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Combating IP Theft Using Unfair Competition Law

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The typical headline—theft of intellectual property threatens U.S. companies—causes many to think of media reports about patent lawsuits or pirated music and movies. But there is another form of intellectual property theft that poses a great threat to American businesses while receiving far fewer headlines: the rampant theft of information technology (IT) by overseas competitors.

Given the challenges in directly reaching the foreign companies' theft of this intellectual property, state attorneys general have begun to fight back, using the tools of unfair competition law in an attempt to level the playing field for American competitors. This is a promising development and a potentially useful technique for states and companies to fight back against foreign competitors using stolen technology.

Industry Effects and Calls for Help

While the immediate effects of IT theft are felt directly by vendors when an overseas company uses illegal copies of their products, the indirect effects are damaging to American companies across many industries. By stealing the key applications used to run their businesses, these foreign companies gain a significant cost advantage, allowing them to produce and import their goods into the United States at an unfair advantage against law-abiding U.S. companies that pay significant amounts to build and maintain their IT infrastructure.

The financial implications of misappropriated IT are significant. In a May 2012 report, the Business Software Alliance (BSA) estimated the commercial value of stolen software to be $63.4 billion annually, driven primarily by theft in emerging market economies such as China, Russia, India, and Brazil.[1] Another study conducted by Keystone Strategy in 2011, which was commissioned by Microsoft, analyzed data from various sources, including BSA and government statistical reports, to estimate the advantage foreign companies gain by using stolen software. The study showed that these companies have an aggregate $2.9 billion advantage annually and a $14.4 billion competitive advantage over the course of a typical five-year software usage life cycle, over American companies that pay to maintain their IT infrastructure.[2] To give a sense of scale, Keystone provided examples of the impacts of the estimated $837 million annual competitive advantage that Chinese companies alone gain from using pirated software. Those savings would allow Chinese firms to build more than 60 manufacturing plants, buy nearly 13,000 plastics molding machines, or hire approximately 217,000 employees each year.

Even if the estimated financial value of the stolen IT resources may be discounted by claims of bias, the BSA study also estimated that the software piracy rate in emerging market economies was 68 percent, meaning that two-thirds of American companies' competitors from these countries are operating their businesses free of the IT costs incurred by American businesses. Given the fundamental nature of most IT resources in day-to-day business operations, this is like trying to compete when two-thirds of your competitors do not have to pay for basic costs of doing business, like rent or utilities. Furthermore, when taking into account the other cost advantages of emerging market companies, such as significantly lower labor costs, it is easy to understand how foreign companies can save even more money by misappropriating IT resources, further extending pricing power over American competitors.


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These impacts have not gone unnoticed by American companies and policy makers at the

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state and federal levels. At the federal level, unfair competition is generally addressed through the Federal Trade Commission Act (FTC Act) that allows federal officials to bring suit for "[u]nfair methods of competition in or affecting commerce, and unfair or deceptive acts or practices in or affecting commerce."[3] However, the FTC Act has a significant limitation: It does not provide for a private right of action. This means states and private companies must wait for federal officials to take action against foreign competitors—something the FTC has been reluctant to do despite the dollar value impacts to American business. In an attempt to prompt action, attorneys general from 36 states and three territories signed a letter to the FTC and head of the Unfair Competition Bureau in November 2011, asking the FTC to help address the issue and announcing their collective commitment to use their powers at the state level to increase enforcement against manufacturers that use stolen IT.[4]

And the calls for help have continued. Sixteen members of the U.S. Senate Small Business Committee issued a letter to the FTC in April 2012, referencing the letter from the state attorneys general and urging the FTC to work with them to fight the problem of IT theft.[5] In August 2012, 19 members of the U.S. House Small Business Committee sent their own letter to the FTC, asking it to work with the states to "identify the best solutions to fight illegal IT theft."[6] Also in 2012, the Missouri and New York legislatures passed resolutions calling on the FTC and their state attorneys general to address unfair competition.[7]

Unfair Competition Laws

While the FTC has thus far not acted, states have not stood idly by waiting for assistance to deal with foreign competitors suspected of using stolen IT resources. Many states have passed unfair competition laws termed "baby FTC" acts that are modeled on the federal FTC Act, with the distinction that these baby FTC acts generally provide for a private right of action and provide varying levels of specificity regarding the application of unfair competition as it relates to misappropriated IT.

Several states, including Louisiana and Washington, have passed specifically tailored legislation to address the problem directly, including unfair competition laws that extend basic prohibition against "unfair methods of competition" and explicitly requiring manufacturers whose products are sold in their states to verify that properly licensed software is used in their business operations.[8] If manufacturers are found to have used stolen IT, they may be subject to liability if their products are sold in these states in competition with products that were made without the use of stolen IT, regardless of where the manufacturing took place or the IT theft occurred.

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Most other states rely on baby FTC unfair competition laws for now. For example, New York's baby FTC act states: "Deceptive acts or practices in the conduct of any business, trade or commerce or in the furnishing of any service in this state are hereby declared unlawful."[9] The attorney general is given the authority to bring an action if there is a belief that a company or person "has engaged in or is about to engage in any of the acts or practices" quoted above, and to seek damages or injunctive relief.[10] In addition to the authority granted to the attorney general, the act also provides that "any person who has been injured by reason of any violation of this section may bring an action in his own name to enjoin such unlawful act or practice, or an action to recover his actual damages."[11]

For comparison, the operative language of the federal FTC Act is similar: "Unfair methods of competition in or affecting commerce, and unfair or deceptive acts or practices in or affecting commerce, are hereby declared unlawful."[12] However, the remainder of the statute gives only the FTC, and not individuals or companies, the authority to bring suit:

> The Commission is hereby empowered and directed to prevent persons, partnerships, or corporations…from using unfair methods of competition in or affecting commerce and unfair or deceptive acts or practices in or affecting commerce.[13]

While New York has not yet followed the lead of Louisiana and Washington in passing a statute providing relief against competitors that use stolen IT resources, similar legislation has been proposed. A bill is currently pending in the state Senate to amend the General Business Law to add such a provision, making it "unlawful for a person to develop or manufacture a product or supply services using stolen or misappropriated software."[14]

Actions Taken by State Attorneys General

Following the calls for federal action, two state attorneys general have taken matters into their own hands. And perhaps surprisingly, the actions were not in Louisiana or Washington under their new statutes directed toward stolen IP. Instead, the first action was brought in October 2012 by the Massachusetts attorney general against a Thailand-based seafood company for using pirated software.[15] The allegations were premised on a violation of Massachusetts unfair competition law worded nearly identically to the FTC Act and to New York's unfair competition law.[16] The Thai company chose to settle with the state AG, agreeing not to use illegal software in connection with goods being imported into Massachusetts and to pay a $10,000 fine.

More recently, California attorney general Kamala Harris has taken the next step in using unfair competition law to fight back against foreign companies allegedly using stolen software. In January 2013, she filed suit against two overseas apparel manufacturers—one from China and one from India—that regularly import their goods into California.[17] Like the New York and Massachusetts unfair competition laws, the language of the California unfair competition law is general in nature: "As used in this chapter, unfair competition shall mean and include any unlawful, unfair or fraudulent business act or practice…."[18]

The complaints against the two companies are nearly identical, but are instructive in the manner in which the unfair competition claims are pled.[19] First, the complaints appear to be the result of collaboration by the state and the companies that are directly harmed by pirated IT. The complaints contain specific references to court-ordered inspections of the foreign companies' computers resulting from a separate action previously brought against the companies. The results of these searches, which uncovered illegal copies of Microsoft software such as Windows and Office, that are cited in the complaint give a high level of specificity to the complaint's factual allegations. In addition, though not explicitly stated to have been found

in the inspections, the complaints allege that the companies are using pirated software from other software vendors such as Adobe (maker of design tools and Acrobat PDF software), Symantec (maker of antivirus software), and Corel (maker of design, photo editing, and office productivity software). Probably not a surprise to find that if the company was willing to steal a whole suite of Microsoft software, the company was also stealing other business critical software.

Second, the complaints give valuable context to the unfair competition claims. The factual allegations and venue statements explain how the companies' use of pirated software provides an advantage over California companies in the apparel industry, including estimates of the size and value of the California apparel manufacturing industry and specifically the size of the industry in the Los Angeles market where these companies import their goods. The complaints also give specific measures of the volume of goods the companies have shipped into California, measured in pounds of apparel products.

Prospects for the Future

Even without the passage of the proposed New York bill targeting stolen software as an unfair competitive advantage, the potential to use the New York unfair competition law to pursue foreign companies using pirated IT may still be a productive option. Historically, New York courts have broadly construed the unfair competition statute: "The incalculable variety of illegal practices denominated as unfair competition is proportionate to the unlimited ingenuity that overreaching entrepreneurs and trade pirates put to use."[20] Combining this broad construction with the size and nature of New York state's industries—including fashion and apparel, manufacturing, and technology companies—likely competing against foreign competitors using stolen IT, the opportunity is ripe to follow the lead of California and Massachusetts and fight back by asserting unfair competition claims.

Furthermore, whether the New York state attorney general or aggrieved private companies bring the suits, there is a natural synergy by banding together with major vendors as demonstrated by the California suits. By teaming up with large IT vendors that are losing direct, bottom-line revenue by foreign companies' theft, New York companies could develop their claims of unfair competition by working with IT companies to identify specific instances of piracy to support their claims. New York levels the playing field and the IT companies benefit by realizing additional revenue and incrementally reducing piracy rates.

However, using unfair competition laws, whether in specialized forms like Louisiana or Washington, or general forms such as in New York or California, is not without some challenges. Chief among these will be determining just which overseas competitors are using pirated IT in such a volume that they are gaining an advantage. And while any use of pirated IT is technically an unfair advantage, there are of course de minimis levels where pursuing such a claim would not make financial sense. Sussing out exactly where the opportunities lie will be the primary challenge, particularly if IT vendors are not able to partner to address the problem. Even without the IT vendors' assistance, interested New York companies or the New York attorney general could partner with an organization such as the BSA's Global Anti-Piracy Team to identify possible targets for bringing suits.

Alternatively, forward-thinking New York companies could use this strategy of considering unfair competition litigation as a way of encouraging compliance. By pointing to the actions in Massachusetts and California and showing the similarities to New York law, the implicit threat of bringing similar litigation against competitors may encourage compliance without necessarily going through the challenge of identifying instances of piracy. Given the extensive nature of piracy in certain regions of the world, such threats could carry significant weight as relates to competitors in those regions where there is some momentum in bringing these suits.

Conclusion

While foreign theft of American companies' patents and creative works is a serious issue, the theft of IT is also very serious and can have wide-ranging effects on many American industries. The recent move to use unfair competition laws as an alternative tool to fight this problem presents a new and potentially useful avenue to leveling the playing field between American and foreign competitors. New York companies operating in industries that regularly compete with foreign companies likely to be misappropriating IT would be wise to follow the suits filed by the California attorney general and consider how the complaints could be used to develop claims in their respective industries. With little apparent help on the horizon from federal officials, concerted efforts by business and state attorneys general could prove a strong weapon to claw back some of the billions of dollars in ill-gotten advantage foreign companies are enjoying—a result that would benefit not only New York companies but America and our economy generally in an era of global competition.

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3. 15 U.S.C. §45(a)(1).
4. See Letter to the Federal Trade Commission Commissioners and the Director of the Bureau of Competition, available at http://www.naag.org/assets/files/pdf/signons/FTCA Enforcement Final.PDF.
5. See Letter to the Commissioners of the Federal Trade Commission, available at http://www.sbecouncil.org/uploads/04-02-2012+SBC+Letter.pdf.
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8. See La. Rev. Stat. §51:1427; Wash. Rev. Code §19.330 et seq.
9. N.Y. Gen. Bus. Law §349(a).
10. Id. §349(b).
11. Id. §349(h).
12. 15 U.S.C. §45(a)(1).
13. Id. §45(a)(2).
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