10-1978

Aronson v. Quick Point Pencil Company

Lewis F. Powell Jr.

If but only by another Justice, I'll vote to Grant & Reverse on basis of dissenting op by ~~DJ~~ J Larson.

But case is not c/w

CA 8 simply ignored plain language of a contract to pay royalties - & misconstrued the ctt. to hold it was conditioned on a patent.

PRELIMINARY MEMORANDUM

May 25, 1978 Conference
List 1, Sheet 3

No. 77-1413

ARONSON	Cert to CA 8 (Ross, Lay; Larson, DJ, dissenting)	
v.		
QUICK POINT PENCIL CO.	Federal/Civil	Timely

1. SUMMARY: Petr objects to CA 8's invalidation, on the basis of a conflict with federal patent policy, of an agreement requiring resp to pay her royalties "as long as you continue to sell" a product devised by petr.

2. FACTS: In 1956, petr developed a fairly simple form of pocket key holder and entered into an exclusive manufacture and sale

Bob

Deny. CA 8 has done it again — another holding that defies common sense. Still, Mike is probably correct in saying that there is no need for this Court to take this narrow contract case agreement with resp. The agreement provided that resp "will have the exclusive right to make and sell key holders of the type shown in your [patent] application," and would pay petr a royalty of 5% of the selling price. (Petn, appx., p. A30) The agreement further provided that, if the patent application was not allowed within five years, resp would pay petr a royalty of 2 1/2%, "as long as you continue to sell same." (Petn, appx., p. A32) Petr's patent application was rejected, and in 1961 the Board of Patent Appeals held it an unpatentable invention. Nevertheless, resp continued to pay royalties until 1975, when competitors began to copy the key holder, cutting into resp's market. Resp then brought this action for a declaratory judgment in the DC (E.D. Mo., Merrideth, J.), seeking relief from the payment of further royalties.

The DC ruled for petr. It found, "The language of the agreement is plain, clear, and unequivocal and has no relation to whether or not a patent is ever granted or is not granted." (Petn, appx., p. A23) The court distinguished Compco Corp. v. Day-Brite Lighting, Inc., 376 U.S. 234 (1964), and Sears Roebuck & Co. v. Stiffel Co., 376 U.S. 225 (1964), which held that state law could not prohibit the copying of items held unpatentable. Nor was the case controlled by Lear, Inc. v. Adkins, 395 U.S. 653 (1969), which held that state law could not bar a licensee from challenging the validity of the patent. Here, since the contractual obligation to pay royalties bore no relation to whether or not a patent was granted, patent law posed no obstacle to the enforce ment of the contract according to its terms.

A divided panel of CA 8 reversed. Judge Ross characterized resp as "a patent application licensee," and asked whether resp was bound to pay royalties "as long as it manufactures the item described in the patent application even though the licensor abandoned the application many years ago and the licensee's competitors are freely manufacturing the unpatented item." (Petn, appx., pp. A3-A4) (The court rejected the dissent's contention that the contract should be characterized as a "trade-secret license in agreement," since the "secret" of this key holder was given away the first time it was put on the market.) The court began with the principle established by Stiffel and Lear that all ideas in general circulation are dedicated to the common good unless protected by a valid patent. The court noted that, under Lear, if petr had obtained a patent later ruled invalid, resp's liability would have terminated. The results should be no different here, where the Patent Office itself rejected the application. Furthermore, if a patent had been obtained and was valid, the royalty agreement, despite its terms, would expire by force of federal law at the end of the patent period, under Brulotte v. Thys Co., 379 U.S. 29 (1964). The court saw no reason why petr's failure to patent her invention should put her in a better position. The court distinguished Kewanee Oil Co. v. Bicron Corp., 416 U.S. 417 (1974), in which the court recognized that a state could provide protection for unpatentable trade secrets which have not been placed in the public domain. Here,

Because that was the bargain for which resp may have received consideration in the form of a lower royalty on the patent contingency.

Yes

petr's key holder was the sort of invention which was fully disclosed the first time it was marketed. Thus, the protection authorized by Kewanee is not involved here.

Judge Larson's dissent reiterated the DC's conclusion that resp's liability for royalties bore no relation to the patent application:

> "In retrospect, Quick Point made a bad bargain. It agreed to pay royalties on the Aronson invention as long as it continued to make and sell the same, and the agreement, as the district court found, had no relation to whether or not the item was ever patented."
> (Petn, appx., p. A9)

Yes. Seems clear.

Judge Larson agreed that the key holder might not be a trade secret in the Kewanee sense of the term, but it was a secret before petr disclosed it to resp, and resp agreed to pay for that secret as long as it manufactured the key holders. He found the case indistinguishable from Warner-Lambert Pharmaceutical Co. v. John J. Reynolds, Inc., 178 F.Supp. 655 (S.D.N.Y. 1959) affirmed 280 F.2d 197 (CA 2 1960). That case involved the secret formula for Listerine, which had ceased to be a secret some years before that suit was brought. The court nevertheless held that Warner-Lambert was contractually bound to pay royalties despite the fact that its competitors had obtained the same formula for free. Judge Larson concluded that nothing in Lear would require a different result in this case. In Lear this Court held that a licensee must be allowed to attack the validity of a patent because there was no better situated plaintiff to obtain the release of the idea into the public domain. Here, the design for the key holder is already in the public domain, and there is no public good to be served by relieving resp of its contractual obligations. Furthermore, Kewanee, supra at 486-487, specifically noted that trade secret licensing advanced the policy of getting ideas into the public domain since it enabled inventors to take advantage of existing manufacturing and marketing structures. The fact that the marketing of the product reveals the secret does not lead to a different result. So long as the arrangement does not provide "a significant disincentive to patent," (petn, appx., p. A-15) federal law does not bar its enforcement.

3. CONTENTIONS: Petr largely repeats the arguments stated by the dissent. She contends that this decision conflicts with CA 2's decision in Warner-Lambert, and that it in no way advances the patent policy as described in Lear. She presents a fairly restrained parade of horribles, suggesting the implications of the decision:

> "It renders unenforceable every trade secret license where the trade secret later becomes known to the trade for whatever reason. It also would render unenforceable every agreement by which a previously undisclosed idea or article which is not patentable or protectable by copyright is licensed under continuing royalties." (Petn, p. 6)

Resp emphasizes the majority's conclusion that this contract licensed a patent application, and not a trade secret. It contends that, if, under Lear, the invalidity of a patent relieves a licensee from further liability, certainly the inability to obtain a patent in the first instance should provide the same relief. It contends that there is no conflict with Warner-Lambert, since no patent application was involved in that case. Furthermore, the formula there involved in Kewanee was a true trade secret, and not the sort of device which is fully disclosed as soon as it is marketed. Since CA 8 carefully limited its holding to patent applications, it does not endanger true trade secrets of the sort involved in Kewanee.

I agree

4. DISCUSSION: I think petr is correct that CA 8 is dead wrong, but I think resp is correct that CA 8's reliance on the presence of a patent application will keep this case from having the horrible consequences foreseen by petr. It does seem to me that the dissent's reading of this contract is absolutely correct, and that no federal patent policy will be served by denying its enforcement. CA 8 has also given an unnecessarily narrow reading to Kewanee, and the result here does conflict with CA 2's result in Warner-Lambert. However, 18 years have elapsed since Warner-Lambert, and it is entirely possible that CA 2 might reach a different decision today in light of more recent patent cases.

Thus, while I think the decision below is wrong, it is a fairly narrow opinion, and it does not seem to establish the sort of conflict that cries out for resolution. I would deny.

There is a response.

5/15/78 Wallace Op in petn.
CMS

Court .... | Voted on ...., 19...
Argued ...., 19... | Assigned ...., 19...
Submitted ...., 19... | Announced ...., 19...

No. 77-1413

ARONSON

vs.

QUICK POINT PENCIL CO.

WHR agrees with me that case is "dead wrong".

Grant

Relisted for CJ to take second look

	HOLD FOR	CERT. G	CERT. D	JURISDICTIONAL STATEMENT N	POST	DIS	AFF	MERITS REV	MERITS AFF	MOTION G	MOTION D	ABSENT	NOT VOTING
Burger, Ch. J.					Join 3								
Brennan, J.			✓										
Stewart, J.		✓											
White, J.			✓										
Marshall, J.			✓										
Blackmun, J.			✓										
Powell, J.		✓		*	Rev								
Rehnquist, J.		✓			"								
Stevens, J.			✓										

June 1, 1978

Court ....

Argued ...., 19...

Submitted ...., 19...

Voted on................., 19...

Assigned ...., 19...

Announced ...., 19...

No. 77-1413

ARONSON

vs.

QUICK POINT PENCIL CO.

Relisted for the Chief Justice.

Grant

	HOLD FOR	CERT.		JURISDICTIONAL STATEMENT				MERITS		MOTION		ABSENT	NOT VOTING
		G	D	N	POST	DIS	AFF	REV	AFF	G	D		
Burger, Ch. J.		✓											
Brennan, J.			✓										
Stewart, J.		✓											
White, J.			✓										
Marshall, J.			✓										
Blackmun, J.			✓										
Powell, J.		✓											
Rehnquist, J.		✓											
Stevens, J.			✓										

ea Reviewed: Eric would Reverse - language of ctt. is plain & no policy of Fed patent or anti-trust law preempts what otherwise is a valid & enforceable ctt. The SG agrees. I am inclined also to agree.

BOBTAIL BENCH MEMORANDUM

TO: Mr. Justice Powell

FROM: Eric

DATE: 12-5-78

RE: Aronson v. Quick Point Pencil Co., No. 77-1413

I. OVERVIEW

Contrary to the impression given by the preliminary memorandum first written in this case, the issues presented are not easy. Although on the particular facts the argument for reversal seems strong to me, a proper analysis requires an awareness of a broad range of legal and policy issues cutting across the fields of contract, patent, and anti-trust law. Because, until yesterday, I was a stranger to this kind of problem, I feel unsure of my understanding of the case. My recommendations therefore are tentative.

My feeling at this point is that the decision should be reversed. I agree with amicus Ercon, however, that this is not an ideal case on its facts in which to decide issues having an important effect on the legal status of highly complex and commercially valuable intellectual property. It therefore might be especially important to "write narrowly" in this case, leaving open the important questions not presented here. Because the briefs are ably written and the facts and proceedings below are uncomplex, I will not rehearse the prior history of the case.

II. CHARACTERIZING THE CONTRACT

Characterizing the contract in issue is crucial to the outcome of the case. The agreement is very poorly written, but the following conclusions seem clear to me. The parties contemplated that petr would apply for, and attempt to obtain, a patent on the device. They also anticipated that the patent might not issue and provided for indefinite, reduced royalties in that event.

Resp's attempt to construe the contract differently strikes me as more desparate than reasoned. Resp's Brief at 48-

53. I believe petr's reply brief adequately disposes of this argument. Petr's Reply Brief at 6-10.

A more substantial characterization problem relates to whether petr's invention was a trade secret at all. Resp uses most of its brief arguing that this device does not qualify as a trade secret at all, and that the decisions showing deference to state protection of trade secrets are therefore not really applicable. With all due respect to Erwin Griswold, this argument is transparent. Both the reply brief of petr and the SG's amicus brief convincingly demonstrate that petrs keyholder device fits well within the purposes for which production license and trade secret laws exist. Because of its preoccupation with what is really a non-issue, resp's brief is not particularly helpful in dealing with the more difficult questions in the case.

III. ISSUES

Under the Court's recent decisions in this area, especially Kewanee Oil Co. v. Bicron Corp., 416 U.S. 470 (1974), the issue in this case is whether enforcing petr's contract with resp would so interfere with the policies underlying the federal patent system that federal preemption should apply. I have found it most helpful to approach this question in two steps: (1) If there had been no patent application involved in the agreement and petr had relied solely on her 2-1/2% royalty provision to exploit her invention, would enforcement of that contract be permissible under federal law? (2) If so, should the result be any different because a patent application was involved?

A

The starting point should be Kewanee. In that case the Court did not apply preemption to a state trade secret law that permitted an injunction against the use or disclosure of material until after it made its way legitimately into the public domain. The opinion discusses at length whether the existence of such protection would thwart the patent-law policies of encouraging innovation and giving the public the benefit of new ideas. The Court concluded that it would not: the protection of the patent system is generally so superior to that of state law (especially since, after Sears, Roebuck, & Co. v. Stiffel Co., 376 U.S. 225 (1964), the States may not prevent the public copying of unpatentable ideas) that inventors will not be deterred from applying for federal patents. In addition, unpatentable ideas make an important commercial contribution; if the originators of such ideas could not count on receiving some protection under state law, they would tend to hoard their knowledge rather than disseminate it to those licensees in the best position to put it to public use.

This case is distinguishable from Kewanee on its facts because the injuction there was limited to the life of the secrecy of the trade secret. Here, by constrast, the contract sought to be enforced would exact royalties as long as resp chooses to manufacture the keyholders, long after secrecy was lost. In spite of this difference, I have a hard time seeing why the general reasoning of Kewanee should not apply. It would seem that receiving a higher royalty from the sole manufacturer of a commercially successful product would not be any less attractive than receiving a lower royalty for a long or even an indefinite period from one of many competing manufacturers. Moreover, the indefinite royalty provision is probably unusual, representing a careless bargain on the part of resp. One would expect an acute businessman to agree to pay no more than his estimate of the money value of the head-start he would receive from disclosure of the trade secret, knowing that his competitors eventually would be able to compete fully. Typically, a royalty of finite duration would constitute the core of a trade-secret license in which no patent is involved. I have found nothing in resp's brief that convinces me that inventors would bypass the patent system if trade-secret license agreements based on facts similar to those here are held to be generally enforceable.

yes

yes

The real difficulty is in foreseeing whether the same is true of all or most trade secret licenses. The Ercon amicus brief points out the vast range of ideas and forms of agreement falling under the trade-secret rubric. It suggests some hypotheticals, pp. 21-22, in which contracts similar in form to the one in this case could have adverse economic effects if enforced. As I understand Ercon's argument, the problems it forecasts are more anti-competitive than anti-patent; *i.e.*, it is only when bargaining power is unequal due to superior economic strength in a licensor that trade secret licensing becomes troublesome. Ercon insists, p. 22 n.27, that the anti-trust laws are not an acceptable solution to this problem.

Ercon's proposed solution to this case deserves some attention since it attempts to carve out a middle ground between complete preemption and no preemption. The proposal is to enforce contracts such as the one here only to the extent they are reasonably related to the head-start value conferred by the disclosure of the trade secret to the licensee. The theory is appealing because it gives the inventor as much as he seems to "deserve," but no more. I have two difficulties with this proposal, however. First, I am not entirely convinced that this rule would truly further, other than indirectly, the twin patent-law policies of promoting public disclosure and providing incentives for invention. Rather, it seems to be more of an anti-trust measure. To be sure, anti-trust and patent law are related, but it would be anomalous to hold that the patent laws preempt an otherwise binding contract solely because of its anti-competitive effect. Second, as a practical matter, how is a court to judge the head-start value of an invention? The parties' agreement itself would seem to be the best indicator of this factual question, provided bargaining is at arms length. The length of the royalty payment period should not be dispositive; there is no reason why a licensee such as resp could not rationally decide that its head start value would adequately be represented by amortizing royalties over a long period of time, even past the point where competitors were freely copying the idea. In addition, it could be difficult to compute, even with the benefit of hindsight, what the head-start value actually was. (Ercon claims that such determinations are commonly made in state damages actions for violation of trade secret covenants, however.)

Taken as a whole, it appears to me that Ercon's argument is basically that an anti-trust problem exists which the anti-trust laws are incapable of solving; the Court should therefore adapt preemption doctrine to fill the gap. Although I question both Ercon's complete lack of faith in the anti-trust laws and its proposed solution, I do think its point is well taken that the Court should not infer from the facts and equities of this particular case that no trade licensing agreement could seriously disrupt federal patent policy. The matter obviously bears further thought and study. Even if the problems Ecron warns of are genuine risks, it may be that preemption is simply not a suitable doctrine for dealing with them.

B

The issue becomes more complicated when a patent application in involved. If the contract were based solely on the existence of a patent, then this case would be like Lear Inc. v. Adkins, 395 U.S. 653 (1969). That case establishes that an agreement to pay royalties on a patented invention becomes unenforceable if the patent is declared invalid. It is also clear that one may not enforce a contract to pay royalties beyond the life of a valid patent. Brulotte v. Thys, 379 U.S. 29

(1964). Thus, if the contract between petr and resp were, as resp now argues, made solely in contemplation of a patent, and that patent had issued, the rights and obligations of the parties would be clear.

The issue presented by this case, however, is whether an inventor can make an agreement relying on state contract or trade secret law in the alternative to federal patent law. Thus, if a patent issues, the law described in the preceding paragraph governs the enforceability of the contract for royalties. If no patent issues, then the contract is governed under the Kewanee principles described in part III A above.

The issue

For reasons that are not entirely clear, resp and the court below find this to be impermissible. Except for situations in which state trade-secret protection is invalid in and of itself, however, it is not clear to me why a licensor should not be able to strike this kind of a bargain. Indeed, it would seem that the objectives of patent law would be served especially well. The inventor clearly is not deterred from seeking patent protection, since that is his first option under the contract. And in the event a patent is not awarded, the introduction of the idea to the public is hastened since the licensor already is using it.

yes

The prior decisions of the Court do not preclude this result. The underlying rationale in Lear appears to be that, given the existence of a patent monopoly, there is a strong need to allow the licensee to challenge the validity of the patent. Here, by contrast, there is no monopoly since a patent never was issued. Lear expressly reserved the question of the validity under federal law of licenses for unpatented devices, and Kewanee now seems to have answered that question in favor of state law. Similarly, Brulotte assumed the existence of a patent, and also reserved the question of lengthy licenses for unpatented devices.

In light of Kewanee and the policy arguments advanced by petrs and most amicii, there would appear to be no reason not to permit a licensor, as a general rule, to invoke state law in favor of his trade secret in the event patent protection is refused. A potentially hard question arises when a patent is originally issued, but later declared invalid. In that circumstance, should a licensor be allowed to revert to his state law protection, in spite of the fact that a contract based on patent rolyalties alone would be unenforceable? The SG says that preemption would be proper in this case, and I tend to agree. See SG's brief at 21 n.8. This question, however, is not before the Court and need not be decided now. True

III. SUMMARY

I would reverse the decision of the Court below and hold that nothing in federal patent law preempts the enforcement of the contract between petr and resp. I would read the contract as the trial court did: the parties contemplated the issuance of a patent, but made independent provisions intended to govern in the event a patent was not forthcoming. I would conclude that the prior decisions of the Court do not govern this case directly, and that the policies of federal patent law will not be frustrated by the enforcement of this agreement. The most difficult part of writing an opinion reaching this result would be to decide whether the rule against preemption in such cases should be a broad or narrow, and, if the latter, how to draw the line between acceptable and unacceptable contracts. For the reasons state above, I question the soundness of Ercon's suggested limiting principle.

77-1413 ARONSON v. QUICK POINT PENCIL Argued 12/6/78

Cook (for Petr) (Able counsel)

Q - Does Fed patent law pre-empt state law even tho no patent was obtained

Case is governed by Kewanee.

~~Pet~~. Test under Kewanee is whether the ctt. will discourage invention.

~~He~~ Argues that this type of ctt will encourage invention - because it gives an inventor two options: a patent, or if unsuccessful - a binding ctt.

This type ctt. also places the invention in hands of public promptly. Here ~~to~~ inventor, protected by the ctt., had ~~no incentive to~~ incentive to disclose the invention - not ~~withhold~~ with hold it pending a patent.

Grossman (amicus for SG)
Supports reversal

Griswold (Resp)

This case involves no "secret" & thus Kewanee is irrelevant. No issue of "know-how" & "technology" is involved

Not a "trade secrete" case in Kewanee. ~~N~~ Normally, a trade secrete has not been ~~placed in~~ exposed to public. Here, since 1956, the key holder has been in public domain

(Rehnquist asked my Q: what difference does this make as to validity of ctt?)

Not a simple ctt. case like Warner-Lambert case

J. Stewart asked what if there had been no reference to patent law? Griswold replied that he knows no reason this would not be valid. The distinction here is that this ctt. contemplated a patent. Griswold relies on fed. statute authorizing assignment of a patent.

Griswold (cont.)

Central point is that Pet. operated under Patent law. Pet. "capitalized" on Pat. law.

→ Griswold gave John Stevens no specific answer ~~a~~ to Q: "what fed. policy - either under patent or anti-trust law - is implicated by this ctb.

When an item is marked "Pat Pending" this deters others from entering ~~to~~ the market with similar device.

Petr.

Royalties probably need not have been made after the patent application was denied. This is not a suit to recover these prior payment.

Reverse 9-0

77-1413 Aronson v. Quick Point Pencil

Conf. 12/8/78

The Chief Justice Reverse

Easy case.
Treat as a contract case.
Immaterial whether there was a trade secret.

Mr. Justice Brennan Reverse

Mr. Justice Stewart Reverse

Mr. Justice White Reverse

Mr. Justice Marshall Reverse

Mr. Justice Blackmun Reverse

In a contract case.

Mr. Justice Powell Reverse

Mr. Justice Rehnquist Reverse

Mr. Justice Stevens Reverse

Join
WJB
JPS

To: Mr. Justice Brennan
Mr. Justice Stewart
Mr. Justice White
Mr. Justice Marshall
Mr. Justice Blackmun
Mr. Justice Powell
Mr. Justice Rehnquist
Mr. Justice Stevens

From: The Chief Justice

Circulated: ______

Recirculated: JAN 22 1979

STYLISTIC CHANGES AS MARKED:

Reviewed
Join
LFP
1/22

2nd DRAFT

SUPREME COURT OF THE UNITED STATES

No. 77-1413

Jane Aronson, Petitioner, *v.* Quick Point Pencil Company.	On Writ of Certiorari to the United States Court of Appeals for the Eighth Circuit.

[February —, 1979]

MR. CHIEF JUSTICE BURGER delivered the opinion of the Court.

We granted certiorari to consider whether federal patent law pre-empts state contract law so as to preclude enforcement of a contract to pay royalties to a patent applicant, on sales of articles embodying the putative invention, for so long as the contracting party sells them whether or not a patent is granted.

(1)

In October 1955 the petitioner Mrs. Jane Aronson filed an application, Serial No. 542677, for a patent on a new form of keyholder. Although ingenious, the design was so simple that it readily could be copied unless it was protected by patent. In June 1956, while the patent application was pending, Mrs. Aronson negotiated a contract with the respondent, Quick Point Pencil Company, for the manufacture and sale of the keyholder.

The contract was embodied in two documents, the first being a letter from Quick Point to Mrs. Aronson. In that letter, Quick Point agreed to pay Mrs. Aronson a royalty of 5% of the selling price in return for "the exclusive right to make and sell keyholders of the type shown in your application, Serial No. 542677." The letter further provided that the parties would consult one another concerning the steps to be taken "[i]n the event of any infringement."

The contract did not require Quick Point to manufacture the keyholder. Mrs. Aronson received a $750 advance on royalties and was entitled to rescind the exclusive license if Quick Point did not sell a million keyholders by the end of 1957. Quick Point retained the right to cancel the agreement whenever "the volume of sales does not meet our expectation." The duration of the agreement was not otherwise prescribed.

A second, contemporaneous contract document provided that if Mrs. Aronson's patent application was "not allowed within five (5) years, Quick Point Pencil Co. [would] pay two and one half percent (2½%) of sales . . . so long as you [Quick Point] continue to sell same." *

In June 1961, when Mrs. Aronson had failed to obtain a patent on the keyholder within the five years specified in the agreement of the parties, Quick Point asserted its contractual right to reduce royalty payments to 2½% of sales. In September of that year the Patent Office Board of Appeals issued a final rejection of the application on the ground that the keyholder was not patentable, and Mrs. Aronson did not appeal. Quick Point continued to pay reduced royalties to her for 14 years thereafter.

The market was more receptive to the keyholder's novelty and utility than the Patent Office. By September 1975 Quick Point had made sales in excess of seven million dollars and paid Mrs. Aronson royalties totalling $203,963.84; sales were

*In April 1961, while Mrs. Aronson's patent application was pending, her husband sought a patent on a different keyholder and made plans to license another company to manufacture it. Quick Point's attorney wrote to the couple that the proposed new license would violate the 1956 agreement. He observed that:

"your license agreement is in respect of the disclosure of said Jane [Aronson's] application (not merely in respect of its claims) and that even if no patent is ever granted on the Jane [Aronson] application, *Quick Point Pencil Company is obligated to pay royalties in respect of any keyholder manufactured by it in accordance with any disclosure of said application.*" (Emphasis added.)

continuing to rise. However, while Quick Point was able to pre-empt the market in the earlier years and was long the only manufacturer of the Aronson keyholder, copies began to appear in the late 1960's. Quick Point's competitors, of course, were not required to pay royalties for their use of the design. Quick Point's share of the Aronson keyholder market has declined during the past decade.

(2)

In November 1975 Quick Point commenced an action in the United States District Court for a declaratory judgment, pursuant to 28 U. S. C. § 2201, that the royalty agreement was unenforceable. Quick Point asserted that state law which might otherwise make the contract enforceable was pre-empted by federal patent law. This is the only issue presented to us for decision.

Both parties moved for summary judgment on affidavits, exhibits, and stipulations of fact. The District Court concluded that the "language of the agreement is plain, clear and unequivocal and has no relation as to whether or not a patent is ever granted." Accordingly, it held that the agreement was valid, and that Quick Point was obliged to pay the agreed royalties pursuant to the contract so long as it manufactured the keyholder.

The Court of Appeals reversed, one judge dissenting. It held that Mrs. Aronson's effort to obtain a patent estopped her from denying that patent law principles governed her contract with Quick Point. Although acknowledging that this Court had never decided the precise issue, the Court of Appeals held that our prior decisions regarding patent licenses compelled the conclusion that Quick Point's contract with Mrs. Aronson became unenforceable once she failed to obtain a patent within the stipulated five-year period. The court found that a continuing obligation to pay royalties would be contrary to "the strong federal policy in favor of the full and free use of ideas in the public domain." *Lear, Inc.* v. *Adkins,* 395 U. S. 653, 674

(1969). The court also observed that if Mrs. Aronson actually had obtained a patent, Quick Point would have escaped its royalty obligations either if the patent were held to be invalid, *id.*, at 674, or upon its expiration after 17 years under *Brulotte* v. *Thys Co.*, 379 U. S. 29 (1964). Accordingly, it concluded that a licensee should be relieved of royalty obligations when the licensor's efforts to obtain a contemplated patent prove unsuccessful.

(3)

The parties contracted with full awareness of both the pendency of a patent application and the possibility that a patent might not issue. The clause de-escalating the royalty by half in the event no patent issued within five years makes that crystal clear. Quick Point apparently placed a significant value on capitalizing on the basic novelty of the device, even if no patent issued; its success in exploiting the keyholder demonstrates that this judgment was reasonable. Assuming, *arguendo*, that the initial letter and the commitment to pay a 5% royalty was in contemplation of and was subject to federal patent law, the provisions relating to the $2\frac{1}{2}$% royalty were explicitly independent of patent law. The cases and principles relied on by the Court of Appeals and Quick Point do not bear on a contract that does not rely on a patent, particularly where, as here, the contracting parties agreed expressly as to alternative obligations if no patent should issue.

omission

Commercial agreements traditionally are the domain of state law; state law is not displaced merely because the contract relates to intellectual property which may or may not be patentable. The states are free to regulate the use of such intellectual property in any manner not inconsistent with federal law. *Kewanee Oil Co.* v. *Bicron Corp.*, 416 U. S. 470, 479 (1974); see *Goldstein* v. *California*, 412 U. S. 546 (1973). In this as in other fields, the question of whether federal law pre-empts state law "involves a consideration of whether that law 'stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress.' *Hines* v. *Davidowitz,* 312 U. S. 52, 67 (1941)." *Kewanee Oil Co.* v. *Bicron Corp., supra.* If it does not, state law governs.

In *Kewanee Oil Co.,* we reviewed the purposes of the federal patent system. First, patent law seeks to foster and reward invention; second, it promotes disclosure of inventions, to stimulate further innovation and to permit the public to practice the invention once the patent expires; third, the stringent requirements for patent protection seek to assure that ideas in the public domain remain there for the free use of the public. *Kewanee Oil Co.* v. *Bicron Corp., supra,* at 480–481. omission

Enforcement of Quick Point's agreement with Mrs. Aronson is not inconsistent with any of these aims. Permitting inventors to make enforceable agreements licensing the use of their inventions in return for royalties provides an additional incentive to invention. Similarly, encouraging Mrs. Arsonson to make arrangements for the manufacture of her keyholder furthers the federal policy of disclosure of inventions; these simple devices display the novel idea which they embody wherever they are seen. omission

Quick Point argues that enforcement of such contracts conflicts with the federal policy against withdrawing ideas from the public domain by allowing states to extend "perpetual protection to articles too lacking in novelty to merit any patent at all under federal constitutional standards," *Sears Roebuck & Co.* v. *Stiffel Co.,* 376 U. S. 225, 232 (1964), and hence discourages recourse to the federal patent system.

We find no merit in either contention. Enforcement of this agreement does not withdraw any idea from the public domain. The design for the keyholder was not in the public domain before the parties contracted at arm's length. See *Kewanee Oil Co., supra,* at 484. In negotiating the agreement, Mrs. Aronson disclosed the design in confidence. Had

Quick Point tried to exploit the design in breach of that confidence, it would have risked legal liability. It is equally clear that as a result of the agreement, the manufacture and sale of the keyholders and the subsequent denial of Mrs. Aronson's patent application, the design entered the public domain.

Requiring Quick Point to bear the burden of royalties for the use of the design is no more inconsistent with federal patent law than any of the other costs involved in being the first to introduce a new product to the market, such as research and development expenditures and marketing and promotional expenses. For reasons which Quick Point's experience with the Aronson keyholder demonstrate, innovative entrepeneurs have usually found such costs to be well worth paying.

Finally, enforcement of this agreement does not discourage anyone from seeking a patent. Mrs. Aronson attempted to obtain a patent for over five years. It is quite true that had she succeeded, she would have received a 5% royalty only on keyholders sold during the 17-year life of the patent. Offsetting the limited term of royalty payments, she and Quick Point would have been able to license any others who produced the same keyholder. Which course would have produced the greater yield to the contracting parties is a matter of speculation; the parties resolved the uncertainties by their bargain.

(4)

No decisions of this Court relating to patents justify relieving Quick Point of its contract obligations. We have held that a State may not forbid the copying of an idea in the public domain which does not meet the requirements for federal patent protection. *Compco Corp.* v. *Day-Brite Lighting, Inc.*, 376 U. S. 234 (1964); *Sears Roebuck & Co.* v. *Stiffel Co.*, 376 U. S. 225 (1974). Enforcement of Quick Point's agreement, however, does not prevent anyone from copying the keyholder. It merely requires Quick Point to pay the consideration which it promised in return for the use of a new and secret invention which enabled it to pre-empt the market.

In *Lear, Inc.* v. *Adkins,* 395 U. S. 653 (1969), we held that a person licensed to use a patent may challenge the validity of the patent, and that a licensee who establishes that the patent is invalid need not pay the royalties accrued under the licensing agreement subsequent to the issuance of the patent. Both holdings relied on the desirability of encouraging licensees to challenge the validity of patents, to further the strong federal policy that only inventions which meet the rigorous requirements of patentability shall be withdrawn from the public domain. *Id.,* at 670–671, 673–674. Accordingly, neither the holding nor the rationale of *Lear* control when no patent has issued, and no ideas have been withdrawn from public use.

Enforcement of the royalty agreement here is also consistent with the principles treated in *Brulotte* v. *Thys Co.,* 379 U. S. 29 (1964). There, we held that the obligation to pay royalties in return for the use of a patented device may not extend beyond the life of the patent. The principle underlying that holding was simply that the monopoly granted *under a patent* cannot lawfully be used to "negotiate with the leverage of that monopoly." The Court emphasized that to "use that leverage to project those royalty payments beyond the life of the patent is analogous to an effort to enlarge the monopoly of a patent. . . ." *Id.,* at 33. Here the reduced royalty which is challenged, far from being negotiated "with the leverage" of a patent, rested on the contingency that no patent would issue within five years.

No doubt a pending patent application gives the applicant some additional bargaining power for purposes of negotiating a royalty agreement. The pending application allows the inventor to hold out the hope of an exclusive right to exploit the idea, as well as the threat that the other party will be prevented from using the idea for 17 years. However, the amount of leverage arising from a patent application depends on how likely the parties consider it to be that a valid patent will issue. Here, where no patent ever issued, the record is entirely clear that the parties assigned a substantial likelihood to that contingency, because they specifically provided for a reduced royalty in the event no patent issued within five years.

omission

This case does not require us to draw the line between what constitutes abuse of a pending application and what does not. It is clear that whatever role the pending application played in the negotiation of the 5% royalty, it played no part in the contract to pay the 2½% royalty indefinitely.

Our holding in *Kewanee Oil Co., supra,* puts to rest the contention that federal law pre-empts and renders unenforceable the contract made by these parties. There we held that state law forbidding the misappropriation of trade secrets was not pre-empted by federal patent law. We observed:

> "Certainly the patent policy of encouraging invention is not disturbed by the existence of another form of incentive to invention. In this respect the two systems [patent and trade secrets law] are not and never would be in conflict." *Id.*, at 484.

Enforcement of this royalty agreement is even less offensive to federal patent policies than state law protecting trade secrets. The most commonly accepted definition of trade secrets is restricted to confidential information which is not disclosed in the normal process of exploitation. See Restatement of Torts § 757, comment b (1939). Accordingly, the exploitation of trade secrets under state law may not satisfy the federal policy in favor of disclosure, whereas disclosure is inescapable in exploiting a device like the Aronson keyholder.

Enforcement of these contractual obligations, freely undertaken in arm's length negotiation and with no fixed reliance on a patent or a probable patent grant, will:

> "encourage invention in areas where patent law does not reach, and will prompt the independent innovator to

proceed with the discovery and exploitation of his invention. Competition is fostered and the public is not deprived of the use of valuable, if not quite patentable, invention." [Footnote omitted.] *Kewanee Oil Co., supra,* at 485.

The device which is the subject of the contract here ceased to have any secrecy as soon as it was first marketed; yet when the contract was negotiated the inventiveness and novelty were sufficiently apparent to induce an experienced novelty manufacturer to agree to pay for the initial exclusivity on the terms adopted by the parties for the opportunity to be first in the market. Federal patent law is not a barrier to such a contract.

Reversed.

Supreme Court of the United States
Washington, D. C. 20543

CHAMBERS OF
JUSTICE JOHN PAUL STEVENS

January 22, 1979

Re: 77-1413 - Aronson v. Quick Point Pencil Co.

Dear Chief:

Please join me.

Respectfully,

The Chief Justice

Copies to the Conference

Supreme Court of the United States
Washington, D. C. 20543

CHAMBERS OF
JUSTICE WM. J. BRENNAN, JR.

January 22, 1979

RE: No. 77-1413 Aronson v. Quick Point Pencil Co.

Dear Chief:

I agree.

Sincerely,

Bill

The Chief Justice

cc: The Conference

ea/lab 1/23/79

MEMORANDUM

To: Justice Powell Date: January 23, 1979

From: Eric

No. 77-1413 Aronson v. Quick Point Pencil Co.

I believe the Chief's opinion in Aronson generally is on the mark. I have only a few minor reservations:

1.) The opinion fails to note a difficult question that this decision properly leaves unresolved: What result if the Aronson patent had issued, but subsequently were declared invalid in court? That case would fall midway between this Aronson and Lear. It would not be advisable to address the issue now, but it might be wise to show that this Court is aware of what lies down the road.

yes

2.) The opinion stresses that once Aronson's key ring was marketed, it was easily copied by any competitor; therefore there was no withholding of information from the public in contravention of federal patent policy. It is not clear to me whether the Chief believes the case might come out differently if the federal disclosure policy were not so clearly supported by the contract in this case. Kewanee suggested that even if disclosure might be inhibited to some extent by state-law protection of trade secrets, pre-emption was still improper. I don't imagine the Chief is backtracking from his Kewanee position, but the emphasis in this opinion on the disclosure policy arguably could intimate such a retreat.

3.) The opinion doesn't appear to anticipate the kind of problem raised in Ercon's amicus brief: that contracts such as this could be inconsistent with federal policy if the product of unequal bargaining power. There was no such problem in this case, but had I written the opinion, I might have left open the possibility of a different result if the contract were shown to be the product of market leverage applied in such a way as to defeat federal patent policy.

* * *

None of these reservations go to the substance of the opinion. The only question is whether any of them w~~a~~re important enough to call to the Chief's attention.

Eric

January 23, 1979

No. 77-1413 Aronson v. Quick Point Pencil Company

Dear Chief:

Please join me.

Sincerely,

The Chief Justice

Copies to the Conference

LFP/lab

Supreme Court of the United States
Washington, D. C. 20543

CHAMBERS OF
JUSTICE POTTER STEWART

January 23, 1979

Re: No. 77-1413 - Aronson v. Quick Point Pencil Co.

Dear Chief:

I am glad to join your opinion for the Court.

Sincerely yours,

The Chief Justice

Copies to the Conference

Supreme Court of the United States
Washington, D. C. 20543

CHAMBERS OF
JUSTICE THURGOOD MARSHALL

January 23, 1979

Re: No. 77-1413-Aronson v. Quick Point Pencil Co.

Dear Chief:

Please join me.

Sincerely,

T.M.

T.M.

The Chief Justice

cc: The Conference

Supreme Court of the United States
Washington, D. C. 20543

CHAMBERS OF
JUSTICE BYRON R. WHITE

January 23, 1979

Re: No. 77-1413 - Aronson v. Quick
Point Pencil Co.

Dear Chief,

Please join me.

Sincerely yours,

Byron

The Chief Justice

Copies to the Conference

Supreme Court of the United States
Washington, D. C. 20543

CHAMBERS OF
JUSTICE WILLIAM H. REHNQUIST

January 24, 1979

Re: No. 77-1413 Aronson v. Quick Point Pencil Co.

Dear Chief:

Please join me.

Sincerely,

The Chief Justice

Copies to the Conference

Supreme Court of the United States
Washington, D. C. 20543

CHAMBERS OF
THE CHIEF JUSTICE

February 21, 1979

Re: 77-1413 - Aronson v. Quick Point Pencil Co.

MEMORANDUM TO THE CONFERENCE:

I am making some belated stylistic changes in this case so it will not come down tomorrow.

Regards,

WEB

cc: Mr. Cornio

THE C. J.	W. J. B.	P. S.	B. R. W.	T. M.	H. A. B.	L. F. P.	W. H. R.	J. P. S.
12/11/78								
1st draft 1/15/79 2nd draft	agree 1/22/79	Join CJ 1/23/79	Join CJ 1/23/79	Join CJ 1/23/79	concurring opinion typed draft	Join CJ 1/23/79	Join CJ 1/24/79	Join CJ 1/22/79
1/22/79 3rd draft 1/23/79					1/24/79 concurring opinion 1st pr. draft 1/25/79			
4th draft 1/24/79								

77-1413 Aronson v. Quick Point Pencil