Engineering Entrepreneurship: Leaving Your Employer

ENGR 4302/5302; EE 4302/5302

WHAT EVERY ENGINEER SHOULD KNOW ABOUT

STARTING A HIGH-TECH BUSINESS VENTURE

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Leaving an employer to start your own business

- It is often beneficial to work for a while in the real world, get experience, and then start up.
- If your startup is related to your former occupation, be careful.
- You may be bound by
  - Noncompete agreements
  - Confidentiality agreements
  - Employee nonsolicitation agreements
  - Customer nonsolicitation agreements
- This lecture has some examples, including legal case studies and terminology. There is a lot of info about such legal battles on the internet. There is often much money at stake.

Torrent Technologies vs NFS

National Flood Services, Inc. ("NFS") and Fiserv, Inc. ("Fiserv") bring this lawsuit against two of NFS's former employees, Travis Pine ("Pine") and Theresa N. Johnston ("Johnston"), and against Torrent Technologies, Inc. ("Torrent"), alleging, in part, that Pine and Johnston breached employment contracts when they left NFS to form Torrent.

Defendants Pine and Torrent set forth eleven counterclaims in Defendants' Answer to Plaintiffs' Amended Complaint.

Plaintiffs moved to dismiss Counterclaims I-IV, which allege: (I) restraint of trade in violation of Section 1 of the Sherman Act; (II) monopolization in violation of Section 2 of the Sherman Act; (III) attempt to monopolize in violation of Section 2 of the Sherman Act; and (IV) violation of state antitrust, monopolization, unfair competition, and restraint of trade laws. Counterclaims, docket no. 9, ¶¶ 36-56.

Note: The purpose of the Sherman Act is to preserve "free and unfettered competition" in the marketplace.

Torrent Technologies vs NFS

For the reasons outlined above, the Court GRANTED Plaintiffs' Motion to Dismiss Counterclaims I-IV, docket no. 14. The Court DISMISSED Defendants' Counterclaims I-IV without prejudice.

https://www.casemine.com/judgement/us/59147151add7b0493436b980

NOTES:

- NFS lost 2 Vice Presidents=Pine and Johnston
- Lost staff
- Gained a competitor
- Torrent operates in same geographical region
- Info/training from NFS is basis for the new company
- "Fiserv/NFS forces employees of the over one hundred companies owned by Fiserv to enter into contracts that restrict competition with any Fiserv company and restrict the use of confidential information."
- Claimed that Finserv buys up competing companies
- In the formal **legal** world a court case that is dismissed with **prejudice** means that it is dismissed permanently. A case dismissed with **prejudice** is over and done with, once and for all, and can't be brought back to court. A case dismissed **without prejudice** means the opposite. It's not dismissed forever.

A "TORRENT" DEPARTURE

Usually a startup welcomes a bit of free publicity, particularly when it comes from John Cook, the startup and venture capital reporter for the Seattle *Post-Intelligencer*. However, this wasn't the type of press Torrent Technologies founder Travis Pine had hoped for.

Pine and his cofounder Theresa Johnston started Torrent after each left the NFS. Torrent was featured in the *Post-Intelligencer* on this occasion because NFS, the former employer of over half of Torrent's employees as well as Torrent's largest competitor, filed suit against its former employees and their new company just two months after they'd incorporated. According to the *Post-Intelligencer*, NFS alleged that "the two former NFS vice presidents violated noncompete agreements, stole trade secrets, solicited NFS employees and interfered with customers" and the lawsuit described the conduct of Pine and Johnston as "willful, extreme and egregious."

Despite the mounting legal challenges, Torrent was still able to raise $3.3 million in its Series A round with the lawsuit outstanding, but not without its share of headaches in assuring potential investors that the lawsuit would not affect the company. Torrent finally settled the lawsuit in late 2006.

http://torrentcorp.com/

Shockley Semiconductor Laboratory

Where the semiconductor revolution began

In 1956, William Shockley formed a team of talented young professionals to develop and produce **new semiconductor devices**. Despite being a Nobel Laureate in Physics and an experienced researcher and teacher, he **failed as a manager**.

As it turned out, he chose a hopeless strategy and created an intolerable working atmosphere. In March 1957, those who disagreed with Shockley began negotiations to form a separate company, and in August reached an agreement with Sherman Fairchild. The formal break occurred on September 18, 1957.

The newly founded Fairchild Semiconductor soon grew into a leader of the semiconductor industry; in 1960 it became an incubator of Silicon Valley, and was directly or indirectly involved in the creation of dozens of corporations such as **AMD and Intel**.

Reference: Wikipedia

Shockley Semiconductor Laboratory

The **traitorous eight** are eight men who left Shockley Semiconductor Laboratory in 1957, due to a conflict with William Shockley, to form Fairchild Semiconductor.

Shockley described the incident as a "**betrayal**", and it is unclear who coined the term. The eight are Julius Blank, Victor Grinich, Jean Hoerni, Eugene Kleiner, Jay Last, Gordon Moore (of “Moore’s Law”), Robert Noyce and Sheldon Roberts. They have sometimes been called "Fairchildren", although this word might also refer to Fairchild alumni or spin-off companies in Silicon Valley.

Fairchild Semiconductor

From left to right: Gordon Moore, C. Sheldon Roberts, Eugene Kleiner, Robert Noyce, Victor Grinich, Julius Blank, Jean Hoerni and Jay Last. (1960)

Reference: Wikipedia

The vision communicated

According to Sherman Fairchild, Noyce's **impassioned** presentation of his **vision** was the reason Fairchild agreed to create the semiconductor division for the traitorous eight. Noyce advocated the use of silicon as substrate — since the material costs would consist of sand and a few fine wires, the major cost would be in the manufacturing process. Noyce expressed his belief that silicon semiconductors would herald the start of **disposable** appliances that, due to **cheap** electronic components, would not be repaired but merely discarded when worn out.

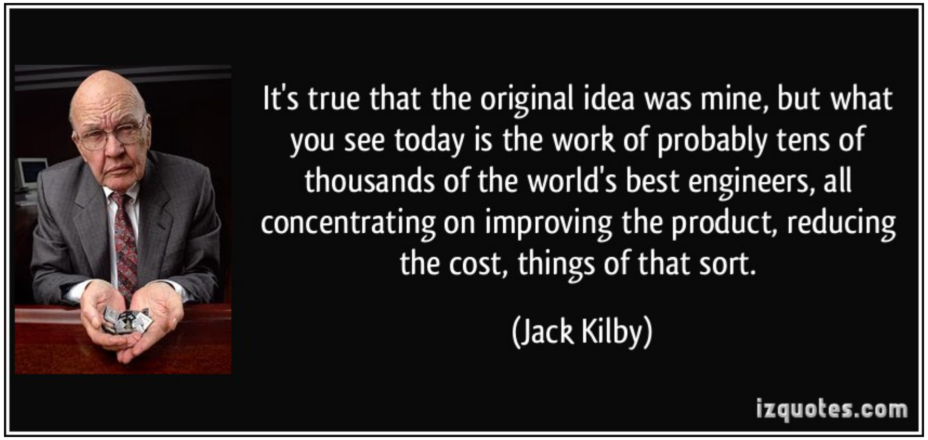
Their first transistors were of the silicon mesa variety, innovative for their time, but with several drawbacks. Later Fairchild pioneered the planar process developed by Jean Hoerni in 1958, which was a huge improvement — transistors could be made easier, cheaper, and with much higher performance. **Fairchild's planar process made most other transistor processes obsolete.** One casualty of this was Philco's transistor division, which had just built a $40 million plant to make their now-totally obsolete germanium-based transistors. Within a few years every other transistor company copied or licensed the Fairchild planar process.

Their first marketed transistor was the 2N697 (1958) and was a huge success. The first batch of 100 was sold to IBM for **$150 a piece.** The first planar silicon transistor was the 2N1613 developed by Jean Hoerni. Its introduction was a historic event in semiconductor technology. Only two years later (1960) they had managed to build a circuit with **four transistors** on a single wafer of silicon, thereby creating the first silicon integrated circuit. (Texas Instruments' **Jack Kilby** had developed an integrated circuit made of germanium on September 12, 1958, and was awarded a U.S. patent. He got the Nobel prize for the IC.) The company grew from twelve to twelve thousand employees, and was soon making $130 million a year.

Reference: Wikipedia

Jack Kilby and the UT-Arlington NanoFab

He cut the ribbon when it was opened in 1999



CONSIDERATIONS FOR A "CLEAN" DEPARTURE: AVOIDING PROBLEMS BEFORE YOUR DEPARTURE

Before you depart your employer to start your new business, it is good practice to run through a series of questions and considerations.

Are you bound by an employee nonsolicitation agreement? Your new startup company should never initiate contact with your former coworkers about any job prospects if you or any other members of your founder team are under a nonsolicitation agreement. Disputes regarding employee nonsolicitation clauses often focus on who initiated contact and when. If the candidate initially contacted the company about employment prospects, then generally there will be no violation of the nonsolicitation clause. As a result, it is critical to maintain documentation establishing how the initial contact was made and when (e.g., an e-mail inquiry from the candidate, an Internet application, or written notes of a telephone inquiry).

Are you bound by a customer nonsolicitation agreement? Your new startup company should not initiate contact with the customers or clients of your former employer if you are subject to a nonsolicitation agreement for the customers of your previous employer. You may announce your new business and your participation, but be cautious about additional solicitation. If a customer does approach you (and not the other way), be certain to document the conversations and keep records as to the formation of the relationship.

CONSIDERATIONS FOR A "CLEAN" DEPARTURE: AVOIDING PROBLEMS BEFORE YOUR DEPARTURE (CONTINUED)

Have you breached your duty of loyalty to your current employer before departing? For example, you should not solicit other employees to leave, undertake any work for the recruiting company, or inappropriately take or gain access to any information. If any such improper activity has occurred, you should promptly consult legal counsel to evaluate whether and how the situation may be corrected and whether it remains feasible to proceed with forming your business and hiring other employees.

Are there any restrictive agreements in your employment documentation and do you have copies in your files (including confidentiality agreements, noncompete agreements, nonsolicitation agreements, etc.)? Soon-to-be founders have a tendency to overlook or "forget about" restrictive agreements, so it is important to be particularly diligent in performing a search on any possible restrictions. Restrictive covenants are often found in confidentiality and invention assignment agreements, offer letters, employment agreements, and stock agreements.

Keep copies!

Have you identified every contractual limitation you would need to observe? For example, if you are bound by a confidentiality agreement, how does the agreement define "confidential information"? What is the scope of any noncompetition agreement? What is the scope of any nonsolicitation clause?

Have you been careful to not reveal any trade secret information? You should identify, at a high level, the areas of trade secret information that may be considered sensitive and avoid tasks that would jeopardize the trade secret. You should also explore the time duration of the sensitivity and plan the timing of forming your business in conjunction with these durations. You should then evaluate whether any work duties you had contemplated undertaking in your new startup could create a risk of using or disclosing such sensitive information in the course of the new job.

Summary

HOW MIGHT YOU VIOLATE YOUR DUTY OF LOYALTY?

The most common mistakes that have been made that could infringe on the duty of loyalty include the following:

- Doing work for your new startup company while still employed by the competitor (also known as moonlighting).
- Soliciting other employees to leave your employer while still employed.
- Taking information or other property from your employer.
- Gaining access to information of your employer for improper reasons (such as customer addresses, pricing information, or research and development plans and goals).

USING WHAT YOU LEARNED FROM YOUR FORMER EMPLOYER

What could happen

While at your former employer, you learned a great deal of technical and market data that your former employer was not effectively leveraging. Can you use it in your new business venture?

Watch out for

Trade secrets learned on the job at your current employer that will be protected even after your departure, preventing you from using or disclosing them. Litigation over use of trade secrets can derail your new business. Courts have not been kind to former employees in these situations. If you were exposed to trade secrets at a former employer and left to work for another employer (including your own business), and your job will be substantially similar, you may increase your risk. Certain cases have found, under a doctrine known as "inevitable disclosure," that it is inevitable that you will use facts and information learned from your previous employer. A court could force an injunction to prevent you from starting your new business or working for your new employer for a number of months until the trade secrets at issue would be considered to have expired or no longer be useful.

Take the time to understand the information you will be using and its source. If you would not have known the information without your former employer and they took actions to protect that information, then tread lightly. Broad understandings of markets is typically of less concern than is specific customer lists or technical specifications. Don't derail your new business by acting careless with information from a former employer.

If there is information, technology, or market data that you want to leverage, you may consider negotiating a license from your former employer.

TIP: Don't risk an injunction by using trade secrets from a former employer.

WHAT IS MISAPPROPRIATION?

The Uniform Trade Secrets Act makes it unlawful to misappropriate trade secrets. Under the act, "misappropriation" is defined as follows:

1. acquisition of a trade secret of another by a person who knows or has reason to know that the trade secret was acquired by improper means; or
2. disclosure or use of a trade secret of another without express or implied consent by a person who:
   - A. used improper means to acquire knowledge of the trade secret; or
   - B. at the time of disclosure or use, knew or had reason to know that his or her knowledge of the trade secret was:
     - i. derived from or through a person who had utilized improper means to acquire it;
     - ii. acquired under circumstances giving rise to a duty to maintain its secrecy or limit its use; or
     - iii. derived from or through a person who owed a duty to the person seeking relief to maintain its secrecy or limit its use; or
   - C. before a material change of his or her position, knew or had reason to know that it was a trade secret and that knowledge of it had been acquired by accident or mistake.

PEPSI AND ITS TRADE SECRETS: AN EXAMPLE

What can happen when a company fears its employees may take their trade secrets to a new employer? Look no further than the story of the Pepsi employee and the Quaker Oats job.

Redmond had worked for PepsiCo for 10 years in various capacities, becoming general manager for noncarbonated drinks. Quaker Oats Co. offered, and Redmond accepted, the job of Vice President of Field Operations for Quaker's directly competing Gatorade product line. PepsiCo sued, claiming that Redmond was privy to trade secret information, such as strategic marketing, pricing and competition plans, as well as innovations in PepsiCo's selling and delivery systems. PepsiCo claimed that Redmond would inevitably use such information in his new job at Quaker.

The federal trial court issued a preliminary injunction prohibiting Redmond from assuming any duties with Quaker that related to beverage pricing, marketing, and distribution for six months. The federal court of appeals upheld this ruling and prevented Redmond from taking a position at Quaker. The court believed that Redmond possessed "extensive and intimate knowledge about [PepsiCo's] strategic goals for 1995 sports drinks and new age drinks" and reasoned that "unless Redmond possessed an uncanny ability to compartmentalize information, he [would necessarily be] making decisions about [Quaker's] Gatorade and Snapple by relying on his knowledge of [PepsiCo's] trade secrets."

Source: PepsiCo Inc. v. Redmond (7th Cir. 1995) 54 F.3d 1262.

Definitions

injunction
an authoritative warning or order.
synonyms: order, ruling, directive, command, instruction;
In LAW:
a judicial order that restrains a person from beginning or continuing an action threatening or invading the legal right of another, or that compels a person to carry out a certain act, e.g., to make restitution to an injured party.

appellee in some jurisdictions the name used for the party who has won at the trial court level, but the loser (appellant) has appealed the decision to a higher court. Thus the appellee has to file a response to the legal brief filed by the appellant. In many jurisdictions the appellee is called the "respondent".

plaintiff
a person who brings a case against another in a court of law.

defendant
a person, company, etc., against whom a claim or charge is brought in a court (opposed to plaintiff).

http://openjurist.org/54/f3d/1262/pepsico-inc-v-e-redmond

PEPSICO, INC., a corporation, Plaintiff-Appellee,
v.
William E. REDMOND, Jr., and The Quaker Oats Company, a corporation, Defendants-Appellants.
No. 94-3942.
United States Court of Appeals, Seventh Circuit.
Argued April 6, 1995.
Decided May 11, 1995.*

Plaintiff **PepsiCo**, Inc., sought a preliminary injunction against defendants William Redmond and the Quaker Oats Company to prevent Redmond, a former **PepsiCo** employee, from divulging **PepsiCo** trade secrets and confidential information in his new job with Quaker and from assuming any duties with Quaker relating to beverage pricing, marketing, and distribution. The district court agreed with **PepsiCo** and granted the injunction. We now affirm that decision.

PepsiCo Agrees to Buy Quaker for $13.4 Billion—year=2000!

A FEW PRACTICAL CONSIDERATIONS OF LEAVING YOUR EMPLOYERS

As you begin to consider leaving your employer, you should consider a few practical considerations:

- **Salary:** Although the concept of foregoing your salary may seem obvious, the reality is that many self-employed entrepreneurs fail to realize the fiscal impact and the likely time period it may be before they can begin drawing a salary. Be certain to plan appropriately. Use the personal financial summary found in Chapter 3 to determine the impact of leaving your employer.
- **Business equipment:** When you depart from your employer, remember that you will no longer have access to certain items of business equipment, such as photocopiers, printers, laptops, software tools, etc. In particular, many of the key tools necessary for operations such as software, laboratory equipment, or other technology will involve the incurrence of substantial expenses.

A FEW PRACTICAL CONSIDERATIONS OF LEAVING YOUR EMPLOYERS (CONTINUED)

- **Insurance:** Insurance is one of the items that many entrepreneurs wrestle with after their departure from their employer. Obtaining insurance when you strike out on your own may be difficult. The first alternative to consider is obtaining coverage under a spouse, partner, or parent's health insurance policy. In the event you are unable to obtain coverage under another policy, one option is to obtain a high-deductible insurance plan (sometimes referred to as a catastrophic illness policy because insureds hope to use them only in the event of a catastrophic illness or injury). The premiums will be much lower when compared with low-deductible plans that would be more in line with the typical coverage an employer provides. However, it is important to keep in mind that these high-deductible plans do limit the benefits to major medical procedures. Some self-employed entrepreneurs will combine the high-deductible health plan with a health saving account (HSA). The benefit of the HSA is that it allows you to pay for medical expenses with pretax dollars. By combining the high-deductible plan with an HSA, you can pay for your routine medical expenses with money from the HSA (pretax dollars) and use the health plan for major medical procedures.