Litigation Alert: *FLIR Systems, Inc. v. Parrish*

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The California Court of Appeal's recent opinion in *FLIR Sys., Inc. v. Parrish*, ___ Cal. App. 4th ___, 2009 Cal. App. LEXIS 943 (2d Dist. June 15, 2009) reinforces the need for careful deliberation in determining when and where to seek injunctive relief against trade secret misappropriation by former employees. The court affirmed a judgment both denying an injunction and awarding the ex-employees $1,641,216.78 in attorneys' fees where their former employer was found to have sought an injunction in bad faith—since misappropriation was possible but not actually "threatened" within the meaning of California's Uniform Trade Secret Act ("CUTSA," or Civil Code § 3426).

The key takeaways from *FLIR* are:

- Courts can, and do, impose attorneys' fees as sanctions against those who pursue CUTSA claims for injunctive relief in "bad faith";
- "Bad faith" can be established based on a finding that the suit was brought prematurely—*e.g.*, against an ex-employee who possesses, but does not imminently threaten to use or misuse, the trade secret; and
- Other factors that demonstrate "bad faith" include: unreasonable settlement demands, or ones which restrain trade; pursuit of injunctive relief broader than what is protectable by the trade secret; and, the continued pursuit of claims on legal theories expressly rejected by California courts.

THE FACTS

In 2004, appellant FLIR acquired the assets and intellectual property of Indigo, a manufacturer and seller of microbolometers, devices used with infrared cameras and night vision equipment. Respondents were officers at Indigo and continued to work there after the FLIR acquisition. In 2005, respondents decided to start a new company to sell microbolometers based on a pre-existing business plan developed before their work at Indigo. Respondents intended to partner with Raytheon for product development and/or licensing. Fearing that this new business would undermine their own market, FLIR sued for permanent injunctive relief under CUTSA on June 15, 2006. FLIR premised its claim on the theory that respondents could not mass produce low-cost microbolometers based on the timeline they projected in their business plan without misappropriation of trade secrets—*i.e.*, the misappropriation was inevitable if they intended to go to market so quickly.

For FLIR to have succeeded in this CUTSA claim, it would have had to demonstrate that trade secret misappropriation was "threatened," which can be established through evidence that the former employee (1) had previously misused or misappropriated the employers trade secret, which now remains in his or her possession; (2) intends to disclose the trade secret; or, (3) wrongfully refuses to return the trade secret. *See Central Valley General Hosp. v. Smith*, 162 Cal. App. 4th 501 (2008). FLIR could not establish a "threat" because respondents had been unable to obtain funding for the new company, and it "was uncontroverted that respondents . . . did not start a new business, had no employees or customers, did not lease a facility or develop technology, and did not design produce, sell, or offer to sell infrared product." *FLIR*, 2009 Cal. App. LEXIS 943 at * 4. Nor was there any ongoing wrongdoing. *Id.* at * 10. The trial court thus went on to find that the suit had been brought in bad faith in the absence of any threat, and awarded attorneys fees to respondents.

On appeal, the court agreed that FLIR had maintained the suit in bad faith—predominantly because FLIR premised its claims on the impermissible theory of "inevitable disclosure." The "inevitable disclosure" doctrine allows a trade secret owner to enjoin former employees from working for competitors on the grounds that employment would inevitably implicate use of trade secret knowledge. *See, e.g., Whyte v. Schlage Lock Co.*, 101 Cal. App. 4th 1443, 1462 (2002). California courts have rejected the doctrine because "it contravenes a strong public policy of employee mobility that permits ex-employees to start new entrepreneurial endeavors." *FLIR*, 2009 Cal. App. LEXIS 943 at * 5. Instead, claimants must demonstrate an actual threat of misuse. Where there is merely a "speculation" that a departing employee may misappropriate and use a trade secret in a startup business, injunctive relief under CUTSA is not available, and the absence of a true threat can also be indicia of bad faith for purposes of awarding attorneys' fees. *Id.* at * 10.

The Evidence Supporting "Bad Faith"

The most interesting aspects of *FLIR* are those factors the Court of Appeal found to be evidence of FLIR's bad faith. "Bad faith" under CUTSA is determined through application of the two-pronged *Gemini* test: 1) objective speciousness of the trade secret claim, and (2) subjective bad faith in bringing or maintaining the trade secret claim, *i.e.* for an improper purpose, such as a restraint on trade. *Id.* at * 5.

As to the first *Gemini* prong, the following facts, among others, evidenced FLIR's "objective speciousness":

- FLIR suffered no economic harm because no business was actually formed by respondents, despite their expressed intention to;
- FLIR's executives gave testimony evidencing their "anticompetitive motive" in filing the lawsuit, namely their concerns that respondents intended to compete with FLIR, and their lack of personal knowledge of any actual or threatened trade secret misuse; and
- FLIR pursued an action based not on threatened misappropriation or ongoing wrongdoing, but rather on the "inevitable disclosure" doctrine, which is not a viable legal theory in California.

As to the second *Gemini* prong, the Court of Appeal found that "subjective bad faith" or "improper motive" was established by, among other things:

- FLIR's assertion that respondents were lying about working "cleanly" with Raytheon to develop their own microbolometers, where uncontroverted testimony presented by respondents and Raytheon suggested they were, indeed, working together to do that;
- FLIR's failure to identify the trade secrets with specificity suggested that FLIR intended to get an injunction to cover both trade secret and non-trade secret aspects of the technology—constituting an unlawful restraint on trade; and
- FLIR's imposition of "inflammatory" settlement conditions, including non-competition requirements, evidenced that the suit was filed to squelch competition.

Important Lessons

What if the respondents *had* been able to find funding, or succeeded in getting the business off the ground? What actions by respondents would have amounted to more than a speculation of intent to misuse? When, if ever, could FLIR have filed suit? While the absence of threatened misappropriation or wrongdoing may have been fairly cut-and-dry in *FLIR*, it is a reminder of the uncertainty businesses face when seeking to protect their trade secrets at some point short of their dissemination and misuse.

One thing *FLIR* does make certain in this regard is that pursuit of CUTSA claims prior to a former employee's threat to use the trade secrets may result not only in dismissal or judgment against the trade secret owner, but also an award of attorneys' fees to the former employee. *FLIR* also raises the importance of the forum in which trade secrets rights are pursued. Some courts, like those in New York, for example, have expressly adopted the "inevitable disclosure" doctrine in connection with injunctive relief. If *FLIR* had been tried there, it may have had a very different result. Counsel can assist in advising both about whether circumstances are ripe for seeking relief, and the consequences of litigating in various jurisdictions.

Finally, *FLIR* also presents an interesting interplay with last year's decision by the California Supreme Court in *Edwards v. Arthur Anderson*, 44 Cal. 4th 937 (2008). In that case, the Court unequivocally held non-compete provisions invalid in California, except in limited situations where expressly authorized by code provisions, or where necessary to protect trade secrets. There has been much speculation about what this "trade secret exception" in *Edwards* really means, and whether companies can permissibly prohibit ex-employees from soliciting their customers or clients. While the law evolves in this arena, in the meantime *Edwards* may be read consistently with *FLIR* to mean that agreements must not restrict the fields in which ex-employees can practice, and relief from trade secret misappropriation is alternatively available through CUTSA, provided that misuse by the ex-employee is actually "threatened."

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