

TORTS—UNFAIR COMPETITION—TRADE SECRETS—ENFORCEMENT OF  
LICENSING AGREEMENTS—*Painton & Co. v. Bourns, Inc.*, 309 F.  
Supp. 271 (S.D.N.Y. 1970).

Plaintiff, a manufacturer and seller of electronic components, entered into a contract with defendant, a similar manufacturer and seller, whereby plaintiff had the right to and did receive from defendant drawings, instructions, and technical assistance relating to the manufacture of various models of potentiometers. In return, plaintiff was obliged to pay royalties as specified, including royalties on models for which no patent application had been or would be made. Just prior to the expiration of the contract, defendant requested the return of the drawings and other information as to certain of these models, upon which all required royalties had been paid. Plaintiff refused to return the materials, claiming the right to permanently use them if royalties would continue to be paid. Plaintiff brought action for a declaratory judgment as to its rights under the contract, and defendant counterclaimed for a declaratory judgment as to such rights and for an injunction. Upon motions by both parties for summary judgment, plaintiff's motion was granted in part and denied in part; defendant's motion was denied. The Federal District Court for the Southern District of New York held that an agreement whereby a trade secret licensee would pay royalties on models for which no patent application had been or would be made would not be enforced, since "enforcement of such an agreement would be contrary to our national patent law and policy."<sup>1</sup>

The law of trade secrets covers a great variety of industrial and commercial information. In the *Restatement of Torts*, there is a broad recitation of the subject matter that has been protected under the law of trade secrets:

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.<sup>2</sup>

Generally, the owner of a trade secret holds a relative monopoly with respect only to parties who have a legal relationship with the owner and who have not discovered the secret independently or by "reverse engi-

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<sup>1</sup> *Painton & Co. v. Bourns, Inc.*, 309 F. Supp. 271, 274 (S.D.N.Y. 1970).

<sup>2</sup> RESTATEMENT OF TORTS § 757 (1939).

neering." A trade secret remains secret for an indefinite period of time;<sup>3</sup> however, it is defeasible as soon as the secret is acquired through honest industry.<sup>4</sup> Trade secrets are enforced under state law, under a variety of theories: property right,<sup>5</sup> express contract,<sup>6</sup> implied or quasi-contract,<sup>7</sup> confidential relationship,<sup>8</sup> and others.<sup>9</sup>

The Patent Act of 1952 defines the subject matter of patent protection as follows:

Whoever invents or discovers any new and useful process, machine, manufacture, or composition of matter, or any new and useful improvement thereof, may obtain a patent therefor, subject to the conditions and requirements of this title.<sup>10</sup>

Thus, many business secrets that may be protected under trade secret law are not proper subject matter for patents. Novelty and invention are essential requisites for patentability, because a patent protects against unlicensed use of the patented device or process, even by one who discovers it properly through independent research.<sup>11</sup> A patent grants a limited monopoly by giving the patentee the right to exclude others from making, using, or selling the patented invention during the term of the patent, seventeen years. Patents are enforced under federal law.

Generally speaking, both the federal patent law and the common

<sup>3</sup> *E.g.*, consider the formula for Coca-Cola.

<sup>4</sup> See Milbank, *Finders Keepers, Licensors Weepers*, 52 J. PAT. OFF. SOC'Y 343 (1970).

<sup>5</sup> See *Kinkade v. New York Shipbuilding Corp.*, 21 N.J. 362, 122 A.2d 360 (1956); *Club Razor & Blade Mfg. Corp. v. Bindzsus*, 131 N.J. Eq. 283, 25 A.2d 31 (Ch. 1942), *aff'd*, 133 N.J. Eq. 38, 30 A.2d 31 (Ct. Err. & App. 1943); *Pomeroy Ink Co. v. Pomeroy*, 77 N.J. Eq. 293, 78 A. 698 (Ch. 1910); *Salomon v. Hertz*, 40 N.J. Eq. 400, 2 A. 379 (Ch. 1886).

<sup>6</sup> See *Irvington Varnish & Insulator Co. v. Van Norde*, 138 N.J. Eq. 99, 46 A.2d 201 (Ct. Err. & App. 1946); *Stone v. Goss*, 65 N.J. Eq. 756, 55 A. 736 (Ct. Err. & App. 1903) (leading case); *Club Razor & Blade Mfg. Corp. v. Bindzsus*, 131 N.J. Eq. 283, 25 A.2d 31 (Ch. 1942), *aff'd*, 133 N.J. Eq. 38, 30 A.2d 31 (Ct. Err. & App. 1943).

<sup>7</sup> See *Stone v. Goss*, 65 N.J. Eq. 756, 55 A. 736 (Ct. Err. & App. 1903) (leading case); *Sun Dial Corp. v. Rideout*, 29 N.J. Super. 361, 102 A.2d 90 (App. Div.), *aff'd*, 16 N.J. 252, 108 A.2d 442 (1954); *Golden Cruller & Doughnut Co. v. Manasher*, 95 N.J. Eq. 537, 123 A. 150 (Ch. 1923).

<sup>8</sup> Compare *Irvington Varnish & Insulator Co. v. Van Norde*, 138 N.J. Eq. 99, 46 A.2d 201 (Ct. Err. & App. 1946); *Club Razor & Blade Mfg. Corp. v. Bindzsus*, 131 N.J. Eq. 283, 25 A.2d 31 (Ch. 1942), *aff'd*, 133 N.J. Eq. 38, 30 A.2d 31 (Ct. Err. & App. 1943) (cases expressly recognizing the trade secret owner's property right) *with* *Vulcan Detinning Co. v. American Can Co.*, 72 N.J. Eq. 387, 67 A. 339 (Ct. Err. & App. 1907) (leading case); *Stone v. Goss*, 65 N.J. Eq. 756, 55 A. 736 (Ct. Err. & App. 1903); *Sun Dial Corp. v. Rideout*, 29 N.J. Super. 361, 102 A.2d 90 (App. Div.), *aff'd*, 16 N.J. 252, 108 A.2d 442 (1954); *Carver v. Harr*, 132 N.J. Eq. 207, 27 A.2d 895 (Ch. 1942) (cases not alluding to the property right).

<sup>9</sup> See Milbank, *supra* note 4, at 347.

<sup>10</sup> 35 U.S.C. § 101 (1964).

<sup>11</sup> See RESTATEMENT OF TORTS § 757 (1939).

law of trade secrets<sup>12</sup> of the several states serve to protect similar interests in inventions, but they employ different means: disclosure v. secrecy.<sup>13</sup> The patent monopoly is a reward to the inventor,<sup>14</sup> in accordance with the federal constitutional provision:

The Congress shall have Power . . . [t]o 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.<sup>15</sup>

Trade secrets are enforced by the states, on the other hand, mainly because of a general distaste for unscrupulous business practices,<sup>16</sup> and also because of social values such as security from violence, the right of privacy, and the expectation of truthfulness.<sup>17</sup> But questions of pre-emption and the supremacy clause<sup>18</sup> are always present when both federal law and state law "touch upon" a given area.<sup>19</sup>

The leading case on the recognition of a legally protectable interest in a trade secret is *Morison v. Moat*,<sup>20</sup> where the English Court of Chancery enjoined the use of a recipe for medicines. On appeal the judgment was affirmed, the court holding that where a party who has a trade secret employs persons under contract or duty, expressed or implied, those persons cannot gain knowledge of the secret and then set it up against the employer.<sup>21</sup> The decision in *Morison* influenced the course of trade secret law in the United States through the case of *Peabody v. Norfolk*,<sup>22</sup> where the Supreme Judicial Court of Massachusetts held that one who invents or discovers, and keeps secret, a process of manufacture, whether a proper subject for a patent or not, has a pro-

<sup>12</sup> *Id.* at §§ 757-59.

<sup>13</sup> See Milbank, *supra* note 4.

<sup>14</sup> See RESTATEMENT OF TORTS § 757 (1939).

<sup>15</sup> U.S. CONST. art. I, § 8.

<sup>16</sup> See Milbank, *supra* note 4, at 348.

<sup>17</sup> See Doerfer, *The Limits on Trade Secret Law Imposed by Federal Patent and Antitrust Supremacy*, 80 HARV. L. REV. 1432, 1450 (1967).

<sup>18</sup> U.S. CONST. art. VI, cl. 2.

<sup>19</sup> Congress in 1790 enacted the first federal patent and copyright law, 1 Stat. 109, and ever since that time has fixed the conditions upon which patents and copyrights shall be granted . . . . These laws, like other laws of the United States enacted pursuant to constitutional authority, are the supreme law of the land. See *Sperry v. Florida*, 373 U.S. 379 (1963). When state law touches upon the area of these federal statutes, it is "familiar doctrine" that the federal policy "may not be set at naught, or its benefits denied" by the state law. *Sola Elec. Co. v. Jefferson Elec. Co.*, 317 U.S. 173, 176 (1942). This is true, of course, even if the state law is enacted in the exercise of otherwise undoubted state power.

*Sears, Roebuck & Co. v. Stiffel Co.*, 376 U.S. 225, 229 (1964).

<sup>20</sup> 9 Hare 241, 68 Eng. Rep. 492 (V.C. 1851).

<sup>21</sup> *Morison v. Moat*, 21 L.J. Ch. 248 (1852).

<sup>22</sup> 98 Mass. 452 (1868).

perty right therein, which a court of equity will protect against another who, in violation of contract and breach of confidence, undertakes to apply it to his own use, or to disclose it to third persons.<sup>23</sup> As was recently noted:

In the years following the *Peabody v. Norfolk* decision of 1868, there grew up in the United States, by judicial pronouncement, an extensive body of law upon the protection of trade secrets. The State courts, in their efforts to elevate the level of morality in business and foster ethical business practices by the development of a body of law on unfair competition, gave protection to trade secrets wherever the breach of an implied or an express obligation to maintain secrecy was found. Almost imperceptibly, the law of "trade secrets" developed to include unpatented inventions, whether or not the unpatented inventions were actually secretly used in a trade. Thus, State courts enforced contracts in which licenses for the use or practice of unpatented inventions were conditioned upon the payment of royalties, and that protection was extended to contracts concerning unpatented inventions even where, by nature of the invention, it could not be maintained as a trade secret.<sup>24</sup>

Until recently, federal patent law and state trade secret law were relatively compatible. "What the manufacturer could not protect under patent law, he could maintain as a trade secret."<sup>25</sup> Then, in 1964, two Supreme Court cases, *Sears, Roebuck & Co. v. Stiffel Co.*<sup>26</sup> and *Compco Corp. v. Day-Brite Lighting, Inc.*,<sup>27</sup> upset the old balance and severely limited the protection that could be given to unpatented inventions under state unfair competition law.<sup>28</sup> In both *Sears* and *Compco*, plaintiffs had secured patents for their products and defendants had copied the products. Plaintiffs brought suits in the same district court for patent infringement and unfair competition. The court found the patents invalid and entered judgments for defendants as to patent infringement, but judgments were entered for plaintiffs as to unfair competition.<sup>29</sup> The judgments were affirmed by the court of appeals,<sup>30</sup> but the Supreme Court reversed, holding that because of federal patent

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<sup>23</sup> *Id.* at 458.

<sup>24</sup> Orenbuch, *Trade Secrets and the Patent Laws*, 52 J. PAT. OFF. SOC'Y 638, 646 (1970).

<sup>25</sup> Milbank, *supra* note 4, at 344.

<sup>26</sup> 376 U.S. 225 (1964).

<sup>27</sup> 376 U.S. 234 (1964).

<sup>28</sup> See Orenbuch, *supra* note 24, at 649; Adelman, *Trade Secrets and Federal Preemption—The Aftermath of Sears and Compco*, 49 J. PAT. OFF. SOC'Y 713 (1967).

<sup>29</sup> These decisions of the Federal District Court for the Northern District of Illinois are reported in the cases cited in note 30 *infra*.

<sup>30</sup> *Stiffel Co. v. Sears, Roebuck & Co.*, 313 F.2d 115 (7th Cir. 1963); and *Day-Brite Lighting, Inc. v. Compco Corp.*, 311 F.2d 26 (7th Cir. 1962).

law a state may not prohibit the copying of an unpatented article, or award damages for such copying, even if selling the copy was likely to produce and did produce confusion as to the source. In *Sears*, Justice Black<sup>31</sup> wrote:

An unpatentable article, like an article on which the patent has expired, is in the *public domain* . . . . To allow a State by use of its law of unfair competition to prevent the copying of an article which represents too slight an advance to be patented would be to permit the State to block off from the public something which federal law has said belongs to the public. The result would be that while federal law grants only 14 or 17 years' protection to genuine inventions, . . . States could allow perpetual protection to articles too lacking in novelty to merit any patent at all under federal constitutional standards. This would be too great an encroachment on the federal patent system to be tolerated.<sup>32</sup>

In *Lear, Inc. v. Adkins*,<sup>33</sup> federal patent law confronted state law enforcing contracts concerning unpatented inventions, and the Supreme Court further expanded the public domain concept.<sup>34</sup> In *Lear*, plaintiff, an inventor, was employed by defendant, a manufacturer of gyroscopes, under an agreement which provided that although plaintiff's new inventions relating to vertical gyros would become his property, he would license them to defendant on a mutually satisfactory royalty basis. One year later plaintiff filed a patent application on improvements he had made, and he entered into negotiations with defendant, the result of which was a lengthy licensing agreement relating to the then pending application. Six years after the application was filed, a patent was issued on a relatively narrow claim. Meanwhile, however, defendant, on the basis of its own patentability search, had ceased making royalty payments to plaintiff. Upon the issuance of his patent, plaintiff promptly brought suit against defendant in the state court for breach of the licensing agreement. The case finally reached the United States Supreme Court on the issue of whether or not a patent licensee was estopped from challenging the validity of the patent.<sup>35</sup> The

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<sup>31</sup> Justice Black also wrote the opinion in *Compro Corp. v. Day-Brite Lighting Inc.*, 376 U.S. 234 (1964).

<sup>32</sup> 376 U.S. at 231-32 (emphasis added).

<sup>33</sup> 395 U.S. 653 (1969).

<sup>34</sup> See Milbank, *supra* note 4, at 354; Arnold & Goldstein, *Life Under Lear*, 48 TEXAS L. REV. 1235 (1970).

<sup>35</sup> [O]ne of the oldest doctrines in the field of patent law establishes that so long as a licensee is operating under a license agreement he is estopped to deny the validity of his licensor's patent in a suit for royalties under the agreement. The theory underlying this doctrine is that a licensee should not be permitted to

Court held that a patent licensee was not estopped from challenging the validity of the patent, and so buried the already dead licensee estoppel doctrine,<sup>36</sup> in spite of the demands of the common law of contracts,<sup>37</sup> because the "federal law [of patents] requires that all ideas in *general circulation* be dedicated to the common good unless they are protected by a valid patent."<sup>38</sup> The Court also held that if the patent was invalid, the licensee was entitled to avoid payment of all royalties accruing after the patent had issued. However, the majority refused to allow the licensee to cease making royalty payments prior to the issuance of the patent.<sup>39</sup> The question was left to the states:

Adkins' claim to contractual royalties accruing before the 1960 patent issued is, however, a much more difficult one, since it squarely raises the question whether, and to what extent, the States may protect the owners of *unpatented* inventions who are willing to disclose their ideas to manufacturers only upon payment of royalties. . . . [W]e have concluded, after much consideration, that even though an important question of federal law underlies this phase of the controversy, we should not now attempt to define in even a limited way the extent, if any, to which the States may properly act to enforce the contractual rights of inventors of unpatented secret ideas. Given the difficulty and importance of this task, it should be undertaken only after the state courts have, after fully focused inquiry, determined the extent to which they will respect the contractual rights of such inventors in the future.<sup>40</sup>

In a separate opinion in *Lear*, Justice White reasoned that the Court ought not to have dealt at all with the question of whether federal law forbids the collection of royalties which might otherwise be collectible under a contract rooted in state law. However, Justice Black's dissent "showed none of the majority's timidity in considering

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enjoy the benefit afforded by the agreement while simultaneously urging that the patent which forms the basis of the agreement is void.

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

<sup>36</sup> Long before *Hazeltine* [*Automatic Radio Mfg. Co. v. Hazeltine Research, Inc.*, 339 U.S. 827 (1950)] was decided, the estoppel doctrine had been so eroded that it could no longer be considered the "general rule," but was only to be invoked in an ever-narrowing set of circumstances.

<sup>395</sup> U.S. at 664.

<sup>37</sup> [T]he law of contracts forbids a purchaser to repudiate his promises simply because he later becomes dissatisfied with the bargain he has made.

<sup>395</sup> U.S. at 668.

<sup>38</sup> *Id.* (emphasis added).

<sup>39</sup> See *Milbank*, *supra* note 4, at 356.

<sup>40</sup> 395 U.S. at 674-75.

this question."<sup>41</sup> With Chief Justice Warren and Justice Douglas concurring, Justice Black wrote:

I still entertain the belief I expressed for the Court in *Stiffel* and *Compco* that no State has a right to authorize any kind of monopoly on what is claimed to be a new invention, except when a patent has been obtained from the Patent Office under the exacting standards of the patent laws. 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.<sup>42</sup>

In *Painton & Co. v. Bourns, Inc.*, the United States district court appeared to respond to the challenge of the Supreme Court by echoing the dissent of Justice Black in *Lear*:

[T]his 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.<sup>43</sup>

The court's rationale was given in the opinion of Judge Motley:

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 . . . ) 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.<sup>44</sup>

It is submitted that the judgment in *Painton*, now being appealed, should be reversed, and the question as to whether federal patent law and policy require a patent application as a prerequisite to licensing a trade secret for royalties, be answered in the negative.

The holding in *Painton* was based solely upon the court's consideration of *Lear*. But *Lear* was concerned only with ideas in "general cir-

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<sup>41</sup> Milbank, *supra* note 4, at 358.

<sup>42</sup> 395 U.S. at 677.

<sup>43</sup> 309 F. Supp. at 274.

<sup>44</sup> *Id.*

ulation."<sup>45</sup> An applicant for a patent discloses his invention to the public immediately upon issuance of the patent. Hence, a patentee's ideas are in "general circulation," whether or not his patent is challenged or unchallenged, valid or invalid. Similarly, *Sears* and *Compco* were concerned with articles in the "public domain,"<sup>46</sup> *i.e.*, ideas in "general circulation." However, in *Painton*, the licensor's ideas were not in "general circulation." It is strongly urged that as long as ideas are not placed in "general circulation," they do not fall within the ambit of federal patent law or policy.

There is also the rule that pending patent applications are preserved in secrecy by the Patent Office; abandoned and rejected applications are likewise not open to public inspection.<sup>47</sup> Thus, ideas which are not patented and which may fall short of the "exacting standards of the patent laws,"<sup>48</sup> are treated as trade secrets under the federal patent laws. Ideas which are not submitted to the Patent Office should not be treated any differently. Otherwise, the Patent Office would be burdened with considering every idea which may be a subject of a licensing agreement.

The *Painton* holding had been anticipated:

If Black would not allow the inventor protection during the application period, he certainly would oppose state protection of an inventor who had never applied for a patent. The great weakness of Black's dissent [in *Lear*] is that he fails to recognize the legal and economical implications of his position.<sup>49</sup>

Under Black's dissent in *Lear*, and now under *Painton*, an inventor is not to be protected as a trade secret licensor prior to the issuance of a patent. Therefore, he will not license his invention before that time. However, an inventor is never sure of the "true" patentability of his invention until his patent is challenged in the courts; that is, his patent is still conditional on a judicial determination of validity.<sup>50</sup> If his patent is declared invalid, which is often the case, then, under *Lear*, the licensee can avoid payment of all royalties accruing after the patent had issued, and the inventor would receive nothing for his innovative effort. As has been recently stated:

It is unlikely that American industry would invest more than \$15

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<sup>45</sup> 395 U.S. at 668.

<sup>46</sup> 376 U.S. at 231.

<sup>47</sup> 37 C.F.R. § 1.14 (Supp. 1970).

<sup>48</sup> 395 U.S. at 677.

<sup>49</sup> Milbank, *supra* note 4, at 358.

<sup>50</sup> In the United States there exists a statutory presumption of patent validity; however, the presumption is rebuttable. 35 U.S.C. § 282 (Supp. V, 1970).

billion dollars in research and development annually if the uncertain and erratic protection of the patent laws were the sole assurance of return on investment.<sup>51</sup>

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<sup>51</sup> R. MILGRIM, TRADE SECRETS § 6.05 (1970).