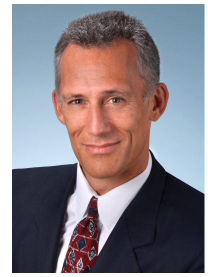
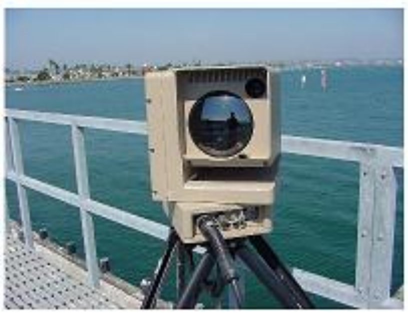
$1.6 MILLION SANCTION AWARD SENDS A LOUD MESSAGE -- INEVITABLE DISCLOSURE REALLY IS DEAD AND BURRIED IN CALIFORNIA



By Michael D. Young *

You've probably heard about the inevitable disclosure doctrine. It's a great trick for employers. It's like getting all the benefits of a non-compete without actually having to bother with those nettlesome non-compete agreements.

Just don't try it here in California.



[A Flir infrared imaging system utilizing a microbolometer array]

At least not without a sizeable bankroll and a Get Out Of Jail Free card, as Flir Systems, Inc. learned the hard way. It was sanctioned $1.6 million for seeking to invoke the doctrine in a California trade secret case.

This is just one of the many lessons provided to us by the California appellate court in the case of *Flir Systems, Inc. v. Parrish* (2d Civ. No. B209964, June 15, 2009).

For those of us who practice trade secret law, it's a good read.

THE INEVITABLE DISCLOSURE DOCTRINE

The inevitable disclosure doctrine is a judicial creation aimed at protecting an employer's trade secrets. It comes up when a former employee accepts a new position with a new employer that, because of the new job's requirements, *would inevitably require* the employee to *disclose* or use the original employer's trade secrets. Even though the former employee hasn't yet misused or disclosed anything, a former employer can run into court to obtain an injunction forbidding the employee from taking that job with the competitor.

This has happened recently in a few high profile cases around the country (see, for example, *IBM Corp. v. Papermaster*, where IBM had some initial success with the doctrine in preventing a top executive from working at arch rival Apple.)

Pretty nifty… if you're an employer.

Unless, of course, you are a California employer, in which case it is *totally irrelevant.*

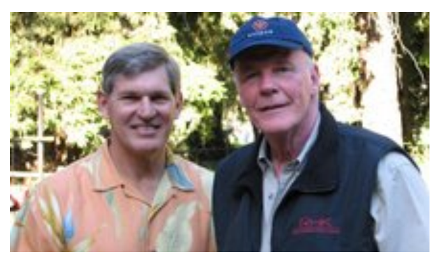
Seriously, you didn't think this would work here, did you, in the land of Free Employee Mobility where non-competes are persona non grata?

Let's take a look at *Flir*.

FLIR – THE MICRO FACTS

Here is the very short version of the facts: In 2004, Flir bought a high tech company (a company that sells microbolometers if you must know) for $185 million. The key employee and inventor was William Parrish (seen below with colleague and fellow defendant, Tim Fitzgibbons). In 2005, Parrish decided to start a new company (one that would, coincidentally enough, mass produce bolometers), and offered Flir an opportunity to buy into the new company, an opportunity Flir declined. Parrish thus entered into negotiations with Raytheon to license necessary technology and obtain manufacturing facilities.

Significantly, Parrish told Flir he would not use, and did not need, any of Flir's trade secrets.



William Parrish and Tim Fitzgibbons

Flir felt this new company would nonetheless be competitive and, regardless of what Parrish said, believed Parrish could not operate it without relying on Flir's own trade secrets.

So Flir did what many employers do when threatened…it sued. According to the appellate court, the action, which was filed in Santa Barbara County, "was premised on the theory that respondents could not mass produce low-cost microbolometers based on [the new company's aggressive time line] without misappropriating trade secrets." In other words, it's not that Parrish did anything wrong yet, it's just that, in Flir's mind, Parrish would need to misuse Flir's secrets to accomplish the aggressive business plan he had developed.

(If you are paying attention, you should be seeing inevitable disclosure written all over this.)

Once filed, Raytheon backed out of the new deal, and Parrish's business never got off the ground. It went nowhere.

(Now, if you are really paying attention, you should be thinking to yourself right now, "aha, no damages to Flir, no risk of future damages, and therefore no need to continue the lawsuit." Oh, if only Flir had thought of that. It would be a few million dollars richer today.)

FLIR'S PRELIMINARY INJUNCTION EFFORT

Instead, Flir maintained the lawsuit, seeking a preliminary injunction that restrained Parrish from, among other things:

> a) Misusing Flir's trade secrets [Seriously, do you really need this? Parrish is already prohibited from misusing Flir's trade secrets. That's what the California Uniform Trade Secret Act is all about. Do you really need to sue to turn this statutory prohibition into an injunction?]; and
>
> b) Selling the microbolometers within 12 months of licensing technology from Raytheon [presumably on the assumption that the only way Parrish could produce microbolometers so quickly would be by relying on Flir's secret stuff. Sound familiar? It's another effort to apply the inevitable disclosure doctrine to prevent Parrish from competing].

THE TRIAL

This section of the story is pretty simple. The trial court found that Parrish neither misappropriated, nor threatened to misappropriate, Flir's secrets. This shouldn't be a surprise considering Parrish not only had no new business, he had no funding for a new business, had no employees, had no customers, no facilities, no technology, and no product. (But other than that….)

THE SANCTION

Because the judge found the action to have been brought in bad faith, based as it was on the discredited inevitable disclosure doctrine, he awarded Parrish *$1.6 million in attorneys fees and costs*. (Not bad. Of course poor (or not so poor) Parrish requested fees and costs totaling $2.7 million. That must have been some bench trial.)

THE LESSONS LEARNED

This opinion, I think, provides employers and their counsel with a number of valuable lessons, some more obvious than others:

1) <u>The obvious</u>: Inevitable Disclosure is still dead and buried in California. The state's "strong public policy" in employee mobility – reflected in the 147 year old statute now residing at Business & Professions Code Section 16600 – simply overpowers judicial doctrines that conceivably could restrain that freedom. Speculation that a former employee might take an employer's crown jewels and run off with them is not enough to secure an injunction; one must show actual misuse of a trade secret, or a substantial threat of impending injury. Flir did neither.

2) <u>Also obvious</u>: Don't maintain a trade secret case after you learn that the former employee not only abstained from engaging in competitive activity with your trade secrets, he indeed doesn't even have your secrets. (You'd think some things wouldn't need to be spelled out.)

Here, Flir maintained its lawsuit even after Raytheon pulled out of Parrish's new venture and Parrish stopped all activities to pursue it. Hence, there were no damages, and there was no threatened use of trade secrets.

3) <u>No Prohibitory Injunctions</u>: (Granted, this lesson is a bit geeky, but interesting nonetheless to trade secret junkies.) According to the *Flir* court, injunctions under California's Uniform Trade Secret Act must be *mandatory*, not *prohibitory*. In other words, under the Act, a court's injunction must demand that the defendant *do something* (like return the trade secrets). It cannot simply *prevent* the defendant from doing something (like don't misuse secrets in the future). (See Civil Code Section 3426.2 (c).)

In this case, where Parrish wasn't doing anything, the only injunction Flir could ask for was a prohibitory one (don't misuse Flir's secrets). Because this was facially invalid under the law, the Court recited Flir's improper injunction request as another example of its bad faith justifying the sanctions award.

4) <u>The attorney's fee provision in the California Uniform Trade Secret Act (Civil Code Section 3426.4) has teeth</u>: Go figure. More than that, the provision for fees is not simply a cost shifting mechanism, it is considered a sanction. Why is this important? Because trial courts are given wide discretion in awarding sanctions, which means appellate review is very narrow. In other words, it is easier to get and to keep a sanction award, even when it is $1.6 million.

5) <u>Here's a tip</u>: If you're the plaintiff employer, don't have an arrogant CEO testify that he brought the lawsuit for anti-competitive purposes.

Here, when asked why he brought the lawsuit, Flir's CEO testified it wouldn't be "healthy for [Parrish] to go and directly compete with us." The company "couldn't tolerate a direct competitive threat by [Parrish and Fitzgibbons] because it would fly in the face of everything that we spent 200 million dollars to buy."

(Why not just admit that he brought this lawsuit in bad faith to prevent competition? Oh, wait, that's what he just did.)

It didn't help that Flir's own employees had nothing but nice things to say on the stand about Parrish.

6) *Don't have your trade secret experts make stuff up*! You might think this lesson is self-evident, but apparently not.

In response to Parrish's motion for summary judgment, Flir submitted a declaration from its "trade secret expert" that said (and I will quote the court just to prove that I am not making this up) "*there was a scientific methodology to predict the likelihood of trade secret misuse*." Presumably, the expert opined that this scientific methodology *predicted* that Parrish would misuse Flir's trade secrets. (Really.)

At trial (and again, I am not making this up), *"[Flir's] experts admitted there was no valid scientific methodology to predict trade secret misuse and agreed that no trade secrets were misappropriated.*" At least the experts came clean.

Not surprisingly, the court found this all to be additional evidence of bad faith that justified the sanctions award.

7) What happened to settlement confidentiality? In looking at whether Flir maintained the action in bad faith (as if the above was not enough), the court reviewed Flir's settlement tactics and found them to be in bad faith as well.

Apparently, after Parrish disclosed his new business plan to Flir, reaffirmed his promise not to use Flir secrets, and offered to have a neutral third party monitor Parrish's technology to verify this, Flir made a settlement demand: It wanted $75,000, a non-competition agreement (in Free Mobility California, really?), a promise not to hire Flir's employees (in Free Mobility California, really?), and a promise not to challenge Flir's patents.

The court found these settlement demands not only to be unrelated to the trade secret issues involved in the lawsuit, but "made for an anticompetitive purpose." It also found that Flir was seeking to impose on Parrish a condition (the no hire provision) that violated basic California public policy. A bad settlement demand became additional fodder for the finding of bad faith warranting sanctions.

(Who said settlement discussions were inadmissible? Had these discussions occurred in mediation, I have no doubt they would have been inadmissible under Evidence Code Section 1119.)

DID FLIR REALLY WIN IN THE END?

With all this, it would seem easy to conclude that Flir took quite a beating. Not only did it lose the case, it had to pay Parrish $1.6 million in legal fees and costs, not to mention its own hefty legal expenses (Latham & Watkins was not cheap last I checked). All that, plus the ignominy of finding itself written up in articles like this one.

On the other hand…

While Flir lost the case, think of this: Parrish did not enter into the competing business. He never started his company, did not enter into a deal with Raytheon, and did not mass produce low cost microbolometers to compete with Flir. Sure it cost Flir a few million dollars, but perhaps, just perhaps, in the end it was worth it….

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