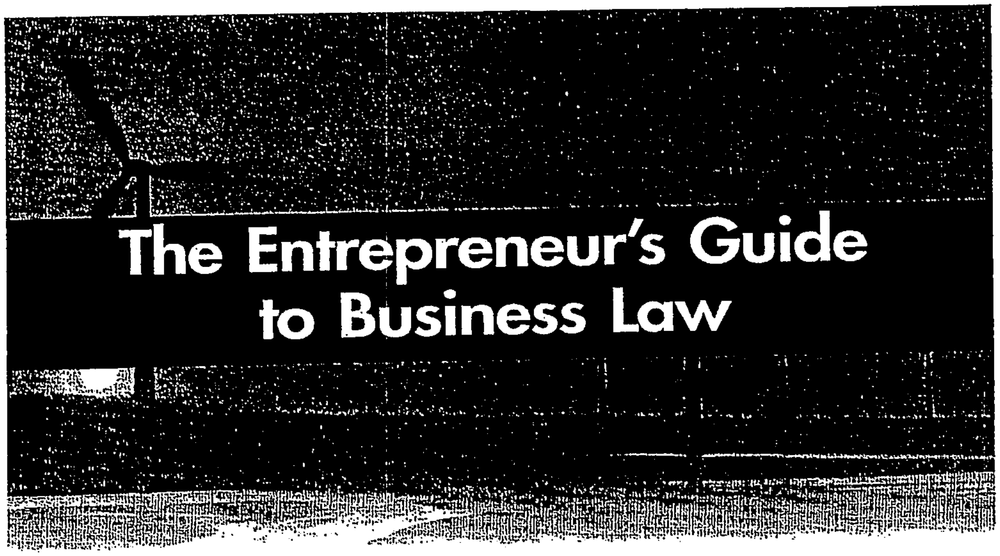

The Entrepreneur's Guide to Business Law

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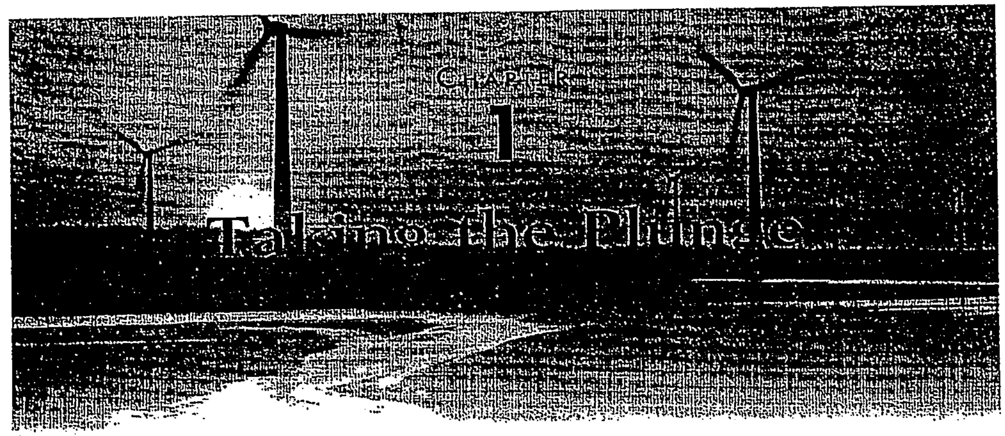

Chapter 1

Taking the Plunge

Individuals start businesses for any number and combination of reasons: to be their own boss, to pursue a passion, to achieve financial rewards, to establish a new livelihood after corporate downsizing, to fill an unmet need with an innovative product or service, or to create something enduring. Despite the vast variety of entrepreneurs and their companies, once individuals decide to become entrepreneurs, they will encounter many of the same issues. These issues will include whether to work alone or with one or more partners, which products or services to provide, and where to obtain the necessary capital.

One example of a highly successful entrepreneur is Mohamed "Mo" Ibrahim, the founder and chairman of Celtel, the leading mobile telecommunications company in Africa. Born in 1946, Ibrahim studied engineering at the University of Alexandria in Egypt before returning to his home country of Sudan.[1] After working for Sudan Telecom, Ibrahim spent several years at the University of Birmingham in the United Kingdom—first as a Ph.D. student, then as a research fellow. British Telecom (BT) then hired him to oversee its foray into mobile communications. As technical director, Ibrahim helped develop the world's first cellular network, which began operating in England in 1985.

After Europe opened the cellular communications industry to competition in 1989, companies were attracted by the growth opportunities but often lacked the knowledge to design and implement their own networks. Recognizing the demand for his expertise and wanting to determine his own fate, Ibrahim left BT to found Mobile Systems International (MSI) in 1989. In addition to consulting, MSI developed novel software that simulated network installations and operating conditions. MSI took equity positions in some of its clients, building an investment portfolio that was eventually placed in a Dutch holding company, MSI Cellular Investments. The company was subsequently renamed Celtel International.

Celtel began building its multination network in Africa in 1998.[2] Although this business faced numerous unique obstacles, including lack of infrastructure in some areas and rampant corruption, Ibrahim was convinced that cellular communications would help African countries expand their economies and build their infrastructures by leapfrogging the installation of landlines. He also wanted his company to be an example of a business that could succeed without stooping to paying kickbacks and bribes.[3] By 2005, when MTC, a Kuwaiti mobile telecommunications concern, purchased 85% of Celtel for $3.4 billion, Celtel was operating in 13 sub-Saharan countries and had more than 5 million customers.[4] Ibrahim remained as chairman of Celtel and through his Mo Ibrahim Foundation increased his commitment to battling corruption in his home continent. The Foundation funds the Mo Ibrahim Award for Achievement in African Leadership, a $5 million prize awarded to the outgoing president of a sub-Saharan nation who has demonstrated the greatest commitment to democracy and good governance.[5] It also funds several scholarships, including one to the London Business School for students from sub-Saharan African countries.[6]

Before taking the plunge, the would-be entrepreneur should consider the sacrifices, both professional and personal, that will be required. These sacrifices may include accepting several years of low pay and long hours in exchange for a large potential payoff later. Successful entrepreneurship also requires a willingness to take risks. As Sandra Kurtzig, founder of Ask Computer Systems (a company she grew to more than $400 million in sales), points out, the act of quitting one's job and starting a new business is only the beginning.[7] An entrepreneur must continually take risks and be prepared to make the bet-the-company decisions that will determine the venture's ultimate success or failure.[8]

From the TRENCHES

Adam Lowry and Eric Ryan bonded at a young age by, among other things, brainstorming ways to improve or reinvent familiar products. In the late 1990s, this childhood fascination turned serious when Adam and Eric had the idea of reinventing household cleaning supplies as environment-friendly products featuring elegant packaging. In 2000, they quit their jobs, used their savings as seed capital, and created Method Products, Inc. Adam and Eric began mixing their first all-purpose cleaner in a bathtub, delivering orders around the San Francisco Bay area with their own pickup truck. After surviving the dot-com recession and near insolvency, they quickly spent their savings and maxed out their credit cards. Method soon took off. By 2009, it had grown to more than $100 million in revenues and earned a spot as one of *Inc.* magazine's fastest-growing private companies in America.

Source: How Two Friends Built a $100 Million Company, INC., *available at* http://www2.inc.com/ss/how-two-friends-built-100-million-company (last visited Feb. 27, 2010).

Regardless of how carefully one deliberates before making decisions, an entrepreneur will make mistakes. As Kurtzig puts it, "Screwing up is part of the process."[9] One key to being successful is to make fewer mistakes than the competition.

Most entrepreneurs and their backers are not risk *seekers*; rather, they are risk *takers* who attempt to manage the risks inherent in pursuing new opportunities by making staged commitments and conducting a series of experiments.[10] In selecting an opportunity to pursue, savvy entrepreneurs look for an attractive risk/reward ratio, that is, the set of possible negative and positive cash flows and the likelihood of each possible outcome.[11]

When harnessed correctly, the law and the legal system can be a positive force that helps entrepreneurs increase predictability, maximize realizable value, marshal the human and capital resources needed to pursue opportunities, and manage risk.[12] Failure to comply with the law can result in crippling lawsuits, devastating fines, and, in egregious cases, imprisonment for the individuals involved. Because legal risks are among the most important of the many risks faced by a young company, an entrepreneur can increase the likelihood of success by understanding and managing legal risk, that is, by spotting legal issues before they become legal problems. Legally astute entrepreneurs can also use legal tools, such as contracts and intellectual property protection, to increase realizable value.

PUTTING IT INTO PRACTICE

Pierre Harvey (our fictitious entrepreneur) had been an employee of Sun Spot Cells, Inc. (SSC), a Delaware corporation headquartered in Texas, for six years before taking the plunge to start his own venture. SSC manufactures crystalline silicon solar cells for use in two types of photovoltaic systems for converting sunlight directly into electricity: (1) basic flat panel modules, which expose semiconductor materials directly to the sun, and (2) concentrator modules, which use mirrors to direct sunlight onto the solar cell material. Silicon is the primary raw material used to make these solar cells. Although silicon is widely available, using it for solar cells is expensive because it must be refined to almost 100% purity. Even though concentrator modules use less silicon than flat panel modules, increased demand and projected shortages of silicon had further driven up costs over time.

Founded in 2001, SSC was the world's third largest producer of photovoltaic cells. It had revenues of more than $820 million in 2010. Even though SSC increased production each year, the ongoing shortage of usable silicon made it impossible for SSC to satisfy customer demand.

Pierre began his career at SSC as an engineer in the quality control department and advanced rapidly. At the suggestion of the head of engineering, Pierre used the company's tuition reimbursement program to attend the Yale School of Management from 2006 through 2008. After he earned his MBA, Pierre returned to SSC to oversee the development of next-generation concentrator cells. He spent the majority of his time designing and testing new mirror arrangements in an attempt to find one that would allow the cells to produce the same electrical output with less silicon. He also worked to develop less fragile concentrator cells. Decreasing the breakage rate would enable customers to install arrays of concentrator cells in a wider variety of locations, including industrial building rooftops.

Pierre had graduated from Stanford University in 2002 with an environmental engineering degree. While attending his fifth reunion in 2007, he bumped into an engineering classmate Maya Yoshida, who had just finished the first year of the MBA program at Stanford's Graduate School of Business. Between college and business school, Maya had worked for Kyosharpa, a large Japanese firm outside Tokyo that was the world's foremost producer of silicon solar cells. Following a presentation at the reunion on the need for increasing alternative energy sources in the United States, the two discussed developments in photovoltaics that might make solar power more viable for use in everyday life.

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Both realized that reducing the cost of producing photovoltaic cells was key. Most traditional photovoltaic cells produce electricity at a rate of about $3.50 per watt and capture just 10–20% of the sunlight energy striking the cell. Pierre and Maya thought that thin film technology was a promising alternative to traditional flat panel and concentrator cells for three reasons. First, thin film solar cells use less semiconductor materials than flat panel and concentrator cells. Thin film cells are created by pouring extremely fine layers of semiconductor materials upon one another until they have a combined thickness of 1 to 10 micrometers. In contrast, traditional cells, which are made by slicing wafers from a pure silicon ingot, use a layer of silicon that is 100 to 300 micrometers thick. As a result, significant amounts of the expensive silicon are lost during production. Second, unlike traditional cells, thin film cells can incorporate alternative, less expensive semiconductor materials. Third, unlike purified silicon, which is a solid typically produced in wafers with a fairly uniform shape and size, thin film cells are initially in liquid form, so they can be molded into any size or shape. This makes it easier to incorporate thin film cells into existing product designs.

Pierre and Maya also discussed alternative uses for photovoltaics. In the course of their work prior to business school, both had recognized that efficient solar cells would be attractive to many industries, including home building, automobile manufacturing, and electronics production. Demand for "clean technology," or "cleantech," had increased as concerns about global warming, volatile oil prices, and political uncertainty surrounding the regulation of greenhouse gases prompted a search for viable alternatives to fossil fuels. If a clean power source could be inexpensively incorporated into products without drastically altering production methods or the object's appearance, and without diminishing its performance, they knew companies and consumers would be interested. The two also expressed a mutual desire to work for themselves one day. They promised to stay in touch and not wait until their 10th reunion to meet again.

Following business school, both Pierre and Maya returned to their previous employers. But inspired by his conversation with Maya, Pierre spent much of his spare time over the next two years using computer models to test designs for improving thin film technology. In particular, he was interested in replacing silicon with another semiconductor material, cadmium. Cadmium has an almost perfect bandgap, the minimum level of energy at which a material converts sunlight into electricity. Additionally, cadmium absorbs a relatively high level of incident sunlight. The more sunlight a semiconductor material absorbs, the more

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electricity it can produce. Pierre occasionally borrowed technical manuals from work and attended SSC in-house presentations on related topics.

Pierre frequently called Maya to discuss his findings, and she made several helpful suggestions for tweaking the tests. They were careful not to discuss their outside project with coworkers. By early 2010, they felt they had a viable design for a cadmium-based thin film that increased the efficiency of previous cadmium-based designs by significantly reducing the amount of energy lost to internal resistance.

Pierre and Maya knew that if they were going to take the next step with their product, they would need to test their theoretical design with actual physical components. Faced with the prospect of investing money in addition to time, the two decided they should commit their business relationship to writing. They signed a brief handwritten agreement to form a company to develop what Pierre had taken to calling the CadWatt Solar Cell (CSC). The agreement stated that they would "divide any profits fairly."

Pierre took a two-month leave of absence to thoroughly test their design in rented laboratory space. He and Maya split the rental cost equally. Pierre discovered that his projections were accurate. The design was efficient, absorbing nearly 20% of the sunlight energy striking the cell and retaining nearly 75% of the electrical energy that was lost in other cadmium-based designs. Additionally, he discovered that the superstrate of conductive material he laid over the cadmium was strong enough to hold the entire structure together, thereby eliminating the need for a backing material. He and Maya envisioned affixing these cells onto other objects, so they estimated that the cells would need less support than the traditional cells used on rooftop panels. With the increased efficiency and reduced raw material needs, Pierre calculated that the cell produced electricity at a rate of roughly $1.50 per watt—a dramatic improvement over previous photovoltaic technology. This diminished cost increased the chance that manufacturers and consumers would be interested in integrating photovoltaic cells into their products and lives.

While Pierre was testing the cell design, Maya prepared a presentation for potential investors and completed plans for commercializing the technology. She envisioned creating a company that would develop and sell thin film photovoltaic panels based on Pierre's breakthrough technology. She estimated that they would need $8 million to purchase the necessary production equipment and materials and eventually to hire employees. In addition, they would need to conduct further tests to

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ensure that the design was pliable enough to be incorporated into a variety of products. She believed that the success of the design would depend on its ability to adapt to existing products rather than forcing manufacturers to change their construction methods.

Pierre wanted to get their new venture under way as soon as possible, and he realized that to do so he would have to leave SSC. For economic and family reasons, Pierre and Maya decided to set up their new business in the San Francisco Bay area. Locating in California would enable them to take advantage of the California Solar Initiative, a government program that provided $3.2 billion in incentives for solar power installations over an 11-year period.

In preparation for his departure, Pierre asked to review his personnel file to determine what agreements he had signed when he joined SSC. Pierre vaguely remembered being given a stack of papers to sign and return in conjunction with his post-business-school promotion to head of concentrator cell development. In his file he found forms for health insurance and tax withholdings along with a long nondisclosure agreement that he had only skimmed before signing. After reviewing the agreement more carefully, he realized that it contained provisions assigning the rights to his inventions to SSC, a nondisclosure provision, a one-year covenant not to compete, and a no-raid provision prohibiting him from actively hiring SSC's employees. (For a further discussion of these provisions, see Chapter 2.)

Before taking any action, Pierre knew that they needed to investigate these and a number of other crucial issues. Below are some of the questions our founders will confront in the initial and later stages of forming their business and the corresponding chapters of this book that address his questions.

1. Who owns the CadWatt Solar Cell technology? What rights, if any, can SSC claim to it? *(Chapter 2: Leaving Your Employer)*
2. What can Pierre do to make his departure from SSC amicable? Should he have left sooner? What ongoing obligations does he have to SSC? *(Chapter 2: Leaving Your Employer)*
3. Can Pierre ask several of his colleagues at SSC to join his new enterprise? *(Chapter 2: Leaving Your Employer)*
4. Should Pierre and Maya hire an attorney? How do they select the right one? (*Chapter 3: Selecting and Working with an Attorney*)
5. Given their limited budget, can Pierre and Maya afford an attorney? Can they afford not to have one? (*Chapter 3: Selecting and Working with an Attorney*)

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6. What would be an appropriate legal form for the business from a liability and tax standpoint? (*Chapter 4: Deciding Whether to Incorporate*)
7. How should Pierre and Maya approach the issue of splitting the equity in the new venture between them? (*Chapter 5: Structuring the Ownership*)
8. How will they manage the venture? What happens if one of the founders leaves? (*Chapter 5: Structuring the Ownership*)
9. What are the advantages and disadvantages of having an active board of directors? Who should sit on the board, and what should the founders expect the directors to do? (*Chapter 6: Forming and Working with the Board*)
10. What are the founders' options for financing the new venture? (*Chapter 7: Raising Money and Securities Regulation*)
11. Does the company have to pay laboratory engineers the minimum wage and overtime? When is the company required to withhold taxes from a worker's check and pay Social Security taxes? What accommodations must the company make for workers with physical or mental disabilities? How should the company resolve a claim by a 41-year-old Muslim man that he was laid off because of his age, national origin, and religion, and how can the company protect itself against such claims in the future? How should the company resolve a sexual harassment claim brought by a male employee against a female supervisor? (*Chapter 8: Marshaling Human Resources*)
12. How can Pierre and Maya ensure that the company's customers pay on time and that its suppliers ship goods in the quantity and of the quality they need for the business? What should they consider before signing a standard-form lease for office, laboratory, or manufacturing space? (*Chapter 9: Contracts and Leases*)
13. What warranties are implied when the company sells a product? Can the company disclaim all warranties and limit its liability to replacement of the product or refund of the purchase price? Can the company imply in its advertising that plants with large electricity demands can run exclusively on solar power collected with CadWatt Solar Cells? (*Chapter 10: E-Commerce and the Sales of Goods and Services*)
14. Does the company need to be concerned that the property it is considering leasing for manufacturing is near a river? (*Chapter 11: Operational Liabilities and Insurance*)
15. How should the company resolve a claim for assault, battery, and false imprisonment arising out of an altercation with one of the

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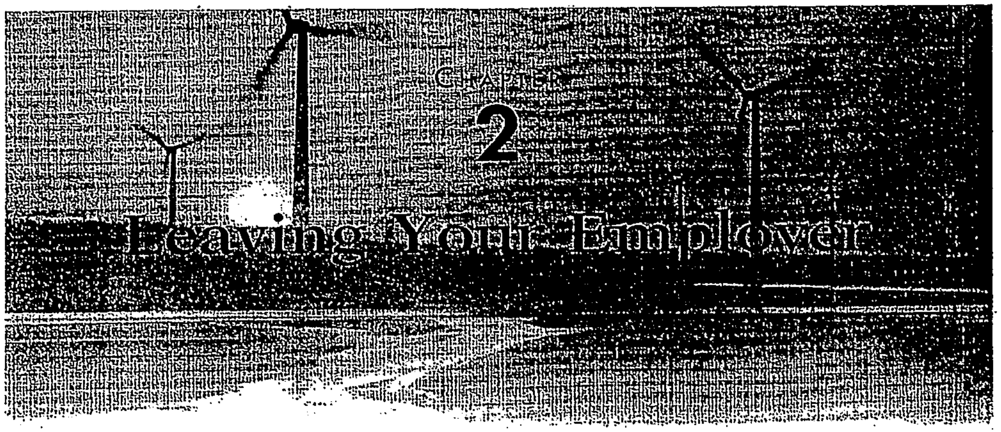
company's employees, and how can the company protect itself against such claims in the future? (*Chapter 11: Operational Liabilities and Insurance*)

16. What happens if the company runs out of cash and cannot pay its debts? (*Chapter 12: Creditors' Rights and Bankruptcy*)
17. If Pierre and Maya seek venture capital financing, how should they approach the venture community? What business and legal provisions in the term sheet and other financing documents should concern them? What is negotiable? Are any of the terms deal breakers? (*Chapter 13: Venture Capital*)
18. How can the company protect its proprietary technology? Does the company need to worry about violating other companies' patents or copyrights? (*Chapter 14: Intellectual Property and Cyberlaw*)
19. Should the company expand beyond the United States? What are the advantages and disadvantages of going global? (*Chapter 15: Going Global*)
20. What risks are involved in growing the business by acquisition? Is it better to grow the business internally? When should entrepreneurs consider selling their business to a larger competitor? (*Chapter 16: Buying and Selling a Business*)
21. When is an initial public offering an appropriate exit strategy? What is involved in going public? What does it mean to be a public company? (*Chapter 17: Going Public*)

Notes

1. *See* Anver Versi, *Africa's Heroic Entrepreneur (Mohamed Ibrahim) (Biography)*, African Bus., Feb. 1, 2006.
2. G. Felda Hardymon & Ann Leamon, *Celtel International B.V.*, HBS Case No. 805061 (Boston: Harvard Business School Publishing, 2004), at 5.
3. Versi, *supra* note 1.
4. Mark Odell, *Celtel Accepts Kuwaiti Offer*, Fin. Times, Mar. 30, 2005, at 26.
5. Alan Cowell, *Prize to Honor Heroes in African Democracy*, N.Y. Times, Oct. 27, 2006, at A11.
6. *See* Scholarship Opportunities, *available at* www.moibrahimfoundation.org (under Scholarships) (last visited Feb. 27, 2010).
7. Sandra L. Kurtzig, CEO: Building a $400 Million Company from the Ground Up 2 (1994).
8. *Id.* at 2–3.
9. *Id.*

10. *See* Howard Stevenson, *The Heart of Entrepreneurship*, Harv. Bus. Rev. 85–94 (Mar.–Apr. 1985).
11. William A. Sahlman, *Some Thoughts on Business Plans*, *in* The Entrepreneurial Venture (Sahlman et al. eds., 2d ed. 1999).
12. *See generally*, Constance E. Bagley, Winning Legally: How to Use the Law to Create Value, Marshal Resources, and Manage Risk (2005).
13. Constance E. Bagley, *Winning Legally: The Value of Legal Astuteness*, 33 Acad. Mgmt. Rev. 378 (2008).



Sometimes an entrepreneur will start a new business right out of school or while between jobs. More often, a person decides to start his or her own company while still employed by a more established company. The idea for a new business may come from a project the person was working on for the current employer. Depending on the agreements the entrepreneur has with the current employer, the entrepreneur's position, and the nature of the proposed new business, the entrepreneur may not be free to work on the venture while still employed or for some time thereafter.

For example, the employee may have signed an agreement containing a *no-moonlighting clause*, which prohibits the employee from engaging in any business activities (even after-hours activities) unrelated to the employee's job with the employer. A signed nondisclosure agreement (discussed later) prohibits the entrepreneur from using or disclosing any of the employer's trade secrets (such as a customer list) unless the employer authorizes it. The prohibition often continues even after the entrepreneur quits. In some cases, the entrepreneur may have signed an agreement in which he or she agreed not to compete with the former employer for some period of time after leaving the employer (a *covenant not to compete*). The entrepreneur's ability to recruit former coworkers to join the new enterprise may also be restricted.

Awareness of these restrictions is crucial. A lawsuit arising out of the entrepreneur's duties to a former employer can be so expensive and occupy so much management time that it sinks the venture.

At a minimum, the new company would be greatly impeded by the threat of a lawsuit by the former employer. The departing employee should review all forms and materials in his or her personnel file for provisions that may limit future entrepreneurial activities.

This chapter discusses both restrictions that are applicable while a person is still employed by another and postemployment restrictions, including covenants not to compete. It then presents strategies for leaving on good terms.

RESTRICTIONS WHILE STILL EMPLOYED

The employer-employee relationship is based on confidence and trust, which give rise to certain legal duties. For example, the employer has a duty to maintain a good working environment and to compensate employees for their efforts. In return, the employees have a duty to use their best efforts on behalf of the employer and not to act in any way that is adverse to the employer's interests. The extent of an employee's duties to a former employer depends on the position held at the company and whether the new venture will compete with the employer. In addition, the employee needs to consider whether it is permissible to solicit coworkers.

Position with the Company

Absent a covenant not to compete and a no-moonlighting clause, the employee's position will largely determine what he or she can legally do while contemplating starting a new business. In large part, employees' rights and duties depend on whether they are classified as key employees, skilled employees, or unskilled employees.

Key employees (such as officers, directors, and managers) and *skilled employees* (such as software engineers, marketing specialists, and sales representatives) owe a duty of loyalty to the company. This duty, which exists regardless of whether there is an employment contract, prohibits an employee from doing anything that would harm the employer while he or she is still employed. This includes operating a business that competes with the employer or that usurps any business opportunities that the employer might be interested in exploring. During the period of employment, a key or skilled employee may make plans to compete with an employer but may neither actually compete nor solicit employees to work for the new business.

The duties of *unskilled employees* (and other employees not in positions of trust) are generally confined to the period of time during which they are actually working. Their off-hour activities are not restricted unless these activities are detrimental to the employer's interests. However, even unskilled employees can be restricted from competing with the company during their nonworking hours by a covenant not to compete or a no-moonlighting clause in an employment agreement.

Type of New Venture

The activities in which an employee may engage to further a new venture while still employed also depend on whether the venture will compete with the current employer. If the new enterprise is a noncompeting business, the employee (whether a key employee, skilled employee, or unskilled employee) is essentially free to establish and operate the new venture as long as it does not interfere with current job performance or violate any provisions (such as a no-moonlighting clause) in any employment agreement. An employee may make telephone calls, rent an office, hire employees (but not coworkers, except as explained below), and retain attorneys and accountants for the noncompeting business provided that two conditions are met. First, the employee may not use any of the employer's resources (e.g., telephone, fax machine, printer, copying machine, laptop or home computer supplied by the employer, or conference room). Second, all activities must be conducted after hours.

What constitutes *after hours* is not always clear. For an employee with specified work hours, defining what is after hours may be easy. It becomes more difficult when the entrepreneur is a key employee whose working hours are not strictly defined and who has a duty to use best efforts to further the interests of the employer. For example, software engineers are famous for doing their best work between midnight and dawn. For them, there may be no clear after hours during the workweek. Instead, vacations may provide the only truly free time to develop an outside venture.

From the TRENCHES

When cofounder Steve Jobs left Apple Computer, Inc. in 1985, he outraged Apple's board by persuading five top Apple managers to join in starting NeXT, Inc. Jobs had been chair and CEO of Apple but was stripped of the CEO position and control over day-to-day operations in May 1985. Thereafter, he began planning his new company. Five days before resigning as chairman, Jobs gave the newly appointed CEO, John Scully, a list of the five employees who would be joining him at NeXT. Jobs also inquired about the possibility of licensing Apple technology for his new venture. Apple responded by suing Jobs for breach of his fiduciary responsibilities as chairman and for misappropriation of confidential and proprietary information. Four months later, Apple agreed to settle the suit in return for Jobs's promise that NeXT would not hire any additional Apple employees for a six-month period and would not solicit Apple employees for a year. NeXT also granted Apple the right to inspect NeXT's products before they were marketed. Ironically, Apple Computer bought NeXT in 1996 for $402 million and hired Jobs as CEO of Apple in 1997.

If the new venture will compete directly with the current employer, the entrepreneur's actions are significantly more restricted. Key employees and skilled employees may not prepare for or plan the new venture if doing so would interfere with their job responsibilities. Under no circumstances may they be involved in the actual operation of a competing venture while still employed by the employer.

Once plans for the competing business are in place, it is almost always advisable to terminate the employment relationship. Although it may be tempting to continue working, the potential liability and the time required to straighten out any legal or business conflicts that may arise will probably outweigh the benefit of the extra income.

These rules are summarized in Table 2.1.

Solicitation of Coworkers

Solicitation of coworkers to leave their employment and come to work for the new company can be a sensitive issue. If the

TABLE 2.1 Summary of Permissible Activities While Still Employed by Another

	Type of Venture	
Type of Employee	Noncompeting Venture	Competing Venture
Key employee or skilled employee	Can prepare for and operate venture as long as it does not interfere with responsibilities or fiduciary duty. If subject to a no-moonlighting clause, the employee cannot operate venture.	Can prepare for venture as long as it does not interfere with responsibilities or fiduciary duty. Cannot operate venture.
Unskilled employee	Can prepare for and operate venture as long as it does not interfere with responsibilities or fiduciary duty. If subject to a no-moonlighting clause, the employee cannot operate venture.	Can prepare for venture as long as it does not interfere with responsibilities. If subject to a covenant not to compete or a no-moonlighting clause, the employee cannot operate venture.

coworker has an employment contract for a definite term (e.g., two years), the entrepreneur seeking to lure the coworker away may be liable for damages for intentionally and improperly encouraging the coworker to break that contract and to leave the employer before the specified term is over. The employer could sue for intentional interference with contract, a tort discussed further in Chapter 11.

Even if the coworkers do not have a written employment contract and their employment is terminable *at will* (i.e., at any time, by either party, for any reason), an entrepreneur can still be held liable if his or her conduct leads coworkers to violate any applicable restrictive covenants. For example, an entrepreneur may want to hire away a coworker who has access to the company's confidential information or who has developed special expertise that could be of great value to the new business. Doing so, however, may result in the violation of the coworker's nondisclosure agreement or of a covenant not to compete. (As discussed below, even in the absence of a nondisclosure agreement, the entrepreneur and the coworker may be opening themselves up to liability for misappropriation of trade secrets.)

In addition, deliberate campaigns to disrupt another company's business by wrongfully inducing its employees to join another firm may constitute tortious intentional interference with prospective economic advantage. For example, the founders of a new law firm were held liable for damages suffered by their prior employer after they not only induced six other at-will employees to join the new firm but also persuaded the employees to resign without notice, to leave no status reports of outstanding matters or deadlines, to destroy the firm's computer files and forms, to take confidential information, and to improperly solicit the former employer's clients.[1]

Often employees are asked to sign an agreement expressly prohibiting them from soliciting coworkers, inducing coworkers to leave, or hiring them for some stated period of time after leaving the former employer. Such a provision is referred to as a *no-raid* or *antipiracy clause*. If the entrepreneur has signed such an agreement and solicits or hires in violation of it, the former employer could successfully sue for breach of contract and perhaps even obtain an injunction or court order preventing the former coworkers from working for the entrepreneur. A distinction is generally drawn between soliciting coworkers and telling them about future plans, however. Even when a no-raid clause prohibits an entrepreneur from soliciting coworkers while still an employee, some courts would not prevent the entrepreneur from discussing future plans with coworkers. If coworkers are interested, they can contact the entrepreneur later and discuss any potential job opportunities.

Key employees are even more restricted in how they may approach coworkers. Generally, even in the absence of a no-raid clause, a key employee who induces another employee to move to a competitor is liable for breach of fiduciary duty if the inducement is willfully kept from the employer. Everyone who has participated in or benefited from that breach may be held liable. In one case, several key management employees induced several coworkers to leave their employer and enter into employment with their newly formed competing air-freight forwarding company. The management employees were held liable to the former employer for breach of fiduciary duty, fraud, and interference with contractual relations. The fact that none of the employees had an employment contract was irrelevant.

POSTEMPLOYMENT RESTRICTIONS AND THE COVENANT NOT TO COMPETE

Once an entrepreneur leaves the former place of employment, he or she may still be restricted by a no-raid clause (discussed above) or by a covenant not to compete (also known as a *noncompete covenant*). A *covenant not to compete* is an agreement between an employer and an employee that is designed to protect the employer from potentially unfair competition from a former employee. Prohibited competition usually includes dealing with or soliciting business from the former employer's customers, or using the former employer's confidential business information for the benefit of the new employer.

To be binding and legally enforceable, the covenant not to compete must meet certain requirements. It must be ancillary to some other agreement; supported by adequate consideration, that is, the person agreeing to the covenant must receive something of value from the other party; designed to protect a legitimate interest of the employer; reasonably limited in scope, geography, and duration; and not contrary to the interests of the public. If a court finds that a legally valid covenant has been breached, the court may issue an injunction ordering the entrepreneur to stop the offending activities, award damages, or both. Inducing an employee to violate a valid noncompete covenant can also give rise to a lawsuit against the new employer for tortious interference with contract.

Ancillary to Another Agreement

A stand-alone covenant not to compete is a naked restraint on trade, which, in many states, is *per se*, or by itself, invalid. For a noncompete covenant to be valid, it must be subordinate to some lawful contract that describes the relationship between the parties. A formal employment agreement, a sale-of-business contract, or an agreement dissolving a partnership satisfies this requirement. An Illinois appellate court held that an at-will employment agreement is sufficient to support covenants not to compete, reasoning that "although an at-will employment agreement ... might not be considered 'enforceable' in the strictest sense of the term, it is nonetheless an agreement and relationship with numerous legal consequences, imposing rights and obligations on both parties."[2]

Consideration

Like other contracts, a covenant not to compete must be supported by consideration. This can include the payment of money or an exchange of promises. Although certain courts take the position that covenants entered into after employment has commenced are not supported by consideration,[3] others reason that an employer provides consideration when it does not terminate an at-will employment relationship.[4] To ensure consideration, an employer seeking a noncompete covenant from an existing at-will employee should either make an additional payment to the employee (even a nominal amount would suffice) or provide something else of value, such as a promotion.

Legitimate Interests

A noncompete covenant may legally protect only legitimate interests of the employer. A general interest in restricting competition is insufficient. For the employer to enforce a restrictive covenant, the employee must present a substantial risk either to the employer's customer base or to confidential business information. Employer interests that have been found to be legitimate include protecting trade secrets, customer lists, and other confidential information; preserving long-term customer relationships; and protecting the goodwill, business reputation, and unique skills associated with the company. Courts have also ruled that "the 'efforts and moneys' invested by an employer to provide to its employees specialized training in the methods of the employer's business" qualify as legitimate interests worthy of protection.[5]

Limited in Scope

The restrictions imposed by the noncompete covenant must be reasonably related to the interests protected. To be valid, these restrictions must be limited in time, geographic area, and scope of activities affected. In a dispute, the court will closely scrutinize the imposed restrictions to determine how they relate to the employer's business. If the court finds the restrictions overly broad, it will typically either modify some terms of the covenant to make them reasonable (e.g., shorten the duration) or declare

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Jeffrey Hirshberg was employed in the Buffalo, New York, office of BDO Seidman, a national accounting firm. As a condition of receiving a promotion to the position of manager, Hirshberg was required to sign a "Manager's Agreement," which provided that if, within 18 months following the termination of his employment, Hirshberg served any former client of BDO Seidman's Buffalo office, he would be required to compensate BDO Seidman "for the loss and damages suffered" in an amount equal to one and a half times the fees BDO Seidman had charged that client over the last fiscal year of the client's patronage. After Hirshberg resigned from BDO Seidman, the accounting firm claimed that it lost 100 former clients to Hirshberg who were billed a total of $138,000 in the year he left the firm.

The New York Court of Appeals ruled that the agreement was reasonable and enforceable except to the extent that it required Hirshberg to compensate BDO Seidman for fees paid by (1) the personal clients whom he had brought to the firm through his own contacts or (2) clients with whom he had never acquired a relationship through his employment at BDO Seidman.

Source: BDO Seidman v. Hirshberg, 712 N.E.2d 1220 (N.Y. 1999).

the whole covenant invalid. For example, the Nevada Supreme Court invalidated a noncompete agreement restricting a lighting-retrofitting employee from competing with his former employer within a 100-mile radius of the former employer's site for five years. The duration placed a great hardship on the employee and was not necessary to protect the former employer's interests. A well-drafted covenant will contain a provision that invites the court to enforce the covenant to the greatest extent possible under applicable law and to modify the covenant as needed to make it enforceable. This is called a *blue-lining clause*.

The determination of the validity of restrictions varies greatly from case to case and is very fact-specific. For example, one court upheld a two-year covenant not to compete that prohibited a dermatologist from practicing dermatology within a 30-mile radius of the offices of the doctor for whom he had worked. Two years was considered reasonable to erase from the public's mind

any identification of the dermatologist with his former employer's practice and to allow the former employer to reestablish his relationship with patients who had been referred to the dermatologist. The 30-mile radius covered the territory from which the dermatologist's former employer drew most of his patients.[6]

With respect to the time restriction, courts have generally found one year or less to be a reasonable limitation; a court probably would never enforce a covenant for a period of more than five years, except perhaps in connection with the sale of a business. In some states, the geographic limitations of a noncompete covenant are only enforced to the extent that they correlate with the employee's territory. One court held that a clause prohibiting an employee from competing with his former employer anywhere within the United States, Puerto Rico, or Canada was excessive because the employee had only worked in Colorado, Kansas, Missouri, Nebraska, and Wyoming. The court modified the clause to cover only those five states.[7]

Interests of the Public

In determining the validity of a noncompete covenant, a court will also look at the interests of the public affected by the covenant. Noncompete covenants can prevent the uninhibited flow of labor necessary for a competitive market. The public policy of preserving free labor markets disfavors restraints on trade and puts limits on the use of restrictive covenants. In addition, there is a basic belief that a person must be able to ply his or her trade to earn a living. But covenants not to compete also help deter unethical business practices, such as stealing trade secrets. If companies cannot adequately protect legitimate interests, entrepreneurs may be less likely to start new businesses and spend time and money developing and marketing better and cheaper products that increase consumer wealth. The balance struck between these competing public policies varies from state to state and is reflected in each state's legislation and judicially created law (called *common law*).

State Legislation A number of states have enacted legislation restricting the enforceability of noncompete covenants. Such legislation generally falls into three categories. Some states, such as

California, have statutes that broadly prohibit covenants restraining anyone from engaging in a lawful profession, trade, or business. Some credit this California law with providing part of the impetus for the growth of Silicon Valley, as many companies were founded by former employees of existing companies. Other states, such as Oregon, have statutes that regulate some aspects of noncompete covenants without broadly prohibiting them. Texas and a number of other states have taken yet another approach, adopting statutory reasonableness standards that must be satisfied for the covenants to be enforced. Some states prohibit enforcement of noncompete covenants in their state constitutions. States that do not have special legislation or constitutional provisions governing the use of noncompete covenants usually have common law rules of reason for determining the validity and enforceability of such covenants.

Exceptions to Legislation Many states with broad prohibitions against covenants not to compete have exceptions permitting such covenants in certain limited circumstances. For example, California has statutory exceptions permitting reasonable restrictions, not to exceed five years in duration, when the covenantor sells all of his or her shares in a corporation in a transaction in which the company is sold as a going concern. The covenantor is typically the owner selling the business and, upon the sale, may be restricted from starting a similar business in a certain location. Restrictions are also permissible in the case of a partnership dissolution or the sale of a limited liability company. California's statutory exceptions have been further narrowed by judicial rulings that limit restraints against the pursuit of an entire or substantial part of a profession, trade, or business and allow restrictions only if the effect on competition is not significant.

Choice of Law With the high degree of employee mobility in the information economy, it is common for employees to move from state to state for a transfer or a new job. Such moves may affect the enforceability of noncompetition agreements. In particular, some provisions may be enforceable in the state where the employee began working but not in the state to which the employee moves. It may be difficult for a company with

employees in many different states to use a single noncompetition agreement that will be enforceable in every state where employees are located.

Companies can use forum selection clauses and *consents to personal jurisdiction*—agreements to litigate any dispute in a specifically named jurisdiction—as well as choice-of-law provisions to achieve more predictability about the enforceability of their noncompetition agreements, but these clauses will not always be honored. In particular, even when an employment agreement specifies that the law of the employer's principal place of business will govern disputes, a state may refuse to enforce a covenant not to compete if the covenant is not consistent with the state's own law. For example, the U.S. Court of Appeals for the Eighth Circuit refused to enforce against Nebraska employees a noncompete agreement entered into and to be performed in Nebraska that provided that Ohio law would govern disputes arising from the contract. The employer, which had its corporate headquarters in Ohio, had sued the employees for breach of contract in federal court in Nebraska. The federal district court applied Nebraska's choice-of-law statute, which prohibits applying the law of another state where that application would violate a fundamental Nebraska policy. Recognizing Nebraska's interest in the employment of its citizens and that Nebraska and Ohio have "materially different approaches to the reformation of unreasonable noncompete agreements,"[8] appeals court ruled that Nebraska law should be used to resolve the case. Unlike Ohio law, Nebraska law does not allow courts to modify restrictive covenants to make them reasonable. As a result, the noncompete agreement was struck down in its entirety because it was overbroad.

On the other hand, if the employer secured a money judgment against an employee who had consented to jurisdiction in the employer's principal place of business, then the employer might be able to invoke the Full Faith and Credit Clause of the U.S. Constitution to require that the employee's home state court enforce the judgment. Federal courts may also be willing to enforce provisions forfeiting an executive's rights to retain profits from the exercise of stock options if the executive leaves the firm a short time thereafter. For example, the U.S. Court of Appeals for the Ninth Circuit upheld provisions requiring Dr. Bajorek, an executive to whom IBM had granted stock options worth more than $500,000, to return any profits he obtained from the options if he worked for a competitor within six months after exercising the options.[9] Although the stock option agreement stated that New York law should apply to any disputes, Bajorek sued IBM in federal district court in California and argued that California law should apply. The district court agreed, after finding that applying New York law would violate California public policy against both recoupment of wages paid to employees and employee noncompetition agreements. The appeals court reversed on the grounds that these California policies were inapplicable. In addition to finding that stock options were not wages, the appeals court ruled that California restricts only agreements that completely restrain an individual from pursuing his or her profession. The court commented:

> It is one thing to tell a man that if he wants his pension, he cannot ever work in his trade again ... and quite another to tell him that if he wants a million dollars from his stock options, he has to refrain from going to work for a competitor for six months.[10]

Sometimes, noncompetition issues involve a "race to the courthouse," in which the person who files the first lawsuit in a jurisdiction with favorable law prevails in the dispute.[11] But a court in one state may be reluctant to enjoin proceedings in another.[12]

Dismissal for Refusal to Sign an Unenforceable Covenant Not to Compete Sometimes an employer will require an existing employee to sign a covenant not to compete. The California Court of Appeal held that Playhut, Inc. could not legally discharge an at-will employee for refusing to sign a confidentiality agreement that contained an unenforceable covenant not to compete.[13] Other jurisdictions have reached the opposite result, arguing that the employee should sign the covenant, then assert its invalidity if later sued by the company for violating the covenant.[14]

Remedies for Breach of a Noncompete Clause

If a court finds that an employee breached a valid noncompete covenant, it will impose liability on the offender. The most

common form of relief is an injunction requiring the employee to stop competing against the former employer. In some cases, actual damages may be assessed against an employee in an amount calculated to put the employer in the same position that it would have been in had there been no breach.

TRADE SECRETS

Most states expressly prohibit the misappropriation of trade secrets as a matter of law, regardless of whether the employee signed an agreement prohibiting their use or disclosure. Unauthorized use or disclosure of the employer's trade secrets is generally prohibited both during and after employment. Even if a particular state will not enforce a covenant not to compete, all courts will generally enforce an agreement by an employee not to disclose or use trade secrets belonging to the former employer.

For example, most states have passed statutes, such as the Uniform Trade Secrets Act (UTSA), that prohibit an employee from disclosing or using trade secrets belonging to the former employer even in the absence of a confidentiality agreement. In those states that have not adopted the UTSA or comparable legislation, judges have developed common law rules that prohibit misappropriation of trade secrets.

What Is a Trade Secret?

A *trade secret* is information used in one's business that is neither generally known nor readily ascertainable in the industry and that provides the business owner a competitive advantage over competitors who do not have access to this information. (Trade secrets and programs for their protection are discussed further in Chapter 14.) A trade secret can be a formula, pattern, program, device, method, technique, process, or customer list. What constitutes a trade secret is not always evident. The two critical factors in determining whether a trade secret exists are (1) the value of the information to the business owner and competitors and (2) the amount of effort made to maintain the secrecy of the information. These two factors are closely related: the more valuable a certain piece of information is to a business owner, the more likely he or she will make efforts to keep it secret.

Misappropriation of Trade Secrets

A prohibition on the use or disclosure of trade secrets and confidential information is usually included in a specialized agreement called a *nondisclosure agreement* (*NDA*). (Nondisclosure agreements are discussed in detail in Chapter 14.) The purpose of an NDA is to put employees on notice that they are exposed to trade secret information in their work, to inform employees about their duties with regard to such information, and to create a covenant restricting their disclosure or use of trade secrets or other confidential information after the termination of their employment. The validity of an NDA is conditioned on the existence of the trade secrets it is designed to protect. If trade secrets do exist, then a reasonable NDA will be upheld even in states (such as California) that will not enforce postemployment covenants not to compete.

Under the *inevitable disclosure doctrine*, some courts will enjoin a former employee from working for a competitor firm for a limited period of time if the former employer is able to prove that the employee's new employment will inevitably lead him or her to rely on the former employer's trade secrets. The leading case involved a former PepsiCo marketing manager who was privy to sensitive, confidential, strategic plans for the marketing, distribution, and pricing of PepsiCo's sports drink All Sport and its ready-to-drink tea products and fruit drinks. The employee left PepsiCo to work for Quaker Oats, seller of market leaders Gatorade and Snapple. The court concluded that the former employee would necessarily rely on his knowledge of PepsiCo's trade secrets when making decisions at Quaker Oats about Gatorade and Snapple. This put PepsiCo "in the position of a coach, one of whose players has left, playbook in hand, to join the opposing team before the big game."[15] The court prohibited him from working at Quaker Oats for a period of six months.

Similarly, after an executive left Bimbo Bakeries, maker of Thomas' brand English muffins, to work for rival food company Hostess Brands, a federal court applying Pennsylvania law enjoined him from commencing employment during the pendency of the trial. Applying the inevitable disclosure doctrine, the court noted that the executive had extensive knowledge of Bimbo's strategic

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Peak Computer maintained computer systems, including MAI Systems Corp. computers, for its clients. Peak's maintenance of MAI computers accounted for between 50% and 70% of Peak's business. MAI also maintained MAI computers for its customers. MAI's customer service manager and three other employees left to join Peak. Thereafter, MAI began to lose maintenance business to Peak. MAI sued Peak and its former employees for, among other things, copyright infringement, misappropriation of trade secrets, trademark infringement, and unfair competition.

MAI sought and received a temporary restraining order and preliminary injunction and then a permanent injunction that enjoined Peak from infringing on MAI copyrights, misappropriating MAI trade secrets, maintaining MAI computers, soliciting MAI customers, and making certain MAI customer contacts. The court determined that MAI's customer database was a protectable trade secret that had potential economic value because it allowed a competitor such as Peak to direct its sales efforts to those potential customers that were already using MAI's computer system. The court was not swayed by Peak's contention that the former customer service manager did not take MAI's customer database or put such information into the Peak database.

Source: MAI Sys. Corp. v. Peak Computer, Inc., 991 F.2d 511 (9th Cir. 1993).

plans and was one of only seven employees who had knowledge of all three elements of the secret process for making the muffins' famous "nooks and crannies" texture.[16] In contrast, the California Court of Appeal rejected the inevitable disclosure doctrine, holding that it was inconsistent with California's statutory ban of most postemployment covenants not to compete.[17]

Criminal Liability

People who steal trade secrets risk not only civil liability but also criminal penalties. For example, Guillermo "Bill" Gaede, a former Intel Corp. software engineer, was sentenced to 33 months in prison after pleading guilty in March 1996 to mail fraud and interstate transportation of stolen property for stealing copies of Intel's designs for its 486 and Pentium microprocessors and sending

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General Motors Company (GM) became involved in a heated dispute with Volkswagen AG (VW) over the defection of GM's former purchasing chief to the German carmaker. GM filed suit in March 1996 against VW, Jose Ignacio Lopez de Arriortua, and 10 former GM managers, alleging that Lopez and the other former employees took numerous boxes of secret GM documents when they quit GM to join VW. The documents in question allegedly contained confidential GM information about prices for parts, new models, and marketing strategies. The parties settled in early 1997, with VW agreeing to pay GM $100 million and to buy at least $1 billion worth of GM parts over seven years. Lopez resigned from VW and was criminally indicted by German authorities.

Source: Brian S. Akre, *VW to Pay GM $100 Million to Settle Suit Alleging Theft of Secrets*, WASH. POST, Jan. 10, 1997.

them to Advanced Micro Devices, Inc. (AMD), a rival microprocessor company.[18] AMD had returned the plans to Intel and contacted the Federal Bureau of Investigation. Theft of trade secrets may also be prosecuted as a federal crime under the Economic Espionage Act.

INVENTION ASSIGNMENT AGREEMENTS AND WORKS FOR HIRE

An *invention assignment agreement* is another type of agreement an employee is often asked to sign. This document requires the employee to assign to the employer all inventions conceived, developed, or reduced to practice by the employee while employed by the company. Some states restrict the scope of such agreements. California, for example, prohibits the application of such agreements to inventions that the employee developed entirely on his or her own time without using the employer's equipment, supplies, facilities, or trade secret information, except when such inventions relate to the employer's business or to current or demonstrably anticipated research and development, or result from any work performed by the employee for the employer. Thus, if, for example, an employee subject to an invention assignment agreement with a software development company involved in developing database management software created a new and improved way to input files, that new program will belong to her employer even though she created it on her own time and using her own home computer, because it is related to her employer's business.

Invention assignment agreements may provide for the assignment of inventions not only during the period of employment but also within a certain time, typically one year, after the termination of employment. Such agreements are not *per se* invalid. One court found, for example, that an agreement was valid and enforceable as it related to ideas and concepts based on secrets or confidential information of the employer even if conceived of within one year after the termination of employment.

It is important that any restriction on an employee's future inventive activities be limited in time. Thus, although some agreements providing for assignment of inventions made within one year of employment termination have been found valid, other agreements requiring assignments for longer periods have not been enforced. One court, for example, found a contract provision requiring an employee to assign ideas and improvements conceived by him for five years after termination of employment to be unreasonable and void as against public policy.

As explained further in Chapter 14, even if there is no assignment-of-inventions agreement, the patent to any invention by a person expressly "hired to invent" belongs, as a matter of law, to the employer. The courts construe this narrowly, holding, for example, that a person "hired to improve" is not subject to this rule. Similarly, as a matter of copyright law, the copyright to any work created by an employee acting within the scope of employment belongs to the employer, even if the employee has not signed an invention assignment agreement.

STRATEGIES FOR LEAVING ON GOOD TERMS

To the extent possible, an employee should try to leave the current employer on good terms. To do this, the employee must be honest with the employer about the real reasons for leaving. The

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Two employees of a software company told their employer that they were leaving to start a restaurant. In fact, they founded a competing software company. Their former employer was furious—in part because he had been lied to and in part because he suspected misappropriation of trade secrets—and was successful in getting a court to issue an injunction that prevented the closing of the start-up's financing arrangement.

employer is likely to think the worst of former employees who say they are going to set up a noncompeting business but then in fact start a competing company. Such behavior will spark fears of stolen trade secrets and other misdeeds.

When the employee tells the employer of his or her future plans, it may be appropriate to offer the employer an opportunity to invest in the new venture. The employer will be most likely to invest if the entrepreneur's prospective business will make products that are complementary to the employer's products. Complementary products can increase a product's market and help establish it as an industry standard. For example, one reason Autodesk's AutoCAD (Computer Aided Design) program has been so successful is that it contains "hooks" that allow other software companies to design applications for AutoCAD. The availability of these additional applications has helped make AutoCAD an industry standard.

Having the employer invest in the new business offers several benefits. First, it may provide an easy source of funding for the entrepreneur. In addition to money, the employer may contribute technology, commercial expertise, and industry contacts. Second, it generates goodwill between the parties by aligning the interests of the employer with those of the entrepreneur.

This alignment is important because the employer may be a valuable customer or supplier of the entrepreneur's business. Additionally, with an equity interest in the new enterprise, the employer may be more willing to allow the entrepreneur to hire other current employees. The entrepreneur should be careful, however, about how much of an ownership stake and control is

given to the former employer. Allowing the former employer to be more than a passive investor may create the same situation that the employee left in the first place—namely, that the entrepreneur will again be working for someone else.

Entrepreneurs should avoid soliciting coworkers while still employed. Active solicitation of employees by a skilled or key employee during employment constitutes a breach of the entrepreneur's duty of loyalty and could lead to an injunction preventing the entrepreneur from hiring anyone from the prior employer. A good strategy is for entrepreneurs to tell people that they are leaving. If people ask about their future plans, entrepreneurs are permitted to tell them that they plan to start a new business and to give them a phone number where they can be reached. Because Donna Dubinsky, cofounder of Palm Computing, had kept a copy of the e-mails from coworkers soliciting her for a job when she left Palm in 1998 to form Handspring, she was able to prove that she had not initiated the contacts and therefore had not breached her duty to Palm by actively soliciting any Palm employees to leave and join Handspring.

PUTTING IT INTO PRACTICE

Pierre decided that the time had come to inform his boss at Sun Spot Cells, Inc. (SSC) of his future plans. Before discussing his departure, he contacted Stefano Fava, a college roommate who had graduated from Yale Law School, for advice on the enforceability of the agreement he had signed. Stefano told him that the agreement specified that Texas law governed its interpretation and enforcement. However, Stefano believed that a California court would not enforce a posttermination noncompete covenant against a California resident, even though the contract stated that Texas law governed the employment relationship.

Stefano told Pierre that he was bound by the provisions covering the assignment of inventions, however, and by the no-moonlighting, nondisclosure, and no-raid clauses. Of the four provisions, the one covering assignment of inventions was potentially the most problematic. Even though Pierre had developed the CadWatt Solar Cell (CSC) technology on his own time, SSC probably owned the technology because the invention related to SSC's business and he had used some of SSC's resources (namely, his SSC computer and SSC training sessions) when developing it.

Stefano explained that the no-moonlighting clause prohibited Pierre from starting his business while employed at SSC. Pierre breached this agreement when he and Maya Yoshida signed an agreement to develop the CSC technology. Although it would have been all right for Pierre to make plans for his new venture before quitting, he should not have begun operating until he left. The nondisclosure provision prohibited Pierre from using or disclosing any confidential information that he learned while working for SSC. The no-raid clause prohibited him from soliciting employees from SSC. He was permitted, however, to hire employees if they contacted him about a potential job. Pierre and Maya did not plan to hire any other employees in the initial phases, so this was not an issue.

Armed with this advice, Pierre went to see his supervisor. After he informed her of his plans, the supervisor told him that he would need to speak to the director of research regarding the rights to the CSC technology. A few days later, Pierre and Stefano met with the director of research and SSC's corporate counsel. After some negotiating, both parties agreed that SSC would transfer all of its rights to the CSC technology to Pierre's new company and release all claims against Pierre and his cofounder Maya in exchange for 15% of the equity.

(continued)

Satisfied with the agreement he had reached, Pierre gave official notice of his resignation. If people asked about his plans, he informed them that he was leaving to start a new business and gave them a phone number where they could reach him.

Pierre realized that if he took any SSC documents, electronic data, or other proprietary items, he could be accused of stealing trade secrets. He returned all non-CSC-related documents, flash drives, and concentrator cell raw materials to his supervisor, deleted all non-CSC-related information on the storage drives on his office and home computers, and walked out of SSC carrying only his personal effects.

Although Stefano had been helpful in advising Pierre about issues related to leaving SSC (and seemed willing to do so for little or no fee), he was not experienced in representing start-ups. Pierre and Maya next turned their attention to selecting a lawyer for their new venture.

Notes

1. Reeves v. Hanlon, 95 P.3d 513 (Cal. 2004).
2. Abel v. Fox, 654 N.E.2d 591, 597 (Ill. App. Ct. 1995).
3. Gibson v. Neighborhood Health Clinics, Inc., 121 F.3d 1126 (7th Cir. 1997).
4. Lake Land Employment Group of Akron, LLC v. Columber, 804 N.E.2d 27 (Ohio 2004).
5. Wellspan Health v. Bayliss, 869 A.2d 990, 997 (Pa. Super. Ct. 2005) (citing Pennsylvania Funds Corp. v. Vogel, 159 A.2d 472, 476 (Pa. 1960)).
6. Weber v. Tillman, 913 P.2d 84 (Kan. 1996).
7. Coventry First, LLC v. Ingrassia, 2005 U.S. Dist. LEXIS 13759 (E.D. Pa. 2005).
8. DCS Sanitation Management, Inc. v. Castillo, 435 F.3d 892, 897 (8th Cir. 2006).
9. Int'l Bus. Machs. Corp. v. Bajorek, 191 F.3d 1033 (9th Cir. 1999).
10. *Id.* at 1041.
11. Manuel v. Convergys Corp., 430 F.3d 1132 (11th Cir. 2005) (in a case brought by an employee who left an Ohio employer to join a Georgia firm, the federal court in Georgia applied Georgia law to invalidate a noncompete agreement that specified that all disputes would be resolved under Ohio law; the federal court in Ohio reserved action in a second lawsuit filed in Ohio by the Ohio employer pending resolution of the Georgia case, thereby respecting the general rule that the law of the state where the first case was filed should govern a dispute).
12. Advanced Bionics v. Medtronic, Inc., 59 P.3d 231 (Cal. 2002).

13. D'Sa v. Playhut, Inc., 102 Cal. Rptr. 2d 495 (Cal. Ct. App. 2000).
14. *See, e.g.*, Maw v. Advanced Clinical Communications, Inc., 846 A.2d 604 (N.J. 2004).
15. PepsiCo, Inc. v. Redmond, 54 F.3d 1262 (7th Cir. 1995).
16. Bimbo Bakeries USA, Inc. v. Botticella, 2010 WL 571774 (E.D. Pa. Feb. 9, 2010).
17. Whyte v. Schlage Lock Co., 125 Cal. Rptr. 2d 277 (Cal. Ct. App. 2002).
18. Calvin Sims, *Troubling Issues in Silicon Valley Spy Case*, N.Y. Times, July 8, 1996.