

ClientAlert

Antitrust

June 2012

US State Unfair Competition Laws Create Increased Exposure for Misappropriated IP



For many years, information technology companies in the United States have expressed concern regarding what they have perceived to be the prevalence of pirated software in certain countries. One recent report, the Global Software Piracy Study, published earlier this month on May 15, 2012 by the Business Software Alliance (BSA), concludes that the commercial value of the world's market of pirated software makes up US\$63 billion. According to the report, the United States is one of the jurisdictions with the highest levels of misappropriated software, along with China, Russia, India and Brazil.

In response to these concerns, the United States Congress and certain states have re-evaluated anti-piracy and unfair trade practice legislation, with the early results potentially leading to the imposition of sanctions on those companies that are found to have stolen or misappropriated proprietary information technology ("IT"). Proponents of such legislation believe that the advantages such companies gain when using pirated software must be considered, among other things, as unfair competition.

Notably, on November 14, 2011, the National Association of Attorneys General forwarded to the Federal Trade Commission Commissioners and the Director of the Bureau of Competition a petition in which Attorneys General of 36 states raised this problem and called for legislative measures to prevent such unfair competition. Any company that sells in the United States must be aware of the potential implications of such unfair competition laws, at both the federal and state levels.

One recent example of such a state law that has gained significant visibility is Washington State's revised Unfair Competition Law, Wash. Rev. Code § 19.330 et seq., (the "UCL"), which became effective on July 22, 2011. Washington State's revised law will potentially impose severe new sanctions including: (1) possible seizure of products; (2) an injunction against sales; and/or (3) damages—including, potentially, treble damages. However, the revised law offers several "safe harbors," discussed below, intended to protect a manufacturer from liability under certain circumstances.

In seeking to punish exporters to the United States that misappropriate IT, Washington State has followed the state of Louisiana. Louisiana passed a similar law in 2010. See La. Rev. Stat. Ann. § 51:1427. While the focus of this Alert is on the revised Washington statute, many of these same principles apply to the Louisiana statute as well.

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Overview of the Revised Washington UCL

The revised Washington UCL creates the potential for liability for both (1) companies that misappropriate proprietary IT and incorporate that IT into their products (“direct violators”), and (2) third parties that contract with foreign manufacturers who utilize misappropriated proprietary IT (“third parties”).

Direct Liability

The threshold value for a claim is low. The value of the IT at issue must be greater than US\$20,000—taking into account the value per unit and number of units sold—a relatively modest sum in the IT world. Additionally, a plaintiff must satisfy the following requirements to have standing to bring an action: (1) the plaintiff is a competitor of the direct violator that manufactures products that are in direct competition with the products alleged to have used misappropriated IT, (2) the plaintiff does not itself use misappropriated IT, and (3) the plaintiff sells its competing products in Washington State.

Additionally, the UCL requires the plaintiff to provide notice to the alleged direct violator and afford that violator an opportunity to cure the violation—such as by agreeing to appropriate licenses.

Third-Party Liability

Under the revised Washington law, third parties—including manufacturers, distributors and retailers—also face potential exposure to significant liability if they sell or offer products in the state that incorporate the allegedly misappropriated IT. Plaintiffs pursuing these third parties do have one additional hurdle: they must pursue the direct violator first. If the direct violator fails to appear or simply cannot pay any resulting judgment, the plaintiff may pursue the third party “who sells or offers” for sale the alleged direct violator’s products in Washington State.

In any case, a plaintiff may only recover from the third party if (1) the third party either sells or offers the direct violator’s *final product*, or (2) the direct violator “produced a *component equal to thirty percent* or more of the value of the final product.” In other words, Washington State has provided for a *de minimis* exception to the rule of liability for third parties.

Remedies

A person found to be a direct violator may be liable for actual direct damages in the amount of the retail price of the stolen or misappropriated IT. “Willful” violations may lead to the imposition of *treble* damages.

Third parties face less exposure. The maximum exposure for a third party is the *lesser* of the retail price of the misappropriated IT or US\$250,000, less any amount the plaintiff is able to recover from the direct violator (presumably in the instance of a direct violator who appeared for the case, but could not pay the full judgment).

The UCL also provides for the attachment of products containing allegedly misappropriated IT that are sold or offered for sale in the state of Washington, as to which the company alleged to have violated the law has title. Additionally, injunctions may issue against direct violators and third parties. Again, third parties have more defenses available to them.

To date, there have been no cases applying these definitions and exceptions.

Affirmative Defenses and Safe Harbors

Certain products and circumstances are not covered by the law. These include, among other things: (1) a medical product regulated by the FDA; (2) a food or beverage; (3) a product that is copyrightable; (4) a product that displays copyrighted work; and (5) a product involving alleged patent infringement or stolen trade secrets. In addition, for third parties, the UCL provides several affirmative defenses and safe harbors that may apply.

Conclusion

In summary, the revised Washington State UCL extends potential liability for misappropriated IT to both direct violators and third parties that incorporate misappropriated IT into products they sell into the state of Washington. However, the law provides defenses and safe harbor provisions that allow a third party to guard against liability through compliance efforts.