Legal Backgrounder

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RULING ON COMMON LAW IN TRADE SECRET DISPUTES MAY EXPAND TRADE COMMISSION CASELOAD

by
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Companies are fighting intellectual property disputes at the U.S. International Trade Commission (ITC) in record numbers. From 2000 to 2011, there was a 530% increase in cases brought under 19 U.S.C. § 1337, "Section 337" for short. A rise in Section 337 proceedings involving high tech products, such as smartphones and tablet computers, and a huge swell of cases against Chinese companies since 2000 have both indisputably contributed to this increase. But as this LEGAL BACKGROUNDER explains, it is important not to overlook the impact two developments in federal court have had on the ITC's expanding § 337 docket, developments which will propel the caseload increase well beyond 2012.

Section 337 Basics. Section 337 has two distinct prongs. The first prevents the importation and sale in the United States of articles that infringe a valid and enforceable U.S. patent, copyright, or trademark ("Statutory Intellectual Property Violation"). 19 U.S.C. § 1337(a)(1)(B)-(E). The second prevents "[u]nfair methods of competition and unfair acts" in the importation or sale of such articles in the United States which injure or threaten U.S. commerce ("Nonstatutory Unfair Practices In Importation Violation"). 19 U.S.C. § 1337(a)(1)(A). "Unfair practices" is a broad umbrella that includes, among other causes of action, misappropriation of trade secrets, trade dress infringement, passing off, false advertising, and violations of the antitrust laws.

Statutory Intellectual Property Violation cases represent the vast majority of claims brought under Section 337. A complainant (plaintiff) must show: (1) she is the owner or exclusive licensee of a valid, enforceable, and federally registered patent, copyright, or trademark; (2) the articles which are the subject of the 337 action infringe that intellectual property right; (3) those articles are imported into the United States; and (4) an "industry in the United States" with respect to the articles protected by the intellectual property right at issue exists or is in the process of being established. Significantly, there is no injury requirement.

In a Nonstatutory Unfair Practices In Importation Violation case, a complainant must establish: (1) an unfair method of competition or an unfair act in the importation of certain merchandise exists; (2) the effect or tendency of this unfair method or act is to destroy, to substantially injure or to prevent the establishment of an industry in the United States (or to restrain or monopolize U.S. commerce); and (3)

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the complaining party qualifies as an "industry in the United States."

Judicial Inspiration for Upswing in Patent Cases. The ITC's nationwide *in rem* jurisdiction and extraordinary power to exclude imported products from the U.S. market have made it an attractive forum for intellectual property holders. The ability to argue cases before knowledgeable judges with an exclusive intellectual property docket and the sheer speed of ITC proceedings further cement its strong reputation. These two factors have consistently led patent holders to seek ITC involvement. According to some commentators, recent federal court opinions and the increased aggressiveness of "non-practicing entities," have created further incentives for property owners' migration to the Commission.

In 1988 legislative amendments to Section 337, Congress clarified that licensing and other related activities are sufficient to meet the domestic industry requirement. The legislative changes were in response, in part, to the ITC's denial of a Warner Brothers' copyright claim in the *Gremlins* case. There, Warner Brothers claimed injury to its business in merchandise bearing registered "Gremlins" copyrights. In *Gremlins*, the ITC found that Warner Brothers had failed to establish a domestic industry despite substantial investment in the extensive licensing of its intellectual property. Shortly after the ITC's decision, there were calls on Capitol Hill to "avoid unfortunate results which have occurred in some recent cases, such as *Gremlins*." 132 Cong. Rec. H. 1782, 99th Cong., 2nd Sess. (Apr. 10, 1986) (citing Rep. Kastenmeier).

In the early 1990s, a new business model emerged where non-manufacturing firms focused on purchasing and asserting patents through licensing and litigation. Pejoratively termed "patent extortionists" and later "patent trolls," these plaintiffs are now sometimes referred to as "non-practicing entities" (NPE), a broader term which can encompass inventors, universities, start-ups, and others who do not engage in manufacturing but do conduct R&D, engineering, or licensing activities. Given their focus on licensing, NPEs were in a position to become unintended beneficiaries of Congress's 1988 Section 337 reforms.

In addition to those reforms, a 2006 Supreme Court ruling further pushed NPEs towards the ITC. *Ebay, Inc. v. MercExchange*, 547 U.S. 388 (2006), raised the bar on patent plaintiffs' attempts to obtain injunctions in federal court. Justice Kennedy's concurrence in *Ebay* noted the tactics of "firms [who] use patents not as basis for producing and selling goods but, instead, primarily for obtaining licensing fees." Following this thinly veiled swipe at NPEs, district court judges now subtly factor in whether granting an injunction under *Ebay* would be used by plaintiffs as a bargaining tool to charge exorbitant licensing fees.

Ebay requires federal judges overseeing patent cases to apply the traditional four-part equity test affirmed by the Court in *Winter v. Natural Resources Defense Council, Inc.*, 129 S. Ct. 365 (2008). A patent plaintiff seeking an injunction must establish: (1) she is likely to succeed on the merits; (2) is likely to suffer irreparable harm in the absence of preliminary relief; (3) that the balance of equities tips in her favor; and (4) that an injunction is in the public interest. The *Ebay* and *Winter* rulings apply only to federal courts and *not* to ITC proceedings, a distinction that certainly has not been lost on NPEs.

Some commentators have questioned the roles *Ebay* and the rise of non-practicing entities have played in the increase of Section 337 cases. They cite data on complainant filings that senior ITC staff compiled and released in mid-June of 2012. *Facts and Trends Regarding USITC Section 337 Investigations*. The source of the surge, what should be done about it, and whether NPEs should be entitled to ITC relief is currently being debated on Capitol Hill. While interest groups argue over legislative proposals, the ITC continues to add new courtrooms and capacity.

Federal Common Law for Trade Secret Cases. A Federal Circuit decision in *TianRui Group Co. v. ITC*, 661 F.3d 1322 (Fed. Cir. 2011) may also generate additional Section 337 investigations. The court's ruling arose from a complaint filed by Amsted Industries Inc. (Amsted) at the ITC.

Amstead owns two secret processes for manufacturing cast steel railway wheels—the "ABC process" and the "Griffin process." Amsted no longer uses the ABC process in the United States but licensed it to several firms in China. TianRui sought to license Amsted's ABC process in 2005, but the parties could not agree on terms. Following the failed negotiations, TianRui hired nine employees from Datong, one of Amsted's Chinese licensees. While at Datong, the nine employees were advised that the ABC process was confidential and proprietary, and eight signed a confidentiality agreement. Amsted and TianRui (through a joint venture) were the only companies selling or attempting to sell cast steel railway wheels in the United States.

Following a ten-day evidentiary hearing, the ITC Administrative Law Judge (ALJ) found that TianRui had misappropriated 128 trade secrets related to the "ABC process." Some of the TianRui specifications even contained the same typographical errors found in the Datong documents, and the evidence included an admission by TianRui's expert that its foundry used the asserted trade secrets. The ALJ found that TianRui exploited Amsted's trade secrets in producing the subject goods.

In the Federal Circuit, TianRui argued against the extraterritorial application of U.S. law, claiming that Section 337 does not authorize the ITC to apply Illinois state secrets law to activities occurring wholly within China. They argued further that the ITC's domestic industry analysis was incorrect. The ITC reframed the issue. Instead of arguing the proper reach of Illinois trade secret law, ITC lawyers focused on the application of Section 337 to address unlawful importation of products. Complainant Amsted, filing an intervenor brief, argued that the ITC properly applied Illinois trade secret law. Both Appellee and Intervenor argued that the ITC's finding on domestic industry was correct.

The Federal Circuit majority opinion examined whether Section 337 authorizes the ITC to apply domestic trade secret law to conduct that occurs in part in a foreign country. The dissent characterized the issue as whether to apply domestic trade secret law to conduct that occurs *entirely* in a foreign country.

As a matter of first impression, the majority rejected Amsted's argument that Illinois trade secret law governs the inquiry. Instead, it held that a single federal standard determines what constitutes a misappropriation of trade secrets sufficient to establish a violation of Section 337. In short, the issue is one of federal law and should be decided under a uniform federal standard rather than by reference to a particular state's tort law.

In deciding that Section 337 applies to imported goods developed using trade secrets stolen in China, the Federal Circuit recognized the longstanding presumption that congressional legislation is meant to apply only within the territorial jurisdiction of the United States. *See EEOC v. Arabian Am. Oil Co.*, 499 U.S. 244, 248 (1991) (*Aramco*). Nonetheless, it found that the presumption against extraterritoriality did not govern TianRui's appeal for three reasons.

First, drawing an analogy to immigration statutes, the Federal Circuit noted the focus of Section 337 concerns an inherently international transaction, *i.e.*, importation. Second, it found the ITC did not sanction purely foreign conduct. Rather, Section 337 relates to when the importation of goods into the United States causes domestic injury. Section 337 does not technically police foreign business practices because the foreign conduct is used only to establish an element of a claim that alleges a domestic injury and seeks a wholly domestic remedy. Finally, the legislative history of Section 337 reflects that the ITC may consider conduct that occurs abroad.

On the domestic industry issue, the majority found that Section 337 contains different requirements when comparing statutory intellectual property cases (19 U.S.C. § 1337(a)(1)(B)-(E)) and nonstatutory unfair practices in importation cases (19 U.S.C. § 1337(a)(1)(A)). An industry will be deemed to exist for patents, copyrights, and registered trademarks if there is significant domestic investment or employment relating to the protected articles. Because there is no express requirement in trade secret cases that the domestic industry relate to the intellectual property involved in the investigation, and because the general provisions relating to unfair practices require that the unfair practices threaten to destroy or substantially injure a domestic industry, the court dismissed TianRui's appeal. Appellant's request for rehearing *en banc* was denied, and it did not petition for a *Writ of Certiorari* to the Supreme Court.

***After* TianRui**. In sum, the Federal Circuit clarified that Section 337 applies to the theft of trade secrets even when the misappropriation occurs wholly outside of the United States when articles made using the subject trade secrets are imported into the United States. The decision clearly broadens the protection of Section 337 available to trade secret owners. Whether it will expand the number of trade secret cases filed at the ITC has yet to be confirmed, but early signs indicate it will.

For example, a recent trade secret dispute involving Richtek Technology, a Taiwanese company, indicates that Section 337 may be the only mechanism a trade secret owner which had its rights infringed upon overseas has to enforce its rights in the United States. There, Richtek sued its Taiwanese competitor, uPI, at the ITC and in district court alleging trade secret misappropriation and patent infringement. The district court dismissed the trade secret claims, holding that it did not have subject matter jurisdiction over such claims because, among other reasons, they occurred abroad. The ITC, on the other hand, issued a consent order against uPI to prevent it from importing products made using the subject trade secret, and the ITC is currently investigating whether uPI violated its consent order. Such jurisdiction and potential relief is, evidently, not available in district court.

In another case filed at the ITC on May 21, 2012, SI Group alleged misappropriation in China of trade secrets relating to rubber resins, including tackifiers (chemical compounds used in rubber formulations to increase the tackiness of the surface of the rubber compound). SI Group had initially sought relief against Sino Legend and its affiliated entities in China by filing a Chinese "report for crime" in November 2008 and initiating Chinese civil proceedings in February 2010. The ITC complaint alleges the Chinese courts have not taken action to stop the misappropriation.

Other high profile trade secret cases are arising in China. For instance, American Superconductor Corp (AMSC), a U.S. maker of wind-turbine components, is pursuing four suits in China against Sinovel Wind Group Co., formerly AMSC's largest customer. AMSC is seeking more than $1.2 billion in damages. Sinovel stopped accepting contracted shipments in March 2011, and AMSC accused Sinovel of stealing its technology. Reportedly around the same time, a former AMSC employee in Austria was sentenced to a year in jail after pleading guilty to crimes, including economic espionage for obtaining software and source code for Sinovel. Whether AMSC or others will turn to the ITC for relief under Section 337 remains to be seen. But post-*TianRui*, if Sinovel's products are imported into the United States, clearly Section 337 reaches the alleged misappropriation, even if it occurred abroad.