



## Addressing Bad Faith Claims Risk in Trade Secrets Cases

Originally published by *Law360*  
February 2, 2012  
Reproduced with permission

**Written By:**  
Matthew F. Prewitt

For the trade secrets plaintiff, the risk of a fee award under Section 4 of the Uniform Trade Secrets Act is all too easy to ignore in the initial stages of litigation. In most jurisdictions, there are few reported decisions addressing the award of fees to a prevailing defendant under the UTSA, and most trade secrets plaintiffs commence litigation persuaded of the defendants' villainy and the justice of their claims.

However, plaintiff's counsel who ignores the client's potential exposure under UTSA § 4 risks serious strategic and client relationship issues as the litigation unfolds. Prudent trade secrets counsel will include the risk of a bad faith counterclaim as part of the plaintiff's initial case assessment, will address this risk with the client, and will develop a strategy for neutralizing this exposure.

Representation of a trade secrets plaintiff can be among the most challenging engagements for a trial lawyer. By their nature, these actions often arise in an emergency posture, and most trade secrets claims are commenced on an expedited basis with very limited time for presuit investigation and case assessment.

Compounding these issues, the facts giving rise to the litigation may inflame the passions of the client's executive team, with evidence of bad acts by a key competitor or a disloyal former employee or executive, and the client may respond with impatience when trial counsel advises caution and additional time for presuit investigation.

While the plaintiff may demand immediate action, the UTSA's standard for proving the existence of a protectable trade secret demands careful presuit investigation. The statute places on the plaintiff a heavy burden under a nuanced, fact-intensive standard, and most of the relevant facts concern matters that should be ascertainable by the plaintiff with reasonable investigation.

Together, the conflicting demands of emergency litigation and complex factual analysis invite precipitate litigation based on inadequate case assessment and inaccurate factual assertions in the plaintiff's initial submissions to the court. In short, plaintiff's counsel in a trade secrets action faces a potential minefield of self-inflicted litigation hazards.

Under UTSA Section 4, the consequences of imprudently commenced litigation can be a substantial fee award. Section 4 provides in relevant part that, "If (i) a claim of misappropriation is made in bad faith ... the court may award reasonable attorney's fees to the prevailing party."

This exposure can mount quickly before counsel even realizes that the client is at risk. Given the intensive work by both sides' counsel, experts, and litigation vendors that may be prompted by an expedited discovery and hearing schedule, a trade secrets plaintiff may face seven figures in liability under Section 4 before plaintiff's counsel even realizes that the plaintiff has made a material misstatement of fact in its verified complaint or affidavit in support of a temporary injunction or that the plaintiff otherwise has overlooked a material issues that substantially undermines the plaintiff's claim.

Nonetheless, plaintiff's counsel may discount the importance of the defendant's counterclaim for fees because there are so few reported decisions. In this author's experience, the limited number of reported decisions is attributable to the unique context in which a strong bad faith claim is most likely to be asserted against the plaintiff. By the time both sides are squarely focused on defendant's counterclaim for fees as a significant issue, the plaintiff undoubtedly will have invested substantial legal spend and management resources in the prosecution of the action and yet will have already suffered or will be facing the prospect of an embarrassing public defeat to a competitor or disloyal former employee.

The plaintiff's confidence in trial counsel probably has been seriously eroded, and trial counsel's revelation that the client now faces the prospecting of paying a substantial fee award to its adversary may destroy any remaining confidence in the trial team, especially if trial counsel did not address with the client at the outset of the litigation the risk of a fee award.

In the defendant's camp, even though the mood may be very different, the defendant probably shares plaintiff's litigation fatigue. In other words, both sides are ready for peace. Under these circumstances, it is only the most unusual case in which plaintiff and defendant cannot reach a settlement that eliminates the prospect for a reported decision on the plaintiff's Section 4 liability.

It is in part the dearth of binding precedent that makes a bad faith counterclaim so difficult to assess from the plaintiff's perspective. There is no controlling precedent in most jurisdictions even on the basic question of what standard the court should apply to define bad faith, much less more nuanced questions such as whether the counterclaim should be tried to the court or to a jury, the scope of relevant and admissible evidence, or the sequence and scope of permissible discovery on the counterclaim. Once the plaintiff is confronted with a significant misstep that give the defendant a plausible basis

for asserting bad faith, then the lack of controlling precedent makes the fee claim an anxiety-provoking wild card for the plaintiff.

Consider, for example, the plaintiff who files a verified complaint or affidavit in support of a temporary restraining order after only limited investigation. The plaintiff's sworn pleading recites that certain competitive information is confidential and that all persons to whom the information has been disclosed are subject to confidentiality agreements. Once the defendant discovers that the plaintiff has in fact voluntarily disclosed the information to a third party without any assurance of confidentiality, then the plaintiff may be facing not only a motion for summary judgment but also a motion or counterclaim under Section 4 for an award of fees.

The plaintiff's error may have been an innocent oversight — for example, the disclosure might have been unknown to current management because the responsible employees left the company long before the litigation — but in the absence of any binding precedent establishing the standard for what constitutes bad faith and the permissible scope of discovery and admissible evidence on the question of plaintiff's bad faith, counsel may have a difficult time assessing the defendant's likelihood of success on a claim or even framing the plaintiff's defense

### **What Can Trial Counsel Do To Avoid This Predicament?**

First, a discussion with the client of the potential exposure for a Section 4 fee award should be an essential part of initial case assessment for any plaintiff. This discussion accomplishes two goals: protecting the client from surprise if the defendant later vigorously asserts a fee claim, and focusing the client on the need for careful development of the facts supporting the trade secrets claim. Discussing the risk of a fee award can discipline the client's approach to the litigation and help ensure sufficient time and resources for counsel's presuit investigation.

Second, trial counsel needs to conduct and document a thorough presuit investigation. Of course, the extent of the presuit investigation must be balanced against the exigencies of the litigation, but trial counsel cannot blindly accept in-house counsel's recitation of the facts supporting the claim without further inquiry. Even in the most extraordinary litigation emergency, outside counsel must interview at least by telephone or videoconference the most knowledgeable client executives, and outside counsel must personally be responsible for carefully questioning the executive who is acting as the

affiant or declarant for plaintiff on the accuracy of each paragraph of any declaration or verified pleading

In this author's experience, retained counsel too often rely blindly on the client to make its own self-guided, internal review of draft pleadings to verify their accuracy, trusting in-house counsel to ensure the factual accuracy of the company's initial pleadings. Trial counsel's cross-examination skills should not be reserved for use only against the opposing party at deposition and trial; counsel must call upon the same skills to probe the client's own witnesses before they attest to the accuracy of any statement of fact.

This may seem a fundamental point, but all too often this author has seen otherwise diligent and skilled counsel respond to the client's urgings to commence suit immediately by cutting corners on what ordinarily would be considered the minimal requirements of professional responsibility.

One of the least certain aspects of litigating bad faith claims under UTSA Section 4 is the assertion of the attorney-client privilege by the plaintiff who resists full discovery of its presuit investigation and yet must present some evidence of this investigation to show the good faith basis for the claim. There still is not yet extensive case law on this question. Thus, prudent plaintiff's counsel will carefully document the steps taken in the presuit investigation with contemporaneous memoranda and emails containing only circumscribed, nonprivileged information that can later be disclosed without risking a broad waiver of privilege.

Third, counsel should exercise restraint in drafting the plaintiff's complaint and other initial submissions, particularly those submitted by the client under oath. Facts that appear rock-solid at the outset of litigation may later be contradicted by documents in the plaintiff's own possession, and perhaps even by the declarant's own admissions disclosed in discovery. Careful trial counsel will not take unnecessary risks in committing the client to assertions of fact on personal knowledge.

A judicious use of allegations "on Information and belief" should be considered, and when the time for presuit investigation is especially short, counsel should consider whether to file initially only a bare-bones complaint and then follow the complaint with a motion for temporary injunction after further investigation. This may be particularly appropriate where the plaintiff seeks to commence litigation as soon as possible in order to secure the plaintiff's choice of forum or for other tactical considerations but requires

additional time to develop the factual basis for a motion for temporary injunctive relief. Even an additional 48 hours can substantially impact trial counsel's understanding of the dispute and ability to identify litigation risks.

Fourth, trial counsel should consider that mitigating the risk of a bad faith claim does not end with the initial case assessment and filing the complaint. Instead, plaintiff's counsel must reevaluate the client's exposure for a bad faith counterclaim on a continuing basis through the completion of discovery and pretrial motion practice.

Counsel should identify the key witnesses whose testimony will establish the plaintiff's good faith basis for its claim and prepare these witnesses for examination at deposition on the plaintiff's presuit investigation and factual basis for its suit, and counsel should examine the impact of discovery disclosures and deposition testimony on defendant's Section 4 counterclaim. In short, the trade secrets plaintiff must litigate as both plaintiff and defendant throughout the case in order to neutralize the risk of the defendant's bad faith counterclaim.

Finally, trial counsel must understand the importance of protecting in-house counsel from what may be intense pressure from management to commence litigation against an "arch-rival" competitor or a disloyal former executive. The plaintiff has retained trial counsel, not only for counsel's skill as an advocate, but also for trial counsel's independence, judgment and discretion in evaluating litigation risk for the company. Trial counsel must have the courage to speak up when the company's appetite for litigation exceeds the good faith basis for its claims. UTSA Section 4 can be the ally of both retained and in-house counsel when they must advise the company of the risks of hasty litigation.

The drafters of UTSA included Section 4(i) for a reason — to give would-be plaintiffs pause to consider the merits of their claims before commencing suit. Trial counsel who rush into litigation without due consideration place at risk both the client and the client relationship.

This publication has been prepared for the general information of clients and friends of the firm. It is not intended to provide legal advice with respect to any specific matter. Under rules applicable to the professional conduct of attorneys in various jurisdictions, it may be considered advertising material. The advice contained in this article is not intended or written to be used, and cannot be used by a taxpayer, for the purpose of avoiding penalties that may be imposed on the taxpayer under law.

For more information visit our Web site at [www.schiffhardin.com](http://www.schiffhardin.com).

© 2012 Schiff Hardin LLP