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California Supreme Court to Decide Whether Finding That UTSA Claim Was Filed in Bad Faith Can Revive a Previously Dismissed Malicious Prosecution Claim

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The California Supreme Court's recent decision to review the Second District Court of Appeals' ruling in *Parrish v. Latham & Watkins*, 238 Cal. App. 4th 81 (2015) sets the stage for a potential sea change in the litigation of Uniform Trade Secrets Act ("UTSA") claims, and could lead to an unsuccessful UTSA claimant being subject to a malicious prosecution action.

At the center of the case is the interim adverse judgment rule, which provides a defense to a malicious prosecution claim. The rule allows a party defending a malicious prosecution claim to point to a previous non-final ruling on the merits to prove that there was probable cause for their claim, and thwart a malicious prosecution action. In June of this year, California's Second District Court of Appeals affirmed that the interim adverse judgment rule prevents a party that prevailed on summary judgment from subsequently being named in a malicious prosecution action. However, on October 14, the California Supreme Court granted a petition to review this decision, suggesting the law may soon change in this area.

The *Parish* Case

The appellants in *Parish* were a group of former employees ("Former Employees") of FLIR Systems, Inc. ("FLIR"), a company that specializes in the design, manufacture and marketing of thermal imaging infrared cameras. The Former Employees joined FLIR in connection with its acquisition of Indigo Systems Corporation ("Indigo") – a company that developed and sold a range of infrared imaging products – in 2004. After Indigo was acquired by FLIR and the Former Employees began working for FLIR, they presented the company with a business plan to outsource the manufacture of microbolometers[1] (a product that Indigo developed and sold).

On January 6, 2006, the Former Employees' contracts with FLIR expired and they left the company with the plan of launching a business that would compete with FLIR by outsourcing the manufacture of microbolometers. Upon learning of the Former Employees' plan to compete with the company, FLIR informed the Former Employees that the plan for the competing business was FLIR's intellectual property, as the Former Employees presumably developed it during their

1 A microbolometer is a device that is used as a detector in a thermal camera.

employment with Indigo, and the Former Employees had assigned their intellectual property rights to Indigo. FLIR also contended that the competing business the Former Employees planned to start would necessarily use intellectual property that belonged to FLIR. The Former Employees held several meetings with FLIR over this issue, during which they explained to FLIR that the plan for their new business had been created by one of the Former Employees (Fitzgibbons) before he joined Indigo, and it was not Indigo's intellectual property, and therefore was not FLIR's intellectual property.

On June 15, 2006, FLIR, through its counsel Latham & Watkins ("Latham"), filed a lawsuit against the Former Employees alleging, among various other causes of action, a claim for misappropriation of trade secrets. In its misappropriation of trade secrets claim, FLIR alleged that "on information and belief" the Former Employees had solicited venture capital for their new business by presenting a business plan that misappropriated FLIR's confidential information and trade secrets. After receiving notice of FLIR's lawsuit, counsel for the Former Employees' sent letters to Latham in an effort to prove that the Former Employees' business plan was not FLIR's intellectual property, but the parties were unable to reach a resolution.

The Former Employees' Motion for Summary Judgment is Denied by the Trial Court

In December 2006, the Former Employees moved for summary judgment, arguing that their business plan was not FLIR's intellectual property because it was originally conceived by Fitzgibbons before he joined Indigo, and nothing in their business plan was copied from the business plan they presented to FLIR in 2004. The trial court disagreed and denied the Former Employees' motion for summary judgment, ruling that after reviewing the 1999 business plan and the 2004 business plan the Former Employees presented to FLIR, it was unable to find as a matter of law that FLIR did not own any of the concepts in the Former Employees' 2006 business plan.

The Former Employees Are Awarded Attorney's Fees After Trial Court Rules the USTA Claim Was Filed in "Bad Faith"

After the Former Employees were denied summary judgment, the case proceeded to a bench trial. The Former Employees sought a finding that FLIR's action was brought in bad faith, and requested an award of attorney's fees under the UTSA. The court agreed, ruling that FLIR's complaint "rested on concern and speculation that [Former Employees] would, in the future, misappropriate trade secrets if [Former Employees] started a new, competitive company." The court noted that California law prohibits injunctions based on a former employee's concern and speculation that a departing employee might commit future trade secret use, and the "inevitable disclosure" doctrine that is commonly applied by courts across the country is not followed by California courts.

Significantly, the trial court ruled that the Former Employees' request for attorney fees was not precluded by the court's earlier denial of the summary judgment motion, because the "request for a finding of bad faith was not at issue on the motion for summary judgment," as "[t]he Court had not heard all the evidence or considered witness credibility." FLIR appealed the judgment and attorney fee award but it was affirmed by the appellate court.

The Appellate Court Rules That the Former Employees Cannot Bring a Claim for Malicious Prosecution Against Latham & Watkins Because of the "Interim Adverse Judgment Rule"

On April 6, 2012, the Former Employees filed a malicious prosecution action against Latham, in which they alleged that Latham filed the misappropriation of trade secrets claim against the Former Employees with malice and without probable cause. In response, Latham moved to strike the complaint under the anti-SLAPP (strategic lawsuits against public participation) statute, and contended that the Former Employees could not maintain a malicious prosecution claim because the trial court's denial of summary judgment in the underlying action established that Latham had probable cause to bring the action. After the trial court granted Latham's anti-SLAPP motion on statute of limitations grounds, the Former Employees appealed.

The Appellate Court's Ruling

On review, the Appellate Court agreed with Latham, and ruled that the interim adverse judgment rule precluded the Former Employees' from bringing a malicious prosecution claim, and the trial court's finding that the UTSA claim was brought in "bad faith" did not change this.

Notably, the Court began its analysis by ruling that the trial court's basis for granting Latham's anti-SLAPP motion was no longer valid, due to a recent change in the law governing malicious prosecution actions. As a result, the Court focused on the viability of Latham's argument that the interim adverse judgment rule prevented the Former Employees from bringing their malicious prosecution claim. Reviewing California Supreme Court precedent, the Court held that the interim adverse judgment rule applies with equal force when a trial court concludes that issues of material fact remain for trial, and when a party defeats an interim dispositive motion but later has that decision overturned. Put differently, the Court ruled that unless a trial court determines that a claim has no merit, the interim adverse judgment rule serves to prevent a malicious prosecution claim.

Based on this, the Court rejected the Former Employees' argument that the finding of bad faith in connection with awarding UTSA attorney fees negated the trial court's summary judgment ruling, making the interim adverse judgment rule inapplicable. Critically, the Court held that the trial court's finding that the UTSA claim was brought in bad faith did not mean that there was no probable cause for the UTSA claim. The Court noted that the Former Employees' request for a finding of bad faith was not at issue on the motion for summary judgment, and the Court had not heard all the evidence or considered witness credibility when it denied the motion for summary judgment.

Conclusion

While it is unclear whether the California Supreme Court's decision to review the *Parish* case suggests that the Court disagrees with the Appellate Court's finding, the potential impact of the Supreme Court's ruling is plain. If the Supreme Court rules that a UTSA claim found to be filed in "bad faith" can be used to support a malicious prosecution action – regardless of whether the UTSA claim survived a summary judgment motion, motion to dismiss, or other type of dispositive motion – employers will undoubtedly be forced proceed with additional caution when asserting a UTSA claim.

For now, we will continue to monitor this case and provide an update when the Supreme Court issues its ruling.