PowerScreen Problem

Teaching Notes

This case is a negotiation between lawyers of the two partners of HackerStar, Inc., concerning the ownership of a new computer program one of them has developed.

Overview

HackerStar, Inc., is a small, closely held corporation that develops and markets software for microcomputers. The six-year-old company was founded by Hacker, a brilliant programmer who manages the company and is responsible for its products, and Star, a dentist and computer hobbyist who provided the capital. Hacker and Star each own 50 percent of the company. HackerStar has done moderately well, but now faces a crisis resulting from a dispute between the partners over PowerScreen, a new product developed by Hacker. The dispute originated when Hacker went ahead and developed PowerScreen against Star's wishes. Hacker contends that because he developed the product on his own time and used the company computer only in the evenings after work for debugging, he exclusively owns the product. Star, however, argues that, no matter what the language of the employment contract says, it is perfectly clear that all of Hacker's creative software energy is to be owed to the company in exchange for Star's backing. Star insists that HackerStar owns the product. The company lawyer has referred Hacker and Star to separate counsel in order to avoid a conflict of interest. The exercise revolves around the meeting of these lawyers. (The exercise is also suitable for use by non-lawyers.) At stake are the ownership of PowerScreen and the future of HackerStar, Inc.

A professionally produced videotape, *The HackerStar Negotiation*, based on the case *The PowerScreen Problem*, is available at additional cost from the Clearinghouse. This video is an extremely useful teaching tool when viewed after negotiating *The PowerScreen Problem*. If class time is short, the video may be viewed without having negotiated the case. See Appendix A of these teaching notes for a video overview and ordering information.

These Teaching Notes were written by Thomas Wiegand for the Harvard Negotiation Project. The exercise was written for the Harvard Negotiation Project by Bruce M. Patton with the help of Mark Gordon and Andrew Clarkson. Copies are available from the Teaching Negotiation Resource Center (TNRC), online at www.pon.org, by email: tnrc@law.harvard.edu, or by telephone at 800-258-4406.

Mechanics

Time Required:	2 hours:	preparation outside of class
	45-60 min.:	preparation by side (optional)
	45-60 min.:	negotiation
	1-2 hrs.:	debriefing
	1-2 hrs.:	view and discuss *The HackerStar Negotiation* videotape (optional)

Group Size: 2 or 4 persons

Materials:
General Instructions for Both Parties
Confidential Instructions for Stanley Star's Attorney
Confidential Instructions for Allen Hacker's Attorney
CPC Tool/Target Balance Sheet

Procedure:

1) Distribute roles before class and ask participants to prepare individually in advance of the negotiation. See notes below on "Advance Distribution."

2) (Optional) Divide participants into groups by role (i.e. put all the Hackers together and all the Stars together) and ask participants to act as consultants to each other in preparing the case. See notes below on "Preparation by Side." Allow 45 to 60 minutes.

3) Divide participants into negotiating pairs (or two-on-two quads), and allow 45 to 60 minutes for them to negotiate.

4) Debrief.

5) (Optional) View and discuss *The HackerStar Negotiation* videotape. (See Appendix A of these teaching notes for more information.)

Advance Distribution

Participants should prepare in advance to negotiate the exercise. Without making any judgment as to how one should negotiate in order to be most effective, a premise of negotiation training is that a negotiator is more effective when acting purposely rather than by simply reacting to the other party or parties. Towards this goal, the participants should be encouraged to prepare for the negotiation by:

1) listing the interests that motivate them and the other side to enter into the negotiation,

2) drafting what they think might be the elements of a good outcome of the negotiation in order to meet these interests, and

3) thinking about a variety of approaches that they might use in the negotiation to achieve that outcome.

See Appendix B for a preparation guide organized along these lines that can be supplied to the participants with their instructions for the negotiation.

Preparation by Side

This case involves a complex set of facts and issues. Adequate preparation is essential to successful negotiation. Participants can improve their preparation skills, test the quality of their own preparation, and learn from each other if they are provided time in class to prepare with each other's help. The group can be divided with those representing Hacker working in one room, and those representing Star in another. Participants can meet in groups ranging in size from three to 12. The groups may be facilitated by teaching staff, which can be helpful for managing the group process, or the groups may be permitted to work on their own.

Explain that individuals should regard themselves as consultants to one another. The purpose is to share good ideas and insights, *not* to decide as a group on strategies and tactics to follow.

The process and usefulness of the preparation sessions can be a subject for review in the debriefing session. See Appendix C for an example of a detailed preparation memo.

Appendix B: Preparation Guide

Before entering into a negotiation, you want to be aware of your interests and of various ways that you might meet these interests. The following questions are offered for use in addition to other preparations that you will want to make on your own. (Use extra space as needed.)

Why are you entering into this negotiation? What are your interests? What are your client's interests, and which ones do you not know? What is your best guess as to the other parties' interests?

Given your interests, what are some outcomes, areas of agreement, understanding, etc., that you might want to reach in this negotiation in order to meet these interests?

List some approaches or strategies that you might use during the negotiation to help you develop the desired products. Remember that, because negotiation is a dialogue, not a monologue, no one approach will necessarily be appropriate. Be prepared with a range of approaches.

Options

Options for improving the company in general include:

- hire a manager;
- obtain outside advice on marketing (from an independent marketing consultant, not an advertising agency);
- find another company, perhaps Jeremy Gates' firm, to handle all marketing;
- rewrite employment contract to avoid future disputes; and
- appoint additional members to the board of directors.

Options for ending the company include:

- one partner buying out the other (could use sealed bids, with price 1/2 value of company, with highest bidder buying the company) and
- sue for dissolution and split assets according to debt and then equity.

Options for PowerScreen include:

- arbitrate ownership,
- split proceeds between Hacker and HackerStar,
- keep it a HackerStar product with an internal division of revenue as agreed,
- distribute all income to Allen first until he is compensated for his "overtime," and then to the company, and
- distribute all income to HackerStar first until the company is compensated for the use of its machines, and then to Allen or to Allen and Stan in some non-equal division.

Criteria

Possible criteria for an agreement include:

- value of computer time Allen put in on PowerScreen,
- reduction in HackerStar earnings attributable to time spent on PowerScreen,
- what the employment contract should have said or would say if HackerStar were hiring a new programmer,
- value of Allen's time put in on PowerScreen—at least the part that can reasonably be seen as overtime,
- average hours per week Allen worked before writing PowerScreen,
- what would have happened if Star had supported the development of PowerScreen, and
- expected values of legal outcome (the range of possibilities with odds) predicted by one or more lawyers in opinion letters.

Some fair procedures for an agreement include:

- seek arbitration and
- develop contingent agreements based on differing predicted values of PowerScreen and/or other factors

Commitments Questions

What would be a *good outcome* of this meeting between lawyers?

- A joint recommendation?
- A range of options for critique?
- A second-order agreement on the precise issues in dispute?

Communication Questions

- How do we insure that our points will have the maximum impact on the other side?
- How do we let them know they have been heard?
- Should we go through their Currently Perceived Choices Worksheet?
- Should we let them start?
- Should we start with an apology or a proposal for one?

Relationships Questions

- Do the parties want to repair and continue their working relationship?
- If so, how to proceed? Apology? Informal meeting?
- Should the parties be present at the negotiation?
- Should the parties do the negotiating?
- How can the company's structure promote a better relationship and avoid future disputes like the current and past ones over marketing and product development? Should the company hire an additional board member, professional manager, and/or an outside small business consultant. Should the company develop a new business plan?
- Should the company develop agreed actions on various sales or income contingencies?
- What should be the process and strategy?

With these points in mind, it is helpful to *return to the question of what constitutes a good outcome* to the meeting, and how you plan to get there.

PowerScreen Problem

General Instructions

HackerStar, Inc., is a small, closely held corporation that develops and markets software for microcomputers. It was founded six years ago by Alan Hacker, a trained programmer who brought to the company its first product and became its manager, and Stanley Star, a dentist who has provided the capital. Hacker and Star are each 50 percent owners. The company has always turned a profit, though never a large one, and has appreciated substantially in value. The company is now facing a crisis, however, resulting from a disagreement between the principals over the ownership and disposition of a new product Hacker has developed.

HackerStar's first and still main product is a program called Resource Controller. It is a flexible, multi-purpose tool for controlling peripheral devices of all kinds without extensive custom programming. Its primary uses are in scientific research and small-scale manufacturing, although there are certainly potential home and office applications. First written for the Apple II, it is now available for the IBM PC and other MS-DOS computers, and for the major entries in the Radio Shack line. A version for the Apple Macintosh is under development. Resource Controller is popular among its users, but its installed base of 3,500 users is less than half of the founders' initial expectations, which were:

Year	1	2	3	4	5	6	7
Unit Sales (projected)	750	1,250	2,000	1,500	1,250	1,000	1,000
Unit Sales (actual)	350	448	552	753	696	701	---

Resource Controller retails for $800, and the company actually sees that much if a user buys direct through the mail. If the package is sold through a dealer, there is a 35 percent discount (the industry standard), so the company sees only $520. Schools and charities can buy direct at a 20 percent discount, providing the company with $640.

Just over a year into HackerStar's life, Hacker proposed to Star that he begin work on a second product "to keep HackerStar a growing company." Star, concerned about slow sales of Resource Controller (only 350 packages in the first year), suggested that Hacker's time might be better spent on marketing but finally agreed reluctantly to Hacker's proposal. This second product was PortaWord, a straightforward, "what-you-see-is-what-you-get," word-processing package that works "as is" (except for different disk formats, which are included) on most popular machines. Marketing began halfway through year three. The product is well-designed and has received favorable reviews, but sales revenue didn't catch up with advertising expenses until the beginning of year six. PortaWord retails for $400. Again, the price for a dealer is $260 and for a school or charity is $320.

PortaWord is useful for individuals and larger businesses with incompatible hardware, but market recognition has clearly been a problem. Advertising has been expensive, but used less heavily than Hacker argued it should be. Star, concerned about costs and cash flow, has resisted Hacker's proposals for heavier advertising. He argues that Hacker should push the sales representative to make more of personal contacts with corporate accounts. This basic disagreement about advertising has been a recurring theme between Star and Hacker. Hacker has argued that up to 50 percent more advertising of various kinds would more than pay for itself. Star thinks the risk is too great and the benefits overstated.

In this context, Hacker again proposed at the beginning of year four that he begin development of a new product to position HackerStar to exploit the "nascent but predictable" demand for computer graphics. This proposal, coming only six months after the introduction of PortaWord and at a time when HackerStar's cash flow was at its lowest ebb, greatly concerned Star, who vetoed it. "We need to make the products we have sell before we can afford to think about new ones," he told a disappointed Hacker. He repeated these sentiments on the four or five occasions since then when Hacker again raised the issue, the last time being about six months ago, halfway through year six.

Hacker apparently did undertake efforts to boost sales without additional advertising, because sales of both Resource Controller and PortaWord increased dramatically in year four:

Year		**1**	**2**	**3**	**4**	**5**	**6**
Unit Sales	**RC**	350	448	552	753	696	701
(actual)	**PW**	--	--	14	53	63	85

At the same time, however, Hacker went ahead and began work on a new program, PowerScreen, doing almost all the work in his spare time but making frequent use of (otherwise idle) HackerStar equipment. He finished the bulk of the work on the program halfway through year six and gave Star a quick demonstration after their monthly meeting. Star seemed to think the program was "too esoteric for the business market," however, and he again expressed his displeasure at the prospect of paying to advertise another untried new product.

When Star continued to evidence disinterest in Hacker's new program, Hacker began discussing it with a group of industry venture capitalist friends led by Jeremy Gates whom he met at a computer show. They became seriously interested when they realized the product was essentially complete, and they were enthusiastic when they witnessed a demonstration. They already had plans to set up a software marketing organization to support independently developed programs and thought PowerScreen would be a terrific first product. They proposed an arrangement where Hacker would bear no risk and get a royalty on gross revenue from sales of PowerScreen.

Hacker thinks this approach makes good sense and is an eminently fair way to go forward given Star's lack of interest or support. However, when Hacker told him about this proposal, Star was enraged. He argued that PowerScreen was the sole property of HackerStar, both according to the terms of Hacker's employment contract and because Hacker had used HackerStar equipment in developing it. Therefore, he argued that any and all royalties should go to HackerStar and be divided equally. He had no objection in principle to the idea of having Hacker's friends take the risk of marketing PowerScreen. Star's response made Hacker boil in turn. Things went downhill from there.

At a meeting last week between Hacker and Star, an extremely bitter argument between the two occurred. Star accused Hacker of making a deal on PowerScreen behind his back. Hacker told Star that he had offered the program to Star, but Star had rejected it insultingly. As the conversation became increasingly acrimonious, Hacker said, "You have a dentist's mentality. Your wife said that when she split on you… You're an amateur!" Star retorted, "I think you're a child!" The meeting ended with Hacker saying, "Just do something now, quickly, I don't want to talk about this for another six months. Do it now. Dissolve the company, sue me, do whatever you're going to do, just do it now. I just don't want to continue like this, Stan." As Star left the office, he said, "Alan, we're going to have to see you in court and that's not your environment. They don't do things the way you like them in court."

Within hours of their fight, each party independently called the company lawyer to inquire about the law and possible litigation. The lawyer, Dale Levinson, said that, in her opinion, the employment contract was ambiguous as to both the question of whether Hacker had "spare time" that might not be covered by the agreement and as to the question of whether this new product developed without the consent of the board of directors, which comprises Star and Hacker, is covered by the covenant not to compete. (The agreement was drawn up by Levinson's predecessor, James Black, whom Hacker replaced in year two because of dissatisfaction with his work.) She also suggested that Star could sue to enforce the contract, with unpredictable results, and that either party could petition under the state corporations' statute for an involuntary dissolution of the corporation if he so chose. Dissolution would, of course, cause each party to recognize income at long-term capital gain rates in the amount of the difference between the tax basis in his HackerStar stock and the liquidation value of half of the HackerStar stock.

Finally, Levinson commented on some of the difficulties Hacker and Star might face in litigation. She noted, for example, that, despite her frequent exhortations that the two keep better minutes of board meetings, the official records of the corporation and minutes of board meetings were not very detailed and provided little evidence of the intentions of the principals with respect to products such as PowerScreen and the employment contract generally. Likewise, she pointed out the general lack of records documenting Hacker's work habits or use of equipment.

The above opinions were somewhat reluctantly given and expressly stated to be tentative and not to constitute advice to either party. To avoid a conflict of interest under the Code of Professional Responsibility, Levinson referred Hacker and Star to separate attorneys of their own for advice on how to proceed. Each has met with his lawyer, and the two attorneys have agreed to meet.

Background Information on Alan Hacker

Alan began his computer career as a high school student working summers and after school with the time-sharing machines he could get access to at the universities near his home. He sold his first program, which was for inventory control, to a small business as a sophomore in college. By the time he finished his M.S., he was on the university payroll as a consultant and also had consulted to several large New York firms. After graduation, Alan worked for six years for Digital Equipment Corporation as a programmer and customer service representative specializing in the use of the UNIX operating system with Digital's powerful and popular minicomputers.

Alan left DEC 12 years ago to work as an independent consultant. (DEC was a frequent client.) This work produced a steady, but unspectacular income of about $25,000 to $30,000 per year. When the Apple II microcomputer was released three years later, Alan saw great potential in the microcomputer market, and began planning ways to get into it as a software vendor. Star heard about his plans and expressed interest, and they began to explore the possibility of a joint venture. Star had the capital Alan needed, and Alan had the kind of ground-floor product in which Star was looking to invest a modest sum. Within a couple of months, HackerStar was under way.

Background Information on Stanley Star

Stanley is a dentist with a medium-sized solo practice in town. Seven years ago, shortly before the creation of HackerStar, Stanley's wife left him for a stock broker. Having just turned 50, Stanley went through a major reevaluation of his life and career. He decided to ease up a bit on the practice of dentistry and spend his spare time on an exciting new business venture. Stanley began to dabble in real estate investments, followed the stock market with some interest but little success, and spent a couple of months trying to figure out just what kind of serious business endeavor he should embark upon. Although he had no particular business experience other than managing his own investments, Stan believed that he would make a first-rate entrepreneur.

Stanley had accumulated enough capital in years of practice that his savings and investments, even after the divorce settlement, enabled him to put a chunk of his own money into some business enterprise without any significant risk to his financial well-being. It was complete serendipity that Stanley ran into Alan at a computer show just at that time. Stanley had met Alan at a few previous social gatherings, but they were merely casual acquaintances. As soon as Stanley heard that Alan was looking for capital to enter the microcomputer market, he knew that, with Alan's technical capabilities and his own business acumen, a joint venture would be beneficial to both of them. Stanley had always been interested in computers as a hobby and as a tool for keeping track of patient records in his office, so teaming up with a computer whiz like Alan seemed very attractive, especially given the potential for growth in the computer software industry. Stanley thought that HackerStar had the potential for huge financial gain with minimal financial risk and that the company would not require him to divert too much of his energies from his ongoing dental practice.

Background Information on HackerStar, Inc.

HackerStar was founded six years ago. Alan Hacker and Stanley Star are the sole shareholders and directors; each holds 50 percent of the company. Star provided initial capital of $65,000 and loaned the company an additional $30,000 (at nine percent interest) at the beginning of year three. Interest is paid monthly; none of the principal has been repaid. HackerStar's note to Star is a demand note; no demand for principal repayment has ever been made.

Hacker has an eight-year employment contract with the company (attached). He is assisted by one sales representative, Jim Sparks, who works on a straight salary. Hacker is quite satisfied with Sparks' work. Star is more skeptical about Sparks' performance, but he spends too little time in the office to have much concrete basis for his concerns other than the company's general cash flow. Sparks declined a suggestion in year four that 40 percent of his salary be switched to commission income, although he was willing to accept commissions above his salary and a link between sales and raises in his base salary. No action was taken on his counterproposal, however, because Star was not enthusiastic, and Hacker did not push the issue.

HackerStar uses the David Marks Advertising Agency for copy design and campaign planning. The HackerStar ads generally have a clean design and a good impact. The Marks agency has a good industry reputation.

The company hired an additional programmer, Jay Gould, in year four to help with the conversion of the company's products to new equipment, including new printers. The company also employs two secretaries, Janice Banks and Dorothy Devine. Office equipment and a receptionist are shared with other enterprises in their office complex. The company has no profit-sharing plan. Annual raises are currently running at five percent, although they were as high as seven percent in the first three years of the company when inflation rates were high.

HackerStar's products are sold through mail order advertising in computer magazines, such as *Byte*; through about 20 dealer representatives, mostly Computerland stores; and through direct mail and personal contact with potential buyers. Detailed income and expense summaries for the first six years are attached.

EMPLOYMENT AGREEMENT

This agreement is made this first day of July, [six years ago], between HackerStar, Inc., a corporation existing under the laws of New York, hereinafter referred to as the company, and Alan Hacker, hereinafter referred to as the manager.

Whereas the manager has for a number of years been engaged in the business of computer software design and development for mini– and microcomputers, a business similar to that to be conducted by the company, and whereas the knowledge and skills he has gained in that enterprise are considered essential in conducting the business of the company, it is hereby agreed:

1. The company will employ the manager as its general manager for a period of eight years from this day, at an annual salary of $30,000. It is understood and agreed between the parties hereto that this annual compensation may be altered, revised, or increased by mutual consent of the parties hereto without detriment or prejudice to the remainder of the covenants herein, all of which shall remain in full force and effect until terminated, as provided by this agreement.

2. In consideration of the compensation arrangements hereby covenanted, the manager hereby covenants and agrees to devote his full time, energies, knowledge, and abilities to the management, operation, and development of the business of the company. The manager shall conscientiously and diligently perform all required acts and duties and faithfully discharge all responsibilities entrusted to him as general manager.

3. The duties of the general manager, subject to supervisory approval of the board of directors of the company, shall include the supervision of the company's plant; the purchase, installation, and supervision of equipment; the employing and discharge of employees; the design, placement, and evaluation of advertising; and any and all other duties usually incident to those of a general manager, including such duties as the board of directors of the company from time to time may suggest. No expenditures or liabilities outside of those arising from the ordinary and usual course of business shall be incurred unless the direct approval of the board of directors of the company shall have been first obtained, and all purchases made by said manager on behalf of the company shall be at net cost price. All contracts for salaries of personnel shall be submitted for approval to the board of directors of the company.

4. While the manager is employed hereunder and for one year after termination of such employment, the manager will not (i) engage in competition with the company, either directly or indirectly, in any manner or capacity as advisor, principal, agent, partner, officer, director, stockholder, employee, member of any association, or otherwise in any phase of the business of designing, writing, testing, selling, or producing microcomputer software for the control of peripheral devices or for other such purposes as the company may develop software, and (ii) compete, either directly or indirectly, in any such manner or capacity with any other business of the company in which the manager served while employed hereunder. Ownership by the employee, in the aggregate, of less than one percent of the outstanding shares of capital stock of any corporation with one or more classes of its capital stock

listed on a national securities exchange or publicly traded in the over-the-counter market should not constitute a breach of the foregoing agreement.

5. This agreement constitutes and expresses the whole agreement of said parties hereto in reference to any employment of the manager by the company and in reference to any of the matters or things herein provided for, or herein before discussed or mentioned in reference to such employment, all promises, representations, and understandings relative thereto being herein merged, unless the terms and provisions of any subsequent employment shall be in writing and duly authorized by the board of directors of the company.

In witness whereof the parties have signed and sealed this agreement this first day of July, (six years ago).

Stanley Star

Stanley Star
Chairman of the Board
HackerStar, Inc.

Alan Hacker

Alan Hacker
President and General Manager
HackerStar, Inc.

PowerScreen Problem

Currently Perceived Choice Tool

[Whom are we trying to influence? What is the primary decision they see themselves facing? From their perspective, what are the pros and cons of that decision?]

Decision Maker:____

Question: Shall I (we)____

If "YES"

[negative consequences of saying "yes" to the above question, in possible order of importance]

-

-

-

-

-

BUT: *[favorable consequences of saying "yes"]*

+

If "NO"

[favorable consequences of saying "no" to the above question, listed in order of the subjects on the left]

+

+

+

+

+

BUT: *[negative consequences of saying "no"]*

-

Currently Perceived Choice Tool

Decision Maker:____

Question:____

If "YES"	**If "NO"**
-	+
-	+
-	+
-	+
-	+
-	+
-	+
-	+
BUT:	**BUT:**
+	-
+	-
+	-

Target Balance Sheet

[How would we like, and how can we reasonably expect, the target decision maker to see their choice in the near future? Faced with a new choice (our new proposal), what favorable consequences do we want the decision maker to see if they say "yes"? What negative consequences do we want them to see if they say "no"?]

Decision Maker:____

Question: "Shall I (We) accept their new proposal, the X plan?"

<u>If "YES"</u>	**<u>If "NO"</u>**
+	-
+	-
+	-
+	-
+	-
BUT:	**BUT:**
-	+
-	+

Target Balance Sheet

Decision Maker:____

Question: "Shall I accept proposal X?"

If "YES"	**If "NO"**
+	-
+	-
+	-
+	-
+	-
+	-
+	-
+	-
BUT:	**BUT:**
-	-
-	-
-	-

Yesable Proposition

[Once we understand the target decision maker's interests and concerns, what proposal can we generate and refine to meet those interests?]

Proposed Action: *Who should do what, when, to address the immediate problem?*

____

____

____

Proposed Action Formulated as a YES or NO Question: *Will you (do)*

____

____

____

Sufficient: *The proposed action is sufficient to deal with the immediate problem because it addresses the following issues within this problem:*

____

____

____

Legitimate: *The proposed action is legitimate for dealing with the immediate problem because it addresses the following issues within this problem:*

____

____

____

Realistic: *There is some reasonable chance they will agree to the proposed action because it meets the following important interests of theirs:*

____

____

Operational: *Once they agree to the proposed action, it can be implemented without the need for them to make further decisions. (check)* _______

Restraints on Choice

[Even if our yesable proposition meets the target decision maker's interests, that decision maker will face restraints on his or her choice to say "yes" because of criticisms from third parties and/or constituents.]

If the target decision maker agrees to our proposal, his worst responsible critic (one whose opinions can't easily be ignored) might say:

"____

____

____"

[In order to persuade our target decision maker, it is useful to draft a possible response to that criticism.]

Our target decision maker can respond persuasively, "This is the best decision for us because

____

____

____"

