

# CALIFORNIA

## EMPLOYMENT LAW LETTER

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### TRADE SECRETS

#### **Court revives malicious prosecution case against law firm**

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*An employer sued its former employees for misappropriation of trade secrets. The court ruled in favor of the employees, found that the employer had filed the case in bad faith, and ordered it to pay over \$1.6 million to the employees for their attorneys' fees and costs.*

*After that order was affirmed on appeal, the employees sued the employer's law firm for malicious prosecution. The law firm succeeded in having the case dismissed on the grounds that the employees could not establish a probability of prevailing on the malicious prosecution action. The California Court of Appeal reversed and reinstated the case against the law firm.*

#### ***Employer sues for misappropriation of trade secrets***

FLIR Systems, Inc., purchased Indigo Systems Corporation, a company that manufactures microbolometers, which are devices for detecting infrared radiation used for infrared cameras, night vision, and thermal imaging. William Parrish and E. Timothy Fitzgibbons worked for FLIR. During their employment, they presented a business plan proposing that the company outsource the manufacturing of microbolometers. They left FLIR in 2006 and pursued a plan for a new business that also involved outsourcing the manufacturing of similar products.

FLIR took the position that the business plan presented by Parrish and Fitzgibbons constituted the company's intellectual property and that the former employees had no right to use it. Parrish and Fitzgibbons

assured FLIR that they had no intention of using its intellectual property and explained that the business plan they were using was not its intellectual property because Fitzgibbons had created it *before* he started at Indigo, FLIR's predecessor.

**The court of appeal chastised Latham for pursuing the case based on an invalid legal theory.**

While these discussions were ongoing, Parrish and Fitzgibbons were deep in negotiations with Raytheon, a defense manufacturer, to proceed on a new business venture involving the manufacturing of microbolometers. While those negotiations were occurring, FLIR hired the law firm of Latham & Watkins and filed suit against Parrish and Fitzgibbons for misappropriation of trade secrets. It asserted that its former employees' new business plan made improper use of its intellectual property in violation of the Uniform Trade Secrets Act (UTSA). Once Raytheon learned of the lawsuit, it broke off all further negotiations with Parrish and Fitzgibbons.

Lawyers for Parrish and Fitzgibbons sought to convince Latham that the business plan at issue could not be FLIR's trade secret because it had been conceived before either of them had gone to work for Indigo and because the new business plan envisioned licensing intellectual property from Raytheon and could not have come from FLIR. In response, FLIR changed its theory of the case. Before this exchange of information, Latham had asserted that the *business plan itself* constituted FLIR's trade secret. After the exchange, Latham asserted that the only way for Parrish and Fitzgibbons to bring production of microbolometers to market within their projected timeline was to use FLIR's intellectual property, effectively identifying technology related to the microbolometer as the

Parrish and Fitzgibbons moved for summary judgment (i.e., asked the court to determine there were no disputed issues of significant fact and that they were entitled to judgment in their favor). The court denied the request, and the case went to trial before a judge. The judge ruled in favor of Parrish and Fitzgibbons, concluding that FLIR had filed the action in bad faith and awarding the former employees over \$1.6 million in attorneys' fees and costs.

After an appellate court affirmed the trial court's decision, Parrish and Fitzgibbons sued Latham for malicious prosecution. They argued that the firm had filed and pursued the underlying case with malice and without probable cause and that it knew FLIR had an anti-competitive purpose in filing the action. Latham asked the court to dismiss the case under California's "anti-SLAPP" statute. ("SLAPP" is an acronym for "strategic lawsuits against public participation.")

The trial court granted the anti-SLAPP motion and dismissed the case on the grounds that Parrish and Fitzgibbons had filed the malicious prosecution action too late under the applicable statute of limitations. Parrish and Fitzgibbons appealed. The California Court of Appeal reversed the decision and sent the malicious prosecution action back for trial.

### ***Standards for malicious prosecution actions***

As an initial matter, the court of appeal determined that the trial court had relied on the incorrect statute of limitations in granting Latham's anti-SLAPP motion. As a result, Parrish and Fitzgibbons had filed their case against Latham within the allowable time period. So

the key issue presented to the court of appeal became whether, under the anti-SLAPP statute, the former employees could establish a probability of prevailing in the malicious prosecution action.

To prove malicious prosecution, a plaintiff must show that the underlying action was:

- (1) Commenced by or at the direction of the defendant and pursued to a legal termination in the plaintiff's favor;
- (2) Filed without probable cause; and
- (3) Initiated with malice.

"Probable cause" is a low threshold designed to protect a litigant's right to assert arguable claims even if they are extremely unlikely to succeed. Probable cause exists if any reasonable attorney would have thought the claim tenable.

### ***Court reinstates employees' case***

Latham argued that because the trial court had denied the motion for summary judgment filed by Parrish and Fitzgibbons in the underlying trial for misappropriation of trade secrets, it necessarily meant that FLIR and Latham had "probable cause" to file the case. The court of appeal disagreed. Although the trial court had denied summary judgment, at trial the court had the opportunity to hear all the witnesses—and particularly to assess the credibility of FLIR's experts—and the court found that the action had been filed in bad faith and awarded attorneys' fees and costs to the former employees.

The court of appeal chastised Latham for pursuing the case based on an invalid legal theory under

California law. After FLIR and Latham learned that Fitzgibbons had in fact developed the business plan before working for Indigo, they conceived of a new legal theory charging *not* that the former employees had misappropriated trade secrets but that it was impossible for them to pursue their new plans with Raytheon without using FLIR's trade secret technology. This new legal theory depended on the "inevitable disclosure" doctrine, which permits a trade secret owner to prevent a former employee from working for a competitor if it can prove his new job duties will inevitably cause him to rely on the former employer's trade secrets.

According to the court, the problem for FLIR and Latham was that Latham knew or should have known that the "inevitable disclosure" doctrine is *contrary to California law*. Thus, it effectively continued its prosecution of the case based on a faulty legal theory.

Further, the factual basis for Latham's theory relied on expert testimony that had considered only publicly available technology, when the firm knew the former employees intended to license nonpublic technology from Raytheon. And the testimony of FLIR's president indicated that he had no factual basis for asserting that the former employees would use FLIR's intellectual property and strongly implied that the company had filed the case to accomplish a "preemptive strike."

Based on the above, the court of appeal concluded that Parrish and Fitzgibbons had offered sufficient evidence to demonstrate a probability that they would prevail on the issue that FLIR and Latham did not have "probable cause" to file suit. The court of appeal noted that the totality of the evidence supported the conclusion that Latham had pursued an obviously meritless claim. Therefore, the court of appeal reversed the trial court's decision to grant the anti-SLAPP motion and sent the case back to the trial court. *Parrish v. Latham & Watkins* (Court of Appeal, 2nd Appellate Dist., 8/27/14).

## **Bottom line**

Under California law, an employer's attempt to prevent a former employee from going into competition in most cases is considered an unlawful "restraint of trade." To get around that obstacle, many employers broadly define what they perceive as their "trade secrets" and then seek to inhibit former employees from competing by filing suit against them for misappropriation of trade secrets.

In many cases, simply the threat of a trade secrets case is enough to scare former employees into changing their plans. In this case, the court of appeal effectively concluded that the employer and its attorneys went too far in their pursuit of a trade secrets claim and in doing so exposed the employer to paying the former employees' legal fees and exposed the lawyers to a claim for malicious prosecution.

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