded upon this statute; shall recover three times so much as the damages which he or they sustained by means or occasion of being so hindred, grieved, disturbed or disquieted, or by means of having his or their goods or chattels seized, attached, distrained, taken, carried away or detained, and double costs.

Provided nevertheless, That any declaration before mentioned shall not extend to any letters patents and grants of privilege for the term of one and twenty years or under, heretofore made, of the sole working or making of any manner of new manufacture within this realm, to the first and true inventor or inventors of such manufactures, so they be not contrary to the law; nor mischievous to the state.¹

* * *

While the Chancellor's foot may vary in size, his arm is ever reaching to restrain a party from enjoying a capital gain from his fraudulent conduct.²

INTRODUCTION

The United States patent finds its origin in the Constitution, where Congress is given the power "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."³ The

¹ The Statute of Monopolies, 21 Jac. 1, c. 3 (1623), abridged from the original language.

² *United States v. Hartford Empire*, 73 F.Supp. 979, 982, 75 USPQ 118, 120, (D. Del. 1947).

³ U.S. Const. art. I, § 8.

granting of such exclusive monopoly rights to an inventor securing a United States patent in our free enterprise system rests upon the assumption that the benefits to society will outweigh the disadvantages of creating a monopoly⁴ in at least two respects.

In exchange for 17 years of monopoly rights,⁵ the inventor discloses his invention to the public and thus increases the general wealth of public technical knowledge. This is an obvious value to society when one considers the alternative of denying statutory patent protection and encouraging the inventor to maintain his invention in secrecy and so rely upon the common law doctrine of trade secrets lest someone determine the nature of his invention.⁶ A second benefit to society

⁴ There is a semantic question as to whether the right granted by a patent, to exclude others from making, using, or selling the invention is a true monopoly. *Webster's New World Dictionary*, 952 (College Edition, 1968), defines "monopoly" as "exclusive control of a commodity or service in a given market." In at least one case, that of an improvement patent dominated by a patent on a basic invention, the patentee does not have exclusive control of the invention since he may not even be able to use his own patented improvement without a license from the owner of the dominant patent. The exclusive control of the patentee on a market is also subject to the right of the U.S. Government to use or manufacture his invention subject to reasonable compensation under 28 U.S.C. § 1498 (1960). Disregarding these two situations, it will be assumed that the exclusive right possessed by the patentee, or title holder, does constitute the "exclusive control" in a given market which is a monopoly.

⁵ The patentee is given the statutory right to exclude others from making, using, or selling his patented invention. Those who make, use, or sell his invention without authority are infringers of the patent. 35 U.S.C. § 271 (a) (1965). The courts are given the power to grant injunctions against infringement of patents by others. 35 U.S.C. § 283 (1965).

⁶ Today there is a real question whether an inventor has a choice between relying on the patent law by securing a patent or relying on the law of trade secrets by keeping his invention a secret. Justice Black's dissent in the Supreme Court case *Lear, Inc. v. Adkins*, 395 U.S. 653 (1968), relied upon *Sears, Roebuck and Co. v. Stiffel Co.*, 376 U.S. 225 (1964), and *Compco Corp. v. Day-Brite Lighting*, 376 U.S. 234 (1964), for the view that:

[N]o State has a right to authorize any kind of monopoly on what is claimed to be a new invention, except where a patent has been obtained from the Patent Office under the exacting standards of the patent laws.

Lear, at 677.

At least one court has relied upon this *Lear* dissent to deny a contractual claim for royalties for a trade secret on which no patent exists. As the court said:

Pursuant to [the] contract, Painton agreed to pay royalties on models for which no patent application had been or would be made. Painton is not required, however, to make any future payments. This court's enforcement of such an agreement would be contrary to our national patent law and policy, *Lear v. Adkins*, *supra*. Our patent policy of strict regulation of inventions would be undercut if inventors could enforce agreements for compensation for alleged secret ideas without being required to submit those ideas to the Patent Office, and, thereby, eventually have the ideas disclosed to the public.

Judge Constance Baker Motley in *Painton & Co., Ltd. v. Bourns Inc.*, 309 F.Supp. 271, 274, 164 USPQ 595, 596 (S.D.N.Y. 1970).

sought from granting exclusive patent monopoly rights is the acceleration of technological progress through the stimulus that the temporary granting of such monopoly rights will provide for the financing of research and development in industry and of new industrial ventures.

To achieve these benefits for society results in the disadvantages of creating the very "monopoly" which the antitrust laws have been designed to remove. But the framers of the Constitution made the initial judgment that these benefits outweighed the societal disadvantages of creating a limited monopoly, and it has therefore been up to the courts to achieve a working balance between the patent and antitrust bodies of law.

At the beginning of the Twentieth Century, the whole area of patents had been carved out as an exemption from the existing Sherman Antitrust Law.⁷ For example, in the 1907 case of *Rubber Tire Wheel Company v. Milwaukee Rubber*,⁸ the Seventh Circuit Court of Appeals said that:

Congress, having created the patent law, had the right to repeal or modify it, in whole or in part, directly or by necessary implication. The Sherman law contains no reference to the patent law. Each was passed under a separate and distinct constitutional grant of power, each was passed professedly to advantage the public; the necessary implication is that not one iota was taken away from the patent law; the necessary implication is that patented articles, unless or until they are released by the owner of the patent from the dominion of his monopoly, are not articles of trade or commerce among the several states.⁹

However, the view that patented articles were not to be excepted from the Sherman Act was heralded by the concurring judge in that case,¹⁰ and soon became the rule rather than the exception in antitrust law. Today there are many antitrust law violations which are not defended by there being a patented invention. The patent monopoly right to exclude others from making or using or selling the subject matter of a patent is severely limited. For example, a patent holder may grant a license to another to make, use, or sell the subject matter of his patent only if he stays within the bounds of several antitrust limita-

⁷ See also, *The Statute of Monopolies*, 21 Jac. 1, c. 3 (1623), a portion of which is quoted at the beginning of this paper.

⁸ *Rubber Tire Wheel Co. v. Milwaukee Rubber*, 154 Fed. 358 (7th Cir. 1907).

⁹ *Id.* at 362.

¹⁰ Judge Grosscup said: "I concur in the foregoing judgment; but am not prepared to hold that patented articles are never, under any circumstances, articles of trade or commerce among the several states, within the meaning of the Sherman Act; and do not think that premise is essential to the conclusion arrived at." *Id.* at 364.

tions. Among these are the antitrust prohibitions against such restrictions as those on price,¹¹ quantity,¹² and field of use.¹³

Decisions of the Supreme Court in *Walker Process Equipment, Inc. v. Food Machinery and Chemical Corp.*,¹⁴ and the Court of Appeals for the Eighth Circuit in *Acme Precision Products, Inc. v. American Alloys Corp.*¹⁵ have held that the fraudulent procurement of a patent from the Patent Office coupled with the assertion or enforcement of that patent monopoly may create antitrust liability under the Sherman Act,¹⁶ therefore subjecting the patent owner to both criminal liability¹⁷ and treble damages.¹⁸ This is an extreme result and it will be necessary to examine these and other cases in detail to determine exactly what conduct on the part of an applicant in patent prosecution and on the part of a patent owner in enforcement of the patent the courts find so reprehensible that antitrust liability should attach.¹⁹

HISTORICAL DEVELOPMENT OF FRAUD ON THE PATENT OFFICE

Although antitrust liability for fraudulent patent procurement is a relatively recent development, other penalties have often been judicially enforced for a fraud upon the Patent Office. The most important penalties for the procurement of a patent through fraud are criminal²⁰

¹¹ *Bement v. National Harrow Co.*, 186 U.S. 70 (1902); *United States v. General Electric Co.*, 272 U.S. 476 (1926).

¹² *American Equipment Co. v. Tuthill Bldg. Material Co.*, 69 F.2d 406, 21 USPQ 198 (7th Cir. 1934).

¹³ *United States v. National Lead Co.*, 332 U.S. 319, 73 USPQ 498 (1947); *Ethyl Gasoline Corp. v. United States*, 309 U.S. 436, 44 USPQ 614 (1940).

¹⁴ 382 U.S. 172, 147 USPQ 404 (1965).

¹⁵ 422 F.2d 1395, 165 USPQ 164 (8th Cir. 1970).

¹⁶ 15 U.S.C. § 2 (1964).

¹⁷ *Id.*

¹⁸ The treble damage provisions of the Clayton Act 15, U.S.C. § 15 (1964) are available to an injured party:

Any person who shall be injured in his business or property by reason of anything forbidden in the antitrust laws may sue therefor in any district court of the United States in the district in which the defendant resides or is found or has an agent, without respect to the amount in controversy, and shall recover threefold the damages by him sustained, and the cost of suit, including a reasonable attorney's fee.

¹⁹ It is assumed that the reader is familiar with the patent laws and the practice for securing a patent from the U.S. Patent Office.

²⁰ Under § 1001 of Title 18 (1966), entitled Crimes and Criminal Procedure:

Whoever, in any matter within the jurisdiction of any department or agency of the United States knowingly and willfully falsifies, conceals or covers up by any trick, scheme, or device a material fact, or makes any false, fictitious or fraudulent statements or representations, or makes or uses any false writing or document knowing the same to contain any false, fictitious or fraudulent statement or entry, shall be fined not more than \$10,000 or imprisoned not more than five years, or both.

Although this is a seldom-used statute for criminal liability in cases of patent pro-

prosecution, a suit by the government to cancel a patent,²¹ and the allowance of the equitable defense of "unclean hands" in a suit for patent infringement. The last of these penalties is that most often inflicted upon one who obtained a patent by fraud upon the Patent Office: in an infringement suit, the patent owner is met with a valid defense of "unclean hands" and is denied relief for patent infringement.²² This result, although it does not officially cancel the patent

cursement fraud, it is occasionally applied. In the 1945 case of *Mas v. United States*, 151 F.2d 32, 66 USPQ 350 (D.C. Cir. 1945), *cert. denied*, 326 U.S. 776, a conviction was affirmed for an individual's having made fraudulent statements to the Patent Office in an interference proceeding.

²¹ *E.g.*, in an 1888 Supreme Court case, *United States v. American Bell Telephone Co.*, 128 U.S. 315 (1888), it was held that a bill in equity brought by the Attorney General would lie to cancel a patent granted to Alexander Graham Bell through fraud upon the Patent Office.

And even today the United States can bring an action to cancel a fraudulently procured patent. *United States v. Saf-T-Boom Corp.*, — F.2d —, 167 USPQ 195 (8th Cir. Sept. 30, 1970).

²² In *Providence Rubber Co. v. Goodyear*, 76 U.S. 240 (1869), the Supreme Court had originally refused to allow such a defense to patent infringement since it was not one of the statutory defenses to infringement listed in the patent law. This judicial exclusion of such a defense was overruled; in *Keystone Driller Co. v. General Excavator Co.*, 290 U.S. 240, 19 USPQ 228 (1933), a plaintiff suing for patent infringement was denied relief because he came before the court with "unclean hands." He had suppressed a prior use of invention which would have made the patent invalid by having paid the brother of the inventor to falsely swear that such prior use was only an abandoned experiment.

In *Hazel-Atlas Glass Co. v. Hartford Empire Co.*, 322 U.S. 238, 61 USPQ 241 (1944), the Supreme Court denied relief against an infringer on grounds of fraud in the procurement of a patent and made it clear that fraudulent procurement would be a valid defense to an infringement suit even if the fraud were limited to the Patent Office and not directly practiced on the court.

The leading case in this area today is *Precision Instrument v. Automotive Maintenance Machinery Co.*, 324 U.S. 806, 65 USPQ 133 (1945). In that case, the defendant had filed an application for a patent, and the Patent Office had placed it in interference with an application of the plaintiff's which covered common subject matter. An interference settlement was made between plaintiff and defendant, plaintiff acquiring defendant's patent application which plaintiff then prosecuted to become an issued patent. The suit was brought for infringement of the patent. The defendant's answer stated that its original patent application had been supported by false swearing of priority dates, that this fact had been known by plaintiff, and that defendant had settled with plaintiff because the latter had threatened to expose the fraud. The Supreme Court held that plaintiff's conduct was fraud before the Patent Office and was a defense to the infringement suit such as to deny relief for "unclean hands," thus rendering the patent unenforceable. The Court noted the public interest in limiting the patent monopoly whenever it resulted from such inequitable conduct. As the Court said:

[The] patent is an exception to the general rule against monopolies and to the right to access to a free and open market. The far-reaching social and economic consequences of a patent, therefore, give the public a paramount interest in seeing that patent monopolies spring from backgrounds free from fraud or other inequitable conduct and that such monopolies are kept within their legitimate scope.

Id. at 816.

grant, at least removes all the rights of the patent owner to enforce his patent monopoly.²³

In the antitrust area the courts have evolved a general doctrine of patent misuse whereby the owner of a patent who engages in an activity ostensibly involving a patent but actually beyond the scope of the patent grant is stripped of the rights and privileges of his patent since such activity extends the scope of the patent monopoly.²⁴ The efforts of a patent owner to extend his patent monopoly through its misuse may not only render the patent unenforceable²⁵ but may be extended by the court to constitute an affirmative violation of the antitrust laws.²⁶

The patent misuse cases usually were limited to illegal extension of an otherwise valid patent, not dealing with fraud in the acquisition of the patent. In one case, *United States v. Singer Manufacturing Co.*,²⁷

²³ Some courts make "unclean hands" a defense to patent infringement but do not even declare the patent invalid. *See, e.g., SCM Corp. v. Radio Corp. of America*, — F.Supp. —, 167 USPQ 196 (S.D.N.Y. Sept. 28, 1970).

²⁴ *E.g.*, In the early case of *Motion Picture Patents Co. v. Universal Film Mfg. Co.*, 243 U.S. 502 (1917), the Supreme Court barred the owner of a patent on movie equipment from enforcement of his patent where he attempted to control the sale of motion picture film. The court said that:

Such a restriction is invalid because such a film is obviously not any part of the invention of the patent in suit; because it is an attempt, without statutory warrant, to continue the patent monopoly in this particular character of film after it has expired, and because to enforce it would be to create a monopoly in the manufacture and use of moving picture films, wholly outside of the patent in suit and of the patent law as we have interpreted it.

Id. at 518.

Thus the extension of a patent beyond its statutory scope was found to be a violation of the Clayton Act which would defeat an action for infringement of the patent.

²⁵ *Id.*

²⁶ *E.g.*, In the companion cases *Mercoide Corp. v. Mid-Continental Investment Co.*, 320 U.S. 661, 60 USPQ 21 (1944), and *Mercoide Corp. v. Minneapolis-Honeywell Regulator Co.*, 320 U.S. 680, 60 USPQ 30 (1944), suits were brought against Mercoide for patent infringement. The patent covered a control system for heating equipment. The patentees sold an unpatented switch, which served as a part of the patented combination, but required each switch purchaser to take a license to use the patented control system. The defendant, Mercoide Corp. sold similar unpatented switches, but refused to take a patent license on the control system in which the switches were applicable.

The Supreme Court found that the patentee's practice of requiring unpatented switch purchasers to take a license on the patented control system in which the switch was designed to serve was an illegal attempt to control commerce in unpatented switches beyond the grant of the control system patent. In the second case, the Supreme Court held further that the defendant, Mercoide Corp., was entitled to treble damages from the plaintiff since the attempt to extend the control system patent to control sale of the unpatented switches constituted a violation of the antitrust laws.

²⁷ 374 U.S. 174, 137 USPQ 808 (1963).

however, the Supreme Court did suggest that proceedings before the Patent Office could alone subject a patent owner to antitrust liability. In that case, Singer had made an agreement with another inventor to terminate an interference proceeding set up between them by the Patent Office. As a result of such an agreement, a patent issued which would probably have been found to be invalid had they not agreed not to contest each other's priority.²⁸ The agreement terminated the interference proceeding in order to prevent disclosure of information which would have prevented a patent from issuing, and therefore resulted in the issuance of a patent of questionable validity. It was made in return for mutual promises to cross-license the patent and thus exclude competition from others in the patented invention. The Supreme Court held that the agreement was a conspiracy in restraint of trade and thus violated Section 1 of the Sherman Antitrust Law.²⁹

Justice White, in a concurring opinion, pointed out that two possible grounds existed for the decision. First, there was a conspiracy to exclude others than the parties to the agreement from the market. Secondly, the fraudulent termination of interference proceedings before the Patent Office was in itself a conspiracy in violation of the Sherman Act. Justice White made it clear that either ground would be sufficient in itself to justify a finding of antitrust conspiracy.³⁰ Therefore, the *Singer* case is at least an alternate holding to the effect that antitrust consequences may be premised upon Patent Office fraud.

²⁸ This case arose before the patent statute was amended to require the filing of patent interference settlements with the Patent Office. See 35 U.S.C. § 135(c) (1965); *Old Dominion Box Co., Inc. v. Continental Can Co., Inc.*, 273 F.Supp. 550, 155 USPQ 70 (S.D.N.Y. 1967).

²⁹ 15 U.S.C. § 1 (1964): "Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several states, or with foreign nations, is hereby declared to be illegal."

³⁰ *United States v. Singer Manufacturing Co.*, 374 U.S. 174, 197, 137 USPQ at 818. Speaking of a fraud on the Patent Office through such an agreement, Justice White said:

There is a public interest here which the parties have subordinated to their private ends—the public interest in granting patent monopolies only when the progress of the useful arts and of science will be furthered because in consideration for this grant the public is given a novel and useful invention. When there is no novelty and the public parts with the monopoly grant for no return, the public has been imposed upon and the patent clause subverted. Whatever may be the duty of a single party to draw the prior art to the Office's attention, clearly collusion among applicants to prevent prior art from coming to or being drawn to the Office's attention is an inequitable imposition on the Office and on the Public. In my view, such collusion to secure a monopoly grant runs afoul of the Sherman Act's prohibitions against conspiracies in restraint of trade—if not bad *per se*, then such agreements are at least presumptively bad.

Id. at 199-200, 137 USPQ at 819.

WHO MAY VIOLATE THE ANTITRUST LAWS?
THREE CASES

The first case of major importance, *American Cyanamid Co. v. Federal Trade Commission*,³¹ involved the Federal Trade Commission's action against five companies producing the wonder drug tetracycline. Pfizer and Co. applied for a patent to protect its discovery of the new wonder drug tetracycline. The Patent Office examiner initially concluded that the drug itself was unpatentable since it was readily recoverable from broths well known in the drug field for production of another drug, aureomycin. The theory of this rejection was that the drug could not be patented if it was an obvious product of a known process.

The Patent Office examiner met with Pfizer's representatives and agreed that he would withdraw his rejection of the patent application if Pfizer would perform certain chemical tests to determine if tetracycline resulted from the known production method for aureomycin. The Pfizer scientists supposedly ran the requested tests by producing aureomycin and submitted affidavits swearing that tetracycline did not result from the production of aureomycin. A second defendant in the case, who was to get a license under the patent according to an agreement to settle a possible interference, American Cyanamid Co., withheld information pertinent to the granting of the patent to Pfizer by not telling the examiner of the inherent production of tetracycline. The tetracycline patent was granted Pfizer by the examiner who relied upon the affidavits and representations of Pfizer and American Cyanamid. In actual fact it was later proven that the sworn affidavits and representations of both companies which induced the patent examiner to withdraw his rejection and issue the patent were false and misleading. The patent should never have issued, since tetracycline was in fact a product of past aureomycin production methods.³²

The Federal Trade Commission, upon discovery of the fact that the patent had been procured by fraud upon the Patent Office, filed a complaint against Pfizer charging, among other things,³³ that Pfizer's

³¹ 363 F.2d 757, 150 USPQ 135 (6th Cir. 1966), *aff'd. after remand*, 401 F.2d 574, 159 USPQ 193 (6th Cir. 1968).

³² *Id.* The court appears to assume coproduction in dealing with the question whether the applicant and prospective licensee tricked the examiner in the belief that it did not exist.

³³ American Cyanamid Co., 3 Trade Reg. Rep. para. 16,527, *final order entered*, *id.* para. 16,699 (FTC, 1963).

The complaint was brought against five companies in the case, since it was alleged that they had agreed, with knowledge of the fraud committed on the Patent Office

having obtained a patent by fraud on the Patent Office and subsequently administering that patent to practice its patent monopoly was an unfair method of competition in violation of Section 5 of the Federal Trade Commission Act as well as an "attempt to monopolize the tetracycline market in violation of Section 2 of the Sherman Act."³⁴ The Commission held that the totality of the patentee's actions amounted to a violation of the FTC Act, and further, that the Commission had jurisdiction to remedy the noncompetitive situation by ordering Pfizer to license the patent at a limited royalty to all drug manufacturers.³⁵

The Commission's action was later appealed to the Sixth Circuit Court of Appeals, which, in the case of *American Cyanamid Co. v. Federal Trade Commission*,³⁶ affirmed the jurisdiction of the Commission to explore the methods of obtaining the patent and the subsequent use of it under Section 5 of the FTC Act,³⁷ but remanded the case for the examiner to be called as a witness³⁸ to determine if he would have rejected the application had he not been misled by Pfizer's affidavits and Cyanamid's representations. In the FTC hearing on remand it was found from the examiner's testimony that the Patent Office was misled into issuing the patent³⁹ and this finding was affirmed on a subsequent appeal to the Sixth Circuit Court of Appeals.⁴⁰ The court found substantial evidence to support the FTC's having found a violation of Section 5 of its Act.

The court thus approves the levy of antitrust liability upon the patent holder Pfizer who is enforcing the patent he secured through fraud. There may be some question about the liability of the prospective licensee Cyanamid who here actively participated in the fraud before the Patent Office. While the finding of a Sherman Act violation was not necessary to the Commission's decision, it appears from both the remedy granted and the language used that the Commission considered the Act to have been violated by both Pfizer and Cyanamid. First

by Pfizer. In addition to the fraudulent conduct before the Patent Office in reporting the incorrect results by affidavit, the FTC charged the defendants with the fraudulent settlement of an interference and price fixing.

³⁴ See *American Cyanamid Co.* 3 Trade Reg. Rep. para. 18,077 at 20,519 (FTC, 1967).

³⁵ *American Cyanamid Co.* 3 Trade Reg. Rep. para. 16,527 (FTC, 1963).

³⁶ 363 F.2d 757, 150 USPQ 135 (6th Cir. 1966).

³⁷ 363 F.2d at 772, 150 USPQ at 144-45.

³⁸ 363 F.2d at 779, 150 USPQ at 150-51.

³⁹ *American Cyanamid Co.* 3 Trade Reg. Rep. para. 18,077 (FTC, 1967).

⁴⁰ *Charles Pfizer & Co. v. FTC*, 401 F.2d 574, 150 USPQ 135 (6th Cir. 1968), cert. denied, 393 U.S. 1022 (1968).

the compulsory licensing remedy was levied against both parties,⁴¹ and, secondly, the Commission said that their joint conduct “amounted to a combination in restraint of trade.”⁴²

The second case establishing the existence of antitrust liability for practice of a patent monopoly obtained through fraud is *Walker Process Equipment, Inc. v. Food Machinery and Chemical Co.*⁴³ In the *Walker* case, FMC brought a suit against Walker for infringement of its patent on swing-action diffusers used in sewage treatment systems. Walker denied infringement and counterclaimed for a declaratory judgment that the patent was invalid. After discovery proceedings, FMC moved to dismiss its infringement suit with prejudice. Walker then amended its counterclaim, alleging that FMC had procured the patent by intentional fraud on the Patent Office and that FMC had “illegally monopolized interstate and foreign commerce by fraudulently and in bad faith obtaining and maintaining” the patent in violation of Section 2 of the Sherman Act.⁴⁴ Walker prayed for treble damages under Section 4 of the Clayton Act.⁴⁵

Walker alleged that the patent should never have issued since the invention had been in public use more than one year prior to the filing of the patent application, that FMC knew of this prior use which was a statutory bar to patentability and had falsely sworn that there had been no such prior use.

Both the district court⁴⁶ and the court of appeals⁴⁷ dismissed the infringement suit with prejudice and dismissed the amended counterclaim without leave to amend. The Supreme Court reversed the decision, holding that the enforcement of a patent procured by intentional fraud upon the Patent Office may be a violation of Section 2 of the Sherman Act if all the other elements of a Section 2 offense are proven, and, if such a violation be established, then an injured party has a remedy under the treble damage provision of Section 4 of the Clayton Act. The Supreme Court remanded the case in order that Walker would “have the opportunity to make its Section 2 claims more specific, to prove the alleged fraud and to establish the necessary elements of the

⁴¹ American Cyanamid Co. 3 Trade Reg. Rep. para. 18,077 at 20,522 (FTC, 1967).

⁴² See *id.* at 20,505.

⁴³ 382 U.S. 172, 147 USPQ 404 (1965).

⁴⁴ Record, p. 60, *Walker Process Equip., Inc. v. Food Mach. & Chem. Co.*, 382 U.S. 172 (1965).

⁴⁵ *Id.* p. 63.

⁴⁶ U.S. District Court for No. Dist. of Illinois.

⁴⁷ 335 F.2d 315, 142 USPQ 192 (7th Cir. 1965).

asserted Section 2 violation,"⁴⁸ thus approving the imposition of antitrust liability upon the patent owner FMC.

The final case in the trilogy of cases which have found affirmative antitrust liability in enforcement of a patent procured by fraud upon the Patent Office is *Acme Precision Products, Inc. v. American Alloys Corp.*⁴⁹ Plaintiffs Acme and Jobbins brought a patent infringement action against defendant American Alloys. The patent in suit had been assigned to Acme and Acme had given Jobbins an exclusive license under the patent. Exclusive licensee and assignee joined to bring the present action for infringement of the patent against defendant American. As in the *Walker* case, the defendant determined from the prosecution history or otherwise learned in the course of discovery that the allegedly infringed patent did not have a clean bill of health and appeared to have been fraudulently obtained from the Patent Office. Basing his case on the authority of *Walker*, the defendant counter-claimed for violation of Section 2 of the Sherman Act and prayed for treble damages.

The invention, an aluminum-magnesium alloy, was originally invented in 1946, by one Cooper while working for a research division of Acme; Acme took patent rights to the invention of its employee, and an employee of a wholly owned subsidiary of Acme supervised the filing of this application. In 1947, or early 1948, Acme was publicly selling the alloy and transferred its production and sale to its wholly owned subsidiary. One Willmore, the head of metallurgy for Acme's subsidiary, was working with the alloy and, in "1949, fully aware of the Cooper application and claims, Willmore also filed an application for an aluminum-magnesium alloy with the Patent Office."⁵⁰ As was later admitted, many of these claims duplicated and overlapped the Cooper application. An employee of the subsidiary supervised the handling of both applications.⁵¹

The Cooper application was finally rejected by the Patent Office on the ground of prior art and the Board of Appeals sustained that rejection. The Willmore application was initially rejected by the Patent Office although the examiner found a limitation in the claims in the amount of impurities in the alloy which he did not find shown by the prior art. Applicant Willmore submitted evidence of comparative test results which showed that his alloy was superior to the alloys of the prior art which did not contain his limitation in the amount of impuri-

⁴⁸ 382 U.S. at 178, 147 USPQ at 407.

⁴⁹ 422 F.2d 1395, 165 USPQ 164 (8th Cir. 1970).

⁵⁰ *Id.* at 1397, 165 USPQ at 165.

⁵¹ *Id.*

ties and the patent issued in 1951. What he allegedly did not tell the examiner was both that Cooper's earlier application had shown that very limitation in which the examiner found the invention to be novel⁵² and that the alloy had been sold by Acme more than one year prior to the filing of Willmore's application.⁵³

Shortly after the patent issued, it was assigned to Acme, probably under Willmore's employment agreement with his employer, the Acme subsidiary. In 1956, five years after the patent issued, the Acme subsidiary was dissolved and a new corporation was formed which was independent of Acme. In 1958, Acme gave this separate corporation, Jobbins, an exclusive license under the patent to sell and distribute the patented alloy. The defendant being sued for infringement of the Willmore patent alleged these facts together with proving to the sufficiency of the court of appeals that both assignee Acme and exclusive licensee Jobbins had full knowledge of the facts. These facts, if proved, would show that the patent should never have been granted to Willmore and, having been granted, the patent is invalid.

The court of appeals in *Acme* did not hold that defendant had established the violation of the antitrust laws alleged in the counterclaims,⁵⁴ but the court did approve the theory upon which the anti-

⁵² This would be a bar to patentability because Willmore was not the first inventor of the alloy, including the critical limitation in the amount of permissible impurities. Cf. *Minnesota Mining & Mfg. Co. v. Projection Optics*, 256 F.Supp. 354, 150 USPQ 33 (W.D.N.Y. 1966).

⁵³ Under 35 U.S.C. § 102 (b) no patent can be obtained for an invention sold or in public use more than one year before filing a patent application on that invention. It does not matter whether the use or sale was by the applicant or another. See *Watson v. Allen*, 254 F.2d 342, 117 USPQ 68 (D.C. Cir. 1958).

⁵⁴ *Acme* arose on an appeal by the alleged infringer from the district court's dismissal of his counterclaim, which prayed for treble damages for an alleged Section 2 violation of the Sherman Act. The district court had dismissed the counterclaim on what the court of appeals found to be, first, an erroneous construction of the defendant's theory as to fraud and, secondly, an erroneous finding that plaintiffs lacked knowledge of the facts with respect to the filing of both applications having duplicate and overlapping claims and with respect to the public use of the patented alloy prior to the Willmore application. In reversing, the court found that the assignee of the patent, Acme, was conclusively presumed to have knowledge of its own conduct in prosecution of both patents because of its legal relationship to its subsidiary and the imputed knowledge of its officers and key employees. In addition, the court found that the exclusive licensee, Jobbins, had corporate knowledge of the facts relating to the procurement of the patent imputed to it by the knowledge of its president.

The district court was of the belief, when it dismissed the antitrust counterclaim, that the issue of whether or not a fraud was committed in the procurement was not to be decided, since it found that there was no motive to commit fraud as

trust counterclaim had been based, that “under the *Walker* case a party to sustain recovery must either show that the patent was procured by fraud or, if the original applicant is not the party enforcing the patent, that the acquiring party had knowledge of the fraudulent manner in which the patent was procured.”⁵⁵

The *Acme* case thus suggests that the theory upon which *Cyanamid* and *Walker* were based, that it is a violation of the antitrust laws to enforce a patent which one has secured through a fraud on the Patent Office, is not to be limited to a patent which the enforcer acquired through his own fraud on the Patent Office but may be extended to a patent which the enforcer acquired from another, as long as that enforcer has actual or imputed knowledge of that fraudulent procurement. With respect to the possible liability of Acme on the particular facts of the case, nothing is really added to the teachings of *Cyanamid* and *Walker*; both American Cyanamid and FMC were assignees of the fraudulently procured patents in their respective suits. Both patents had been assigned to employers by their respective inventors.⁵⁶ What is added by the *Acme* case is the holding that the exclusive licensee under the patent, Jobbins, may be held liable under the Sherman Act for his use of the patent monopoly with knowledge of the patent's infirmity. Admittedly the facts of the case showed a very close relationship between the assignee of the patent and the exclusive licensee, but there is no reason to believe the relationship need be any closer than

the plaintiffs had no reason to support one of the two patent applications over the other. The court of appeals made it clear that the issue was:

not whether plaintiffs were fraudulently supporting the Willmore claims over those of Hugh Cooper. The charge is that the Willmore patent was fraudulently procured in disregard of the public interests as to restraint of trade, by concealing the facts that Acme had publicly used the same alloy for at least one year prior to Willmore's application and that Hugh Cooper, rather than Willmore, was the original inventor of [the alloy].

422 F.2d at 1400, 165 USPQ at 168.

The court thus saw the fraud not in the plaintiffs' having backed one of the two applications rather in the filing of the second Willmore application with knowledge of the possible prior public use and earlier inventorship of the alloy, and in the concealment of these known facts from the Patent Office. Since the lower court had never passed upon the issue whether there was collusion in obtaining the patent on the second application by concealment from the Patent Office of all the relevant facts known by the plaintiffs concerning prior art and prior usage, the case was remanded for determination of this issue and all other issues which are elements of a Section 2 Sherman Act violation.

⁵⁵ 422 F.2d at 1396, 165 USPQ at 165.

⁵⁶ In *Walker* the patented invention had even been made by an employee of a division of FMC, the employee having previously assigned the patent rights to the division, his employer. This is very close to the *Acme* case where the subsidiary was the assignee of the patent.

sufficient for the licensee to know of the patent's fraudulent procurement.⁵⁷

The court of appeals relied only upon the authority of *Walker* and never really made the distinction between the assignee of the fraudulent patent there and the exclusive licensee under the allegedly fraudulently acquired patent in *Acme*. There probably should be no distinction made between the two, since the rights of the exclusive licensee to perpetrate a monopoly by excluding others are as great under the patent laws as those of an assignee of all rights, title, and interest.

Where such a distinction may become important is the time when the patent owner, be he exclusive licensee or assignee, learns of the fact that the patent was fraudulently acquired.⁵⁸ In cases such as *Walker* the facts show that it was the alleged violator of the antitrust laws who was a party to the fraud on the Patent Office in procurement of the patent. This is not so clear in *Acme* where the exclusive licensee, Jobbins, did not come into existence until five years after the patent had issued, so—as a legal corporate entity—it couldn't have participated in the fraudulent procurement process, where the public use and prior inventorship were concealed. In point of fact however, the court found that knowledge of the facts surrounding the procurement of the patent were imputed to the corporation because the president of Jobbins had been a plant metallurgist with the Acme subsidiary which was a predecessor of Jobbins,⁵⁹ and in that capacity he had known of the facts surrounding the procurement through his correspondence with the attorney handling the Willmore application, and the fact that he was the son of Cooper, who had been the inventor in the first application.⁶⁰

Thus the required knowledge of the fraud came when the president of Jobbins was an employee of Acme and well aware of the public use and prior inventorship. When later he took the knowledge of the fraudulent procurement with him in the formation of a new company with an exclusive license under the patent, it is not surprising, on equity alone, that the court would look beyond the form of the arrangement to find antitrust liability. The real extension of the Sherman Act would come in a case where an assignee or licensee acquires a

⁵⁷ See, e.g., the broad language of *Acme* quoted earlier that:

a party to sustain recovery must either show that the patent was procured by fraud or, if the original applicant is not the party enforcing the patent, that the acquiring party had knowledge of the fraudulent manner in which the patent was procured.

492 F.2d at 1396, 165 USPQ at 165.

⁵⁸ See pp. 545-6 *infra*.

⁵⁹ 422 F.2d at 1399, 165 USPQ at 167.

⁶⁰ *Id.* at 1397-98, 165 USPQ at 167-68.

fraudulently obtained patent and later learns that it was so obtained, but was not himself involved in the prosecution of the patent to have been a party to the fraudulent scheme to obtain the patent. It may also be that there is antitrust liability in a situation where there was no fraud in the actual procurement of a patent, yet facts which become known later to the patent owner show that the patent should never have issued.⁶¹

At any rate, it is clear from *Acme* that one with knowledge of the fraudulent procurement of a patent cannot avoid the antitrust liability which would normally attach under *Walker* for that procurement by the formation of a corporation to enforce that patent through an exclusive license; the courts will look beyond form to seek the substance⁶² of any arrangement which seeks to separate the fraudulent procurement from the enforcement of the patent so obtained.

A FALSE STATEMENT OR A CONCEALMENT BEFORE THE PATENT OFFICE

From the many cases following the *Walker* case dealing with fraud on the Patent Office as a violation of the antitrust laws, much can be

⁶¹ See *United States v. Union Camp Corp.*, Crim. No. 4558 (E.D. Va., filed Nov. 30, 1967), and *United States v. Union Camp Corp.*, Civ. No. 5005-A (E.D. Va., filed Nov. 4, 1968), where civil and criminal antitrust suits were brought on the theory that enforcement of a patent known to be invalid is a violation of the Sherman Act.

The Union Camp Corporation was the owner of a patent on a certain type of paper bag. Bemis Bag Co. was the patent owner of a patent on a method and apparatus for making this type of bags. When Bemis approached Union Camp threatening an infringement suit if they did not take a license under its patent, Union Camp informed Bemis that they had been making and selling bags more than one year before the Bemis patent application was filed and the bags sold had been made using the very method and apparatus claimed in the Bemis patent. Under Section 102 (b) of the Patent Act and case law interpreting it, Bemis was not entitled to have a patent on the apparatus and method if the alleged prior public use and sale of the invention were in fact made. Bemis then pointed out to Union Camp that it knew of facts which, if divulged, would prove that the Union Camp product patent on the bag was also invalid. Instead of either of the corporations giving up their potentially invalid patents, they made a mutually beneficial agreement to grant each other licenses under the two patents, Union Camp getting an exclusive license to use the method and apparatus invention, to the exclusion of all others.

The civil suits were never tried, but were settled by consent decrees. *United States v. Union Camp Corp.*, Civ. No. 5005-A (E.D. Va., entered Feb. 24, 1969), 3 Trade Reg. Rep. para. 72,689 (1969); *United States v. Union Camp Corp.*, Civ. No. 5005-A (E.D. Va., entered July 1, 1969), 3 Trade Reg. Rep. para. 72,843 (1969).

See also *W. Geophysical Co. of America, Inc. v. Bolt Associates*, 165 USPQ 182, 5 Trade Reg. Rep. para. 73,126 (D.Conn. Feb. 20, 1970).

⁶² Compare the cases in other areas of the law which "pierce the corporate veil"; e.g., *Weissner v. Mursam Shoe Corp.*, 127 F.2d 344 (2d Cir. 1942).

learned about exactly what type of fraud must necessarily have been committed upon the Patent Office in order to subject a patentee, or his successor in title,⁶³ to antitrust liability for assertion of the patent secured through that fraud.

Initially, there must of course have been a misrepresentation in the form of a false statement or a concealment from which the fraud springs. In *Walker*, this element was supplied by FMC's having "sworn before the Patent Office that it neither knew nor believed that its invention had been in public use in the United States for more than one year prior to filing its patent application when, in fact, Food Machinery was a party to prior use within such time."⁶⁴ In *Cyanamid*, the misrepresentations were the assertions in prosecution of the patent application that no tetracycline was coproduced with aureomycin.⁶⁵ In addition to these affirmative assertions on the part of Pfizer, the court of appeals found that both Pfizer and Cyanamid had individually withheld pertinent information from the examiner.⁶⁶ Therefore, fraud does not always have to take the form of an affirmative misrepresentation, but may be embodied by a withholding of pertinent information which the applicant, or party dealing with the Patent Office, has a duty to disclose.⁶⁷

The case of *Monsanto Co. v. Rohm and Haas Co.*⁶⁸ is illustrative of the situation where an applicant has suppressed or omitted facts which were inconsistent with his right to secure a patent. In that case, Monsanto sued Rohm and Haas for alleged patent infringement; defendant counterclaimed for, among other things, a declaration of invalidity and damages for plaintiff's allegedly unfair competitive acts. In the trial on the issue of validity of the patent, the district court held the patent to a herbicide invalid. The plaintiff

... presented to the Patent Office incomplete data, carefully and intentionally chosen to support the position that 3,4-DCPA [the herbicide invented] possessed unique herbicidal properties not possessed by closely related compound[s]. Although the affidavit contains no affirmative misrepresentation and is accurate as far as it goes, it is

⁶³ 35 U.S. C. § 100 (d) (1965):

The word "patentee" includes not only the patentee to whom the patent was issued, but also the successors in title to the patentee.

Thus, the patent owner is taken to be either the patentee or his successor in title for the purpose of this discussion.

⁶⁴ 382 U.S. at 174, 147 USPQ at 406.

⁶⁵ 401 F.2d at 580-82, 159 USPQ at 196-98.

⁶⁶ 401 F.2d at 580-82, 159 USPQ at 196-99.

⁶⁷ See pp. 524-6 and cases cited note 74, *infra*, on the duty to disclose.

⁶⁸ — F. Supp. — 164 USPQ 556 (E.D. Pa., Feb. 17, 1970), *modified*, — F. Supp. —, 165 USPQ 683 (E.D. Pa. 1970).

misleading, and was intended to be misleading, in that it fails to state facts known to the applicant which were inconsistent with its position that propanil [the herbicide invented] is a superior herbicide. It is, in short, composed of half-truths.⁶⁹

The court held the patent invalid because the applicant intentionally failed to state material facts in order to mislead the Patent Office. The court admitted that the evidence was insufficient to prove that Monsanto intentionally made false statements of fact to the Patent Office but refused to "distinguish the making of false statements of material fact to the Patent Office from misleading omissions of material fact," because to do so "would be to invite the kind of deception that occurred here."^{70, 71}

A recent case, *SCM Corp. v. Radio Corp. of America*,⁷² shows a common situation where a patentee or assignee may find himself committing fraud in the omission of facts before the Patent Office. There the applicant was attempting to establish a limitation for one of the elements of a patent claim. The applicant's affidavits omitted the results and conclusions of laboratory scientists which indicated that the limitation may have been too broad, since some of the elements covered by the claim probably would not work in the performance of the invention. The court found the continued assertion of the claim limitation to the Patent Office without change or qualification to be "intentional nondisclosure of relevant data which might have effected the outcome of the patent application."⁷³

Courts have often discussed the type of facts which, when within an applicant's knowledge, there is a duty to disclose in order to avoid a fraud upon the Patent Office.⁷⁴ Basically these are the facts which

⁶⁹ *Id.*, 164 USPQ at 567.

⁷⁰ *Id.*, 164 USPQ at 568.

⁷¹ A fraud on the Patent Office might even result in a case where no actual misrepresentation or concealment existed. Take for example an applicant's purposeful delay in prosecution of his application in the Patent Office in an effort to extend the issuance of the patent, and thus, the term of his patent monopoly, to a later date. Such a delay was alleged to invalidate the subsequently issued patent in *Honeywell, Inc. v. Piper Aircraft Corp.*, — F.Supp. —, 165 USPQ 273, 274 (M.D. Pa. Mar. 27, 1970).

⁷² — F.Supp. —, 167 USPQ 196 (S.D.N.Y., Sept. 28, 1970).

⁷³ 167 USPQ at 207.

⁷⁴ See, e.g., *Admiral Corp. v. Zenith Radio Corp.*, 296 F.2d 708, 131 USPQ 456 (10th Cir. 1961); *Benton-Dickinson v. Scherer*, 106 F.Supp. 665, 94 USPQ 138 (D. Mich. 1952), *aff'd*, 211 F.2d 835, 101 USPQ 98 (6th Cir. 1954); *United States v. Standard Electric Time Co.*, 155 F.Supp. 949, 116 USPQ 14 (D. Mass. 1957), *appeal dismissed*, 254 F.2d 598, 116 USPQ 422 (1st Cir. 1958).

would tend to make the applicant's oath⁷⁵ before the Patent Office false. The statutory bars of Section 102 of the Patent Act are good examples.⁷⁶ If an applicant knows of, for example, a prior printed publication or patent which may prevent him from obtaining a patent under Section 102 (a) or (b) of the Patent Act, he would be under a duty to disclose that reference if he believes it to disclose the claimed invention or come "so close thereto that every reasonable man would say the invention claimed is not original."^{77, 78}

With respect to references, such as patents or prior printed publications, which would be Section 103 bars as of the times indicated by Section 102⁷⁹ because the claimed invention would have been obvious to one skilled in the art, no fraud should normally be found to exist as long as it is a clear matter of judgment whether the invention would be

⁷⁵ 35 U.S.C. § 115 (1965) *Oath of Applicant*. "The applicant shall make oath that he believes himself to be the original and first inventor . . ."

See also 37 C.F.R. § 1.65 (1967). The Rules of Practice of the Patent Office require an applicant for a patent to:

state that he verily believes himself to be the original and first inventor or discoverer of the process, machine, manufacturer, composition of matter, or improvement thereof, for which he solicits a patent.

In actuality there are situations where an applicant may secure a patent under the patent statute where he is not, in fact, the original and first inventor of the invention. See, e.g., 35 U.S.C. § 102 (a) (1965) where, "A person shall be entitled to a patent unless—(a) the invention was known or used by others in this country, or patented or described in a printed publication in this or a foreign country, before the invention thereof by the applicant for patent." Under this statute, another may have invented the subject matter in a country other than the United States and the applicant is still entitled to a patent as long as the invention is a patentable one, he himself invented it, etc. There is no statutory requirement that the inventor *not* know about the foreign inventor's work. To avoid this anomaly, the oath is considered to be limited to a compliance with the patent statute and, in particular, with Section 102. Cf. 35 U.S.C. § 102 (g) (1965).

⁷⁶ 35 U.S.C. § 102 (a) and (b) (1965):

A person shall be entitled to a patent unless—

- (a) the invention was known or used by others in this country, or patented or described in a printed publication in this or a foreign country, before the invention thereof by the applicant for patent, or
- (b) the invention was patented or described in a printed publication in this or a foreign country or in public use or on sale in this country more than one year prior to the date of the application for patent in the United States.

⁷⁷ *United States v. Standard Electric Time*, 155 F.Supp. 949, 952, 116 USPQ 14, 16 (D. Mass. 1957), *appeal dismissed*, 254 F.2d 598, 116 USPQ 422 (1st Cir. 1958). See also, *In re LaGrice*, 301 F.2d 929, 133 USPQ 365 (1962).

⁷⁸ Another example of a false oath is where there is a clear and convincing proof of a misjoinder of inventors. In the recent case of *Acme Highway Products Corp. v. D. S. Brown Co.*, —F.2d —, 167 USPQ 129 (6th Cir., Sept. 24, 1970), a violation of the antitrust laws was alleged in the patentee's failure to join another as an inventor. The court held there was no misrepresentation, and therefore no fraud, since there was no clear and convincing proof of the joint inventorship.

⁷⁹ *In re Foster*, 343 F.2d 980, 145 USPQ 166 (1965).

obvious over the references. But where an applicant actually believes the invention would be obvious under the statutory test of Section 103,⁸⁰ he would be under a legal duty to disclose the references he is relying on for this belief.⁸¹

THE PATENT WOULD NOT HAVE ISSUED
"BUT FOR" THE MISREPRESENTATION OR CONCEALMENT

In order for there to be antitrust liability for fraud upon the Patent Office it is necessary that the applicant has misrepresented or concealed a fact, or group of facts, which were determinative of a legal issue material to the issuance of the patent. By "materiality" it is thus meant materiality of the subject matter of a misrepresentation or concealment;⁸² that is, the representation deals with a fact, the truth or falsity of which would be determinative of the question whether or not a patent should be, or should have been, granted.

It is also necessary for antitrust liability that the Patent Office has relied upon those representations of material fact in issuance of the patent. These two requirements are usually lumped together by a court in a single consideration of whether or not a patent would have been granted had the fraudulent representations not been made⁸³ by asking if the patent would have issued "but for" the misrepresentation; but they are two separate concepts.⁸⁴

The "But For" Test

By requiring that a patent would not have issued had the fraud not been committed, the courts have combined these two separate require-

⁸⁰ See *Graham v. John Deere Co.*, 383 U.S. 1, 148 USPQ 459 (1966).

⁸¹ There is now no statutory duty to disclose prior art references; *but see* S. 2756, 91st Cong., 1st Sess. § 131 (c) (1969).

⁸² The term misrepresentation is used in this discussion to include both a false statement and a concealment where there is a duty to speak.

⁸³ See, e.g., pp. 530-1 *infra*.

⁸⁴ There are four situations possible in the granting of a patent based upon misrepresentations made to the Patent Office:

- (1) A misrepresentation was made of a material fact bearing directly upon an issue determinative of whether the patent should be granted; and the examiner relied upon the misrepresentation in granting the patent.
- (2) A misrepresentation was made of a material fact which directly bears upon an issue determinative of whether the patent should be granted; but the examiner—either because he does not see or understand the misrepresentation or because he does not know of its materiality—does not rely upon the misrepresentation and grants the patent.
- (3) A misrepresentation was made of a non-material fact, which did not bear upon any issue determinative of whether the patent should be granted; but the examiner, in a mistaken belief of the materiality of the misrepresentation, grants the patent in reliance upon the misrepresentation.
- (4) A misrepresentation was made of a non-material fact, which did not bear upon any issue determinative of whether the patent should be granted; and the examiner correctly disregards it and grants the patent based upon the fulfillment of the statutory criteria for a patent.

ments into a single condition to test the sufficiency of an antitrust claim. For, if either the misrepresentation did not relate to a material fact or the Patent Office did not rely on it in granting the patent, it cannot be said that the patent would not have issued “but for” the fraud.⁸⁵

The best illustration of the application of this “but for” test is the district court decision in *Corning Glass Works v. Anchor Hocking Glass Corp.*⁸⁶ There the court dismissed a counterclaim for fraudulent patent acquisition and enforcement in contravention of Section 2 of the Sherman Act on the ground that the fraud before the Patent Office was not “material” to the issuance of the patent. What the court meant by the word “material” was not merely that material facts had been misrepresented but as the court said, “that the patent would not have issued but for the fraud.”⁸⁷ Although admitting that the previous *Walker* case had not decided “that the patent must have issued because of the fraud” in order for antitrust liability to attach, the court in *Corning Glass* found this implicit in the language of *Walker*.^{88, 89}

Misrepresentation of Material Facts

In *Walker*, the facts which were misrepresented showed a prior use of the invention more than one year before the filing of the application. Since these facts show a statutory bar existed against the granting of the patent, and therefore the invalidity of the patent, the facts were a priori material to the question of granting the patent. The necessity that the misrepresentations be material to the granting of the patent was illustrated by the *Acme* case, where the court of appeals corrected the trial court on the theory of law under which a fraud on the Patent Office would be brought. The court specified the legal theory that a patent could not have been legally granted if Acme had publicly used the alloy more than one year prior to the filing of the application nor if

⁸⁵ That is, it is only in the first of the situations of note 84 where antitrust liability should be imposed.

⁸⁶ 253 F.Supp. 461, 149 USPQ 99 (D. Del. 1966), *rev'd on other grounds*, 274 F.2d 473, 153 USPQ 1 (3d Cir. 1967).

⁸⁷ *Id.* at 469, 149 USPQ at 106.

⁸⁸ *Id.* at 470, n. 23, 149 USPQ at 106.

⁸⁹ The “but for” test is usually not used in the “unclean hands” defense to infringement, since the making of relevant and significant misrepresentations—which are not necessarily material to the patent grant—may cause a court to refuse to enforce the patent. *Corning Glass Works v. Anchor Hocking Glass Corp.*, 253 F.Supp. 461, 470, 149 USPQ 99, 106-07 (D. Del. 1966), *rev'd on other grounds*, 274 F.2d 473, 153 USPQ 1 (3d Cir. 1967). *But see* *Waterman-Bic Pen Corp. v. W. A. Sheaffer Pen Co.*, 267 F.Supp. 354, 153 USPQ 499 (D. Del. 1967); *accord*, *Henkels & McCoy, Inc. v. Elkin*, — F.Supp. —, 167 USPQ 97 (W.D. Pa., Aug. 26, 1970).

the applicant was not the original inventor.⁹⁰ Both of these are statutory requirements for the granting of the patent. By specifying the law, the court was making it clear that fraud could result from the representations which had been made, representations which were material to the issuance of the patent.⁹¹

Similarly, an antitrust count based on a Patent Office fraud was dismissed by summary judgment in *Sticker Industrial Supply Corp. v. Blaw-Knox Co.*,⁹² since the misrepresentation—if there was one—had to not have been material to the question whether a patent was granted. In that case, it was alleged that the applicant falsely swore that the subject matter had not been in public use for more than one year prior to the date of the application. The court found that, since the application in which this statement was made was actually a continuation-in-part⁹³ of an earlier application which had been filed before the public use, there could not have been any fraud in this swearing.⁹⁴ This would be true even if applicant had intentionally lied to hide the prior use, since such a falsehood would not—under the patent law—have been a material fact upon which the grant of a patent would depend.⁹⁵

The Patent Office Relied on the Misrepresentations

Not only must the misrepresentation or concealment have gone to an issue material to the granting of the patent, but it must also be shown that the Patent Office, or its examiner, relied upon the misrepresentations.

The necessity for Patent Office reliance is illustrated by the *Cyanamid* case where the court of appeals initially remanded the case to the Commission in order that the examiner who handled the case could be given the opportunity to testify on the question whether or not he relied upon the misrepresentations and concealment of Pfizer and

⁹⁰ 422 F.2d 1395, 1400, 165 USPQ 164, 168 (8th Cir. 1970).

⁹¹ The "unclean hands" defense does not require that material facts have been misrepresented, only that the facts have been "relevant and significant" intentional misrepresentations. See *Corning Glass Works v. Anchor Hocking Glass Corp.*, 253 F.Supp. 461, 471 n. 27, 149 USPQ 99, 107 (D. Del. 1966), *rev'd on other grounds*, 274 F.2d 473, 153 USPQ 1 (3d Cir. 1967); cf. *Monsanto Co. v. Dawson Chem. Co.*, — F.Supp. —, 165 USPQ 560, 568 (S.D. Tex. 1970).

⁹² 367 F.2d 744, 151 USPQ 443 (7th Cir. 1966).

⁹³ See *Manual of Patent Examining Procedure* (3d ed. 1961), § 201.08.

⁹⁴ 367 F.2d at 748, 151 USPQ at 445.

⁹⁵ There would be no statutory liability directly under the patent laws for such a false statement. But see 18 U.S.C. § 1001 (1966), reproduced *supra* note 20. Cf. Lanham Trademark Act, 15 U.S.C. § 1120 (1966).

Cyanamid that there was no co-production of tetracycline in aureomycin.⁹⁶ It was essential to the court of appeals that the examiner had been tricked into issuance of the patent by the misrepresentations.⁹⁷

In the *Walker* case, the Supreme Court took the allegations as true,⁹⁸ so it did not have to determine whether the Patent Office actually relied on the misrepresentations. However, in a case such as *Walker* where the facts which were hidden show a clear statutory bar, such as a prior public use of the invention, under Section 102 of the Patent Act,⁹⁹ the court can infer that the misrepresentation would have been relied upon by the examiner. This is because such a statutory bar would, as a matter of law, prevent the patent from having been legally granted.

In cases other than those involving clear statutory bars, the court must either call the examiner to testify as in *Cyanamid* or independently look at the prosecution history as in *SCM v. RCA* to determine whether the Patent Office relied upon the false representation. The courts will not infer examiner reliance on misrepresentations in a case which does not on its face show a clear statutory bar to patenting. For example, in a recent case, *Nashua Corp. v. RCA Corp.*,¹⁰⁰ the court was faced with the analysis of an affidavit which an applicant had submitted in prosecution of a patent. Invalidity was asserted due to a fraud upon the Patent Office in that misrepresentations were made in the affidavit. The court concluded that fraud was not proven, adding the following:

There is no evidence as to how this affidavit was interpreted and understood by the Patent Examiner and there is no evidence as to what extent, if any, the Patent Examiner relied on it. This, perhaps, may be inferred, but an allegation of fraud requires clear and conclusive proof and should not be based on inferences.¹⁰¹

In *Kolene Corp. v. Motor City Metal Treating, Inc.*,¹⁰² the court looked at the file wrapper of the patent to determine if the examiner

⁹⁶ 363 F.2d at 777, 150 USPQ at 150.

⁹⁷ Similarly, if in the course of prosecution the applicant had submitted false affidavits or made false statements which did not serve to overcome any objection to patentability, the making of these representations should not result in antitrust liability for the applicant since the examiner would a priori not have relied upon them. See *Martin v. Ford Alexander Corp.*, 160 F.Supp. 670, 685, 117 USPQ 378, 390 (S.D. Cal. 1958).

⁹⁸ 382 U.S. at 174-75, 147 USPQ at 406.

⁹⁹ See note 76, *supra*.

¹⁰⁰ 307 F.Supp. 152, 165 USPQ 89 (D.N.H. 1969).

¹⁰¹ *Id.* at 158, 165 USPQ at 95.

¹⁰² 307 F.Supp. 1251, 163 USPQ 214 (D. Mich. 1969).

must necessarily have relied on the concealment by the applicant. The fraud alleged was a concealment of the best prior art from the examiner since the applicant had disclosed only data which was based on a process older than the claimed invention. The court held that an antitrust violation was not made out because, among other things, there was no showing "that any representations had a tendency to (or did, in fact) mislead the examiner into granting a patent which he would otherwise not have granted." In reading this conclusion the court had gone into the file wrapper to see that the examiner could not have relied upon the alleged concealment since he was well aware of the fact that applicant was describing an old process. As the court said:

The use of the old process data was completely proper (indeed, we would say, essential) provided only, and here is when the charges of fraud collapse, provided the examiner was informed of the relation of the old process to the new.¹⁰³

In the *SCM v. RCA* case the court went into the file wrapper to attempt to determine what the examiner would have done had he been informed of data, known to applicant, which would perhaps have made a claim limitation an unreliable method for distinguishing the materials with the necessary properties to work in the invention. The court "found no convincing evidence, one way or the other as to what the examiner would have done had he been informed" of the true facts and thus determined that "what position the examiner would have taken had RCA [the assignee of the inventor] been candid with him remains a matter of speculation."¹⁰⁴ In such a situation, doubts are resolved in favor of the applicant and no violation of the Sherman Act is found to exist.

Inherent in the requirement of Patent Office reliance is that the examiner did not know of the falsity of the representation. This is true because the courts will not presume his reliance on a statement which he knew to be untrue. It also appears that the examiner must not have been able to easily determine the falsity of the statement or the courts will refuse to find the commission of a fraud upon the Patent Office.

That the examiner must not have been able to find the falsity in the applicant's statements for applicant to be guilty of violating the anti-trust laws is best illustrated by a recent case in the Seventh Circuit. In *University of Illinois Foundation v. Blonder-Tongue, Inc.*,¹⁰⁵ an anti-

¹⁰³ *Id.* at 1263, 163 USPQ at 224.

¹⁰⁴ — F.Supp. —, 167 USPQ 196 (S.D.N.Y. Sept. 28, 1970).

¹⁰⁵ 422 F.2d 769, 164 USPQ 545 (7th Cir.), cert. granted, — U.S. —, 107 USPQ 321 (1970).

trust counterclaim was dismissed on the following set of facts. In October of 1960, the inventor first made application for a patent. The examiner rejected applicant's claims as being obvious over a published reference dated May, 1960. In response, applicant filed an affidavit under Rule 131¹⁰⁶ swearing back behind the reference. This would be a proper removal of the reference had it not been for the fact, known to the applicant, that the reference was a slight revision of an earlier article published June, 1959. On the theory, assumed by the court, that the earlier publication would have also been a reference against the claims, the earlier article would be a statutory bar against the application filed in October, 1960, since it was more than one year prior to the date on which the application was filed in this country.¹⁰⁷ On these facts standing alone, the court would clearly have found the applicant to have committed a fraud on the Patent Office by "affirmatively present[ing] a half-truth to the Patent Office in order to overcome a rejection when he must know that the whole truth would support rather than overcome the rejection."¹⁰⁸

However, the court noted that the very reference applied by the examiner had a footnote to its title disclosing to the world "that the article was a revised manuscript the original of which had been previously published"¹⁰⁹ in June, 1959, although the "examiner did not refer to the 1959 publication date, and perhaps overlooked it."¹¹⁰ Since the examiner could have easily seen the fact that the first publication was a statutory bar and should not have let the applicant swear behind its later revision, the court determined that no fraud was practiced on the Patent Office; as the court said, "We are reluctant, however, to find fraud in this instance because of the circumstance that the article relied on by the Patent Office itself disclosed the correct first publication date."¹¹¹

The court thus indicates by this ruling its belief that no fraud should be found where the examiner was aware of the truth on the very point where a misrepresentation was made, or where the examiner was easily able to see that a misrepresentation was being made.¹¹²

¹⁰⁶ 37 C.F.R. 1.131 (1967).

¹⁰⁷ 35 U.S.C. § 102 (b) (1965).

¹⁰⁸ 422 F.2d at 777, 164 USPQ at 550.

¹⁰⁹ 422 F.2d at 776, 164 USPQ at 550.

¹¹⁰ *Id.*

¹¹¹ *Id.* at 777, 164 USPQ at 550.

¹¹² The merits of such a rule are questionable since it results in fraudulent patent procurement only when a good examiner is tricked; the worse the examiner, the less likely an antitrust violation will result in misleading him.

See also *Dole Valve Co. v. Perfection Bar Equip., Inc.*, — F.Supp. —, 167

Valid Patent: An Exclusionary Test

Many courts will never reach either of the two questions whether the misrepresented facts were material to the patent's having issued and whether the Patent Office relied upon the misrepresentations. The courts simply look at the true facts as they existed and determine that the patent is clearly valid regardless of whether any false representation was made.¹¹³ Once a valid patent is found, no antitrust violation can exist for its fraudulent procurement, although there may have still been false representations made to the Patent Office¹¹⁴—a priori they could not have been material to the patent grant. The converse determination that the fraudulently acquired patent is invalid ought not to necessarily indicate that antitrust liability attaches. This is true for several reasons; first there may be reasons other than the truth behind the misrepresentations in procurement which created the invalidity. Secondly, invalidity due to the misrepresented or concealed truth is only one element of an antitrust violation; other things such as willful and knowing fraud and the foreclosure of a relevant market are requisites for antitrust liability.

A good example of a court's use of validity as a factor which would eliminate the necessity for a determination of the materiality of the

USPQ 445, 446 (N.D. Ill. Oct. 16, 1970), which suggests that a patent examiner should be familiar with his art to the level of the ordinary skill in that art such that an applicant's failure to disclose prior work which represents that level of skill will not be a fraud upon the Patent Office to justify an award of attorney's fees under 35 U.S.C. § 285. The wisdom of such a rule in the antitrust cases is questionable, since it would probably limit liability to cases in which the applicant concealed information known only to himself.

¹¹³ Note that the existence of a valid patent should only prevent liability under the antitrust laws since it is the valid patent which sanctions the monopoly which is carved out by the patent grant. Where invalidity or unenforceability due to a fraud on the Patent Office is asserted as a defense to infringement, the actual validity of the patent over the prior art will not prevent the success of the defense. *Abington Textile Works v. Carding Specialists Ltd.*, 249 F.Supp. 823, 148 USPQ 33 (D.D.C. 1965).

The Court of Customs and Patent Appeals agrees that the objective patentability of an application or patent should not prevent the Commissioner from striking a fraudulently procured application. In *Norton v. Curtiss*, — F.2d —, 167 USPQ 532 (C.C.P.A. Nov. 12, 1970) the court said:

Indications in the record that the claims at issue would not have been allowed but for the challenged misrepresentations must not be overlooked due to any certainty on the part of the reviewing tribunal that the claimed invention, viewed objectively, should have been patented. If it can be determined that the claims would not have been allowed but for the misrepresentation, then the facts were material regardless of their effect on the objective question of patentability.

Id., 167 USPQ at 545.

¹¹⁴ In the example in note 84, *supra*, situations (1) and (2) are not possible since only (3) and (4) could exist with a valid patent.

misrepresentations is *Corning Glass*. While the court purported to determine if the patent would not have issued but for the fraud, it really had predetermined that, since it had validly issued, the misrepresentation did not go to a material issue. As the court said, "Since the patentee was legally entitled to the patent, any misrepresentations directed to overcoming the prior art, assuming *arguendo* there were some, could not be material."¹¹⁵ Thus if a court can make the initial determination that a patent is valid, it has determined that one of the elements of an antitrust action for a fraud on the Patent Office is lacking, and the antitrust claim can be dismissed.

THE MISREPRESENTATION WAS MADE
"KNOWINGLY AND WILLFULLY"

Walker made it quite clear that two elements of the Sherman Act violation were that the applicant committing a fraud upon the Patent Office have both an intent to deceive the Patent Office and knowledge of the truth behind the representations or concealments made before the Patent Office. Walker's counterclaim alleged that FMC "obtained the patent by knowingly and willfully misrepresenting facts to the Patent Office,"¹¹⁶ and the Supreme Court was taking the allegations as true.¹¹⁷ Justice Clark made it quite clear, however, that FMC's "good faith would furnish a complete defense."¹¹⁸ In a concurring opinion, Justice Harlan spelled out exactly what conduct the Court meant to exclude from the antitrust charge by the "knowing and willful fraud" requirement; as he said:

... such a private cause of action would *not* be made out if the plaintiff: (1) showed no more than invalidity of the patent arising, for example, from a judicial finding of "obviousness," or from other factors sometimes compendiously referred to as "technical fraud"; or (2) showed fraudulent procurement, but no knowledge thereof by the defendant.¹¹⁹

The many decisions following *Walker* where an antitrust cause of action for fraudulent procurement has been pleaded, have been uniform in their following *Walker* making it a necessity that the fraud

¹¹⁵ 253 F.Supp. 461, 469-70, 149 USPQ 99, 106 (D. Del. 1966), *rev'd on other grounds*, 274 F.2d 473, 153 USPQ 1 (3d Cir. 1967).

¹¹⁶ 382 U.S. at 177, 149 USPQ at 407.

¹¹⁷ *Id.* at 174-75, 149 USPQ at 406.

¹¹⁸ *Id.* at 177, 149 USPQ at 407.

¹¹⁹ *Id.* at 179, 149 USPQ at 408.

have been made knowingly and willfully.¹²⁰ For example, the Seventh Circuit Court of Appeals in *Bendix Corp. v. Balax, Inc.*,¹²¹ recently affirmed the district court's holding that an antitrust counterclaim be dismissed since no proof had been made that "any misstatements by plaintiff in its patent applications were the products of intentional fraud and not good faith mistake."^{122, 123}

Knowledge of the Falsity of the Representation

Within this good faith requirement are the two separate concepts that there have been a knowledge of the falsity of the misrepresentation made, as well as an intent to deceive the Patent Office into issuing the patent by the use of the misrepresentation or concealment. If the court can first determine that an applicant did not know that his representation was in fact false, the question whether he intended to trick the examiner does not have to be reached. In *Donald F. Duncan, Inc. v. Royal Tops Manufacturing Co.*,¹²⁴ a defendant in a trademark infringement suit alleged that plaintiff had fraudulently obtained the trademark monopoly by a fraud on the Patent Office. The trademark was for the well-known term "yo-yo" which had been found to be

¹²⁰ Cf. *Crown Mach. & Tool Co. v. KVP-Sutherland Paper Co.*, 297 F.Supp. 542, 155 USPQ 309 (N.D. Cal. 1967), *aff'd*, 409 F.2d 1307, 160 USPQ 584, *cert. denied*, 396 U.S. 824, 163 USPQ 584 (1968). There the court dismissed an antitrust counterclaim for fraudulent procurement since the fraud did not come "within the type of fraud contemplated by the *Walker* case, to wit, 'knowingly and wilfully misrepresenting facts to the Patent Office.'" *Crown v. KVP*, *id.* at 567, 155 USPQ at 328. However, the court had found that the patentee had enlarged the scope of pending applications to appropriate improvements in the invention made by others, an enlargement which "could hardly have been inadvertent." *Id. Quare* what more evidence of knowing intent would have to exist for "knowing and willful" fraud within the *Walker* standard?

¹²¹ 421 F.2d 809, 164 USPQ 485 (7th Cir. 1970).

¹²² *Id.* at 819, 164 USPQ 493.

¹²³ Presumably, the party alleging a fraud can concede that the misrepresentation was not knowing and willful by the use of broad language in his pleading. See *SCM Corp. v. Radio Corp. of America*, — F.Supp. —, 167 USPQ 196, 226 (S.D.N.Y. Sept. 28, 1970), where SCM's brief stated:

If, however, the court should find that RCA's conduct amounted to unclean hands, but did not constitute intentional fraud on the Patent Office (though we strongly urge it was) then, while the antitrust relief sought would therefore be denied, SCM would be entitled under 38 U.S.C. §285 to its reasonable attorney's fees and expenses with respect to this entire case.

Id., n. 28.

Quare whether such language is a concession at all, particularly in the federal courts which broadly sanction inconsistent pleadings?

¹²⁴ 381 F.2d 879, 154 USPQ 124 (7th Cir. 1967).

generic, and therefore invalid, by the court.¹²⁵ The defendant asserted that plaintiffs well knew of the fact that no trademark could be obtained on the term and therefore committed a fraud upon the Patent Office in so seeking to register the term as a trademark. The court noted that plaintiff had “acknowledged the existence of doubt as to whether the term ‘yo-yo’ would be held descriptive,”¹²⁶ but held this doubt did not show that plaintiffs knew that their attempt to secure a trademark was improper. The court said:

Duncan may have been mistaken in its statements to the Patent Office that it was entitled to the trademarks, but the evidence falls short of showing that Duncan's claims to the trademarks were knowingly made in bad faith, or that its applications were punctuated with false or fraudulent statements.¹²⁷

The necessity that an antitrust defendant have knowledge of the falsity of his misrepresentations or concealments is shown by the *Acme* court in its reversal of the district court's finding that Acme did not have “knowledge of any fraud in the procurement of the patent.”¹²⁸ As the court said with respect to the assignee's knowledge, “We hold Acme, at least, must be conclusively presumed to have knowledge of its own conduct.”¹²⁹ Acme's acts in prosecution, which were known to its officers and employees, thus gave the Acme Corporation knowledge of its conduct.

Intent to Deceive the Patent Office with the False Representation

Finally, in the proof of a fraud upon the Patent Office it must be shown that the defendant had the intent to deceive the Patent Office into issuing the patent which otherwise would not have been granted.

In denying an antitrust counterclaim in *Kolene*¹³⁰ the district court made it clear that it considered the plaintiff's intent to deceive the Patent Office one of the elements of the antitrust action when the court said, “Moreover, and most importantly, there is no showing of an intent deliberately to mislead the examiner.”¹³¹

¹²⁵ A mark may not be registered, and if registered the registration is invalid, if the term is generic. *See, e.g., Dresser Ind., Inc. v. Heraeus Engelhard Vacuum, Inc.*, 267, F.Supp. 974, 152 USPQ 743, 752, *aff'd*, 395 F.2d 362, 158 USPQ 65 (3d Cir. 1968), *cert. denied* — U.S. —, 159 USPQ 800.

¹²⁶ 381 F.2d at 884 n. 6, 154 USPQ at 127.

¹²⁷ *Id.*, 154 USPQ at 127-28.

¹²⁸ 422 F.2d 1396, 1397, 165 USPQ at 165.

¹²⁹ *Id.* at 1398, 165 USPQ at 167.

¹³⁰ 307 F.Supp. 1251, 163 USPQ 214 (D. Mich. 1969).

¹³¹ *Id.* at 1263, 163 USPQ at 224.

In a recent case in the Fifth Circuit, the court of appeals remanded a case for consideration of an antitrust counterclaim since enforcement of a patent procured by "intentional fraud" may violate Section 2 of the Sherman Act. In *Beckman Instruments, Inc. v Chemtronics, Inc.*,¹³² the court directed the district court on remand to look "first to the evidence to determine whether appellants indulged in knowing, willful misrepresentation of material facts"¹³³ since only intentional fraud would be actionable.

Thus it appears that both knowledge of the falsity of a misrepresentation or concealment made to the Patent Office and some intent to trick the Patent Office into issuing a patent based on the false representation will be necessary for antitrust liability to attach for fraudulent patent procurement.^{134, 135}

SECTION TWO OF THE SHERMAN ACT

Every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several States, or with foreign nations, shall be deemed guilty of a misdemeanor, and, on conviction thereof, shall be punished by fine not exceeding fifty thousand dollars, or by imprisonment not exceeding one year, or by both said punishments, in the discretion of the court.¹³⁶

This section proscribes three specific types of conduct: monopoliza-

¹³² 428 F.2d 555, 165 USPQ 355 (5th Cir.), cert. denied, 400 U.S. 956, 168 USPQ 1 (1970).

¹³³ *Id.*, 165 USPQ at 365.

¹³⁴ Note that the Court of Customs and Patent Appeals would apparently allow a court to infer the fraudulent intent from "the fact of misrepresentation coupled with proof that the party making it had knowledge of its falsity" in order for the Commissioner to strike a patent application for fraud. *Norton v. Curtiss*, — F.2d —, 167 USPQ 532, 545 (C.C.P.A. Nov. 12, 1970). As the court said: "Where public policy demands a complete and accurate disclosure it may suffice to show nothing more than that the misrepresentations were made in an atmosphere of gross negligence as to their truth." *Id.*

¹³⁵ Nor is it necessary for there to have been an intent to deceive the Patent Office for a court to allow an invalidity defense in an infringement suit. *See Monsanto Co. v. Rohm & Haas Co.*, — F.Supp. —, 165 USPQ 683 (E.D. Pa. May 21, 1970) where the court said:

Even if we were persuaded to change our mind and find that although there were intentional omissions of fact, Monsanto did not intend to mislead the Patent Office, this would not lead us to a different conclusion with respect to the validity of a patent in light of such omissions. For the same policy considerations which underline our [earlier opinion, —F. Supp.—, 164 U.S.P.Q. 556, 567-69], we hold that even if Monsanto did not intend to mislead the Patent Office, the fact that it intentionally withheld facts which were material to the decision whether it was entitled to a patent is sufficient to bar the issuance of a patent to it.

Id., 165 USPQ at 684.

¹³⁶ 15 U.S.C. § 2 (1964).

tion, attempts to monopolize, and combinations or conspiracies to monopolize. One or more of these violations should result from a particular line of conduct by a patentee or his successor in title fraudulently acquiring and asserting the patent, but the cases which have dealt with this conduct as an antitrust violation have not clearly delineated which conduct of Section 2 is allegedly violated.¹³⁷

For the crime of monopolization, Section 2 clearly requires a showing that "a part of the trade or commerce among the several States" has been monopolized. This is the concept of the showing of monopolization within the "relevant market"—the "area of effective competition,"¹³⁸—since monopolization has little meaning unless embraced within the area of competition.¹³⁹ Once the existence of relevant market is established for a particular product or service, the courts have required that it be established that an antitrust defendant (1) had a dominant position in that market such that he could control the relevant market,¹⁴⁰ and (2) that such monopoly power had been deliberately acquired or maintained.¹⁴¹

With respect to attempt and conspiracy to monopolize the requisite elements of the crimes are different. In attempts, the courts require that the antitrust defendant have had a "specific intent" to acquire monopoly power.¹⁴² In conspiracies, there is a requirement that there have been an agreement between two or more parties to acquire the monopoly power.¹⁴³ The necessity for the proof of a relevant market, and its control, in these situations is not at all clear; there is a definite split of authority. The Ninth Circuit, in *Lessig v. Tidewater Oil Co.*,¹⁴⁴ takes the position that the relevant market is not a consideration in

¹³⁷ In addition, many of the courts which have dealt with fraudulent procurement as an antitrust violation have only decided the legal issues of whether or not the fraud is of a type which should result in antitrust liability, either dismissing a particular case for a failure of proof of one of the elements or remanding the case for a trial court to consider the specific allegations of Section 2 violations as in *Walker* and *Acme*.

¹³⁸ *Standard Oil of Calif. v. United States*, 337 U.S. 293, 299 n. 5 (1949).

¹³⁹ Att'y. Gen. Nat'l. Comm. Antitrust Rep. 44 (1955).

¹⁴⁰ *United States v. Griffith*, 334 U.S. 100, 107 (1948); *Acme Precision Products, Inc., v. American Alloys Corp.*, 422 F.2d 1395, 1396, 165 USPQ 164, 165 (8th Cir. 1970). See also *American Tobacco Co. v. United States*, 328 U.S. 781, 789 (1946).

¹⁴¹ See *United States v. Griffith*, 334 U.S. 100, 107 (1948); *American Tobacco Co. v. United States*, 328 U.S. 781, 809-14 (1946).

¹⁴² *United States v. Aluminum Co. of America*, 148 F.2d 416, 431-32 (2d Cir. 1945). This is not a general intent to perform an act toward achieving a monopoly but a specific intent as required by the criminal laws.

¹⁴³ *Id.* at 432.

¹⁴⁴ 327 F.2d 459 (9th Cir. 1964).

these cases¹⁴⁵ since the words of Section 2 would have no meaning if it were necessary to achieve what amounts to a monopolization before an attempt or conspiracy was found. The contrary position is taken by the Fourth Circuit in *American Football League v. National Football League*,¹⁴⁶ which held it necessary to consider the relevant market in such cases, since the specific intent which is necessary "must be to gain control over some relevant market sufficient to set prices in that market or to exclude competitors therefrom"¹⁴⁷ or there would be no illegal intent. With this as a background, the elements of the violation of Section 2 which results from the enforcement of a patent which was obtained by a fraud upon the Patent Office can be better determined from the cases which have dealt with this subject.

CONTROL OF THE RELEVANT MARKET

In *Walker* the counterclaim asserted a violation of Section 2 which the Supreme Court appears to have treated as alleging monopolization.¹⁴⁸ In response to Walker's request,¹⁴⁹ supported by the Attorney General,¹⁵⁰ for the finding of a per se violation of the Sherman Act, the Court said:

To establish monopolization or attempt to monopolize a part of trade or commerce under §2 of the Sherman Act, it would then be necessary to appraise the exclusionary power of the illegal patent claim in terms of the relevant market for the product involved. Without a definition of that market there is no way to measure Food Machinery's ability to lessen or destroy competition. It may be that the device—knee-action swing diffusers—used in sewage treatment systems does not comprise a relevant market. There may be effective substitutes for the device which do not infringe the patent. This is

¹⁴⁵ *Id.* at 474.

¹⁴⁶ 205 F.Supp. 58 (D. Md. 1962), *aff'd*, 323 F.2d 124 (4th Cir. 1963). *See also* *United States v. Chas. Pfizer & Co.*, 245 F.Supp. 737 (E.D.N.Y. 1965); *United States v. Johns-Manville Corp.*, 231 F.Supp. 690 (E.D. Pa. 1964).

¹⁴⁷ *AFL v. NFL*, 205 F.Supp. at 64-65.

¹⁴⁸ Monopolization is indicated by the court's language throughout the opinion; the only use of the word "attempt" is in the next quoted portion of the opinion.

Other courts have treated *Walker* as a monopolization case. *See, e.g.*, *Diamond Int'l Corp. v. Walterhoefer*, 289 F.Supp. 550, 575 n. 120, 159 USPQ 452, 472 (D. Md. 1968).

¹⁴⁹ *Walker* had asked for a per se ruling on the basis of the allegation that a patent monopolized a part of trade or commerce within the meaning of Section 2. *Record, Walker Process Equip., Inc. v. Food Mach. Corp.*, 382 U.S. 172 (1965).

¹⁵⁰ The Solicitor General supported *Walker* arguing as *amicus curiae* that *Walker* had what amounted to a *prima facie* case of a Section 2 violation. *Id.* Brief for Solicitor General.

a matter of proof, as is the amount of damages suffered by Walker. . . . the area of *per se* illegality is carefully limited. We are reluctant to extend it on the bare pleadings and absent examination of market effect and economic consequences.¹⁵¹

By refusing to rule on the *per se* violation without examining "market effect and economic consequences" the Court thus requires that the exclusionary effect of the FMC patent be measured within the relevant market. The Court then pointed out that the trial court had dismissed the suit without consideration of the economic data relating to "the relevant market," and "the dominance of the patented device therein,"¹⁵² thus requiring proof of monopolization by showing both the relevant market and the control with that market which the patent possesses.¹⁵³ The Supreme Court in *Walker* is either clearly following the monopolization cases here; or—if the Court is thinking of the attempt crime—the Court is following the line of attempt cases¹⁵⁴ which holds it necessary to consider the foreclosure of the relevant market.¹⁵⁵

It is suggested that the Court is correct in its requirement that economic data be analyzed to determine the relevant market and the dominance of the patent therein. Not to do so in the case of a patent monopoly could result in a defendant's violation of the antitrust laws where his patent gave him no monopolistic ability to set prices and exclude competitors, and thus affect competition.¹⁵⁶ To see this it is necessary to analyze the economic effect which a patent may have within a relevant market. Take for example a patent on a product, the proverbial "better mousetrap." On the first level the relevant market for mousetraps must be delineated. As in the *Cellophane* case,¹⁵⁷ the relevant market will depend upon the "availability of alternative commodities for buyers of mousetraps."¹⁵⁸ This interchangeability is largely gauged by the purchase of competing products for similar uses considering the price, characteristics and adaptability of the competing

¹⁵¹ 382 U.S. at 177-78, 149 *USPQ* at 407.

¹⁵² *Id.* at 178, 149 *USPQ* at 407.

¹⁵³ See cases cited note 140 *supra*.

¹⁵⁴ Cases cited note 146 *supra*.

¹⁵⁵ The *Walker* case has been cited for the proposition that, "One who alleges an antitrust conspiracy other than price fixing must plead relevant market and show control of that relevant market." *Canaan Prod. Inc. v. Edward Don & Co.*, 273 F.Supp. 492, 501, 154 *USPQ* 393, 400 (D. Ill. 1966).

¹⁵⁶ "Monopoly power is the power to control prices or exclude competition." *United States v. E. I. duPont de Nemours & Co.*, 351 U.S. 377, 391 (1956).

¹⁵⁷ *United States v. E. I. duPont de Nemours & Co.*, 351 U.S. 377, 391 (1956).

¹⁵⁸ *Id.* at 393-4.

commodities.¹⁵⁹ Since there are other products available which effectively compete with mousetraps under these criteria—for example, rodent poisons—these must be included in the relevant market with other “worse mousetraps” which are in the public domain and also available to customers in the relevant market. Next, the dominance of the “better mousetrap” in this relevant market must be determined. Today, with the effectiveness of poisons and their ease of operation, it is doubtful, or at least arguable, whether any “better mousetrap” could dominate the relevant market.

Taking it as arguable whether the “better mousetrap” dominates the relevant market, suppose the patent covered not the product, but only one of many methods of making this “better mousetrap.” It is obvious that the patentee clearly would not dominate this relevant market, although he is still entitled to his method patent under the patent laws. “Better mousetraps” made by other methods plus available effective substitutes may reduce his control of the market to a de minimus level.

To see why it is necessary that the courts make the relevant market analysis, one more example must be given: Suppose that the patentee’s “better mousetrap” patent is an improvement patent which is dominated by the basic mousetrap patent of another. In such a case, not only could the patentee not control the market for mousetraps and effective substitutes, he could not even make his improved trap without a license from the owner of the basic patent.¹⁶⁰ It is clear that it would be wrong to subject the holder of the subservient patent to antitrust liability, even if it were secured by a fraud on the Patent Office, since the patent holder could not even make the improved “better mousetrap” himself, let alone set its price or exclude competitors.

Although the courts have not clearly distinguished the crime of monopolization from the attempt crime where fraud on the Patent Office is involved,¹⁶¹ it does appear that even if treated as an attempt to monopolize, the courts may follow the line of cases which necessitate a consideration of the relevant market.¹⁶² In *Diamond International*

¹⁵⁹ *Id.* at 394-5.

¹⁶⁰ See *Cochrane v. Deener*, 94 U.S. 780 (1876).

¹⁶¹ This may be because no cases have held that there was, in fact, a violation of the Sherman Act; the cases, like *Walker*, have merely denied summary dismissal of the antitrust claims.

¹⁶² It is not at all clear that all courts will find that a relevant market analysis is required in a violation of Section 2 other than monopolization. See, e.g., *Beckman Instruments, Inc. v. Chemtronics, Inc.* 428 F.2d 555, 165 USPQ 355 (5th Cir. Apr. 14, 1970), where the Court of Appeals for the Fifth Circuit correctly states that monopolization requires a relevant market analysis but appears to leave open the question whether such an analysis would be needed in other Section 2 charges. *Expressio unius est exclusio alterius*.

Corp. v. Walterhoefer,¹⁶³ the court adjudicated an antitrust defense. After deciding that there was no fraud on the Patent Office, the court went on—in dictum—to “consider the ‘exclusionary power’ of the patent ‘in terms of the relevant market for the product involved’ ”¹⁶⁴ as required by *Walker*. Treating the case as one of an “attempt to monopolize,” the court rejected defendant’s contention that this language in *Walker* “did not mean, for a mere attempt, that an ‘exclusionary power’ in a ‘relevant market’ must *actually be found*, but that all that was necessary was that there be a ‘specific intent to acquire exclusionary power over any substantial part of interstate commerce . . . and a dangerous likelihood of success’.”¹⁶⁵ The district court followed the line of cases including *AFL v. NFL* and held that the relevant market must be considered lest a defendant be “punished for attempting to do what, if accomplished, would be legal.”¹⁶⁶

The court then proceeded to analyze the relevant product and geographical markets. The patent covered molded pulp egg cartons, but the court considered the relevant market to include all types of egg cartons because they all competed with each other and were “functionally interchangeable.” The geographical market was found to be the United States. Looking at the fact that plaintiff’s share of the American market for egg cartons of all types was only 51 percent of the market and the fact that this was a slight decrease from previous years, the court said that “even if there were an attempt by plaintiff to monopolize the egg carton market, there is no dangerous likelihood of success.”¹⁶⁷ The court used the concept of relevant market to determine if plaintiff were likely to succeed in monopolization, one of the two conditions which the defendant had said must be fulfilled for an attempt violation. What the court failed to consider, and what is the crux of the attempt violation, is the question of plaintiff’s specific intent to monopolize.¹⁶⁸

The *Diamond* court may have missed the specific intent requirement because it believed the intent in securing a patent by fraud was sufficient to constitute “specific intent” within its usual meaning in antitrust law.¹⁶⁹ At any rate, the court did require a consideration of the relevant market, albeit to show that there was no dangerous likelihood

¹⁶³ 289 F.Supp. 550, 159 USPQ 452 (D. Md. 1968).

¹⁶⁴ *Id.* at 573, 159 USPQ at 472.

¹⁶⁵ *Id.* at 574, 159 USPQ at 472.

¹⁶⁶ *Id.* at 577, 159 USPQ at 474.

¹⁶⁷ *Id.* at 578, 159 USPQ at 475.

¹⁶⁸ See pp. 543-5 *infra*.

¹⁶⁹ *Id.*

of a patentee succeeding to monopolize since the market he sought was too small. This is a little different use of the market analysis than in *AFL v. NFL*, where it was used as part of the "intent" analysis to determine what a defendant intended to gain control of by his actions. It may not really matter how the relevant market is used as long as it is always used to avoid antitrust liability for fraudulent procurement of a patent which, in fact, gives a patent holder no monopoly power in the necessary sense of being able to set prices or exclude competitors.

In the recent *SCM v. RCA* case, the court dealt with a Section 2 counterclaim alleging both an attempt to monopolize and monopolization. The court made no distinction between these two allegations and proceeded to analyze the relevant market since under *Walker* there must be shown both fraudulent procurement and the fact "that defendant thereby secured the necessary exclusionary power in the relevant market."¹⁷⁰

The court defined the relevant market for the electrofax copier covered by RCA patents to be not only the "electrostatic photocopy field" which comprised the RCA electrofax and the Xerox machine, but the whole "convenience copy market" which includes other types of machines which "serve the same purpose and compete with electrofax and Xerox."¹⁷¹ The 20 percent share of that market which was controlled by RCA was held to be "not large enough to establish monopolization or an attempt to monopolize under the Walker doctrine."¹⁷²

Although the FTC has much broader authority to find an antitrust violation in Section 4 of the FTC Act and would thus not be limited to the specific criteria of Section 2 of the Sherman Act,¹⁷³ the Federal Trade Commission seems to have recognized that not all patents will have the economic effect to foreclose a market when it said in *Cyanamid*, "Some patents may be completely worthless or have no adverse effects on competition."¹⁷⁴ The Commission then pointed out the great size of the monopoly foreclosed by the single patent on tetracycline, the annual sales of which "exceeded \$100,000,000."¹⁷⁵ It would

¹⁷⁰ — F.Supp. —, 167 USPQ 196, 226 (S.D.N.Y. Sept. 28, 1970).

¹⁷¹ *Id.*

¹⁷² *Id.*

¹⁷³ 15 U.S.C. § 45 (a),

(1) Unfair methods of competition in commerce, and unfair or deceptive acts or practices in commerce are hereby declared unlawful

(6) The Commission is empowered and directed to prevent persons, partnerships, or corporations . . . from using unfair methods of competition in commerce and unfair or deceptive acts or practices in commerce.

¹⁷⁴ American Cyanamid Co., 3 Trade Reg. Rep. para. 16,257 at 21,427 (FTC Aug. 8, 1963).

¹⁷⁵ *Id.* at 21,428.

thus be expected that the FTC would also require that a patent controls what amounts to a relevant market.

INTENT TO MONOPOLIZE

The Section 2 cases have required that a defendant have a particular intent in his actions in order to be subject to antitrust liability. The crime of monopolization has a very limited degree of intent required, since it is the possession of monopoly power which has been made a crime. Since no monopolist monopolizes unconsciously,¹⁷⁶ all that may be necessary is that the possessed monopoly power not have been thrust upon the defendant.¹⁷⁷ Thus it is sufficient for monopolization that a defendant had only intent to perform a specific act.¹⁷⁸

The "specific intent" which is required in the attempt cases goes beyond this to require that the defendant actually intended to acquire monopoly power with that act.¹⁷⁹ This distinction between "specific intent" and the limited intent necessary to do an act may work fine in usual antitrust cases where the act is, for example, the acquisition of a competitor, where the doing of the act may not necessarily imply an intent to acquire monopoly power.¹⁸⁰ But the distinction breaks down in cases of fraudulent patent procurement, since a patent is, by its very nature, a monopoly. Some other means must be found if monopolization cases are to be differently treated.

In cases of fraudulent patent procurement, the patent must have been obtained by "knowingly and willfully misrepresenting facts to the Patent Office."¹⁸¹ From this element of procurement intent, a court could easily conclude that there was a deliberate acquisition of the patent monopoly. This would supply, without more, the limited intent required for a charge of monopolization, thus proving the intent along with proof of the fraud committed on the Patent Office. It is submitted that it would be within legal bounds to use the fraud to show sufficient intent in monopolization cases where there must necessarily have been foreclosure of a relevant market—monopolization in fact—for liability. However, if the intent were supplied by the act of fraudulently acquiring the patent for an attempt or conspiracy to monopolize violation of

¹⁷⁶ *United States v. Aluminum Co. of America*, 148 F.2d 416, 432 (2d Cir. 1945).

¹⁷⁷ *Id.* at 429.

¹⁷⁸ *Id.* at 431-32.

¹⁷⁹ See Att'y. Gen. Nat'l. Comm. Antitrust Rep. 55 (1955).

¹⁸⁰ *E.g.*, a competitor's plant may be acquired to achieve economies of scale.

¹⁸¹ See pp. 533-4 *supra*.

Section 2, there would be a great danger of imposing liability in cases where it should not be imposed. For example, a court may find a person guilty of an attempt to monopolize a market which he could not control, or even participate in.

In the case of an improvement patent, as in the "better mousetrap" example given earlier,¹⁸² a court which followed the line of cases which did not consider the relevant market in an attempt case could easily find an attempt to monopolize from the mere fraudulent acquisition of a patent which had no economic value at all. Secondly, using the intent to commit a fraud upon the Patent Office as the "specific intent" element in a Section 2 case could result in imposing liability upon a fraudulent procurer of a patent who had no anticompetitive intent at all. For example, if a patentee were to trick the Patent Office into granting him a patent by the requisite fraud, but his intent was innocent in the sense of affecting competition since he only wanted the patent so he could impress his neighbors with it, he could still be guilty of an attempt to monopolize in violation of Section 2.¹⁸³

To avoid the chance of imposing antitrust liability in cases such as these, plus the danger of using an intent which existed much earlier than the anticompetitive effects of the act, it is suggested that the "specific intent" of an attempt case and the agreement¹⁸⁴ of a conspiracy should more properly be related to the enforcement of the patent¹⁸⁵ than its fraudulent procurement. This would allow a rational extension of the Sherman Act to cover the situation, suggested in *Walker*,¹⁸⁶ and existing in *Acme*,¹⁸⁷ where an exclusive licensee, or

¹⁸² See pp. 540-1 *supra*.

¹⁸³ If, in addition, he agreed with another person in the process of acquiring the patent, they might jointly be guilty of a conspiracy to monopolize although neither intended to enforce the patent to exclude others.

¹⁸⁴ See p. 547 *infra*.

¹⁸⁵ It is possible that one case has already used the procurement intent as the requisite intent needed for an attempt to monopolize charge. See pp. 540-2 *supra* where the court in the *Diamond* case did not even deal with the question whether or not there was a "specific intent" to monopolize. This may be because the court took the view that procurement of the patent would show a sufficient specific intent to acquire a monopoly. Since the court had concluded that no fraud was practiced in procurement, the lack of a finding of specific intent cannot be taken as an indication that the court believed this element to have existed from the patent procurement alone.

¹⁸⁶ A footnote to language in *Walker* which said that proof of misrepresentation in obtaining the patent would strip the patentee of his exemption from the antitrust laws added that, "This conclusion applies with equal force to an assignee who maintains and enforces the patent with knowledge of the patent's infirmity." 382 U.S. at 177 n. 5, 147 USPQ at 407 n. 5.

¹⁸⁷ See pp. 520-1 *supra*.

the later owner of a patent, may be guilty of violating the antitrust laws for enforcing a patent with knowledge of its fraudulent procurement. By separation of the act of fraudulently procuring the patent from the knowing enforcement of that patent, it may even be that the assertion of a patent which is known to be invalid can be a violation of the Sherman Act—even if the invalidity of the patent is not the result of a fraud upon the Patent Office.¹⁸⁸

To relate “specific intent” to the knowing enforcement of a fraudulently procured patent rather than to its mere procurement would be more in keeping with the criteria usually applicable in attempt cases. “Specific intent” requires proof that the defendant intended to acquire monopoly power.¹⁸⁹ While a patent is in a broad sense a monopoly,¹⁹⁰ it may not give at its issuance date any power, in an antitrust sense, to set prices or exclude competitors. Later, when the patent is known to be a valuable monopoly in that it carves out a large or important piece of property, its enforcement would, without question, be the assertion of monopoly power.

ASSERTION OR ENFORCEMENT OF THE PATENT

Walker and the cases dealing with the antitrust implications of a fraud upon the Patent Office made it clear that a necessary condition for such liability is that the inherent monopoly in the fraudulently acquired patent grant be exercised by asserting, enforcing, or otherwise using the patent to exclude others and thus have an anticompetitive effect on the relevant market.¹⁹¹ For example, in the *Cyanamid* case, the FTC noted that the “patentee has asserted monopoly rights under a patent so acquired.”¹⁹²

Inherent in the patent grant is the statutory monopoly right to exclude others from making, using, or selling the invention. Yet, it is not the mere existence of the patent—however fraudulently it has been obtained—which brings antitrust liability to its owner; it is the owner’s assertion or enforcement of the patent which brings on antitrust liability.

¹⁸⁸ See note 61 *supra* and accompanying text.

¹⁸⁹ See authority cited note 179 *supra*.

¹⁹⁰ See note 4 *supra*.

¹⁹¹ The *Walker* court said, “We have concluded that the enforcement of a patent procured by fraud on the Patent Office may be violative of Section 2 provided the other elements necessary to a Section 2 case are present.” 382 U.S. at 174, 147 USPQ at 406.

¹⁹² American Cyanamid Co., 3 Trade Reg. Rep. para. 16,427 at 21,427 (Aug. 8, 1963).

ty. In *Walker*, *Acme*, and many of the cases dealing with fraud,¹⁹³ the assertion of monopoly rights under the fraudulently acquired patent was self-evident, as the antitrust action was a counterclaim in a patent infringement suit; the bringing of an infringement suit shows that the patent owner is asserting the monopoly by enforcing his patent. In other situations, the antitrust action may arise in a declaratory judgment suit¹⁹⁴ and the court would have to determine if the patent owner is enforcing his fraudulently acquired patent such that the relevant market would be controlled. A patent may dominate a significant part of trade or commerce by its claims, yet if its owner did not enforce it and gave royalty-free nonexclusive licenses to all who wished them,¹⁹⁵ it is doubtful if the owner would be subject to antitrust liability.¹⁹⁶ Yet, there may be anticompetitive effects resulting from the mere existence of a patent in that it would discourage others from making, using, or selling the patented invention.

Assertion or enforcement can take many forms in addition to bringing infringement suits. A patentee may bring threats of an infringement suit against one infringing his patent;¹⁹⁷ he may just license the patent to some while refusing to license others.¹⁹⁸ A patentee may just sell the patented article himself, and thus imply to the world that he has a valid patent, such that a court may find the necessary assertion of his patent in that sale. It is not at all clear from the limited number of cases thus far what a minimum assertion, less than the bringing of an infringement suit, will be necessary to subject the patent owner to antitrust liability.

¹⁹³ In addition to many of the cases dealt with specifically here, *see, e.g.*, *Dresser Ind., v. Heraeus Engelhard, Inc.*, 395 F.2d 457, 158 USPQ 65 (3d Cir. 1968), *cert. denied*, — U.S. —, 159 USPQ 800; *Carter-Wallace, Inc. v. Riverton Labs.*, 47 F.R.D. 366, 161 USPQ 697 (S.D.N.Y. 1969); *Crown Mach. & Tool Co. v. D & S Ind., Inc.*, 409 F.2d 1307, 160 USPQ 584 (9th Cir.), *cert. denied*, 396 U.S. 824 (1968).

¹⁹⁴ *See, e.g.*, *SCM Corp. v. Radio Corp. of America*, — F.Supp. —, 167 USPQ 196 (S.D.N.Y. Sept. 28, 1970); *Holmes v. Struthers Scientific & Intl. Corp.*, — F.Supp. —, 155 USPQ 167 (W.D. Pa. 1967).

¹⁹⁵ As the federal government does. *Tektronic, Inc. v. United States*, 351 F.2d 630, 147 USPQ 216 (Ct. Cl. 1965).

¹⁹⁶ It is recognized, however, that a civil or criminal action may be brought against such a defendant.

¹⁹⁷ *See, e.g.*, *Celebrity, Inc. v. Trina, Inc.*, 264 F.2d 956, 121 USPQ 61 (1st Cir. 1959).

¹⁹⁸ There is no requirement that a license be granted under a patent, let alone that licenses be granted to all.

AGREEMENTS

Section 2 of the Sherman Act includes a third category of proscribed conduct: conspiracies or combinations to monopolize. In addition, Section 1 proscribes combinations or conspiracies in "restraint of trade or commerce,"¹⁹⁹ and the *Singer* case suggested that this section was violated by fraudulent patent procurement.²⁰⁰

In *Cyanamid* the facts came very close to proving a conspiracy between Pfizer and Cyanamid in their having misled the examiner into issuing the patent. The FTC ruled that:

Cyanamid's acceptance of a license from Pfizer to make and sell tetracycline with knowledge that it had made false statements of fact to the Patent Office which bore directly on the question of patentability of tetracycline . . . amounted to a combination in restraint of trade.²⁰¹

In *Acme* too, there may have been an agreement between parties such that a conspiracy to monopolize existed, since the court of appeals remanded the case to decide "whether there was collusion in obtaining the [Willmore] patent letters by concealing all relevant facts known by the applicants."²⁰² Thus, it is quite possible that a conspiracy to monopolize might also exist in cases of fraudulent patent procurement.

Unfortunately, no cases have yet delineated the precise area of conduct which will be held to be a conspiracy to monopolize in violation of Section 2.²⁰³ It should be noted that there may be liability for a conspiracy to monopolize in a case where an agreement between two parties can be shown to exist, and that agreement involves fraudulent procurement or the enforcement of a patent obtained by fraud. Perhaps the future cases which deal with fraudulent patent procurement will establish some boundaries of this conduct which may be an anti-trust violation.

¹⁹⁹ 15 U.S.C. § 1 (1964).

²⁰⁰ See pp. 513-14 *supra*.

²⁰¹ American Cyanamid Co., 3 Trade Reg. Rep. para. 18,077 at 20,505 (FTC, 1967).

²⁰² 165 USPQ at 168.

²⁰³ Nor has a case yet dealt with Section 1 "combinations or conspiracies." There may also be antitrust liability for fraudulent patent procurement under this Section. See *Beckman Instruments, Inc. v. Chemtronics, Inc.*, 428 F.2d 555, 165 USPQ 355 (5th Cir. Apr. 14, 1970), where the court said:

We do not fully understand the basis of appellees' other claim, that under section 1, but leave appellees to develop it, if they can do so, before the trial court. Provided the proper elements are present, we see no reason why the Walker cause of action should not encompass section 1 suits as well as monopolizations.

Id., 165 USPQ at 365 n. 28.

IN SUMMARY

This paper has attempted to show some of the many factors of a defendant's conduct which the courts have found determinative of the issue whether or not the Sherman Act has been violated by obtaining a patent through a fraud upon the Patent Office and a subsequent assertion of that patent.

It is now clear the assertion of a patent which has been obtained from the Patent Office by a fraud which fulfills particular criteria may be a violation of the Sherman Act. The patent must have been secured from the Patent Office through misrepresentation by a false statement or the concealment of a fact which is so vital to the issuance of the patent that no patent would have issued "but for" the misrepresentation. The patent owner must have had both knowledge of the falsity of the representation and an intent to trick the Patent Office into issuance of the patent.

Although the fraud may be of this type in every respect, no Sherman Act violation should result unless the patent holder has actual or imputed knowledge of the fraud and yet asserts or enforces the patent in a relevant market for a product or service which is dominated by the fraudulently acquired patent. It is only when all of these conditions are fulfilled that the patent owner should be guilty of violating Section 2 of the Sherman Antitrust Act.

Several rational guidelines have been used by many different courts to determine if a particular line of conduct is violative of the Sherman Act. It is hoped that by laying them all out here in an orderly fashion, the legal profession of patent and antitrust lawyers will be aided in their future advocative attempts to rationalize these cases, thus better enabling the courts to reach just and equitable results in cases where fraudulent patent procurement may be a violation of the Sherman Act.

Section 293: The Patent Long-Arm Statute*

ROGER M. RATHBUN

INTRODUCTION

TWO PATENT ANTITRUST ACTIONS¹ were commenced by the Justice Department in the U. S. District Court of the District of Columbia in 1968, both actions being brought pursuant to Section 4² of the Sherman Act to restrain various defendants from violating Section 1 of that Act.³ In *United States v. Glaxo Group Ltd.*⁴ the complainant apparently conceded that neither defendant resided within the United States, while in *United States v. Farbenfabriken Bayer*⁵ only one of the defendants was admittedly a nonresident. In both cases, a relatively unused statute,

* This paper was submitted by the author in partial fulfillment of the requirements in the Trade Regulation Program of the New York University School of Law, Graduate Division. Mr. Rathbun is presently Division Patent Counsel of Air Reduction Company, Inc., Murray Hill, New Jersey.

¹ See notes 4, 5, *infra*.

² 15 U.S.C. § 4.

³ 15 U.S.C. § 1, reading in part "Every contract, combination . . . or conspiracy, in restraint of trade or commerce among the several states, or with foreign nations, is declared illegal."

⁴ Civil Action No. 558-68, United States District Court for the District of Columbia. See 302 F. Supp. 1 (D.D.C. 1969) and 163 USPQ 668 (D.D.C. 1969).

⁵ Civil Action No. 586-68, United States District Court for the District of Columbia. The case was terminated by a consent judgment filed October 24, 1969.

Section 293 of the 1952 Patent Act⁶ was relied upon to vest jurisdiction in the district court, and service of process was, on *ex parte* motion, authorized by the court under Rule 4 (i) (1) (D).⁷ A substituted service was thereafter made by serving the non-resident defendants by registered mail without any personal service attempted.

The common legal issue as to the applicability of Section 293 is one of first impression in an antitrust action for the courts and may be rather simply stated to be whether or not a civil action, brought under the antitrust laws, having patents involved, but where the validity or infringement of any patent is not in issue⁸ is rightly an action "affecting the patent or rights thereunder."

The Glaxo and Bayer Complaints

Before discussing the somewhat obscured meaning of Section 293, a brief resumé of the allegations in the complaints of *Glaxo* and *Bayer* is instructive to show the type of actions which the government felt were properly within the above classification of such actions.

The allegations in both complaints were essentially similar as to their basis for founding the district court jurisdiction. In *Glaxo*, it was alleged that the two defendants, Glaxo Group Limited and Imperial Chemical Industries, Ltd., entered into a pooling agreement combining four patents of Glaxo and one patent of Imperial Chemical Industries and thereafter entered into unlawful patent license agreements with certain American Companies.⁹ The complaint conceded that neither

⁶ Every patentee not residing in the United States may file in the Patent Office a written designation stating the name and address of a person residing within the United States on whom may be served process or notice of proceedings affecting the patent or rights thereunder. If the person designated cannot be found at the address given in the last designation, or if no person has been designated, the United States District Court for the District of Columbia shall have jurisdiction and summons shall be served by publication or otherwise as the court directs. The court shall have the same jurisdiction to take any action respecting the patent or rights thereunder that it would have if the patentee were personally within the jurisdiction of the court.

35 U.S.C. § 293.

⁷ Whenever a statute of the United States or an order of court thereunder provides for service of a summons, or of a notice, or of an order in lieu of summons upon a party not an inhabitant of or found within the state in which the district court is held, service may be made under the circumstances and in the manner prescribed by the statute or order, or, if there is no provision therein prescribing the manner of service, in a manner stated in this rule.

Rule 4(e).

Alternative Provisions for Service in a Foreign Country.

(1) Manner. . . . (D) by any form of mail, requiring a signed receipt, to be addressed and dispatched by the clerk of the court to the party to be served; . . .

Rule 4(i).

⁸ In *Glaxo*, a declaration of invalidity of one of the patents was initially sought; however, that ground was later eliminated from the case. See footnote 11, *infra*.

⁹ The American companies involved were Johnson and Johnson, Schering, Inc. and American Home Products, Inc.; the ICI-American Home Products, Inc. agreement was held illegal per se as an attempt by ICI to restrain the later resale of bulk form of griseofulvin by American, clearly contrary to *U.S. v. Schwinn Co.*, 388 U.S. 365 (1967).

Glaxo nor Imperial Chemical Industries resided in the United States and further, that neither defendant had "designated any person on whom may be served process or notice of proceedings affecting the . . . patents or rights thereunder."¹⁰ The government sought a declaration that the license agreements were unlawful and an injunction prohibiting continuation of the agreements. Additionally, it sought relief in the form of a requirement that the pooled patents be available for compulsory licensing at reasonable royalties and a declaration of invalidity of the Imperial Chemical Industries patent.¹¹

In *Bayer*, the thrust of the complaint was against a United States corporation, Chemagro, alleged to be an exclusive licensee¹² and a wholly owned subsidiary of the non-resident Bayer, the patent owner. The complaint charged that the subsidiary Chemagro entered into illegal sub-licenses based on its exclusive license with Bayer. It did not, however, assert that Bayer, the non-resident, itself was a party to the alleged illegal sub-licenses or that Bayer even took part or entered into the negotiations of the alleged illegal sub-licensing activities. In addition, the government did not rely on the possible corporate control of

¹⁰ In §§ 5 and 6 of the Glaxo complaint, it is stated:

5. Glaxo and Imperial do not reside in the United States. Neither defendant has designated in the United States Patent Office any person on whom may be served process or notice of proceedings affecting the Glaxo or Imperial patents or rights thereunder. This is a proceeding affecting such patents and rights thereunder.

6. Pursuant to 35 U.S.C. § 293 the United States District Court for the District of Columbia has jurisdiction to take any action respecting such patents and rights thereunder in the same manner as if Glaxo and Imperial were personally within the jurisdiction of such court.

¹¹ The cause of action seeking a declaratory judgment of invalidity of the ICI patent was disposed of on summary judgment, the court holding that the government had no standing to challenge the validity of the patent unless fraud or deceit is alleged in the complaint, or unless the patent is raised as a defense to an antitrust action. Here, no fraud or deceit was alleged and ICI presented affidavits that it would not raise its patent as a defense. 302 F. Supp. 1, 11-15. In ruling out the invalidity issues, the court indicated that the question of jurisdiction, previously raised by motion to quash service, should be re-examined:

The litigants incorrectly assume that this ruling on jurisdiction is a binding "rule of the case" while it is in this Court. It is appropriate for a court to inquire into its jurisdiction and should there be further proceedings directly involving Glaxo in this Court, this Court will need to make such an inquiry.

302 F. Supp 1, 3 n. 7.

However inviting this footnote by the court may have been to Glaxo, its later motion to quash service of the summons and complaint upon it was denied. 163 USPQ 668, 669.

¹² Even had the patent been assigned in its entirety to the U.S. company with all the alleged wrongdoing by the assignee, a non-resident prior owner would be literally within the wording of § 293 referring to a "patentee," defined in Section 100 (d) as including "not only the patentee to whom the patent was issued but also the successors in title to the patentee." 35 U.S.C. § 100(d).

Bayer over its subsidiary but treated both corporations as separate entities.¹³

In *Bayer* the government sought a declaration of the illegality of the sub-licenses, a judicial modification of the license or sub-licenses, and an injunction against both defendants against certain practices relative to the licensing of the patent. No declaration of invalidity of the patent was sought by the government.

In both *Bayer* and *Glaxo*, the non-resident defendants moved to quash service, contending Section 293 was inapplicable under the facts to confer jurisdiction upon the court; however, the motion was denied in both instances.

As the Department of Justice has brought further antitrust actions, based upon jurisdiction obtained through Section 293 where the validity of a patent is not challenged,¹⁴ the present paper will attempt to determine the scope of Section 293, its purpose, and review the earlier cases which have commented upon this Section in an effort to show whether it has been or should be used in the broad sense contended by the government i.e., affecting the . . . patents or rights thereunder as including antitrust actions where patent validity is not in issue and which the court has tentatively decided affirmatively on a "first impression" basis.

GENERAL FEDERAL SCHEME

In order to determine the purpose and effect of Section 293 in the federal system, it may be helpful to briefly review the posture of that system in order to determine in what category this Section is best sectionalized.

The federal courts must have subject matter jurisdiction, granted by Congress and based on a specific constitutional grant.¹⁵ Without a specific granting of subject matter jurisdiction, the federal courts, being courts of "limited jurisdiction" have no power to hear or decide any

¹³ Had there been sufficient "control" by Bayer over acts of Chemagro, the government may have chosen to lay venue of the action in a district where Chemagro could have been served conveniently, and proceeded via substituted service on Bayer. See *Cannon Mfg. v. Cudahy Packing Co.*, 267 U.S. 333 (1925).

¹⁴ One of the more recent cases is that of *U.S. v. Ziegler*, Civil No. 1255-70, filed April 24, 1970 in the D.C. District Court.

¹⁵ *Kline v. Burke Const. Co.*, 260 U.S. 226 (1922); *Barron and Holtzoff*, *Federal Practice and Procedure*, § 21 *et seq.*

particular case.¹⁶ Subject matter jurisdiction cannot be waived or vested by consent of the parties, and the lack of such subject matter power of the court may be raised at any time during an action in a federal court.¹⁷

Secondly, there must be a jurisdiction over the persons or the res, in certain proceedings, concerned by the suit before the court.¹⁸ Jurisdiction over a person is obtained through some means of authority over the person plus a reasonable notice in order to afford opportunity to appear and participate in the action. Assuming the court has subject matter, and therefore is competent to hear a particular subject, it cannot validly issue a decree affecting the rights of a person or a res without some nexus of authority over the person or thing. The type of action may determine basically what personal jurisdiction is required. There must be a sufficient binding jurisdiction over the person when the cause of action is in personam, or over the res if the cause of action is in rem, or quasi-in-rem.¹⁹

The court's jurisdiction may attach in a limited fashion to a person by an act of the court exercising control of specific property within its jurisdiction, as an in rem proceeding, thereafter requiring the person to appear to defend his interest or claim to that property. In an in rem action the relief sought must be of the type that may be satisfied through some action taken upon the property, such as affecting title to real or personal property within the jurisdiction.²⁰

A middle ground between in rem and in personam jurisdiction is the quasi-in-rem jurisdiction where, unlike an in rem cause where only title

¹⁶ See generally, 36 C.J.S. Federal Courts § 4; *Skelly Oil Co. v. Phillips Petroleum Co.*, 339 U.S. 667 (1950).

¹⁷ *Louisville & Nashville Railroad Co. v. Mottley*, 211 U.S. 149 (1908). For a judicial review of the various jurisdictions and the federal court determination under each, see *Joseph Sachs & Colt's Patent Fire Arms Co. v. Wadsworth Electric Mfg. Co.*, 16 *USPQ* 44 (E. D. Ken. 1932).

¹⁸ *Alexander v. Hillman*, 296 U.S. 222 (1935).

¹⁹ It should be remembered during the later discussion in this paper that the federal District Courts have generally rejected quasi-in-rem proceedings for original actions as a means of obtaining some personal jurisdiction over the defendant. Bunn, *United States Courts* (5th Ed. 1949), ch. IV, pps. 104-113, citing *Toland v. Sprague*, 12 Peters 300 (1838); *Big Vein Coal Co. v. Read*, 229 U.S. 31 (1913) and others. However, in removal cases, see *Clark v. Wells*, 203 U.S. 164 (1906). Subsequent to 1963, Rule 4(e) F.R.C.P. was amended to permit a quasi-in-rem type of action in an original case before federal courts. Carrington, "The Modern Utility of Quasi-in-Rem Jurisdiction," *Harvard Law Review*, Vol. 76 (1962), p. 303.

²⁰ An example of a federal "in rem" statute is discussed on pp. 563-4 of this paper. See also *Dan Cohen Realty Co. v. National Savings & Trust Co.*, 125 F.2d 288 (6th Cir. 1942).

or status of property within the jurisdiction is affected, a personal claim may be asserted against a party by the court's dominion over certain property of that party. The relief may include a money judgment against the person and may be satisfied through the court's power over the res within its jurisdiction, or, if the person enters the jurisdiction to defend the quasi-in-rem action and therefore to protect his property, a personal judgment may be rendered even above the amount of the property value.²¹

Further, an in personam basis of jurisdiction may exist over even a non-resident if the person or corporation has undertaken certain acts within the territorial jurisdiction of the court.²² The concept of in personam jurisdiction is extended to non-residents or non-domiciles where the court has found some act of the non-resident to create sufficient ties within the court's territorial boundaries as to imply a consent to be within the general jurisdiction of the court.²³ The notice of the commencement of the action is normally made, in the federal courts, pursuant to the *Federal Rules of Civil Procedure*, and, specifically Rule 4 which provides alternate methods of best affording sufficient announcement to the party sought to be brought before the court.

Finally, if the court has jurisdiction in the above categories, the action must be properly laid in the court where venue is appropriate, which is no more than a means of choosing the more convenient of available forums.²⁴ Both personal jurisdiction and venue may be waived or modified by consent. Therefore, Section 293 must fit into the federal scheme of jurisdiction: It may invoke subject matter jurisdiction, a type of personal jurisdiction, or be a venue statute, and the courts which have, to date, discussed this Section have considered all three categories as possibilities.²⁵

²¹ Wright and Miller, *Federal Practice and Procedure*, § 1070 *et seq.* Generally, the quasi-in-rem jurisdiction binds only that property within the jurisdiction and on which the particular action was based.

²² This type of action has traditionally been a "state" imposed jurisdictional basis, known today as the "long-arm" statute. For a development of this type of in personam jurisdiction, see 2 J. Moore, *Federal Practice* ¶ 4.25. The applicability of this type of statute is discussed on p. 565 of this paper.

²³ Included within this classification are the nonresident motorist statutes, held not to violate the 14th Amendment due process in *Hess v. Pawloski*, 274 U.S. 352 (1927). A collection of the more recent cases is found in 19 A.L.R. 3d 13, "Products Liability."

²⁴ 36 C.J.S. Federal Courts § 16(b). See also *In re Robertson*, 127 F. Supp. 39 (W.D.Mo. 1954), where venue called a "procedural matter," and "Doing Business as a Test of Venue and Jurisdiction Over Foreign Corporations in the Federal Courts," *Columbia Law Review* Vol 56 (1956), p. 394.

²⁵ See p. 559 *infra*.

LEGISLATIVE HISTORY AND INTENT

Section 293 was a new provision added to the Patent Act of 1952²⁶ and apparently did not evoke any considerable written legislative concern over its purpose. In the House Report²⁷ on the Revision of Title 35, only a terse statement appears in connection with Section 293 stating:

Section 293 is a new section that is needed on some occasions to obtain jurisdiction over foreign patent owners that do not reside in the United States.²⁸

The Senate Report²⁹ sets forth the same statement while neither go any further to elucidate upon what is meant by "some occasions" or attempts to set forth the purpose of the statute.

Further, in the Reviser's Notes to the 1952 Patent Act, the following is stated:

Section 293—NEW SECTION

This section provides for service on non-resident patentees.³⁰

There is some indication in the House hearings³¹ that the Section was interpreted as being directed toward rectifying the situation that foreign patent owners were unavailable for declaratory judgment suits of invalidity and non-infringement:

. . . that this provision Sec. 293 has been added for the benefit of American residents desiring to bring action against foreign owners of United States patents. At the present time, American manufacturers *threatened by charges of infringement* of the United States patents by persons resident abroad are especially handicapped by the inability to bring suit for declaratory judgment.³² (Emphasis added.)

Congressional intention may also be implied, as contended by *Bayer*, because the location of Section 293 is within the Patent Act, and had it intended to apply as a general jurisdictional, or general venue provision, it most likely would have been relocated to Title 28 and included as a

²⁶ Title 35, U.S.C. § 1-293, enacted by the Patent Act of July 19, 1952 (Public Law 593, 82nd Cong., 2d Sess. ch. 950; 66 Stat. 792) which became effective January 1, 1953.

²⁷ H.R.Rep. No. 1923, 82d Cong. 2d Sess. (1952).

²⁸ *Id.* at p. 10.

²⁹ S.Rep. No. 1979, 82d Cong., 2d Sess. (1952) accompanying H.R. 7794.

³⁰ Reviser's Notes, 35 U.S.C. § 293, *U.S. Code Cong. & Adm. News*, Vol. 2, 82d Cong., 2d Sess. (1952) p. 2424.

³¹ *Hearings before Subcommittee No. 3 of the House Committee on the Judiciary*, 82d Cong., 1st Sess.

³² *Id.* at p. 91. This Section was quoted by *Bayer* in its "Petition for Certiorari to the District Court for the District of Columbia," and represented, in part, opinions of the State Department. *Bayer* further noted that the Department of Justice agreed with this interpretation. See *Id.* at p. 98.

supplement to the present federal jurisdictional venue provision.³³ In addition, the Section is conveniently located within the Patent Act in Chapter 29, entitled "Remedies for Infringement of Patent, and Other Actions," and strengthened by the Senate and House reports stating:

Beginning with 281 is a group of sections relating to remedy for *infringement of a patent*, the suit in the Courts.³⁴ (Emphasis added.)

Again, therefore, if a Congressional intention can at all be pointed to, it would appear to favor the interpretation that Section 293 was enacted to cure the defect relating to declaratory judgments against a "foreign patent owner."

In the absence of precise, clear legislative history, the mere presence of the Section in a limited chapter of a specialized Act would tend to negate the court's broad contention that the Act was intended to be as far sweeping as to confirm personal jurisdiction in antitrust cases, where patents are only incidentally involved.

The exact meaning of the wording in Section 293 is certainly not free from doubt. The wording may be somewhat illuminated by a comparison with other relative sections in the 1952 Patent Act and, therefore, wording which Congress certainly could have considered in expressing its intention.

A similar statutory provision is expressed in Section 146³⁵ entitled "Civil action in case of interference," which provides, in certain cases of an adverse party residing in a foreign country, the District Court for the District of Columbia "shall have jurisdiction" and is given discretion in the manner of service.³⁶ Under this Section, in an interference suit, service by registered mail on a non-resident has been utilized and upheld.³⁷ Unfortunately, the issue of jurisdiction over a foreign compa-

³³ The general federal venue provisions appear in 28 U.S.C. §§ 1391 *et seq.* while special venue statutes, such as for antitrust actions are located within those special acts; 15 U.S.C. § 22. The import of the distinction is later discussed.

³⁴ *Supra* notes 3 & 5.

³⁵ 35 U.S.C. § 146.

³⁶ *Id.*

If there be adverse parties residing in a plurality of districts not embraced within the same state, or an adverse party residing in a foreign country, the United States District Court for the District of Columbia shall have jurisdiction and may issue summons against the adverse parties directed to the marshal of any district in which any adverse party resides. Summons against adverse parties residing in foreign countries may be served by publication or otherwise as the court directs.

³⁷ *Autogiro Co. of America v. Kay Gyroplanes Ltd.*, 62 USPQ 239 (D.D.C. 1944). Service by substituted means has been specifically noted in 2 J. Moore, *Federal Practice* ¶ 4.33:

Federal statutes providing extraterritorial service includes Section 146 which authorizes service under Rule 4(c) upon "a party not an inhabitant of or found within the state in which the district court is held."

ny, not residing in the United States has been very infrequently litigated under this Section.

In a fairly recent case, however, the District of Columbia court felt that Section 146 was one of "jurisdiction over the parties,"³⁸ and that subject matter jurisdiction was separately conferred upon the district courts by the normal patent jurisdiction provision Section 1338 (a) and such a decision would appear consistent with Section 293.³⁹

A further theory of the use of Section 146 appeared in *Autogiro Company of America v. Kay Gyroplane Limited*⁴⁰ where the plaintiff relied on the predecessor to Section 146,⁴¹ to serve process on a British company, a nonresident of the United States in an interference proceeding. Not unlike *Glaxo* and *Bayer*, the defendant was served by registered mail upon an order of the court and, in deciding the issue of whether or not this service was valid, the court stated:

The principal contention of the defendant is that the matter in controversy, being the validity of a patent, is personal property and as such has its situs at the place which is the residence of its owner, and in this case such place is beyond the jurisdiction of this Court. . . . It is unnecessary to labor the question as to whether this is an action in personam or one in rem. When the letters patent here in question were issued to the defendant and accepted by it, such issue and acceptance were subject to all provisions of law respecting the question of validity and the rights of others to call such validity into question. The defendant cannot now be heard to assert that he did not assent to the applicable provision. . . .⁴²

Therefore, the court felt that by accepting the issuance of a patent, the patentee took the patent with an implied assent to the applicable law governing that patent's validity.

In *Autogiro*, however, the court apparently went no further than to include an assent to provisions respecting *validity* and, therefore, the doctrine would have to be extended to include an antitrust action where validity is not in issue.⁴³

³⁸ *Diva Laboratorium A.G. v. DeLoney & Co.*, 144 *USPQ* 337 (D.D.C. 1965).

³⁹ *Id.* at 339. The court relied upon *Amerio Contact Plate Freezers v. Knowles*, 274 F. 2d 590, 124 *USPQ* 91 (D.C.Cir. 1960) which recognized the need for a separate basis for subject matter jurisdiction under 28 U.S.C. § 1338 (a) in the U.S. District Courts; however, the use of venue and personal jurisdiction was never distinguished in the cases.

⁴⁰ 62 *USPQ* 239 (D.D.C. 1944).

⁴¹ R.S. 4915, Revised Statutes.

⁴² 62 *USPQ* 239, 240 (D.D.C. 1944).

⁴³ The *Autogiro* case is particularly relevant for its theory of a party subjecting itself to the jurisdiction. Despite the characteristic wording, however, the analogy between §§ 293 and 146 may be inapposite since § 146 is more in the nature of a continued proceeding from the Board of Interferences in the Patent Office, to

It is also possible that the wording "affecting the patent or rights thereunder" was taken from a similar provision presently in the Lanham Act:

If the applicant is not domiciled in the United States he shall designate by a written document filed in the Patent Office the name and address of some person resident in the United States on whom may be served notices or process in proceedings affecting the mark. Such notices or process may be served upon the person so designated by leaving with him or mailing to him a copy thereof at the address specified in the last designation so filed. If the person so designated cannot be found at the address given in the last designation, such notice or process may be served upon the Commissioner.⁴⁴

Again, however, the legislative history of this Section is almost nonexistent even though the particular wording above quoted was considerably broadened in scope from the corresponding Section of the prior act⁴⁵ which limited the type of action which could be brought to those "affecting the right of ownership of the trademark."⁴⁶

Presumably, therefore, Section 1051 (d) was intended to cover actions beyond those relating to ownership, but the outer limit of scope is certainly not free from doubt.

Probably the most interesting effect of Section 1051 (d) is the requirement that the applicant "shall" designate, being mandatory in nature, rather than the permissive wording found in Section 293 of "may" file (or designate) a written designation within the Patent Office, and, further, that there may be service made on the Commissioner of Patents in the event the designated person cannot be found.⁴⁷ The

which presumably all parties have already participated, and for which relief can be granted by default should one party, validly served, not appear in the proceedings. Section 293 is an original action in the federal courts, and in this sense is more akin to the corresponding extraterritorial provision of the Lanham Act.

⁴⁴ 15 U.S.C. § 1051 (d) Public Law 489, 79th Cong., ch. 540, 60 Stat. 427 referred to as the "Lanham Act" in its entirety.

⁴⁵ Act of February 20, 1905, 15 U.S.C. § 83, ch.592, 33 Stat. 725, § 3, states:

That every applicant for registration of a trademark, . . . who is not domiciled within the United States, shall, before the issuance of the certificate of registration . . . designate, by a notice in writing, filed in the Patent Office, some person residing in the United States on whom process or notice of proceedings affecting the right of ownership of the trademark of which such applicant may claim to be the owner, brought under the provisions of this Act or under other laws of the United States, may be served, with the same force and effect as if served upon the applicant or registrant in person. . . .

⁴⁶ *Id.* The broadening of the scope from actions "proceedings affecting the right of ownership" to "proceedings affecting the mark" was probably due to the restrictive meaning given to the latter phrase in the only case utilizing the Section prior to the 1946 Act. See *Georg Jensen Handmade Silver, Inc. v. Georg Jensens Solvsmedie A/S*, 79 F.2d 142 (D.C.Cir. 1935).

⁴⁷ The importance of this point is discussed in the section "Judicial Interpretation," *infra*. The original Lanham Act bill, H.R. 9041, 75th Cong., 3d Sess., did not provide for service on the Commissioner; however, during the hearings it was felt that to obtain jurisdiction over the proceedings, some person within the

patent Section 293 has no such alternate service.⁴⁸ Clearly, Section 1051 (d) shows that service upon someone within the United States was a requirement in order to obtain jurisdiction over the applicant. Further, there is no limitation that such an action be brought in the District Court of the District of Columbia.⁴⁹

The foregoing distinctions between the patent and trademark extra-territorial statutes is believed to be of importance in a final analysis of the rationale of Section 293.⁵⁰

JUDICIAL INTERPRETATION

Since there is no positive expression shown in the legislative history of an intent to create a broad provision which would extend beyond actions specifically involving the infringement or validity of a patent, a resort to the decided cases to determine judicial interpretation of Section 293 is necessary.

Of the relatively few cases decided since the passage of the 1952 Patent Act where a plaintiff has relied upon Section 293 to establish jurisdiction,⁵¹ the case of *North Branch v. Fisher*⁵² most fully probed into the jurisdictional questions which the Section propounds.

In *North Branch*, the plaintiff brought an action for declaratory judgment to adjudicate the title to certain United States patents and did

territorial boundaries of the United States had to be personally served. Note the statement of Earl H. Thomson before the Patents Subcommittee, with which the Committee agreed: "You see, without any agent present, if the agent dies or disappears, the court has no jurisdiction of proceedings to cancel the mark." Comm. on Patents, Subcomm. on Trademarks, House of Rep., 76th Cong., 1st Sess. on H.R. 4744, March 28, 29 and 30, 1939.

The Bill was later modified to include service upon the Commissioner of Patents.

⁴⁸ Note 6, *supra*.

⁴⁹ The action may be commenced in any District Court where the designated agent is within the territorial boundaries for service of process.

⁵⁰ See the section "Judicial Interpretation," *infra*.

⁵¹ Excluding Bayer and Glaxo, only seven other cases have been uncovered in which § 293 has been employed against a non-resident defendant: *Abington Textile Works v. Carding Specialists Ltd.*, 249 F. Supp. 823 (D.D.C. 1965); *Scandia House Enterprises Inc. v. Dam Things Establishment*, 243 F. Supp. 450 (D.D.C. 1965); *Sealol Corp. v. Flexibox Ltd.*, 242 F. Supp. 693 (D.D.C. 1965); *North Branch Products, Inc. v. Fisher*, 179 F. Supp. 843 (D.D.C. 1960), *rev'd on other grounds*, 284 F.2d 611 D.C.Cir. 1960), *cert. den.*, 365 U.S. 827 (1961); and *Webster-Chicago Corp. v. Holstenssen*, 132 F. Supp. 287 (D.D.C. 1955); *American Greiner Electronic, Inc. v. Etablissements Henry-Le Paute*, 174 F. Supp. 918 (D.D.C. 1959).

⁵² 179 F. Supp. 287, 124 USPQ 59 (D.D.C. 1960) *rev'd on other grounds*, 284 F.2d 611 (D.C.Cir. 1960), *cert.den.*, 365 U.S. 827 (1961).

not assert any cause of action relating to validity or infringement. The action was commenced in the District Court of the District of Columbia, based on jurisdiction obtained through Section 293. In deciding the case, the court squarely met the issue of whether such an action could be based on Section 293 and held that there was no jurisdictional basis for the suit on this Section.⁵³ In so holding, Judge Holtzoff concluded that there was no subject matter jurisdiction under Section 1338⁵⁴ since the action did not concern infringement of a patent or an "action for declaratory judgment involving validity or infringement of patents."⁵⁵

The court then, in discussing the merits of jurisdiction under Section 293, considered arguments of the defendant that the words "affecting the patent or rights thereunder" were intended to be broader than the traditional actions involving infringement and validity, and would encompass "any suit which directly affects patents, such as actions involving a title to a patent. . . ."⁵⁶ And here, Judge Holtzoff found little solace in a review of the legislative history but concluded that the Section "should be construed as being limited to actions under the patent laws, rather than to all patents generally."⁵⁷ Clearly discerning constitutional issues had he reached the alternate conclusion, he chose the interpretation which he felt would avoid raising and battling the constitutional problems.

Section 293 was then held to be synonymous with Section 1338 (a) and therefore "restricted to actions for infringement of patents and actions for declaratory judgments to adjudicate the validity or infringement of patents. Section 293 does not apply to it and hence service by publication under that Section was ineffective."⁵⁸ On appeal, however, jurisdiction was sustained on alternate ground⁵⁹ and the issue of whether or not Section 293 was here applicable was set aside.

⁵³ The court did feel that sufficient personal jurisdiction existed, however, by the defendant's imposition of a counterclaim, and therefore the defendant was held to have waived his objections to service of process as well as to jurisdiction over the person. Despite this holding, the action was dismissed by the District Court on the grounds of *forum non conveniens*.

⁵⁴ 28 U.S.C. 1338. This provision sets forth the subject matter jurisdiction of federal District Courts for patents, copyrights and trademarks.

⁵⁵ 124 USPQ 59,60.

⁵⁶ *Id.*

⁵⁷ *Id.* at p. 61.

⁵⁸ *Id.*

⁵⁹ Personal jurisdiction over the defendant was sustained on the basis that by filing an answer and counterclaim unaccompanied by a timely objection to the jurisdiction, the defendant willingly submitted to the jurisdiction of that court. 127 USPQ 349,351.

Of particular interest here was the fact that the District of Columbia Court of Appeals apparently concluded that Section 293 concerned subject matter jurisdiction and in a somewhat confused discussion of subject matter jurisdiction seemed to feel that a proper service could bestow subject matter jurisdiction upon the federal court.

Deeming the action to be one in which service on a non-resident patentee could be made under 35 U.S.C. Section 295, plaintiff attempted such service. We do not decide whether service so made gave the Court jurisdiction over the *subject matter*. . . . Both Section 293 and 28 U.S.C. § 1338 (1958), . . . are special grants of jurisdiction in the area of patents, copyrights and trademarks, . . .⁶⁰

The court then separately considered the issue of jurisdiction over the person.

In other earlier cases relying upon Section 293 it has been considered as an "in rem" determination respecting the patent and rights thereunder,⁶¹ and in *Etablissements Henry-Le Paute, S.A. v. American Greiner Electronics, Inc.*⁶² the court discussed Section 293 as establishing jurisdiction over the person, and concluded with a statement that the District of Columbia court, where an action was pending based upon § 293 had "jurisdiction over the res,"⁶³ and apparently an intention of some control over the patent was involved.⁶⁴

A more recent in-depth discussion of Section 293 appeared in *Japan Gas Lighter Association v. Ronson Corp.*⁶⁵ where one of the defendants unsuccessfully contended that Section 293 was a special venue statute and therefore analogous to the *Fourco* decision,⁶⁶ and that Section 293 superseded the general venue statute and was therefore the only proper

⁶⁰ 284 F.2d 611, 614; 127 USPQ 349,351 (D.C.Cir. 1960).

⁶¹ Webster-Chicago Corp. v. Holstenssen, 132 F.Supp. 287,288 (D.D.C. 1955) "[I]n the instant action jurisdiction is limited to an in rem determination respecting the patent and rights thereunder."

⁶² 172 F.Supp.228 (D.Conn. 1959).

⁶³ *Id.* at p. 694.

⁶⁴ The court then concluded that a suit between the same parties, commenced in the District of Columbia, for declaratory judgment should be determinative of the issues as taking precedent and staged the action for infringement in this court. The District of Columbia action was later dismissed in favor of the suit in the Connecticut District Court at 121 USPQ 368 (D.D.C. 1959).

⁶⁵ 257 F.Supp.219, 150 USPQ 589 (D.N.J. 1966).

⁶⁶ *Fourco Glass v. Transmirra Products Corp.*, 353 U.S. 222, 113 USPQ 234 (1957) which held that the special patent venue statute 28 U.S.C. § 1400(b) was "exclusive" for actions for patent infringement, thereby excluding resort to the general venue statutes, 28 U.S.C. §§ 1391-93. See also 36 C.J.S. Federal Courts § 16 (b) stating the general rule for "special" v. "general" venue provisions.

venue for an action against a non-resident affecting a patent or rights thereunder. Judge Coolihan undertook in some length to reject the argument by pointing out the distinctions between subject matter jurisdiction, personal jurisdiction and venue, and pre-emptorily dismissed the subject matter issue as not being in dispute.⁶⁷ The venue was held to be properly laid for a foreign non-resident under the general venue statute 28 U.S.C. § 1391 where, for an alien, venue is proper in any district.⁶⁸ Section 293 was specifically rejected as being a venue statute but instead, held to concern personal jurisdiction stating:

... § 293 does not supersede the general venue statute because it is not a special venue provision. Rather, it provides a method for invoking ... personal jurisdiction over foreign defendants. ... In this sense it is, in effect, a Federal "long-arm" statute, whose constitutionality is premised on the District of Columbia situs of a United States patent.⁶⁹

The court in *Ronson* very persuasively pointed out the choice of wording in Section 293; the use of the words "shall have jurisdiction" in referring to the district court appeared to negate the argument that this was a venue provision where alternate language relating to where an action "may be prosecuted" is more acceptable.⁷⁰ In particular, the conclusion of personal jurisdiction was founded by Judge Coolihan in the language of Section 293 that the court "*shall have the same jurisdiction . . . that it would have if the patentee were personally within the jurisdiction of the Court.*"⁷¹ (Emphasis by the court.) In addition the foregoing statement was supplemented by reference to Congress' intention as set forth in the Reviser's Notes.⁷²

It is submitted that the evaluation of Section 293 by Judge Coolihan is more palatable than that offered by the District of Columbia Court of Appeals. Clearly, Section 293 is not a subject matter jurisdiction statute

⁶⁷ Subject matter jurisdiction was considered to arise, in this case, under "the Patent Laws of the United States, 28 U.S.C. § 1338 and the Federal Declaratory Judgment Act, 28 U.S.C. § 2201, 2202," 150 USPQ 589, 590.

⁶⁸ 28 U.S.C. § 1391 (d) "An alien may be sued in any district." See 1 J. Moore, *Federal Practice*, ¶ 1510, p. 7.

⁶⁹ 150 USPQ 589,593. However, the constitutionality of most long-arm statutes is not based on the situs of any res within the jurisdiction, but rather on acts taken within the court's territorial boundaries, thus the need for a judicial "long-arm." To the contrary, the constitutionality of basing the court's jurisdiction on an intangible may be even more questionable. See Wright and Miller, *Federal Practice and Procedure*, Civil, § 1071.

⁷⁰ 150 USPQ 589, 594. See n. 58 where the court compares typical language used in venue statutes.

⁷¹ *Id.*

⁷² See generally, the section, "Legislative History and Intent," *supra*.

as suggested by the latter tribunal and consistent with the wording or the brief legislative history. There was really no difficulty with subject matter jurisdiction at the time of the passage of the 1952 Patent Act, as clearly an action for declaratory judgment of invalidity and non-infringement was well within the subject matter jurisdiction of the federal district courts.⁷³ In addition, the issue of venue was not in great controversy with regard to a foreign non-resident corporation.⁷⁴ Instead, the difficulty was in obtaining the personal jurisdiction over a nonresident patentee who could remain outside of the United States and freely harass and threaten United States companies with infringement of their United States patents while the United States companies were powerless to assert their right of a declaratory judgment. This would appear the logical purpose of adding Section 293, to place non-residents on a parity with United States companies and to subject the former to declaratory judgment suits where validity and/or infringement issues could be litigated.

Although the court in *Ronson* differed in substance with the court in *North Branch*, one point in common was that both courts felt some presence of the patent as a res within the District of Columbia was a necessary condition to the court's jurisdiction.⁷⁵ The use of the presence of a patent within a particular court's jurisdiction to establish jurisdiction over a person or corporation has, in the past, been occasionally litigated under the Federal Lien Statute.⁷⁶ Under this statute, the district courts are given certain limited jurisdiction over non-residents based on the existence of a particular res which is located in the court's jurisdiction, and has been interpreted as a federal "in rem" or "quasi-in-

⁷³ Subject matter jurisdiction is clearly established in the federal District Courts for such cases, 28 U.S.C. § 1391 and 28 U.S.C. § 2201.

⁷⁴ *Supra*, note 68.

⁷⁵ This was particularly evident in *Consolidated Trimming Corp. v. Loudon*, 106 USPQ 87 (D.D.C. 1955) where the court held that, under substituted service authorized by § 293, the court was given jurisdiction over the *patent*, but not over the person of the defendant. Presumably, therefore, the court was interpreting § 293 as strictly an "in rem" statute.

⁷⁶ 28 U.S.C. § 1655:

In an action in a district court to enforce any lien upon or claim to, or to remove any incumbrance or lien or cloud upon the title to, real or personal property within the district, where any defendant cannot be served within the State, or does not voluntarily appear, the court may order the absent defendant to appear or plead by a day certain. Such order shall be served on the absent defendant personally if practicable, wherever found, and also upon the person . . . in possession or charge of such property, if any. Where personal service is not practicable, the order shall be published. . . . If an absent defendant does not appear or plead within the time allowed, the court may proceed as if the absent defendant had been served with process within the State, but any adjudication shall, as regards the absent defendant without appearance, affect only the property which is the subject of the action. . . .

rem" statute,⁷⁷ and the relief sought had to be against the property. The service on non-residents normally is by some substituted service. In a series of patent cases, personal jurisdiction was sought based upon this statute and it has been consistently held that no personal judgment may be had against a non-resident for accrued royalties⁷⁸ nor could the action be brought as an "in personam" cause of action.⁷⁹

In *Rainbow Rubber v. Holtite Mfg. Co.*⁸⁰ in an action for infringement, one co-owner of the patent in suit attempted to join the other co-owner, a nonresident of the forum, by means of substituted service pursuant to Section 1655. It was there held that a patent is "nothing more than an intangible property interest, namely the right to exclude others from the use of the patent. . . . Thus a patent for the purposes of this section, may not be considered as a res within a definite situs within the district where the suit is brought. . . ." ⁸¹ Therefore, substituted service was not allowed.⁸²

The theory of these cases, although not directly applicable to Section 293 may show a judicial recognition of the intangible effect of a patent and the presence of the same, and a reluctance to exercise a quasi-in-rem or an in rem jurisdiction based on such an intangible feature. In addition, *Rainbow Rubber* suggests a further technical argument which may be used against an extension of Section 293 to non-validity type cases; i.e., the only "rights" given to a patentee is the right to "exclude others from making, using and selling the invention,"⁸³ and there is no *right* given to the patentee to license his patent; it is more in the nature of a privilege.

Therefore an action, in order to affect the "rights" of a patentee must concern an attack on the validity, in which case his right to exclude may be lost, or involve an action of infringement where the right to exclude

⁷⁷ *Graff v. Nieberg*, 233 F.2d 860 (6th Cir. 1956); *Norrie v. Lohman*, 16 F.2d 355 (2d Cir. 1926).

⁷⁸ *Kohagen v. Harwood*, 185 F.2d 276 (8th Cir. 1950).

⁷⁹ *Rainbow Rubber Co. v. Holtite Mfg. Co.*, 20 F. Supp. 913 (D.Md. 1937).

⁸⁰ *Id.*

⁸¹ *Id.* at p. 916.

⁸² Other decisions rejecting the res of patents include: *Automotive Products Corp. v. Wolverine Bumper & Specialty Co.*, 15 F.2d 745 (6th Cir. 1926); "patent rights are not such tangible property." *Standard Gas Power Co. v. Standard Gas Power Co.*, 224 F.990 (D.Ga. 1915); "generally, property rights in patents are not such tangible property as will justify court in proceeding against non-resident parties." *Kleinschmidt v. Kleinschmidt Laboratories*, 89 F.Supp. 869 (N.D.Ill. 1950). *Standard Stoker Co., Inc. v. Lower*, 46 F.2d 678 (Md. 1931).

⁸³ 35 U.S.C. § 271, which gives the patentee the right to prevent others from making, using or selling the patented invention.

is actively pursued. An action to declare a patent license invalid, therefore, does not affect the basic patent rights unless coupled with a claim that because of the alleged illegal license provision, the patent is invalid. It may be argued by seeking a court order to require compulsory licensing under reasonable royalties, the right to exclude is affected; however, it more concerns the curtailment of the licensing privilege for an abuse of that privilege, and the patentee is still free to exclude those who do not take a license or pay the reasonable royalty, and therefore the patentee still derives his royalty based on the right to exclude others, as with any other license of his own choice.

THE RATIONALE OF SECTION 293

The rationale of Section 293 as an in personam "single act" or "long-arm" statute need not, however, rest entirely on the legislative or judicial precedents heretofore discussed but is strengthened by an overall chronological development of the type of personal jurisdiction, up to the present interpretations, and includes a general lack of such progressive movement of the traditional fictional bases for extension of in rem or quasi-in-rem jurisdictions.

The traditional concept of a "territorial limitation" of a court's jurisdiction was established early in American jurisprudence and was rigidly adhered to in the case of *Pennoyer v. Neff*⁸⁴ where the Supreme Court invalidated a default judgment which had been entered after notice by publication and where the defendant had been outside the state's jurisdiction. In so holding, the Court stated:

And so it is laid down by jurists, as an elementary principle, that the laws of one state have no operation outside of its territory, except so far as is allowed by comity; and that no tribunal established by it can extend its process *beyond that territory* so as to subject either persons or property to its decisions.⁸⁵ (Emphasis added.)

Therefore, the person had to, even for a short time, be within the court's territorial boundary, or have made some waiver, in order to be validly served with process.

Due to the increasing transitory movement of our developing society, the "territorial limitations" theory of jurisdiction was clearly inadequate and soon expanded to include the personal jurisdiction over a domiciliary who was outside the territory, but who could be properly brought before the court through substituted service.⁸⁶ The non-resident motor-

⁸⁴ 95 U.S. 714 (1877)

⁸⁵ *Id.* at 722.

⁸⁶ *Blackmer v. United States*, 284 U.S. 421 (1932).

ist statutes followed thereafter and in *Hess v. Pawloski*⁸⁷ the Supreme Court sanctioned an extension of personal jurisdiction over non-residents who operated a motor vehicle within the territorial jurisdiction of the court, utilizing an "implied consent" to a suit and further, where service of process was made upon a designated official within the territory, with a substituted type of notice to the actual defendant.

The *Hess* case opened the door to various state statutes based on certain activities of a non-resident within the court's territorial jurisdiction and when the action itself was limited to a course of action arising out of the prescribed activities. Further developments included subjecting non-resident corporations to local court jurisdiction where the corporations were "present" or "doing business" within that jurisdiction; therefore an implied consent to be amenable to suit was established.⁸⁸

Finally, in the landmark case of *International Shoe Company v. State of Washington*,⁸⁹ the Supreme Court broadened its definitions of what "ties" or "standards" were required consistent with due process, for jurisdiction over a non-resident. In *International Shoe*, the Court recognized the fiction in the use of "presence" or "consent" and stated:

Since the corporate personality is a fiction . . . it is clear that unlike an individual its "presence" without, as well as within, the state of its origin can be manifested only by activities carried on in its behalf by those who are authorized to act for it. . . . For the terms "present" or "presence" are used merely to symbolize those activities of the corporation's agent within the state will deem to be sufficient to satisfy the demands of due process."⁹⁰

For the purposes of this section, the chronology may terminate at this point, at the establishment of the principle, in 1945, where an in personam jurisdiction may be obtained over a non-resident having with the state "minimum contacts" of such character that the maintenance of the suit does not offend "traditional notions of fair play and substantial justice." In addition, *International Shoe* finally ended the concept of requiring some explicit consent or statutory authorization for an agent or representation within the jurisdiction to accept service of process.⁹¹

With this chronology, it is interesting again to view both the Lanham

⁸⁷ 274 U.S. 352 (1927).

⁸⁸ See note 23, *supra*.

⁸⁹ 326 U.S. 310 (1945).

⁹⁰ *Id.* at p. 316.

⁹¹ *Id.* at p. 318:

True, some of the decisions holding the corporation amenable to suit have been supported by resort to the legal fiction that it has given its consent to service and suit, consent being implied from its presence in the state through the acts of its authorized agents. . . . But more realistically it may be said that these authorized acts were of such nature as to justify the fiction.

Act Section 1051 (d) and the Patent Act Section 293. At the time Section 1051 (d) was drafted in 1938,⁹² the advancement of the non-resident personal jurisdiction was in the development stage and apparently the framers of that provision felt actual service within the jurisdiction was necessary.⁹³ A further theory upon which this provision may have felt actual designation was necessary was the "waiver" theory of *Nierbo v. Bethlehem*⁹⁴ where some actual waiver need be shown to be subjected to a particular venue and jurisdiction over a non-resident.

Therefore, consistent with either theory, Section 1051 (d) made it compulsory for a non-resident to designate a person to receive process and, if not found, the Commissioner of Patents could be served. Further consistent with a territorial concept, the Section did not designate any particular federal court or rely on "contacts" but intended the suit to be entertained in any federal district court where the requisite personal service on the designated agent, or Commissioner of Patents, could be validly obtained.

At the time of drafting of the Patent Act the trend of expanding personal jurisdiction based on certain acts within the jurisdiction was apparent and it is submitted that such expansion of traditional barriers was tacitly taken into account in arriving at a provision to serve essentially the same purpose of Section 1051 (d).

First, by recognizing the lack of a need for actual service over a designated agent, Section 293 made it permissive to designate a resident or person upon which service of process could be made.

Secondly, it is submitted that the drafts of Section 293 recognized the fiction of requiring a res within the jurisdiction, heretofore needed for in rem or quasi-in-rem⁹⁵ jurisdiction, and designated the forum as the District of Columbia, where the patentee had done sufficient acts, or had sufficient contacts to deem it an equitable forum for him to return to litigate certain issues involving his patent. This is also consistent with the extreme reluctance of the federal courts, under Section 1655,⁹⁶ to

⁹² H.R. 9041, January 19, 1938.

⁹³ Again, note that § 1051 (d) is mandatory, and not permissive in nature; see section on "Legislative History and Intent," *infra*.

⁹⁴ 308 U.S. 165 (1939). *Nierbo* ruled that when a corporation specifically designated an agent within the court's jurisdiction, any objections to venue were waived when that agent was served. This waiver theory is also applicable to patent cases, *Clayton v. Swift* 106 USPQ 35 (E.D.Va. 1955).

⁹⁵ There is even some doubt whether a federal quasi-in-rem statute could have been founded in the *Federal Rules of Civil Procedure*, prior to 1963 when Rule 4 (3) was amended. See 2 J. Moore, *Federal Practice*, ¶ 4.25 (s).

⁹⁶ *Supra* note 76.

determine the situs of a patent or a patent right involved in ownership of patents.

Logically, this would appear to be a favorable construction, as, after a patent issues, there is no real purpose of maintaining the fiction that the res may be found within the District of Columbia as in any other federal district, particularly in view of the growing trend of rejecting fictions in favor of practical jurisdictional considerations i.e., where actual acts, contact or the like have occurred. As a federal long-arm statute, there is no need to rest the situs of an issued patent within any particular jurisdiction, but, more like the theory of *Autogiro*,⁹⁷ the act of the patentee of filing, prosecuting and finally securing his patent, thus taking advantage of the privilege of laws to his benefit, should be sufficient acts within the District of Columbia to fairly warrant the later exercise of the long-arm.

CONCLUSION

In the final analysis, therefore, the scope of Section 293 is not to be judged by the jurisdictional predicate of a fictional res having its situs within the District of Columbia, as such traditional fictions heretofore felt necessary are today more troublesome than useful. The situs of an issued patent is an ephemeral res at most, having attributes of personal property,⁹⁸ and logically should be governed by the situs of the patent owner⁹⁹ rather than raise further constitutional difficulties of in personam jurisdiction based on an intangible property.¹⁰⁰

The test of personal jurisdiction is, therefore, whether the acts or business undertaken by the patentee, that of filing, prosecuting and receiving the issued patent are such that, under *International Shoe*, there are sufficient "contacts or ties" with the forum to make it "reasonable and just" according to the traditional conception of fair play and "substantial justice" to enforce obligations which arose in that forum.

Later Supreme Court decisions have carried the *International Shoe* doctrine¹⁰¹ further and perhaps the farthest extension was made in

⁹⁷ *Supra* p. 557.

⁹⁸ 35 U.S.C. § 261. "Subject to the provisions of this title, patents shall have the attributes of personal property."

⁹⁹ See the discussion and cases cited relating to 28 U.S.C. § 1655, *supra* p. 563 *et seq.*

¹⁰⁰ *Supra* note 89.

¹⁰¹ Note Perkins v. Benguet Consolidated Mining Co., 342 U.S. 437 (1952), based on continued and systematic doing of business within the forum, even though the actual cause of action arose elsewhere.

McGee v. International Life Insurance Co., 355 U.S. 220 (1957), where an insurance company was held subject to a state's jurisdiction on an action based on an insurance contract where the beneficiary resided within the forum. The insurance company, however, had only very minimal contacts with the forum, having no office or agents there, and apparently did not even solicit insurance business in the forum state. It is clear, therefore, that only minimal contacts are necessary where the action is "based on a contract which had substantial connection with that State"¹⁰²; however, there are limits to the minimum contacts necessary.¹⁰³

The contacts of securing a patent i.e., filing, prosecuting, are possibly sufficient upon which to base an action for declaratory judgment for a declaration of invalidity of that patent, certainly the main thrust of Section 293; however, the substantive action within the District of Columbia is the securing, not the licensing of the patent. The acts relate to the contract between the patentee and the government, and it is submitted that any action based on Section 293 should in some way directly relate to that contract, by way of an attack on the validity of the contract, and not merely allude to some "rights" affected by the action.

In short, therefore, the action should by some means, attack the validity, either by way of alleging fraud upon the Patent Office, one of the two instances where the Justice Department may attack the validity of a patent,¹⁰⁴ or by a private litigant seeking a declaratory judgment on the conventional grounds alleging invalidity of the patent. In neither *Glaxo* nor *Bayer* is there an attack on the procuring of the patent or, in any way, an assertion that the patents involved are invalid, and as such, the action in these cases should be reappraised either by the district court or through a positive determination by a higher court.

¹⁰² *Id.* at p. 223.

¹⁰³ See *Hanson v. Denckla*, 357 U.S. 235 (1958), decided in the same term of the Supreme Court as *McGee*.

¹⁰⁴ See note 11, *supra*.

FORUM

Although the primary purpose of *IDEA* is to communicate the research work of the Institute, it also serves as an educational vehicle for the exchange of informed opinion. The positions taken by the authors of papers and notes in this section are not necessarily those of the Institute. It is hoped that the material published in this section will stimulate researchers to undertake further study of the issues.

The Patent System in Distress*

ABE FORTAS

IT IS FASHIONABLE FOR PATENT COUNSEL to say that judges, particularly federal appellate judges, regard the patent system as an alien growth, and that they look upon patents as inherently suspect. Patent counsel are correct. Many federal appellate judges—perhaps most of them—approach patents with the kind of suspicion and hostility that a city-bred boy feels when he must traverse a jungle full of snakes.

The patent system is strange and weird territory to most judges. They have never seen anything that resembles it. All patents look more or less strange and threatening to them; and since they are heavily armed with the power of the U.S. Government, they frequently get the idea that it's their duty to kill everything that moves in this dangerous land.

* A speech before the Association of Corporate Patent Counsel on January 19, 1971 at Rancho Bernardo, California. Mr. Fortas is a former Justice of the United States Supreme Court.

Of course, the law says that a properly issued patent is presumptively valid. But confronted by judicial hostility, this presumption is about as formidable as a silk screen against a machine gun. To many appellate judges, the presumption is something to acknowledge, and then to show that it's not controlling. It's sort of like tipping your hat to a lady as a gesture of respect. It doesn't follow that you're subscribing to the Women's Lib Movement.

Of course, patents are solidly rooted in the soil of a specific constitutional provision and are supported by the wisdom of the Founding Fathers of the Republic. Even Thomas Jefferson who started out as a skeptic, inclined to be opposed to the grant of patent rights, became a proponent of them as essential to the progress of the useful arts.

One would think that these constitutional roots and the testimony of practically all nations as well as our own history would lend a measure of protection to the patent system. They do, in measure; but something has gang aglae.

Senator McClellan recently reported that in a two-and-a-half year period, 72 percent of all patents adjudicated were found invalid. I don't know whether this figure includes the cases where courts decided that patents had been misused and were therefore unenforceable, or, even worse, gave rise to antitrust liability. Whatever the precise appraisal may be, the casualty rate among patents which are submitted for court adjudication is very high. Candor requires us to recognize that judicial nullification of patents and denial of their enforcement are the order of the day—the rule and not the exception.

In these circumstances, the company and the lawyer who seek judicial aid in the enforcement of a patent are indeed brave and bold. The cost of litigation is phenomenal. Its risks are colossal. And if they seek to enforce their patent rights by resort to the muscle of the marketplace, hoping to avoid entrusting their faith to the courts, they are similarly intrepid.

Lear v. Adkins and *Walker Process* have not only furnished those who seek to resist patent enforcement with an arsenal of formidable weapons; they also promise to give rise to a family of lawyers who regard guerilla warfare in the patent field as the new road to fame and fortune—particularly the latter.

In the world of finance, we have long experienced this guerilla warfare in which plaintiffs' lawyers are the standard bearers. Now you who are primarily concerned with the defense and enforcement of patents will be able to share this exciting experience, probably on a scale that was unimaginable a decade ago.

You will find that your life may be difficult, but it will not be dull.

As I read your literature and the accounts of your meetings, I share your concern and sympathize with your unhappiness. But it is unlikely that concern and agony will solve your problem. We can all wring our hands, but we can hardly wash the federal judiciary out of our hair, and we can hardly discourage the plaintiffs' lawyers who will appear in increasing numbers, animated by the zeal of antitrust, dedicated to the defense of the American abhorrence to monopoly and privilege—and cheered by the prospect of financial recovery.

I know that a candid friend is seldom welcome; but I intend to take this risk. I am a friend. I believe that a workable, effective patent system is essential to the health and progress of the nation. I firmly believe that we must provide the mechanisms and bring about attitudes by which invention is encouraged, and by which investment in invention and in the development of inventions is protected and facilitated; and in which nationally valuable patents are reasonably safeguarded as instruments for the scientific, technical and economic development of the nation.

Unless we can fashion a patent system in which genuine invention and the public disclosure of invention are fostered and promoted, and the appropriate exploitation of invention is protected, we will garner not the fruits of competition, but the chaos of guerilla warfare and the stagnation of a closed and secret industrial society.

Certainly, we are presently moving towards a destructive result; and I invite you to join with me in an effort to try to figure out why this is so and what could be done to reverse the present trend.

We must begin, I suggest, by a frank appraisal: First, by a frank acknowledgment that to obtain public recognition of the need to protect patents properly obtained and properly used, we must combat a basic American prejudice. Despite their constitutional sanctification, patents are an exception to the generality of American folkways.

This nation's philosophy stems from the frontier; it is still highly seasoned by the rugged, individualistic, laissez-faire principles of the frontier.

Antitrust is a basic article of faith, like the American flag. To paraphrase a former head of the Antitrust Division, Marcus Hollabaugh, it is as if the patent system were an island in a sea of antitrust.

Like so many other articles of political faith, antitrust is apt to be more loved than understood. It is a tremendous weapon, the wise and forceful use of which is essential to the nation's well-being. But sometimes it is used like a machine gun in the hands of an irresponsible

adolescent. So used, it can stultify essential and rational development of the nation's economy.

After all, antitrust is not like Serutan, or Lydia Pinkham's Vegetable Compound, or Hadacol. It's not an answer for all of the ills of the railroads or the stock exchanges—or the problem of encouragement, development and utilization of the inventive genius of the nation.

But the genius of antitrust—a sort of innate hostility to a monopoly of anything—is a fact of life, and it is beginning to strike at the patent system with powerful force. It is, I think, our duty—not merely as lawyers or patent counsel but as Americans—to do everything we can to see that this impact is not destructive, but is restrained, guided and directed so that it hits abuses which should be eliminated and does not destroy the status, vitality and indispensable role of the patent system.

We shall not achieve this without major effort and a willingness on the part of the Patent Bar and the industrial community to participate not merely in opposition to attack, but in sensible and constructive handling of the situation which they now face. Given such willingness and given an intelligent, objective appraisal of the current scene, I would have hope that this, too, will pass, and that the patent system will emerge with continued vigor and vitality.

Perhaps a beginning should be a renewed determination that we will not accept the glib reference to patents as monopolies, as instruments for engrossing an entire field of technical or economic activity. The patent system has too long suffered from this misapprehension. It is true that sometimes the accumulation of patents by a single company will result in engrossing an entire field—but this is a problem of the use of patents. It does not go to their essence.

The patent system has suffered through the years from the misconception of the patent privilege—the idea that the patentee or patent licensee is a monopolist broadly excluding others from an entire field, beyond the scope of the patent itself. Of course, a patent confers an *exclusive* right—but it is a *limited* right, not a monopoly, because it is subject to the competition of other inventions in the same economic field—or as the antitrust jargon has it, the same relevant market.

Unfortunately, we have all too often loosely used the word monopoly in connection with patents; and we are suffering from the climate of opinion which this carelessness has fostered. And it is sad but true that some patentees and licensees have acted as if a patent were not only a right conferring limited exclusivity, but a license to engross everything in conceivable range of the subject matter of the patent.

I suggest to you that we must change our vocabulary in this respect, and we must carefully police our practices if we wish to gain public respect and judicial support for the patent system in this time of crisis.

Unfortunately, the public is constantly reminded of instances of the monopolistic misuse of patents; and the public is relatively unaware of the fact that, over and over again, patents have a unique and constructive function, and have served to stimulate others to creative effort which, cumulatively, have opened whole new fields of competitive and fruitful enterprise.

So long as the public is suspicious of the patent system, we can hardly hope that either the Congress or the courts will extend themselves to nurture and protect it. And so, if I may be pardoned for putting it this way, we will be well advised to convert some of the time that the Patent Bar spends in talking to itself into efforts to inform the public and our wayward members of the virtues and functions—and the limitations—of the system.

This is background—a basic conditioning proposal. But it is also symptomatic of what I believe to be fundamental, specific and tangible reasons for judicial inhospitality to patents. Fundamentally, I believe, the difficulty that the patent system encounters in the courts stems from the peculiarities—the insularity—of the system, particularly from its unique procedures.

The patent system is not only an island in terms of its substance. It is also an island harboring a family of specialists who have developed folkways that have only a generic relationship to the rest of the nation.

The aspect of the patent system that is most disconcerting to a judge is the procedure by which patents are granted. Most judges are familiar with the fact that in many fields, our government does indeed grant monopoly privileges. They are familiar with the procedure by which a television or radio monopoly or a telephone, electric light or water service monopoly is granted. But these are typically granted after a familiar sort of legal proceeding—after a tough, hard, adversary fight between contesting parties, before an administrative tribunal of responsible officials who act on the basis of specific standards and in accordance with rigorous procedural requirements, whose conclusions are subject to court review, on the basis of findings and a record; and the monopoly grant is subject to continual administrative supervision of rates and services so long as the monopoly lasts.

Judges are familiar with this. But I have seen—and perhaps you have, too—a look of amazement on the face of a judge when he first is advised of the procedure by which patents are obtained. They are told

that a patent monopoly is typically granted in a secret, *ex parte* proceeding before a minor bureaucrat called a patent examiner.

If the nameless, faceless and often young patent examiner grants the application, that is the end of the matter so far as the issuance of the patent is concerned. The patentee or the assignee is then armed with a weapon of assertedly formidable power. If the examiner doesn't grant the patent as requested, the applicant may appeal to the Board of Patent Appeals and then to the Court of Customs and Patent Appeals.

Most judges, rightly or wrongly, are inclined to think that a strong, well-financed applicant has a pretty good chance of getting at least some patent claims allowed somewhere along the line, and they don't have much confidence in the process or respect for the result.

I have often wondered whether those who have spent most of their lives as patent counsel really appreciate the impact of this procedure upon the minds of judges—as well as nonpatent lawyers. To most of them, the procedure has little resemblance to legal process as they know it. To them, the procedure seems to be an anomalous perpetuation, on a bureaucratic level, of the ancient system by which in the 16th and 17th centuries the English Crown granted monopolies to presumably deserving persons; and most of the judges are not Royalists.

I understand that to the Patent Bar the system is regarded as adversary. The picture is one in which the patent examiner and the applicant are viewed as adversaries. To the average judge, this is a strange conception that the patent examiner is both adversary and judge. When he is told that the product of this procedure is entitled to a presumption of validity, he is usually quite unimpressed.

It is unimportant for my purpose whether this is or is not a fair or justifiable reaction on the part of judges. I assume that most patent examiners are able, well-trained, demanding and highly conscientious; and one need only to look at the history of patent applications to realize that the proceedings are quite often in the nature of a titanic struggle.

The important point for my purposes is that judges tend to be highly skeptical of Patent Office procedure. This is in part the background of the statement in *Graham v. Deere* (1966) where the Supreme Court said "We have observed a notorious difference between the standards applied by the Patent Office and by the courts."

The skepticism about Patent Office procedure, perhaps stemming largely from its differences from familiar judicial and quasi-judicial proceedings, is, in my opinion, the fundamental stumblingblock in the way of obtaining more sympathetic treatment of patents in the courts.

Until we can materially reduce the vast distance between Patent Office procedure and conventional quasi-judicial proceedings, I do not believe much progress will be made in reducing judicial hostility to patents.

I am skeptical that the presumption of validity of a properly issued patent will ever amount to much until procedures in and before the Patent Office are revised and conventionalized. I doubt if there is much basis for hope that the courts will really be much affected by the presumptions of validity until the procedures for the grant of a patent are revised so as more closely to resemble those that are requisite in the case of other governmental grants. And I don't think that revised and strengthened legislation will make much difference unless the procedural gap is narrowed.

I appreciate the difficulties that this involves because of the special characteristics of patents, the need for secrecy in the proceedings, and the limited practicability of a true adversary proceeding between contesting private parties.

But some things can be done! An example is the proposal for a separation between the search and adjudication functions of the Patent Office: That is, that technical personnel should do the Office's research and act as the "adversary" or screening personnel and the decision should be made by an examiner or board acting in a quasi-judicial capacity.

Perhaps, also, an expert, well-staffed public counsel's unit in the Patent Office which would be a party to the processing of every application would help. It would not be necessary for this office to participate in the processing of every application, but it might be its duty to participate in respect of all important cases. The objective would be that the examiner in the Patent Office should, so far as practicable, become more like a trial examiner in the usual administrative agency with the technical staff and the public counsel occupying the role of adversary.

Of course, this more elaborate system might require reduction of the number of patent applications which are processed. But I think it would be possible, and beneficial to all concerned, if patents were confined to matters of substantial public importance. The Patent Office should be authorized to dismiss at an early stage applications of minimal public importance. I know that this presents many problems; but I doubt if the Constitution or the nation would suffer severely if there were a summary denial of patent rights to devices which at best represent trifles or mere conveniences. For example, I recently read about

a patent granted for a device which is able mechanically to stroke a baby's behind.

If volume were reduced on this basis, or if some other way could be found to confine the work of the Patent Office to patents of some consequence, perhaps the Commissioner should be replaced by a multi-member commission appointed by the President with the advice and consent of the Senate, and the ultimate power and responsibility of granting patents, after the hearing examiner or board has acted, should be vested in this commission. The technical staff or public counsel, if they were opposed to the issuance of a patent in a patent case, would have an opportunity to contest it not only at the processing stage, but also before the commission itself, and to prosecute appeals to the Court of Customs and Patent Appeals.

An additional possibility which has been suggested is that interested persons should have an opportunity to contest the patent not only in interference proceedings, but also for a limited period after issuance. This could be done, not just before the constitutional courts, but before a specialized agency or court. I do not believe that this could oust the constitutional courts of their jurisdiction, but it would help to relieve their minds!

If a quasi-judicial system along the suggested lines could be established, consideration might be given to adoption of the substantial evidence rule: That is, that the courts might not reverse or set aside a grant based upon adequate findings supported by substantial evidence in the record. In my judgment, if the procedural changes were made or suggested, this limitation upon judicial action, which is entirely familiar to the courts, would be substantially effective. Certainly, it would have much more effect than the "presumption of validity." It is true that it would involve the making of a record and some difficulty and expense; but perhaps this is not too great a price to pay.

In summary, I am suggesting what may be strong medicine. I'm saying that in my view, the patent system, and many owners of patent rights, face a hard, rough and possibly extremely detrimental future unless the attitude of the courts—and particularly the federal appellate courts—can be changed; and I am saying that this cannot be changed, in my view, unless there is fundamental reorganization of Patent Office procedures.

I do not suggest that the changes which I suggest will solve all of the problems facing the patent system. You have before you a vast job of public education as to the value of the patent system; you have the challenge of domesticating your own practices so that the special rights

conferred by patents are not abused; and you face, beyond all of this, a strong tide in this nation that is running against corporate right and business power—what is called the Establishment.

We are today experiencing in this nation a sort of People's Revolution. People are demanding that the policies of what is referred to as the Establishment—the practices and policies of our great corporations—should reflect a large infusion of what is considered to be the public interest.

Power and privilege, no matter how responsibly acquired or constructively used, are viewed with new suspicion and hostility. No longer is the answer accepted that the power of industrial and commercial enterprises is producing vast national benefit. The demand is being made—and the demand has met with great success—that power and privilege be denied or domesticated and controlled.

It would be surprising if the patent system were immune from the impact of this demand—and the fact is that the system is in the line of fire, however inarticulate the targeting may be. Perhaps the most significant evidence of this is the emergence of the Department of Justice as the aggressive vindicator of the public interest and the shining gladiator to attack patents, patentees, assignees, lawyers and company officials who in the Department's judgment abused the rights and privileges offered by the patent system. Their approach, as you know, has emerged most dramatically in the recent *Glaxo* and *Bemis Bag* cases.

We must recognize the depth of the attack and of the public attitude from which it emerges. It is a dangerous period, for those who believe they are attacking the abuses of the system may inadvertently damage the system itself. We must, of course, resist these excesses and struggle to confine the attack to those things that warrant its fury. But to do this effectively, we must put our house in the best possible order. I wish you all success.

The Antitrust Status of Territorial Limitations in International Licensing

RICHARD H. STERN*

INTRODUCTION

THE ANTITRUST IMPLICATIONS of international technology licensing arrangements have received increasing attention during the last decade.¹ Increased antitrust litigation activity in the area, after many

EDITOR'S NOTE: In the next issue of IDEA we will carry a paper in this Forum Section on the same general topic written from an opposing point of view.

* Chief, Patent Unit, Antitrust Division, U.S. Department of Justice. Portions of the material in this paper have, in different form, been delivered before the American Patent Law Association (Chicago, May 15, 1970) and the New York State Bar Association (New York, January 27, 1971). The views expressed herein are those of the author and do not necessarily represent those of the Department of Justice.

¹ See, e.g., Barton, "Limitations on Territory, Field of Use, Quantity and Price in Know-How Agreements with Foreign Companies," *University of Pittsburgh Law Review*, Vol. 28 (1966), p. 195; Ladas, "Problems of Licensing Abroad," 1965 *University of Illinois Law Forum*, pp. 411, 423, 449; Stedman, "Legal Problems in the International and Domestic Licensing of Know-How," *A.B.A. Antitrust Section*

years of relative inactivity, has recently heightened such attention.² There are various nonantitrust policies important in this field. This paper, however, will be confined to a purely patent and antitrust appraisal of territorial provisions in international technology agreements, with a view toward suggesting possible bases for answering counseling or drafting questions. It will cover, first, patent licenses; second, know-how licenses; and, finally, it will seek to assess the general state and direction of the law in the area.

TERRITORIAL LIMITATIONS IN PATENT LICENSES

Types of Limitations

The central issue, around which all the others revolve, is the lawfulness of a division of domestic and foreign license rights. There are various ways of effecting such a division. The patentee may grant a license under his patents and then expressly prohibit the licensee from exporting to the United States or secure from the licensee a covenant not to export, but such license provisions have become uncommon. Alternatively, the patentee may grant a license upon the condition that the licensee not export to the United States. Finally, and most fre-

Proceedings, Vol. 29 (1966), p. 247; Timberg, "The Impact of Antitrust Laws on Multinational Licensing and Franchising Arrangements," *Antitrust Bulletin*, Vol. 8 (1968), p. 39; Wolfe, "Restrictions in Know-How Agreements," *Antitrust Bulletin*, Vol. 12 (1967), pp. 749, 759-63.

² See *Zenith Radio Corp. v. Hazeltine Research, Inc.*, 395 U.S. 100 (1969); *United States v. Singer Mfg. Co.*, 374 U.S. 174 (1963).

The principal potential antitrust and antitrust-related liabilities are in the area of misuse and antitrust defenses to patent infringement suits, antitrust counterclaims in patent infringement suits, and independent antitrust damage suits. In the field covered by this paper, the principal relevant statutory provisions are §§1-2 of the Sherman Act, 15 U.S.C. §§1-2 (1964).

The misuse defense is an outgrowth of the equity doctrine of "clean hands," and may be used by an infringer to defeat recovery, *Mercoid Corp. v. Mid-Continent Inv. Co.*, 320 U.S. 661, 668-69 (1944); *Morton Salt Co. v. G. S. Suppiger Co.*, 314 U.S. 488 (1942); or a licensee to avoid royalty payment, *United States Gypsum Co. v. National Gypsum Co.*, 352 U.S. 457, 465 (1957); in either case the misuse of patent monopoly power need not rise to the level of an actual antitrust violation. *Transparent Wrap Mach. Corp. v. Stokes & Smith Co.*, 329 U.S. 637, 641 (1947). The closely related antitrust defense is based on the principle that the courts will not enforce an illegal contractual restriction or one against public policy. See *Mercoid Corp. v. Minneapolis-Honeywell Regulator Co.*, 320 U.S. 680, 684 (1944); *Standard Fashion Co. v. Magrane-Houston Co.*, 258 U.S. 346 (1922); *Pope Mfg. Co. v. Gormully*, 144 U.S. 224, 236-37 (1892).

Counterclaims or independent suits for damages are based on Clayton Act §4, 15 U.S.C. §15 (1964); see *Mercoid Corp. v. Minneapolis-Honeywell Regulator Co.*, *supra*. Suits by the federal government for injunctive relief may be based on Sherman Act §4, 15 U.S.C. §4 (1964); see *International Salt Co. v. United States*, 332 U.S. 392 (1947).

quently, the patentee will grant a license under his foreign patents, and then either fail to make any reference to his domestic patents or else state that the grant shall not be construed to include any license under the domestic patents. Of course, the same type of provisions may be applied in the case of a foreign patentee and American licensee, where the protected territory is that of the foreign patentee.

At one time, lawyers seem to have thought that the difference in language among these various types of license agreements had a special significance. It was thought that whatever objections there might be to the language of express prohibition, nevertheless no antitrust question could be raised by a mere failure to grant a domestic license of scope corresponding to the foreign license. It would appear fair to observe, however, that most antitrust lawyers now recognize that niceties in wording will not save what is otherwise an unlawful scheme.³

That is to say that the facts that make a reservation of domestic territory an economic equivalent of a prohibition of importation are much the same facts that make a contract, in which either of them is embodied, one in unreasonable restraint of trade. Thus, the definitional problem of characterizing a territory provision in a license as a "restriction" or not would seem to merge with the problem of determining whether the alleged restriction is in fact an undue one. The latter is the more important question, it is suggested, and the one on which courts will properly focus the greater attention.⁴

For the purposes of this paper, then, no distinction will be made between various verbal forms by which domestic and foreign patent rights are divided in a licensing arrangement; all types of such arrangement will be referred to as territorial limitations or restrictions. We turn now to the legality of such provisions.

The Applicability of the Per Se Rule Against Division of Markets

The Per Se Rule

The illegality of territorial limitations in international patent licensing agreements, if they are illegal at all, is premised on the antitrust rule prohibiting the allocation or division of markets by actual or potential competitors. Commercial agreements to divide markets have

³ See, e.g., *United States v. Masonite Corp.*, 316 U.S. 265, 278 (1942).

⁴ Compare *United States v. Pabst Brewing Co.*, 384 U.S. 546, 549-50 (1966) ("section of country" question subordinate to competitive effect question); *Standard Oil Co. v. United States*, 221 U.S. 1 (1911) (analysis of whether or not practice is "restraint of trade" superseded by analysis of reasonableness or unreasonableness of restraint).

long been held to be unreasonable in themselves, by reason of their character and their necessary effect on competition.⁵ The courts have refused to make any elaborate inquiry into the motivation for or economic consequences of any particular arrangement of this type because of the inevitable tendency of such restrictions to injure competition. Indeed, such agreements may be said to eliminate competition even more completely than a price-fixing agreement, because the division of markets by agreement among competitors completely eliminates all competition, whether in the form of service, quality of goods, or any other competitive factor, as well as competition in terms of the price they charge buyers.

Carried to its ultimate logical conclusion, this principle against allocation of markets might seem to outlaw any licensing agreement by which the owner of any domestic and foreign patent, whether of major or minor technological significance, granted a license under only one of the two patents. Nevertheless, to take the principle so broadly, as a matter of principle and without a more detailed economic analysis, would seem, at least to the author, probably to carry the rule farther than we should go. The problem should not be viewed as one of mere characterization (*viz.*, should this provision be deemed a division-of-markets agreement?), but rather as one of whether the economic effect is anticompetitive in the manner a division of markets injures competition.

National Boundaries of Patent Rights

Another, and perhaps preferable, way to view the matter is that the rights of a patentee are compartmented along national boundary lines. Each sovereign state awards a grant that is valid only within the borders of the grantor state. By way of contrast, an ordinary agreement to divide territories, whether internationally or domestically, is not based on the existence of such discrete legal rights. It would seem that a proper accommodation of patent and antitrust policies should take this distinction into account. The question then becomes one of the degree to which this distinction should be considered to make a legal difference, for again the effect, and not the label, should be determinative of the outcome.

⁵ The landmark case is *United States v. Addyston Pipe & Steel Co.*, 85 Fed. 271 (6th Cir. 1898) *aff'd*, 175 U.S. 211 (1899). See also *United States v. Arnold, Schwinn & Co.*, 388 U.S. 365, 375 (1967); *United States v. Sealy, Inc.*, 388 U.S. 350, 254 (1967); *White Motor Co. v. United States*, 372 U.S. 253, 259 (1963); *Northern Pac. R.R. v. United States*, 356 U.S. 1, 5 (1959); *United States v. Consolidated Laundries Corp.*, 291 F. 2d 563 (2d Cir. 1961).

It would scarcely appear that the matter has been thought through enough yet to permit a final answer to the question about the extreme and perhaps commercially unimportant case previously posited—that is, the single domestic patent and its foreign counterpart which are not licensed together. Indeed, the premise of the question may make it quite academic. It is therefore suggested that, for analytic purposes, it would be more fruitful to approach the whole matter in a different way, by getting away from the extreme case and starting the analysis (from the other end) with a look at what may be much easier and more determinable cases.

Factor Analysis Approach

To do that, we may consider a variety of other factors which may be present to flavor the case, and which may permit us to reach an antitrust diagnosis without focusing on the bare issue of national boundary of the legal right. First, the size of the licensor and licensee in their industry or industries is important, as is their degree of establishment in the market affected by the license. Second, the number of licensed products or product lines and dollar value of the patented products deserve consideration; similarly, the size of the package of patents that is licensed should be considered. Third, the term of the agreement is pertinent. Another factor that may have a bearing is whether there is a cross-license or reciprocal license. Finally, the presence of restrictions on either party, in addition to one on territory, tends to affect the antitrust prognosis adversely. The possible antitrust impact of these factors will now be taken up in turn.

Size of Parties

The size and economic importance of the parties is highly pertinent as is the extent of their establishment in the industry or in the product lines covered by the agreement. The principal justification usually advanced in favor of a restrictive territory provision in an international patent license is that no competition is really eliminated because, but for the license, there would be no manufacture of the product by the licensee. This is similar to an argument that has been accepted in the case of certain other agreements which are not thought to have an inherently anticompetitive character and effect. Thus, exclusive dealing arrangements entered into by a struggling newcomer have been held permissible, although they would not be legal, for example, if a dominant firm employed them.⁶

⁶ See, e.g., *White Motor Co. v. United States*, 372 U.S. 253, 269 (1962) (con-

When the licensor and licensee are major industrial factors, in this and the foreign country, respectively, the accuracy of the prediction that no entry into the market would have occurred but for the license, is obviously open to considerable doubt. Similarly, if both firms have been in the same or similar lines of industrial activity for some time—so that they are actual or potential competitors—the argument is not available that the license was necessary to permit a struggling newcomer to enter a market that would otherwise have been closed to him.

Subject Matter of License

The next factor or group of factors to consider is the subject matter of the license—the number of different products involved, their dollar value, the number of patents in the licensed package and their technological importance. The number of different types of product involved is important because the bigger and more ramified the product type coverage of the license, the less plausible the “necessity” argument tends to become. It may be that the licensor’s technology was necessary to the licensee’s entry into one line of activity or even several, but this can hardly be true for a great many different product lines. As the product type coverage of the license expands, the court is more likely to find convenience rather than necessity as the explanation, even absent suspicion of a plan to allocate markets under the guise of the license.⁷

Similar considerations apply when the dollar value of the products manufactured under the license is very high and when there is a large number of different patents licensed. Like broad product scope, these factors tend to negate the argument based on necessity. Moreover, they indicate the existence of a considerable incentive for the licensee to try to enter the market by means of independently derived technology. Finally, these factors tend to indicate that the competitive impact of the territorial restraint is greater because of the greater economic impor-

curing opinion); *Harley-Davidson Motor Co.*, 50 F.T.C. 1047, 1066 (1954); cf. *Brown Shoe Co. v. United States* 379 U.S. 294, 330 (1962); *United States v. Jerrold Electronics Corp.*, 187 F. Supp. 545 (E.D. Pa. 1960), *aff’d per curiam on other grounds*, 365 U.S. 567 (1961).

⁷ Broad technical scope within a single product line, covering many different aspects of the same product, as contrasted with coverage of a large number of different types of product, creates a further problem, discussed at pp. 586-7 *infra*, that has to do with creating undue uncertainty as to the scope and duration of the territorial limitation. The preceding discussion relates, therefore, to the number of different product types covered rather than the breadth of coverage of the art within a particular product line.

tance of the subject matter. This is obviously a prime factor in making an antitrust challenge to any allegedly undue restriction.

Term of Agreement

Applicability of Newcomer Defense

The term of the agreement (or the territorial limitation in it) is important, first, in connection with the applicability of the struggling newcomer defense. The cases dealing with this defense recognize it only for a limited period, approximating the time necessary for the break-in.⁸ That is, once the struggling newcomer is established in the market, the necessity of the restriction to enable his entry vanishes.

Extension of Term by Flow-Through

A further problem involving the term of the agreement occurs with "flow-through" or "flow-forward" provisions—that is, provisions in a license that provide for a continuing transfer of technology within the field of the license. Sometimes, the scope of the flow-through provision is limited to improvements on the original patents; at other times, the scope may embrace any related subject matter. In both instances, the life of the territorial restriction might well be prolonged indefinitely if a separate territorial limitation were permissible, even for a few years, on each new installment of technology.

Scope, Term, and Uncertainty

It would seem, generally, that the antitrust risks of the license could be lessened by careful drafting—to avoid unnecessarily sweeping restrictions. The relation of scope of the license and term of the territorial limitation, with particular reference to flow-through provisions, is illustrative. At the initial stages of a technology exchange, the licensee may quite reasonably want to obtain all the information needed to make the licensed product and therefore may request a transfer of all technology in the field of the product. Even such an agreement, however, should specify the particular patents licensed, so that, in time, the licensee may decide whether to make a product avoiding the patents and consequently the territorial restriction, thereby making it permissible for him to penetrate the licensor's home market. By the same token an

⁸ See cases cited in note 6 *supra*. In *Jerrold* the district court determined that tying service contracts to equipment sales and requiring purchases of a full system were reasonable at the outset, but became unreasonable and therefore illegal when the passage of time destroyed the initial justification—protection of a complex infant industry.

agreement, which creates undue uncertainty for the licensee as to which products are covered by a territorial restriction, may unreasonably deter the licensee from legitimately competing with the licensor in the sale of unpatented goods. Hence such an arrangement would present antitrust problems.

One way to handle the flow-through problem is to eliminate all territorial limitations on the use of patented technology after a specified time period, such as five to ten years. Otherwise, beyond a certain reasonable period of time, there is sound legal basis to bar a continuing and automatic flow-through of technology in broad product lines, that is subject to territorial limitations, and to permit only separate transfers of discrete items in order to avoid mutual involvement that has the effect of dividing markets into geographic spheres of influence.

Cross or Reciprocal Licenses

A cross license between the parties or a set of reciprocal licenses on the same or different technology, subject to a territorial limitation, is probably more vulnerable to antitrust challenge than a simple, one-way license arrangement. By such an arrangement each party promises, in effect, to respect the other's territory and not to invade it, as part of the *quid pro quo* for the license. While the presence of this factor is hardly a decisive consideration, it is something which tends to affect the antitrust prognosis adversely; and, it seems fair to say, when a reciprocal license is combined with flow-through provisions for a long period, the antitrust problem tends to become a good deal more serious.

Presence of Other Restrictions

The presence of other restrictions in the license agreement, in addition to territorial limitations, is bound to increase antitrust vulnerability. It is a well-recognized fact that when courts are presented with a number of different restrictions, they tend to consider their cumulative impact, rather than analyze the case made against each restriction, taken in isolation from the others. As a result, plaintiffs are frequently able to convince the court that the different restrictions have a cumulative or even synergistic effect, so that the total impact in some way exceeds the sum of the parts. Thus, the Supreme Court has declared, in reversing a court of appeals for treating an antitrust plaintiff's claims "as if they were five completely separate and unrelated law suits"—

We think this was improper. In cases such as this, plaintiffs should be given the full benefit of their proof without tightly compartment-

alizing the various factual components and wiping the slate clean after scrutiny of each. ". . . [T]he character and effect of a conspiracy are not to be judged by dismembering it and viewing the separate parts, but only by looking at it as a whole . . . [I]n a case like the one before us, it is the duty of the jury to look at the whole picture and not merely at the individual figures in it."⁹

The antitrust status of other types of licensing restrictions, unrelated to territorial restrictions, is outside the scope of this paper. It appears sufficient for its purposes to observe, without making any invidious suggestions and viewing the matter purely from the standpoint of practical litigation considerations, that the presence of such provisions as customer-class restrictions, field restrictions, quantity limits, and the like, will necessarily convert what the defendant alleges is a pure case of merely reserving domestic patent rights into something quite different.

Relation of Factors

As previously indicated, these factors are not of equal significance. Probably, if every one of them is adverse, then the agreement between the parties would be deemed in violation of the Sherman Act. If every one of them were favorable, then we would approach or be presented more with what was previously referred to as the extreme and perhaps commercially unimportant case. The balance the author would strike, on the basis of the limited data so far advanced, would be in favor of letting the patent owner, at least in the case of the single and nondominating patent, impose a territorial limitation on his license, that is, not license him under the American counterpart of the foreign patent.

If the analysis proposed in this paper is accepted, then the question that becomes important is the status of agreements somewhere in the middle of the continuum. That seems, however, to be a question not admitting of a definite answer. The kind of analysis necessary seems reminiscent of that required under the pre-*Philadelphia Bank*¹⁰ Clayton Act, Section 7 dispensation—that is, the approach proposed in the

⁹ *Continental Ore Co. v. Union Carbide & Carbon Corp.*, 370 U.S. 690, 698-699 (1962). Similar considerations apply to the aggregation of probabilities of anti-competitive effect. Compare Bok, "Section 7 of the Clayton Act and The Merging of Law and Economics," *Harvard Law Review*, Vol. 74 (1960), pp. 226, 336 & n. 324, with Kessler and Stern, "Competition, Contract, and Vertical Integration," *Yale Law Journal*, Vol. 69 (1959), pp. 1, 35 & n. 156. See also *United States v. Northwest Industries, Inc.*, 301 F. Supp. 1066, 1096-1097 (N.D. Ill. 1969).

¹⁰ *United States v. Philadelphia National Bank*, 374 U.S. 321 (1963).

earlier *Pillsbury*¹¹ and *Brown Shoe*¹² decisions, or in Sherman Act merger decisions such as *Columbia Steel*.¹³ The matter, it is suggested, is one of more or less, rather than one of absolutes.

Although such an analysis is not wholly satisfactory for predicting the outcome of litigation, at least it provides some assistance in drafting. That is, to lessen risk one should attempt to move to a place on the continuum that is closer to what has been suggested to be the favorable end. Where limitations are unnecessary, they should not be thrown in as a matter of principle or habit. Some factors may have to be accepted as given, such as the size of the parties. On the other hand, there are some aspects of the license which may be altered without disrupting the underlying agreement, such as by tailoring the product scope or the size of the licensed package of patents more exactly to fit the real needs of the parties. This is the area in which careful drafting makes a difference to the probable antitrust risks. Given the present state of the art, there is an obvious premium on the development of conservative and careful drafting technique.

TERRITORIAL LIMITATIONS IN KNOW-HOW AGREEMENTS

Separate questions and distinct issues are raised by licenses of technical information, know-how, and other types of secret or nonsecret unpatented technology. Such data may be embodied, for example, in the form of blue-prints, descriptions of processes, or specifications of machining tolerances. For convenience, the term "know-how" will be used to apply to any of the foregoing.

The Analogy of Patent Licensing

Validity of Analogy

Efforts have been made to analyze know-how licensing restrictions in the same way as one would analyze licensing restrictions based on a product patent or a use patent. Such an analysis raises several problems, however. In the first place, the analogy to patent licensing may be faulty. A know-how agreement would appear more usually to be analogous to a license under a process patent, rather than one under a product or use patent. For example, as soon as most products are sold there is nothing secret about them, and they are automatically in the

¹¹ *Pillsbury Mills*, 50 F.T.C. 555 (1953).

¹² *Brown Shoe Co. v. United States*, 370 U.S. 294 (1962).

¹³ *United States v. Columbia Steel Co.*, 334 U.S. 495 (1948).

public domain. What is secret and valuable (if anything is), what corresponds to what would be claimed in a patent, and what is the subject of the know-how license agreement, is usually the knowledge of how to make the product, that is, the process for manufacturing the product.

Product Restrictions Based on Process Patents

The case law on process patents would seem to be that a patentee may not impose territorial or other restrictions on the sale of the unpatented product resulting from the patented process.¹⁴ In the case of a patent license, any commercially significant restrictions of this type would constitute violations of the antitrust laws. By parity of reasoning, the same principle would appear to apply to know-how. Surely, the know-how on which a license may be based cannot support any more of a restraint on the sale of licensed goods than a patent could. Probably, it cannot support as much of a restriction.¹⁵

Preferred Legal Status of Patents

This is so—and it is submitted that here we come to the more important consideration—because the patent is, after all, a statutory monopoly decreed by Congress and the Constitution as a limited exception to our general free enterprise policy against monopolies.¹⁶ A know-how agreement, even though the know-how might be substantial, valuable, and secret, cannot rely upon any such statutory or constitutional policy which would sustain an exception to the antitrust laws. Moreover, since know-how does not have to follow the rules of the patent system—with regard to novelty, utility, inventive level, sufficiency and clarity of disclosure, and the like—the general public receives no *quid pro quo* of a substantial addition to the common store of knowledge, as it does after the expiration of the 17-year patent monopoly.

For these reasons, restrictions which might be tolerated in the case of a license under a valid patent, in order to accommodate the complementary policies of the patent system and the antitrust laws, might well

¹⁴ *Barber Colman Co. v. National Tool Co.*, 136 F.2d 339 (6th Cir. 1943); *see Cummer-Graham Co. v. Straight Side Basket Corp.*, 142 F.2d 646 (5th Cir. 1944), *cert. denied*, 323 U.S. 726 (1944). More generally, ownership of a process patent does not confer rights over the product of the process. *See Merrill v. Yeomans*, 94 U.S. 568 (1877); *Welsbach Light Co. v. Union Incandescent Light Co.*, 101 Fed. 131 (2d Cir. 1900); *In re Amtorg Trading Corp.*, 75 F.2d 826, 832-33 (C.C.P.A. 1935). *But cf.* Tariff Act of 1930, § 337, as amended, 19 U.S.C. § 1337-1337a (1964).

¹⁵ *See* Stedman, "Legal Problems in the International and Domestic Licensing of Know-How," *A.B.A. Antitrust Section Proceedings*, Vol. 29 (1966), 247, 253.

¹⁶ *See* *Lear, Inc. v. Adkins*, 395 U.S. 653, 663 (1969).

be prohibited in the case of a know-how agreement. This does not compel the conclusion that know-how agreements may not be accompanied by any restrictions or limitations whatsoever. But it surely demands, at the very least, that the parties must do more than cite the analogy of permissible patent restrictions. Instead the parties would seem to be subject to the general law and policy governing all business agreements.

Competing Policies and Theories

Accordingly, the further question has to be asked—even though we cannot properly treat international know-how licenses as if they were international patent licenses—is there reason, nonetheless, to give these know-how licenses preferential status under the general law rather than to leave them subject to the general antitrust per se rule against division of territories or markets? The matter is by no means free from doubt, and the writer hesitates to predict what courts would ultimately hold in this area. It is, therefore, worth considering some of the possible policy arguments which may be made on either side of the issue.

Entry Theory

It may be argued that a transferor of know-how, like the owner of domestic and foreign product patents, is entitled to a reasonable and limited period of territorial protection to induce licensing—to make possible a new entry into the field. Hence, provided that the restriction is kept within proper limits, in the end there may be more rather than less competition as a result of the transaction. By analogy, certain otherwise objectionably restrictive distribution practices (although not territorial limitations on one's distributors) have been tolerated, under the antitrust laws, in order to encourage or permit the entry of a "struggling newcomer" into the market.¹⁷ A territorial sales restraint on goods made with licensed know-how, it may be argued, will not have a substantial adverse effect on competition and should be permitted where (1) the know-how is essential to the licensee's entry into the market, (2) the know-how is unavailable from alternative, restriction-free sources, and (3) the restraint is limited in time to approximately the break-in period.

Relevance of Licensor's Intransigence

In the writer's view, the foregoing test probably represents the outer limit of permissiveness toward territorial sales restraints in know-how

¹⁷ See note 8 *supra*.

licensing. There are, of course, factors tending in the contrary direction—policies opposing authorization of such restraints beyond this outer limit and suggesting even more circumscribed boundaries for them—and, it is submitted, they would appear to carry the day. In the first place, that a party to a know-how agreement may desire to restrict an existing or potential competitor and will refuse to deal without the guarantee against competition, is not a sufficient basis, in itself, to sustain the validity of the territorial restriction. This is clear from the decisions of the Supreme Court. Thus, the Court has said that “the promotion of self-interest alone does not invoke the rule of reason to immunize otherwise illegal conduct.”¹⁸

Incentive to License

Nor, does it appear, is a territorial restriction on the place of sale of licensed goods to be justified by reference to public policies favoring the dissemination of technology. In fact, there are strong incentives for the sale or licensing of technology, which assure that it will normally take place to a substantial extent without the inducement of allowing continuing anticompetitive arrangements. These incentives include the advantage to the licensor of royalty payments, the demand by customers for alternative sources of supply, the licensor's unwillingness to invest in additional production facilities, and the licensor's concern about competitors' inventing around the technology. Moreover, the licensor will seek to recoup, by means of the royalty charge, any economic loss anticipated by reason of the licensee's competition.

That there exist substantial domestic patent and know-how licensing programs of American corporations, with minimal incidence of restrictive licensing practices,¹⁹ would seem to indicate that the economic risks in licensing one's competition do not, in general, unduly hinder the transfer of technology in return for the payment of reasonable royalties.

Such considerations should be even more applicable in the case of international technology licensing. Transportation costs and applicable tariffs are, to some extent, always a shield for the licensor against competition from his licensee. It therefore seems to be wholly unnecessary to authorize still further restrictions in order to encourage and promote the dissemination of technology by licensing.

¹⁸ *United States v. Arnold, Schwinn & Co.*, 388 U.S. 365, 375 (1967).

¹⁹ See S. Chesterfield Oppenheim and John C. Scott, “Empirical Study of Limitations in Domestic Patent and Know-How Licensing: A Second Report,” *IDEA*, Vol. 14, Conference Number 1970, p. 123.

Potential Competition

Finally, even if a case could in some way be made for the thesis that possessors of know-how would refuse to sell or license it unless they were allowed to limit the foreign buyer or licensee from using it to make goods sold in the United States, it would not follow that the limitation should be regarded as proper. As Professor Stedman had observed, know-how denied is not irretrievably lost to the market.²⁰ The prospective licensee should not be presumed to be incapable of duplicating the technology or else developing an alternative, thereby making a restriction-free entry into the market.²¹ Moreover, the performance of the licensor and others in the market may well be better, if there are several restriction-free potential entrants waiting on the sidelines, than if one of them enters upon the stage by means of the licensor's know-how but remains subject to the restrictions contained in the license.²²

Minimization of Risk

For these reasons, the ultimate rule of law that the courts decree in this area may well be to proscribe all territorial limitations on the place of sale of goods made with licensed know-how, which is to say, to apply the general rule against division of markets, because there is no sufficient counter-policy arguing against its application here as it is applied elsewhere—and this, even if the parties can show that the know-how is essential to entry, that it is unavailable on other, less restrictive terms, and so forth. Nevertheless, even though the presence of these mitigating factors may not be deemed wholly exonerative of the agreement, their presence at least tends to decrease the impact of the restriction on competition and thus decreases the likelihood of litigation's taking place.

Once again, therefore, the draftsman or counsellor may consider the avoidance of litigation as a goal, even if he is uncertain as to the

²⁰ Stedman, *supra* note 15.

²¹ One of the recognized benefits of the patent system, for example, is the encouragement of "innovation around" the subject matter of patents—the result of this being that the public gets the benefit of further increments to technology as a result of such competitive efforts to avoid the reach of the monopoly grant. *See Chicago Steel Foundry v. Burnside Steel Foundry Co.*, 132 F.2d 812, 816 (7th Cir. 1943); *James P. Marsh Corp. v. United States Gauge Co.*, 129 F.2d 161, 165 (7th Cir. 1942). It would not appear that there is any reason to believe that what holds for domestic competition does not apply internationally.

²² *See United States v. Penn-Olin Chemical Co.*, 378 U.S. 158, 174 (1964).

outcome if such lightning strikes his license. To achieve that goal, he should avoid inserting territorial restrictions out of force of habit rather than actual business need. He should limit their duration to approximately the period the licensee would have in any event required to break into the market. And he should consider the checklist of various other factors previously discussed in connection with the analogous patent licensing problem.²³ By so doing, he can at least minimize antitrust risks.²⁴

THE DIRECTION OF THE LAW

In attempting to analyze the direction of the antitrust laws in this area, the writer has tried to avoid—not always successfully—talking in terms of absolutes rather than more or less. This is not because of an allergy or objection to absolutes as a matter of principle—for antitrust has a few absolutes, like patent tie-ins²⁵ or restraints on alienation.²⁶ Absolutes have very definite advantages, as Justice Black has noted, in terms of administrative and judicial economy and certainty to the business community and its advisors.²⁷ But this is too early a stage of

²³ See p. 584 *supra*.

²⁴ What has been said previously about patent licenses and know-how agreements applies with equal force to mixed patent and know-how licenses. Such mixed licenses present a further problem, however, which may arise from the difficulty in separating the components of the license from one another. It has been suggested in this paper that territorial limitations on the place of sale of licensed goods in international patent licensing arrangements will be deemed permissible or impermissible on the basis of the economic circumstances of the case; but that the courts may ultimately hold that territorial limitations on the sale of goods made with licensed know-how are wholly impermissible. Application of such rules becomes difficult in mixed patent and know-how agreements when it is uncertain, as to a particular product, whether the licensed technology yields goods that infringe a domestic product patent.

As indicated *supra* at pp. 586-7, with respect to product scope uncertainty, it would appear that the draftsman who wishes to minimize antitrust risks and at the same time protect the legitimate interests of the licensor and licensee should make a serious effort to separate out the various components of the license. The desired end is that the licensee be reasonably able to determine, in the case of all licensed products that he manufactures, whether and the extent to which such products infringe the licensor's domestic product patents. To the extent that the licensor is unwilling to minimize the licensee's uncertainty as to his legal rights by separating the know-how and patent licenses from one another, it may be argued that the licensor should not be entitled to impose any territorial limitations on the licensee's place of sale of the licensed goods.

²⁵ *International Salt Co. v. United States*, 337 U.S. 322 (1947).

²⁶ *Boston Store v. American Graphophone Co.*, 246 U.S. 8 (1918); see *United States v. Glaxo Group Ltd.*, 302 F Supp. 1, 8-11 (D.D.C. 1969).

²⁷ *Northern Pacific R.R. v. United States*, 356 U.S. 1, 5 (1958).

the analysis of international technology agreements to permit one to know surely which absolute, if any, to grasp.

The tentative character of any proposed rules of thumb in this area is the inevitable concomitant of the state of the case law. This was so, as previously indicated, only a few years ago in the horizontal merger field.²⁸ Similarly, the relation of *Times-Picayune*²⁹ to *Northern Pacific*³⁰ for nonpatent tie-ins, and that of *White Motor*³¹ to *Schwinn*³² for geographic distribution restraints on resale, illustrate the same potential for movement from an elaborate analysis of all the "economic stuff" to a focus on a few, select factors. It is to be hoped that the courts will be forthcoming with similar guidance in this field. Until then, however, it would appear that lawyers will have to take refuge in a case-by-case approach—calculating the risk of drawing litigation and the probable outcome of litigation as best they can. This is not a deplorable state of affairs, however, for it is the path the common law has successfully followed in all fields—and it is far preferable to a hasty generalization or ukase from some arbitrary, single font of authority.

In the meantime, the approach that has been suggested here may seem over-conservative (although the author does not so regard it), in terms of forestalling a misuse or antitrust defense or insuring against a treble damages suit or counterclaim or an equity suit by the government.³³ The business risk of following non-conservative antitrust counsel, however, may be severe. In any event, it would seem that most major American licensors follow practices based on analyses similar to that suggested here.³⁴ Apparently, the benefits of the contrary course—that is, the business value of a territorial restriction—will not justify the contingent liability of taking non-conservative advice. The result has been, as it has been generally in the patent-antitrust field, that the predictions and counseling of many practitioners have anticipated the development of the case law.

Since the large majority of licensors seem to have been able to

²⁸ See pp. 588-9 *supra*.

²⁹ *Times-Picayune Pub. Co. v. United States*, 345 U.S. 594 (1953).

³⁰ *Supra* note 20.

³¹ *White Motor Co. v. United States*, 372 U.S. 253 (1963).

³² *United States v. Arnold, Schwinn & Co.*, 388 U.S. 365 (1967).

³³ See note 2 *supra*.

³⁴ The statement in text is based on the writer's personal experience and the comments of other lawyers; he is aware of no published empirical data on the relative incidence of territorial limitations in international technology licensing. But see Behrman, "U.S. Companies as Licensees Under Foreign-Owned Patents, Trademarks, and Know-How," *P.T.C. J. Res. & Ed. (IDEA)*, Vol. 5, No. 1 (1961), pp. 16, 21-22. With respect to domestic license restrictions, see Oppenheim and Scott, *supra* note 19 at p. 148.

conduct their affairs satisfactorily without trying to see how close to the Plimsoll Line it is possible to load the ship, it is probable that the courts will eventually adopt the same rules that they and conservative antitrust lawyers have been using, without any undue damage to legitimate business expectations or the security of transactions. In the interim, as the case law fills in the uncharted parts of the map where as yet there are only lawyers' tales that "heere there be tygers," it would seem reasonable to predict that the courts and other agencies of government in determining equitable enforcement policy will believe that (as the Supreme Court has declared in connection with another regulatory law) it would not be "unfair to require that one who deliberately goes perilously close to an area of proscribed conduct shall take the risk that he may cross the line."³⁵ Such considerations would appear to warrant particular scrutiny in the field of international licensing, in which law enforcement is just beginning to catch up with the advice of the private Bar.

³⁵ *Boyce Motor Lines v. United States*, 342 U.S. 337, 340 (1952).

Technological Transfer and Skill Conservation: A Modest Proposal

IRVING H. SIEGEL*

A TEMPORARY PROJECT

THIS PAPER PROPOSES THE ESTABLISHMENT OF a temporary federal project that would link and advance two national purposes widely recognized as vital. One of these purposes is to help maintain our national resource of specialized manpower—more explicitly, to give transitional work to some of the tens of thousands of scientists, engineers, and trained technicians who are ironically celebrating with unaccustomed joblessness this jubilee year of the Employment Act of 1946. We say “transitional” because—in the light of past economic experience, of extensive unmet social needs, and of projections made by the Department of Labor—the demand for specialized manpower as a category should soon rebound strongly, even though the demand for senior and formerly well-paid individuals may remain sluggish. The second, and coordinate, purpose of the proposed project is to facilitate productive industrial application of some of the research findings generated at a cost of tens of billions of dollars of public funds during the past two decades. Initial or more extensive industrial utilization of such research could substantially improve the nation’s competitive position in domestic and foreign markets that no longer are secure.

Two general ways of expediting technological transfer are conceivable, and the charter of the project should allow for both in an agreeable mix. Both ways would make use of the same body of information that has been generated under public sponsorship and is releasable for nonexclusive, royalty-free use. In particular, both would draw upon

* Dr. Siegel, an independent economic and management consultant, has been on the staff of the PTC Research Institute since the beginning of its research activity.

documents stored in the Clearinghouse for Federal Scientific and Technological Information (Springfield, Virginia) and in various other federal facilities, such as the National Library of Medicine. The first general way of aiding technological transfer is to organize teams of persons who have preferably had first-hand experience in the aerospace, defense, atomic energy, or other government-aided industries and to send these teams into the field for teaching, demonstrating, and exhibiting available processes, products, or materials. The second general way is literary—the use of qualified teams for retrieving information from eligible federal data banks and then abstracting, digesting, tailoring, or otherwise repackaging the results to meet the needs of probable or actual customers.

A CLOSER LOOK

The first general mode of promoting technological transfer, through the use of mobile teams operating in the field, should be construed liberally to allow the counterflow of customers to project offices. Thus, the teams or its members might also provide counsel and briefings to visiting individuals or groups of industry representatives.

Federal precedents for both general modes of promoting technological transfer are numerous, but attention should be called especially to pertinent current activities of the Small Business Administration. This agency has a "technology utilization program" that aims at "keeping the small manufacturer informed concerning technological advances and motivating him to apply relevant innovations, new processes, techniques and materials." Through this program, it "brings small manufacturers in contact with the wealth of scientific and engineering information generated by government-sponsored research and development." It taps the store of technical knowledge that has been accumulated by National Aeronautics and Space Administration, Atomic Energy Commission, and other agencies; digests reports available in the Federal Clearinghouse; and disseminates copies of patents on government-owned inventions. It makes use of "conferences, seminars, workshops, individual counseling, and publications."¹ It offers "direct counseling by mail, phone, or personal interview at its field offices or during onsite visits to the small businessman's plant."²

¹ This quotation and preceding ones are from *Management and Technical Assistance*, Small Business Administration (1968), p. 15.

² *Selected Advances in Metalworking Technology*, Small Business Administration (1970), p. 1.

Whether the project is organized to use field teams or as a literary undertaking, branches could be established in or near the home cities of most unemployed scientists, engineers, and trained technicians. Opportunities for the decentralization of project activities are implicit in the availability of microfiche copies of documents on file in the Federal Clearinghouse. They are also implicit in the existence of 42 field offices of the Department of Commerce, 64 field offices of the Small Business Administration, and patent depository libraries in 13 states.

The temporary national project that we envisage could either be attached to a permanent government agency or be set up as a separate entity. Whichever alternative is preferred, we should look forward to liquidation of the project as the economy experiences a decisive renewal of employer interest in the skills of dislodged scientists, engineers, and technicians and of jobless recent graduates. Liquidation of the project, however, is not the same as liquidation of the national purpose of more effective use of applicable or adaptable technology generated at great expense. Determined technological transfer could, in principle at least, remain a function of a permanent agency even after a temporary project is dismantled. This fact would argue assignment of the project to a permanent federal agency, but any enthusiasm is chastened by recall of the unfortunate fate of the statutory program for diffusing technology that had been established under the State Technical Services Act of 1965. This program, conducted by the Department of Commerce in support of state and interstate efforts "to place the findings of science usefully in the hands of American enterprise," has been allowed by the Congress to lapse for want of funds despite the conclusion reached in 1968 by a Public Evaluation Committee:

We believe this is a good program for America. The law has been tested for three years. Much energy, thought and imagination has been given to it. It is clear that the time has come to greatly increase appropriations for the program at the national, State and local levels. We believe the program must grow in order to survive. It would be a tragedy for it to die.³

A CAUTION

We should caution against casual dismissal of the proposed temporary project as "just another WPA." First of all, as already noted, the

³ *Growth Through Technology*, Final Report of the Public Evaluation Committee for the State Technical Services Act of 1965 Presented to the Secretary of Commerce (November 14, 1968), p. 5.

project need not be set up as an independent entity; it could be administered, for example, by a pertinent old-line federal agency such as the Department of Commerce. Second, the project need not be administered to engage a large proportion of the idle technical manpower—and thereby to interfere, perhaps, with normal or more permanent reemployment. The scale of the project might be determined, for example, according to a cost-effectiveness comparison with alternate approaches that have already been suggested or adopted. Third, despite the aim of transitional assistance, the project would not exemplify charitable action by government as “employer of last resort.” Rather, the coordinate purpose of facilitating technological transfer to improve the competitiveness of American industry acknowledges a significant probable benefit to the nation and confers a “first-resort” urgency on the undertaking.⁴

Finally, the common overidentification of WPA with “leaf-raking” or “boondoggling” or “shovel-leaning” ignores that temporary agency’s critical role of protecting the nation’s tinier base of technical manpower in the 1930’s for decisive achievement during and after World War II. How timely still seems this paragraph in the letter of transmittal of a pioneer WPA report on industrial research, a report published when the number of *employed* research workers was apparently much smaller than the number of their presently *unemployed* counterparts:

The rapid growth of industrial research has been an important source of employment for an increasing number of specially trained persons, but the rate of absorption of such persons by industry has not been as great as the rate of training them by our schools. There are today many capable scientists whose knowledge and training are being largely wasted because they are either unemployed or working at jobs which do not make use of their specialized skills. It has been one of the tasks of the WPA to provide special projects for the useful employment of highly trained scientists whose services were not being used by industry.⁵

⁴ On the role of government as “employer of first resort,” see I. H. Siegel, ed., *Manpower Tomorrow: Prospects and Priorities* (New York: Augustus M. Kelley, Publishers, 1967), pp. 14-17.

⁵ Quoted from letter of Corrington Gill, Assistant Commissioner of Work Projects Administration, to F. C. Harrington, Commissioner, in George Perazich and P. M. Field, *Industrial Research and Changing Technology*, WPA National Research Project on Reemployment Opportunities and Recent Changes in Industrial Techniques (Philadelphia: January 1940), p. v. The same letter cites a 1938 figure of 50,000 for “research scientists, technicians, and assistants employed by American industry.” At a White House press conference on March 3, 1971, an Assistant Secretary of Labor estimated “about 60,000 engineers, scientists, and high-level technicians . . . currently out of work” and an annual production rate of scientists and engineers of “about 35,000 . . . from college.”

Institute Schedules Special Conference on R&D, Technological Education, and Industrial Property: Policy Correlations for the 1970's

A Special Conference of Invited Experts has been scheduled by the Institute to explore government and private stakes and responsibilities in R&D, technological education and industrial property to better plan our national priorities as we move through the Seventies.

The cutback in funds for Research and Development has intensified in the last few years. It has special significance for the "Science Policy" of the U.S., and if it results in a weakening of our "Knowledge Industry"—that is, R&D and higher education, especially in science and engineering—will undermine our position in world markets. The significance of the reduction of funds for R&D reaches beyond sales and earnings; it could profoundly affect the present and future technological and economic well-being of the U.S. and the progress of the less developed countries.

There could be another major, albeit more subtle, effect of the reduced support for R&D. The conduct by government and by private industry of R&D requires an ade-

quate output of scientists and engineers from our schools. When this support is diminished, the demand for talent is affected and centers of education are weakened. This, too, would seriously depress the vigor of our technological progress and our economic condition.

Accordingly, the Institute is holding this special Conference on May 20, 1971 at the Twin Bridges Marriott in Washington, D.C. Speakers of prominence will make the main presentations on the following topics:

- (1) New Conditions and Problems of the "Knowledge Industry," National and International;
- (2) New Challenges to Patent, Know-How, and Other Industrial-Intellectual Property Rights;
- (3) Antitrust and Competition Policy in New R&D Setting; and
- (4) Emerging Needs in Tax Policy Concerning Research and Education.

Clinics on International Trademark Protection and Joint Ventures Abroad to Be Published

As part of the Institute's continuing professional educational program, a Clinic on "International Trademark Protection: Private Interests and Public Programs" was held on January 27, 1971 at the Institute headquarters in Washington, D.C. The experts invited to the Clinic contributed their special expertise in trademark problems and practices here and abroad with particular reference to the following topics:

- (1) National Laws and International Conventions and Treaties: Implications and Interactions;
- (2) Multiple-Country Filing: Madrid and Its Alternatives;
- (3) Trademark Protection and Enforcement Abroad; and
- (4) Unfair Competition in Trademarks Abroad.

Another Clinic on "Joint Ven-

tures Abroad: Industrial Property, Taxation, and Competition" was held at the Institute headquarters on March 31. Here invited experts in this area discussed papers on the following topics:

- (1) Business Organization for Joint Ventures;
- (2) Joint Ventures and the Patent, Trademark, and Know-How Laws;
- (3) Joint Ventures and the Anti-trust and Unfair Competition Laws; and
- (4) Joint Ventures and the Tax Laws.

The information and perspectives revealed in both Clinics by the in-depth interchange of experiences, opinions, and proposals by experts will be made available to our readers in the edited proceedings which will be published in subsequent issues of *IDEA*.

Derenberg to Receive 1970 Kettering Award

Walter J. Derenberg, eminent scholar in trademark, copyright and unfair competition law, has been named the Kettering Award Recipient for 1970. The Award will be presented to Professor Derenberg at the Institute's Fifteenth Annual Conference to be held in Washington, D.C. in October.

Born in Hamburg, Professor Der-

enberg has been teaching at the New York University School of Law since 1935. He received his Jur. D. from the University of Hamburg in 1926 and from New York University in 1938. Since 1951 he has been a partner in the firm of Von Maltitz, Derenberg, Kunin & Janssen of New York. From 1947 to 1950 Professor Derenberg served

as Counsel (for trademark matters relating to the Lanham Act) to the U.S. Patent Office.

Active internationally, Professor Derenberg served from 1950 to 1967 as Chairman of the Trade Marks Committee of the International Law Association (and in the same capacity for the American Branch). He was also a member of the Executive Committee of the American Branch of AIPPI. In 1966 as a Fulbright Professor he lectured at Waseda University in Tokyo and at Osaka and Kyushu Universities. Professor Derenberg is the author of two textbooks, *Warenzeichen und Wettbewerb in den U.S.A.*, dealing with U.S. trademark and unfair competition law, and *Trademark Protection and Unfair Trading*.

In the field of copyright law, Professor Derenberg has since 1953 been a member of the Panel of Consultants Appointed by the Librarian of Congress for the Revision of the U.S. Copyright Law. He was one of the founders of the Copyright Society of the U.S.A., served as its President from 1957 to 1961, and is now an Executive Director of the Society and chairman of the Editorial Board of its *Bulletin*.

Named in honor of the late Dr. Kettering, Chairman of the Board of the Charles F. Kettering Foundation and a Director and Research Consultant to the General Motors Corporation, the Award is presented annually by The PTC Research

Institute for outstanding work in research and education in the fields of invention, innovation, patents, trademarks, copyrights and related areas. Dr. Kettering aided in the formal establishment of the Institute in 1954 and served as a member of its Advisory Council until his death in 1958.

Previous recipients of The Charles F. Kettering Award were: Charles Stark Draper, President, Charles Stark Draper Laboratory Division, The Massachusetts Institute of Technology—1969; John M. Olin, honorary chairman of the board, Olin Mathieson Chemical Corporation—1968; Stephen P. Ladas, senior partner, Langner, Parry, Card & Langner—1967; Lawrence R. Hafstad, vice-president in charge, General Motors Research Laboratories—1966; David Sarnoff, chairman of the board, RCA Corporation—1965; Edwin H. Land, president, Polaroid Corporation—1964; Giles S. Rich, Judge of the U.S. Court of Customs and Patent Appeals—1963; Joseph W. Barker, former chairman of the board, Research Corporation—1962; Vannevar Bush, past president, Carnegie Institution—1961; Jo. Baily Brown of Brown, Critchlow, Flick & Peckham—1960; the late Frank A. Howard, chairman, Sloan-Kettering Institute for Cancer Research—1959; Robert C. Watson, former Commissioner of Patents—1958; S. Chesterfield Oppenheim, former Professor of Law, University of Michigan—1957.

Fourteenth Annual Conference Number Published

Selected papers from the Fourteenth Annual Conference are published in Volume 14, Conference Number 1970 of *IDEA*. The Conference theme is "Industrial Property in Today's Competitive Setting."

The Conference is divided into four parts relating to the major areas of Institute research. That research and current issues are discussed in the following sessions:

- A. Computer Program Protection;
- B. Trademarks in World Markets;

- C. Managing Technology and Enforcing Rights (including company innovation, international industrial property rights, and costs of litigation);
- D. Antitrust and Unfair Competition (including patent licensing limitations and franchising and trade secrets).

Also in the published proceedings is the Kettering Award Address given at the luncheon session in his honor by Award recipient for 1969, Charles Stark Draper, who spoke on "Technology, Creativity and the Changing Social Environment."

Founders Day Award Presented to P. J. Federico

The PTC Research Institute is pleased to announce the selection of P. J. Federico as the recipient of the 1971 Founders Day Award for Distinguished Government Service.

Mr. Federico recently retired as Examiner-in-Chief of the U.S. Patent Office after 47 years of continuous service. His career in the Patent Office included chairmanship of a committee which prepared the Rules of Practice of the U.S. Patent Office in Trademark Cases in preparation for the coming into force of the new Trademark Act in 1947, and chairmanship of the committee which in 1948 revised the Rules of Practice of the U.S. Patent Office in Patent Cases. He has been called

upon to prepare patent legislation and appear before committees of Congress dealing with patents and trademarks and served as technical adviser to the chairman of the Patent, Trademark and Copyright Subcommittee of the Committee on the Judiciary of the House of Representatives in the preparation and passage of the Patent Act of 1952 which revised and codified all the patent statutes.

Mr. Federico has also worked with the Department of State in an advisory capacity in connection with treaties and other international matters in the field of patent and trademark law arising in the Department. In 1958 he was a member

of the U.S. Delegation at the diplomatic conference held in Lisbon to revise the Convention for the Protection of Industrial Property (the multilateral treaty relating to patents) and has attended various international conferences and meetings on behalf of the Patent Office or Department of State.

In 1923, Mr. Federico received a B.S. degree in physics from Case-Western Reserve University. He also holds a degree of M.A. in mathematics from The George Washington University and received a J.D. from the Washington College of Law of the American University in 1932. He is a member of the Bar of the District of Columbia and of the United States Supreme Court.

An author of many articles in the field of patent law and Patent Office activities, Mr. Federico was from 1935 to 1941 editor of the *Journal*

of the Patent Office Society. His writings, particularly the Commentary on the New Patent Act which appears in the *U.S. Code Annotated*, Title 35, have frequently been cited by the courts. He has also contributed patent articles to the *Encyclopedia Britannica*. Mr. Federico has written on the inventions of Oliver Evans, the invention of the zipper, and Eli Whitney's patent. He has contributed several articles to professional mathematical journals.

Mr. Federico is presently a consultant on patent law with the firm of Cushman, Darby and Cushman, Washington, D.C., and a Professorial Lecturer in Law of The George Washington University.

The previous recipient of the Founders Day Award for 1970 was Judge Giles S. Rich of the Court of Customs and Patent Appeals.

Institute Monograph on Environment Attracts Wide Interest

Copies of the Institute's monograph, "Air and Water Depollution: Roles of Industrial Property, Innovation and Competition" are being ordered by a widely diversified audience of interested people. Comprising the complete edited proceedings of a Special Conference of Invited Experts on this subject which took place on March 31, 1970 in Washington, D.C., the monograph contains significant informa-

tion not previously available on these two areas of major concern in the current national crisis in environmental contamination.

Emphasis is placed on the contributions of the patent and other industrial property systems. Attention is also directed to antitrust factors involved in sanctioning cooperation among private parties in technically based organizations seeking to meet the changing environmen-

tal needs of the country.

Copies of the monograph may be ordered from The PTC Research Institute, The George Washington

University, Washington, D.C. 20006. The price is \$5 per copy for members of the Institute and \$7.50 for nonmembers.

Neil A. Smith Receives Patent Office Society Student Award

Neil A. Smith, a graduate student in Patent and Trade Regulation at The National Law Center of The George Washington University, was the 1970 recipient of the Patent Office Society Student Award for his paper "Fraud Upon the Patent Office As a Violation of the Sherman Antitrust Law."

The award program is open to all the law schools in the District of Columbia including American, Catholic, Georgetown, George Washington and Howard Universities.

The Award, consisting of a cita-

tion from the Institute and an honorarium contributed by the Society, will be presented to Mr. Smith at the annual Patent Office Society banquet to be held in May. On this occasion a citation will also be given to Joel M. Freed for his paper representing Georgetown University, entitled "*Shapiro, Bernstein and Company v. Goody Revisited: Judicially Sanctioned Restraint on Alienation and Double Satisfaction.*"

Mr. Smith's paper is published in this issue under the "Student Papers" section.

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Proceedings
Fourteenth
Annual Conference

**October 29, 1970
Washington, D. C.**

**The PTC Research Institute of
The George Washington University**

*Industrial Property in Today's
Competitive Setting*

The Conference

The Fourteenth Annual Conference of The PTC Research Institute dealt with "Industrial Property in Today's Competitive Setting."

Last year the Thirteenth Annual Conference focused on "Technical Knowledge: Its Protection, Use and Flow." The previous Annual Conference was directed to the Report of the President's Commission on the Patent System.

At the Fourteenth Annual Conference the staff of the Institute and outside contributors discussed Institute reports and current issues relating to major areas of Institute research: Computer program protection; trademarks in world markets; managing technology and enforcing rights, including company innovation, international industrial property rights, and costs of litigation; antitrust and unfair competition, including patent licensing limitations and franchising and trade secrets. The luncheon session honored the Charles F. Kettering Award recipient for 1969, Charles Stark Draper, who spoke on "Technology, Creativity and the Changing Social Environment."

The research work of The PTC Research Institute represents the first university attempt at a comprehensive study of the patent, trademark, copyright and related systems in the United States. This study is systematically planned and coordinated, inter-disciplinary in nature and utilizes a combination of specialties such as economics, statistics, psychology, sociology, and law; and empirical, that is, based on the facts gathered by the staff on the actual operation of the systems.

In attendance at the Conference were key representatives from different fields of activity throughout the nation: commerce, education, science, manufacturing, finance and government.

The presentation of the proceedings of the Institute's Annual Conference this year comprises the principal contributions. These contributions, submitted for publication by the participants, are set forth below as separate papers and are published in this Conference Number in the order in which they appeared on the Conference program. Although it is our custom to print the edited version of the verbatim presentation, several of the participants upon their request substituted more

complete papers or reports. In view of the time constraint, these authors were not able to make complete presentations at the Conference. Robert Kramer, Dean of The National Law Center of The George Washington University, welcomed the participants to the Annual Conference. In addition to the authors whose papers appear in this issue, the following Moderators and Contributors also participated:

<u>Name</u>	<u>Capacity</u>	<u>Session</u>
John H. Schneider	Moderator	Trademarks in World Markets
Stuart P. Greene	Contributor	
Theodore L. Bowes	Moderator	Managing Technology and Enforcing Rights
Robert A. Klayman	Contributor	
George E. Frost	Moderator	Antitrust and Unfair Competition
Richard F. Dole, Jr.	Contributor	
Sigmund Timberg	Contributor	

A. COMPUTER PROGRAM PROTECTION

Proprietary Rights in Computer Software Inventions: Preliminary Results of Two Surveys

HERBERT R. KOLLER*

BACKGROUND

AS PART OF A CONTINUING STUDY of legal protection for computer software inventions, The PTC Research Institute has previously published two reports. One summarized the current situation in this field in the United States, including the issues which have developed in response to new legislative proposals and new policies and procedures in the Patent Office and the Copyright Office.¹ The second paper reported on the discussions conducted at a Clinic sponsored by the Institute to explore previously proposed new forms of protection and to develop additional alternatives.²

* Research Associate, The PTC Research Institute; Executive Director, American Society for Information Science.

¹ *IDEA*, Vol. 12, No. 4 (Winter 1968-1969), pp. 1109-1127.

² *IDEA*, Vol. 13, No. 3 (Fall 1969), pp. 351-372.

Recently two questionnaire surveys have been conducted and the preliminary results are noted here. One questionnaire was designed to elicit information about the current law and practice, as well as proposed changes, in this area in foreign countries. The other was developed to investigate the attitudes within several groups of interested organizations toward the routes for protection which are now available or which have been suggested.

THE INTERNATIONAL QUESTIONNAIRE

A number of foreign patent offices were asked a series of questions to determine the status of their laws which are concerned with patent and copyright protection of inventions in the area of computer programming. At this time only 14 responses have been received. In general, at least as it appears from the results so far, few countries have yet made provisions in their law for this new field of technological development. Only 1 respondent indicated any existing statutory provision for patents on computer programs. In that country, France, no such patents have yet been granted.

No country reported the existence of specific statutory provisions for computer programs in their copyright law. However, the response from Canada stated that copyright registration has been granted to one application. Only 1 response, that from the U.K., stated that a specific statutory provision is being considered with respect to software protection. Three replies, from the Netherlands, Australia and Great Britain, indicated that cases have been litigated involving protection for software.

No countries' replies showed that short-term patents, petty patents or *gebrauchsmuster* are available for computer programs; it is possibly the case that general provisions relating to these forms would also be applicable to inventions in the software field.

With respect to the form in which software inventions should be claimed, 1 country's reply stated that a machine claim would be appropriate. None indicated that process claims were preferred. Three replied that they have not yet had to face the problem and said, at this point in the questionnaire, that such inventions are probably not patentable.

With respect to the classification of software patents, 9 countries indicated that no specific provision is made in the national classification, 1 indicated that software inventions would be classified as ma-

chine, 2 indicated that whatever provisions existed in the International Patent Classification System would be used, and 2 stated that classification would depend on the form of the claim.

THE DOMESTIC QUESTIONNAIRE

A questionnaire was sent to a number of organizations having the following interests: Professional societies, trade associations, software companies, computer manufacturers, peripheral equipment manufacturers, and industrial users of computer services. So far only 6 replies have been received; of the others, 3 declined to answer the questionnaire and the rest have not yet responded. The 6 positive responses were received from 1 professional society, 1 main frame manufacturer and 4 software companies. They have been analyzed as follows:

As to the adequacy of the protection available from any of the current forms of legal protection, 4 indicated that they are adequate, 2 said they are not. Of the 4 that indicated adequacy, 2 prefer patents and 2 prefer contracts. On the question of the most widely favored forms of protection which are now available, 5 replied that contracts were preferable, and 1 did not reply; none said that copyrights, trade secrets, or patents are the favorite. With respect to which of the available forms are used in the respondents' organizations, 1 noted copyrights, 4 contracts and 1 did not reply. On the question of which form of protection is the strongest 1 stated that copyright offers the strongest protection, 1 trade secret, 1 contract, and 3 patents.

On the question of ease of detecting violations of rights, 1 indicated copyrights, 2 contracts, 2 did not reply, and 1 indicated no difficulty in any of these; none felt that violations of trade secrets or patents are the most easily detected. Regarding the question of whether trademark registration would be an appropriate form of protection, all respondents agreed that it would not. In response to whether copyright protection would be preferable, provided that it also protected use of the program, 4 said yes and 2 said no.

As to whether short term patents would be favorable, provided that at least a minimal search would be made prior to the grant of the patent, 3 favored this practice, 2 were opposed, and 1 was uncertain. Regarding the question of whether oppositions for patents in this field would be desirable, 2 said yes, 2 said no, 1 was uncertain and 1 did not reply.

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A question was also asked as to the proper classification of inventions in this field. One reply showed a preference for process, 1 broadly proposed intellectual property, 2 favored machine *and* process, 1 indicated that no existing classification was appropriate, and 1 did not answer. No one urged that either a machine or article of manufacture classification would be appropriate.

CONCLUSION

The data which has been collected is obviously too fragmentary to permit any valid and meaningful conclusions to be drawn. We plan to encourage more recipients of the survey instrument to respond and will prepare an analysis of the data when it is available.

Protecting Computer Program Concepts and Copies

MARTIN A. COETZ*

APPLIED DATA RESEARCH IS DIRECTLY ENGAGED in the development and marketing of software programs. ADR has invested over four million dollars in proprietary software systems and we are keenly concerned with the problems of protecting both its innovations and the products which we manufacture and market.

There are two problems of concern in connection with the protection of the proprietary aspects of computer programs. One of these is protecting the inventive concepts which may underlie an innovation in the software field. We believe that the principles of the patent system are applicable for the protection of these inventions in a similar way, and with full equality to those used in the protection of hardware programming in special purpose computer systems. We believe that the current patent policy fully protects software concepts.

The second aspect in the protection of computer programs is primarily a practical, not a legal, problem and stems from the fact that programs are relatively easy to duplicate. As a consequence, there has

* Vice President, Applied Data Research.

been much concern that people would improperly duplicate programs without the approval of the owner and thereby injure or substantially destroy his property rights in such programs. Various proposals have been made suggesting that the U.S. Government (for example, the Patent Office) engage in something in the nature of a registration system whereby ownership rights might be established so that the owner ultimately could proceed against those who had illegal possession of a copy of the program.

We believe that substantial protection can be readily provided to owners of computer programs without the elaboration of government and legal procedures. That is, the real problem lies in the ability of a wrongdoer, after he has obtained a copy of the program, to use it in any other machine of the same model.

The following proposed system, which requires no government intervention, would make it extremely difficult (and with refinements, perhaps impossible) for a program copy to be used in any computing machine other than the particular machine for which it was originally established.

The proposed system is as follows:

- (1) Every computer system would have about four to eight characters of read-only storage to uniquely identify the computer. This would be equivalent to the computer serial number in use today (but stamped on the central processing unit.)
- (2) A proprietary software program would be able to access the read-only storage during its execution.
- (3) The software program, when generated for sale or lease to a user, would create unique code and constants within the program, which would represent a particular serial number, and which would then act as an "electronic key" when the program was executed. If the serial number was as expected, the program would perform correctly; if not, it would terminate (or not perform correctly).

There is no doubt in my mind that an "electronic key" or "electronic combination lock" would make it virtually impossible to use a program that was copied with one serial number representation embedded in it to be used on a computer system containing another serial number. Programs that use an "electronic key," in my opinion, would afford adequate protection for computer programs.

The cost to provide a hardware serial number facility is small relative to the cost of a computer. Its value in protecting computer programs far outweighs the cost of the hardware addition. This proposed

system addresses itself solely to the problem of protecting a copy of a computer program and requires the cooperation of computer manufacturers. Since manufacturers, themselves, may sometime in the future desire protection of their own software, there is the excellent possibility that manufacturers would be in favor of such a scheme and there is some reason to believe that this system has been put into the new IBM 370 Series computers.

Computer Program Protection

CARL HAMMER*

BEFORE COMMENTING on the substantive parts of the very interesting research presented by Herbert R. Koller, we note with some dismay that in A.D. 1970 we have allegedly available to us all these huge data banks on computers—yet in order to find out what various countries are doing, we must send out questionnaires! Furthermore, we cannot even learn what our own industry is doing with regard to protecting software inventors since even responsible industries fail to respond to perfectly harmless questions put to them in good faith. In part, of course, all this derives from the exponentially growing data trail that man and our complex society have created in trying to cope with the problems which derive largely from this complexity. General systems science and cyberneticists have maintained for years that systems generally tend to increase in complexity, and legal protection of software is a typical example of this “law.”

Some of us have never had occasion to worry about the problem of protecting software inventions, possibly because we were never creative enough to “invent” new processes for our powerful machines. Never-

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theless, as long as our society protects the rights of the inventor, we must be concerned with all aspects of this problem, made more urgent by the recent decision of several manufacturers to "unbundle." I submit that software invention is a complicated process which involves at least the stages of concept formulation, implementation, and validation or testing. Therefore, we must determine for every proposed process whether it is feasible and economical (practicable). For example, a number of algorithms have been proposed for the evaluation of certain problem areas in operations research. Some of these algorithms work on the principle of enumeration and thus apply only to very small problems in which parameter values can be held quite low. Other algorithms use statistical methods (Monte Carlo approach) and determine population parameters through sampling techniques; thus they can be applied to a much wider range of parameter values and larger numbers of parameters. Therefore, algorithms which require inordinate amounts of computer time are of little economic interest to most users, even in the age of number-crunching machines with a great economy of scale.

There is another aspect of this problem that requires even more intense study: Is the protection offered (by law) enforceable? Among the 70,000 computer installations in this country, there are constantly circulating copies of program decks, data decks, magnetic tapes, and disc packs. What protective mechanism can be offered to prevent the proverbial user in Timbuktu from making a copy of a deck or tape illegally and surreptitiously using it happily ever after? A partial answer can be found in the development of copyrighted maps. The map makers have for decades placed dummy towns or roads in odd places on their maps so as to detect fraudulent reproductions. I have such a map in my possession; the road around the Lincoln Memorial in Washington is not a complete circle, an error that only a few people would spot. Similarly, software programs may be written with dummy lines of coding to identify them to someone capable of scanning the code and identifying these meaningless program steps as telltale!

It is difficult for us to envision what policing methods exist to protect today's software inventor. Possibly the best protection is offered by adhering to well-established principles of security, such as those described by Bernard Peters in his celebrated paper published in the *1967 Proceedings of the Spring Joint Computer Conference* (Thompson Book Company, Volume 30). His association with the NSA and their permission to have this paper published has put some semi-official stamp of approval on these procedures. However, the main thrust of his

paper is twofold: (i) One can never achieve absolute security, no matter what the price; (ii) The price for protection increases exponentially as the degree of protection increases from 99 to 99.9 or 99.99 percent; each additional 9 costing exponentially more than the preceding 9.

Let me illustrate the success of these procedures with an example dating back to 1958. At that time we made a survey of scientific computer installations to learn whether they had ever done any work with celestial mechanics, such as writing programs for calculating orbits of ballistic missiles. The pertinent equations have been well known since the days of Kepler and we identified 31 independent and separate efforts of the type that go today by the name of "orbital packages." None of the installations involved was aware of the fact that 30 others had essentially duplicated their efforts because the relevant programs had all been written under a classified label. You see that adequate procedures existed even then to protect software from being freely distributed, copied, or pilfered, even though in this case there was really no reason to maintain this classification or protection.

In establishing a need for protecting software inventions we must also remember the volatility of our industry. Few pieces of coding and even fewer concepts have survived the short history of our industry. What we have learned is that software, like hardware, has a mean life which is generally measured only in months or sometimes years. Therefore it seems reasonable to postulate the following: (i) Only *fundamental* software concepts should be afforded the luxury of legal protection; (ii) Such concepts should have an estimated mean life of ten years or better; (iii) Concepts should be considered independent of implementation but at least one such implementation (in whatever computer language) should be exhibited.

You may ask, where does that leave the short-term inventor? Many of us believe that he will be served better by adherence to security procedures mentioned earlier without the need for setting into motion the gigantic apparatus of patent, copyright, or trademark laws. However, for those desiring stronger protection than that offered by methods and procedures, we can finally suggest a slightly more costly but also more effective alternative: Cryptography. Numerous techniques are available to incorporate crypto protection into software and they are, in fact, being used successfully in numerous pilot programs. While these techniques are not quite as spectacular as self-destructing tapes in the TV show "Mission Impossible," they will cause severe systems problems of similarly catastrophic nature to the unauthorized user of crypto-

protected software!

We are not suggesting that disclosure of this method at this meeting makes it patentable but we hope that it will stimulate your interest and assist us in our search for ways and means that afford reasonable protection of software at a reasonable cost.

B. TRADEMARKS IN WORLD MARKETS

Commercial Practicalities and International Trademarks

JOSEPH M. LIGHTMAN*

I AM PARTICULARLY PLEASED to be on this panel with attorneys who are not only highly experienced in international trademark practice but who also serve as house counsels in this field for the multinational companies with which they are associated. Since I am an economist associated with The PTC Research Institute in studies in the trademark field, it is hoped that we can provide you with a balanced legal-economic viewpoint on today's subject. My remarks will be directed primarily to the Institute's research, after which my colleagues will offer comments relative to what I have said, as well as their own experiences and viewpoints.

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INTRODUCTION

The basic function of a trademark is, of course, to distinguish goods and services and to identify their origin or ownership. Additionally, in world commercial societies trademarks have emerged in importance as guarantee symbols, sales promotion tools, and consumer "aid in selection" devices. The trademark that symbolizes a firm's goodwill to the public, and enables it to evaluate and select the goods and services it wants, is truly the firm's "silent salesman." But, trademarks have assumed yet another function in world markets and that is as media for commercial communication. In many countries where illiteracy limits the use of printed language, the trademark symbol itself may be the only focal point of selection decision by the consumer for domestic as well as foreign-made goods. Also, consider the reputation in non-English, as well as English-speaking areas abroad, of U.S.-made products symbolized and identified by well-known American brands, some perhaps in foreign adaptation, but all associated with U.S.-made products that established the reputation of these marks. And this, of course, prevails with respect to many foreign-made products in the U.S. whose reputation has reached the point where the brand name alone is sufficient to capture the consumer's interest.

Today, virtually every country in the world has a system for recognition and enforcement of trademark rights, many with criminal penalties, as well as injunctive procedures against infringement. Countries with colonial possessions, such as the U.K., Netherlands, France and Portugal have systems under which registrations obtained in the home countries may form the basis for automatic protection, or separate subordinate registrations in the possessions. There are also certain colonial possessions, such as Hong Kong, with trademark laws completely autonomous and independent of those in the parent country. In all, there are about 160 separate jurisdictions throughout the world where trademarks may be registered and protected.

The PTC Research Institute has a continuing study project underway on the role of trademarks in world trade. The project has a two-fold approach—one is directed to trademark systems in geographic areas and their role in U.S. trade relations. The other is directed to trademark values, including the economic importance of trademarks from business management and consumer protection standpoints. In our geographic area approach, we recently completed a series of studies on the trademark systems of Eastern Europe and their role in East-West trade. In the field of trademark values, we recently completed a research

project on the economic implications of trademarks to U.S. manufacturing and service industries in their overall domestic and international operations. We have also completed reports on trademarks in international licensing, and are now engaged in research relative to their global role in franchising and in quality control maintenance. Before discussing our specific findings, however, I would like to touch briefly on some basic groundwork relative to trademarks in international contexts.

TRADEMARKS AND MULTINATIONALISM

The growing multinationalism among a good number of U.S. and foreign firms, and the resultant changes in their global marketing concepts have been reflected in no small part in their trademark philosophies. A key factor in their planning, in many cases, is the creation of an effective international name and house mark truly to establish their global identity; to provide a proper link for a wide variety of their marks used for products made all over the world; but not to run afoul in any country of national semantics or prejudices.

Thus we see, as examples, such well-known firms, formerly known as United States Rubber Company; Radio Corporation of America; Corn Products Company; and Aluminium, Ltd., changing their names and house trademarks respectively, to Uniroyal, Inc.; RCA Corporation; CPC International Inc.; and Alcan Aluminum Ltd.

Regarding its name change from United States Rubber Company to Uniroyal, Inc., the corporation's management has noted that:

The designation "United States" in the corporate name obscures the fact that the Company has become truly international in the scope of its activities. Moreover, that designation is unsuitable both in identifying the Company's foreign subsidiaries and in labelling its products for overseas marketing. Lacking a single unifying name under which to conduct its worldwide business, the Company has been at a disadvantage with respect to its major competitors.

The designation "Rubber Company" fails to portray the substantial diversification of the Company's business which has occurred in recent years.

While the company continues to manufacture such conventional rubber products as tires, footwear, and conveyor belts, it has also become an important producer of chemicals, plastics and textiles and is now conducting research in such diverse fields as oceanography, space and the products of atomic fission. Thus, it adopted Uniroyal, Inc. as the company name, with a view toward use of the term UNIROYAL for corporate and product identification throughout the world.

RCA Corporation has also noted that its prior name, Radio Corporation of America, failed to reflect its international operations. According to its management:

The words "of America" in the present corporate name obscure the fact that the Corporation has become truly multi-national and globally oriented in the scope of its activities, interests and plans and that its products and services are available throughout the world. Moreover the words "of America" are unsuitable both in identifying the Corporation's increasing important foreign subsidiaries and in identifying the Corporation's products and services for overseas marketing. Lacking a single unifying name places the Corporation at a disadvantage with respect to its competitors throughout the world.

The Board of Directors of former Corn Products Company recommended the change to CPC International Inc. because:

[T]he present name no longer reflects either the diversity or multinational character of the company's business. The new name is a key step in a program which has as its objective the linking of the corporate name to the many names under which we conduct our operations throughout the world. The Board of Directors believes that a more widely used and thus better recognized corporate name would be an asset to the business. . . .

The desire of Aluminium, Ltd. to identify itself with one of its well-known trademarks worldwide resulted in its name being changed to Alcan Aluminium Ltd. Said the company's representatives: "The name Alcan identifies our company more closely with our products and reflects the fact that our company and its subsidiaries constitute an integrated worldwide enterprise."

Available statistics indicate that since the early 1960's well over half of the 500 largest firms in manufacturing and services in the U.S. have begun new corporate and house mark identification programs, many to reflect their expanding global activities, as well as product diversification. It is estimated that over 10 percent of the firms listed on the New York Stock Exchange have altered their names and house marks for such purposes during this period.

While patents may be in the international limelight more than any other form of industrial property right, it is interesting to note that trademarks are more widespread and more substantively protected within the framework of existing intergovernmental agreements. And this is true in the context of bilateral, as well as multilateral agreements. A check through most of the trade and commercial treaties which the U.S. has concluded with various countries bilaterally since the early 1800's, for example, reveals few that do not have some provision for

national or reciprocal protection of trademarks and commercial names. Also, among other countries, more bilateral agreements on trademarks appear to exist than for any other form of industrial property right.

Among the multilateral agreements, the most important, of course, is the "Paris Union" International Convention for the Protection of Industrial Property. In examining the history of this convention, one will find that the major changes made in its last complete substantive revision, at Lisbon in 1958, concerned trademarks.* It was this aspect of the convention where the need for urgent updating was particularly recognized and more complete agreement could be reached for effecting the necessary changes. The basic changes, among those adopted in 1958, were elimination of the prior home registration requirement as a condition for applying for a trademark registration in other member countries, and specific recognition of service marks as a form of industrial property right to be protected in member countries.

Regionally, there came into effect on January 1, 1971, a Benelux Trademark Convention, providing a central filing and registration procedure for the three countries. In the Central American area, a Convention establishing uniform trademark legislation and classification systems is also expected soon to come into effect. The latter will supplement the existing Inter-American Trademark Convention of 1929 to which the U.S. and nine Central and South American countries adhere.

The African and Malagasy Industrial Property Agreement, to which 13 former French colonies, now independent countries, adhere, provides for centralized trademark, as well as patent filing and registration procedures.

As Commissioner Schneider* has noted, there is also the "Madrid Agreement Concerning the International Registration of Trade-marks" which provides for a centralized trademark application filing procedure including forwarding of the application to other member countries for registration, if acceptable, under their own laws. Twenty-one countries, mostly in Western Europe, adhere to this agreement; the U.S. does not.

Thus, we see in world markets the elements of two basic infrastructures in trademarks—one management, and the other government oriented. In the management pattern there are the "global-type" trade-

* The 1967 Stockholm Revision was directed basically to administrative changes in the Paris Convention. The only substantive revision that was made (Article 4) pertains to "Inventors' Certificates."

* John H. Schneider, Assistant Commissioner of Patents, U.S. Patent Office.

marks, together with commercial names, underpinning corporations' protection programs for all of their marks used in domestic and foreign trade. On the governmental level, there are the international agreements—bilateral, regional and worldwide, providing basic protection for corporations and others in acquiring and enforcing trademark rights, also in domestic and foreign trade.

PTC RESEARCH INSTITUTE PROGRAMS

Returning now to the Institute's research projects, I will discuss first our study on trademark values in world markets relative to manufacturing and service industries. Here, we used a sampling base of approximately 140 firms of varying sizes, from so-called small business enterprises to those with annual sales of over \$1 billion, in a wide variety of industries. Virtually all of these firms regard trade and service marks among their most valuable assets in the U.S. and abroad. Many professed to be unable to assign a dollar value to the goodwill inherent in their trademark portfolios. Those that did assign quantitative amounts provided figures ranging in the millions. Typical of responses we received from firms on the value of their marks was that by a leading insurance firm with assets in the billions. The company said of its well-known house mark:

Over the years the Company has expended literally millions of dollars in advertising and promoting the mark in all the principal advertising media, including newspapers, magazines, television, and radio. For many years the mark has been and is presently identified with the business activities conducted by the company and has acquired a secondary meaning, so that it is universally identified with the company's activities in the fields of insurance, corporation financing, mortgage lending services, investments, securities, and real estate. In view of the very substantial sums spent in advertising and promoting the mark and the fact that the public associates the mark with the Company and its services, the mark is of inestimable value.

Among the most well-known and valued trademarks in the business world are, of course, Coca-Cola and Coke. Yet, how can the real measure of their goodwill and value in world trade be determined? In answer to this question, The Coca-Cola Company's Legal Department offers the following published statement:

The production plants and inventories of The Coca-Cola Company could go up in flames over night. Yet, on the following morning there is not a bank in Atlanta, New York, or anywhere else, that

would not lend this Company the funds necessary for rebuilding, accepting as security only the inherent goodwill in its trademarks Coca-Cola and Coke.

It is also to be noted that many industrial goods producers have attached no lesser importance to their trademarks in world trade than have those manufacturing consumer goods. An important element in many firms' trademark programs is the desire to make themselves better known—to achieve more recognition by the general public both at home and abroad. In other words, the firms' motives go beyond the specific purpose of using a trademark as the focal point around which to establish or expand a marketing program. Thus, many of the companies in our sampling base tied their trademark portfolios into extensive educational campaigns to achieve as much worldwide exposure as possible. The industrial goods producers, particularly, were interested in informing the public that well-known consumer products bore their branded components or were made with their branded machinery. Also, as certain industrial producers expanded into, merged with, or otherwise acquired consumer goods manufacturing interests, it became important for them firmly to establish their public image within these new contexts. Further details on the results of our studies appear in various issues of The PTC Research Institute's Journal, *IDEA*.

We also looked into the role of trademarks as income earners in U.S. foreign licensing operations. In few instances were trademarks licensed separately by the 90 respondents in our particular sampling base. They were generally licensed in combination with patents and know-how. However, trademarks proved to be important bargaining items for those seeking to license for and acquire profitable returns on their foreign-owned industrial property rights. Many U.S. firms found that the goodwill inherent in their trademarks afforded them considerable negotiating leverage in the overall licensing arrangements and payment terms agreed upon. In this context, trademarks became important elements in enhancing foreign income earnings for U.S. licensors, as well as for the U.S. balance of payments. Our latest reports on compensation and earning patterns in trademark licensing appear in the Spring and Fall 1970 issues of *IDEA*.

Our present study concerns trademarks in franchising. Presently, franchising accounts for about \$90 billion in U.S. sales. Economists estimate that the number of franchisees, which is now about a half million, could reach about a million in the next few years. With this growth pattern, franchisers are prompted to take a hard look at their public identification policies and the goodwill inherent in their trademarks. As franchise operators strive to attract business by maintaining high

levels of quality for their goods and services, their trademarks, as focal points for such goodwill identification, presumably become the most valuable assets being franchised. This is clearly exemplified by one of our respondents, a leading food service franchiser, with about a half billion dollars in sales, who stated:

Needless to say the [house] trademark made our business. Selected in 1939 to describe the products being introduced, we had to be different to grow as we did. The mark told our customers where they could find us. As the product line was expanded, the marketing approach was altered accordingly and the mark became the *place*, rather than the product. Now franchise [operations] cover more than 4,000 retail units in all 50 states and several foreign countries. Over the years we have spent many millions of dollars advertising and promoting the mark. It is our biggest single asset. It has to be worth at least as much as our company is worth. We have not set the sale price of the company.

We also plan to look into the quality control aspects of trademarks—with particular reference to certification marks. Certification marks have sometimes been referred to as consumer “security blankets”—as exemplified by those of us who have carefully examined an electrical gadget before purchase to be sure that it bears the UL seal of approval. The well-known guarantee seal or trademark is generally as impressive, if not more so, than any statement of guarantee the certifying organization itself may make. Since certification marks, in a trademark sense, do not identify originators of goods or services as such, just how is their value measured in U.S. domestic and international trade? This we intend to pursue as the subject of a comprehensive research project. The results of our research on these subjects will, of course, also be published in *IDEA*, as these projects are completed.

On the subject of trademarks in world markets, I should like also to discuss a series of studies we recently conducted on Eastern European trademark systems.

A growing number of American firms are interested in selling in Eastern Europe. The lure is a market for imported goods from the free world that has almost trebled in the past decade from about \$3 billion to well over \$8 billion per year. The major industrialized trading companies comprising COCOM (International Committee that coordinates controls on exports of strategic goods to Communist countries) exported about \$4.2 billions worth of goods to Eastern Europe in 1968 (latest figures available). All NATO countries, except Iceland, plus Japan are members. While the U.S. share of this East-West trade is still very small, it has nevertheless risen sharply in recent years and continues on the upswing. The result is that American firms interested in

Eastern European markets are taking a hard look at these countries' industrial property systems and the protection available for their well-known and valuable marks used in world trade. Traditionally, trademarks in Eastern Europe have served primarily as factory and quality identification devices to facilitate government surveillance activities. In effect, they have been "grademarks," rather than "trademarks." However, as these countries' "command economies" have begun to predicate success in certain consumer industries on profitable operations, rather than production quota targets, the significance of trademarks as marketing tools has increased. Also, as East-West trade relations continue to expand, the potential role of trademarks as market promotion instruments in these countries has become increasingly important to interested Western exporters. The result is that all Eastern European countries (except Albania) are now members of the "Paris Union" Industrial Property Convention and have trademark systems basically similar in their administrative and enforcement procedures to those of Western Europe.

I should mention particularly the growing recognition of trademark values in the Soviet Union. Trademarks, which are generally associated with concepts of commercial individuality and competitive enterprise, had played a minor role in the Soviet State "command economy," until recently. A few years ago, however, economic planners began to realize that the public was relying on factory code markings to decide whether or not to buy various consumer-type products. The public, for example, was refusing to buy certain television sets. Investigators later determined that these sets, being turned out by particular factories, were considered by the public to be inferior to those from other factories.

In effect, the factory code markings, intended primarily for convenience of identity by planning and production authorities, were inadvertently enabling consumers to choose products of plants with good reputations and to avoid plants with poor ones. Also, with introduction of price and profit criteria in the Soviet Union in certain consumer goods industries, a growing interest was stimulated in use of brand-name type distinctive markings by those factory managers who felt that they were producing particularly good products.

Thus, between 1962 and 1966, the Soviet Union adopted and refined a new trademark law that compares in protective scope with those laws of Western Europe. The Soviet law not only specifies that the function of a trademark is "to distinguish goods or services of one enterprise from [those of others]" but that its function is also "to advertise" such goods and services. All Soviet organizations engaged in foreign trade

activities have a registered trademark used exclusively to identify themselves abroad.

The results of our research on the role of trademarks in East-West trade are also published in *IDEA*, and with respect to the Soviet Union, specifically, in the Institute's recently published book, *Nurturing New Ideas: Legal Rights and Economic Roles* (Washington, D.C.: BNA Books).

Finally, on the subject of geographic studies, I note that the U.S. is party to intergovernmental agreements with well over 100 countries which guarantee to U.S. citizens treatment therein equal to that which they extend to their own nationals in acquisition and enforcement of trademark rights. I emphasize, however, that this country is not party to any agreement whereby a U.S. trademark registration is automatically registered and protected in a foreign country, or vice versa. U.S. nationals must proceed under the laws of each country to obtain the necessary trademark rights.

As I indicated earlier, increasing attention is being given by U.S. firms to the role of trademarks in foreign marketing. We hope that this Institute's research on the subject will continue to offer important insights to the U.S. business community in its international trade endeavors.

Trademark Licensing in British Law Countries*

EMIL SCHELLER**

LICENSING OF TRADEMARKS is an accepted and necessary part of commercial practice in today's world. As a result, it is taken for granted by many business managers. The law governing this practice, however, is complex and full of many pitfalls. Failure to observe proper precautions and lack of familiarity with the intricacies of the law governing the licensing of trademarks may lead to the invalidity and even cancellation of registrations of valuable marks.

The most basic requirement of licensing is quality control and it is probably one of the few requirements sometimes known to general lawyers and market managers. The concept behind quality control is that a trademark is intended to indicate one source of a product and that, if it fails to indicate one source, it is not functioning as a trademark. Once it stops functioning as a trademark, or is deceptive or misleading as to the source which it represents, it can no longer be enforced as a trademark and "infringements" may have to be allowed to go unchecked.

* Emil Scheller presented a summary of this paper at the Conference.

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Since, in a licensing situation, two companies or business entities might be using the trademark, it is apparent that, without some legal fiction, the trademark might indicate two sources and would, as a result, be invalid. As a matter of fact, in many legal jurisdictions, any attempt at licensing, even with quality control, at one time invalidated the trademark.¹ As the commercial need for licensing increased, however, the common law and eventually the statutes of most countries came to recognize licensing, provided proper quality controls are exercised. The theory to justify this result is that, with the trademark owner exercising strict quality controls, there is only one source responsible for the quality of the goods, even if there are actually two or more sources for the goods themselves. Thus, the theory of what makes a good trademark has shifted—

from: that a trademark must indicate one source of the goods;
to: that a trademark must indicate one source that controls
the quality of the goods.

As long as quality controls are exercised, licensing appears to be safe in the United States, though even in the United States it is doubtful whether a trademark which has never been used by the intended proprietor can be effectively licensed. As a matter of fact, this proposition may be more doubtful in the United States than in Great Britain or other British law jurisdictions, for in the United States, rights in a trademark can be acquired only by use, while in Great Britain and the British law countries, rights in a trademark can be acquired if the applicant has a bona fide intent to use the mark or alternatively has used it.

In Great Britain, and in those countries whose statutes follow Britain's 1938 Act, there are rather specific provisions governing licensing and, as a result, consideration must be given to whether the mere observance of quality controls insulates a licensed trademark from attack.

Section 28 (1) of the British Act² provides:

Subject to the provisions of this section a person other than the proprietor of a trade mark may be registered as a registered user thereof in respect of all or any of the goods in respect of which it is registered (otherwise than as a defensive trade mark), and either with or without conditions or restrictions.

The use of a trade mark by a registered user thereof, in relation

¹ In the following countries there is as yet no statutory provision for licensing and, accordingly, licensing may still jeopardize a trademark registration: Bermuda, Burma, Fiji Islands, Gambia, Kuwait, Malta, Seychilles, Thailand and Zanzibar.

² Most other countries having statutes which follow Britain's 1938 Act have identical or similar provisions.

to goods with which he is connected in the course of trade and in respect of which for the time being the trade mark remains registered and he is registered as a registered user, being use such as to comply with any conditions or restrictions to which his registration is subject, is in this Act referred to as the "permitted use" thereof.³

Since this is the only provision in the British Act governing licensing, it was at first thought that a license granted without entering the licensee or permitted user as a registered user would make the license illegal and the registered trademark invalid.

In the celebrated *Bostitch* case,⁴ however, the court held that a registered user entry was not a prerequisite to proper licensing, but that the basis was lack of deception. The court held that there was no deception where proper quality controls were exercised and the label and advertising material did not deceive or mislead as to the relationship of the parties.⁵

The *Bostitch* case is probably more important in its emphasis that quality controls and full disclosure of a licensing arrangement on the label of a product is the crux of valid licensing than in its holding that recordation of licensing is not essential, for, as we shall see hereafter, recordation of licensing despite this decision is still of vital importance.

In the light of this decision, it must be concluded that, in the British law countries, licenses should be set forth in writing with quality controls clearly set forth, quality controls should be exercised and the name of the licensor and licensee and their relationship as licensor and licensee should be clearly indicated on the labels of the product.

It should, however, be kept clearly in mind that a licensing arrangement does not always exist wherever the goods are manufactured by one other than the trademark proprietor. It is entirely possible for a trademark proprietor to hire another to manufacture the goods for him. In such an arrangement, the manufacturer is a contract manufacturer or manufacturing agent of the trademark proprietor. Since the acts of an agent are the acts of the principal, the principal, in the eyes of the law, is doing his own manufacturing and no licensing arrangement exists.

The essential difference between a licensee and a contract manufac-

³ Most of the statutes of the British law countries and most key decisions bearing on such statutes may be found in *Offners International Trademark Service* published by Fieldston Press (1970).

⁴ Decided in the British High Court of Justice Chancery Division 1963 R.P.C. 183.

⁵ The principal was most recently *reaffirmed* in the G.E. trademark case decided in the British High Court of Justice Chancery Division 1969 R.P.C. 418; *reversed on other grounds*, Supreme Court of Justice Judicature Court of Appeal 1970 R.P.C. 339.

urer or manufacturing agent is that a licensee makes the goods for his own account under quality controls of the trademark proprietor, while a contract manufacturer or manufacturing agent makes the goods for the account of the trademark proprietor. The distinction is derived from the contractual arrangement between the parties with an important factor being whether title to the goods remains with the manufacturer or whether title passes to or remains with the trademark proprietor before the goods pass into trade. It is, in fact, not uncommon for a licensee to employ a contract manufacturer or a manufacturing agent. The contract manufacturer or manufacturing agent is not a sublicensee, but merely the agent of the licensee, and the label need only show the licensee in that capacity. Similarly, if a registered user is to be recorded, only a bona fide licensee need be recorded and not a contract manufacturer or manufacturing agent.

In terms of the flow of money that is of vital importance to the determination of which arrangement to employ, the contract manufacturer or manufacturing agent usually gets a manufacturing fee which is often cost plus a percentage, while the licensee pockets the selling price and pays a percentage royalty to the trademark owner.⁶ Needless to say, a licensee will usually obtain greater proceeds than a contract manufacturer or manufacturing agent. A licensee will also usually do the selling and promoting of a product, while a contract manufacturer or manufacturing agent will usually be limited to manufacturing. In terms of product liability, a licensee will generally be liable, while a contract manufacturer or manufacturing agent will be liable only to his principal. If a parent company wishes to have a non-manufacturing subsidiary obtain proceeds, it must make them a licensee and have them employ a contract manufacturer or manufacturing agent. If it retains the manufacturer as its own contract manufacturer or manufacturing agent or makes him a licensee, it would have no way of justifying any proceeds flowing into its subsidiary.

It was previously stated that, despite the *Bostitch* and *General Electric* decisions, it is still important to record a licensee as a registered user.

Section 26 (1) (b) of the British Act⁷ provides:

(1) Subject to the provisions of the next succeeding section, a registered trade mark may be taken off the register in respect of any of the goods in respect of which it is registered on application by any person aggrieved, . . . on the ground . . .

(b) that up to the date one month before the date of the

⁶ If permitted by local law.

⁷ See note 1 *supra*.

application a continuous period of five years or longer elapsed during which the trade mark was a registered trade mark and during which there was no bona fide use thereof in relation to those goods by any proprietor thereof for the time being.

It may well be asked, "What does this provision have to do with licensing?" The answer becomes readily apparent when we consider that most trademark proprietors who license their trademarks do not use the trademarks themselves. Thus, unless the use by the licensee is considered to be the use by the licensor and trademark proprietor, the trademark registration could well be cancelled after five years for non-use. It was stated before that the *Bostitch* decision held that trademark licensing without a registered user registration will not invalidate the trademark. However, neither that decision nor any other has held that use by an unregistered licensee will be considered to be use by the licensor. Nor is there anything in the statutes which would support such a view.

Section 28 (2) of the British Act⁸ states:

(2) The permitted use of a trade mark shall be deemed to be use by the proprietor thereof, and shall be deemed not to be use by a person other than the proprietor, for the purposes of Section 26 of this Act and for any other purpose for which such use is material under this Act or at common law.⁹

It will be evident from the provisions of this section that, if a licensee is recorded as a registered user, his use will be considered to be the use of the licensor and trademark proprietor. Thus, while a trademark will in line with the *Bostitch* case not be invalidated because licensed without recordation, it will be vulnerable to cancellation for non-use if the licensee is not recorded and the trademark proprietor does not himself make use of the mark. It should be borne in mind, however, that, if the trademark proprietor wishes, he can use a contract manufacturer or manufacturing agent and no recordal will be necessary. In that case, the trademark proprietor relies on the legal principle, *qui facit per alium facit per se*. The acts of an agent are the acts of his principal. A licensee, on the other hand, is not an agent of the trademark proprietor and the legal fiction provided by Section 28 is needed. To take advantage of this fiction, entering the licensee as a registered user is absolutely necessary.

I previously stated that the British law countries allow marks to be registered without use preceding the application as is the requirement

⁸ See note 1 *supra*.

⁹ Permitted use is defined as use by a registered user in Section 28 (1) which is quoted *supra*.

in the United States. However, it is not possible in the British law countries to acquire rights in a trademark only by registration, for in applying for registration of a trademark, the applicant must allege either that he is using the mark or that he intends to use the mark himself.

Section 17 (1) of the British Act¹⁰ provides:

(1) Any person claiming to be the proprietor of a trade mark *used or proposed to be used by him* who is desirous of registering it must apply in writing to the Registrar in the prescribed manner for registration either in Part A or in Part B of the register. (Emphasis added)

For a long time, it appeared that the need for a bona fide intent to use might be a dead letter, for who is to say that there is no intent on the part of the applicant when he says there is. It is a reasonable assumption that it is difficult, if not impossible, to examine the thought process of anyone and state with conviction that he does not have the intent which he claims to have.

In the recent *Pussy Galore* case,¹¹ however, the widow of Ian Fleming decided that good money could be made by registering and then licensing *Pussy Galore*¹² as a trademark for numerous diverse products in various classes of the British classification system. The British Registrar questioned whether she had a bona fide intent to use the trademark herself on the many diverse products for which registration was sought. She admitted that she had no intent to use the mark herself, but alleged that she intended to use the mark through registered users whom she would seek after she obtained the desired registration. She argued through her attorney that she had a bona fide intent to use the mark because, since under Section 28 (2), use by a permitted user is use by the proprietor and intent to use through a registered user or permitted user is an intent to use by the proprietor.

The Registrar, however, held that Section 28 (2) was applicable only after registration in order to avoid invalidity through non-use and had no application with respect to intent to use.

The Registrar set forth his opinion in the following words:

[The applicant's attorney] submitted as I understood, that since under Section 28(2) use by a registered user is equated to use by the proprietor himself, then a proposal by the proprietor that a registered user shall use the mark satisfied the requirement that the proprietor proposes that the mark be used "by him." This is not, in my view, a necessary consequence of Section 28(2). This section relates

¹⁰ See note 1 *supra*.

¹¹ Decided by the British Board of Trade, February 24, 1967.

¹² A character in the late Ian Fleming's novel, *Goldfinger*.

to the use of registered marks and in my view the words "such use" must be construed as relating to the use of registered marks. In other words Section 28(2) is concerned to protect a registered mark from the consequences of non-use by the registered proprietor where there has been "permitted use" by a registered user. It seems to me to have no relevance to an application to register a mark.

On appeal, the Board of Trade affirmed the Registrar's decision.

If Mrs. Fleming had alleged that she intended to use the marks by hiring a manufacturing agent who would make goods for her, and then turning them over to a selling agent or distributor in order to provide the sales outlet, would the decision have been different? Logic would dictate that it would have had to be different because Mrs. Fleming would then have set forth a plausible manner of using the marks herself and her stated intention could not have been questioned further.

As a matter of fact, Mrs. Fleming could definitely have based her application on intent to use through a registered user because Section 29 (1) (b) of the British Act¹³ provides:

(1) No application for the registration of a trade mark in respect of any goods shall be refused, nor shall permission for such registration be withheld, on the ground only that it appears that the applicant does not use or propose to use the trade mark . . . ;

(b) If the application is accompanied by an application for the registration of a person as a registered user of the trade mark, and the tribunal is satisfied that the proprietor intends it to be used by that person in relation to those goods and the tribunal is also satisfied that that person will be registered as a registered user thereof immediately after the registration of the trade mark.

Unfortunately for Mrs. Fleming, she could not have taken advantage of this section because since she had not yet located her prospective licensees, she could not at the time of her application have applied to record them as registered users. If effect, the *Pussy Galore* decision set into motion what appears to be the correct interpretation of the British Act, i.e., that the applicant must either:

- (1) Have a bona fide intent to use the mark himself; or
- (2) He must proceed under Section 29 (1) (b) .

Under any other course, he faces the possibility that the Registrar will reject the application.

As has been stated, however, lack of intent is difficult to refute if claimed. Thus, one could argue that *Pussy Galore* was an isolated case in that Mrs. Fleming had no business and certainly was not in business of making the diverse goods specified in her applications for registra-

¹³ Most British law countries with the notable exception of India have identical or similar provisions.

tion. Is there any risk of challenge to an application filed by an applicant who is in the business of making and selling the goods specified in the application, but who intends to use only through a registered user and who does not take advantage of the provisions of Section 29 (1) (b)? If intention to use by the applicant is alleged, the Registrar would have no cause to question the intent and the registration would undoubtedly be granted. This is certainly true, but even if registration is granted, the trademark proprietor might still be vulnerable, for Section 26 (1) (a) of the British Act¹⁴ provides:

(1) . . . a registered trade mark may be taken off the register in respect of any of the goods in respect of which it is registered . . . , on the ground . . .

(a) that the trade mark was registered without any bona fide intention on the part of the applicant for registration that it should be used in relation to those goods by him, and that there has in fact been no bona fide use of the trade mark in relation to those goods by any proprietor thereof for the time being up to the date one month before the date of the application; . . . (Emphasis added)

Thus, if there has been no bona fide intent to use and there has, in fact, been no use at the time the cancellation action is filed, the registration may be cancelled. This, of course, brings us back to the question—can the lack of intent to use by the applicant be proven? If the registrant is in the business of making and selling the goods specified in the registration, it is difficult to prove such lack of intent. However, in a recent decision of an intermediate court in India in *American Home Products Corporation v. Mac Laboratories Private Ltd. & Ans.*,¹⁵ it was held by the court that there was sufficient proof of no intention to use the mark on the part of the proprietor himself.

In that case, American Home Products Corporation had registered its trademark Dristan in India in 1958. In April of 1961, the respondent had brought a cancellation action to strike Dristan from the register and American Home Products Corporation had filed its application for registered user in October of 1961. To this date, the application for registered user has not been granted.

Though the owner of the registration admitted that it intended to use the mark only through its registered user and not itself because of import restrictions in India, the court indicated that even without such an admission the lack of intent could have been established as a result of all the facts.

¹⁴ See note 1 *supra*.

¹⁵ Decided in the High Court at Calcutta, Appellate Civil Jurisdiction, January 15, 1970. This case is presently on appeal to the Supreme Court of India.

After reciting the admissions and expressing its view that, on the basis of the admission, the lack of intent is established, the court says:

This view is fortified by the fact that the appellants are using all their other registered trademarks in India through their registered users and in no other manner.

While it is not clear from the decision, it is entirely reasonable to assume that, even without the admission, the court would have found the lack of intent on the basis of the practice that was followed in other cases.

When it became evident that the court would find against it on the question of intent to use by itself, it was also argued:

- (1) That its licensee was really a contract manufacturer or manufacturing agent. The court held that if the licensee instead of being a licensee had, in fact, been a contract manufacturer or manufacturing agent, the registrant would have prevailed. The court said:

It may be conceded that if a proprietor of a trademark manufactures his goods in India through his servants or agents and sells them under his trademark, he will, in the eye of the law, be regarded as using the trademark himself.

However, the court goes on to find that the proprietor did not intend to manufacture and sell through an agent, but through a licensee. They cited the application for registered user as evidence that a license was contemplated.

- (2) That they did, in fact, intend to use all their trademarks in India, but were being prevented from exporting to India by Indian import restrictions. They indicated that they had intended and still intend to use the mark as and when circumstances permit. The court, however, rejected this by saying:

I do not . . . subscribe to the unqualified proposition that . . . an applicant for registration of a trademark is entitled to registration as a matter of course, if he merely intends to use his mark as and when circumstances permit.

- (3) That an intent to use through a registered user meets the requirement of Section 17 (1) because Section 28 (2)¹⁶ makes the use by a permitted user the use by the proprietor.

The court, however, after analyzing the *Bostitch* decision finds it not applicable. It reviews the *Pussy Galore* decision and finds it in point. The court then points out that Section 29 (1) (b) of the British Act

¹⁶ These sections have been quoted. For convenience, the section numbers used above refer to the British Act. The sections of the Indian Act which are the equivalent of §§ 17 (1) and 28 (2) are §§ 18 (1) and 48 (2) respectively.

must have had a purpose and that it would have been unnecessary if an intent to use through a registered user was an intent to use by the proprietor himself.

The court concludes that an applicant for trademark registration who intends to use only through a registered user can only succeed if he files under British Section 29 (1) (b) and, since India has no equivalent section, it is not possible in India for an applicant who intends to use only through a licensee to obtain a valid registration. The court said:

Section 48 (2) comes into operation only after a registered user has been registered and has used the mark. It has relevance only to the use of a trademark and not to the intention to use it.

Thus, an analysis of the British statute and the decisions referred to shows that an applicant who intends to use only through a registered user will be safe only if he files under Section 29 (1) (b).¹⁷

If he does not file under Section 29 (1) (b), his registration will be vulnerable at least until he or his registered user commences use of the mark. A look at Section 26 (1) (a), however, leads to the conclusion that once use by the proprietor or his registered user commences, the lack of intent to use at the time of the application is cured, for the section provides that the petition for rectification must not only prove lack of intent to use, but also "that there has, in fact, been no bona fide use of the trademark in relation to those goods by any proprietor thereof, for the time being up to the date one month before the date of the application [for rectification]."

Unfortunately, the plain language of this section appears to be misleading, for Section 32 (1) of the British Act¹⁸ provides:

(1) Any person aggrieved by the non-insertion in or omission from the register of any entry, *or by any entry made in the register without sufficient cause*, or by any wrongly remaining on the register, or by any error or defect in any entry in the register, may apply in the prescribed manner . . . and the tribunal may make such order for making, expunging or varying the entry as the tribunal may think fit. (Emphasis added)

Since a lack of intent to use would appear to show that the registration was issued "without sufficient cause," it seems that under Section 32 (1), a registration can be cancelled if the prerequisite intent did not exist at the time of the application even if there is use at the time the cancellation action is begun.

¹⁷ This solution is not available in India because the Indian statute has no equivalent provision. Thus, in India, there must be a bona fide intent to use by the applicant or his true agents.

¹⁸ See note 1 *supra*.

The Indian court in the *Dristan* decision takes this view and in spite of the obvious contradiction between Section 26 (1) (a) and Section 32 (1), simply says:

In an application under Section 56,¹⁹ it is not necessary to establish non-use of the trademark.

In conclusion, it may be stated that in order to have a valid registration in the British law countries, one must either:

- (1) Have a bona fide intent to use the mark oneself or through one's agents. A trademark licensee or registered user is not one's agent.²⁰ Intended use through a licensee or registered user is not sufficient; or
- (2) Intend to use through a registered user and file an application for registration simultaneously with the trademark application under Section 29 (1) (b). This, however, is not possible in India; and
- (3) Actually use oneself or through an agent, within five years, or use through a registered user within five years. (Use through an unregistered licensee will not meet the criteria.)

If, for any reason, the filing of simultaneous trademark application and registered user application is not possible for economic or business reasons in Great Britain or other British legal jurisdictions or legal reasons in India, consideration should be given to allowing the prospective "licensee" to register the mark with an agreement that he will assign to the "licensor" after registration and that the licensee will simultaneously with the assignment be entered as a registered user.

In India, the problems are particularly difficult not only because of the omission from the Indian statute of any equivalent of British Section 29 (1) (b), but also because, for economic reasons, India is increasingly reluctant to allow any registered user entries to be made. Until now, it has taken upwards of seven years to obtain registered user entries and it now appears that applications for registered users will be regularly denied and, in fact, old registered user entries refused renewal. The only solution to licensing in India may be to allow the "licensee" to own the trademark registration with an agreement to assign to the "proprietor" upon demand.

In any of the British law countries, however, it is essential that a full understanding of the law be obtained and that the consequences of any particular approach be weighed.

¹⁹ The Indian equivalent of British § 32.

²⁰ If other facts showing agency are not present.

The Kettering Award Address

The Kettering Award Address was given by Charles Stark Draper, President, Charles Stark Draper Laboratory Division, the Massachusetts Institute of Technology. Dr. Draper was presented the Award at a luncheon in his honor at the Fourteenth Annual Conference of The PTC Research Institute held on October 29, 1970, at the Shoreham Hotel in Washington, D.C. Dr. Draper received the Institute's 1969 Charles F. Kettering Award in recognition of his outstanding contribution in research, education and public service relating to the field of industrial and intellectual property.

Technology, Creativity and the Changing Social Environment

CHARLES STARK DRAPER

KETTERING HAS LONG BEEN A NAME of great distinction in technology, in research, in legal protection for creativity, in business, in finance, in education, and in the general progress of society. For me, a teacher who has worked earnestly toward the advancement of pioneering technology, to receive the Kettering Award is an honor of which I am humbly and deeply proud.

The basic motivations for my career stem from the important needs of our nation and the advantages of providing engineering education through learning experiences within environments of effective practice. Fortunately, I have been able to maintain intimate relationships with a laboratory stressing creativity, design, testing, development, and overall real-world technological results, leaving for others the associated processes of patenting, entrepreneurship, and innovation. Opportunities to observe activities of this kind without actual involvement myself have been many during the past forty years. Perhaps, because of this experience, I may be forgiven for having opinions on matters outside the realm of physical devices.

Technology, the complex of resources and activities concerned with

the realization of means for changing circumstances of the environment toward improved compatibility with human needs and desires, has long been a primary factor for progress in the history of mankind. In the beginning, this progress must have been painfully slow, but was accepted with favor by people who were glad to have better living conditions, food and transportation however long it may have taken for improvements to appear. As man's power to alter natural states to his desires became greater, his knowledge and resources also increased, and so, by the inevitable process of pyramiding his capabilities for ever-more-rapid pioneering in technology, became exponentially greater. Today, a decade often sees more progress on frontiers in some area of technology than appeared during a full millenium of earlier times. Along the trail of several thousand years, systematic rational thought, the scientific attitude, and the methods of engineering appeared to stimulate the ages of steam, of electricity, of electronics, of communication, of air transportation, of space, et cetera. The end is not yet, with each more or less well defined "age" being followed by another providing men with ever-more-remarkable powers over nature.

An example of the acceleration that the overall modern complex of science and engineering now provides for technology as compared with developments of earlier times may be taken from the associated fields of rocket propulsion and spaceship guidance. Beginnings of rocket propulsion are mentioned in Chinese records of over three thousand years ago, while really effective guidance did not begin to appear until the early 1940 development of V-2 military missiles by the Germans at Peenemünde. Today, after three thousand years of recorded effort, rocket technology is able to propel manned and unmanned spacecraft on lunar voyages and to send unmanned vehicles on journeys throughout the solar system and beyond. On the other hand, after a beginning only three decades ago, existing guidance systems made in limited production have successfully directed man-carrying craft from the earth to landings on the moon and return, while unmanned information gathering ships have ranged through space to close passes of other planets in the sun's family.

The technology applied in these systems makes use of the six degrees of geometrical freedom that exist for the world in which we live, three in rotation and three in translation, which combined with first and second derivations for all six of these basic quantities completely define navigational problems. By applying digital computers capable of dealing with these eighteen items, and also taking gravitational fields

into account on the basis of known theoretical relationships, it is certain that guidance outputs are comprehensive and may be made as accurate as necessary for any purpose of guidance. Combining optical, radio, radar and laser line-of-sight sensors with instruments for receiving inertially generated motion signals, with computing systems, with readouts, with displays and with vehicle control interface arrangements, make it possible to achieve adequate guidance for substantially all missions of space. Because theory is effectively complete and the ability of technology to instrument this theory is assured, it is certain that guidance systems of adequate performance are now within the realm of engineering for the full spectrum of missions from those of deep ocean submarines, of airplanes, of orbiting vehicles, of lunar craft and of spaceships for the solar system and beyond.

This statement, based on demonstrated results generated during only thirty years of effort, clearly shows that modern technology is capable of reducing complex systems to effective operation in short time periods once the objectives are clearly stated and adequate resources for development are made available. The reason that such spectacular results are possible stems from the procedures with which men have learned to coordinate and utilize scientific knowledge, engineering know-how and technological resources for the purposes that were beyond even the most advanced imagination of a few years ago. Technology surely has all the elements for continuing its advances, with limitations on results generally residing, not in the capabilities of technology itself, but in the areas of the decision-making that determines where efforts are to be applied.

For a very long time, results using the products of technology to modify nature toward more tolerable or even pleasurable living conditions were so obvious the technology was generally accepted with approval. To be sure there has always been opposition from some groups on philosophical and religious grounds, or because they did not regard their share of benefits as equitable. Undesirable effects on the environment that inevitably accompany the realization of technological benefits have always been present, often with devastating results. Medieval cities, spawned by the necessities of local defense in an environment of continuous warfare, paid the penalties of disease and death exacted by the lack of technology to insure good sanitation and safe food supplies. Glaring environmental damage of this kind had to be controlled by remedial technology before modern societies could develop.

In the present, other deteriorative effects which were formerly less obvious, such as water and air pollution, soil erosion, chemical waste

accumulation, ocean resources depletion and many others, have built up to levels that are now so obvious that critical discussions in the popular press, among scientists, citizens in general, and politicians are commonplace. In particular, college students and other young people are becoming strongly involved with actions to define and solve the problems of protecting the human environment.

Any effective attack to improve the existing bad situations and to prevent others from appearing in the future must come from systems technology, in which engineering considers beneficial results and undesired results as parts of a common problem, with adequate remedial technology always implemented as part of the same pattern that provides for desired outputs. Success in such endeavors surely depends upon careful accumulation of complete information on the circumstances involved, thorough understanding of the situation, the application of rational thought to generate good engineering designs, and the provision of support to implement and operate technological systems adequate for supplying desired results while maintaining undesired results within tolerable limits.

Certainly, the highest forms of rationality are required for success in objectives of this kind. Unfortunately such rationality is not a natural capability of many individuals. Rather, it must be developed by years of experience and careful education in science and engineering which insures that plans and actions will be determined by knowledge and reason rather than unmodified emotional reactions.

It is an uncomfortable fact of recent experience that emotions rather than rationality have controlled the reactions of dissidents, parading protestors, anarchists and other radicals who loudly demand immediate great changes in government, industry and schools without accepting responsibility for any arrangements required for implementation of changes in the real world.

Modern technology has helped to provide sanitation, food, transportation, communication, entertainment, clothes, education, general support, et cetera, until a surfeit has developed for most of the people in our society. Having the things needed for good living available without strong personal efforts from individuals has brought a lack of appreciation for the benefits that have been provided for our use by much painful and hard work by our ancestors. The elements desired by society are accepted as a matter of course while bad effects on the environment are loudly described and protested without any recognition that pollution accumulated for a long time before it was recognized that so-

ciety as a whole must deal with the existing circumstances as matters of comfort and perhaps ultimately of survival for the race.

Technology, having obviously played the essential role of making this situation possible although certainly not being to blame for humanity's decision to accept benefits without worrying about costs in terms of bad effects on the environment, is blamed for all the ills, actual and potential, that have come from man's actions in modifying his environment. Thus, a great number of people, with many faculty and student activists among them, have decided for themselves that all of a sudden technology in general, is evil and military technology is criminal. Starting with these unproved and actually not even rationally discussed assumptions, it follows in their opinions that agencies dealing with technology should be restrained and laboratories advancing the frontiers of technology should be destroyed or forced to change exclusively to non-defense problems. Such mundane matters as proper projects and the availability of adequate support are not concerns of people who, without investigating situations or capabilities of those whose activity they would dictate, loudly attempt to direct the actions of organizations with which they have no relationships or responsibilities. Administrators, members of industry, educators and the general public, all puzzled and many with emotions that tend toward guilt for having allowed the present situations to develop, have listened to the complaints and started to search for procedures to reduce the identified troubles. Certainly there have been few definite and positive defenses of the excellent progress that humanity has already made toward better conditions for itself on this earth.

It would appear that less attention is now being devoted to the advancement of technology by invention, entrepreneurship and innovation than to ways for inhibiting further progress. This means that inventors can expect less encouragement for their efforts than has been commonly expected in the past. Laws now under consideration for dealing with invention may tend to be less favorable than those of the past. In general, the pattern of legislation for intellectual property may be expected to be more explicit and stringent in its effects.

It is a matter of great importance for our country that ideas be allowed to develop freely in technology, and in the patterns of action under which these ideas reach stages in which they can provide benefits for society.

Technology and its contributions are too important in the continued progress of mankind for any emotional reactions to halt their advances indefinitely. It is certain that before too long, opinions will change and

creativity will once more occupy a universally recognized place of primary importance among the activities of mankind. Even now, in spite of all the words and confusion, dedicated and creative people are carrying invention, engineering and technology to new heights of benefits for society. I am sure that this situation will continue no matter how discouraged the public may appear to be with its greatest benefactor.

C. MANAGING TECHNOLOGY AND ENFORCING RIGHTS

On Company Innovation

IRVING H. SIEGEL*

MY TOPIC OF COMPANY INNOVATION is large, my scheduled time is much too brief, and the time actually available for me to strut and fret upon this stage before you is even briefer. Having been associated with The PTC Research Institute throughout most of its first incarnation as a chartered part of The George Washington University, and being envious of my unknown counterpart who will be complaining about insufficient time at such a conference two decades hence, I should like to take a Janus-look at today's competitive setting for company innovation. Looking backward and then forward, I wish to set this setting itself within an historical and dynamic context.

The factors pertinent to company innovation are much more numerous than anyone normally tries to elucidate or ever tries to write into an econometric expression. They are not only technological and economic but also psychological, managerial, sociological, political, and cultural.

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These factors, furthermore, may be international as well as domestic. Finally, time too exerts its influence, through the modification of a company's impulse and capacity to innovate with age, growth, or success, and through the alteration of external conditioning factors.

During most of the current life cycle of the Institute, technology has seemed a securely enthroned sovereign, even a fairly popular one. If, however, the consumer is really the sovereign, as economists would have us believe and as recent events have tended to verify, we must instead say that technology has seemed a well-established regent. The position of technology was particularly strengthened in the 1950's and early 1960's by the vigorous expansion of research and development activity under both public and private auspices. This expansion was stimulated by the Korean Conflict (which would nowadays be called a "war"), the 1954 revision of the Internal Revenue Code (which clarified the right either to expense or to amortize company research outlays for tax purposes), the persisting strategic and military rivalry between the Western and Soviet blocs, and the race into space. Public support for higher education became more generous. A scientific-academic complex emerged that, in its own way, was as subtly influential as the military-industrial complex discerned by President Eisenhower. The economy flourished during most of the Institute's two decades, making innovation easier and a more natural dimension of company growth.

The favorable external climate encouraged the launching of myriads of new products and company variants—wonder drugs, miracle fibers, petrochemicals, frozen foods, television, computers, jet passenger planes, et cetera. Escalating union wage demands and intensifying foreign competition in a generally expansive economy fostered the adoption and diffusion of improved processes. Although this kind of capital investment surely contributed somewhat to the volume and duration of unemployment, the nation did not at all experience productivity gains of the magnitude foreseen by imaginative journalists and automation buffs or feared by labor leaders and government officials. Indeed, agriculture proved the unexpected star. Despite the heralded new industrial revolution, it was agriculture, not manufacturing, that registered striking productivity advances throughout the period. Quietly but mightily, technological innovation and diffusion on the farm contributed to the blight and fright of the city. It is ironic that the "green revolution," which has suddenly attracted attention as a phenomenon of today's preindustrial economies, has typically been overlooked as a commonplace of American history and as a continuing support of our nonagricultural technological advancement.

The atmosphere of the past two decades has been congenial to inquiry and speculation concerning technological change, including innovation. The Institute, of course, has made a special contribution in its chosen field of industrial-intellectual property, and I am pleased to have had a place in its interdisciplinary research program. With Dr. Harris, I developed the concept of "positive competition" and showed how transactions involving patents, trade secrets, and know-how commonly serve as vehicles of this benign competition. We have paid continuing attention to the role of trade secrets in advancing technology; Volume 14, Number 2, of *IDEA* (Summer 1970) carries the report of a Clinic on this subject that I moderated in February. Before it became fashionable to emphasize the potential of company-to-company or intracompany transfer of technology for economic development, Dr. Harris and I explored this prospect for Latin America. I like to believe that some of my other work at the Institute has widened appreciation of the economic character of information, which is as eligible as materials and energy for the "embodiment" of form, place, time, and ownership "utilities"; has aided understanding of the critical importance of know-how for small business, which is too often encouraged to seek a more explicit technological base; and has heightened awareness of the continuing dominance of sole inventors, even in the typical corporate environment of team research.

As we surveyed the ground from the Institute's ivied tower, we could also scan the sky for signs and portents. (One of the beauties of interdisciplinary research, when it really is encouraged, is that it recognizes, even insists upon, the interdependence, the mutual adaptiveness, of the organism being studied and the associated environment. This acceptance of organism and environment as a "system" allows a proper scope for informed judgment and thus avoids the confinement of research to sterile or inane factualism). Clouds were gathering, at first no larger than a man's hand, and they have now broken in a storm about technology's head.

Sovereign or regent, technology now sits like a mere puppet or figure-head upon an uncertain throne that is rocked like an automobile in a riot. In the 1950's, dissenters from its rule or role exaggerated wildly the probable adverse impacts of automation; but, perhaps, wolf-crying about "technological unemployment" merely is a tradition of the industrial era, and it might have been discounted with impunity if other wells of social irritation and uneasiness had proved fewer and drier. Various wonder drugs, pesticides, food additives, miracle fibers, et cetera that had been accepted with trust or enthusiasm were found to

have seriously objectionable properties. Standard amenities of our culture, such as cigarettes and automobiles, and newer ones, such as household detergents and enzymes, have also been found harmful. Despite our vaunted technological prowess, foreign competitors have penetrated, or even gained primacy in, markets once regarded as safe. Similarly, our technology-based military might and our achievements in space are being matched by our chief rival, even though the new fashion is to underplay the undiminished, and possibly increasing, threat. Meanwhile, a minor Asiatic power has unexpectedly withstood the punishment of our air power.

At home, modern technology has facilitated urbanization and organization, but now seems inept in the presence of the accompaniments of smog, water pollution, litter, crowding, poor housing, transportation snarl, electricity shortage, violence, poverty, malnutrition, accident, alienation, et cetera. Lions of irrationality and anti-intellectualism are in the streets and on the campuses; Luddites of hand and brain attack the fragile and hard-won institutions of civilization and mock the symbols of authority and order.

I have not yet mentioned the inflation induced in the mid-1960's by the superimposition of the demands of a larger Vietnam War (in the 1950's, it would have been called a "conflict") on an economy that had finally reached full employment. The required retrenchment of federal expenditures for research and education will have regrettable long-term impacts on our technological store. The high cost of money has discouraged the real capital investment that could really help restrain rising unit labor costs. Urgent domestic needs—of our troubled cities, of people "left behind," of the despoiled environment—have had to be neglected, and the glue of our society is accordingly weaker. Once, we heard the boast of "guns and butter"; too many citizens, including engineers, now taste the bitter toast of "buns and gutter." Alas, economics remains, even in this era of the Employment Act, too crude a science for reattainment of an elusive price stability without the governmental contrivance of joblessness.

From this recital, it is clear that, in addition to the usual problems that beset company innovation, new difficulties will be experienced in the next two decades. Present administrators may feel baffled by these emerging challenges, but a later generation of hired managers will somehow learn to deal with them. In the rest of this paper, I shall review a few of the nagging familiar obstacles to company innovation and note some of the new complications with which would-be innovators will wrestle.

A hardy perennial problem for innovation is the facilitation of technological transfer—within and between organizations or jurisdictions. It is a problem for small business; it is a problem for larger ones that have sufficient resources for speculative research programs and that sense a need to “grow or die.” It is mentioned in the *Nineteenth Annual Report* of the Senate Select Committee on Small Business (the latest, for 1969). There, reference is made to the commercial underexploitation of the publicly supported research that had cost about \$100 billion in the preceding decade. The Committee called for strong administration of the State Technical Services Act, which was passed with high hopes in 1965 but has languished on meager funds and withered without fulfilling President Johnson’s optimistic vision. Though satisfied with the first decade of accomplishment of the Small Business Investment Act (independent watching and study are still needed to determine its true contribution), the Committee had nothing to say about the zero impact of Section 9 of the Small Business Act that was also passed in 1958—the section that allows small firms to collaborate in research ventures with antitrust immunity. It did see a further need for subsidized consultation services to assist companies otherwise unable to benefit from public provisions for technological transfer.

I wish at this point to repeat two observations made at earlier conferences. First, the most important and most overlooked variety of technological transfer is still the movement of “knowledge on the hoof”—the movement of trained personnel from colleges and graduate schools to industry and government, between government and industry, and between firms. Second, a small firm does its proper economic thing by merely being profitable; and it need not attempt to acquire an unnatural technological visage or posture for this purpose. What is wrong with success as a hamburger king, or in any franchised operation, or as a subcontractor, or as a vendor? I do not at all mean to rule out the inventive or ambitious scientist-entrepreneur who insists on doing what comes naturally—to *him*.

Recent literature acknowledges more amply the importance, both past and present, of the mobile skilled person in the transfer of technology. For example, Rosenberg, in *Technology and Culture* (October 1970), cites the role of trained migrants in the Nineteenth Century in furthering the progress of Britain, the European Continent, and the United States, as well as in promoting interindustry cross-fertilization within our country. A study of the contemporary instrument industry by Shimshoni, reported in *Minerva* (January 1970), has found that,

"even within the framework of large organizations, the processes of diffusion and innovation and of charting new paths depend inherently on the possibility of action and movement—for the individual man or small group—which can enhance the chances of the unplanned, unforeseeable discovery" (p. 88). Accordingly, public policy should "encourage the mobility of those with special knowledge." Far from having run their course, "the small firm and the individual scientific entrepreneur" remain "central to a great deal of innovation." A report of the National Academy of Sciences, *Applied Science and Technological Progress* (1967), properly notes that technological transfer is "a vital and often misunderstood step" in the process of innovation. Within a company and between companies, it singles out for attention the "movement of knowledgeable people, either temporarily or permanently." While agreement is easy on the proposition that a decisive role is often played by "the technical entrepreneur, or missionary—the man who carries the torch for a new idea," we may well view as unfeasible the report's recommendation that his distinctive qualities should be nurtured:

Even though he may sometimes be more distinguished for enthusiasm and ingenuity than for profound understanding, his courage and tenacity are frequently vital elements of successful innovation. We need to identify such individuals early in their careers, to encourage appropriate educational preparation, and to ensure an occupational environment that will enhance their contributions. (P. 17)

Yes, the small firm—but it is the rare one of this *genre*—can still prove an appropriate vehicle for innovating radical departures, while the larger firm tends to concentrate on scoring points instead of knock-outs. Established organizations are tempted to maintain successful life styles by means of incremental process improvement or minor product modification and to recapture or shine up earlier reputations for product creativity by resort to merger. Many medium and large companies are alert to the dangers of complacency, however, and try explicitly to avoid technological lethargy and the eventual decay of innovative impulse. Formal research programs are intended as insurance against competitive surprise. Incentive payments for patent generation also are intended to keep a company vital.

At a 1968 symposium sponsored by the National Academy of Engineering, Harold W. Fisher told how Standard Oil Company of New Jersey has sought to protect the *élan* of its creative personnel. He cited regional decentralization, the shortening of communication lines, easi-

er access to pertinent decision-makers, and establishment of a separate group charged with new product development.

At the same meeting, Patrick Haggerty cited the efforts made at Texas Instruments to forestall the innovative entropy that is threatened by growth and success. Proud of the company's record of enlargement without merger, the leadership is attempting to devise a "system of management for innovation"—literally, to "institutionalize" growth from within.

These two papers on corporate "self-renewal" through continuing innovation merit fuller attention than I can here give to them. You will find them in *The Process of Technological Innovation*, National Academy of Sciences (1969). Another article of interest, in *Fortune* (November 1970), reflects the critical role of Dr. Edwin Land in preserving the dynamism of successful Polaroid.

Vigilance respecting the economic justification of mergers is always warranted in a free society, yet growth by the acquisition of companies can serve the interests of positive competition. In Part 8A of the 1969 *Hearings on Economic Concentration* before a subcommittee of the Senate Judiciary Committee, the Federal Trade Commission's staff remarked (p. 84):

Thus, merger is a device which expands the apparent supply of growth companies. Investors are continually seeking new investment vehicles through which substantial capital gains may be procured. Since product innovation is a risky and time consuming process, the basis on which IBM, Xerox, and Polaroid generated geometric increases in earnings per share cannot quickly be duplicated. However, earnings performance per se can be duplicated readily, in the short run, through a vigorous acquisition program and, under the mantle of managerial innovation, it may be generously rewarded.

Certainly, the public interest in economic efficiency, honest accounting, and open markets and the rights of ordinary shareholders have to be promoted and safeguarded; but we ought not overzealously and simplistically test the career of every company against a proverbial paragon, an innovating exception. Maintenance of operating profitability within the law, with reasonable service to customers, and without ponderable damage to competition would seem to be accomplishment enough for most companies, small or large, new or old. A firm need not be distinctively or continually creative for proof of its economic relevance.

Incidentally, Xerox, which is favorably mentioned in the above F.T.C. quotation, has embarked on a diversification program through acquisition; and the wisdom of, say, its acquisition of Scientific Data

Systems—engaged in computer production—remains to be determined. The prior existence of IBM or the Xerox subsidiary's initial failure to make a profit does not decisively rule the venture to be redundant and foredoomed. On the other hand, if the venture does succeed, it may unfairly be discounted in retrospect as a mere acquisition—regardless of any critical post-merger contribution, whether technical, financial, or managerial, from the parent company.

Earlier, I hinted at the shape of the new world that company innovators will have to brave, at the peculiarities of the noneuclidean terrain that future Institute researchers will have to traverse. The international environment, I think, will impinge more directly than ever on the consciousness of company decision-makers. Unfortunately, this intrusion will involve defense and expropriation as well as the more agreeable hazards of intensifying competition for markets. On the domestic scene, would-be innovators will have to reckon with a new breed of personnel and a more pervasive governmental presence.

War-weary as our people already are, they will not be able to retire comfortably into a post-imperialist twilight. Other nationalisms loom. Besides, the Soviet drive for strategic dominance is more insistent than in the past, although this topic is nowadays dismissed as boring, paranoid, obsolete, or incompatible with national policy. Furthermore, Chinese power grows, and it has been given no reason to become benign. Who can convincingly predict that a rapprochement of China and USSR is impossible? Presumably, the international dangers of the post-Vietnam era will reverse the sentiment for more abstemious defense outlays and for limitation of the concept of defense research (as expressed, for example, in the Mansfield amendment of 1969 to the military authorization bill for fiscal year 1970). Incidentally, one of the seven recommendations in *Science and Technology: Tools for Progress*, a report of the President's Task Force On Science Policy (April 1970), is that the President should "enunciate a national policy of increased emphasis on research and development for national security purposes—even at the expense of current military hardware procurement, if necessary". (P. 2)

It is unnecessary for me to dwell at any length on the implications of the recent presidential election in Chile or the increasing economic dynamism and ideological independence of the Common Market countries and Japan. Surely, the generous, sharing spirit still voiced in a report made in February 1970 by a panel of experts to the Department of Commerce, *Factors Affecting the International Transfer of Technology among Developed Countries*, will have to be subordinated to the

kinds of concerns being voiced by businessmen, government officials, and assorted noneconomists, who see a narrowing or reversing trade gap in such research-intensive or high-technology industries as electrical machinery, scientific instruments, jet aircraft, computers, and chemicals. I am deliberately ignoring the more familiar foreign competitive challenge to our shoe and textile industries. I commend to your attention an article by P. H. Abelson, a noted chemist, in *Technology Review* (January 1970), which documents and reflects on our deteriorating trade position in high-technology industries and finds no reassurance in our growing income from foreign investments and licensing operations.

Turmoil in the city and on the campus, the failures of government policy in stemming inflation, and other circumstances induced or exacerbated by the Vietnam involvement mean that extra costs have to be overcome in process and product development. Safety to person and property becomes an explicit consideration in the location of new facilities. More dramatic is the cost of reclaiming or conditioning new personnel, especially college-trained professionals who have participated in or witnessed illegal actions performed with impunity. Will such personnel accept readily enough the constraints and rules of work in an organizational context? In particular, will they be respectful of trade secrets?

Additional costs that will have to be hurdled in company innovation are posed by the trends toward "consumerism" and "technology assessment." Advance assurance of safety in use and of neutrality toward the quality of the environment will presumably slow the innovation of processes and products and entail a larger role for government regulation.

Finally, government will assume a greater entrepreneurial role. This hardly means classical socialism. Governmental leadership in policy and program formulation is compatible with partnership with private industry in implementation. Past relationships of government with business and universities in research and defense point the way. The subject matter, however, will be different—the liquidation of the huge backlogs of neglected public affairs. In *Manpower Tomorrow: Prospects and Priorities* (New York: Kelley, 1967) and elsewhere, I have noted the requirement for government to become the "employer of first resort"—not last resort—in refurbishing the cities, reducing crime, raising literacy and health standards, et cetera. Of course, the government will not only engage directly in such activities but work also

through private contractors. In this connection, I conclude with the recommendation in *Science and Technology* that:

The President enunciate a national policy of increasing long-term participation by private institutions—particularly business—in social, urban, and environmental programs. It is also recommended that the President direct appropriate Departments and Agencies to establish broadly-based efforts systematically to identify the deterrents to private investment of capital and technology in social, urban, and environmental programs, and to suggest specific incentives for action and remedies for each such deterrent. (P. 2)

A toast, then, to the future: May it exist, first of all; may our evolving nation prosper in it; and may the Institute make the unique constructive contribution for which this first incarnation has been a time of training.

International Industrial Property Rights

JOHN C. GREEN*

MANY OF THE INSTITUTE'S STUDIES include consideration of the international aspects of industrial property protection. I've selected a few items to report upon which demonstrate the range and variety of concern.

First are some of the practices U.S. companies follow in seeking protection abroad; second is information on the growing receptivity of Eastern European nations to conventional patent protection and licensing; and third is a description of a cooperative research program, with licensing implications, that the Organization of American States is embarking upon.

Prior to the meeting in Washington to consider the proposed Patent Cooperation Treaty, the Institute undertook to find out how adherence to that treaty would be viewed by innovators. Part of that assignment called for developing information on how U.S. companies decide to file abroad and in what countries. Our clinic and questionnaire provided a

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wealth of useful information showing that such decisions are the result of a combination of technical, economic and legal factors. One U.S. manufacturer's "case history" is indicative of the systematic procedures followed by firms with substantial foreign patent holdings. Let me highlight them.

The company in question conducts a decentralized research effort. Therefore, they find it necessary to have a patent committee in each of the domestic groups which carefully analyzes each invention and reports to the central patent branch. The report describes the invention, points out its technical merit and, where possible, offers an estimate on its value at home and abroad. Next, patent counsel prepares an analysis which outlines the practical factors involved, the advantages over comparable items and the hoped-for scope of protection. All this material is studied by the managers of licensing in the international group. Action is then taken based on this combination of information and experiment.

The 12 months priority period has been the time frame governing the necessary reports, decisions, and action. Counsel observed that during that period most, or all, of the "forecasts" for the invention are optimistic. Later, after the foreign applications have been filed, disturbing information turns up with respect to the invention's inadequacies and faults. As a result, those concerned with patent management feel that substantial sums are spent on inventions that don't pay off.

This company and a number of other firms active in international trade found the 20-month period contained in the proposed treaty most attractive. Their intended routine is to file an international case, pay a nominal fee to designate countries, then as close to the 20-month period as possible, to make a last minute commercial-technical review to see whether prosecution in the individual foreign countries should be continued. These firms believe that this technique will reduce the number of cases filed and later abandoned, thus saving some costs. More important, they see the acquisition of more information about the invention's features as leading to a better prosecution and stronger patents.

These views were echoed by the representative of a U.S. firm whose scientific laboratories, staff and accomplishments are world famous. He noted also that the desire of the company's scientific personnel to have their findings published at the earliest possible time, constituted an additional problem. Since scientists place great value on publication as a means of advancing their recognition and reputation, this company is under pressure to file as soon as possible. Later they may learn that the

scientist's calculations and conception didn't work out in a practical embodiment. Hence, that approach is dropped and the scientist goes off in another and currently promising direction. (Incidentally, this company's policy is to permit publication after the case has been filed in the U.S. Patent Office.)

The company's representative emphasized his belief that with more time to consider the technical feasibility and commercial potential they would do a better job of investing the dollars they commit for overseas protection.

The above observations were obtained from large companies experienced in international trade and technology exchanges. When we enlarged the forum of inquiry to medium-sized firms we were surprised to find a somewhat differing view. Nearly one-half of our respondents advised that the time extension wouldn't produce the information needed to make these more prudent judgments. In this connection one official said that their cases fall into two groups:

- (1) Those in which the company is reasonably sure that foreign protection is necessary; and
- (2) Those in which they don't have enough facts upon which to base an intelligent judgment. (He said that usually in case two, the information needed doesn't develop promptly enough to make a sophisticated decision.)

Why this difference in response? Perhaps the answer lies in the frequency of foreign filing and in the methods employed by large and small firms in deciding where to file. The large company, with its research and development division and patent counsel, can be expected to generate a greater number of patentable inventions than a small firm. Further, the large company may be in a better position to exploit these inventions abroad, either by sale or licensing or through manufacture by an affiliate. The smaller company, with fewer inventions, has less international experience and has not devised internal management methods for deciding promptly which inventions merit overseas protection.

Of course firms have to decide *where* to file abroad as well as when. The practical considerations involved here were summed up by an executive of a large, diversified manufacturing company who stated,

When we are faced with filing these overseas—there are so many places you can't file and maybe at least 50 that are worthy, that have patent systems worthy of the name. But if we were to take all of our U.S. inventions and file them in, say 50 countries overseas, we would have an astronomical cost that there would be absolutely no justification for in terms of any possible return. So just pragmatical-

ly, as it works out, being more selective and having perhaps different criteria for filing, we end up with about three times the filings overseas that we have domestically. And this is roughly composed of something less than 50 percent of our U.S. inventions filed in an average of seven countries.

Now why seven countries? Well, it has been our observation that you can have a very valid patent but it is no use to file in a country where there is no foreseeable opportunity for someone in that country to exploit it. Let's say you have something wonderful in space technology. Well, you're not going to file this in any country where there is probably not going to be any significant effort made by entities in that country in space technology. It just isn't worth it. So the tendency as you're hedging your bets is that you pick the highly industrialized countries as primary. Then as the importance of your invention in your view is greater or has a more catholic use, you extend this to other countries.

I should qualify those observations by noting that where a developing country has abundant natural resources and the U.S. firm has patents, and perhaps know-how, directed to the processing of those resources, the U.S. company will be likely to file there. And this is particularly true if the processing plant will be constructed in the developing country. However, generally speaking—

- (1) It doesn't make much sense to seek patent protection where the opportunities for exploitation are negligible; and
- (2) The chances are not good that one will get a strong, enforceable patent in a country with a weak system for protecting industrial property.

Many who agree that U.S. firms should be encouraged to transfer their technology to developing countries ignore these economic facts of life.

Now let's discuss a part of the world where the climate for "technological transfers" may be more attractive than heretofore has been the case.

East-West trade has been talked about for many years and interest waxes and wanes in direct relation to our diplomatic cordiality with the nations behind the Curtain. At present there is increasing interest which leads to a report on negotiations of such agreements prepared by the well-known French attorney Yves Plasseraud and reported in *IDEA* early this year.*

Plasseraud observes that as far as the acquisition of Western technology is concerned, the policy of the Iron Curtain countries has changed recently. For many years their practice was to take advantage of good technical ideas without consideration of the rights of their inventors

*Yves Plasseraud, "East-West Trade and Industrial Property," *IDEA*, Vol 13, No. 4 (Winter 1969-1970), p. 683.

who at that time didn't seek legal protection in those countries. Plasseraud points out that since the ideas were not protected by industrial property rights, strictly speaking, they weren't infringed.

It seems that this practice is proving less and less beneficial and that recognition of this fact is leading officials in the Socialist countries to seek licenses to use foreign technology. Among the reasons given for this change of attitude are:

- (1) The technically sophisticated developments now desired cannot be recreated easily from samples or studies of patents specifications. Know-how is needed and this is controlled by the foreign owner; and
- (2) The Socialist countries, especially the Soviet Union, are seeking an international position in harmony with the size of their industry. Such a position requires overcoming their traditionally bad reputation and leads them to respect patents belonging to foreigners.

Plasseraud's argument is that Western industry should be aware of this radical change and become interested in protecting commercially valuable inventions in such countries. He goes on to point out that negotiations with officials from Curtain countries are frustrating and protracted. Further they can rarely be on a direct basis between the U.S. company and the State manufacturing enterprise. Usually the organization which takes the initiative in seeking out the Western firm, deciding that its technology is needed, conducting the negotiations, and arranging for payment is a specialized organization created for this purpose, staffed with skilled negotiators and having an amount of currency at its disposal.

One of Plasseraud's themes is that in dealing with the State enterprise it is well to have a patent. He claims that such protection facilitates the licensing arrangements, and prevents unauthorized use of the invention in the absence of a properly executed agreement. A last word of caution, he notes that the Eastern organizations scrupulously comply with the requirements of a well-drafted agreement but that lack of precision risks "misinterpretations."

My last report relates to Central and South America, a part of the world which has relatively advanced economies, like Argentina, Brazil and Mexico, less developed countries like Paraguay and Bolivia, and intermediate nations like Chile and Colombia.

The central forum for these numerous countries, the Organization of American States, has ambitious plans to encourage the development of technology in Latin America, which technology will be more directly

related to the needs of Central and South America than are many developments imported from abroad. One element of the OAS program is titled, "Multinational Cooperative Research." This is a new program to be built around the idea of identifying a research project which has a reasonable chance of success, and of advancing the economics of Latin America—then designing a project which enlists the talents and resources of a number of research institutes. The four salient features of the program are:

- (1) It will emphasize *applied* research;
- (2) OAS will identify suitable research areas and will marshal personnel and facilities;
- (3) OAS will seek multinational participation; and
- (4) OAS will provide some of the financial support.

You can see that unusual questions of patent procurement and administration will undoubtedly arise.

Planning personnel at OAS headquarters approached the Institute to obtain guidance on a suitable patent policy. They made it clear that their major objective was to discover and adopt a policy which would encourage local industries to employ the research findings. Of course they also made it clear that the policy would have to be in harmony with the fundamental objectives of the OAS and could not especially favor one country over another.

The Institute accepted the challenge and a research unit was formed. Joseph Lightman undertook a substantial amount of the effort and deserves credit for the quality of the product and for OAS commendation for a job well done. The first step in the project was to inventory patent policies of national governments, international organizations and "public service" institutes to identify such policies, to seek useful precedents and to clearly distinguish the special OAS requirements from those followed by such nations and organizations. This was a task of no mean dimensions. Among operations examined were:

- (1) The organization of Economic Cooperation and Development (COECD);
- (2) The European Economic Community (EEC);
- (3) The World Health Organization (WHO);
- (4) The European Atomic Research Community (EURATOM);
- (5) The European Coal and Steel Community; and
- (6) The United Nations, especially the United Nations Industrial Development Organization (UNIDO)

Policies of other governments encompassed included Japan, the United Kingdom, Belgium, France, Germany and the Scandinavian

countries. And of course the policies followed by agencies of the United States Government were looked at in detail since one of the objectives of President Kennedy's 1963 directive was to promote commercial utilization of inventions resulting from government research and development contacts.

In addition the policies followed by U.S. research organizations in close touch with industry, like Research Corporation, American Research and Development Corporation, Arthur D. Little, Battelle Memorial Institute and Stanford Research Institute were a part of the examination.

It was found that, with one exception, no international, or regional organization, supporting R&D had an on-going program for acquiring patents. That exception was the European Atomic Research Community (Euratom). Other international bodies usually publish research results, or otherwise place them in the public domain. On the other hand, governments, our own included, have developed patent holdings and have laid down policies designed to encourage the industrial application of the findings. One plan is that followed by the United Kingdom which has a quasi-governmental organization known as the National Research and Development Corporation to hold and exploit inventions. (In passing I might mention that the French Government has authorized a similar mechanism which should become a reality shortly.)

Analyzing the numerous policies, probing for the reasons behind them and matching them to the OAS criteria was a considerable task. Finally, the team concluded that there were five alternative policies available to OAS each with certain advantages and disadvantages. We titled these the EURATOM type, the U.S. Government type, the OECD type, the case-by-case approach, and dedication.

In the EURATOM type the OAS would assume title and patent rights to all such disclosures with full licensing responsibility.

In the U.S. Government type OAS headquarters would function as does the President's Office, in setting general policies with respect to patents and in monitoring R&D activities that it would sponsor. This monitoring would include review of patents obtained and their administration.

The OECD type would be a step further down the rung of government participation. Here OAS would, as OECD does, encourage its members to develop sound national patent systems on the theory that a strong and valuable patent is unlikely to exist in a country with a weak and ineffective system.

The case-by-case approach is essentially not to have a specific policy yet, but to make decisions as successive inventions arise. Ultimately, this approach could develop into an OAS policy tailored to its needs but built upon national and international experience.

The last and simplest, from an administrative standpoint, was simply dedication of all rights in OAS-sponsored R&D followed by publication.

We were obviously not in a position to make firm recommendations on which alternative, or combination of alternatives, an international body with special economic and political considerations should choose. Therefore, these five alternatives were presented to OAS with an explanation of the advantages and disadvantages of each. Discussions are still taking place and I suspect a final and firm choice will await the funding of the first multinational project. In the meantime the Institute has published its findings which, as I observed earlier, were received most favorably by the Organization of American States.

As I indicated at the beginning, many of the Institute's recent efforts have included examination of international aspects of industrial property protection. Looking ahead is a complementary approach based on the idea that commercial transfers of technology flourish or wane depending on a number of variables. A firm in country X considering sale or licensing in country Y wishes to make sure that its rights in that technology are protected. This assurance is not conveyed alone by the laws and treaties to which country Y may subscribe. Such matters as the strength of its patent system, the government's policy with respect to industrialization, the attitude toward foreign capital, the method of doing business, including the degree of government intervention, and country Y's economic development, are all significant factors. The Institute plans to identify and examine items to show where they facilitate or impede. I should state that this project is not yet "cast in concrete" and we would welcome suggestions on its design from knowledgeable persons.

The Cost of Patent Litigation Study: Current Status and Future Direction

L. JAMES HARRIS*

BACKGROUND

THE INSTITUTE IS CONDUCTING A SERIES OF STUDIES designed to draw together factual information and expert opinion on reducing the delay and expense in patent litigation while maintaining patent reliability. In the first phase of this study, the Institute sent a pilot questionnaire to a sample of patent experts in industry and in private practice seeking their opinion and experience with respect to (1) the patent system in effect today and (2) their reaction to a proposed Dual Patent Program suggested as a long-range proposal for the future.¹ Following the pilot survey, questionnaires were sent to a larger sample; they were primarily

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¹L. James Harris, "A Dual Patent Program: To Increase Patent Reliability and Decrease Litigation Costs," *IDEA*, Vol. 13, No. 1 (Spring 1969), pp. 1-24; L. James Harris, *IDEA*, Vol. 13, Conference Number 1969, pp. 51-59, 93, 94.

concerned with the current system. The questionnaire data is published on pages 77 to 88 of this issue of *IDEA*. In addition to the questionnaires, we reviewed approximately 300 patent decisions from 1965 through 1969 included in the *USPQ* involving those factors most often referred to by respondents to our questionnaires as areas of cost-cutting opportunity. Mr. Peter Rosenberg reports on pages 89 to 92 on the cost-benefit patterns these decisions reveal that might usefully supplement our other survey data. A sample of Cleveland attorneys were interviewed by Mr. Frederic Schramm to provide further depth to this phase of the study, and is presented on pages 93 to 110.

In pursuit of speedy and inexpensive determination of patent litigation, respondents to the Institute's questionnaires most often advocated that (1) greater use be made of Pre-Trial Conferences; (2) more cases be decided on the basis of Summary Judgment motions; (3) judges be more effectively educated; (4) additional attention be given to the separation of issues; (5) limitations be placed on Discovery procedures. There was also sentiment, to a lesser degree, in favor of some form of judgment estoppel. In our examination of the returns, we were impressed with the many factors respondents thought affected costs and where they suggested that economies could be made—for example, the complexity of the case, the type of relief chosen, the number of parties, the expected recovery, the financial potential of the parties, the defenses available, the location of the trial, the jurisdiction of the court—and even the temperament of the parties. Respondents were well aware that courts were under continuous surveillance and that changes in judicial regulations were constantly being made.² They pointed out, however, that these changes were directed to general judicial problems, and were not particularly designed to remedy patent litigation difficulties.

SUMMARY JUDGMENT³

Certain speedy and relatively inexpensive methods of procedure, such as a motion for Summary Judgment, respondents think are practically lost to patent cases. Even where credibility is not involved and there is no issue of fact—except that understanding the art escapes the judge—he usually requires demonstration before a trial court.⁴ He

²See Historical Note in Federal Rules of Civil Procedure for the U.S. District Courts, as amended July 1, 1970 (Washington, D.C.: G.P.O. 1970).

³Title VII, Rule 56, Federal Rules of Civil Procedure for the U.S. District Courts.

⁴See *Technograph Printed Circuits v. Method Electronics* 148 *USPQ* 181 (1966); *International Silver Co. v. Pomerantz* 271 F. 2d 69 (2nd Cir. 1959).

considers himself incapable of determining whether there is a “genuine issue as to any material fact” in accordance with Section 56 (c) of the Federal Rules of Civil Procedure.

Since judges appear to be overcautious in using this technique in patent cases,⁵ whether because of the technical complexities of the art involved or their lack of experience with such cases, respondents advocate changes so that it can be employed, as it is in other cases, as a very useful part of court procedure. Though courts have granted Summary Judgment in patent cases where issues have been easily understandable, this has been the exception rather than the rule.

Curiously, some judges *say* that with respect to Summary Judgment patent cases should be treated like any other cases, yet patent Summary Judgment motions are actually handled uniquely even by them.⁶ Perhaps it is because these cases are unique: They deal with technical subject matter, generally complicated to the lay person; with unusual patent concepts, such as file wrapper estoppel, unobviousness, and novelty; with experts at all stages of the litigation, both in technology and patent law; with an intangible, limited property right created by administrative grant; with multidistrict litigation; and with an array of economic evidence due to the growing popularity of fraud, misuse and antitrust defenses and counterclaims. Small wonder that we encountered patent attorneys in our personal interviews who thought there would be a saving if filing Summary Judgment motions were avoided. They pointed out that Summary Judgments are now seldom granted in patent cases because the relatively complex cases are generally litigated and the simple ones settled by disputants themselves. These attorneys question whether the time, effort and cost involved in the preparation and prosecution of such motions, pursuant to present practice, are really worthwhile.

DISCOVERY⁷

Theoretically, there are many benefits that should accrue from a liberal Discovery procedure—and many of these benefits do accrue in patent cases. From the responses we received, it appears to educate the parties in advance of trial; prevent surprise at the trial; and assist in ascertaining truth and preserving testimony. However, it does *not* appear to be a simple, convenient and inexpensive way to obtain facts.

⁵See *Rankin v. King* 123 USPQ 397; *John Wood Co. v. Metal Coating Corp.* 144 USPQ 402; *Walker v. General Motors* 149 USPQ 472.

⁶See Peter Rosenberg, p. 91 of this issue.

⁷Title V, Rules 26, through 37, Federal Rules of Civil Procedure for the U.S. District Courts.

Nor does it seem to encourage settlements before trial. It certainly does not appear to save the time of litigants. Thus, it may facilitate the trial of cases due to advance preparation, but this is difficult to support because respondents were more frequently concerned with the abuses of the Discovery procedure and dwell much less on the assistance it provided for trial.

However, Mr. Schramm's personal interviews in the Cleveland area surfaced certain positive effects of Discovery on settlement. He found some evidence of a tendency to settle where the costs of Discovery had not yet run very high, due to the possibility of incurring high Discovery costs in the future. He also noted that early and penetrating Discovery appears to improve the chances of settlement when counsel is experienced and can evaluate the relative strength of the parties.

Both corporate and outside counsel responses agree that the principal cost of litigation is Discovery. Since the rules for Discovery are already integrated for the purpose of expediting litigation with other pre-trial Federal Rules, such as that under Rule 56 for a motion for Summary Judgment, it seems most important to examine carefully the reciprocal effects⁸ among these rules of the suggested changes proposed by respondents. The following are a few examples of the suggestions they made on Discovery. An eminent New York private practitioner recommends the following:

- (1) Place a time limitation on Discovery;
- (2) Charge costs to litigants making unnecessary Discovery;
- (3) Have all matters of Discovery handled by a single judge who will also try the case; and
- (4) Experiment with Discovery before special officers of the court with appeal to the trial judge.

A well-known Cleveland patent attorney suggests that Rule 33 be limited to 50 interrogatories without leave of court, and that Rule 36 be limited to genuineness of documents and to not more than 50 facts with the court's leave. Attorneys interviewed in the Cleveland area suggest utilizing the "much criticized" interrogatories for non-crucial points instead of taking depositions, permitting not more than a group of 10 interrogatories submitted at any one time without leave of court, and limiting each group to one major issue.

⁸Reference is directed to the careful attention given to the reciprocal effects of Rules 26-37 on each other in the amendments to the Federal Rules of Civil Procedure relating to Discovery proposed by the U.S. Supreme Court Advisory Committee on Rules of Civil Procedure. (See House of Representatives document No. 91-291, pp. 17-62.) Similar care should be exercised in instituting changes among Discovery and the other procedural rules advocated by our respondents.

A motion for Summary Judgment is based on the pleadings, depositions, answers to interrogatories, admissions and affidavits. Accordingly, the fruits of Discovery (depositions, answers to interrogatories, admissions), it is thought, can play an important role in the granting or denial of Summary Judgment. In fact, where depositions and admissions are used to establish a claim for Summary Judgment, they are considered superior instruments to affidavits because admissions are against interest and the person deposed has usually been cross-examined. Thus, if the changes recommended in Discovery procedure by respondents can enhance its effectiveness for patent purposes, such changes are likely to dispose judges to grant Summary Judgments more frequently. Judges are loath to dispense with a trial where there is a possibility that such an action would defeat, in whole or in part, the recovery of a just claim. If depositions and admissions can separate for the court what is immaterial and pretended from what is genuine and substantial so that the court can determine to its satisfaction that the facts are undisputed, the court can reasonably be expected to apply the law to such facts and render Summary Judgment. As a matter of tactics, respondents suggest that motions for Summary Judgment be delayed until all Discovery procedures have been completed. Even if the case does go to trial, Rule 56 compels the court to examine the issues and ascertain what material facts exist without substantial controversy and what material facts are actually and in good faith controverted. Therefore, improvement of Discovery procedures could benefit the suit even if it were not summarily adjudicated in its entirety.

Although Rules 26 through 37 are intended to provide procedures for the parties to discover for themselves the facts in controversy not disclosed by the pleadings, a number of the respondents advocated the exercise of effective control by judges of all pre-trial procedures, including Discovery. Most of these suggestions included additional limitations on the methods of Discovery. One highly regarded New York patent practitioner recommended that permission for all manner of Discovery "should come from the same judge who should deny it in the absence of good cause." The responses show that to further the objective of simplifying and of shortening patent litigation, and possibly avoiding trial, a reappraisal of the relationship to and function of the judge in the federal pre-trial procedure plan with respect to patent cases is essential, particularly his role in Rules 26 through 37 for Discovery, Rule 56 for a motion for Summary Judgment, and Rule 16 for Pre-trial Conference. Query: Is the gradual method of introducing direct judicial control insufficiently productive in patent cases (i.e.,

from the self-help of Discovery, through the requirement for motion in Summary Judgment, to the judge's own initiative in the Pre-trial Conference)?

A field survey of federal Discovery practice conducted under the direction of Professor Maurice Rosenberg of Columbia Law School⁹ concluded that the costs of Discovery did not appear to be oppressive¹⁰ and that it provided evidence that would not otherwise be available to the parties.¹¹ There appeared to be no evidence, however, that Discovery promoted settlement.¹²

A comparison of these findings with those in Professor Rosenberg's earlier study of the Pre-trial Conference procedure of negligence cases in the state of New Jersey, is instructive. In the New Jersey study, he found that the Pre-trial Conference did not promote settlement or shorten trial time, but did appear to make the lawyers better prepared;¹³ in the Discovery survey, the results indicate that these procedural rules provide evidence that would not otherwise be available to the parties. Can we conclude from the Columbia surveys that, with respect to *general* judicial problems, the greater the involvement of the judge, the better the preparation for trial, and the more the reliance on counsel, the more likely there is to be evidence not otherwise available—and consequently a fairer, albeit more extensive, and perhaps more expensive trial? Our own figures show that Discovery for medium and complex patent cases is considerably higher, percentage wise, than for simple patent cases, but that costs of trial, percentage wise, remain approximately the same.¹⁴ The Columbia study indicates "that Discovery not only fails to cure the frequency and length of trials, but if anything correlates with more and longer trials." In that study, the investigators contend, however, that the connection is not a causal but a coincidental one. They conclude "that Discovery probably has a tendency in some cases to bring the parties into closer agreement on the facts, thus easing settlement, while in others its tendency is to add new issues that make the case more difficult to settle. Overall it clearly does *not* save court time to any substantial extent."¹⁵

⁹*Field Survey of Federal Pre-trial Discovery*, A Report to the Advisory Committee on Rules of Civil Procedure, Columbia University Project for Effective Justice (1965).

¹⁰*Id.*, pp. 1-19.

¹¹*Id.*

¹²*Id.*, pp. 1-14.

¹³See Brown, Karlen, Meisenholder, Stevens and Vestal, *Procedure Before Trial* (St. Paul, Minn.: West Publishing Co., 1968), pp. 508-511.

¹⁴See Tables 1-4, L. James Harris and Terry M. Chuppe, pp. 77 to 88 of this issue.

¹⁵*Supra* note 9, pp. 1-15.

THE PRE-TRIAL CONFERENCE¹⁶

The Pre-trial Conference, under Rule 16, has generally been recommended for utilization shortly before trial. The theory is that attorneys and their clients are most receptive to the suggestion for settlement shortly before trial, because the imminence of trial makes a question of settlement a real and pressing one. Also, the parties and the judge are supposed to have a clearer picture of the case at that time. Although it may be contrary to this theory and the current trend of liberalizing the Rules of Federal Practice, with respect to patents our responses indicate that it may be advisable to provide legal machinery for earlier and more sustained judicial control or, at least, encourage judges to utilize Rule 16, or devise a similar rule, for the purposes of maintaining a continuous and consistent authority over depositions and other methods of Discovery. In so doing, the judge may at an earlier date become more thoroughly acquainted with all aspects of the case and thus be in a better position to grant Summary Judgment. Even if Summary Judgment were not granted, the judge could eliminate the issues not in dispute and parties could be certain from the outset, by order of the court, as to the points that will govern. Also, the judge would be in a better position to obtain the agreement of counsel that proof may be made inexpensively. This could be a considerable saving in time and cost in complex patent cases.

A caveat is suggested at this point. From our interviews, we learned that certain local rules and custom may hamper the judge in exercising control;¹⁷ and, accordingly, changes in the Federal Rules of Civil Procedure without concomitant modifications in local prescriptions may fail to give the court effective control.

The findings of the Columbia Pre-trial Conference survey appear to support greater utilization of judges with respect to Rules 26 through 37 in Discovery procedures for patent cases, as recommended by respondents in our study. The Columbia study must be given serious consideration since New Jersey was a strong supporter of Pre-trial Conferences. The finding of Professor Rosenberg that the Conferences are valuable in cases that reach trial by making the lawyers better prepared is promising for patent cases. By analogy, if Pre-trial, or similar Conferences were introduced at the Discovery stage in patent cases judges would also be better prepared to rule on motions for

¹⁶Title III, Rule 16, Federal Rules of Civil Procedure for the U.S. District Courts.

¹⁷See Frederic B. Schramm, p. 99 of this issue.

Summary Judgment. Although Professor Rosenberg concluded that Pre-trial Conferences are not useful for those cases which are settled, some authorities take a narrow view of the New Jersey data, voicing the opinion that such Conferences may better prepare judges to "energize" settlements in those jurisdictions in which the Conferences are directed to this objective. They say that the Pre-trial Conferences are held in New Jersey with primary emphasis on the formulation and clarification of issues rather than for settlement; and, therefore, the study findings are not applicable to other jurisdictions where the Pre-trial Conference is directly aimed at settlement.

Patentees may be interested in another aspect of Professor Rosenberg's Pre-trial Conference survey. He found that Conferences tended to increase substantially the amount of plaintiff's recovery. Although the frequency of that recovery was not affected and the survey was confined to negligence cases, the possibility of advantage to plaintiff patentees should not be too lightly regarded.

Precedent and experience for control by the courts (by means of a Pre-trial Conference procedure) rather than by the parties, of Discovery for complex and protracted cases can be found in the program of the Coordinating Committee for Multiple Litigation and the Judicial Panel on Multi-District Litigation, authorized by the Multi-District Litigation Act, signed by the President in April 1968, which provides for coordinated and consolidated pre-trial proceedings in civil actions pending in different districts involving common questions of fact.¹⁸ This Act provided a procedure for the processing of complex litigation resulting from the deluge of antitrust suits that were filed against electrical equipment manufacturers. To process these suits, a program of controlled Discovery on a national basis was instituted. This was accomplished by pre-trial orders recommended by the National Coordinating Committee for entry in the various districts, providing for all phases of Discovery. At least four Pre-trial Conferences were scheduled for each case beginning with the assumption of judicial control to the establishment of a comprehensive plan for conduct of the trial. Where possible, cases were assigned "to a single judge to provide uninterrupted judicial supervision and careful, consistent planning and conduct of pre-trial and trial proceedings."¹⁹ The experience of the Panel on Multi-District Litigation, sparked by the electrical equipment cases, has particular significance for multi-district, protracted patent litigation and is an example of effective utilization of judicial authority for complex Discovery proceedings.

¹⁸Section 1407 of Title 28 of U.S.C.

¹⁹*Id.*

DIVISION OF THE ISSUES

A number of respondents were of the opinion that a proper division of the issues would expedite litigation in patent cases. This suggestion was made in different ways. A Philadelphia patent attorney stated it unequivocally: "If issues were divided, there would be more settlement of patent cases"; and a patent attorney from Cleveland added that issues should be tried first which could dispose of the case. A Chicago patent attorney came right to the heart of the matter, he recommended that "antitrust counter-claims should be permitted only on a verified showing of good cause."

A court, pursuant to Rule 42 (b),²⁰ may order separate trials in furtherance of convenience or to avoid prejudice, and, accordingly, its authority is quite broad in this regard; and because Rule 42 (a), allowing consolidated trial for claims or issues, is liberally construed, Rule 42 (b) might receive a liberal construction for the same reasons. For example, a showing of "good cause" might be required for anti-trust counterclaims in view of the peculiar bias against patents in certain quarters (due to the limited "monopoly" of the patent) and the growing "fashion" of including antitrust counterclaims in patent cases.

To warrant severance, however, and invoke Rule 42, the expectancy of economy in time and expense must be more than speculative. Here again, the interrelationship of the various federal rules to secure the just, speedy, and inexpensive determination of actions might be constructively exploited. Trial judges have been urged to make use of Rule 42 to expedite trial, and adequate Pre-trial Conference could do much to relieve the burden on Rule 42 by either more clearly indicating the need for granting severance or by eliminating the necessity for it. In complex patent cases, where the economy may be speculative despite the size and complicated nature of the case, rather than risk severance, it might be more feasible to utilize the Discovery procedure in furtherance of convenience and to avoid prejudice, instead of severance, if one judge had direct and continuous control.

Attorneys we personally interviewed, who had represented prevailing patentees, were particularly opposed to the pleading of fraud on the Patent Office.²¹ They were of the opinion that defendant could succeed by citing the prior art and that the extra time and effort involved in proving and defending against fraud was an unnecessary and growing abuse. Although their recommendation goes beyond severance—to a restoration of an action for fraud to the Department of

²⁰Title VI, Rule 42, Federal Rules of Civil Procedure for the U.S. District Courts.

²¹See Frederic B. Schramm, pp. 104-106.

Justice—I include the defense of fraud in this section of the paper because of the extraneous issues it raises, from antitrust implications to an inference of collusion.

EDUCATION OF JUDGES

Many respondents advocated more effective education of judges. The concern appears to be with their lack of technological competence, although the significance of judicial skill in the relevant branch of the law is not obscured. Aware of the fact that patent cases are generally assigned to judges who like to try them, respondents find that this is not always the case or that individual judges in certain districts can get little experience with patents. Although a seminar system could educate judges in patent law, such an approach would appear to be ineffective in improving their general technological interest or competence. It seems more practical to systematically assign patent cases to judges who prefer them and to depend, as is presently being done, on the patent attorneys trying the case to prepare the judge technologically (as well as on the patent law) on the particular subject matter in controversy. Since the patent attorney must be educated by the inventor, especially where the invention is complex or opens a new field, the attorney is in a good position to repeat the learning process with the judge. Oral hearings were preferred by the attorneys we interviewed;²² and they wanted a concomitant reduction in formal writing, briefing and reply briefing, except where required by the court. Great weight must be given to the educator's (attorney's) choice of educational instrument.

The ideal solution would be the institution of a Validity Court, which was proposed in a paper I presented to the junta meeting of the Philadelphia Patent Law Association in March 1969.²³ The members of the Validity Court would be technically as well as legally trained and experienced. The Validity Court is part of a proposal comprising a Dual Patent Program, requiring considerable procedural changes in the American patent system, which was offered as a long-range proposal to provide guidelines for the future.²⁴

A feasible, short-term remedy for the education of judges, in line with sentiment of our respondents, is that proposed by George Frost in

²²*Id.*, p. 99-100.

²³*Supra* note 1.

²⁴L. James Harris, "I. Private Stakes in Invention, Part C—Cost of Enforcement of Industrial Property Rights," *IDEA*, Vol. 13, Conference Number 1969, pp. 54-55: "It is in the national interest to transfer more of decision-making on patent valid-

his paper on the "Patent System and the Modern Economy."²⁵ He suggests "the possibility of having district judges in each circuit of technical competence and experience for special assignment to technically complex patent cases."²⁶ He believes that "this can be done in considerable measure within the confines of existing legislation."²⁷

To summarize: The consensus of our respondents is that a preemptory introduction of judges, preferably those interested in patents, at an earlier stage of pre-trial procedure, such as Discovery, and the institution of a personal docket in which each case is assigned to a particular judge,²⁸ would provide the parties more opportunity to educate the

ity from the general courts to (a) the Patent Office where the technical expertise is accessible and the climate is more favorable; to (b) a new special Validity Court, provided that the procedures in the Office are arranged to assure the issuance of high quality patents; and to (c) interested people outside the Office who have the incentive and information to perfect the Patent Office search. There also appears to be a need for two distinct patents with reliability tailored primarily to the unique requirements of two different publics. It is therefore proposed that a long-term, 17-year patent, 'incontestable' five years after issue, and a short-term, 7-year patent, 'incontestable' one year after issue, be instituted. During the first five years of the long-term patent and the first year of the short-term patent, they would continue to be subject to current practice and procedure, except that the issue of validity would be tried only before a Validity Court. After one or five years, as the case may be, the patent would become 'incontestable' with respect to validity and could be challenged before the Validity Court on but three grounds—prior invention, fraud or deception, and the patentee's own publication, use or sale more than one year prior to filing. Prior invention involves complete anticipation; it does not comprehend the obviousness concept. Infringement, antitrust, and misuse issues would continue to be treated in the general courts in accordance with current practice.

"If a question of validity arises the U.S. District Court's proceedings could be suspended while the special Validity Court takes cognizance of the question, unless the District Court determines validity is raised in bad faith or that the patent is valid; or, unless in furtherance of justice and expedition, the District Court decides to retain jurisdiction and render its decision on infringement before referring the case for an opinion on validity to the Validity Court. Thus, when the District Court questions validity (where that court believes the patent to be invalid) but validity and infringement are inseparably intertwined, it can retain jurisdiction to decide whether the patent is infringed were the patent, subsequently, to be declared valid by the Validity Court. The District Court could refer the case at any stage to the Validity Court for decision on validity. After decision by the special court, the District Court would resume its jurisdiction of the case, if necessary, giving full and complete recognition to the opinion of the special court."

²⁵George E. Frost, *The Patent System and the Modern Economy*, Study of the Subcommittee on Patents, Trademarks, and Copyrights of the Committee on the Judiciary, U.S. Senate, 84th Cong., 2nd Sess., pursuant to S. Res. 167, Study No. 2. (Washington, D.C.: G.P.O. 1957.)

²⁶*Id.*, p. 74.

²⁷*Id.*

²⁸*Supra* note 21, pp. 102-104.

judge by involving him in the "nitty-gritty" of getting the facts from the very beginning of the litigation. In this way, even if he weren't experienced with or interested in patent cases, the judge's knowledge would grow along with the labor of attorneys in disclosing the real points at issue and obtaining the evidence. The amount of judicial time consumed should be more than made up in the reduced burden on the court of irrelevant evidence, unnecessary witnesses, and extraneous issues—and in the longer run, developing a panel of highly experienced patent judges.

ESTOPPEL BY JUDGMENT

There was some sentiment among respondents to institute an estoppel procedure that would allow a final judicial determination of patent validity or invalidity. The suggestions took the form of enactment of Recommendation 23, in rem invalidity, proposed by the President's Commission on the Patent System,²⁹ or some form of collateral estoppel with a concomitant relaxation of mutuality. The intention appears to be, with respect to 23, that a claim once held invalid would be treated as cancelled from the patent and preclude a subsequent suit on that claim. The proponents of this type of remedy argue that the patentee has had his day in court, exhausted his remedy of appeal, and should not be allowed to harass others on the basis of an invalid claim.³⁰ Opponents contend that there has not been excessive subsequent litigation on patents held invalid and that invalidated patents have not infrequently been held valid thereafter. Opponents of in rem invalidity fear that such an estoppel will merely change the issues and compel the patentee to litigate more vigorously to avoid the total loss of his rights.³¹

On collateral estoppel with relaxation of mutuality, proponents contend that while it is true that the doctrine of *res judicata* requires that there be identity of parties, the trend of the cases in recent years has been away from this strict rule, and there is no constitutional right violated where the claim was litigated in a previous suit, final judgment entered, and the patentee had full opportunity to litigate the claim. On the other hand, some do question whether the lack of mutuality in such

²⁹*Report of the President's Commission on the Patent System* (Washington, D.C.: G.P.O. 1966), pp. 38-39.

³⁰*Id.*, p. 39.

³¹See Alton D. Rollins, "In Rem Invalidity: A Solution in Search of a Problem?", *IDEA*, Vol. 12, Nos. 2-3 (Fall 1968), pp. 901-943.

estoppel involves certain constitutional rights with respect to due process (e.g. can a party not in privity be bound by a previous holding of validity of a claim without something more, such as "estoppel by conduct,"³² even if that conduct is only implied?); and they, therefore, suggest that the question of estoppel by judgment, where there is not privity of parties, should be determined from the facts in each case.

A number of other suggestions were made by the respondents, such as the utilization of arbitration procedures, filing pre-trial briefs and elimination of trial brief, providing daily transcripts of the trial record, machine retrieval and searching of the record, and increased award of attorneys' fees. However, it is not my purpose in this paper to detail each recommendation; consideration is given only to those suggestions made by a relatively larger number of respondents. Clearly, the nature of the responses indicate that changes in procedure in the federal courts relating to patent cases are not necessarily in line with those which are believed to be, and have been instituted,³³ in the best interest of general practice. This may involve some radical differences in treatment from and raise new and difficult problems with respect to the Federal Rules of Civil Procedure, but this may be necessary to meet the needs of patent cases.

To shed further light on these needs, the Institute is directing the next phase of this study concerned with the reduction of litigation costs, to the four procedures (1-Pre-trial Conference, 2-Summary Judgment, 3-Separation of Issues, 4-Discovery) respondents to our questionnaires most often advocated as providing cost-cutting and delay-eliminating opportunities. We will question a representative sample of plaintiff and defendant litigating attorneys with respect to their cases terminated by settlement, judgment or dismissal during a relatively short recent period. We will be especially interested in information on (1) the costs and benefits resulting from the early preemptory introduction of the judge into pre-trial proceedings in patent cases and (2) how to make pre-trial procedures in patent cases more effective, particularly the methods of Discovery.

³²For an example of the use of "estoppel by conduct" to meet the constitutional question, see the discussion of the Dual Patent Program in *IDEA*, Vol. 13, No. 1 (Spring 1969), pp. 14-17; and *IDEA*, Vol. 13, Conference Number 1969, p. 57 ff.

³³See Federal Rules of Civil Procedure for the U.S. District Courts, as amended July 1, 1970 (Washington, D.C.: G.P.O. 1970).

Cost of Enforcement of Industrial Property Rights: An Analysis*

L. JAMES HARRIS** AND TERRY M. CHUPPE***

INTRODUCTION

THE PROBLEMS RELATING TO PROTRACTED and complicated patent cases have received considerable attention in recent years. However, in view of the fact that there has been no broad-based study to determine specifically how to reduce the delay and expense in patent litigation, the Institute is conducting a series of surveys designed to draw together relevant factual information and expert opinion. This phase of the

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study is designed to gain insight into and information on the cost of litigation in the enforcement of industrial property rights and changes in approach that might significantly decrease costs and delay in litigation while maintaining patent reliability.

SCOPE OF THE SURVEY

The PTC Research Institute sent a pilot questionnaire to a sample of 65 patent experts in industry and private practice. These experts informed us of their opinion and experience with respect to the patent system in effect today and their reaction to a proposed Dual Patent Program, a long-range proposal stemming from The PTC Research Institute's continuing examination of the system.¹ It is primarily with the patent system in effect today with which this paper is concerned. These experts supplied explicit information regarding procedural cost-cutting opportunities: Their replies covered the relationship between technical subject matter to the cost of litigating patent suits as well as information on the composition of total cost for a sample of cases in which they had been associated—generally, one "complex" case, one "average" case and one "simple" case. The perspective obtained from this data, and information from the larger sample outlined below, on the costs in patent litigation as well as factors which have an impact on such costs is responsible for the choice of the discrete areas for cost-cutting to which we plan to direct the next phase of this study.

Following the pilot survey, questionnaires² were sent to 230 patent attorneys in corporate and private practice requesting information on patent cases in which they had been involved and which were litigated. As in the pilot survey, respondents were asked to provide an estimate of total cost as well as the composition of total cost in one or more litigated cases. In addition to this basic cost data, we requested other information which might shed light in each case on key factors (which had been surfaced in the pilot questionnaire) affecting litigation costs. For example, we asked respondents to consider in retrospect what explicit cost-cutting opportunities could have been taken which would have

¹The Dual Patent Program is a phase of the Institute study on the cost of enforcement of industrial property rights, including approaches that might be taken to increase the certainty and reduce the delay and expense in patent litigation. For a complete discussion of this program, see: L. James Harris, "A Dual Patent Program: To Increase Patent Reliability and Decrease Litigation Costs," *IDEA*, Vol. 13, No. 1 (Spring 1969), pp. 1-24; and L. James Harris, *IDEA*, Vol. 13, Conference Number 1969, pp. 51-59, 93, 94.

²A copy of the questionnaire is appended hereto.

accomplished the same results. As a means of gaining an understanding of the motivation involved, respondents were requested to indicate how the total cost of litigation related to their estimate of the total financial stake involved. If the case was settled prior to final judgment, we requested information on the circumstances that induced the respondent to accept settlement. As a means of assessing the impact of judges on the cost of litigation, each participant in the survey was asked to assess the experience of the trial judge in the case in question and to provide information on factors which the respondents thought were subject to judicial control along with their estimate of how they thought the trial judge exercised such control.

COMPOSITION OF LITIGATION EXPENSE

To gain insight into the specific components of litigation costs, we asked the respondents to break costs down into eight major categories:

- (1) Investigation of prior art and the nature of the alleged infringing act;
- (2) Legal studies and evaluation;
- (3) Discovery undertaken at the initiative of the reporting party;
- (4) Discovery undertaken at the initiative of the opposing party;
- (5) Direct expenses of time in the trial court;
- (6) Cost of preparing briefs;
- (7) Cost of appeals including briefs and argument;
- (8) Other expenses, not included above.

We also requested that these costs be broken down further by ascribing each to one of the following categories: outside counsel, house counsel, company personnel other than counsel, outside personnel other than counsel.

RESPONSES TO THE COST OF LITIGATION SURVEYS

The rate of response to the pilot and follow-up surveys was very good. We received replies from nearly half of those to whom questionnaires were sent. Overall, 58 of the 127 responses received provided 71 sample cases, of which half included both cost data and replies to individual questions in the survey. Of these 71 cases, 26 were classified by respondents as complex and 25 as average; the remaining were considered simple cases. (See Table 1.) As might be expected, there was considerable variation in the total cost of cases grouped in each of

TABLE 1

FREQUENCY DISTRIBUTION OF TOTAL COSTS FOR
SAMPLE CASES IN THE COST OF LITIGATION SURVEY

Dollar Values
(000)

Type of Case as Classified by Respondents	Less Than 25	26- 50	51- 100	101- 250	251- 500	501- 1,000	Over 1,000	Total Cases
Simple	9	5	5	—	1	—	—	20
Average	2	4	7	9	2	1	—	25
Complex	—	2	3	4	10	4	3	26
Total Cases	11	11	15	13	13	5	3	71

the aforementioned classifications. Generally, complex cases fell in the cost category ranging from \$250,000-\$500,000, while average cases were in the \$100,000-\$250,000 range. Nearly all suits classified as simple cases were under \$100,000 in total cost and nearly half of these had expenses of less than \$25,000. The degree of grouping of the costs for cases falling in each of these categories was surprising since the choice of categories was left to the subjective judgment of the individual respondents.

There were 69 responses from those who were not able to supply the requested cost or other data. The most often cited reason for not supplying the information requested was that the corporation to whom the questionnaire was sent did not, in fact, have any patent cases litigated in the courts in recent years. Two other principal reasons were mentioned by respondents for not providing the requested data: First, there were those who indicated that their accounting system could not provide a breakdown of litigation expense along the lines we requested; and second, there were other respondents who admitted current litigation experience but did not wish to take the time and incur the expense to assemble the cost and other data requested.

ANALYSIS OF TOTAL PATENT LITIGATION EXPENSES

Although the total cost of litigation as well as the breakdown of such costs into its components varied with the particular circumstances of each case, as noted previously, the cases fell into relatively distinct groups—simple cases involved total costs of less than \$25,000, while the most complex patent cases cost several million dollars.

Before turning to a discussion of those factors which appear to have the most impact on total litigation costs and the means suggested by respondents for reducing such costs, we should first consider the relative importance of individual cost components. The original make-up of these components was revised in accordance with the responses to our pilot questionnaire. We wish to show, to the extent possible, the proportion of total expenses attributable to each of these components of cost. For purposes of comparative analysis, we have grouped our sample of patent cases into categories based on the total cost for simple, average and complex cases supplied by respondents. These data are summarized in Tables 2, 3 and 4 as distributions of expense ratios for

TABLE 2

DISTRIBUTION OF LITIGATION COST RATIOS FOR PATENT
CASES COSTING LESS THAN \$100,000

Cost Factors	Outside Counsel	House Counsel	Personnel Other Than Counsel	Total Cost
	%	%	%	%
Investigation of prior art and the nature of the alleged infringing acts	8.8	2.9	1.9	13.6
Legal studies and evaluations	5.8	5.3	—	11.1
Discovery undertaken at initiative of reporting party	9.3	4.3	.6	14.2
Discovery undertaken at initiative of opposing party	7.6	2.9	—	10.5
Direct expenses of time in trial court	18.9	1.4	.2	20.5
Cost of preparing briefs	9.3	3.9	—	13.2
Cost of appeals, including briefs and argument	7.6	0.9	.6	9.1
Other expenses (please identify)	5.2	1.0	1.6	7.8
Total Cost	72.5%	22.6%	4.9%	100.0%

litigated patented cases. Table 2 shows the distribution of total cost components for patent cases where the total litigation expense was under \$100,000, while Table 3 shows similar data for cases costing between \$100,000-\$250,000. Table 4 comprises those cases where total litigation expense exceeded \$250,000. These tables cover only those cases where respondents completed the breakdown of expenses into the cost categories set forth in the questionnaire.

From an analysis of the data found in these tables, certain general conclusions can be made regarding the relative importance of the various components. The most obvious finding is that outside counsel is the principal source of cost in litigated cases. This is true, not only for total expenses, but for each designated component of litigation expense regardless of the total cost involved in the case. For simpler cases, however, the cost of house counsel tended to be much greater than in the more complex cases. It is possible, however, that even in these cases the proportion of total litigation cost attributable to house counsel may be somewhat understated due to incomplete cost allocation informa-

TABLE 3

DISTRIBUTION OF LITIGATION COST RATIOS FOR PATENT
CASES COSTING BETWEEN \$100,000-\$250,000

Cost Factors	Outside Counsel	House Counsel	Personnel Other Than Counsel	Total Cost
	%	%	%	%
Investigation of prior art and the nature of the alleged infringing acts	8.3	2.2	1.1	11.6
Legal studies and evaluations	6.5	1.9	2.4	10.8
Discovery undertaken at initiative of reporting party	20.8	1.2	1.2	23.1
Discovery undertaken at initiative of opposing party	14.7	1.7	2.0	18.4
Direct expenses of time in trial court	10.6	.6	1.4	12.6
Cost of preparing briefs	14.2	.3	.1	14.8
Cost of appeals, including briefs and argument	5.4	.1	—	5.5
Other expenses (please identify)	2.6	.1	.7	3.4
Total Cost	82.9%	8.0%	9.0%	100.0%

TABLE 4

DISTRIBUTION OF LITIGATION COST RATIOS FOR PATENT
CASES WHERE TOTAL COST EXCEEDS \$250,000

Cost Factors	Outside Counsel	House Counsel	Personnel Other than Counsel	Total Cost
	%	%	%	%
Investigation of prior art and the nature of the alleged infringing acts	6.4	1.2	2.3	9.9
Legal studies and evaluations	7.4	1.3	.3	8.9
Discovery undertaken at initiative of reporting party	18.1	4.3	.6	23.0
Discovery undertaken at initiative of opposing party	16.6	2.2	1.0	19.8
Direct expenses of time in trial court	13.0	1.4	3.5	17.8
Cost of preparing briefs	11.2	1.0	.1	12.2
Cost of appeals, including briefs and argument	3.9	.8	.1	4.7
Other expenses (please identify)	3.0	.3	.2	3.5
Total Cost	79.5%	12.4%	8.1%	100.0%

tion. For outside counsel expense, there are usually direct billings which provide an accurate record of the total cost incurred, whereas with respect to house counsel, respondents generally found it necessary to estimate the charge for the proportion of the workload of the case handled by house counsel. Thus, it is likely that certain house counsel expense may have been overlooked.

Turning our attention to the individual components of total cost, it is apparent that, regardless of whether a particular case is simple or complex, Discovery is the largest single component of expense—whether undertaken at the initiative of the respondent or at the initiative of the opposing party. Although Discovery was the largest single component of total cost for all cases grouped in Tables 2, 3 and 4, this component tended to be somewhat less significant where total costs were less than \$100,000. Thus, cases where total cost exceeds \$100,000, total Discovery expense, on the average, accounted for about 40 percent of the total cost, whereas for simple cases, total Discovery costs were about one-fourth of total litigation expense. For all types of cases,

Discovery expense undertaken at the initiative of the respondent was somewhat larger than Discovery undertaken at the initiative of the opposing party. This may be due to the added cost of composing and taking action on supplementary inquiries where first responses are unsatisfactory. As was the case with other expense items, most Discovery costs were attributable to outside counsel.

Next to Discovery expense, the largest cost items were the direct expense of time in trial court, followed by the investigation of prior art and the nature of the alleged infringing act. For less complex cases, direct expense of time in court was nearly as large a cost component as Discovery, accounting for around one-fifth of total litigation expense. Generally speaking, direct expense of time in court was relatively more important than investigation of prior art—especially for less complex cases. The other major items of litigation expense, legal studies and the cost of preparing briefs, each accounted for approximately 10-15 percent of total litigation expense.

When direct expenses of time in trial court are combined with cost of preparing briefs, the resulting component amounts to approximately 30 percent of total cost in all three categories of cases.

FACTORS INFLUENCING PATENT LITIGATION EXPENSE

For the most part, the responses to the other questions in the survey substantiated the findings discussed above relating to the relative importance of the various cost components. Especially significant were the respondents suggestions for cost-cutting and their discussion of factors they thought subject to judicial control. Some of their most informative responses concerned the relation of technical subject matter to the cost of litigation and procedural cost-cutting opportunities.

The suggestion made most often by respondents was that protracted Discovery should be subject to judicial control, followed by concern over the length and conduct of the trial itself. Upon their reviewing procedures when the case was completed, Discovery costs were most frequently mentioned as having cost-cutting opportunities that could have been taken and have accomplished the same results. These findings are not surprising in view of the fact that Discovery tends to be the largest single component of litigation expense. Moreover, in the opinion of respondents, lengthy Discovery did not appear to have an appreciable effect in reducing the length or complexity of the trial itself. In fact, lengthy Discovery, in many instances, appeared to accompany lengthy trial.

Many of the respondents thought that some pre-trial Discovery, by both parties, could have been eliminated or at least simplified. Apparently, judges grant wider latitude to the parties in Discovery proceedings than many respondents feel is necessary. Such circumstances may contribute a great deal to increased cost and length of patent litigation. As one respondent noted, unlimited Discovery can result in an overwhelming proliferation of documents and depositions and result in a mass of irrelevancies that require teams of lawyers to find a needle in the haystack. In one complex case, costing several million dollars, the respondent reported that lengthy Discovery proceedings accounted for well over one-half of the total costs. In contrast, the plaintiff sued in France on a similar patent, at about the same time, and the case was settled at less than one-tenth the total cost of the U.S. case. There were no Discovery proceedings of any consequence in France.

Factors often cited by respondents as contributing to increased costs was the length and conduct of the trial itself. Judges were sometimes criticized for technical incompetence but more often for an unwillingness to learn the subject matter at hand. The respondent generally thought that the technical nature of the subject matter was a controlling feature in the cost of patent suits: the more complex the technical subject matter, the higher the cost of a patent suit. If the technology is very complex, there is a need for more expert testimony, demonstrations and tests and the arguments become more difficult to prepare and analyze. There was, of course, some differing opinion in this regard. Many respondents considered that the primary factor determining the overall cost and length of the legal battle was the total financial stake involved—the economic gains or losses resulting from the outcome of the case. In this regard, although the cost of litigation for patent cases is quite high, respondents usually felt that such costs were only a small part of the total financial stake involved.

Another area of concern was that many patent trials are protracted, not so much because of the time spent upon patent issues, but because judges allow peripheral issues not directly involved in the patent question, such as antitrust counterclaims, to seriously burden the case and take a great deal of time.³ The courts were also criticized for not using

³See Professor Derenberg's 1969 annual Progress Report for a trenchant reference to the "efforts on the part of infringers and unfair competitors to allege collateral antitrust violations on plaintiff's part and to seek comfort by reliance on the 'antitrust defense' in Section 33 (b) (7) of the Act of 1946 either by way of affirmative defense or by way of counterclaim." *The Trademark Reporter*, Vol. 59, No. 9 (September 1969), Sec. V. Trademarks and the Antitrust Laws, pp. 714-717. Except for the reliance on Sec. 33, the nature of the alleged industrial property antitrust abuses alluded to are similar to those encountered in patent cases.

existing procedures sufficiently, such as Summary Judgments or partial Summary Judgments, for purposes of "limiting the issues." Despite these criticisms, respondents generally thought that most judges were doing as good a job as possible within the framework of the present judicial system. Concerning the experience of trial judges in patent cases, the responses were evenly divided as to whether the trial judge involved in the case in question was experienced in patent litigation and exercised his control effectively. A number of respondents indicated that it would be desirable if there were more patent judges available who had technical competence in the relevant field of science as a means of controlling costs in patent suits.

A number of respondents did not complete our questionnaire because they had no patent cases litigated in "recent" years. Corporations apparently try to avoid litigation and encourage settlement due to the cost of taking a patent case to court. High costs apparently discourage litigation.

This phase of our study of patent litigation costs has attempted to provide insight on a subject where very little systematically gathered information has previously been available and to delineate discrete areas of cost-cutting opportunity for further study. The Institute is planning to explore a limited number of such areas, those which appear to be most promising, in its continuing study of this subject.

APPENDIX

THE PTC RESEARCH INSTITUTE OF
THE GEORGE WASHINGTON UNIVERSITY

Please check—

- a) "Complex" case ☐
b) "Average" case ☐
c) "Simple" case ☐

QUESTIONNAIRE

1. What were the total costs of this case, broken down, if possible, as follows:

Cost Factors*	Outside Counsel	House Counsel	Company Personnel Other Than Counsel		Outside Personnel Other Than Counsel	
			Expert	Other	Expert	Other
a. Investigation of prior art and the nature of the alleged infringing acts**						
b. Legal studies and evaluations						
c. Discovery undertaken at initiative of reporting party**						
d. Discovery undertaken at initiative of opposing party**						
e. Direct expenses of time in trial court						
f. Cost of preparing briefs						
g. Cost of appeals, including briefs and argument						
h. Other expenses (please identify)						

* These cost factors are not intended to include the award resulting from final adjudication or settlement, or the economic consequences thereof.

** Including tests.

2. Was your employer (or client) the owner of the patent(s) in the case?————
3. Was your employer (or client) the plaintiff or the defendant in the case?————
4. Was the case decided in your employer's (or client's) favor?

If not, what was the decision?

5. Now that the case is completed, what explicit cost cutting opportunities do you see, on reviewing the procedures, that could have been taken and would have accomplished the same result?

6. How did the total costs of this litigation, as shown in question 1 above, compare with your employer's (or client's) estimate of his total financial stake in the subject matter involved?

7. If this case was settled prior to final adjudication, what were the circumstances (e.g., continuing and probably excessive costs) that induced your employer (or client) to accept settlement?

8. In this case, in your opinion,

- a. what were the factors that were subject to judicial control?
- b. how do you think the trial judge exercised that control?
- c. was the trial judge experienced in patent litigation?

9. We would appreciate any further information or comments you may wish to add.

Reported Litigated Cases on Four Court Procedures

PETER D. ROSENBERG*

INTRODUCTION

A SURVEY WAS MADE of those cases reported in the *United States Patent Quarterly* over the past five years in which a court considered the appropriateness of one or more of the following procedures: discovery, summary judgment, estoppel by judgment, and separation of issues. These four procedures were often referred to in the responses to the Institute questionnaire. The data we gathered here on published court decisions supplements the questionnaires with information from another source for comparison purposes. To answer the question "How are these procedures actually faring in the courts," the frequency of success in securing judicial approval for their application was noted, as were salient and recurrent observations by the judiciary.

DISCOVERY

Over 40 decisions involved the disposition of one or more issues

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relating to the propriety of Discovery. In about 70 percent of these the courts deemed Discovery of all the sought-for information appropriate. In only about 15 percent were those objecting to Discovery able to wholly thwart disclosure. In one decision the court, while holding that refusal to allow inspection was proper, indicated that this was only because the existence of materials sought was speculative and that the proper Discovery procedure would have been first to ascertain by interrogatories whether such materials exist.

In those instances in which Discovery was not deemed proper, the courts usually sought to explain in their opinions that the would-be benefit to the party seeking Discovery had been carefully weighed against the expense and inconvenience that would be incurred by the party compelled to disclose. Thus, where one party sought the files of patents not in suit, the court did not require their production, stating that such blanket requests impose an undue burden upon the party from whom Discovery is sought. That court then went on to note that much of the information desired was freely available to all in the Patent Office. Similar views were taken by several other courts.

Courts also appeared disinclined to allow a party to avail itself of depositions prepared in other but related litigation. Most courts are apparently disposed to allow Discovery of information bearing on damages, even before validity is established, particularly where it would serve some legitimate purpose, as the establishment of commercial success.

Trade secrets were not immune from Discovery, particularly where a process patent was involved, although courts took appropriate steps to prevent the indiscriminate dissemination of allegedly secret information.

Also not immune from Discovery was information relating to the preparation of patent applications, it being repeatedly said that the work product doctrine is inapplicable because such materials are not prepared for litigation. One court stated its position as follows: "Attorneys are not giving legal advice when advising their clients about patent matters except in so far as there may be a controversy pending in a court of record. Hence, the attorney-client privilege does not apply to preliminary novelty investigations and to papers relating to the filing of applications for patent in suit."

SUMMARY JUDGMENT

About 60 cases were found in which a court actually ruled upon the propriety of a motion for Summary Judgment made by one or more of

the parties. Just over 30 percent of these determinations were made by circuit courts. Only in two instances did a circuit court reverse and in one instance modify the holding of the district court. No instance was found in which a circuit court held that a district court improperly denied a motion for Summary Judgment. In just about half of the cases in which a motion for Summary Judgment was made and ruled upon was the case disposed of in this manner. In less than 7 percent of these cases were patents held valid and infringed, all by district courts.

In about 14 percent of these cases there were findings of noninfringement without any adjudication of validity. Five percent were by circuit courts, all affirmed a lower court. Thirty-six percent of the decisions held patents invalid; 14 percent were circuit court decisions.

While at least one court remarked that the standards for granting Summary Judgment in patent cases are the same as those in nonpatent cases, most courts at least observed that Summary Judgment should be used only sparingly in patent litigation, being applicable only where the scope and content of the prior art are not complex and would be easily understood by a layman. The most frequent issues on which motions for Summary Judgment turned were obviousness and prior public use.

Lack of familiarity with the relevant technology and, consequently, the need for expert testimony were repeatedly cited as the principal, if not the sole, basis for denying motions for Summary Judgment.

ESTOPPEL BY JUDGMENT

Over 30 reported cases were found in which there was an attempt to expedite the disposition of a patent infringement suit by requesting the court to invoke a prior adjudication on the issue of validity as an estoppel to the instant suit. In half of these, it was held that there was no estoppel. Almost without exception the reason given was that there was a lack of mutuality, in that the party against whom the prior adjudication was sought to be applied had neither participated in nor had succeeded to the interest of one who had been a party to the earlier suit.

However, in about 24 percent of these cases a prior adjudication was held determinative of the issue of validity, notwithstanding a lack of mutuality. In these cases, the courts noted that the issue already had been fully litigated, no new evidence being proffered by the new party. In some of these cases the binding prior adjudication was by a court of a different circuit. Even where the courts did not hold that the prior

judgment constituted an estoppel, they almost invariably indicated that "great weight" would be accorded the earlier determination.

SEPARATION OF ISSUES

In only a handful of reported cases did the courts have the opportunity to rule upon the propriety of separating and/or joining issues relating to infringement and other causes of action arising from the same factual basis. These cases fell into three categories:

- (1) Those in which the only issues related to validity and infringement;
- (2) Those in which there were also issues involving another form of intellectual property, such as a trade secret or a trademark;
- (3) Those in which there were also issues involving a contractual right or a misuse.

The dearth of cases in which there was a question of trying together antitrust and infringement issues is perhaps attributable to the fact that fraud upon the Patent Office as a basis for an antitrust counterclaim is a relatively recent phenomenon.

Although only a limited number of cases dealt with the propriety either of separating or joining of issues, it appears that the courts are definitely reluctant to have piecemeal adjudications of issues arising from infringement situations. This was particularly evident with respect to the issues of infringement and validity. Here, the courts consistently allowed the joinder of counterclaims, whether for invalidity or infringement.

This attitude of favoring the disposition of all issues in one suit was also apparent in cases involving non-federal causes of action, such as the wrongful appropriation of trade secrets. The courts generally found that both the non-federal and patent issues were derived from "a common nucleus of operative facts" or at least that there was considerable overlap between them. Upon such a finding, the courts assumed pendent jurisdiction of the non-federal issues, under the doctrine enunciated in *Hurn v. Oursler*.

Cost of Enforcement of Industrial Property Rights: A Report of Interviews*

FREDERIC B. SCHRAMM**

INTRODUCTION

THIS PAPER IS A REPORT on an investigation by interviews with Cleveland firms for The PTC Research Institute of The George Washington University. The investigation is related to that made by the Institute of utilizing mailed questionnaires on the cost of enforcement of industrial property rights. The questionnaires were sent to representative firms and companies throughout the country. In some respects the investigation reported by this paper is more comprehensive than that involved in the questionnaires mailed out by the Institute, but in general it covers less ground and is less precise for the reason that it does not cover the experience of nearly as many attorneys and does not

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have the advantage of improved accuracy of data by averaging out a large number of reported numerical values. On the other hand, in certain limited aspects it is more comprehensive in that it goes into greater detail on some aspects of the problem of costs of litigation and an effort was made to elicit responses which might not have fallen within any category that might have been placed on a printed questionnaire. Furthermore, the information collected is qualitative rather than precise numerically in that it consists largely of opinions and attitudes of members of the Bar rather than exact data on areas of cost. Consequently, the emphasis in this paper is on ideas rather than numerical data.

The study was limited to a particular geographical area in which there is considerable patent litigation but not as much as in the federal court districts where the bulk of patent litigation is concentrated, such as New York, Chicago and Los Angeles for example. Moreover, although an effort was made to obtain information as to the costs of patent litigation from most of the firms and attorneys regularly engaged in patent litigation, information could not be obtained from all such firms for various reasons.

ILLUSTRATIVE COST BREAKDOWNS

In order to provide a comparison with the more precise numerical data collected from the questionnaires some numerical data has been summarized. The information obtained related to a variety of cases in which the costs ranged from slightly over \$40,000 for one side, to a total of approximately \$1,000,000 for both sides.

In a representative case where charges billed by defense counsel approximated \$70,000, the allocation of charges was approximately as follows:

- (a) Investigation of prior art and nature of the alleged infringing acts 4%
- (b) Legal studies and evaluations over 4%
- (c) Discovery undertaken at the initiative of defendant 14%
- (d) Discovery undertaken at the initiative of plaintiff 12%
- (e) Direct expenses of time in trial court 33%

(The above figures are apparently considerably in excess of percentage averages in other cases.)

- (f) Costs of preparing briefs 16%
- (g) Costs of appeals including briefs and arguments 17%

In another case, where charges billed by plaintiff's counsel also

approximated \$70,000, the following items were accounted for:

- | | |
|---|-----|
| (a) Discovery initiated by plaintiff | 10% |
| (b) Discovery initiated by defendant | 27% |
| (c) Direct expenses of time in trial court | 17% |
| (d) Costs of appeals including briefs and arguments | 46% |

In that case, the approximate costs of company experts measured in percentages of charges billed by plaintiff's outside counsel came to:

- | | |
|--|------|
| (a) Discovery initiated by plaintiff | 3% |
| (b) Discovery initiated by defendant | 1.5% |
| (c) Direct expenses of time in trial court | 3% |

Costs of outside experts:

- | | |
|--|----|
| (d) Discovery initiated by plaintiff | 3% |
| (e) Direct expenses of time in trial court | 4% |

In still another case where the total charges of principal counsel for the plaintiff patentee approximated \$41,000 and of local counsel \$13,000, the charges billed by the attorneys included the following:

- | | |
|--|---------|
| (a) Investigation of prior art and nature of the alleged infringing acts | 7% |
| (b) Legal studies and evaluations | 70% |
| (c) Discovery initiated by plaintiff | 4% |
| (d) Direct expenses of time in trial court | 6% |
| (e) Pre-trial hearings | over 6% |
| (f) Costs of preparing briefs | 3% |

In the cases where the numerical data as to breakdowns were obtained, generally speaking, the reporting party was the one who prevailed.

COST-CUTTING OPPORTUNITIES

The conclusions reached by various reporting attorneys after the completion of their cases as to how costs could have been reduced vary considerably and in some cases were in conflict. There was some feeling that settlement talks were futile and the costs of engaging in such talks could have been saved. There was general agreement that the Discovery practice was costly and that savings could be effected if there were a way of reducing the amount of Discovery taken without interfering with the arriving at facts. Although there was a great deal of criticism of interrogatories there was some support for the view that as to non-crucial points, at least, time and expense could be saved by serving interrogatories instead of taking depositions.

Another suggestion was that some expense and much time could be

saved as well as promoting greater accuracy in the decision if the judge instructed the parties not to file a trial brief, but merely pre-trial briefs and called for immediate arguments at the close of the trial. The judge or his law clerk should then write the opinion which could be promptly checked for accuracy of fact by counsel for both parties. If briefs are required, they usually cannot be called for until a reasonable length of time after the transcript has been received. The judge may have forgotten about the case by the time he receives the briefs. He has probably forgotten still more about the case by the time he gets around to glance at the briefs and write the opinion.

Even in a case where the judge requires the briefs to be submitted at the conclusion of the trial, the case could be speeded up considerably if daily transcripts of the record were obtained. This would add relatively little to the cost of the trial in comparison with the cost saved in the preparation of a brief and the examination of the record. With daily transcripts, the judge could call for the submission of briefs within a relatively short time, within 30 days, for example. The record would have been indexed or marked for high points even before the conclusion of the trial.

The problem of expenses of answering voluminous interrogatories could be solved by providing by rule that except upon obtaining leave of court, not more than ten interrogatories could be submitted at any one time, and that the interrogatories in any group should be addressed to only one major issue of the case. Now under the present practice interrogatories tend to be proliferated because of starting out with a very general interrogatory followed up by various suppositions as to what the answers would be if the answers to the first interrogatory were in the affirmative and what they would be if the answers were in the negative, what the answers would be under various conditions, during various brackets of time, and so forth. An example of this problem is a case in which eight interrogatories calling for narrative answers were actually proliferated into 875 interrogatories.

The view was expressed that the onerous nature of pre-trial Discovery and the opportunity for one party to harass the other could be diminished if the rules were changed to limit Discovery to matters which would be admissible in evidence and to expand Rule 37 to assess costs against a party who attempted to elicit Discovery of matters not admissible in evidence. This should be applied particularly to the filing of requests for admissions.

Another suggestion was that retrieval and searching service would save time and expense, although this would involve typing an additional copy of the record on a continuous strip for conversion to magnetic

tape or other storage means. There should be considerable saving in the time spent locating the points in the record where evidence was adduced that the party expects to rely on in his argument. The transcript on tape or other form of storage would be searched by a retrieval service for the key words, such as, the names of certain witnesses, the names or numbers of certain prior art patents, public users, public sales, et cetera to enable the attorney to find immediately the pages where certain expert witnesses testified, where certain references were referred to, and so on. This would be of great value also in assuring accuracy in the references to the record, quotations from the record, and accuracy in the facts relied upon by the party preparing its brief. It is understood something of this kind has been done in federal rate hearings as well as in some patent infringement litigation.

Another cost-saving suggestion was the elimination of repeated briefing on the same point as the result of laxity of the courts in permitting the filing of reply briefs and replies to reply briefs. It was thought also that there would be a saving if the indiscriminate filing of motions for Summary Judgment were avoided, since Summary Judgments are seldom granted and perhaps seldom justified. Another thought was greater resort to class actions or the amendment of the law to permit class actions with fewer parties under Rule 23 of the Federal Rules of Civil Procedure.

COST OF LITIGATION IN RELATION TO CLIENT'S FINANCIAL STAKE IN SUBJECT MATTER

The investigation of the relationship between what patent litigation costs the client and the amount of money the client had at stake was clouded to some extent by the fact that some attorneys reported that in a considerable portion of the cases the client was anxious to fight even though the cost of litigation was out of proportion to the amount of business at stake. Also obtaining an injunction or preventing the opponent from obtaining an injunction is difficult to evaluate. Considering cases where the foregoing were not factors, it appears that in cases where the cost of litigation was under \$100,000 the financial stake of the client was greater, in some cases much greater, than the cost of litigation, both in cases where the alleged infringer prevailed and in cases where the patentee prevailed. However, the comments of attorneys indicated that in the cases which became more expensive there was a tendency for cost of litigation to become out of proportion to the amount at stake. This appeared to be for the reason that at any particu-

lar point in the case the litigant is confronted not with how much he has already spent but with how much more he will have to spend in order to maintain his position or to prevail.

SETTLEMENT

Insufficient data was obtainable to draw valid conclusions as to the primary reasons for litigants in patent cases accepting settlement. Nevertheless, business judgment seems to be the governing factor where settlement was accepted or considered, including not only such questions as the continuing and probable costs of litigation, or further litigation, but also the probable reactions of other companies in the same or related fields. For example, some companies that did business on other products with competitors or potential competitors were reluctant to establish a reputation for litigiousness and were desirous rather to work out differences with regard to patent infringement on a business basis.

There was some support for the view that our pre-trial Discovery practice had some advantages in that the very cost of Discovery tends to exert some economic leverage on both parties to settle as they realize the expenses involved in continuing Discovery. Another supposed advantage is that penetrating Discovery early in the case has some value in promoting settlement and exposing the relative strength of the positions of the parties. Such early penetrating Discovery should be to the advantage of both sides, even in discouraging the attorney inclined to indulge in delaying tactics in order to put pressure on the opposing party.

On the other hand, in some hard fought cases and especially in those sort of cases in which costs have run very high the question of Discovery is irrelevant to the possibility of settlement since one party would be faced with disastrous or fatal injunction, whereas the other party, if it did not succeed, might be forced out of existence. In such cases, settlement tends to become more and more difficult as Discovery proceeds if the Discovery of one party is purely defensive with the purpose of blocking further Discovery by the opposing party. The view was expressed that Discovery did not promote settlement. Because of the courts disregarding proofs, the opposing parties were still willing to take a chance on prevailing at the trial.

No feeling was discovered that plaintiff's being in a strong position or vice versa tended to promote settlement. However, the comment was made that where the opposing counsel is experienced and consequently

in a better position to evaluate the strength of the respective parties, it was easier to reach a settlement than where the opposing counsel was inexperienced.

FACTORS SUBJECT TO JUDICIAL CONTROL

Control of both pre-trial proceedings and the trial itself were thought to be possible for reducing costs and litigation costs. With regard to pre-trial Discovery the opinion was that the court could reduce costs by conducting oral hearings and Pre-trial Conferences with regard to Discovery, in order to dispose more expeditiously of objections, interrogatories or requests for admissions. Other factors were the granting of motions to dismiss, transfer and postpone trial in suitable cases. The time consumed by trial could be reduced by stricter rulings on evidence at the trial. Opinion was divided as to how well the judge exercised the control within his power, although most cases involved judges with experience in patent litigation. The general feeling was that the judge followed the practice obtaining in the judge's district and that problems arose from the local rules or the practice which had grown up rather than the lack of control by the individual judge.

ACTIVITY OF THE TRIAL JUDGE

There was some support for a rule which would require the judge to exercise his discretion, supervising the conduct of the Discovery, not merely to speed up Discovery, but also in order to protect the party who has been harassed or intimidated by aggressive Discovery tactics. This was difficult to accomplish in districts which did not have a personal docket for each judge. There is a problem even in districts which did have a personal docket if there was no judge experienced in patent matters to whom the chief judge could assign the case at the time. Also in such a case, when the judge does become available, he tends to ride herd on the parties and force them into taking numerous depositions within such a short period of time that attorneys for both sides are subjected to a great burden and considerable hardship.

Although some attorneys prefer the Cleveland practice in which motions and objections are submitted on memoranda and briefs, the majority felt that the courts should limit Discovery and hear objections to interrogatories orally. Nevertheless, there was some criticism of the practice of requiring a statement at frequent intervals, such as every

three months, as to what Discovery has been taken, what the parties expect to prove by the Discovery yet to be taken, and what Discovery would be taken in the future.

Better practice was believed to be that of certain Cleveland judges, which was believed to be of great help in disposing of problems encountered during Discovery. According to this practice, after the parties have failed to reach any understanding as to what Discovery will be given, the judge insists that all objections to Discovery be stated orally, and they are then ruled upon from the Bench. However, memoranda and briefs in support of each parties' positions on objections and motions to compel Discovery are also received before the hearing. There was also considerable support for the view that decisions on motions and objections could be made more rapidly if they were noted for oral hearing on ten days' notice with written briefs eliminated except where required by the court.

The thought was expressed that a formal pre-trial was useless as it resulted in trying cases for the third time, once during Discovery and on hearing of objections to Discovery, again during the pre-trial, and the third time during the actual trial. Accordingly, no support was found for practices such as provided by local Rule 9 of the Los Angeles District Court, which requires very voluminous writing out of the various aspects of the subject matter of the case, or somewhat similar practices in Chicago and Detroit. It was thought also that litigation costs could be diminished if the courts exercised greater power to discourage groundless litigation, such as by taxing of attorneys' fees, when the issue was clear.

When it came to the trial it was suggested that trial time could be reduced by greater judicial control. One possibility was the exercise of judicial discretion to prevent irrelevant cross-examination. It was suggested that cross-examination should be denied with respect to any facts which could have been obtained by Discovery in the pre-trial proceedings. Otherwise the great expense and consumption of time in pre-trial practice does not even accomplish what it was intended to accomplish.

Notwithstanding the fact that many admissions had been obtained and facts established by responses to interrogatories and requests for admissions, the courts not infrequently refused to grant motions to strike Pleadings under Rule 11 as sham, even though the answers to interrogatories establish there is no merit in a pleader's position. For example, in cases mentioned during the investigation, the courts refused to strike affirmative defenses under Rule (c), even where Dis-

covery has disproved such defenses, and the courts have refused to grant motions to strike under Rule 12 (f), notwithstanding the fact that the parties' Pleadings were contrary to their answers to interrogatories. Under such circumstances Discovery does not promote settlement. With the courts disregarding proofs, the opposing parties are still willing to take a chance on prevailing at the trial.

The laxity of the courts in permitting the filing of reply briefs and replies to reply briefs is a major area of cost. If replies to reply briefs are permitted, the opposing parties are required to respond, because the other parties' brief was before the court and the opposing party cannot assume that the judge will not read the "reply brief" and be influenced by it.

To a considerable extent the experience, aptitude and diligence of the judge are important factors in cutting down expense and delay in the trial of patent cases. It was suggested, therefore, that there be a system of rating patent judges. It was proposed that the Patent Bar should rate patent judges according to various aspects of the disposition of patent cases, or encourage the general Bar Association to do so by distributing questionnaires to lawyers having experience in the patent field. This would be analogous to the Cleveland Bar Association's questionnaire to all practicing lawyers in the county with regard to judges who are candidates for election, as to diligence, trustworthiness, judicial temperament, experience, knowledge of the law, fairness, and so forth, and the less detailed questionnaire with regard to incumbent judges standing for re-election.

In questionnaires for state court judges not merely standing for re-election, the questions asked are:

- (1) Have you confidence in his integrity and moral courage? (25 points)
- (2) Has he judicial temperament? (25 points)
- (3) Has he adequate legal ability? (25 points)
- (4) Has he adequate legal experience? (5 points)
- (5) Is he courteous and considerate? (10 points)
- (6) Would he be industrious and prompt in his performance of judicial duties? (10 points)

Federal District Court judges could be rated on their facility in grasping the technology involved quickly enough to rule helpfully on controversies as to Discovery and on their ability to decide intelligently the sort of three-cornered relationship between specification and claims, the prior art and the alleged infringement, attention to pre-trial practice in patent cases, handling of motion practice relating to patent

infringement suits, handling of the trial, and the soundness and promptness of the final decision. While federal judges do not stand for election or re-election, the publication of such a rating sheet by the Bar Association could be expected to have some effect upon the activity of the judges of the District Court and might have some bearing on the prospects of the district judge being recommended for appointment to the Court of Appeals. The only other way that the Bar could exert any control over appointed judges is to obtain the overruling of the decision of the trial court or to bring out instances of conflict of interest of the judge in rendering a decision in the case. The Citizens' Leagues and other organizations in various cities also rate judges and other candidates.

PERSONAL DOCKET FOR FEDERAL COURT JUDGES

There was virtually unanimous approval of adopting what has been called a Personal Docket for federal court judges in which each case is assigned to a particular judge. The judge is therefore able like some judges in Cleveland, after a case has been assigned to a judge, to ride herd on individual parties, setting specific dates for each of the various aspects of the case, such as concluding interrogatories, concluding the taking of depositions and the like, and also setting a series of pre-trial hearings not more than 90 days apart at which the parties are required to report on the progress they have made in their readiness for trial. This particular practice has not been favored so much as practice previously referred to in which the judge, after he has been assigned to the case, calls the parties together if they have not worked out their differences on pre-trial Discovery and holds oral hearings deciding the controverted issues from the Bench. The problem in Cleveland, however, is that the case is not actually assigned to a judge until it is ready for trial so that several judges may have already participated in the pre-trial motions and objections before any particular judge is in a position to exercise any control.

A Personal Docket system has been presented to the chief judge of the Cleveland District by the Cleveland Patent Law Association. However, the proposal of the Cleveland Patent Law Association was that there be a different judge to conduct the pre-trial from the one who would subsequently try the case. This feature met with considerable criticism from the Cleveland Patent Bar. The Personal Docket system of Detroit, Chicago and Los Angeles was favored. It was felt that at the very least the practice should be available such as New York Rule No. 2

under which a motion may be made for an assignment of a single judge because of the complexity of the case. Incidentally, Rule 21 (M) of the Court of Common Pleas of Cuyahoga County, Ohio, provides for assignment of a specific judge to preside over all matters pertaining to a case including trial in "complex" cases.

However, the open calendar practice of the Southern District of New York was criticized, with very numerous motions assigned to a motion judge and argument limited to the extent of possibly not more than three minutes. It is particularly objectionable in a district such as the Southern District in New York which has many judges and the judge hearing motions therefore knows that it is extremely unlikely that he would ever have occasion to hear another matter relating to the same case. There was also some criticism of the practice in Los Angeles where there is a Personal Docket and there is a Motion Day every week at which all motions are heard on oral argument. Particularly for out-of-town counsel this is objectionable because they are forced to travel to Los Angeles and lose an entire day waiting for the case to be called and then heard. The problem comes up more in patent cases because in most cases one or both sides are represented by out-of-town counsel.

The problems of the Motion Day give rise to the preference of some Cleveland patent attorneys for the present Cleveland practice in which motions are submitted on memorandum briefs. It was suggested that the availability of Xerox copies of moving papers and interrogatories enables the judge to make a ruling just as fast on memoranda as he could by hearing oral argument. The contrary view was that delay occurs when motions and objections are not heard orally because under the present Cleveland practice cases are not left with the same judge and motions are decided indiscriminately by different judges on the briefs.

The backlog of five or six months in a district having a Personal Docket such as in Chicago was compared with a two- or three-year backlog of federal cases in Cleveland. One reason for the long delay in Cleveland is the practice in the Northern District of Ohio to set all the patent cases down for trial at a given month of the year but not to assign the cases to a given judge for handling throughout the proceedings in the case. Consequently, an attorney with more than one case ready for trial in Cleveland may find that he has cases set for trial simultaneously before different judges so that only one can be tried at a time and the others are probably postponed for a year. Proceedings would be speeded up by a provision for a Personal Docket for each judge so that he

would retain jurisdiction over a case once it was assigned to him. The judge could then set the case for hearing on his own trial docket on a months' notice, which would be less likely to conflict with the patent trial docket of another judge involving some of the same attorneys.

CHARGING LITIGATION COST TO LOSING PARTY

It was suggested that the British practice of making unsuccessful plaintiffs pay for the entire cost of the litigation, including defendant's counsel fees, would stop a great deal of undeserving patent litigation. It was felt that the plaintiff found to be wrong should be compelled to pay the entire cost of the litigation incurred by the defendant. Awards of attorneys' fees against all litigious parties could diminish litigation and the scope thereof. (*Akins v. McKnight*, 13 FRD 9, 11.)

UNFOUNDED LITIGATION

It appeared to be felt that many cases are brought because someone is angry regardless of the merits of the action, and disputants expect the attorney to obtain some kind of settlement even if there is no merit in the case. A comment was received that there was a tendency on the part of some patent owners to file patent suits to find out whether their patents were any good after they had spent what they considered a great deal of money to obtain the patents.

Criticism was leveled at the practice of filing patent litigation for the purpose of prolonging the collection of royalties on a patent which had been licensed, notwithstanding the fact that the patentee realized that the patent was invalid.

DEFENSES

Fraud on the Patent Office and Antitrust Matters

The opinion was expressed that patent lawyers were their own worst enemies in developing some of the extreme defenses which have been spawned in recent litigation, and the circuits permitting improper use of such defenses were criticized. One of the problems in a patent case in which a defense of fraud on the Patent Office is pleaded, or when a

genuine antitrust defense is pleaded, is that pre-trial Discovery is rendered far more extensive than required for only the patent issues.

Many aspects of antitrust litigation require numerous witnesses, for example, developing enough facts to support an argument for or against the proposition that a change in market conditions has been effected without fostering fair competitive opportunities, viz: *Appalachian v. U.S.*, 288 U.S. 344 (1933)—unreasonable restraint of trade (Clayton Act §3) where the accused parties have conspired to establish a monopoly and also have the power and intent to establish and maintain a monopoly; *American Tobacco v. U.S.*, 328 U.S. 781 (1946)—the existence of conscious price parallelism or that the business affected a substantial portion of the relevant market; *Standard Oil (Indiana) v. U.S.*, 283 U.S. 163 (1931); *Oxford Varnish v. Ault*, 83 F.2d 764, 766-7 (6th Cir. 1936)—what constitutes a relevant market or a line of commerce; *U.S. v. Pabst*, 296 F. Supp. 994 (E.D. Wis. 1969). *U.S. v. E. I. Dupont*, 351 U.S.C. 377 (1956); *Brown Shoe v. U.S.*, 370 U.S. 294, 324 (1962); *U.S. v. Aluminum*, 377 U.S. 271, 275-276 (1964); *U.S. v. Kennecott*, 231 F. Supp. 95, 99 (S.D. N.Y. 1964). It was pointed out that in one case, for example, a hundred depositions had been taken on antitrust aspects of the patent infringement suit.

The view expressed by a prevailing defendant was that if our courts would award attorneys' fees against the patentee who defrauds the Patent Office by concealing his own or another's anticipating use and sales, much dubious litigation would be avoided. However, the general view was that allowing the defense prolongs litigation. When the defense of fraud on the Patent Office is pleaded the patentee is subjected to antitrust implications and forced to continue the litigation to vindicate himself. In an illustrative case where large companies and much business was at stake with litigation costs in the hundreds of thousands, both parties felt forced to continue through trial and to obtain a decision in order to avoid any inference of collusion or contracting with respect to an invalid patent after a defense of fraud on the Patent Office had been pleaded.

In the view of prevailing patentees, pleading the defense of fraud on the Patent Office in every patent suit was an abuse. It was felt that the doctrine should be restored that only the Department of Justice could bring an action for fraud on the Patent Office. Pleading this defense greatly lengthens preparation for trial and pre-trial Discovery and the trial itself. The defense of fraud on the Patent Office was considered unnecessary because any defense which was a valid defense would still be a defense even though the facts supporting it had not been brought

the attention of the Patent Office or the examiner who issued the patent. The defendant could still prevail by citing the prior art in support of the defense of invalidity and have the patent invalidated so that the extra time and effort involved in proving fraud on the Patent Office would be unnecessary.

Moreover, in many cases the inventor himself is not aware of the defense since he does not understand the claims and signs the application without actually knowing that the claims read on work which was previously done or ideas that were disclosed to him even though he knew about the prior work or the ideas that were disclosed to him, to the extent that after taking a great deal of testimony, a defense of fraud on the Patent Office would still fail because of lack of proof that the applicant did not make the statutory oath in good faith.

File Wrapper Estoppel

There was relatively little discussion of the effect of file wrapper estoppel on cost of litigation. However, there was a view expressed that 10 percent of the time and expense of preparation for trial and litigation could be eliminated by excluding this defense. It was argued that the doctrine served no useful purpose because if claims are cancelled as a result of a citation of a prior patent, the only real effect would be that any claim retained would be invalid over the cited patent if given a construction broad enough to embrace the scope of the cancelled claim. The same argument could be made that any claims in the issued patent would have to be interpreted narrowly enough to avoid the cited patent and it would be unnecessary to go into the file wrapper or invoke the estoppel to establish that the patent claims were limited in scope.

SEPARATE COURTS FOR DETERMINATION OF VALIDITY AND INFRINGEMENT

There was relatively little comment on the effect of separating the issues of validity and infringement for determination in different courts. This is a difficult area in which to make a forward step since there is no history in any country of courts of equal dignity separately deciding the issue of validity and the issue of infringement.

The history of foreign countries in taking the issue of validity away from the court which decides infringement appears to be limited to practices in which the validity is determined in what corresponds to an administrative tribunal. For example, annulment courts in Germany

are related to the German Patent Office. In addition to opposition proceedings, there are annulment actions which may be brought after the time for opposition has expired. These are somewhat analogous to oppositions and cancellation proceedings in the United States in trademark cases which are heard in the U.S. Patent Office. Our own Court of Customs and Patent Appeals is a constitutional court which hears cases coming from the Patent Office, but is not in the Patent Office or administratively related to it.

It may be that a constitutional court, such as the Court of Customs and Patent Appeals, could have its jurisdiction enlarged to decide the question of validity with exclusive jurisdiction of this question upon a proceeding filed by a member of the public as well as deciding allowability at the instance of an applicant for patent. Costs could be reduced in this way since such a court could decide validity on a Patent Office record and on prior art brought before it without having to take the time involved in infringement questions. Since it would develop some expertise on comparison of claims with prior art, it could decide validity at less cost to the litigants than the several U.S. District Courts now having jurisdiction of this question. On the other hand, the trial of infringement question in the U.S. District Courts could be speeded up where infringement was still in issue by reason of the claims having been held valid.

DURATION OF CASE

Most of the cases discussed were pending for a period of about five years although there was some discussion of cases that started as long as ten years ago and still pending.

VENUE

Cleveland lawyers were about evenly divided as to those who would predominately take cases which would be tried in the Northern District of Ohio and those who would try cases anywhere in the country where necessary. Among the attorneys representing plaintiffs particularly, it was pointed out that the cases had to be filed wherever the plaintiff could obtain jurisdiction over the defendant and in which the law was most likely to be favorable on the issues that were likely to arise. Consequently, among the Cleveland lawyers who did not restrict

themselves to local cases, the majority of the cases that they tried were away from Cleveland.

PRE-TRIAL DISCOVERY PRACTICE

The pre-trial Discovery practice was mentioned in connection with virtually every case that was investigated, and it received much criticism. It was regarded as one of the bad features of patent infringement litigation because it led to a great deal of abuse. There was the view that it was used primarily for harassment and not for Discovery of facts which would be utilized in litigation. An example is given of an 18-inch stack of interrogatories and answers where none of the numerous answers was offered in evidence at the trial. It was thought that the fact that the courts permitted unwarranted and unlimited Discovery was a major factor in expense and delay. The courts were thought too liberal in granting Discovery over objection on the very remote possibility that something useful might be brought out in the Discovery although as a matter of fact in many cases exceedingly voluminous Discovery is never made use of at the trial. There was a feeling that Discovery was too circuitous and evasive and too often the opposing party changed its mind as to responses made in the course of the Discovery process.

Although recognizing that the Discovery practice was a most significant factor in the cost of litigation and delay, there was a view that no limit should be placed on the number of interrogatories which might be filed because the needed interrogatories can be determined only as the case develops and the opposing party files additional pleadings or papers. One reason that interrogatories are filed merely as a source of delay and harassment to the opposing party is that it is far easier to prepare or file interrogatories with the aid of published form books than to incur the time and expense involved in studying interrogatories and obtaining the facts required to answer or even file a convincing brief in support of objections to interrogatories.

On the other hand, from the standpoint of the party submitting the interrogatories, Discovery is a major item of expense. This arises from the fact that very often only half an answer is obtained and it is necessary to continue filing interrogatories and motions to compel answers in order to obtain the requisite facts for going to trial. In this respect, there was high commendation for the practice of one of our Cleveland judges who heard objections orally when the parties failed to agree among themselves on Discovery questions as required by local Rule 2 (a) 6.

There was criticism of the present Rule 33 and the fact that motions for more definite statement under Rule 12 (e) had fallen into disuse instead of making further use of statements of particulars in order to formulate the issues. Under Rule 33 the issues tend to become greatly proliferated.

On the favorable side of the ledger the very cost of Discovery may induce settlement. A supposed advantage recognized but not given much weight was that Discovery early in the case may promote settlement by exposing the relative strength of the parties. There is a disadvantage in limiting the subject matter of Discovery of persons disposed. This tends to have the effect of prolonging the entire litigation because of the necessity of going to the Court of Appeals and perhaps having the case remanded if it can be shown that the party whose Discovery was limited had been prevented from obtaining Discovery which would have been dispositive of the case.

JURY TRIALS

Although jury trials were not generally favored, it was suggested that when a patent case is tried to a jury, the cost of a jury trial, that is the jury fees, are paid by the federal government and not taxed as cost to the parties. At \$20 for each jury member with a panel of 13 (one reserve jury man in the jury box) the sum would come to \$260 times 25 equals \$6,500. 28 U.S.C. 1871 provides for jury fees of \$20 a day and upon certification of the trial judge a per diem fee not exceeding \$25 for each day in excess of 30 days. This is not taxed as cost because 28 U.S.C. 1920 (taxation of costs) does not include jury fees in the costs which may be taxed.

Nonetheless, the opinion was expressed that the relatively recent development in recognizing the right of jury trial in patent cases adds considerably to the expense, because the introduction of evidence has to be done much more carefully than when the evidence is heard before a judge alone in order to guard against possibilities of reversible error. Another problem of the jury trial is that since damages have to be proved before the jury the question of damages is opened up in a pre-trial Discovery in order that the proof of damages will be available for consideration by the jury.

DELAYS IN PATENT LITIGATION

The comments on pre-trial Discovery, judicial activity and cost factors adverted to delays in litigation. However, one problem in overcoming delay is that delay is a tactic which the defendant usually considers

to his best advantage. It was found also that defendants may resort to every delaying tactic possible in the hope that someone else will knock out the patent.

The consensus was that trial time could not be reduced very much because time is required to educate the trial judge in view of the complexity of the issues involved in patent cases and the technology involved. Nevertheless, trial time is often prolonged by the judge permitting irrelevant cross-examination.

It was felt that patent trials tend to be relatively long because the cases which come to trial are the complex cases, since the simple ones tend to be settled occasionally by the disputants themselves before seeing any lawyers, because they can understand the issues involved more readily. On the other hand, in the more complex cases where there are more patents and more claims involved and a greater number of products in issue with various cross claims, a three- or four-week trial is not unreasonable. It is these cases which give patent litigation a bad reputation with the federal judges.

Reducing the Cost of Patent Litigation: Viewpoint of a Litigating Attorney

FRANCIS C. BROWNE*

MANY OF THE POINTS COVERED by the preceding speakers are borne out by my own experience in litigation. There are a few points which I do not believe were covered but which, in my opinion, deserve careful consideration. In particular, I will try to point out some of the things which may be corrected and which will improve the public image of litigating attorneys if they are taken seriously.

One of the first things which can be done to improve the image of the litigating attorney in the eyes of the public, in general, and litigants, in particular, is to inform the client as adequately as possible as to the substantial financial obligation which is undertaken by initiating or defending a litigated matter. I have found that it is harder to estimate the cost of litigation than to arrive at an opinion as to the likely outcome. Having this in mind, I strongly urge litigating attorneys to refrain from underestimating the cost of litigation when discussing the

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matter of finances with the client and, moreover, to keep the client apprised as to the accumulation of costs for services and disbursements as the litigation progresses. All too often a litigant finds himself obligated financially far beyond his expectations without realizing the extent to which he was becoming involved.

The additional points I wish to make have to do with the reduction of the cost of litigation, primarily by reducing the amount of time spent in preparation for and conducting the trial of the case.

The cost of litigation can be substantially reduced by reducing the time between the filing of the suit and the trial on the merits. This objective can be accomplished by a proper preparation for and expeditious conduct of the interlocutory phases and the Discovery conducted in preparation for trial.

It has been my experience that there is too great a tendency on the part of litigating lawyers to jump into oral depositions of officers of the adverse litigant instead of ascertaining the capacity and knowledgeability of the party to be interrogated with respect to the issues which are sought to be developed in the interrogation. This can be accomplished by first carefully preparing and accurately framing written interrogatories, accompanied or followed by equally carefully framed and accurately prepared written requests for admissions. Much of the attorneys' time and that of all parties concerned will be saved by ascertaining in advance the existence, nature, location, custody and identification of documents and other tangible things in preparation for the oral interrogation of the persons having most direct knowledge of the subject matter to which the documents and other tangible things pertain.

Depositions taken during the Discovery stage are sometimes prolonged unnecessarily because of the tendency of certain attorneys to conduct the trial of the case during the depositions instead of discriminating between that which is proper for Discovery and that which is necessary for proof at trial. If it will be necessary to have the witness testify in open court, it is best to save that line of interrogation until trial.

Throughout the period from the filing of the action until the trial of the case, an additional cause for delay and additional expense is an unwarranted reluctance on the part of many attorneys to stipulate or admit certain facts which really are not in dispute. There still seems to be a certain amount of "gamesmanship" involved in forcing the other party to prove its facts even when you have no legitimate basis upon which the truthfulness of the fact can be disputed. In other words, many of the matters which are developed on Discovery and by way of interro-

gatories and requests for admissions could be resolved by a simple stipulation of facts if the attorneys are willing to cooperate in disposing of all issues of fact except those in which there is a genuine dispute.

Finally, there is the current tendency on the part of counsel for defendants to plead the issues of fraud and antitrust violation by way of affirmative defense, counterclaim or both, whether or not substantial factual basis for the allegation is within the knowledge of the pleader at the time the Pleading is filed. Greater care should be exercised on the part of a pleader in raising legal issues without sufficient factual basis at least to make out a *prima facie* case.

To the end that the costs of litigation may be reduced and, at the same time, enhancing the image of litigating lawyers in the eyes of the public and litigants, I repeat my original suggestion that everything possible be done to reduce the time between the filing of an action and the trial of the case on the merits. In making this plea I am not unmindful of the congestion of the courts' docket and the heavy workload carried by most litigating attorneys. Nevertheless, the backlog of pending cases can be reduced and the time of the busy attorneys can be conserved if at least some of the suggestions I have made will be taken to heart and put into practice.

Simplifying Patent Litigation

JOHN W. MALLEY*

PATENT AND RELATED ANTITRUST, unfair competition and trade secret litigation have the reputation of being prolonged and expensive. The Discovery procedures of the Federal Rules of Civil Procedure (intended to simplify trials) are used extensively by patent lawyers. Prolonged and seemingly aimless Discovery increases the expense of patent litigation, but by adequate initial preparation of a case, it is possible for counsel to avoid or reduce protracted Discovery.

There is not any one thing that will simplify and reduce the cost of patent litigation, but early and thorough preparation by counsel will help a lot. The same thing that offers the most hope for winning the case, i.e., thorough preparation work by counsel, will tend to reduce the overall expense of the case although this may, at first glance, seem contradictory.

In the case of plaintiff's counsel, thorough preparation should take place prior to filing the complaint. Thorough evaluation and preparation of a defendant's case at an early date will also reduce the complica-

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tion and expense of Discovery. The cooperation of counsel, and the willingness of courts to separate out and decide cases on issues which give promise of being determinative of the case, will reduce the expense of litigation. A great deal of the blame for the expense of litigation is placed on the lawyers. We are sometimes tempted to hold our best cards back until close to trial time, in order to get the most mileage when we play those cards. This is even true with respect to invalidity defenses, although the statutes and rules compel specific Pleading and notice of these defenses 30 days before the actual trial.

If a case is thoroughly prepared at an early stage, inconsequential or non-determinative issues can be eliminated or ignored. If counsel will cooperate and bring the determinative issues forward at the earliest possible time and separate out and have the case decided on transcending determinative issues, the expense of litigation can be reduced.

More than 12 years ago in an address to the American College of Trial Lawyers, Justice Brennan stated:¹

The public is fed up with systems under which neither side of a lawsuit knows until the actual day of the trial what the other side will spring in the way of witnesses or facts. The technique of playing the cards close to the vest and hoping by surprise or maneuver at the trial to carry the day, whether or not right and justice lies on the side of one's client, won't be tolerated. It was and is great sport, but hardly defensible as a system for determining causes according to truth and right.

Because it takes more than the counsel on *one* side to segregate and bring the determinative issues forward promptly, and because it also takes the energy and courage of the trial judge to advance cases in this way, complex cases have not been simplified in spite of the fact that "burdens on our judicial systems have reached almost a breaking point."²

SPECIAL PROCEDURES FOR THE TRIAL OF PROTRACTED CASES

In recent years we have used a system of Pleading in which plaintiff's allegations and defendant's defenses may be pleaded in a most general manner, leaving the details of the allegations of the complaint and the answer to be developed during Discovery.

¹164 F. Supp. 910.

²Remarks of Justice Burger in recent address in Philadelphia.

Elaborate special procedures have been recommended for protracted cases under which the parties are required in addition to the usual Pleadings to file specific admissions or denials of each fact to be proved at the trial. The purpose of these elaborate procedures is to simplify the issues, but in actual practice mountains of paper work can be generated, and the court may never find the time, before trial, to digest the elaborate statements and counterstatements which have been prepared. As a result, much time which could be used in really worthwhile preparation for trial can be wasted. It seems inconsistent to use the modern simple and non-specific manner of Pleading, and then shift into elaborate Pleadings of detailed facts for protracted cases.

In patent cases, I wish that the Pleadings could be more specific in the first place. Plaintiff should at least plead specifically just what devices or processes are accused, and specify the claims which are charged to be infringed. In trade secret cases, plaintiffs should be required to specifically allege just what the trade secrets are that they claim have been appropriated, and that these have not been published and have been maintained in secrecy. Charges of misuse and antitrust violations should be similarly detailed. With this clarification of the issues in the basic Pleadings, I believe the present Federal Rules are adequate to handle patent and related litigation.

RECOMMENDATIONS FOR REDUCING TIME AND EXPENSE OF LITIGATION

From the standpoint of plaintiff, I recommend thorough evaluation and preparation of the case before it is filed. This evaluation should weigh the chances of success in the light of Supreme Court decisions, which have held invalid patents on the really *trivial* inventions which have come before that Court.³ These patents are by no means a fair sampling of the quality of invention in the United States today, but they are an indication of the kind of patents which probably should not have been litigated in the first place.

A plaintiff's case can be advanced more rapidly through the Discovery stage and to trial, if there is thorough initial preparation. The chances are also greater of obtaining a decision of such strength that it

³In the Graham case, a spring mounted-plow blade to yield going over bumps; in Calmar, an old seal on a cap; in A. & P. v. Supermarket, a simple rack to pull groceries along a counter; in Anderson's-Black Rock, putting an old radiant burner on the side of a standard road paver.

will not be appealed, with resulting saving of that expense. From the standpoint of defendant, I recommend efforts to get severance of issues for trial and greater use of thoroughly prepared Summary Judgment motions.

SEPARATION OF ISSUES (FEDERAL RULE 42 (B))

In the Trial Court's discretion based on the convenience of the parties as well as the court severance may be ordered as to dispositive issues including:

- (1) Invention already patented in a foreign country:
Woburn Degreasing Co. v. Spencer Kellogg & Sons, 37 F. Supp. 311 (W.D.N.Y. 1941);
- (2) Validity and infringement separated from damages in jury trial:
Lyophile-Cryochem Corp. v. Chas. Pfizer & Co., 7 F.R.D. 362 (E.D.N.Y., 1947); *Swofford v. B & W Inc.*, 336 F.2d 406 (5th Cir., 1964);
- (3) No infringement because of file wrapper estoppel:
Aldridge v. General Motors Corp., 178 F. Supp. 839 (S.D. Cal., 1959);
- (4) Separate trial granted to determine invalidity on prior public use and sale:
Cataphote Corp. v. Desoto Chem. Coatings, Inc., 235 F. Supp. 931 (N.D. Cal., 1964);
- (5) Patent infringement and validity separated from antitrust, misuse and unfair competition issues:
Henan Oil Tools, Inc. v. Engineering Enterprises, Inc., 262 F. Supp. 629 (S.D. Tex., 1966);
- (6) Estoppel:
The Laitram Corp. v. Deepsouth Packing Company, Inc., 156 USPQ 662 (E.D. La., 1968).

Of course, a court must guard against the trial of a case in a piecemeal fashion, and defendant should not be encouraged to sequentially try out each defense, as the same is developed during Discovery.

The defense of prior use or sale by the plaintiff lends itself particularly to separate decision by the trial court. The plaintiff knows or should know the true facts and no injustice should result by having the issue determined in a separate trial. The same is true of noninfringement based on file wrapper estoppel, where the court can determine

the proper scope of the claims from the true prior art which may not have been available to the Patent Office.

Where a defendant can make a strong showing that one issue will probably be determinative of the case, much can be gained by separating off and trying and deciding the case on this issue. The cooperation and willingness of counsel will be required, in many instances, to permit deciding a case in this manner.

SUMMARY JUDGMENT (FEDERAL RULE 56)

In patent cases, it is possible by Summary Judgment to have relatively inexpensive determinations of the issues of noninfringement, or of invalidity based on a prior publication of the invention, or prior public use or sale of the invention. It is possible, in many instances, to sharpen these issues by admissions and the like, to a point where the court can make a fair determination by Summary Judgment prior to trial.

The rule also provides for *partial* Summary Judgments, whereby some of the issues may be determined in advance of the trial so that the whole proceedings may be simplified. If the best defense is thoroughly presented by Summary Judgment proceedings, the parties may be able to re-evaluate their positions for settlement or trial, depending on the outcome.

Federal Rule 56 has been available for many years, but its use in patent cases has not been popular although there is no real reason why Summary Judgment cannot be fairly used in such cases. The rule itself has safeguards against too hasty a decision. The court can give the party against whom the motion is brought ample time to bring in evidence by affidavits, or to take depositions, et cetera, in order to have consideration of all of the evidence which that party can bring forth before the case is submitted by Summary Judgment determination.

On the other hand, Summary Judgment can be unfairly used in patent cases, as in any other kind of case, if a party is hustled through the proceedings and not given adequate time to present his case. A litigant ought not to have a Summary Judgment decided against him, with only a few days to prepare for the hearing. Summary Judgment proceedings should better extend over a longer period of time than is customarily given for the hearing of ordinary motions to permit the party against whom the motion is brought to bring in all of his evidence.

The practice of arguing or suggesting nongenuine issues of fact to avoid Summary Judgment should be discouraged. On the other hand,

the court should not use Summary Judgment to get rid of a heavy case where the right of the matter is not entirely clear. It is probable that Summary Judgments have not been popular in patent cases because of early decisions in which patent infringement complaints were dismissed in too hasty a manner. One court of appeals said about a patent case dismissed on Summary Judgment:

Finally, since this is a patent suit and as such there is a public interest involved, instead of being tried and determined piecemeal, as was attempted here, it ought to be determined as a whole on the issues of patent validity, infringement and misuse. Tried and determined as a whole, the questions raised upon the issue of plaintiff's unjust and unfair uses and practices in respect of the patent could then be considered in the light of the realities as to whether plaintiff has a patent and whether defendant has infringed it, and not, as was done on this record, by a kind of shadow boxing in vacuo.⁴

On the other hand, it has become common for judges in some circuits to say they will not decide cases of any complexity (such as patent cases) on Summary Judgment because they are not encouraged to do so by their court of appeals. The judges may not want to take the risk of being reversed on appeal.

Similarly, the lawyers have been reluctant to proceed by Summary Judgment even when they have a fair enough case to do so. The risk these lawyers see is in playing their best card prematurely. They feel that if the judge rules against them on a motion for Summary Judgment, he will have a feeling that he has finally decided that issue when it is later presented at the trial in a more complete manner using live witnesses in open court. Another concern a lawyer may have about Summary Judgment is that if he loses the motion, after having given it a thorough preparation, his client will feel it is a loss of the whole case on the merits. Another fear is the chance of increasing the expense of the case if a Summary Judgment is won and then reversed on appeal, leaving the litigation in a posture where the trial on the merits must finally be gone through with anyway, after the expense of the initial appeal.

I have mentioned the possibility that Summary Judgments might be side-stepped by over-emphasis on the part of the defending party on issues which are really not genuine. Of course, Summary Judgment should not be granted if any genuinely disputed issue of material fact is present. Where Summary Judgment motions are decided by a court within a few days after they are filed, like other more ordinary motions,

⁴Hawkinson v. Dennis, 166 F. 2d 61, and Gray Tool Co. v. Humble Oil & Refining Co., 186 F. 2d 365, 369.

it would be possible for the opponent to kill off a motion soundly brought by presenting and arguing fact issues which are really pretended and not genuine. It is possible that a litigant, while recognizing that he should ultimately lose the case, will put off the evil day of decision for reasons of his own by arguing issues which are not genuine. This practice should be discouraged.

In summary, it takes some courage for the trial lawyer to bring in his best defense for determination by Summary Judgment. More important, it also takes courage for a trial judge who does not like to be reversed on appeal to take the reins and decide a patent case on Summary Judgment.

INCREASED USE OF SUMMARY JUDGMENT IN PATENT CASES

In the last few years, the reported cases indicate that a substantial number of motions for Summary Judgment of invalidity have been successful, including those on the issue of obviousness under 35 U.S.C. 103.⁵

Valid patents may be held not infringed, based on motion for Summary Judgment, as discussed in the relatively recent and interesting case of *Fraser v. City of San Antonio*, 167 USPQ 1 (5th Cir., 1970). In the *Fraser* case, it appears that the claims were broader than the actual invention disclosed and the court made a declaration of non-infringement on a motion for Summary Judgment. The claims were limited by the court to the invention disclosed in the specification. The broader construction of the claims sought for by the plaintiff was rejected as a matter of law.

JURY TRIALS OF PATENT CASES

Patent cases have been traditionally tried to the court, rather than to a jury, but a party may have a jury trial of a patent case by timely application for same.

Anyone who has had the experience of preparing jury instructions in a patent or similar case can testify that jury trials multiply the time and expense of the case. Any interesting discussion of the agonizing labors involved for the court in trying to deliver proper instructions to the

⁵See discussion in *Proler Steel Corporation, Inc. v. Luria Bros. & Co. et al.*, 417 F. 2d 272, 163 USPQ 321.

jury in a complex patent case appears in *The Thurber Corp. v. Fairchild Motor Corp.*, 122 USPQ 305, 269 F. 2d 841 (5th Cir., 1959). This language from the case suggests the difficulties of instructing the jury:

In dealing with a complex mechanism discussed in intricate language by the experts, portrayed by beautiful and expensive charts and drawings, compared with language used in similarly confounding papers, how can the judge, with fairness and accuracy, and free of inadvertent slanting, summarize it by an authoritative deliverance to the jury?

If this leaves the matter somewhat less than satisfactory it is the unavoidable consequence of seeking a jury trial on a matter which traditionally is left to the judge.

Chief Justice Burger has recommended a more limited use of jury trials in civil cases in his recent Philadelphia address. Expanded use of jury trials in patent cases is not desirable in this era where our judicial systems are already overburdened to the breaking point.

CONCLUSION

The cost of patent litigation depends on so many factors that it is difficult to estimate the expense of simple, average and complex cases. However, the costs may vary in different areas of the country and those which have been quoted during this Conference appear to be very high as compared with Washington practice.

In our experience, it is more reasonable to expect litigation costs through the court of appeals in the three categories, as follows:

Simple case	\$50,000 to \$60,000
Average case	About \$100,000
Complex case	Over \$100,000 and up to \$250,000

Of course, the expense of a patent case is not under the control of one side of the case, and an opponent who will not reasonably cooperate can increase the overall expense of the case.

D. ANTITRUST AND UNFAIR COMPETITION

Empirical Study of Limitations in Domestic Patent and Know-How Licensing: A Second Report*

S. CHESTERFIELD OPPENHEIM** AND JOHN C. SCOTT***

INTRODUCTION

THIS PROJECT IS PART OF the Institute's continuing investigation of licensing operations involving industrial property rights by American companies in the United States and abroad. It is intended to fill a vacuum in empirical information on types of patent and know-how limitations and royalty practices in domestic licensing agreements and

* John C. Scott presented a summary of this report to the Conference. The first report of this study appears in *IDEA*, Vol. 14, No. 2 (Summer 1970), pp. 193-211.

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the reasons for their use. Similar Institute studies on foreign licensing practices of United States companies and foreign companies' licensing in the United States have been made by Professor Jack N. Behrman of the Institute's Research Staff.¹ Messrs. Robert B. Bangs and Joseph M. Lightman, both members of the Research Staff, have also conducted empirical studies on patent, trademark, and know-how licensing.²

While there is a large body of judicial decisions and a vast literature on patent licensing in the United States, the Institute was aware of a virtual vacuum in factual information on types of licensing limitations and the reasons for their use. Both management and judicial decision-making, as well as legislative recommendations, have been based predominantly on opinion evidence. Case-by-case judicial decisions typically involve records lacking in empirical data regarding the extent of utilization of any particular type of license limitations and the factors that may justify its use. The Institute is convinced that availability of empirical data on license limitations will or should lead to economic and legal analysis far more reliable and useful than the abstract and speculative commentaries that have dominated the literature on this subject.

The need for a study of this sort is pointed up by Recommendation XXII in the Report of the President's Commission on the Patent System. The recommendation is that the United States Patent Code be amended to adopt a rule-of-reason approach in determining the lawfulness of patent-license limitations. It would require the courts to consider all relevant factors before determining, in any given case, (a) whether the limitation is within or outside the claims of the patented invention and (b) if the limitation is related to the patent claims, and whether, under the circumstances, the limitation is a reasonable means of securing to the patentee the full benefit of his patent grant. Essentially, it would amount to Congressional sanction for the reasonable reward rationale repeatedly announced by the Supreme Court in patent cases.³

¹ Jack N. Behrman, "U. S. Companies as Licensees Under Foreign-Owned Patents, Trademarks and Know-How," *IDEA*, Vol. 5, No. 1 (Spring 1961), p. 16; Behrman, "Foreign Licensing and Investment in U. S. Foreign Economic Policy," *IDEA*, Vol. 4, No. 2 (Spring 1960), p. 150.

² Robert B. Bangs, "Use of Industrial Property in Foreign Countries," *IDEA*, Vol. 13, No. 4 (Winter 1969-70), p. 553; Joseph M. Lightman, "Compensation Patterns in U. S. Foreign Licensing," *IDEA*, Vol. 14, No. 1 (Spring 1970), p. 1.

³ This was formulated explicitly in *United States v. General Electric Co.*, 272 U. S. 476, 490 (1926), as a standard that the patentee may license for "any royalty or upon any condition the performance of which is reasonably within the reward which the patentee by the grant of a patent is entitled to secure."

We hope the empirical data gathered in this study will be useful to the courts, government officials in the executive and legislative branches, business executives, the Patent Bar, and the larger public interest in technological and commercial innovation. It is hoped the factual findings will contribute to a better understanding of the factors to be considered in balancing the public interest and private rights in this significant area of national concern.

This second report of the empirical study will seek to place the factual findings in the context of existing judicial decisions on patent policies relevant to the specific categories of subject matter covered in the survey. It will also refer to pronouncements and proposals in government reports and documents, and in public statements of government officials (relevant to patent and know-how licensing limitations covered in the Institute's project questionnaire) which are addressed to the ongoing process of accommodation of the exclusive private rights of the patent grant to the public interest in preventing and correcting licensing practices deemed to constitute patent misuse.

No attempt will or can be made in this report, however, to deal with the status which any of these licensing practices should or do have under the antitrust laws. Manifestly, the Institute does not have, and could not obtain, all the details of the commercial and industrial context in which the surveyed patent licenses were negotiated—details essential to a conclusion as to antitrust implications. Rather, we will report, and attempt to evaluate, the survey results as manifestations of the responding patent holders' views of the scope of the rights embodied in their patent grants.

The authors hope that this report will aid readers in making their own evaluation of the pros and cons of current controversial issues in areas where court decisions have not yet clarified whether or not certain types of patent and know-how licensing limitations are within the legally permissible boundaries of the grant of the patented invention or protectible trade secrets of the licensor.

THE QUESTIONNAIRE DESIGN

Data as to the frequency of specific licensing practices are more meaningful when accompanied by like information with respect to other closely related or alternative licensing provisions. Moreover, the economic and competitive impact of such provisions can be evaluated only in the light of the economic motives that prompted them. The

combination of these requirements of a useful survey with the optimum size and patent-activity data needed to assign appropriate weight to each response produced a questionnaire of more than 60 questions. To accommodate the busy respondent, the Institute designed a multiple-choice questionnaire that, by making liberal use of tables or charts, combined multiples of related queries into a single question answerable by the insertion of marks in a few appropriate boxes. (A copy of this questionnaire is appended to the first report of this study in *IDEA*, Vol. 14, No. 2 [Summer 1970], at pp. 206-211.)

In the multiple-choice format, respondents were asked to designate categories of frequency—categories identified by the words “always,” “usually,” “often,” “occasionally,” “seldom,” and “never.” The import of a designation “always” or “never” is obvious. For each of the other four options, the questionnaire assigned a range of percentages: To “usually” was assigned the range above 60 percent but less than 100 percent; to “often” was assigned 30 to 60 percent; “occasionally,” 10 to 30 percent; and “seldom,” below 10 percent.

Each table or chart providing spaces for multiple-choice answers to a series of questions was designed to deal with a particular class of patent-licensing provision. Since it was not possible, however, to anticipate and list every conceivable provision that might fall within that category, each table or chart lists the three or four most common forms of provision and then provides a space labeled “other,” in which the patent owner was asked to identify briefly any other type of arrangement he may use and then to designate the frequency of its use. Only one or two such designations were made in the responses—an encouraging indication of the comprehensiveness of the questions listed.

THE POPULATION SAMPLED

This questionnaire was sent in two mailings to 1,500 corporations. The 1,000 companies that received the initial mailing were selected as follows: The first 200 on “Fortune’s” list of the 500 largest industrials; the ten largest employers in each of 18 basic industries; 220 companies selected by pulling every ninth corporation on the New York Stock Exchange list; 200 selected by picking every third corporation on the American Stock Exchange list; and 200 chosen by picking every fifth company whose stock is traded over the counter. For the second mailing of 500, the selection was made as follows: The remaining 120 on the “Fortune” 500 list (that is, those remaining after the

selection of the first 380 companies for the initial mailing); and 380 companies selected at random from the New York Stock Exchange list and the American Stock Exchange list. In the selection of companies from the stock exchange lists, banks, insurance companies, brokerage houses, and other service agencies not relevant to ownership of patent portfolios were eliminated. The second mailing was made because almost 27 percent (21 of 78) of the responses to the first mailing came from companies reporting no patent ownership or no patent-licensing activity. A total of 166 replies were received, 52 of which came from companies that do not engage in patent licensing, four from companies reporting an inability or unwillingness to contribute the time and effort involved, and two from patent owners maintaining a strict rule of confidentiality as to their licensing practices.

SOME GENERAL OBSERVATIONS ON THE RESPONSES TO THE QUESTIONNAIRE

Completed questionnaires were received from 108 patent-owning and licensing corporations with annual sales ranging from \$800,000 to \$14 billion, with patent portfolios covering from 1 to 14,000 inventions, and with annual patent-licensing royalties totaling as high as \$15 million. Of the firms responding, 34 had sales of over \$1 billion in 1968, 17 had annual sales from \$500 million to \$1 billion, 33 had annual sales of from \$100 million to \$500 million, and 21 had annual sales below \$100 million.⁴ Thirty-seven own more than 700 patents and 10 have outstanding licenses covering more than 700; 37 own between 200 and 700 patents and 9 license that many; 28 own between 50 and 200 patents and 26 license that many; and 5 own fewer than 50 patents, although 55 license fewer than 50.⁵

Almost all of the patents reported on covered inventions developed in the reporting company's own research and development departments. Only 13 of the 108 respondents reported that they had obtained any of their patents through grant-back arrangements with their licensees. Of these 13, 7 said less than one percent of their patents were obtained in this fashion, and the company reporting the largest percentage of acquisitions through grants-back said it got only four percent of its patents that way. Only 2 of the respondents said they had acquired

⁴ Three respondents did not answer the question relating to annual sales.

⁵ One respondent did not answer the question relating to number of patents owned, and eight did not answer the question relating to the number licensed.

most of their patents by purchase (one said it obtained 61 percent of its patents by purchase and the other said it obtained its patents "primarily" by purchase). Only 11 respondents said they had obtained ten percent or more of their patents by purchase, and only 25 of the 108 reported obtaining as many as five percent of their patents by purchase.

The Attorney General's National Committee to Study the Antitrust Laws recognized that acquisition of a patent by original grant "may be subject to less scrutiny than acquisition by purchase," especially when made by a competitor. But the mere purchase of a patent "by itself is perfectly proper. Impropriety will arise only when such acquisition is part of an illegal purpose or plan."⁶

In *United States v. United Shoe Machinery Corp.*, 110 F. Supp. 295 (D. Mass. 1953), *aff'd per curiam* 347 U.S. 521 (1954), the court approvingly noted that United Shoe had purchased only about five percent of its numerous patents. In *Automatic Radio Mfg. Co. v. Hazeltine Research, Inc.*, 339 U.S. 827 (1950), the Court declared in a dictum that "mere accumulation of patents, no matter how many, is not in and of itself illegal." That principle was stated to be particularly applicable where "the unexpired patents cover inventions conceived and developed by the employees of the defendant under an established research program." (*Dollac Corp. v. Margon Corp.*, 164 F. Supp. 41 (D. N.J. 1958)). But monopolization by acquisition of patented inventions in a particular field is subject to attack under Section 2 of the Sherman Act.

The former head of the Antitrust Division of the Department of Justice, Donald F. Turner, assumed that acquisition of a patent and an exclusive license under a patent are "assets" within Section 7 of the Clayton Act. More specifically, he suggested that "serious Section 7 problems would be raised whenever a company acquired a patent, or an exclusive license under a patent, of such importance that the acquirer may obtain thereby an advantage over his competitors which might be decisive." (Turner, "Patents, Antitrust and Innovation," 26 *U. Pitt. L. Rev.* 151, 155 (1966)). In *United States v. Lever Brothers Co.*, 216 F. Supp. 887 (S.D. N.Y. 1963), the court concluded that the acquisition by Lever of patents relating to the detergent "all" constituted an acquisition of assets under Section 7 of the Clayton Act.

More than half (58) of the responses indicated that the reporting companies held sublicensing rights under patent licenses obtained from other companies. But the sublicensing rights reported involved

⁶ Report of the Attorney General's National Committee, 1955, p. 227.

less than 2,000 patents, whereas the 108 respondents reported ownership of a total of more than 128,000 patents and reported on licenses covering well over 27,000 patents.

Domestic licensing of unpatented trade secrets and other technology or know-how was reported by 79 of the 108 respondents. Of the 79, 49 said the know-how is "always" or "usually" licensed in conjunction with patent licensing. Fifteen said that is "often" the case; 15 said it happens "occasionally" or "seldom"; but no one said his know-how licensing is "never" coincident with patent licensing. With only minor exceptions reported by three or four companies, each respondent's know-how licensing practices are identical to its patent-licensing practices.

The dictum of Justice Black in *Lear v. Adkins*, 395 U.S. 653 (1969), has created concern among members of the Patent Bar that a broad federal preemption doctrine based upon the Patent Code might deprive owners of valid unpatented trade secrets and know-how of protection under federal or state law. This concern prompted Senator Hugh Scott (R. Pa.) to introduce in the 91st Congress an amendment (No. 579) to S.2756, which would strike Section 301 and in lieu thereof insert:

§ 301. Preservation of other rights

This title shall not be construed to preempt, or otherwise affect in any manner, rights or obligations not expressly arising by operation of this title whether arising by operation of State or Federal law of contracts, of confidential or proprietary information, of trade secrets or unfair competition, or of other nature.

As might be expected, the most common form of payment exacted from patent licensees is royalties. A total of 91 respondents (84 percent) said royalties are "always" or "usually" the mode of payment (22 of those exacted in addition an initial fixed fee). And 65 reported that the royalties are "always" or "usually" based on a percentage of the licensee's sales. However, a fixed sum per unit of sale or production (as contrasted with a percentage of dollar sales) is "always" used by four respondents, "usually" by 12, "often" by 17 and "occasionally" by 33.

Nearly half (53) of the respondents reported a policy of refusing to license some patents, and most of these (37 of the 53) gave reasons either impliedly or obviously and candidly based on a desire to exclude or avoid competition during the period of the exclusive rights of the patent grant. They "prefer to practice our inventions ourselves" or want "defensive protection" or just simply "don't want competition." Two said their purpose is to protect the heavy investment they have made in market development, and three related their policy to the new, developmental state of the market involved, which made it diffi-

cult to place a value on a license or at least advisable to await further market development before licensing. One replied that a licensee would have to cut prices to enter the market for the patented product and that advice of counsel against attempting first-sale price control led to the decision not to license. Three respondents described a policy of refusing to license whenever they themselves are capable of supplying the entire demand; and three others, phrasing it somewhat differently, said their no-license policies apply whenever the market is too small to support other producers.

These responses apparently reflect a belief that a patentee, acting unilaterally, has a right under Section 154 of the Patent Code "to exclude others from making, using, or selling the invention throughout the United States." The courts have recognized this right. Illustrative is *Sylvania Industrial Corp. v. Visking Corp.*, 132 F. 2d 947, 958 (4th Cir. 1943), where the court said:

It is the right of a patentee to withhold licenses if he sees fit to do so and to confine his patented methods to the manufacture of his own goods. . . . Any advantage accruing from this practice is not unlawful, but is attributable to the monopoly conferred by the patent statute. . . .

Assistant Attorney General Richard W. McLaren, head of the Justice Department's Antitrust Division, has categorically stated that "A patentee may decline to issue any licenses at all." (McLaren, "Patent Licenses and Antitrust Considerations," 13 *IDEA*, Conference Number 1969, 61 at 64.)

Recently the Assistant Attorney General and his Special Assistant have been citing *United States v. Besser Mfg. Co.*, 96 F. Supp. 304 (E.D. Mich. 1951), *affirmed* 343 U.S. 444 (1952) and *United States v. Krasnov*, 143 F. Supp. 484 (E.D. Pa. 1956), *affirmed per curiam* 355 U.S. 5 (1957), for the proposition that it is an illegal restraint of trade for a patentee and his assignee or licensee to agree that no further licenses will be granted without the consent of both parties. The rationale is that the right of exclusion inheres in the patent grant and is therefore one which only the owner of the patent can lawfully exercise.⁷ *Besser, Krasnov and McCullough Tool Co. v. Wells Surveys, Inc.* 343 F. 2d 381 (10th Cir. 1965), *cert. denied* 383 U.S. 933 (1966), hold that an agreement by the patentee to give another a veto power over

⁷ Richard W. McLaren, "Patent Licenses and Antitrust Considerations," *IDEA*, Vol. 13, Conference Number 1969, p. 65; Bruce B. Wilson, "Patents and Antitrust: The Legitimate Bounds of the Lawful Monopoly," Remarks before The Patent Law Association of Pittsburgh, November 19, 1969; Richard Stern, "The Antitrust Laws and Restrictive Patent Licensing Provisions," remarks before U.S. Patent Office Academy, April 20, 1970.

selection of additional licensees violates the Sherman Act.⁸

The number of patents actually withheld by the respondents reporting refusals to license, is not large. While 14 of the 53 respondents who acknowledged a no-license policy did not specify the number of patents affected (those 14 held 22,307 patents), the other 38 reported that the policy applies to only 2,742, or about 5.2 percent, of the 53,075 patents they control. Only one patent owner said he applies the policy to all his patents (and therefore, of course, had no licensing practices to report), and only six others apply it to more than 15 percent of their patents.

THE LICENSING PRACTICES REPORTED

Exclusivity

Apparently an overwhelming majority of the patent-licensing arrangements reported on are nonexclusive. Only 7 respondents said their domestic licenses now in force are "always" or "usually" exclusive (see Table 1). Another 18 said they "often" or "occasionally" use exclusive licenses. But 53 said they "seldom" license exclusively, and 26 said they "never" do so.⁹

It has, of course, long been generally accepted that "a patentee may, without divesting himself of ownership of the patent, grant an exclusive license for the manufacture of the patented device, which license serves to exclude the patentee himself from engaging in the manufacture of the device, and which action, without more, does not constitute an illegal restraint of trade." (*Rail-Trailer Co. v. ACF Industries, Inc.*, 358 F. 2d 15, 17 (7th Cir. 1966)).

Uniformity of Royalties

In response to a question about their nonexclusive licenses, 69 of the respondents to the Institute's questionnaire said they "always" or "usu-

⁸ One of the Justice Department's pending Sherman Act injunction suits lists an agreement "to grant additional licenses only with the consent of existing licensees" among the aggregation of activities alleged to be an antitrust violation (*United States v. Fisons, Ltd.*, N.D. Ill., Civil No. 69 C 1530, filed July 23, 1969), and early last year the Department obtained a consent judgment in another case enjoining a patentee "from agreeing with any licensee or prospective licensee as to whether [patentee] should or should not grant a license to any other person" (*United States v. Union Camp Corp.*, 1969 Trade Cases ¶ 72, 689 (E.D. Va., February 24, 1969)).

⁹ Two respondents failed to respond to this question.

APPENDIX

TABLE 1

FREQUENCY OF MISCELLANEOUS LICENSING PROVISIONS

	Always	Usually (over 60%)	Often (30-60%)	Occasionally (10-30%)	Seldom (under 10%)	Never	No Response	Total Responses
Patent licensing tied to know-how licensing	8	41	16	7	7		1	80*
Licenses are exclusive	2	5	8	10	53	26	5	108
"Most favored nation" clause								
on royalties	16	53	15	6	7	3	8	108
Package licensing	1	17	35	22	16	9	8	108
First-sale price control					2	102	4	108

* 28 of the 108 respondents reported that they do not engage in domestic licensing of know-how.

ally" include in their license a "most favored nation" clause guaranteeing to the licensee that his royalties and other considerations will not exceed those paid by any other licensee. Only two of the companies that indicated they do not use "most favored nation" clauses reported that they nevertheless always use uniform royalty provisions. Those who responded to an inquiry about their reasons for not exacting uniform royalties gave a variety of business or economic explanations for discriminating among licensees. The reasons given most frequently (by 12 respondents) is a desire to assist a first or early licensee charged with the task of pioneering or developing a new product or process. Next in order of frequency (10 respondents) is adjustment of royalty rate to give credit for a cross-license obtained from the licensee. Other considerations supplied by licensees with concomitant royalty reduction are settlement of litigation, grant-back agreements, cooperative development effort, and supplying technology or testing. Six respondents said they vary royalty rate with field-of-use involved; 4 take into consideration the size of the licensee; and 3 act on the basis of the value or price of the product in which the licensee uses the invention. Respondents often pointed out that there are so many variations and combinations of all of these motivating factors that uniform royalty rates would create serious injustices.

The "most favored nation" clause in patent-license royalty provisions has been attacked in litigation as a means of suppressing competition and stabilizing royalty rates "by permitting plaintiffs to argue that as a practical matter this provision forecloses the acceptance of a lower royalty." (*Technograph Printed Circuits, Ltd. v. Bendix Aviation Corp.*, 218 F. Supp. 1 (D. Md. 1963).) In rejecting that argument, the court found the "short answer" to its problems in *United States v. U.S. Gypsum Co.*, 333 U.S. 364 (1948), where the Supreme Court held that the licensor "should be required to license all its patents . . . to all applicants on equal terms." (340 U.S. at 94.) Later, in *Laitram, Corp. v. King Crab, Inc.*, 244 F. Supp. 9 (D. Alaska 1965), a patentee was found to have misused his patents and forfeited his right to infringement damages by charging users of his patented machine twice as high a rental rate in one geographical market as he was charging in another. The district judge cited *U.S. v. United Shoe Machinery, Corp.*, 110 F. Supp. 295 (D. Mass. 1953), for the proposition that price discrimination in machine-leasing arrangements is an abuse of the lawful patent monopoly when it results in monopolization or is part of an attempt to monopolize a market. The court in *Laitram* also referred to FTC Commissioner Phillip Elman's concurring opinion in *Grand Caillou*

Packing Co., Inc., FTC Docket 7887, June 16, 1964. Commissioner Elman took the position that a patent owner has a right generally to exploit his patent monopoly by discriminatory rates, but not when the effect is to destroy or cripple a major segment of an industry. The Federal Trade Commission's order in that case, banning royalty-rate discrimination as a violation of Section 5 of the FTC Act, was affirmed by the Court of Appeals for the Fifth Circuit in *La Peyre v. FTC*, 366 F. 2d 117 (5th Cir. 1966). The Fifth Circuit's opinion has been cited by an Antitrust Division official for the proposition that a patentee's "dealing on a nondiscriminatory basis may be required in situations involving monopoly power."¹⁰

Other statements emanating from the Antitrust Division, on the other hand, explicitly recognize the right of a patent owner to vary his royalty rates from one field of use to another, "establishing different royalty rates for various uses, and then offering to license freely throughout the range of applications."¹¹ These statements apparently assumed that the patentee's intent was simply to maximize his return. But in *Barber Asphalt Corp. v. La Fera Grecco Contracting Co.*, 116 F. 2d 211 (3rd Cir. 1940), the owner of a process patent was denied an injunction against infringement because he applied different royalty measures to licensees who used unpatented material he manufactured and licensees who bought the unpatented material elsewhere. None of the reasons given by companies responding to the Institute's questionnaire would seem to suggest any purpose of thus monopolizing the sale of an unpatented product or of otherwise extending the lawful monopoly afforded by the patent grant.

Package Licensing

Package licensing, in the sense of writing a licensing agreement that covers more than one patent, seems to be commonplace (see Table 1). Only 9 respondents said none of their license agreements cover more than one patent. Almost three-fourths (75) of the respondents said their licensing agreements "usually," "often," or "occasionally" cover two or more patents. Yet only 12 of the 84 companies that answered the question reported that their licensees are not also free to select and take a license under individual patents of the "package." Six other respondents indicated that, while licensees are free to choose fewer than all the pat-

¹⁰ Roland W. Donnem, "The Antitrust Attack on Restrictive Patent License Provisions," address at Michigan State Bar Convention, Detroit, Michigan, September 25, 1969.

¹¹ McLaren and Wilson, *supra* note 7.

ents, the royalty rate is based solely or primarily on the dominant patent or patents and no reduction is granted for elimination of subordinate patents from the package. Of the 12 companies that acknowledged a policy of licensing certain patents only in packages, five justified their policy by reporting that the patents are so closely related to, and dependent upon each other that it is impossible to use them individually. The same situation may have been described in different terms by three respondents who said their policy has developed simply because no one has ever asked for anything less than the whole package of patents. Two other respondents explained that they follow a compulsory package-licensing policy only when the primary subject of the license is know-how and the royalty rate is based upon the importance of the technology communicated rather than upon the value of the related patents.

Companies that do license packages of patents but also permit licensees to select fewer than all the elements of the package were asked to indicate the factors they weigh in determining the royalty rate for individual patents. The responses are somewhat difficult to tabulate, however, since a variety of terms were used to describe what appear to be identical, or at least very closely related, factors or considerations—i.e., “economic value,” “savings available to licensee,” and “potential profits.” Some of the more specifically identifiable factors reported are the relative importance of the individual patents, i.e., whether they are basic or improvement patents (17 respondents); the certainty of the patent’s validity (10 respondents); the scope of the patent claims (9 respondents); the ease with which the patented invention can be avoided (7 respondents); and the remaining life of the patent (3 respondents).

Other reasons for licensing patents in packages were suggested by the Attorney General’s National Committee to Study the Antitrust Laws: “Packaging is frequently used to avoid troublesome questions of infringement, complex bookkeeping, the difficulty of determining which patent controls the present and future needs of the licensee, cost differences, and similar practical considerations.”¹² But the most important reason for the steady increase in the practice of licensing patents in multiples or “packages” is probably related to the modern prevalence of patents covering improvements in former discoveries rather than inventions in completely novel areas. As several of the respondents to the Institute’s questionnaire pointed out, patents are often so closely related to, and dependent upon, each other that it is impossible to use them individually to produce any marketable product or service.

¹² *Supra* note 6, p. 239.

Actually, the Supreme Court made it clear in *Automatic Radio Mfg. Co. v. Hazeltine Research, Inc.*, 339 U.S. 827 (1950), that there is nothing wrong with "package licensing" when the licensee in fact wants all the patents included in the package. The problem arises when the licensee wants fewer than all the patents. The Supreme Court has never ruled squarely on the issue whether a patentee can compel a licensee to take a license under a patent he does not want in order to get a license under the patent he does want, although the 1955 Report of the Attorney General's Committee, at page 239, views *Ethyl Gasoline Corp. v. United States*, 309 U.S. 436, 459 (1940), as condemning this practice.

In any event compulsory package licensing was held to be misuse of the patents in *American Securit Co. v. Shatterproof Glass Corp.*, 268 F. 2d 769 (3rd Cir. 1959). But in *International Mfg. Co. v. Landon*, 336 F. 2d 723 (9th Cir. 1964), *cert. denied* 37 U.S. 988 (1965), the court held that mandatory package licensing of so-called "blocking patents," namely, patents "disclosing inter-dependent parts of the same product," was not patent misuse. And the Attorney General's Committee approved the rule that compulsory package licensing is not within the scope of the patentee's rights under his patents, but "only where there is refusal, after a request, to license less than a complete package." Subsequently, in *McCullough Tool Co. v. Well Surveys, Inc.*, 343 F. 2d 381, 408 (10th Cir. 1965), *cert. denied* 383 U.S. 933 (1966), the Court of Appeals for the Tenth Circuit, upholding a package license, reached a similar conclusion, stating: "In order to constitute a misuse, there must be an element of coercion, such as where there has been a request by a prospective licensee for a license under less than all of the patents and a refusal by the licensor to grant a license." But in *Apex Electric Mfg. Co. v. Altorfer Bros.*, 238 F. 2d 867 (7th Cir. 1956), the court held that a demand by the licensee for licensing of individual patents is not a prerequisite to proving misuse by package licensing. And in *Rocform Corp. v. Acitelli-Standard Concrete Wall, Inc.*, 367 F. 2d 678 (6th Cir. 1966), patent misuse was found where the package license did not provide both for reduction of the license fee on expiration of the most important patent and termination at will of the license. Otherwise the effect, said the court, was to continue collection of royalties on an expired patent, citing *Brulotte v. Thys*, 379 U. S. 29 (1964), and *American Securit*, *supra*. But in *McCullough Tool Co. v. Well Surveys*, *supra*, where there was no request and refusal to license each patent separately, the package license was held valid despite the fact that some of the patents expired during the license term.

The question has often arisen how far a patentee may go in using his schedule of royalty rates to induce licensees to take a license under a package of patents. It was the view of the Attorney General's Committee that

. . . [T]he licensor should not be required to justify on any proportional basis the royalty rate for less than the complete package, so long as the rate set is not so disproportionate as to amount to a refusal to license less than the complete package. For example, where a substantial group of patents are offered at a flat royalty rate, the deletion of one or several specified patents need not affect the rate. . . . Moreover, where several "per piece" licenses are requested and offered, the mere fact that the sum of the "per piece" license royalties exceeds the package royalty rate should not of itself be considered a condition that all or no patents be taken, again, so long as the "per piece" rate is not so disproportionate as to amount to a refusal to license less than the complete package.¹³

The Antitrust Division's position on royalty adjustments or maneuvers of this sort condemns "adjusting royalty provisions in a manner that achieves the same result" as direct compulsory packaging. The statement of that position was accompanied by a reference to *Hazeltine Research, Inc. v. Zenith Corp.*,¹⁴ as a case in which "the district court found that the patentee's demand for a higher royalty on nine patents than for a package containing the nine plus others offended the package licensing doctrine. The Seventh Circuit affirmed, and the Supreme Court approved."¹⁵

Regardless of whether the issue being determined relates to direct compulsory packaging or to package rate adjustments, the ultimate question before the court is whether the licensee contracted voluntarily or was subjected to coercive use of the patent monopoly. In this connection, it might be wise to keep in mind the "inherent coercion" doctrine that has recently won the attention of the courts in some restraint-of-trade cases. (*FTC v. Texaco, Inc.*, 393 U.S. 223 (1968); *Premier Electrical Construction Co., v. Miller-Davis Co.*, 422 F. 2d 1132, 1138 (7th Cir. 1970).

First-Sale Price Fixing

As far as the respondents to the Institute's questionnaire are concerned, patentees' control of first-sale price is virtually nonexistent.

¹³ *Id.*, p. 240.

¹⁴ 239 F. Supp. 51, 77 (N.D. Ill. 1965), affirmed in part and reversed in part, 388 F. 2d 25 (7th Cir. 1967), affirmed in part and reversed in part, 395 U.S. 100, 133-34 (1969).

¹⁵ *Donnem, supra* note 10.

Only two companies said they ever use a provision fixing the licensee's first-sale price, and both use it "seldom." Where royalty is based on sales price, both explained, control of first-sale price is "important to guaranteeing reasonable royalty." Only four of the responses otherwise sufficiently complete to be tabulated failed to answer the question about first-sale price.

The Institute's questionnaire inquired only as to first-sale price of a manufacturing licensee, for "*General Electric* itself [272 U.S. 476, 489 (1926)] reaffirmed the previously settled rule that sale of a patented article puts control of the purchaser's resale price beyond the patentee's power."¹⁶ At first blush, the paucity of affirmative answers to the question about first-sale price appears to reflect patentees' doubts about the continuing vitality of *General Electric*. The Justice Department's continuing declarations of its intention to have that case overruled¹⁷ must be heard with the amplification supplied by its two near misses in *United States v. Line Material Co.*, 333 U.S. 287 (1948), and *United States v. Huck Mfg. Co.*, 382 U.S. 197 (1965). It has been suggested that the *General Electric* doctrine survived the *Huck* case only because the government made a procedural error in the district court.¹⁸

Actually, however, other considerations may have deterred patentees from retaining the right to control first-sale price. The *General Electric* doctrine has been severely limited by holdings that a patentee cannot fix the price to be charged by his licensee if only part of the product involved is covered by the patent¹⁹ or if his patent covers the process and machine used in producing the product but not the product itself;²⁰ that the patent owner may not fix prices when he issues more than one license;²¹ that he cannot control his licensee's selling price when the arrangement is part of a mutual agreement among distributors of competing products;²² and that a licensee's price cannot be

¹⁶ *Supra* note 6, p. 234.

¹⁷ McLaren, *supra* note 7, and Donnem, *supra* note 10.

¹⁸ Antitrust Developments, 1955-68, ABA Antitrust Section, at p. 171. Indeed, Justice Clark, a member of the Court when *Huck* was decided, has said:

In the district court the Department of Justice had specifically denied that its target was the *General Electric* case. A change of its mind did not set well with some of the Justices on the Court and the Government lost what may have been its last chance to overrule that case. Clark, "To Promote the Progress of the Useful Arts," *New York University Law Review*, Vol. 43 (1968), pp. 88, 89.

¹⁹ *United States v. General Electric Co.*, 80 F. Supp. 789 (S.D. N.Y. 1948).

²⁰ *Barber-Colman Co. v. National Tool Co.*, 136 F. 2d 339 (6th Cir. 1943).

²¹ *Newburgh Moire Co. v. Superior Moire Co.*, 237 F. 2d 283 (3d Cir. 1956); *Tinnerman Products, Inc. v. George K. Garrett Co.*, 185 F. Supp. 151 (E.D. Pa. 1960).

²² *United States v. Masonite Corp.*, 316 U.S. 265 (1942).

fixed by patent owners participating in a cross-licensing arrangement.²³

Moreover, until *Lear, Inc. v. Atkins*, 395 U. S. 653 (1969), a patentee contemplating first-sale price control had to take into consideration the rule of *Sola Electric Co. v. Jefferson Electric Co.*, 317 U. S. 173 (1942), that a licensee is not estopped to challenge the validity of the licensed patent if his first-sale price is controlled by the patent owner.

Because recipients of the Institute's questionnaire were selected from lists of industrial corporations, the licensing practices reflected in the responses are probably almost entirely those of patent licensors who themselves also manufacture under, or otherwise use, the patent. For one who does not manufacture in competition with his licensee, the continuing vitality of the *General Electric* doctrine may not be so significant. *General Electric* and both the cases in which the Justice Department attempted to have it overruled involved first-sale price maintenance by a patent owner who manufactured in competition with his licensee. And a number of authorities have recognized the possibility that a different rule would apply to a nonmanufacturing, noncompeting patentee.²⁴ Unfortunately, the Institute's questionnaire did not solicit information that would permit a determination whether the two respondents with outstanding first-sale price patent-license limitations are manufacturing and selling in competition with their licensees.

Grant-Back Provisions

Grant-back provisions are, on the other hand, quite common (see Table 2). Only 16 respondents said they "never" use grant-back clauses of any kind, although 54 respondents reported the use of grant-back provisions requiring only nonexclusive licenses.²⁵ Generally the companies using exclusive-license and assignment grants-back find it necessary to use them only "occasionally" or "seldom." Only one company said it "always" requires an assignment grant-back (of specified existing patents); two said they "usually" require assignment grants-back (of

²³ *United States v. Line Material Co.*, 333 U.S. 287 (1948).

²⁴ *Royal Industries v. St. Regis Paper Co.*, 420 F. 2d 449 (9th Cir. 1969); *supra* note 6 at p. 236.

²⁵ Of these 54, 35 answered our chart-form question fully, definitely stating that they "never" require exclusive-license or assignment grants-back. The other 19 acknowledged use of nonexclusive-license grant-back provisions without marking the portion of the chart relating to exclusive-license and assignment grants-back. In view of the wording of the question and the nature of the chart used, it would appear that these incomplete answers are intended to indicate that the respondents did not use exclusive-license or assignment grants-back.

all improvement patents) ; and one said it "often" requires assignment grants-back (again, of improvement patents) . A total of 12 respondents reported use of assignment grant-back provisions, 70 percent of which are used "seldom." Among those using exclusive-license grants-back, only three said they "always" include such a provision in the license (two asking for all improvement patents and one asking for all patents subsequently acquired by the licensee) . Nine of the companies using exclusive-license grant-back provisions find it "usually" necessary to insert such a requirement, but most said they "seldom" (less than 10 percent of the time) use such licensing provisions.

As might be expected, improvement patents are the most common type of patents covered by grant-back provisions, appearing to account for about 60 percent of existing grant-back provisions identified by the respondents. Specified existing patents seem to be covered by about 22 percent of the grant-back arrangements, and the remaining 18 percent cover all new patents subsequently acquired by the licensee. A few respondents pointed out that a grant-back of existing patents is nothing but a cross-licensing arrangement or exchange of patents. But only three companies that answered this inquiry engage in such exchanges without also having some true grant-back arrangements covering either improvement patents or all new patents subsequently obtained by the licensee.

In response to a request for the reasons for requiring grant-back commitments, 34 respondents stated that these are measures of self-protection—that the licensor who wants to stay in the market in competition with his licensees must protect himself against (1) the licensee's development of improvements that give him a significant competitive edge and (2) the development of improvements that may not only drop the licensor completely out of the market in a sales sense but even prevent him from engaging in further developmental work. Five respondents were interested in receiving all improvements for the purpose of keeping all other licensees competitive in the market, and three others said their purpose is to promote a free exchange of information and technology in the industry (not counting one who said grants-back are not so much a company policy as a generally accepted practice of its industry) . In justification of grants-back in general, 13 respondents made the observation that the licensor has some rights in this regard because it is his patent and know-how that put the licensee in a position to develop improvements and that stimulate invention; three of these indicated that they use grant-back provisions only when the licensing of the patent is accompanied by a furnishing of know-how and technical

assistance. Four of them reported requiring grants-back only for a limited period of time—i.e., during the early development period in the specific field of technology.

It was Justice Douglas who wrote the Supreme Court's decision in *Transparent-Wrap Machine Corp. v. Stokes & Smith Co.*, 329 U.S. 637 (1947), that a patent-licensing agreement requiring the licensee to assign any improvement patents to his licensor is not, in and of itself, an illegal extension of the licensor's lawful monopoly. Justice Douglas was "quite aware of the possibility of abuse in the practice" and limited his holding to the proposition that such an arrangement "is not per se illegal and unenforceable." But he spoke for only a five-four majority of the Court, and during the last five years a succession of Justice Department antitrust enforcement officials have sought to overrule or limit the *Trans-Wrap* doctrine.²⁶

Former Assistant Attorney General Donald F. Turner gave the most detailed definition of the Justice Department's position. After stating a broad view that patent grant-back arrangements should be declared unlawful per se, he explained that he intended his "per se" rule only for "the grant back of the patent itself and the grant back of an exclusive license. . . . We will certainly not oppose as per se illegal a grant-back of a nonexclusive license. Of course I cannot say that we would never oppose the grant-back of a nonexclusive license. I think that prima facie such a grant would be all right, but you can get some rather complex cases involving patent licensing, cross-licensing, and a general pattern of unlawful restraint of which this grant might be a part."²⁷ It is not clear whether Mr. Turner's phrase "exclusive license" was intended to include a grant-back arrangement under which the patent owner merely promises that no one else will be licensed or whether he was referring only to the grant of an exclusive license to make, use, and sell, which excludes the patent owner himself from competing.

More recent comments of Justice Department attorneys have stressed, as justification for overturning or limiting the *Trans-Wrap* doctrine, a tendency of assignment grants-back "to stifle research and development efforts on the part of licensees." That might have appeared to be a justification for the one antitrust case the Justice Department has filed against assignment grant-back clauses, for the patentee sued had a policy of making all assigned-back improvement patents

²⁶ Donald F. Turner, "Antitrust Enforcement Policy," *ABA Antitrust Law Journal* Vol. 29 (1965), pp. 188, 192; McLaren, *supra* note 7; Donnem, *supra* note 10; Wilson, *supra* note 7.

²⁷ *ABA Antitrust Law Journal*, Vol. 29, at p. 192.

available to all its licensees on a royalty-free basis. But a consent judgment negotiated in that case—*United States v. Wisconsin Alumni Research Foundation*, 1970 Trade Cases ¶ 73,015 (W. D. Wis. 1970) — after prohibiting grants-back, whether by license or assignment, permits the patentee to enter into agreements requiring its licensees to grant other licensees nonexclusive licenses under any improvement patents. In terms of discouraging research, the end result of nonexclusive-licensing arrangements permitted by the decree would, as a practical matter, appear to be the same as the result of the original assignment grant-back arrangements. Every WARF licensee, in planning his research and development, still knows he must share all new discoveries with his competitors.

It seems more likely that the government was simply trying to find a test case in which to get a clear-cut overturning of the *Trans-Wrap* doctrine. It will not be easy to find such a case, for, as pointed out by the Attorney General's National Committee to Study the Antitrust Laws:

The issue of the legality of grant backs has rarely been isolated in antitrust cases. Instead their utilization has been considered most frequently in connection with remedial provisions in the decree. In these instances, the grant backs have been eliminated in some cases in order to correct monopolization found to have violated Section 2 of the Sherman Act. In other cases their termination has not been deemed necessary. Apart from remedies, grant backs have been considered as part of a larger pattern of conduct in determining antitrust violation. (Footnotes omitted).²⁸

Field-of-Use Licensing

Field-of-use licensing, like grant-back requirements, is in widespread use. While 76 percent (82 of 108) of the respondents indicated that they never place any restrictions upon the quantity of activity engaged in by their licensees under the patent, and 69 percent (74 of 108) stated they never grant domestic territorial licenses, only 28 percent (31 of 108) said they never engage in field-of-use licensing. Of the 72 companies that reported engaging in field-of-use licensing, 46 (64 percent) license use of the invention in conjunction with some designated product, process or apparatus; 46 (64 percent) use provisions permitting utilization of the invention for only some designated purpose, such as industrial, commercial, or home consumption; 40 (55 percent) license use of the patent in a specified industry or industries; and 21 (29 percent) license use of the patent in a specified stage of production—i.e., research, manufacturing, product testing, or the like (see Table

²⁸ *Supra* note 6 at p. 228.

TABLE 3

FIELD OF USE AND FIELD LICENSING

	Always	Usually	Often	Occa- sion- ally	Seldom	Never	No Re- sponse	Total
Use of invention licensed for specified field or fields (i.e., industrial, commercial, home consumption)		1	13	13	19	57	5	108
Use licensed for specified industry or industries		3	7	10	20	63	5	108
Use licensed for specified stage of production (i.e., research, manufacturing, product testing)			1	4	16	62	5	108
Use licensed in conjunction with specified product, process or apparatus	3	4	9	8	22	44	5	108

3). Only three of the respondents said they "always" give field-of-use licenses, and each identified the type of license as being one authorizing use of the patent only in conjunction with a specified product, process, or apparatus. On the other hand, almost three-fourths (73 percent) of the responses indicated that field-of-use licensing is used only "occasionally" (10 to 30 percent of the time) or "seldom" (less than 10 percent of the time).

In connection with the field-of-use inquiry, the question seeking reasons for using this type of license yielded a rich variety of explanations. Some respondents said they did so to increase their royalty income, to help them "police" their patents, or to test the utility of their invention in a particular field while they collected information on which to base a decision as to general licensing policy. Others granted field-of-use licenses because they could not determine the value of their patents in other fields not embodied in the license or because the licensees themselves demanded exclusivity in their respective fields. Still others (nine of them) stated that they wanted to maintain exclusivity for themselves in their own particular field of endeavor. Indeed three respondents insisted that ability to grant field-of-use licenses is the motivating factor that induced them to adopt a licensing policy. But the most frequent explanation for granting licenses of these types is the needs or capabilities of the licensee; 32 of the respondents said they granted patent licenses designed to fit the licensee's needs or to conform to his production or marketing capability, and this explanation is frequently accompanied by the observation that this licensing procedure enables the licensor to hold down the royalty rate charged each licensee.

Field licensing has gotten more than its share of attention from the Justice Department's Antitrust Division. Since a former Antitrust Division chief first publicized his doubts about the legality, under the antitrust laws, of "restricted-use" clauses in patent-licensing agreements,²⁹ the Antitrust Division has filed six injunction suits attacking patent licenses authorizing sale of patented drugs only in dosage form,³⁰ one suit attacking agreements limiting drug-patent licensees to production for the veterinary field,³¹ and one attacking licenses per-

²⁹ Interview with Donald F. Turner, *New York Times*, December 10, 1965.

³⁰ *United States v. Sterling Drug, Inc.*, Civil No. 175-68, D. N.J., February 23, 1968; *United States v. Syntex Corp.*, Civil No. 478-68, D. D.C., February 23, 1968; *United States v. Glaxo Group, Ltd.*, Civil No. 558-68, D. D.C., March 4, 1968; *United States v. Ciba Corp.*, Civil No. 791-69, D. N.J., July 9, 1969; *United States v. Ciba Corp.*, Civil No. 792-69, D. N.J., July 9, 1969; *United States v. Fisons, Ltd.*, Civil No. 69 C 1530, N.D. Ill., July 23, 1969.

³¹ *United States v. Fisons, Ltd.*, *supra* note 30.

mitting each licensee to sell a patented insecticide either solely for use by commercial growers or solely for home and garden use.³² One of the drug-patent suits has been dismissed without opinion,³³ but another has produced rulings by a federal district court that "dosage form only" licenses are per se violations of Section 1 of the Sherman Act.³⁴ The insecticide case has been terminated by consent order prohibiting licenses that limit licensees' sales of the patented product "(i) to any person, or (ii) in any area in the United States, or (iii) for any consumer end use, or (iv) in any formulation or concentration."³⁵

Meanwhile, the present Assistant Attorney General in charge of the Antitrust Division has spelled out more explicitly—and perhaps amended somewhat—the Justice Department's position on field licensing:

... there may be some justification for a patentee reserving for himself a well-defined field out of the various potential applications for his invention. On the other hand, it is difficult to see how justification can be shown for the type of restriction which divides fields of use among licensees who otherwise would compete. Such restrictions in effect grant a submonopoly to each of the licensees, and all competition among those who would be likely competitors is eliminated. In due course, I expect that we will bring a case directly challenging restrictions of this type.

Some of those who seek to justify all field-of-use restrictions may point out that such restraints are likely to arise where there is a substantial disparity in the value of the invention as applied in various non-competing end uses. A patentee, if he is to gain a maximum royalty, will try to charge different royalties depending on the market served. Royalty discrimination, it is argued, is inherent in the lawful patent monopoly and depends for its success on field-of-use restrictions. However, it is not necessary to eliminate, by contractual restriction, all competition between licensees, in order to achieve maximum royalties from various end-use applications. In some circumstances, the patentee may be able to maximize his return by, for example, establishing different royalty rates for the various uses and then offering to license freely throughout the range of applications.³⁶

Another Antitrust Division staff member has dealt with a question raised by some respondents to the Institute's questionnaire:

³² *United States v. Farbenfabriken Bayer A.G.*, Civil No. 586-68, D. D.C., March 7, 1968.

³³ *United States v. Syntex Corp.*, D. D.C., October 15, 1968.

³⁴ *United States v. Glaxo Group Ltd.*, 302 F. Supp. 1 (D.D.C. 1969); 163 *USPQ* 668, 1969 Trade Cases ¶73,000 (D. D.C. 1969); 1970 Trade Cases ¶73,189 (D. D.C. 1970).

³⁵ *United States v. Farbenfabriken Bayer A.G.*, 1969 Trade Cases ¶72,918 (D. D.C. 1969).

³⁶ McLaren, *supra* note 7, at pp. 63-64. See also Richard Stern, "The Antitrust Laws and Restrictive Field Provisions in Patent Licenses," remarks before Licensing Executives Society Workshop, October 15, 1970.

With respect to field-of-use restrictions, I initially should make one thing clear. We see no difference between a license which contains a positive prohibition against sales in particular fields and one which merely grants a license limited to a particular field. Our investigations have shown that the *effect* of these two types of provisions is precisely the same. The licensee in fact sells only in the fields in which he is licensed. We are not willing to permit the form of the agreement to take precedence over its substance.³⁷

If the Justice Department is to make even limited antitrust inroads into field, field-of-use, or "restricted use" licensing, it will first have to overcome a series of precedents upholding such licensing practices. The landmark case in this area is *General Talking Pictures Corp. v. Western Electric Co.*, 305 U.S. 124 (1938), where the Supreme Court enforced patent-licensing agreements limiting one licensee to use of the patented sound-system device in motion-picture theatres and all other licensees to use of the device in radio speakers. Indeed, the Court went further and held that the patent owner could enjoin not only his licensee but also a buyer from the licensee from using the device in the unlicensed field. In the latter holding, the Court gave patentees greater leeway than it has in the areas of controlling prices or setting territorial or customer limits. In those areas, the first sale of the patented device ends a patentee's power to impose restrictions.

Even as the Antitrust Division looked for its "test case" to challenge the rule of the *General Talking Pictures* case, steps began in Congress to preserve field-of-use licensing. In the 90th Congress, the late Senator Everett Dirksen (R. Ill.) introduced a comprehensive patent-revision bill, Section 263 of which would have permitted field-of-use licensing and would have applied the "rule of reason" as the guideline for determining patent misuse in the employment of field licenses. At hearings before the Judiciary Committee's Subcommittee on Patents, the language of Section 263 was supported by the American Bar Association's Section of Patent, Trademark and Copyright Law but opposed by the Justice Department. At the close of the Subcommittee hearings, Chairman John J. McClellan (D. Ark.) introduced a compromise bill that did not contain any part of Section 263. Early in the present Congress, Senator McClellan reintroduced his bill (S. 1246), and about two weeks later Senator Dirksen introduced S. 1569, which is identical to his original bill and includes the controversial Section 263. These bills were subsequently consolidated by Senator McClellan into S.2756 after Senate Patent Subcommittee hearings. Still later, Senator Scott proposed amendments to S.2756 that would explicitly exempt field licensing from antitrust scrutiny. The Scott amendments would also

³⁷ Wilson, *supra* note 7.

declare territorial licensing provisions (discussed below) lawful and permit any licensing restriction that is "reasonable under the circumstances." Senator Scott defined this last phrase as intended "to secure the patent owner the full benefit of the invention and patent grant." (*Congressional Record*, April 8, 1970, pp. S5321 *et seq.*) S.2756, with the Scott amendments is expected to be reintroduced and given serious consideration in the 92nd Congress.

Territorial Licensing

Licensees' needs and capabilities are also the most frequent explanation given by respondents for territorial licensing practices. Six respondents said they tailored their territorial grants to the licensee's wishes, and four of these reported that the amount of the royalty paid was significantly affected by the scope of the territory granted. However, three said they granted territorial licenses for the purpose of maintaining exclusivity for themselves in particular areas, and three more said they did so to prevent "overlapping" of licensee-manufacturers and overcapacity in specific geographical areas.³⁸

Nearly 70 percent of those responding said they "never" use territorial restrictions of any kind, and almost half of the others said they use territorial licenses only "seldom" or less than 10 percent of the time (Table 4). A geographical limit on manufacturing activity is somewhat more common than a geographical limit on actual sales.

Back in 1955, the Attorney General's National Committee to Study the Antitrust Laws had "no doubt of the right of a patentee to place territorial restrictions upon his assignee or licensee within the United States."³⁹ The Committee was relying on Section 261 of the Patent Code (Title 35, U.S. Code), which authorizes a patent owner to "convey an exclusive right under his application for patent, or patents, to the whole or any specified part of the United States." And, in *Deering, Milliken v. Temp-Resisto Corp.*, 160 F. Supp. 463 (S.D. N.Y. 1958), a patent license limiting the geographical and trade areas of use was upheld.⁴⁰

On the basis of two 1966 Law Review articles,⁴¹ however, the Justice

³⁸ Many respondents who reported field-of-use, territorial or quantitative licensing gave no reason for the practice.

³⁹ Report of the Attorney General's National Committee, 1955, p. 237.

⁴⁰ See also *United States v. Crown Zellerbach Corp.*, 141 F. Supp. 118, 127 (N.D. Ill. 1956).

⁴¹ William F. Baxter, "Legal Restrictions on Exploitation of the Patent Monopoly," *Yale Law Journal*, Vol. 76 (1966), pp. 347-52; Gerald R. Gibbons, "Domestic Territorial Restrictions in Patent Transactions and the Antitrust Laws," *George Washington Law Review*, Vol. 34 (1966), pp. 893, 925.

TABLE 4

TERRITORIAL LIMITS

	Always	Usually	Often	Occa- sion-ally	Seldom	Never	No Re- sponse	Total
Use or manufacture limited to specified geographical area	4	4	4	4	12	68	12	108
Sales limited to specified geographical area	2	2	1	5	9	77	12	108

TABLE 5

QUANTITY LIMITATIONS

	Always	Usually	Often	Occa- sion-ally	Seldom	Never	No Re- sponse	Total
Ceiling on <i>units of production</i> achieved by use of invention		1	1	2	9	83	13	108
Ceiling on number of manufacturing employees used				1	1	93	13	108
Ceiling on number of producing machines used				1	6	88	13	108
Ceiling on man hours or machine hours					1	94	13	108
Ceiling on number of times process or structure is used					3	92	13	108

Department apparently now has doubts whether Section 261 of the Patent Code does in fact authorize domestic territorial divisions. But "we do not yet have a case presenting this issue."⁴²

Quantity Limitations

Licenses granting the right to use the patented invention up to a certain quantity of use or production appear to be less common among the respondents than do territorial licenses, for 76 percent of the respondents said they never limit licensees' production. The most common type of quantity limit (identified by 13 respondents) puts a ceiling on the units of production the licensee can achieve by use of the patent (Table 5). Most (7) of the other affirmative responses said the limit is based upon the number of producing machines permitted the licensee.

Five of the respondents said the provisions are related to the needs or desires of the licensee—particularly his desire to minimize the royalty. Three respondents reported that their purpose is to maintain exclusivity for themselves for the balance of the market, and two said their quantitative licenses were granted for the purpose of conducting a limited test of the invention's usefulness.

One of the reasons given by the Justice Department for its opposition to Section 263 of the House version of Senator Dirksen's patent revision bill is that Section 263 (b) would incorporate certain language of the *General Electric* opinion⁴³ into the patent law. The Department finds this language objectionable because it "is readily transferable to such patent licensing restrictions as quantity limitations that have unwarranted anti-competitive consequences virtually indistinguishable from those caused by minimum price restrictions on manufacturing licensees. Consequently, the proposal would seriously cripple antitrust enforcement in what we firmly believe to be one of its vitally important areas."⁴⁴ No litigation has been instituted to implement the views thus stated, but more recent statements emanating from the Antitrust Division staff indicate that a turnover of personnel in the Antitrust Division has not produced a change of position on quantity or output limitations in patent licenses. "The question of output limitations has not been carefully analyzed in the few cases dealing with the subject."⁴⁵ The

⁴² Donnem, *supra* note 10.

⁴³ *United States v. General Electric Co.*, 272 U.S. 476 (1926).

⁴⁴ Statement of Assistant Attorney General Donald F. Turner on H.R. 13951 before Subcommittee No. 3, House Judiciary Committee, February 29, 1968.

⁴⁵ Donnem, *supra* note 10.

speaker made specific reference to *United States v. E. I. DuPont de Nemours*, 118 F. Supp. 41, 226 (D. Del. 1953), *affirmed on other grounds*, 351 U. S. 377 (1956), which upheld a provision for graduated royalties that increased significantly if the licensee's production exceeded a certain percentage of the total market, and *Q-Tips, Inc. v. Johnson & Johnson*, 109 F. Supp. 657 (D. N. J. 1951), *affirmed*, 207 F. 2d 509 (3rd Cir. 1953, *certiorari denied*, 347 U. S. 935 (1954), which permitted a patent owner to limit the licensee of his patented machine and the number of units produced with the machine. Not mentioned was *Williams v. Hughes Tool Co.*, 186 F. 2d 278 (10th Cir. 1950), which permitted a patent owner to limit his licensee's production by restricting the term of the license to the relatively short life of one element of the patented device.

THE IRRELEVANCE OF COMPANY SIZE

The only characteristics of the responses received by the Institute that seem to fluctuate with the respondent's volume of sales or size of its patent portfolio are the completeness and clarity of the answers given. Except for a few minor areas where the tabulations are so small that the percentages are not meaningful, the various licensing practices seem to be about as prevalent in one size classification of corporation as in another. For example, of the 52 respondents who indicated they never require exclusive-license or assignment grants-back, 12 come from the 19 respondents whose annual sales are below \$100 million; 15 come from the 31 companies whose sales range from \$100 million to \$500 million; 11 fall in the category of 17 companies with annual sales from \$500 million to \$1 billion; and 14 are among the 32 companies with annual gross sales in excess of \$1 billion.

Field-of-use licensing appears to be practiced less frequently by companies with annual sales ranging from \$100 million to \$500 million than by companies in the other size classifications. Almost half (16 out of 34) of that group reported they "never" use field-of-use licensing, whereas only 6 of the 20 companies taking in less than \$100 million annually, 3 of the 17 companies in the \$500 million to \$1 billion class, and 3 of the 33 companies receiving over \$1 billion annually made such a report. Similarly, use of quantitative and territorial licensing appears to be slightly, but perhaps not significantly, lower among smaller corporations. Of the 33 companies over \$1 billion in annual sales, 17 said they "never" engage in quantitative licensing and 19 said they "never"

use territorial licenses. Of the next smaller grouping (\$500 million to \$1 billion) 14 of the 17 said "never" on quantitative licenses, and 9 said "never" on territorial licensing. In the \$100 million to \$500 million group, 30 of the 34 said they "never" license quantitatively, and 21 said they "never" license territorially. Among those companies in the final and smallest classification, 14 of the 20 said "never" on quantitative licensing and 13 said "never" on territories.

THE CHARACTERISTICS IN COMMON AMONG SPECIFIC INDUSTRIES

Six basic industries are represented by as many as five or more respondents in the questionnaires completed and returned to the Institute, and in each of them the answers generally follow the overall pattern. All of the 14 petroleum and chemical producers who participated in the survey said they "usually" or "often" license their patents in packages, but only one said its licensees are not free to take a license under an individual patent. On the other hand, 11 of them reported that they do refuse to license some of their domestic patents. Producers of electrical and electronic equipment also accounted for 14 of the responses; only half of them said they refuse to license some of their domestic patents. Package licensing of patents is less common among these producers (1 said it "always" licenses in packages, and 4 said they "often" do, but 8 reported package licensing of less than 30 percent of their patents) and again only one company said its licensees are not free to select individual patents for separate licensing.

Among the 9 companies whose principal activity was identified as the production and fabrication of basic metals, 5 said they do sometimes refuse to license some of their United States patents, and 5 said they "often" or "usually" license their patents in packages, although none of them reported a compulsory package-licensing policy. "Consumer products" manufacturers accounted for another 9 responses, and again 5 reported a policy of refusing to license some United States patents. Eight of the 9 said they use package licenses less than 30 percent of the time, but 2 did indicate that their licensees are not always free to take a license under individual patents.

The pharmaceutical manufacturing industry accounted for 6 of the answers, and some of those were submitted by corporations that listed pharmaceuticals second, third, or lower in the sequence in which they identified their corporate activities. Five of these companies said they do refuse to license some of their United States patents. Two of the 6

said they "never" license patents in packages, and each of the other 4 said their licensees are free to license individual patents. With respect to quantitative and territorial licensing, not a single pharmaceutical producer indicated any use at all of this type of licensing practice.

With the few exceptions set out in the preceding three paragraphs, the answers supplied by the members of specific industries follow generally the pattern of the responses received on all questionnaires.

CONCLUDING GENERAL OBSERVATIONS

About 10 percent of the corporations circularized responded to the Institute's request for data. As experience with other empirical studies indicates, the length of the questionnaire may have deterred or discouraged some companies from responding. However, this factor was probably reduced to a minimum by the simplicity and balance designed into the questionnaire and the relatively little effort required by respondents to answer the questions. Only four respondents specifically attributed their failure to respond to the length and coverage of the questionnaire. Response was probably more affected by the random method we used to select the companies for our sample; it seems likely a number were deterred by lack of patent or antitrust experience. On the other hand, the amount and degree of current interest in the subject matter covered by the survey would appear to have supplied much of the motivation for responding.

The question arises, however, whether another factor should be considered—namely, the sensitive nature of the activities examined. Although 1300 companies failed to respond—and a number of them may have been deterred by the possibly incriminating nature of some of the data sought—the fact that a relatively large number (representing a sizeable segment of the unexpired patent universe) did furnish information in this sensitive area is significant. Some indication of the high regard in which the Institute is held by those that did reply is that only two of these companies answered that the information was too confidential for disclosure.

The responses do not include information—indeed, there was no intention to elicit such data in this questionnaire—relating to the economic significance of the products covered or affected by the patents licensed. Accordingly, the figures collected cannot be weighted by, or analyzed in the light of, the economic significance of the products and services affected by the various licensing practices.

Taken at face value, the survey results certainly disclose that the

restrictive patent-licensing practices at which the new Patent Unit in the Justice Department's Antitrust Division has been directing its attention are not in general or even widespread use. First-sale price control seems to have been totally discontinued (a finding confirmed by Assistant Attorney General McLaren's statement last year at the Institute's Annual Public Conference⁴⁶ that he is "having some difficulty in finding an appropriate case" in which to test the *General Electric* doctrine); compulsory package licensing is rare; and quantitative and even territorial licensing is relatively uncommon, as is the use of exclusive-license and assignment grants-back. Only field-of-use and field licensing seem to enjoy widespread use, and the responses sent to the Institute explain the bulk of these arrangements are made because of the wishes, desires, and needs of the patent licensee, not the licensor.

Actually, if the reasons or justifications listed in response to the questionnaire for most of the restrictive licensing practices are applicable generally, these practices should survive under the "rule of reason" approach Assistant Attorney General Richard W. McLaren has announced for all these practices except exclusive-license and assignment grants-back and first-sale price control.

On the other hand, where the explanation for the use of the particular licensing practice is that the patentee wishes to "maintain exclusivity" or "protect his competitive edge" (to use some of the respondents' language), it would appear that the patentee may well be advised to be prepared to adduce, as proof of reasonableness, evidence of economic justifications other than protection from competition or mere enhancement of gain or profit.

While the Department's cases filed in the 1940's,⁴⁷ challenged patent-licensing practices as elements of broader aggregations of allegedly anti-competitive conduct, its more recent injunction complaints have focused upon only one or a few specific licensing practices for attack. It remains to be seen how far the Justice Department will carry its reasoning that, "although the patent law confers on the patentee the power to prevent others from using his invention, it does not permit him to control those whom he chooses not to prevent from using it."⁴⁸

⁴⁶ McLaren, *supra* note 7, at p. 66.

⁴⁷ *United States v. Masonite Corp.*, 316 U.S. 265 (1942); *Mercoird Corp. v. Mid-Continent Investment Co.*, 320 U.S. 661 (1944); *Hartford-Empire Co. v. United States*, 323 U.S. 386 (1945); *United States v. National Lead Co.*, 332 U.S. 319 (1948); *United States v. Line Material Co.*, 333 U.S. 287 (1948); *United States v. United States Gypsum Co.*, 333 U.S. 364 (1948); and *United States v. New Wrinkle, Inc.*, 342 U.S. 371 (1952).

⁴⁸ *Donnem*, *supra* note 10.

Franchising and Trade Secrets

ALAN B. HOBBS*

WE ARE SEEING THE GROWTH of a body of judge-made rights and duties, as well as public policy principles, applicable to the distribution method known as "franchising"—a rather old term when used with its "automobile dealer" connotation, but one which nowadays is more usually taken in its "MacDonald's" or "Kentucky Fried Chicken" sense. Whether or not this form of distribution will be permanently lodged in our economy, litigation is determining just how far the franchisor may go in imposing restrictions in conjunction with his licensing of a package consisting of a valuable trademark, processes and know-how, and special materials, and in compelling his franchisees to use his proprietary ingredients and paraphernalia in order to maintain prescribed quality standards in the marketing of goods and services sold under his mark.

My full-time corporate client chooses not to distribute in this fashion. It avoids even the use of the word "franchise," though it does deal selectively with a limited number of wholesalers who find it advantageous to carry a quality product on a nonexclusive basis. The new con-

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notation of the word "franchise" may possibly imply the existence of a contractual course of dealing which under Uniform Commercial Code decisions could lead to curtailment of the theoretical right to pick one's customers. For that reason alone, I think it risky to denote a simple dealer listing as a "franchise."

I am therefore without firsthand experience in the "new" franchising. Nevertheless, there are a few observations on the general subject of trade-secret licensing that I am happy to offer.

When you stop to think of the matter, isn't there an inherent contradiction in the very idea of licensing a secret process? Unlike a patent, it is not necessarily a new technique or mechanical device that has been precisely verbalized, publicly filed, and published to the world as a claim of intellectual terrain from which all but the inventor or his assignees are to be excluded for a term of years. Usually it is a much vaguer kind of information, imparted orally or through visual demonstration under conditions of confidentiality—chiefly to colleagues and employees—and believed by the supposed "owner" to be his exclusive possession. Mankind being naturally communicative, if not garrulous, the integrity of a secret process will vary inversely with the number of its possessors. The more who are in on the trick of preparing the mysterious, exotic sauerkraut served as a tantalizing side dish with the intensively advertised Nonesuch Frankfurter—in other words, the essential substance of the franchisor's "Unique Sales Proposition"—the more precarious is the property right in that information. If others hit upon it, or if it transpires through unidentifiable or untraceable channels, then it loses its proprietary nature altogether.

Proprietary know-how, at best, is a volatile fluid stored in a fragile, even leaky, vessel. As long as it is kept sealed within the minds of a trustworthy few, there are both legal and practical safeguards; but share it with third parties, who will have to impart it to their subordinates, and you are in a fair way to see it evaporate and vanish. And it is usually perishable anyhow, losing its value as better methods are devised.

There are special problems in licensing proprietary know-how in connection with joint ventures abroad with foreign partners. Suppose that an American company wishes to have its products manufactured by a foreign concern in the latter's country of domicile, exchanging its own technology for the foreign company's local advantages. If it has patent protection for its main processes and machinery in the foreign country, the licensing provisions of the agreement should afford a basic protection to the American company in case the arrangement goes sour.

But this is probably not true of valuable trade secrets, and should any of them be usable apart from the patents, their loss would doubtless be a foregone conclusion. Foreign courts can be callous to pleas of unjust enrichment on the part of their own nationals.

One way around this might be to require that the foreign partner refrain from competing with the American company in the foreign country for a reasonable time, in case of termination, but that can introduce other problems. You may as well sell the information outright and hope for the best. Of interest in this regard is the recent suit against Westinghouse Electric Corporation and two Japanese companies (U.S. Dist. Ct. N. D. Calif. No. C-70-852-SAW) challenging certain agreements between patent and technology licensors not to sell in one another's countries. Should that principle find acceptance, one may look for a radical reappraisal of the whole idea of foreign patent licensing by a good many companies.

Sometimes a company is willing to license certain of its patents but decides to retain for its exclusive use its specialized skills in the application of the processes covered, leaving it to the licensees to develop or discover their own techniques. Without doubt, such reticence is within the patent owner's rights. And probably in the present state of the law, it is permissible to offer to sell the knowledge to those patent licensees who are willing to pay additional for it, although it can be predicted that the courts will set limits to any excessively baroque combination of patent licensing with the licensing of the unpatented knack of utilizing the patents advantageously.

In the Supreme Court's *Lear* decision the majority recognized, though they did not undertake to resolve, the basic conflict between the constitutional policy of granting limited monopolies for original inventions and an untrammelled freedom to contract with respect to unpatented or to-be-patented inventions. In *Painton & Co., Ltd. v. Bourns, Inc.*, S.D.N.Y., February 4, 1970, a U.S. district court has held—surprisingly, in the opinion of many observers—that an agreement to pay royalties on inventions for which no patent application has been or is to be made is contrary to the patent law policy and is unenforceable.

In the present context of a trend toward limiting private trade restraints, it seems unlikely that a full body of case law on know-how licensing will be developed to parallel the principles of patent licensing. Much that passes for know-how is probably unpatentable. While the original possessor of a useful but unpatentable technique can probably get equitable relief against an employee who breaks an express or

implied agreement to hold his employer's secrets confidential, it is a matter of conjecture whether unpatented technology is rightfully entitled to all the attributes of patented inventions. In other words, are patent licensing and know-how licensing altogether analogous? The eventual disposition of the *Painton* holding will give some illumination for this important question.

A New *Prima Facie* Approach to Patent License Limitations

LAURENCE I. WOOD*

MANY YEARS AGO DEAN WIGMORE, in introducing a writing by one of my favorite authors, suggested that he was curious and concerned about why it is that no one stood up strongly in defense of patent property rights. He drew an analogy between the discovery of an invention and the discovery of a mine, and he suggested that the two rights should be correlative. He issued a call for a marked change in what he called the *prima facie* attitude with which we approach the questions raised on the patent-antitrust frontier.

I am persuaded by my review of recent developments on this front that it is high time for another such call. We need on the part of some of the judges, of some in the Department of Justice, and of some writers in the patent-antitrust arena, a whole new *prima facie* approach as to the underlying purposes behind both sets of laws and to just what the actual facts are. Almost every writing—whether an opinion or a comment—is replete with a prejudged bias or unfounded assumptions.

For this reason, I want to join in saluting S. Chesterfield Oppenheim

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and John C. Scott for the tremendous undertaking of bringing about this empirical study of what actually happens, what actually motivates a patentee in deciding when or when not to license, et cetera. When these facts are available across the board, we can dispense with the high degree of assumption and surmise that have infested supposedly learned writings and judicial opinions for years.

I should like in the next few minutes to list just a few of the instances in which a new *prima facie* attitude is essential, if anything of the supposed balanced best interests of the public are to be served by both the patent system and the antitrust laws.

We are told by the gentlemen themselves that the members of the Patent Unit of the Department of Justice believe in both the patent laws and the antitrust laws, and that they are compatible and can be reconciled. The mode of reconciliation is obvious: wherever there is a conflict or overlap, the patent system yields. For example, a reading of the paper by Roland W. Donnem, Director of Policy Planning at the Antitrust Division, delivered in September, 1969, reveals the "reconciliation":

. . . [I]mplementation of these two declared public policies in favor of competitive innovation requires that the patent monopoly not be extended so as to infringe on antitrust principles.

Therefore, contractual efforts to expand the patent monopoly should be prevented. The Antitrust Division, in considering whether to attack a particular contract involving patents, considers two fundamental questions. First, is it necessary to the patentee's exploitation of his lawful monopoly? Second, are less restrictive alternatives available to the patentee which are more likely to foster competition? . . .

The answer to the second question is easy—in the Department's eyes, any arrangement can be bettered by substituting simple, nonexclusive licensing. The only difficulty is that while that will certainly resolve the patent-antitrust confrontation, it will do so by ignoring the public policy underlying the patent system and its constitutionally declared purpose of fostering the development of science and the useful arts. As has been pointed out time and again, it is simply not enough to encourage inventions; what needs encouraging—and it was never more apparent than now—is the speculative type of investment necessary to take the germ idea and nurture it through research and engineering and development and production until it comes to the marketplace. And it is thus at the marketplace that the patentee must be given varying kinds of protection in order to protect or guard against a multitude of different economic threats to successful exploitation of the invention.

I suggest that if the constructive purpose of encouraging invention and the useful arts is really to be served, then people who own the patents must be given a reasonable amount of leeway to work out feasible schemes for the exploitation of the patents—in a variety of ways. And the ridiculous concept of per se illegality attaching to any part of the arrangement which is “outside the scope of the patent”—on the ground that it is an “extension of the patent monopoly”—should be replaced by a standard and logical Rule of Reason approach, testing whether in the fact situation presented (bearing in mind *both* public policies) it is a reasonable measure of fostering the birth and marketing of a new discovery.

A reading of Mr. Donnem’s speech—for the Antitrust Division—shows instance after instance of proposing to cut back the patentee’s protection on assumption after assumption that (a) existing limitations are unduly harmful to competition, and (b) cutting away the rights won’t really hurt. What an area for an empirical study!

Let’s look briefly at some of the assumptions.

In speaking of field-of-use limitations, he discussed some of the drug cases where licensees were limited to selling in dosage form—not in bulk form. The author’s assumption:

This limits the number of competitors marketing the drug, unjustifiably deprives the licensee of his economic freedom, and thereby restrains competition in the sale of the drug. The result is that prices are stabilized and protected against normal market forces. A similar type of restriction involves licensing for sale to different consumers such as for human consumption and animal consumption. A licensee for human consumption would not be permitted to sell the product for animal use. [We can only surmise at Mr. Donnem’s concern over the inability of the one manufacturing for animal consumption to sell the product for human use.]

On the field-of-use limitations, the author advises us:

It appears most unlikely that it could be established that exclusive field-of-use licensing is necessary for there to be any license at all. . . . It is usually desirable to license others in order to promote the widespread sale of the patented product and thus stimulate demand [thereby clearly negating the whole theory of exclusive grants of patents]. . . . Therefore, the burden of proving absolute economic necessity for an exclusive field-of-use restriction should rest heavily upon the defendant.

As to a price-fixing provision in a license—ignoring the Supreme Court’s carefully spelled out illustration of why a patentee might need such a provision,¹ he says,

¹ *United States v. General Electric Co.*, 272 U.S. 476, 490 (1926).

The patentee is sufficiently rewarded by exploiting the patent himself or obtaining royalties. . . .

If a nonmanufacturing patentee desires to license more than one manufacturer . . . unrestricted price competition would usually increase his royalties. . . . If the patent owner is at all efficient, he should not fear the competition of a licensee that has the added burden of paying royalties. . . .

Imposition of adequate royalties will usually protect the manufacturing patentee. Thus, price-fixing would be valuable primarily to obtain monopolistic exploitation well beyond the value of what the patentee has contributed.

Mr. Donnem's conclusion on the balancing of the public interest lying behind *both* sets of laws is well evidenced by his paraphrase of *Lear*:² ". . . the Court expressly stated that it was weighing the important public policy in favor of competition against the contract principles. . . ." And it was inevitable that the Court in *Lear*, faced with such an election, said: "Surely the equities of the licensor do not weigh very heavily when they are balanced against the important public interest in permitting full and free competition in the use of ideas. . . ."

One simply can't weigh "contract principles" against "public policy." What we must look for is the countervailing public policy which demands a growing technology and the development, and sponsoring and financing of new ideas. *That* is a *public policy* which *also* must be served. And it may require some reasonable, fair, imaginative contracts, which will be honored in Court, to foster that policy.

Another factor about the Patent Unit concerns me very greatly. That is their evident missionary zeal to evolve a code of logically neat, symmetrical laws—written as these few experts think they should be written, working out the codified matrix in advance, all semblance of a Rule of Reason approach discarded—and then deliberately and patently looking for a whole series of test cases they may bring to make all industry fit their particular design of procrustean bed.

Their approach to the decided cases is remarkable: If a lower court in one case has decided in accordance with their ideas of symmetry and justice, it is good law and authoritative beyond question. Consider the interpretation of a favorable *dictum* in the *Glaxo* case, a 1969 district court decision. In that opinion the court observed—in a passage unnecessary to the decision—that where a party raises a patent in defense of an antitrust suit, the United States plaintiff may challenge the patent's validity. No court had so held before or since. Yet upon that rather slender reed Mr. Donnem rests his conclusion that "of course . . . we will have no problem in defending our standing to assert patent inva-

² *Lear, Inc. v. Adkins*, 395 U.S. 653 (1969).

lidity in cases where patents are asserted in defense." That is, I say, a district court *dictum* in their favor! But what do they do with an *adverse* Supreme Court holding?

Take the *General Talking Picture*³ case. Mr. Donnem says, "Some assume that a patent license limiting the uses for which the licensee may sell the patented article is presently valid under the authority of *General Talking Picture Corp v. Western Electric Co.*, decided by the Supreme Court in 1938. . . . However, the continued authority of that 1938 decision is extremely doubtful both on precedent and in principle." Citing its reliance, *inter alia*, on the *General Electric* case, he says, "The *General Electric* holding is ripe for overruling; . . . If *General Electric* is overturned on the price-fixing ground, . . . *General Talking Pictures* would fall with it."

And in the grant-back area the Department of Justice enforcers do not like the *Trans-Wrap*⁴ decision of 1947. "This decision has not been directly overruled despite widespread criticism," says Mr. Donnem, citing an article in the *Fordham Law Review*. He then announces a plan to bring a series of cases on the ground, "assignment grantbacks . . . [are] contrary to the public interest . . . the Supreme Court's *Trans-Wrap* decision may in some degree be questioned by this challenge."

Consider the portents of this. Are business concerns to be deliberately sought out and prosecuted as law violators although their practices are clearly in accord with extant law and existing Supreme Court decisions, just because a group of lawyers in Justice doesn't like the variance in their symmetrical design which those cases make?

The answer, I'm afraid, is that that's exactly what is afoot. And my concern stems not so much from the novelty of the practice (alas, that has happened before—as with *General Electric* and its lamp case); but my concern stems most deeply from the fact that these people are attacking without having really thought through the soundness of their own position. It is prosecution oriented thinking; not either incentive oriented, or patent oriented, or progress oriented. Nor is it a program well designed for a balance of public policy.

The Black dissent in *Lear* is to me the ultimate irony; here is a Supreme Court Justice who has dedicated a large portion of his career on the bench to a one-man crusade against patents and the patent system. Why, was he against inventions and discoveries? No. They are fine and in the public interest. His dislike for patents was that they

³ *General Talking Pictures Corp. v. Western Electric Co.*, 304 U.S. 175, 305 U.S. 124 (1938).

⁴ *Transparent-Wrap Machine Corp. v. Stokes and Smith Co.*, 329 U.S. 637 (1947).

surround the new invention with a cloak of “monopoly”—albeit a very limited and special one—and some of the Court have for years underscored (and it has long been a Department of Justice contention) that the patent monopoly is a limited exception to the Sherman Act, and as such an exception should be very narrowly construed (although I’ve always been bothered as to how the patent grant is an *exception* to the Sherman Act in the light of the Rule of Reason; are patents in unreasonable restraint of trade?)

Now, however, Justice Black asserts that if the inventor by-passes the patent protection (thereby foregoing his opportunity for a *limited monopoly*), he has nevertheless sacrificed the only means provided for his exploitation by law, and he cannot even contract for the private exploitation of his invention. (“No State has a right to authorize any kind of monopoly.”)

It is as if the antipathy for the patent (i.e., the freedom from competition which that theoretically permits) has suddenly become an antipathy for the invention (which is no monopoly of any kind)—the discoverer to be penalized at the first opportunity if he seeks to let others help exploit his discovery.

Would the result of such a rule be to require complete secrecy? Perhaps we need another empirical study here.

One result of the *dictum* has been the absurd holding in the district court in *Painton*.⁵ Consider such a gem as: “Our patent policy of strict regulation of inventions would be undercut if inventors could enforce agreements for compensation for alleged secret ideas. . . .” What is our policy of “strict regulation of inventions?” Patents, yes. Inventions—I know of none!

In conclusion, I am delighted to learn of Mr. McLaren’s declared policy of treating limitations on trade secrets, to wit, that they will be judged by whether or not the restraint is reasonably ancillary to the principal transaction. I would that similar standards might apply to patent license limitations.

These are at best random observations, but they are heartfelt. We need an altogether new *prima facie* approach, lest the prosecutor’s reform movement cut away much of what little vestigial common sense is left in this highly complex and important field.

⁵ *Painton & Company, Ltd. v. Bourns, Inc.*, 164 USPQ 595 (1970).