HOUSE BILL REPORT
ESSB 5449

As Reported by House Committee On:
Judiciary

Title: An act relating to the unfair competition that occurs when stolen or misappropriated information technology is used to manufacture products sold or offered for sale in this state.

Brief Description: Regarding the unfair competition that occurs when stolen or misappropriated information technology is used to manufacture products sold or offered for sale in this state.

Sponsors: Senate Committee on Labor, Commerce & Consumer Protection (originally sponsored by Senators Brown, Pflug, Carrell, Harper, Murray, Hobbs, Fain, Delvin, Roach, Ericksen, Shin, Tom, Kohl-Welles and Kilmer).

Brief History:
Committee Activity:
Judiciary: 3/14/11, 3/24/11 [DPA].

Brief Summary of Engrossed Substitute Bill
(As Amended by House)

- Creates a civil cause of action against persons that manufacture products sold in Washington while using stolen or misappropriated information technology in its business operations.

HOUSE COMMITTEE ON JUDICIARY

Majority Report: Do pass as amended. Signed by 10 members: Representatives Pedersen, Chair; Goodman, Vice Chair; Shea, Assistant Ranking Minority Member; Chandler, Eddy, Frockt, Kirby, Orwall, Rivers and Roberts.

Minority Report: Do not pass. Signed by 2 members: Representatives Klippert and Nealey.

Staff: Trudes Tango (786-7384).

Background:

This analysis was prepared by non-partisan legislative staff for the use of legislative members in their deliberations. This analysis is not a part of the legislation nor does it constitute a statement of legislative intent.

Consumer Protection Act.
The state's Consumer Protection Act (CPA) prohibits unfair or deceptive acts or practices and unfair methods of competition in the conduct of trade or commerce that directly or indirectly affect the people of Washington. Several statutes specify practices that constitute unfair acts, but they do not provide an exhaustive list. A court may find that conduct not specifically enumerated in statute constitutes an unfair or deceptive act. A private plaintiff or the Attorney General may bring a civil action to enjoin future violations of the CPA or to recover damages caused by an unfair act.

"Personal" vs. "In Rem" Jurisdiction.
In order for a court to hear and determine a controversy, it must have jurisdiction over the matter. Often, courts have "personal" jurisdiction over a person sued in a civil lawsuit because the person made certain minimum contacts with the state. Foreign defendants whose actions give rise to a lawsuit in a Washington court but who have never visited the state and who have no assets within Washington might not be subject to personal jurisdiction. However, courts may have jurisdiction to enter judgment regarding property located within the state, even if the courts do not have personal jurisdiction over that defendant. Such actions against property are called proceedings "in rem."

Intellectual Property.
Federal and state laws protect certain intellectual property rights in creations, such as computer software (programs) and hardware (equipment). A copyright gives the owner of an original work that expresses ideas, such as certain software, exclusive rights to copy, distribute, and adapt the work. A federal patent may protect a publicly disclosed computer-related invention for a period of time. Federal and state trade secret laws prohibit misappropriation of trade secrets, such as formulas, programs, and techniques.

Summary of Amended Bill:

Cause of Action.
A civil cause of action is created for an injured party or the Attorney General to sue a person that manufactures a product while using stolen or misappropriated information technology (stolen IT) in its business operations. The products made with stolen IT must be sold in Washington, either separately or as a component of another product, in competition with a product made without the use of stolen IT. A person may not sue under this cause of action under certain enumerated circumstances, such as when the end product sold is copyrightable or there are allegations dealing with patents.

To be considered an injured party, the person must show, among other things, that the person manufactures products in direct competition with products made with stolen IT and the person suffered economic harm. Economic harm may be established by evidence that the retail price of the stolen IT was at least $20,000.

Notice.
Before a plaintiff can file suit, the owners of the stolen IT must provide written notice to the party allegedly using stolen IT, allowing that party to prove it is not using stolen IT or giving

the party 90 days to stop using it, subject to any extensions approved by the owner. The notice must contain certain information and must state, under penalty of perjury, that after a reasonable and good-faith investigation, the information in the notice is accurate based on the notifier's reasonable knowledge, information, and belief.

Remedies Against Manufacturers.
If the use of stolen IT continues despite the notice, an injured person or the Attorney General may bring an action to enjoin violations of the bill's provisions, including ordering a person not to sell products in Washington. The plaintiff may also seek the greater of actual damages or the amount of the retail price of the stolen IT. The court may triple the damages if the defendant willfully used stolen IT. A court may award costs and reasonable attorneys' fees to the prevailing party in actions brought by an injured person.

Remedies against Third Parties.
The plaintiff may add to the action a claim for actual direct damages against a third party who sells the products made with stolen IT, but only if a court has first entered judgment against the person using stolen IT. Damages may be imposed against a third party only if certain conditions are met, including the requirement that: (1) the third party received 90 days notice before entry of the judgment; (2) the person who was found to have used stolen IT either did not appear in court or has insufficient attachable assets to satisfy the judgment; and (3) the person who was found to have used stolen IT manufactured the final product or produced a component equal to 30 percent or more of the value of the final product.

Damages against a third party are limited to the lesser of the retail price of the stolen IT or $250,000, minus any amounts recovered from the person using stolen IT. The court may award reasonable attorneys' fees and costs, including all litigation expenses, to a third party who: (1) prevails on the requirement that the person who was found to have used stolen IT manufactured the final product or produced a component equal to 30 percent or more of the value of the final product; or (2) qualifies for an affirmative defense. However, in the case in which a third party received a 90-day notice before the filing of the action, the court may award costs and reasonable attorneys' fees only if the third party undertook all the conduct on which the affirmative defense is based and notified the plaintiff of the conduct prior to the end of the 90-day period.

A court may not enforce a damage award against a third party for a period of 18 months from the bill's effective date.

Stay and Dismissal of Proceedings.
The court must dismiss an action against a person using stolen IT or a third party if the person or third party has been subject to a final judgment or entered into a final settlement in a proceeding in any federal or state court arising out of the same theft. If the person or third party is subject to a pending action in a federal or other state court, the court must stay the action pending resolution of the prior action.

In Rem Proceedings.
If the court is unable to obtain personal jurisdiction over a person using stolen IT, the court may proceed in rem against any products sold in the state for which the person using stolen IT holds title. Before the enforcement of an attachment order, the court must notify any

person in possession of the products about the pending attachment order. Any person for whom the products were made or to whom the products were given, under a contract or purchase order, may either show that he or she has an affirmative defense or may post a bond to stay enforcement of the order. If the court fails to provide notice, a third party may seek a stay of the enforcement of the attachment order for 90 days.

If a person is proceeding in rem or seeks injunctive relief, the person must show he or she suffered material competitive injury, which means at least a 3 percent retail price difference over a period of four months between the person's product and the product made with stolen IT.

Affirmative Defenses for Third Parties.
A court may not award damages against a third party if the third party establishes that: (1) it is an end consumer or end user; (2) it is a business with annual revenues of no more than $50 million; (3) it does not have a contractual relationship with the person using stolen IT; or (4) it acquired the products in reliance on a code of conduct applicable to its manufacturers or, in general, undertook commercially reasonable efforts to implement a code of conduct with its manufacturer regarding the use of stolen IT. The steps a third party must take to establish an affirmative defense based on "commercially reasonable efforts" are set forth in the bill.

The court may not enforce any damages award against a third party until after it has ruled on the third party's affirmative defenses. Prior to its ruling, the court may allow discovery only on the particular defenses raised by the third party. The court must allow discovery against a third party on an issue only after all discovery on that issue between the parties has been completed and there is an unresolved issue of material dispute between the parties.

Consumer Protection Act.
The remedies provided in the bill are the exclusive remedies for the parties. The CPA does not apply.

Amended Bill Compared to Engrossed Substitute Bill:

The striking amendment does the following: (1) amends the definition of "copyrightable end product" to include mask works protection; (2) clarifies that the written notice to third parties must be properly served to the third party's agent for service of process; (3) provides that in an action brought by a private plaintiff, the court may award all litigation expenses, including discover expenses, incurred by a third party under certain circumstances; (4) adds language stating that the third party need take no additional action to fully avail itself of the affirmative defense based on written directives; (5) provides that when there is a dismissal of an action due to the existence of a previous action already adjudicated in another jurisdiction regarding the same stolen IT, the dismissal is final and no other action may be brought; and (6) specifies that the damages that may be awarded against a manufacturer or third party are "direct" damages.

Appropriation: None.

Fiscal Note: Available.

Effective Date of Amended Bill: The bill takes effect 90 days after adjournment of the session in which the bill is passed.

Staff Summary of Public Testimony:

(In support) This bill has been through many substantial negotiations. The bill has been diligently negotiated and includes comments from companies such as Amazon, Verizon, and others. Everyone is aware that there is a very serious problem of stolen IT that is costing Washington jobs and revenue. Theft of American technology has been a problem for a long time. There is a piracy rate in Asia of over 80 percent. The products made in those countries are destined to come to the United States and it is unfair to law-abiding companies in this state who play by the rules. The tools that exist now are insufficient. This is a new legal mechanism to address a serious problem. Responsible businesses do not need to worry about this bill. The bill does not impose direct liability on people who are not manufacturers. It gives parties up to six months to cure illegal use. It does not apply to a vast majority of retailers with business of less than $50 million in revenue. Small and medium size businesses do not have extensive supply-chain management practices, so the $50 million cutoff is meant to reach companies that already have existing supply-chain practices. For those businesses that are subject to the bill, they are asked to adopt safe harbors. The bill does not cover food, drugs, or services. It does not ask Washington businesses to police their supply chains. The bill creates an incentive for people to use legal practices. Under the bill, the owner of stolen IT must first send notice to the manufacturer specifying the nature of the stolen use and evidence. The manufacturer has 90 days, which can be extended, to adopt legal practices. If it does not, then a direct contracting party is put on notice and that party can get into one of the safe harbors by sending a notice to the manufacturer directing them to act legally. If title to the products has already passed to the retailer, then those products cannot be attached. But if products can be attached, then notice is given to the person in possession of the goods and the person has time to get into a safe harbor. There are new opponents to the bill that have come forward after the negotiation process. If opponents would like to suggest changes, that is warranted. However, if the opponents want to keep the status quo, then that is not satisfactory. Anything the Legislature can do to protect intellectual property is paramount. There is no value in intellectual property if it is not protected and there would be no incentive to create it.

(Opposed) This is a complicated bill and it is difficult to understand the bill as it is written. It would be prudent to take a step back, study this in the interim, and then come back. It is confusing on how the bill would impact organizations and what level of liability they are exposed to. The fiscal note did not consider the cost to the court systems. There is not a very high burden of proof to be able to bring lawsuits against a company. Section 6 of the bill allows a third party to be added to the action and allows for the award of damages against a third party. These are not insignificant damages. The bill requires a third party to mount an affirmative defense. Section 7 of the bill provides that if there is no personal jurisdiction, then the court can proceed in rem. This impacts Washington businesses. This bill is not the answer to the problem. It does not protect the industry. It is burdensome and places undue requirements on businesses. The bill does not accomplish the goal of reducing piracy or stem the use of illegal software. It would tie businesses up in litigation. It holds companies liable

for the acts of their suppliers. The bill has broad and undefined language which will have unintended consequences. Businesses would avoid doing business here to avoid litigation. No amount of revision would make this bill acceptable. There are provisions under federal copyright law that can be used and trade sanctions can also be used to address the problem. Making cars requires thousands of suppliers. The investigation provisions of the bill could interrupt the supply chain and General Motors' ability to make and deliver its products. This impacts out-of-state and international transactions and raises constitutional issues regarding the commerce clause. Retailers already try to resolve these issues with their manufacturers, and these contract disputes should be left between the parties.

Persons Testifying: (In support) Senator Brown, prime sponsor; Nancy Anderson, Microsoft; Lew McMurran, Washington Technology Industry Association; and TK Bentler, Motion Picture Association of America.

(Opposed) Jim Halstrom, International Business Machines Corporation; Mark Johnson, Washington Retail Association; Charlie Brown, Fred Meyer; and Rene Albury, Software and Information Industry Association.

Persons Signed In To Testify But Not Testifying: None.