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## EDITOR'S NOTES

Volume 33, No. 1 of the *Canada-United States Law Journal* contains the proceedings of the Canada-United States Law Institute's 2007 Conference titled "Comparative Legal Aspects of Entrepreneurship in Canada and the United States." Panels of experts presented on a wide array of topics throughout the conference, ranging from creating and financing entrepreneurs to examining case studies of successful entrepreneurs. I extend a heartfelt thanks to all our speakers for their insightful contributions.

The publication of the proceedings from the 2007 Conference presents second- and third-year law students the chance to contribute to the editorial process of a very unique issue. This opportunity would not be possible without the aid of several individuals. Firstly, I would like to thank Dr. Henry T. King and Richard Gordon. Together, their experience and abilities have made both the *Journal* and the Institute a distinctive success in the international legal field. In addition, I would like to sincerely thank Dan Ujczko for all his unerring advice and support. He has been an invaluable advisor, and I have appreciated his encouragement and guidance throughout the many meetings, conference calls, and e-mail communications. Deborah Turner has also been a tremendous asset. I would like to extend my sincere thanks to her for all her assistance and support. Additionally, I thank Kelly Schmidt, my Managing Editor, whose organization and diligence in preparing this issue was beyond compare. I could not have asked for a better Managing Editor, and I was impressed with her attention to detail, terrific attitude, and her management of the staff. Finally, I would like to extend my thanks to the entire editorial staff of twenty-three Executive Editors and Associate Editors. They comprise the foundation of the *Journal* and their enthusiasm and abilities in finding and citing the supporting sources were remarkable. The publication of this issue would not have been possible without the foregoing individuals, and I am grateful to them all.

The editorial staff's purpose in editing and reviewing the work of each author has been to improve the readability of each session while maintaining the essence of the Conference. The most important work conducted by the staff was the search for and citation of sources that best supported the speakers' remarks. Any questions regarding factual assertions should be directed to the attention of the speakers. Your continued support and readership is greatly appreciated, and any comments you may have are always welcome. Thank you.

Megan McCarthy  
*Editor-in-Chief*





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VOLUME 33, No. 1

2007

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**PROCEEDINGS OF THE CANADA-UNITED STATES  
LAW INSTITUTE CONFERENCE**

*on*

**COMPARATIVE LEGAL ASPECTS OF ENTREPRENEURSHIP IN  
CANADA AND THE UNITED STATES**

**Cleveland, Ohio  
April 13-14, 2007**

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DIRECTORS OF THE CANADA-UNITED STATES  
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**Richard Gordon** is the U.S. Director of the Canada U.S. Law Institute and an Associate Professor of Law at Case Western Reserve University. He received his B.A. cum laude with Distinction in History from Yale in 1978 and his J.D. cum laude from Harvard in 1984. He teaches courses on business associations, corporate governance, financial sector integrity, and international and comparative taxation. Prior to coming to CWRU, Mr. Gordon practiced law at Dewey Ballantine in Washington and taught at the School of Oriental and African Studies of the University of London, where he was a visiting lecturer in the law faculty, and the Harvard Law School, where he was Deputy Director of the International Tax Program. While at Harvard Mr. Gordon completed extensive field work on law and development in both Indonesia and rural India, and advised the government of Indonesia on the reform of tax, company, and securities laws. After leaving Harvard Mr. Gordon joined the staff of the International Monetary Fund, where worked on a wide variety of issues, including public international law, governance, sovereign debt restructuring, and taxation. Following the attacks of September 11, 2001 he was appointed to the select IMF Task Force on Terrorism Finance and was a principal author of the report on the role of the IMF and World Bank in countering terrorism finance and money laundering. He is a principal author of the book *Tax Law Design and Drafting* (Aspen 2001) and the author of numerous scholarly articles and book chapters.

**Chios C. Carmody** is the Canadian Director of the Canada-United States Law Institute. Since 1999, he has been an Assistant Professor, and since 2004 an Associate Professor of Law at the University of Western Ontario. He received an Honours B.A. from the University of Toronto in 1986, a B.Jour. from California State University, Northridge in 1989, and an LL.B. from the University of Ottawa in 1992, where he was Editor-in-Chief of the *OTTAWA LAW REVIEW*. He was subsequently called to the Bars of Ontario (1994) and New York (1995). He later received an LL.M. from the University of Michigan in 1997 and an S.J.D. from Georgetown University in 2000. Professor Carmody clerked with the Court of Appeal for Ontario and was in private practice for two years before pursuing his graduate studies.

Currently, Professor Carmody teaches in the areas of Public International Law, International Trade Law, International Business Transactions, and the Law of International Organizations.

CANADA-UNITED STATES LAW INSTITUTE CONFERENCE

*on*

COMPARATIVE LEGAL ASPECTS OF ENTREPRENEURSHIP IN  
CANADA AND THE UNITED STATES

April 13-14, 2007

LIST OF SPEAKERS

**Dr. H. Douglas Barber**, born on a Saskatchewan farm, attended the University of Saskatchewan obtaining his B.Sc. with Great Distinction, the Governor General's Gold Medal and a M.Sc. in Electrical Engineering. As an Athlone Fellow and NATO Scholar he received his Ph.D. from Imperial College, University of London in 1965.

Dr. Barber began employment at Canadian Westinghouse, Hamilton, Ontario, Canada. In 1973 he was one of the founders of Linear Technology Inc., now known as Gennum Corporation, which designs, manufactures and markets microcircuits. Gennum has grown profitably at 20% per year and now employs about 650 people. Dr. Barber was President and CEO when he retired in 2000. He continues as a Director.

He was a part-time Engineering Physics Professor at McMaster University from 1968 to 1994. In 2001 he was appointed Distinguished Professor-in-Residence. Dr. Barber authored 29 papers and several patents. He speaks frequently on business, technology, learning, innovation and economic development.

Dr. Barber was actively involved in Microelectronics initiatives in Canada including the Canadian Semiconductor Technology Conference, the Canadian Microelectronics Corporation, the Sectoral Skills Council, the Canadian Semiconductor Design Association, Micronet and the Strategic Semiconductor Consortium.

Dr. Barber's honors include the APEO Engineering Medal, the University of Saskatchewan C.J. Mackenzie Distinguished Graduate Award, the Professional Engineers of Ontario Gold Medal, and Engineer of the Year Award of the Hamilton Engineering Institute. Dr. Barber has received an Honorary Doctorate of Engineering from the University of Waterloo, an Honorary Doctorate of Science from McMaster University, and in 1999 was named Ontario's Technology Entrepreneur of the Year, receiving the National Citation for Innovation & Technology. This year Dr. Barber was appointed as an Officer of the Order of Canada.

He was a Director of the Strategic Microelectronics Consortium, the Canadian Advanced Technology Association, the Hearing Industries Association and the Alberta Microelectronics Corp. He was a member of the Sectoral Skills Council, the Natural Sciences and Engineering Research Council of Canada, the National Innovation Strategy, the Ontario Postsecondary Education Quality Assessment Board and Vice Chair of the Ontario Science and Innovation Council. He was a founding co-chair of the National Information Technology Initiative that sponsored eMPOWR Canada Inc. in 2001, and is a past director of the Golden Horseshoe Venture Forum.

He is a member of the Electrochemical Society, the Institute of Electrical and Electronic Engineers, the Hamilton Civic Coalition and the Burlington Post Secondary Task Force. At McMaster University, Dr. Barber is a member of the Board of Governors, the Senate and the Directors College. He is Chair of the Engineering Dean's Advisory Board. He is a Director of Micralyne Inc., NetAccess Systems Inc., DALSA Corporation, and AllerGen NCE Inc. He is a member of the Conference Board of Canada Leader's Roundtable on Commercialization, the Ontario Ministry of Economic Development and Trade's Commercialization Advisory Council, the Institute of Quantum Computing and the Ontario Research and Innovation Council.

Dr. Barber and his wife, June, have raised a family of four whose families now include eight grandchildren. He is a man of faith with over 30 years of active involvement in their church.

**David T. Morgenthaler** is the founder of Morgenthaler Ventures, a 39 year old venture capital mega-fund with \$2.3 billion under management. David has served as a Director, Chairman, or President of more than 30 companies, and over the last 39 years he has built a national reputation for industry leadership and value-added venture capital investing. He served from 1977 to 1979 as the President then Chairman of the National Venture Capital Association (NVCA). In 1998, he received the first Lifetime Achievement Award by the NVCA for his work in venture capital and has been inducted into The Private Equity Analysts Venture Capital Hall of Fame. He received the first Life Time Achievement Award of the IBF Forum and was named one of the first two Kaufmann Fellows. He was an Advisor to the Brentwood Associates Funds, a Limited Partner of Hambrecht & Quist, and Vice Chairman of the Edison Biotechnology Institute. He is serving or has served as a Trustee of The Cleveland Clinic Foundation, a Member of the Visiting Committee of Carnegie Mellon University, the Sloan School of The Massachusetts Institute of Technology, the Weatherhead School of Business at Case Western Reserve University, and a trustee of various philanthropic organizations. He served as the first Senior Vice President-International for

the Young President's Organization and as President of the Chief Executives Organization. He is a member of the President's Circle of the National Academics of Science and Engineering, and a member of the Board of Science, Technology and Economic Policy of the National Academics. From 1957 until 1968, Dave was CEO of Foseco, Inc., a manufacturer of specialty chemicals financed by J.H. Whitney & Co. Earlier in his career, Dave was a member of the management team of several young growth companies. He received both a BS and a MS degree in mechanical engineering from the Massachusetts Institute of Technology in 1941.

**Gail Lilley** has been a partner at Blake, Cassels & Graydon since 1986. She specializes in mergers and acquisitions of businesses for both Canadian and multinational clients. She has particular expertise in the Canadian aspects of global business transactions, including the cross-border structuring and financing of corporate acquisitions. In 2004, Ms. Lilley advised International Paper on its CAD 1.2 billion sale of Weldwood of Canada Limited to West Fraser Timber Co., and, in 2005, she acted as Canadian counsel for Fortune Brands during the Pernod Ricard's GPB 7.4 billion takeover of Allied Domecq.

**Michael Wager** is a lawyer with Squire, Sanders & Dempsey L.L.P., based in the firm's Cleveland and New York offices. He focuses his practice on the representation of private and publicly held entities in matter of securities regulation, corporate finance, corporate governance, mergers and acquisitions, and strategic growth. Mr. Wager has served as counsel and advisor to, and director of several private and public companies. In 1994, Mr. Wager earned the designation of ADealMaker® from The American Lawyer magazine.

Mr. Wager is active in several civic and philanthropic organizations. He is the vice-chairman (and chair-elect) of the board of the Cleveland-Cuyahoga County Port Authority and a member of the selection committee for the American Marshall Memorial Fellowship (an affiliate of the German Marshall Fund) and as a member of the advisory board of the National Leadership Council of the Ireland Cancer Center of University Hospitals of Cleveland. In addition, he serves as a member of the executive committee of the Jewish Community Federation of Cleveland and the Jewish Council on Public Affairs. Mr. Wagers has also served as the chairman of a Cleveland-based private equity firm. He frequently speaks on matters involving capital formation, securities regulation and change of control transactions.

**A. Malachi Mixon, III** is Chairman of the Board of and Chief Executive Officer of Invacare Corporation (IVC;NYC), the leading worldwide manufacturer and distributor of medical products for the home health care market. 2005 sales were \$1.5 billion. Mal led a leveraged buy-out of Invacare in 1979, when sales were \$19 million.

Mal serves on the boards of The Sherwin-Williams Company (NYSE), The Lamson & Sessions Company (NYSE) and Primus Venture Partners, a leading Midwest venture capital firm. He also is a founding investor in MCM Capital Partners, LP, a Cleveland leveraged buyout company. Additionally, Mal has been an active investor in several successful Cleveland-area ventures which became public companies including Royal Appliance Manufacturing Company (NYSE) and STERIS Corporation (NYSE).

The American Association for Homecare (AAHomecare) presented Mal with the 2006 Humanitarian Award in September recognizing his industry leadership. Also during 2006, Mal was honored by the NAACP Cleveland Branch as the recipient of the 2006 Freedom Fund Award and the Lorain County Urban League presented Mal with the Whitney M. Young Humanitarian Award. In November, 2005, the National Conference for Community and Justice (NCCJ) presented Mal with its 2005 Living and Giving Award. Mal and his wife, Barbara, were honored in November 2003 by the Achievement Centers for Children for their civic and philanthropic contributions to Northeast Ohio. In 2002, Mal received the Business Statesman Award from the Harvard Business School Club of Northeastern Ohio. He received the American Association for Homecare Leadership Award in 2001 in recognition of his dedicated leadership in promoting sound public policy affecting homecare providers and manufacturers. In addition, he received the Distinguished Citizen Award from the Greater Cleveland Council, Boy Scouts of America. He was honored as the Master Innovator at the 2000 Anthem Blue Cross and Blue Shield / Small Business News Business Conference. In 1999 and 1992, Mal was awarded the International Business Executive of the Year Award by the Cleveland World Trade Association. He was honored by the National Multiple Sclerosis Society with the Hope Award for distinguished civic and community service and the Students in Free Enterprise (SIFE) Organization presented him with the America's Free Enterprise Legend Award in 1997. Mal was inducted in 1996 as a charter member into the Cleveland Business Hall of Fame. The Paralyzed Veterans of America honored him with the 1996 Corporate Patriot Award in recognition of his significant commitment to the PVA and to all those who have sacrificed in defense of our country. The National Society of Fund Raising Executives Greater Cleveland Chapter honored Mal in 1995 as Outstanding Philanthropist. In 1992, he was awarded the Inc. Magazine Master Entrepreneur of the Year Award for Northeast Ohio. The Harvard

Business School Club of Cleveland honored Mal with the Dively Entrepreneurship Award in 1984.

A graduate of Leadership Cleveland (1986), Mal's current civic activities include serving as Chairman of the Board of Trustees of The Cleveland Clinic Foundation and the Cleveland Institute of Music. He also serves on the Visiting Committee of Harvard Business School and the boards of BioEnterprise and MWV Pinnacle Capital Management, a fund investing in minority ventures. In 1992, Mal established a chair in entrepreneurial studies at the Weatherhead School of Management at Case Western Reserve University in Cleveland, Ohio. In 1997, he established a Mixon Scholarship in each new freshman class at Harvard College for students from Oklahoma and Northeast Ohio.

Originally from Oklahoma, Mal is a graduate of Harvard College (BA) and Harvard Business School (MBA). Between degrees, Mal served four years in the U.S. Marine Corps, including a year in Vietnam, attaining the rank of Captain. Combat decorations include the Air Medal with Oak Leaf Cluster and Navy Commendation Medal with Combat "V".

Mal and his wife, Barbara, have two children, Elizabeth and Ki, six grandchildren, and live in Hunting Valley, Ohio. He enjoys hunting, golfing and playing the piano.

**David Woolford**, a partner in Cassels Brock's Business Law and Entrepreneurial Business Groups, specializes in business law, corporate finance, e-business, privacy law, and securities law and has published extensively on the subject of emerging developments in technology law. In addition to his busy law practice, Mr. Woolford is an active angel investor (member of the Toronto Angel Group), is Chairman and a director of Virox Technologies Inc., and holds various other private directorships and advisory board positions.

**Morton A. Cohen** joined Clarion in 1981 as chairman of Clarion Capital Corporation, which was then a closed-end mutual fund investing in public and privately-held small companies through private placements. After becoming CEO and assuming sole management of the fund in 1982, he had the distinction of taking the only Small Business Investment Company out of bankruptcy in the history of the Program. Clarion Capital today is an active Small Business Investment Company specializing in private placements in public companies. Mr. Cohen purchased the fund in 1987 and took it private in a leveraged buyout in 1989.

In 1994, Mr. Cohen started Clarion Management Ltd., which managed Clarion Partners, L.P., a domestic hedge fund, Clarion Offshore Fund Ltd., an offshore hedge fund, and Dynamic Equity Hedge Fund, a Canadian-based hedge fund. In 2006, Mr. Cohen liquidated Clarion Partners, L.P. and discontinued managing Dynamic Equity Hedge Fund. He continues to manage Clarion Offshore Fund, Ltd. The three hedge funds had approximately \$140 million in assets at their peak and generated an approximate 15% return since their inception.

Between 1983 and 1989, Mr. Cohen also managed First City Technology Ventures, a venture fund investing in small public companies through private placements, for which he achieved an approximate annual investment rate of return of 25 percent. Additionally, as chairman and CEO, Mr. Cohen took Childers Products, a specialty manufacturing company, from \$2 million in losses to \$5 million in profits and industry dominance before selling it in 1989 to a New York-based leveraged buyout group.

Prior to joining Clarion, Mr. Cohen operated MAC Management, a Canadian-based mergers and acquisitions consulting practice. Among his clients were large Canadian companies, such as Reitman's, Ltd., Hiram Walker, Ivaco Industries, and First City Financial, Ltd. (the Belzberg Family) for which he researched major U.S. acquisition candidates.

Earlier, Mr. Cohen was president of Yorkton Securities, then an institutional boutique, which is today one of Canada's leading securities firms. As such, he was responsible for the firm's research department and creation of an institutional research unit. During this time, he was named to the Canadian Institutional Investor All-Star List in Distilling two years running. Before that, Mr. Cohen managed research departments and serviced institutional brokerage clients for a number of Canadian securities firms including: Kippen & Co., which has since been acquired by Nesbitt Burns and is now the largest Canadian securities firm; Baker Weeks, for which he was vice president and the premier U.S. institutional salesman; and Merrill Lynch, for which he was the top performing salesperson in Canada.

Mr. Cohen is currently a member of the board of directors of Cohesant Technologies, Inc. Formerly, he was governor of the Montreal Stock Exchange (1972-73), a member of the board of governors of the National Association of Small Business Investment Companies (1990-92), and a member of the boards of directors of Sanyo-Canada, Adac Laboratories, Abaxis Co., Alexander Energy, DHB Industries, Inc., and Zemex Corporation. He also served on a Senate committee that rewrote the legislation for the Small Business Investment Company Program.

Mr. Cohen was a member of the Visiting Committee of the Weatherhead Business School of Case Western Reserve University in Cleveland, Ohio and a Trustee of The Jewish Federation of Cleveland. He has also been a major contributor to various Cleveland institutions and the Miriam Home Foundation of Montreal.

Mr. Cohen is Chairman of the Investment Committee of the Jewish Community Federation of Cleveland, which has over \$500 million in investment assets.

A Chartered Financial Analyst, Mr. Cohen holds an MBA in Finance from the Wharton School at the University of Pennsylvania and a BA in Economics from Concordia University in Montreal.

Mr. Cohen has an extensive background in Healthcare and Life Sciences investments having focused the portfolio of Clarion Capital in these areas over the past eight years. Among his present and past investments are Conceptus, Genelabs, NexMed, Inc., Johnson & Johnson, ARIAD Pharmaceuticals, Cepheid, Intuitive Surgical, Abaxis, ADAC Laboratories, Maxim Pharmaceuticals, and a large number of other investments spanning the Healthcare field. During the past five years, Mr. Cohen's portfolio investments in this sector have generated an internal rate of return of over 200%.

He is also the author of a number of financial articles and has been published and quoted over the years in *Barron's*, *Fortune*, *Business Week*, *The Canadian Financial Post*, *the Wall Street Journal*, *Crain's Cleveland Business*, and *The Cleveland Plain Dealer*.

**John Connell** is a career public servant with the Public Service of Canada. He is currently Director General, Small Business Policy, Industry Canada. His responsibilities include the development of policies and programs addressing small business development throughout Canada.

Between 1998 and 2003, John served as Senior Chief, Industry and Knowledge Economy, Finance Canada. He was responsible for analysis and advice concerning microeconomic investments and policies aimed at increasing industry productivity and competitiveness in the knowledge-based economy.

Between 1995-98, John served as a Privy Council Officer in the Economic and Regional Development Policy Secretariat of the Privy Council Office. John handled submissions from the Minister of Industry to Cabinet and briefings on priorities and issues concerning the Industry Portfolio.

Prior to 1995, Mr. Connell had a long and varied career in transportation policy with Transport Canada, with assignments in Ottawa, Vancouver and Canberra, Australia.

John engaged in studies leading to Bachelor of Arts (Honours) and Master's degrees from Queen's University in 1979 and 1980, respectively, concentrating in history, political studies and public administration.

**Gilbert B. Goldberg**, as District Director, is responsible for directing the activities of 11 permanent SBA employees; the administration of a business portfolio of over 6,400 individual loans for a total of more than \$604 million; oversight of the Ohio Small Business Development Center and 17 sub-centers; and the coordination for five chapters of SCORE, a volunteer organization that provides free business counseling. He is also responsible for the marketing efforts of the two SBA sponsored micro-lenders in the District as well as the delivery and oversight of the Agency's 8(a), SDB, and HUBZone government contracting programs for small business. Gil also serves as the National SBA representative under the Agency's Lender Liaison Program for KeyBank and National City Bank. In addition, he was a member of the Agency's Goals Team for four years.

Since his appointment as District Director in 1994, the District Office has focused its attention on putting the customer first by instituting a "cut the red tape campaign" and by holding the staff accountable to quantifiable performance standards through individual empowerment. This bottom line focus on the customer has enabled the District Office to outpace the nation in loan growth in FY95, FY96, FY97, FY98, and FY99. For FY05 the Agency recognized the District Office as the national leader in 7(a) loan growth.

The district in FY99 also developed a campaign that enabled it to achieve record loan growth for African Americans and Hispanics. *Crain's Cleveland Business* recognized the results of the campaign in a November 22, 1999 commentary by publisher Brian Tucker entitled "SBA, local banks are right on target."

In FY2000, the District developed a unique initiative for the economic revitalization of the City of Youngstown by combining SBA resources with those from the banking community and the City. The revitalization initiative couples SBA guaranteed loans with supplemental equity funding and economic assistance from the City of Youngstown. The initiative was expanded to Akron and Toledo in 2002 and 2003 respectively. The District has also developed a similar type of initiative with Cuyahoga County, The

Urban League of Greater Cleveland, Case Western Reserve University, and the Hebrew Free Loan Association for the City of East Cleveland.

Before coming to the SBA as District Director in 1994, Mr. Goldberg spent 20 years in commercial banking. The last ten years were devoted to middle market and entrepreneurial business development in Northern Ohio. He also served as Assistant Treasurer for the Lender Mortgage Company in Cleveland, where he was responsible for treasury operations, including cash management and banking relations. Before that, he was a Vice President at Chase Bank of Ohio.

Mr. Goldberg holds a bachelor's degree in Foreign Service from Georgetown University and a master's degree in Business Administration from the University of Notre Dame.

Gil resides in Shaker Heights with his wife Marcia. They have three grown children.

**William A. Davies** was born in Argentina of an Irish Argentine family, raised in Brazil and educated in the United States. He speaks English, Spanish and Portuguese. He graduated from Purdue University in Economics and has a Degree of JD, cum laude, from Indiana University School of Law.

During his professional life, William A. Davies has worked for a variety of private sector enterprises.

After service in the United States Army he became a Reinsurance Representative of Lincoln National Life Insurance Company with responsibility for Latin America and the Caribbean, it is here that his interest in working with Governments for the benefit of private enterprise was developed as the Life Reinsurance business is highly regulated and a significant part of servicing the Life Insurance company clients was lobbying government on their behalf.

He then pursued a legal career; First with Cahill Gordon Reindhel & Ohl a Wall Street law firm where he had the good fortune to work closely with the former legal adviser to the US State Department who was then a senior partner at the firm; Second with Motorola Inc. where he held successively positions of responsibility advising the business sectors. This included 5 years in Geneva Switzerland where he was very active with the fledgling European Commission in the lobbying of the necessary rules for the Common Market while not hindering the conduct of business.

He served as Vice President and Assistant General Counsel and then as VP and Director of Technology Transfer. He also was the founder and architect of the Motorola Government Relations Team for Latin America, which he successfully led for six years.

He then became a Senior Principal for the professional services firm of DeLevante y Asociados, Panama, R.P. where he consulted for clients throughout the Americas on spectrum, telecommunications and standards issues.

He is currently a General Manager and President of Research in Motion (Barbados) Ltd. His current on the Board of Standards Review of the American National Standards Institute, The Joint Government Private Committee of Experts on Electronic Commerce of the FTAA, and the Board of Trustees of Latin American Young Executives, he has been a member of the Argentine, Venezuelan and Canadian Delegations to the CITEL Permanent Consultative Committees I and II (formerly III), and has been a frequent speaker at industry for a in Latin America and the United States.

**John D. R. Craig** began his career as a law clerk to Chief Justice Antonio Lamer and Justice Charles Gonthier of the Supreme Court of Canada in 1994. He joined Heenan Blaikie in 2001 after several years with another prominent Toronto firm. Mr. Craig practises exclusively in the area of labour and employment law at the provincial, federal and international levels. He also provides advice to clients in connection to strategic planning, contract interpretation and negotiation, pension and benefit administration as well as labour relations policy. Mr. Craig is an adjunct professor of labour law at the University of Western Ontario, where he has been teaching since 1999. He is the author of *Privacy & Employment Law* (Hart Publishing, 1999), a book based on his doctoral thesis. He has also published articles related to labour and employment law in the *McGill Law Journal*, the *Comparative Labour Law & Policy Journal*, the *Industrial Law Journal*, the *Review of Constitutional Studies*, the *European Human Rights Law Review* and the *Canadian Labour and Employment Law Journal*.

**Benjamin W. Jeffers** has experience in complex business disputes for both plaintiffs and defendants, at trial and appellate levels of state and federal courts, as well as other forms of alternative dispute resolution. His practice focuses on commercial matters and class actions, with a particular emphasis on automotive OEM/supplier disputes, antitrust and other unfair trade practice claims, and franchise and distributorship cases. Mr. Jeffers also has significant expertise with insurance company insolvencies and insurance guaranty fund laws. He has successfully represented clients in many areas of

litigation. Mr. Jeffers received both B.A. and J.D. degrees from the University of Michigan.

**Brad D. Cherniak** is Co-Founder and Partner of Sapient Capital Partners, a Toronto-based firm which advises mid-market and early stage companies in the areas of growth and corporate strategy, acquisitions and divestitures, and the sourcing of capital. Mr. Cherniak has close to 20 years of experience in investment research, corporate and investment banking, and merchant banking and private equity/venture capital with such firms as CIBC Wood Gundy, Gordon Capital, Bank of America and Chemical Bank. Mr. Cherniak has long specialized in small – to medium sized, private and early stage companies, both as advisor and principal. He has also served on a number of boards of directors and advisory boards of such companies. Mr. Cherniak graduated Summa Cum Laude from the University of Chicago’s Graduate School of Business.

**Cathy Horton-Panzica**, after being educated in High School by the Quakers at George School in Philadelphia, went on to graduate from the University of Michigan in 1983, The Ohio State College of Law in 1986 and The University of Kent Canterbury Theological College in England in 1999. In 2000, she was ordained as an Episcopal priest.

Cathy has spent over 20 years cultivating a global mergers & acquisitions and venture finance legal practice, serving a myriad of clients that range from the Fortune 100 companies to emerging and mid-market enterprises. She spent 15 years in London, where she developed a passion for technology in the emerging companies’ market place. In Europe, she formed her own consulting practice and worked with global enterprises and start-ups to foster and capture the value of strategic technology innovation. Cathy has dedicated herself to transforming economies through the creation of truly innovative business strategies using technology. While in London, Cathy served as a trusted advisor to the Cabinet Office of the Prime Minister, Tony Blair, to help generate ways in which technology development could drive economic outcomes for Britain. After her years in London, Cathy recently returned to her native United States to continue her practice of law and consult with technology-driven enterprises.

Cathy is the founder and leader of the Red Room Revolution, a set of 20 economic development initiatives structured to transform the Northeast Ohio Region using a technology platform. She also is a founder of the Beta Strategy Group and Beta Opportunity Partners Fund which has made a commitment to fund 24 technology companies in 18-36 months. To date, Cathy has funded 6 companies and founded 3 of her own. She also

envisioned and started the Beta Technology Park in Mayfield Village, Ohio which transformed a decaying industrial park into a tech home for early stage companies to grow using a shared services platform to lower overheads. She has recently renovated an old barn to headquarter her new business, Children's Technology Workshop, which educates second to eighth graders in creative play using technology. Finally, Cathy is an Associate Priest at Trinity Cathedral in Cleveland, Ohio.

**Dr. Robert D. Hisrich** is the Garvin Professor of Global Entrepreneurship and Director of the Center for Global Entrepreneurship at Thunderbird. In addition to his M.B.A. and Ph.D. degrees from the University of Cincinnati, Dr. Hisrich has honorary doctorates from Chuvash State University (Russia) and the University of Miskolc (Hungary), and held Fulbright Professorships at the International Management Center in Budapest and the Foundation for Small Enterprise Economic Development. He has authored or co-authored fourteen books, including *Entrepreneurship: Starting, Developing and Managing a New Enterprise* in its 7th edition and *Small Business Solutions: How to Fix and Prevent the 13 Biggest Problems That Derail Business*. Dr. Hisrich has served on the editorial boards of *The Journal of Business Venturing*, *Entrepreneurship Theory and Practice*, *Journal of Small Business Management*, and *Journal of International Business and Entrepreneurship*. He has instituted academic and training programs such as an entrepreneurship training program for high school teachers in Russia and college level programs at the Institute of International Entrepreneurship and Management in Russia and the Entrepreneurship Center in the Ukraine.

**James Longwell** practices in all areas of intellectual property law, particularly as it applies to computer and information technologies. He advises start-up companies, small businesses, universities and large corporations on intellectual property strategy, including acquisition, protection, exploitation and enforcement issues. Mr. Longwell is also involved in Canadian and foreign patent and trade mark agency, primarily preparing and prosecuting patent applications relating to computer software, hardware, enterprise computing, web development, telecommunications, medical devices, house wares and business methods. Mr. Longwell also provides strategic analysis and advice to business owners and investors for financing, joint ventures, technology procurement, development and commercialization transactions.

**Diane H. Dobrea** is a partner in the Columbus office of the law firm Calfee, Halter & Griswold LLP. She practices in the area of intellectual property law, with a combined focus on intellectual property transactions, and the

preparation, prosecution and maintenance of patent and trademark cases. Though her technical background is in biotechnology, Ms. Dobrea's patent practice also includes nanotechnology, chemical, medical device, and consumer product portfolios. Ms. Dobrea oversees several large patent and trademark portfolios, working extensively with associates at law firms around the world on all aspects of intellectual property management. Serving both for-profit and not-for-profit entities, Ms. Dobrea provides due diligence and freedom to operate analyses, counsels clients on a wide range of research and intellectual property related transactions, and assists in litigation and dispute resolution concerning intellectual property.

Along with her law degree, Ms. Dobrea also received her undergraduate and masters degrees in Biochemistry from Case. She is a member of numerous Bar and Intellectual Property Law Associations and the Association of University Technology Managers, and has been an adjunct professor in Biotechnology Law and Policy at Case's Law School. Prior to joining Calfee, Ms. Dobrea served in the offices of the general counsel and technology transfer at the Cleveland Clinic and in the technology management office of Case's medical school.

**Anthony Penhale** is a partner and a member of the Business Development Committee in the Montreal office of Stikeman Elliott and a member of the Corporate/Commercial Group. His practice is focused primarily in the areas of securities transactions, corporate finance, mergers and acquisitions, privatizations and divestitures. Assignments have included advising a broad range of issuers and underwriters in the context of public offerings and private placements, counseling issuers in connection with securities matters, and advising entities in connection with public market or private acquisitions or divestitures. In addition to Canada, his work experience includes transactions in the United States, the United Kingdom and Eastern and Central Europe, particularly Hungary where he was seconded for a period of six months. Mr. Penhale is featured in the publication *The Best Lawyers in Canada*, 2008 edition in Corporate Law and Securities Law. Mr. Penhale is a member of the Quebec Bar, of the Canadian Bar Association and of the American Bar Association. In addition, he is a member of the Association for Corporate Growth.

**Elizabeth Dellinger** focuses on transactional, capital formation, corporate and contract work for privately held companies, capital restructuring, executive contract and strategic business counseling. Her clients include investment fund portfolio companies, manufacturing, healthcare, aerospace, insurance, bank and non-bank providers of senior capital and institutional

and individual providers of mezzanine and equity capital. Ms. Dellinger represents clients in capital restructuring and workout transactions, as counsel to secured lenders, equity stakeholders and corporate constituents. She is also active in the Negotiated Acquisitions Committee of the American Bar Association's Business Law Section.

**Hon. Eddie Francis, Mayor of Windsor, Ontario**, prior to entering politics, ran and operated Royal Pita Baking Company. His operation's distribution quickly grew to include Ontario and 12 U.S. states. In 2003, he was awarded the Windsor Chamber of Commerce Business Excellence Award as the Young Entrepreneur of the Year. Mayor Francis graduated from the University of Windsor Law School in 2002 and articulated with Miller, Canfield, Paddock, and Stone. Subsequently, Francis was called to the Bar of the Law Society of Upper Canada. Mayor Francis also holds a combined Honours Degree in Chemistry and Biochemistry from the University of Western Ontario.

CANADA-UNITED STATES LAW INSTITUTE CONFERENCE

*on*

COMPARATIVE LEGAL ASPECTS OF ENTREPRENEURSHIP IN  
CANADA AND THE UNITED STATES

April 13-14, 2007

LIST OF PARTICIPANTS

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Morton A. Cohen**	Richard Goetz
John Connell**	Gilbert B. Goldberg**
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Richard Cunningham*	Jon Groetzinger
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\* Session Moderator

\*\* Session Speaker



**CANADA-UNITED STATES LAW INSTITUTE  
ANNUAL CONFERENCE**

*on*

**COMPARATIVE LEGAL ASPECTS OF  
ENTREPRENEURSHIP IN CANADA AND THE UNITED  
STATES**

**APRIL 13-14, 2007**



## CONFERENCE INTRODUCTION AND WELCOME

*Dan Ujcz*  
&  
*Dr. Henry T. King, Jr.*

MR. UJCZO: Good morning. I am Dan Ujcz, the Assistant U.S. Director of the Canada-United States Law Institute, and it is my great privilege and pleasure to welcome all of you to the 2007 Canada-United States Law Institute Annual Conference: Comparative Legal Aspects of Entrepreneurship in Canada and the United States.

As many of you have been here for five, ten and in several instances we have people who have been here all 23 years of the Conference, you know that we run a pretty tight schedule, bell included. So the biographical information of all of the speakers this morning, as well as the most updated schedule, is presented in this program – this six by nine that was available at the registration desk. This is about as up-to-date as we possibly could have it. It came from the printer last evening.

I think there is one speaker change, which you will be apprised of tomorrow. Likewise, at the registration desk, there are the Conference materials – available at the front desk as well. This has background information for all of the sessions that we are having.

As many of you are aware, this event has been approved by the Supreme Court of Ohio for 17.5 hours of Continuing Legal Education credit. The Supreme Court of Ohio is fully electronic right now so the process has changed a bit; there are no more bubble cards for those of you that are familiar with that process. The CLE registration desk is outside in the front as well, and that will be done electronically.

In terms of logistics, for those of you that drove in from Cleveland, Northeastern Ohio, or elsewhere, parking is available across the street at the Cleveland Botanical Gardens. Keep your ticket with you at all times and they will validate you on your way out. That is complementary parking. I know many of you are staying at the Glidden House. There is also parking available there for the guests that are staying there.

For those of you that have been with us as in the past, you recognize this morning is a breach of our customary tradition of opening the event with the founder of the Canada-United States Law Institute: Sidney Picker. Sidney is enjoying retirement in beautiful Sanibel, Florida, and he expresses his regrets for not being here. But he has also resigned from the Board as he is focusing his energies on training young lawyers and judges in the Russian Federation.

So it is my charge this morning to talk a bit about the Canada-United States Law Institute and then quickly turn it over to Henry King to introduce the Conference and our first panelists.

The Institute was created and founded in 1976 by Case Western Reserve University School of Law and the University of Western Ontario Faculty of Law. At that time, it was the only program sponsored by two law faculties, one in Canada, and one in the United States. The innovation of the Institute at that time was that the two law faculties adopted the curriculum of the other law school. Even to this day, any course offered at Western is a course offered at Case and visa versa. We spent all of our money on branding, becoming Case, and Western spent all of its money becoming Western, and at the Institute, we are right back to being Case Western.

And what that adoption of the curriculum allows is that our students can freely transfer and exchange between the two law schools for one semester. All of their credits and grades transfer back with them as well. Our faculty freely exchanges between the two law schools; Richard Gordon, who is just joining us, has just returned from a visit to the University of Western Ontario.

We also publish the *Canada-United States Law Journal*, which is available for all of you outside at the registration table. That's published twice yearly. One is the proceedings of this event, the Annual Conference. Everything is on the record, and it is not uncommon to have calls immediately after the conference saying could you strike that from the *Journal*.

We also publish articles that are submitted by scholars, practitioners primarily, as well as our students – from students not only from the two law schools but throughout Canada and the United States that publish scholarly research – we will publish it in the *Journal* as well.

The Institute was designed to be an academic program, but from its earliest days, it sponsored events such as these: conferences for the public and private bars in each country as well as government officials, industry leaders, the media and other scholars. Indeed, one of its first conferences was the first time that a sitting Supreme Court Justice of the Supreme Court of Canada and Supreme Court of the United States sat on the same panel. It was the first time in history since 1981 at the Institute.

But the Institute experienced great success in 1983 when Henry King came not only from his days at the Nuremberg Tribunals but also from TRW and brought with him his professional and personal experience to the Institute and launched a three day – at that time two and-a-half day – retreat type conference: the Annual Conference.

For the past 23 years, it is the predominant forum in Canada-U.S. relations where, again, government officials, industry leaders, businesspersons, legal practitioners, scholars, and the media assemble to

address the issue of the day. While we focus on law – and we mentioned this a bit last night because we are a law institute – it allows us to address any of the myriad of issues confronting the Canada-United States relationship, whether it be trade, the FTA, NAFTA trade and services, but also the environment, Great Lakes, the energy and now, certainly in the world in which we now live, security.

Now, that, in sum, is the Canada-United States Law Institute. We have launched a number of programs in the past year. Each law school is proud to have a Canada-U.S. based curriculum. We sponsor student exchange programs. The University of Western Ontario has, I believe, 17 exchanges throughout schools in North America. Case Western has programs throughout the world but also the exchange program between our two law schools as well as the University of Ottawa, both common and civil law programs. We, again, publish the *Canada-United States Law Journal*, and we host events in Toronto, Washington, Vancouver, and we are looking at programs in Calgary as well. So you not only have to be in Cleveland, we will be coming to you and will continue to do so.

Before turning it over to Henry, I know that some of you arrived before delivery of a box. All of you, beyond the materials I just described in the *Canada-U.S. Law Journal*, there is a bag here that has a portfolio and a Canada-U.S. based pin and our favorite new logo. It is meant to be two sails by the way. That was the graphic design. I have been learning all about graphic design in the past year.

So without further ado, I will again welcome you, but I will now turn it over to the lifeblood of the Canada-United States Law Institute, its U.S. Director, Henry King.

DR. KING: Thanks, Dan. And I don't think Dan's very unusual ability and special contribution to the work of the Institute should be overlooked.

I am going to begin by opening this conference with a few remarks and then introduce the program. Canada and the United States share an entrepreneurial spirit that has rendered our two nations as leaders in the global economic environment. In order to remain economically competitive in the years to come, Canada and the United States must continue to cultivate a society of entrepreneurs.

Throughout this two-day conference, the Canada-United States Law Institute will bring together leading entrepreneurs, legal experts, government officials and scholars to explore the current state of entrepreneurship in our two countries. Panelists will examine entrepreneurial ventures from the manner in which to structure the venture, securing financing, recruiting and retaining entrepreneurs, protecting intellectual property, capitalizing on IPOs, and exploring governmental sources of support. The Conference will also feature remarks from highly successful entrepreneurs.

As in the past, the Conference proceedings will be published in the *Canada-U.S. Law Journal*, the leading academic journal focusing on the Canada-U.S. legal relationship.

Now I turn to the substance of our program. First of all, we'll be drawing the broad strokes in dealing with the relationship of entrepreneurship to economic growth, job creation, and wealth creation. I will be chairing this session with David Morgenthaler, who is a founding partner of Morgenthaler Ventures in Cleveland, Ohio, and H. Douglas Barber, former president and CEO of Gennum Corporation in Ontario. They will be our speakers.

Our next session will deal with structuring entrepreneurs. We'll be dealing with forms of entities, management provisions, and alternative dispute resolution provisions, et cetera. Here, Gail Lilley of Blake, Cassels & Graydon in Toronto and Michael Wager of Squire, Sanders & Dempsey in Cleveland will be our speakers. The session will be chaired by Silvana Alzetta-Real, Coca-Cola's Vice-President and Divisional Counsel in Toronto.

The luncheon speaker will be A. Malachi Mixon, Chair and CEO of Invacare Corporation in Elyria, Ohio. He will discuss what it means to be an entrepreneur. This session will be chaired by Lawrence Herman of Cassels, Brock & Blackwell in Toronto.

Our early afternoon session will deal with private financing of entrepreneurs. Our U.S. speaker will be Morton Cohen, Chairman and CEO of Clarion Capital Corporation of Cleveland and our Canada speaker will be David Woolford, a partner in Cassels, Brock & Blackwell in Toronto.

Our late afternoon session will deal with government assistance to entrepreneurship. Here, John Connell of Industry Canada and Gilbert Goldberg of the Cleveland Office Small Business Administration will be the speakers. The session will be chaired by Ron Straatsma of Toronto.

Our evening session on the first day of the Conference will be devoted to a case study of a successful private entrepreneurship. Substituting for Mike Lazaridis of Blackberry will be Bill Davies of Barbados representing Blackberry. The session chairman will be Dick Cunningham of Steptoe & Johnson in Washington, D.C.

The second day of our conference will open up with a few remarks from Dan Ujcz, Assistant Director of the Canada-U.S. Law Institute. And our first full session will deal with people aspects of entrepreneurship. Our U.S. speaker will be Benjamin Jeffers of Dykema Gossett in Detroit and our Canada speaker will be John Craig of Heenan Blaikie in Toronto. Jerry Torma of Nordson Corporation of Cleveland will chair this session.

Our second session on day two will deal with the importance of venture capital in promoting entrepreneurship. Here our U.S. speaker will be Cathy Bosworth-Horton with the Beta Strategy Group in Cleveland, and our Canada speaker will be Brad Cherniak of Sapient Capital Partners in

Toronto. Professor Daniel Sandler of the University of Western Ontario will chair this session.

On day two of our conference, Robert Hisrich of Thunderbird School of Management in Glendale, Arizona will be our speaker, and he will discuss where the U.S. and Canada stand vis-à-vis other countries regarding entrepreneurship. James McIlroy will chair this session.

Our early afternoon session on day two will deal with intellectual property aspects of entrepreneurship. Here Diana Dobrea, a partner with Calfee, Halter & Griswold in Columbus, Ohio, will be our U.S. speaker, and our Canada speaker will be James Longwell of Gowling, Lafleur, Henderson in Toronto. Professor Raymond Ku of Case Western Reserve University will chair this session.

Our late afternoon session on day two of the Conference will be capitalizing on the success of entrepreneurship. Elizabeth Dellinger of Baker & Hostetler in Cleveland will be our U.S. speaker, and Anthony Penhale of Stikeman Elliott in Montreal will be our Canadian speaker. This session will be chaired by Professor Richard Gordon of Case Western Reserve University.

Our final substantive session will deal with entrepreneurship, business and government. Here the Honorable Eddie Francis, Mayor of Windsor, Ontario, will be our featured speaker. This session will be chaired by Charles Magerman of Baker & McKenzie in Toronto.

We shall have a very brief roundup session to end the conference, which will deal with where we go from here, and I will chair that session.



## THE IMPORTANCE OF ENTREPRENEURSHIP TO ECONOMIC GROWTH, JOB CREATION AND WEALTH CREATION

*Session Chair – Dr. Henry T. King, Jr.  
Canadian Speaker – Dr. H. Douglas Barber  
United States Speaker – David T. Morgenthaler*

### INTRODUCTION

*Dr. Henry T. King, Jr.*

DR. KING: Let's start our first session. I will call on David Morgenthaler first. Your remarks I wanted to – you have got all the details on David Morgenthaler, in his bio, and also my Canadian friend, Douglas Barber – it is all in the bio data. But I just want to repeat one or two things. He is the founder of Morgenthaler Ventures, a 39 year-old venture capital mega-fund with \$2.3 billion under management. David has served as director, chairman, and president of more than 30 companies, and over the last 39 years, he has developed a national reputation for industry leadership and value added venture capital investment. I don't want to take any of your time. I want to hear what you have to say on our opening subject, David. So the floor is yours.

## UNITED STATES SPEAKER

*David T. Morgenthaler\**

MR. MORGENTHALER: Thank you very much, Henry. It is very nice to be with you this morning, and thank you for inviting me. Henry assigned me the topic of the relationship of entrepreneurship to economic growth, job creation, and wealth. This is a subject that is relevant to me as I phase down in the venture business.

The formal venture institutional business really started in 1945, right at the end of World War II.<sup>1</sup> I came back out of the service and became an entrepreneur at that time. So I have been on either side, as both an entrepreneur financed by venture capital and working with venture capitalists. And for the last 39 years I moved across the table. I stopped making an honest living as an entrepreneur and became a venture capitalist.

Question: How does entrepreneurship relate to economic growth, job creation and wealth? Sadly, the answer is that entrepreneurship is nearly everything. This was a very hard thing to get our United States Congress to

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\* David T. Morgenthaler is the founder of Morgenthaler Ventures, a 39-year-old venture capital mega fund with \$2.3 billion under management. David has served as a Director, Chairman, or President of more than 30 companies, and over the last 39 years he has built a national reputation for industry leadership and value-added venture capital investing. He served from 1977 to 1979 as the President and then Chairman of the National Venture Capital Association (NVCA). In 1998, he received the first Lifetime Achievement Award by the NVCA for his work in venture capital and has been inducted into The Private Equity Analysts Venture Capital Hall of Fame. He received the first Life Time Achievement Award of the IBF Forum and was named one of the first two Honorary Kauffman Fellows. He was an Advisor to the Brentwood Associates Funds, a Limited Partner of Hambrecht & Quist, and Vice Chairman of the Edison Biotechnology Institute. He is serving or has served as a Trustee of The Cleveland Clinic Foundation, a Member of the Visiting Committee of Carnegie Mellon University, the Sloan School of The Massachusetts Institute of Technology, the Weatherhead School of Business at Case Western Reserve University, and a trustee of various philanthropic organizations. He served as the first Senior Vice President-International for the Young Presidents' Organization and as President of the Chief Executives Organization. He is a member of the President's Circle of the National Academies of Science and Engineering, and a member of the Board of Science, Technology and Economic Policy of the National Academies. From 1957 until 1968, Dave was CEO of Foseco, Inc., manufacturer of specialty chemicals financed by J.H. Whitney & Co. Earlier in his career, Dave was a member of the management team of several young growth companies. He received both a BS and a MS degree in mechanical engineering from the Massachusetts Institute of Technology in 1941.

<sup>1</sup> See, e.g., Gerald P. Buccino & Kraig S. McKinley, *Turnaround Topics: Is Excess Liquidity Deferring Business Distress?*, 16 AM. BANK. INST. J. 28, 30 (1997); see also Duke K. Bristow et al., *Venture Capital Formation and Access: Lingering Impediments of the Investment Company Act of 1940*, 2004 COLUM. BUS. L. REV. 77, 89 (2004).

believe back in the early 1970s when we formed the National Venture Capital Association,<sup>2</sup> of which I was very active in the formation, and in getting a lot of the legislation changed as well as the capital gains tax rolled back.<sup>3</sup> At that time, the view of our leaders in the country, and certainly the view of our Congress, was that the big companies were nearly everything; they were where jobs were created, they were where wealth was created, and the little companies were kind of a nuisance. In a way, when I came out of graduate school in 1941, that was the attitude at the time. As we dug deeply into this we finally pointed out this fallacy to Congress and got many of the changes that were needed made.<sup>4</sup> The differences were that the large companies were not increasing employment.<sup>5</sup> In many cases, they were moving their operations, particularly their manufacturing operations, out of the older areas, out of the high cost areas, moving them to the lesser cost areas and subsequently moving them outside of the country.<sup>6</sup> It became very important to understand this phenomenon, and the country was very slow to understand it.

It is the sad fact that entrepreneurship is nearly everything – and this bodes badly for the economically mature regions of the country, and even of the world – because one of the characteristics of a mature region is that entrepreneurship tends to fall off.<sup>7</sup> Now why is this true? And, why is it so little is understood by the leadership of the successful regions (underscore *successful*) when they are at their peaks and have the most resources to do something about it? Not only do they lose new companies but, more disturbingly, they show that the regions' industries are mature.

To understand this, it is necessary to think clearly about some practical, realistic, and fundamental factors. The first is that economics drive nearly everything. Go back to the discovery of America. Columbus was an entrepreneur<sup>8</sup> with a very difficult personality<sup>9</sup> history tells us – not untypical

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<sup>2</sup> See About Morgenthaler, <http://www.morgenthaler.com/about.asp> (last visited Sept. 23, 2007).

<sup>3</sup> *Id.*

<sup>4</sup> See, e.g., *id.*

<sup>5</sup> See JUDITH C. BLACKWELL, ET AL., *CULTURE OF PREJUDICE ARGUMENTS IN CRITICAL SOCIAL SCIENCE* 128 (Broadview Press 2003) (“[S]mall- to medium-sized businesses still create far more jobs than do the big transnational corporations operating in the US and Canada.”).

<sup>6</sup> See Ana L. Revenga, *Exporting Jobs?: The Impact of Import Competition on Employment and Wages in U.S. Manufacturing*, 107 Q. J. OF ECON. 255, 255-258 (1992) (discussing the increase in import penetration ratios compared with the fall of U.S. manufacturing employment during 1975 through 1985).

<sup>7</sup> See Linghui Tang & Peter E. Koveos, *Venture Entrepreneurship, Innovation Entrepreneurship, and Economic Growth*, 9 J. DEVELOPMENTAL ENTREPRENEURSHIP 161, 163 (2004).

<sup>8</sup> Pres. George Bush, Statement for U.S. Department of State Dispatch: North American

of entrepreneurs<sup>10</sup> – whose belief that the world was round<sup>11</sup> gave him an opportunity to reach the riches of the Asian markets by sailing West.<sup>12</sup> Columbus was almost a prototype entrepreneur.<sup>13</sup> Such a person believes that he sees a business opportunity and a way to fill it, somehow collects the resources needed, and drives the project through.

The elements listed are like the legs of a stool – omit one, and the stool collapses. There must really be an opportunity – usually called an existing or potential market;<sup>14</sup> a way to fill it – usually called the product or the service; the resources needed – usually called the venture capital;<sup>15</sup> and the person (or people) to drive the project to success – usually called the entrepreneur.<sup>16</sup>

Columbus sought one opportunity but found another: America.<sup>17</sup> What led multitudes to flock to it? It was rich, productive, and free land, when productive land was wealth.<sup>18</sup> Nobody flocked to the Sahara Desert, where there also was free<sup>19</sup> but *unproductive* land.<sup>20</sup> Also, in America there was free

Free Trade Agreement (Aug. 17, 1992) (“Christopher Columbus was an entrepreneur”) available at [http://findarticles.com/p/articles/mi\\_m1584/is\\_n33\\_v3/ai\\_12686819](http://findarticles.com/p/articles/mi_m1584/is_n33_v3/ai_12686819).

<sup>9</sup> See, e.g., Paul E. Hoffman, *Book Review: Columbus: The Great Adventure. His Life. His Times, and His Voyages*, 49 WM. & MARY Q., 3d Ser., No. 2, 372 (1992) (“Columbus cannot remain friends with close collaborators.”), available at <http://www.jstor.org/view/00435597/di976410/97p0091y/0>.

<sup>10</sup> See BILL BOLTON & JOHN THOMPSON, *ENTREPRENEURS: TALENT, TEMPERAMENT, TECHNIQUE* 265 (Elsevier 2004) (“[E]ntrepreneurs are often strongly individualistic and difficult to work with in groups.”).

<sup>11</sup> See generally Valerie I. J. Flint, *Columbus, Christopher*, <http://search.eb.com/eb/article-9109621> (describing Columbus and his voyages to North America).

<sup>12</sup> *Id.*

<sup>13</sup> See generally Entrepreneur, Oxford English Dictionary Online, <http://dictionary.oed.com> (search entrepreneur) (last visited Sept. 23, 2007) [hereinafter Entrepreneur].

<sup>14</sup> See, e.g., Ronald J. Gilson, *Engineering a Venture Capital Market: Lessons from the American Experience*, 55 STAN. L. REV. 1067, 1068-1077 (2003); see also Christopher Gulinello, *Engineering a Venture Capital Market and the Effects of Government Control on Private Ordering: Lessons from the Taiwan Experience*, 37 GEO. WASH. INT’L L. REV. 845, 845-850 (2005).

<sup>15</sup> See Gilson, *supra* note 14 at 1070.

<sup>16</sup> *Id.*; see also Entrepreneur, *supra* note 13.

<sup>17</sup> Flint, *supra* note 11.

<sup>18</sup> See, e.g., David C. Korten, *The Difference Between Money & Wealth: How out-of-control Speculation is Destroying Real Wealth*, <http://www.pcdf.org/1999/wealth.htm> (last visited Oct. 5, 2007) (“Real wealth is in. . . fertile land”); see also United States, Encyclopedia Britannica Online, <http://search.eb.com/eb/article-77683> (last visited Sept. 25, 2007) (discussing the European exploration and settlement of the United States for Commercial gains) [hereinafter United States].

<sup>19</sup> See DAVID PROCHASKA, *MAKING ALGERIA FRENCH: COLONIALISM IN BONE, 1870-1920* 152 (Cambridge University Press 1990) (“[T]he initial French response [in Algeria] was to offer prospective French settlers the inducement of free land. But relatively few accepted the offer”).

timber, free furs, and the hope of gold.<sup>21</sup> Of course, freedom from religious and political discrimination,<sup>22</sup> desire for adventure,<sup>23</sup> et cetera, also brought people.<sup>24</sup> But, make no mistake – the desire for an economically better life drove most of it.<sup>25</sup>

The influx of people provided markets, the flexible and relatively free society let people exercise their entrepreneurial urges without much restraint, and the huge country provided the resources.<sup>26</sup> The innovation was the sudden availability of a new, rich, relatively unused continent. In England and Europe most of the land was already owned and planted.<sup>27</sup> Both England and Europe were, relatively speaking, mature, and innovations were becoming more technically based,<sup>28</sup> such as water-powered mills and later steam engines.<sup>29</sup>

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<sup>20</sup> See C.B. Fawcett, *The Extent of the Cultivable Land*, 76 THE GEOGRAPHICAL J. 504, 505 (1930) (“[A]rid deserts may at once be written off as uncultivable”).

<sup>21</sup> Exploration and Settlement of The Last Frontier by Europeans and Easterners, <http://www.stumpranchonline.com/skagitjournal/Washington/Gen/ExplorationI.html> (last visited Oct 5, 2007) (“[The] great interest in the western shores of America [is] because of the great natural resources of furs, timber, gold”); see generally United States, *supra* note 18.

<sup>22</sup> E.g. An Outline of American History, The Search for Religious and Political Freedom, [http://www.let.rug.nl/~usa/H/1990/ch1\\_p3.htm](http://www.let.rug.nl/~usa/H/1990/ch1_p3.htm) (last visited Oct 5, 2007).

<sup>23</sup> Sen. Mike Crapo, *Profound Desire For Adventure*, [http://itd.idaho.gov/transporter/2005/031105\\_Trans/031105\\_Crapo.html](http://itd.idaho.gov/transporter/2005/031105_Trans/031105_Crapo.html) (last visited Oct 5, 2007) (“[Americans] are the descendants of pioneers whose desire for a better life was mixed with a spirit of adventure.”).

<sup>24</sup> See generally, United States, *supra* note 18.

<sup>25</sup> See Vitor Pinto, *Immigration to America: Understanding Immigration Helps Explain American People*, [http://www.associatedcontent.com/article/206527/immigration\\_to\\_america\\_understanding.html](http://www.associatedcontent.com/article/206527/immigration_to_america_understanding.html) (last visited Oct 5, 2007) (“[S]ettlers were seeking wealth, land and freedom – a better life.”).

<sup>26</sup> See generally Expanding Markets and Moving West, [www.thomasloveshistory.com/9%20Westward%20Expansion.ppt](http://www.thomasloveshistory.com/9%20Westward%20Expansion.ppt) (last visited Oct. 5, 2007) (identifying role of markets, entrepreneurial spirit, and land resources in America’s westward expansion.); see also Virginia, Encyclopedia Britannica Online, <http://search.eb.com/eb/article-77685> (last visited Sept. 25, 2007) (explaining the foundation of the American colonies, Virginia in particular).

<sup>27</sup> See Samuel C. Alessi, *The Coming of the Italians to Chautauqua County*, <http://freepages.genealogy.rootsweb.com/~cheetah/history.html> (last visited Oct 5, 2007) (explaining how the condition where “there was no land which the landless peasants could work and produce food. . . prevailed over most of Europe.”).

<sup>28</sup> See, e.g., PETER MATHIAS, *THE FIRST INDUSTRIAL NATION: THE ECONOMIC HISTORY OF BRITAIN 1700-1914* 121 (Routledge 2001) (discussing technical innovations including water-powered mills and the steam engine.); see also Azizah Y. al-Hibri, *The American Corporation in the Twenty-First Century: Future Forms of Structure and Governance*, 31 U. RICH. L. REV. 1399, 1413-1423 (1997).

<sup>29</sup> *Id.*

In the United States and Canada, the innovations to exploit the vast continental resources continued.<sup>30</sup> First came the canals,<sup>31</sup> which opened the rich soils of the Great Plains to the East Coast and even to world markets<sup>32</sup> for the grains that could be produced so much better in Ohio and the Midwest than in the flinty soils of New England.<sup>33</sup> The result of the canals was that the cost of shipping a ton of grain from Ohio to New York dropped from \$120 a ton to \$6 a ton.<sup>34</sup> From New York, cheap ocean transportation<sup>35</sup> made the world markets available and drove the expansion of Midwest farming.<sup>36</sup> The innovation of the railroads followed, enabled by the steam engine,<sup>37</sup> bringing more flexibility and, thus, tying all regions together.

Note the theme of what I have said so far, that economics drives nearly everything, and innovations, of some kind – new beliefs, new concepts, new inventions, new resources, and new ways of doing things – are what stimulate the economics of a region, a country, or even the world.

Not for nothing were the 1,000 years after the fall of the Roman Empire called the Dark Ages<sup>38</sup> – beliefs became rigid<sup>39</sup> and compulsory,<sup>40</sup> and new

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<sup>30</sup> Nathan Rosenberg, *American Technology: Imported or Indigenous?*, 67 AM. ECONOMIC REV. 21, 21-22 (“Much of [America’s technological innovation] was specifically geared to the intensive exploitation of natural resources which existed in considerable abundance relative to capital and labor.”).

<sup>31</sup> See generally Leah M. Green, *The Erie Canal and the American Imagination: The Erie Canal’s Effects on American Legal Development, 1817-1869*, 56 ALA. L. REV. 1167 (2005) (exploring the canal development as a catalyst for economic change and its legal effects).

<sup>32</sup> See *id.*

<sup>33</sup> See OH. STATE BD. AGRIC., Sixth Annual Report of the Board of Agriculture of the State of Ohio for the Year 1851, at 179 (State Printers 1852) (discussing the West’s soil as being superior to that of New England and the Eastern states).

<sup>34</sup> See NOEL M. BURNS, *ERIE: THE LAKE THAT SURVIVED*, 20 (Rowman & Allanheld 1985) (“[W]hen the Erie Canal was opened eight years later in 1825, the cost of moving freight from Lake Erie to New York dropped from \$120 to \$4 per ton.”).

<sup>35</sup> See generally Green, *supra* note 31.

<sup>36</sup> See An Outline of American Geography: Regional Landscapes of the United States, [http://guangzhou.usembassy-china.org.cn/uploads/images/wNU1FJ-higASwtYYPILXog/An\\_Outline\\_of\\_American\\_Geography.doc](http://guangzhou.usembassy-china.org.cn/uploads/images/wNU1FJ-higASwtYYPILXog/An_Outline_of_American_Geography.doc) (last visited Oct 5, 2007) (“[T]he construction of the Erie Canal, and later other canals farther west, made the markets of the East Coast more accessible to western farmers.”).

<sup>37</sup> See Stephen B. Goddard, *The Road to Now*, 553 ANNALS AM. ACAD. POL. & SOC. SCI. 30 (1997).

<sup>38</sup> See Middle Ages, ENCYCLOPEDIA BRITANNICA ONLINE, <http://search.eb.com/eb/article-9052537> (last visited Sept. 24, 2007) (explaining the period as “a thousand-year period of darkness and ignorance.”).

<sup>39</sup> *Id.*; see also Robert Freeman, *An Entire World Turned Upside Down: The Scientific Revolution in Europe at* 4, [http://www.mvla.k12.ca.us/Projects/694/World\\_Studies/English\\_Civil\\_Wars/Scientific\\_Revolution\\_GM.pdf](http://www.mvla.k12.ca.us/Projects/694/World_Studies/English_Civil_Wars/Scientific_Revolution_GM.pdf) (last visited Oct. 5, 2007) (“[A]ll thought was dominated by the rigid religious orthodoxy”).

<sup>40</sup> See Freeman, *supra* note 39 (stating “Reason was suppressed”).

ideas were frozen out.<sup>41</sup> People like Galileo and others were confined to house arrest and punished for offering new ideas.<sup>42</sup> It was a time of almost total lack of innovation.<sup>43</sup>

But, back to America. The railroads, enabled by the steam engine, tied the country together cheaply and flexibly.<sup>44</sup> Think of what that innovation did! For the first time in the history of the world, man could travel faster than the speed of a horse.<sup>45</sup>

The railroads were quickly followed by a host of lesser but important innovations – the telegraph, the telephone, electrical lighting to replace kerosene lighting.<sup>46</sup> John D. Rockefeller got rich on kerosene.<sup>47</sup> He didn't get rich on gasoline; it was the lighting empire that built the Standard Oil wealth.<sup>48</sup> Gasoline in the beginning was a dangerous and unwanted by-product.<sup>49</sup>

Other lesser innovations: skyscrapers were enabled by the innovation of the elevator;<sup>50</sup> electrical power came along and replaced the water wheels.<sup>51</sup> The reason New England was the center of the wool and manufacturing industry, the weaving industry, was because it had so many small rivers with falls in them, so that you could have water powered wheels, which, through a

<sup>41</sup> See generally *id.*

<sup>42</sup> William H. Eddy, Jr., *Mind Over Matter: The Coming Revolution in the Natural Sciences*, 45 NAT. RESOURCES J. 521, 523 (2005).

<sup>43</sup> See The History Guide Lectures on Ancient and Medieval European History, Charlemagne and the Carolingian Renaissance, <http://www.historyguide.org/ancient/lecture20b.html> (last visited Oct. 5, 2007) (“There [was] little or no intellectual pursuit -- no creativity, no innovation in the arts, the learning, no science.”).

<sup>44</sup> See Goddard, *supra* note 37, at 31-2.

<sup>45</sup> *Id.* (“Before the iron horse, the flesh-and-blood equine had limited how people related to time and space.”).

<sup>46</sup> See The Growth of Industry, ENCYCLOPEDIA BRITANNICA ONLINE, <http://search.eb.com/eb/article-77810> (last visited Sept. 24, 2007).

<sup>47</sup> See generally Kenneth W. Rose, *Rockefeller, John D.*, AM. NAT. BIO. ONLINE, <http://www.anb.org/articles/10/10-01418.html> (last visited Sept 26, 2007).

<sup>48</sup> *Id.*; see also Standard Oil Co. (Indiana), ENCYCLOPEDIA OF CHICAGO, <http://www.encyclopedia.chicagohistory.org/pages/2863.html> (last visited Oct. 5, 2007) (“During these years, the company's main product was kerosene”).

<sup>49</sup> See Kenneth E. Boulding, *Agricultural Economics in an Evolutionary Perspective*, 63 AM. J. AGRIC. ECON. 788, 793 (1981); see also L. M. Gibbs, *Gasoline Specifications, Regulations, and Properties*, 104 AUTOMOTIVE ENGINEERING, 35 (1996) (“Gasoline . . . was an undesirable by-product of kerosene manufacturing.”).

<sup>50</sup> Jean Gottmann, *Why the Skyscraper?*, 56 GEOGRAPHICAL REV. 190, 191 (1966) (“The multistoried building of considerable height was made possible by a remarkable contraption, the passenger elevator”).

<sup>51</sup> See S. SRINIVASAN & C. YANG, *FUEL CELLS FROM FUNDAMENTALS TO APPLICATIONS* 620 (Springer US 2006) (“[T]he hydraulic turbine replaced the water wheel.”).

series of belts and pulleys, opened up the factories.<sup>52</sup> These were replaced originally by steam engines, which meant you could put the factories where you wanted, and then electrical power gave you more flexibility.<sup>53</sup> And there were countless other lesser innovations that gave mankind benefits which he needed or he thought he wanted. The mold board plow<sup>54</sup> made farming the fertile but heavy prairie soil practicable.<sup>55</sup> The cotton gin made that crop useful,<sup>56</sup> and the list goes on and on. *Innovations, innovations, innovations!* That's the most important word I will use today. And the world has discovered the concept.

Earlier this week I conferred by video conference with a group from Singapore who met in our Silicon Valley office. They were told to call on me by the Singapore Minister of Finance. We manage a large amount of money for the Singapore government.<sup>57</sup> This group, which was from the Singapore National Research Foundation,<sup>58</sup> was put together to coordinate the national R&D,<sup>59</sup> innovation and enterprise efforts of Singapore, and advance its economy.<sup>60</sup> That was stated in their mission.<sup>61</sup> They advise the Research, Innovation, and Enterprise Council,<sup>62</sup> chaired by the prime minister himself.<sup>63</sup> Think of our President or the Prime Minister of Canada personally chairing a research and innovation council! The goal of the group was to

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<sup>52</sup> See Robert B. Gordon, *Cost and Use of Water Power during Industrialization in New England and Great Britain: A Geological Interpretation*, 36 *ECON. HIST. REV.* 240, 241-42 (1983) (“[The] concentration of many water-power mills in an industrial city was possible in only those few localities where power canals could be built to distribute water from large dams, as in the Massachusetts towns”).

<sup>53</sup> *Id.* at 242 (“[S]team power. . . permit[ted] growth above the bounds set by the capacity of the hydraulic power systems. . . [and] towns could chose between two competing power sources”).

<sup>54</sup> Lowry Nelson, *The American Rural Heritage*, 1 *AM. Q.* 225, 227-228 (1949).

<sup>55</sup> See *id.*

<sup>56</sup> See generally Paul Finkelman, *The Founders of Slavery: Little Ventured, Little Gained*, 13 *YALE J.L. & HUMAN.* 413, 419 (2001); see also History of Cotton, <http://www.cotton.org/pubs/cottoncounts/story/index.cfm> (last visited Oct 5, 2007) (“[T]he cotton gin in the U.S. paved the way for the important place cotton holds in the world today. . . [because it] could do the work 10 times faster than by hand.”).

<sup>57</sup> See Press Release, Walden International, *Why Your US Venture Capitalist is Not Calling You* (Feb. 16, 2001), [http://www.wiig.com/main/news\\_035.htm](http://www.wiig.com/main/news_035.htm) (“The Government of Singapore Investment Corp (GIC) and Temasek Holdings are among investors in Morgenthaler's funds.”).

<sup>58</sup> See generally National Research Foundation, <http://www.nrf.gov.sg/> (last visited Oct. 6, 2007).

<sup>59</sup> National Research Foundation, <http://www.nrf.gov.sg/> (follow “About Us” hyperlink; then follow “Our Establishment” hyperlink) (last visited Sept. 26, 2007).

<sup>60</sup> *Id.*

<sup>61</sup> *Id.*

<sup>62</sup> *Id.*

<sup>63</sup> *Id.*

understand more of the enterprise eco-system in the U.S., to try to learn what makes the U.S. innovation system so successful, and to try to identify further growth areas for their future programs.<sup>64</sup>

Next week I am chairing a conference in Washington put on by the Science, Technology and Economics Board of the National Academies,<sup>65</sup> which consist of the National Academy of Science, the National Academy of Engineering, and the Institute of Medicine.<sup>66</sup> This is a free conference to advise public policy makers<sup>67</sup> and held at one of the National Academy's buildings in Washington.<sup>68</sup> You are all welcome to attend. The purpose of this conference is to sum up a study we have been doing on Global Innovation Systems, to help U.S. government policy makers ascertain where the U.S. stands, compared to the rest of the world.<sup>69</sup> We are financed partly by Congress,<sup>70</sup> and we are running several conferences<sup>71</sup> to sum up a good deal of the work we have done.<sup>72</sup> We have studied about a dozen of the most important sectors of the U.S. economy<sup>73</sup> and will report briefly on all of these, and in more detail on information technology, life sciences, and financial services.<sup>74</sup>

The preliminary reports I am getting worry me. Why? I fear too many of our industry sectors are too complacent. While I don't expect the bottom to fall out over the next several years, the long-term outlook is sobering. Why? Let's go back in history a bit.

Sixty-six years ago I got my master's degree from MIT. Three years before we were scared we would not be able to get jobs because of World

<sup>64</sup> See generally *id.*

<sup>65</sup> See THE NATIONAL ACADEMIES, *Globalization of Innovation: Emerging Trends in IT, Biopharma, and Finance Conference*, <http://www.nationalacademies.org/gateway/pga/3765.html> (last visited Sept. 25, 2007).

<sup>66</sup> The National Academies, <http://www.nationalacademies.org> (follow "About the National Academies" hyperlink) (last visited Sept. 26, 2007) ("Four organizations comprise the Academies: the National Academy of Sciences, the National Academy of Engineering, the Institute of Medicine and the National Research Council.").

<sup>67</sup> See generally THE NATIONAL ACADEMIES, *supra* note 65.

<sup>68</sup> See *id.*

<sup>69</sup> See Board on Science, Technology, and Economic Policy, The National Academies, <http://www7.nationalacademies.org/step/Globalization%20of%20Innovation.%20April%2007%20Meeting.html> (last visited Oct. 5, 2007).

<sup>70</sup> See Organization of the National Academies, <http://www.nationalacademies.org/about/faq1.html> (last visited Oct. 6, 2007) ("The federal government funds about 85 percent of the institution's work.").

<sup>71</sup> See THE NATIONAL ACADEMIES, *supra* note 65.

<sup>72</sup> *Id.*; see also Board on Science, *supra* note 69.

<sup>73</sup> Board on Science, *supra* note 69 ("[The] Board has commissioned papers on 11 industries ranging from semiconductors to biotechnology to venture capital.").

<sup>74</sup> *Id.* ("They are concentrated in 3 sectors -- information technology (software as well as hardware), life sciences-based industries, and financial services.").

War II. Luckily, the demand had picked up and engineers were hot property.<sup>75</sup> At that time, the automobile was the economic driver of the U.S. economy,<sup>76</sup> and the hot jobs were in Detroit,<sup>77</sup> Cleveland,<sup>78</sup> Pittsburgh,<sup>79</sup> and the other cities now called the Rust Belt.<sup>80</sup> The semi-conductor had not been invented,<sup>81</sup> so the Electronic Age had not started.<sup>82</sup> Boston was a backwash for jobs.<sup>83</sup> The Silicon Valley, Austin, and the Research Triangle did not exist.<sup>84</sup> Shortly, I went off to war as a Captain of Engineers throughout the African and Italian campaign. When the war was over, I joined a group of people starting a company in Erie, Pennsylvania, and became what we today would call a serial entrepreneurial manager,<sup>85</sup> helping to build up several very small companies. Today we seek serial entrepreneurial managers. Today, we seek such people to start companies for us. In those days it was thought people like me couldn't hold a job. Things change.

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<sup>75</sup> Robert P. Morgan, et. al., *The Changing Nature of Engineering*, ASEE PRISM (1998), available at [http://findarticles.com/p/articles/mi\\_qa3797/is\\_199805/ai\\_n8803619](http://findarticles.com/p/articles/mi_qa3797/is_199805/ai_n8803619) (“After World War II, several factors, including the beginning of the Cold War and a postwar economic boom, heightened U.S. demand for engineers and led to large increases in the numbers of practicing engineers, engineering students, and engineering fields and subfields.”).

<sup>76</sup> See Jenny Nolan, *Willow Run and the Arsenal of Democracy*, DET. NEWS, Jan. 28, 1997, available at <http://info.detnews.com/history/story/index.cfm?id=73&category=locations>.

<sup>77</sup> See *id.*

<sup>78</sup> See, e.g., Janet H. Cho, *The Homefront*, CLEV. PLAIN DEALER, Sept. 5, 2005, at E1 (explaining “Cleveland’s booming wartime factories.”).

<sup>79</sup> PHILIP JENKINS, PENNSYLVANIA: A HISTORY OF THE COMMONWEALTH, Ch. 7 (Randall M. Miller & William Pencak eds., 2002) available at [http://www.psupress.psu.edu/Justataste/samplechapters/pennsylvania/Chapter\\_7.pdf](http://www.psupress.psu.edu/Justataste/samplechapters/pennsylvania/Chapter_7.pdf).

<sup>80</sup> *Id.*

<sup>81</sup> See Joe Simnacher & Crayton Harrison, *Jack Kilby: 1923-2005: Longtime TI Engineer's Semiconductor Paved The Way For Computer Revolution*, DALLAS MORNING NEWS, Jun. 21, 2005, available at [http://www.metroplexbc.org/news\\_20050621\\_kilby.html](http://www.metroplexbc.org/news_20050621_kilby.html) (explaining the “invention of the semiconductor chip in 1958.”).

<sup>82</sup> See Guy Ball, *The Birth of the Electronic Age*, [http://www.vintagecalculators.com/html/the\\_birth\\_of\\_the\\_electronic\\_ag.html](http://www.vintagecalculators.com/html/the_birth_of_the_electronic_ag.html) (last visited Oct. 2, 2007).

<sup>83</sup> See Geoff Lewis et. al., *History of Boston's Economy, Growth and Transition 1970-1998*, B. REDEVELOPMENT AUTH. (1999), available at [www.cityofboston.gov/bra/PDF/ResearchPublications//pdr529.pdf](http://www.cityofboston.gov/bra/PDF/ResearchPublications//pdr529.pdf).

<sup>84</sup> See Mylene Mangalindan & Dave Mayfield, *Is Virginia Next Silicon State?*, VIRGINIAN-PILOT, Sept. 3, 1995, at D1, available at <http://scholar.lib.vt.edu/VA-news/VA-Pilot/issues/1995/vp950903/09020360.htm> (“[The Research Triangle started 30 years ago.”); see generally TIMOTHY J. STURGEON, *UNDERSTANDING SILICON VALLEY: ANATOMY OF ENTREPRENEURIAL REGION 1*, Ch. 1 (Martin Kenney ed, Stanford University Press, 2000).

<sup>85</sup> See generally Dan Bricklin, *Natural Born Entrepreneur-Lessons of a Serial Entrepreneur*, 79 HARV. BUS. REV., No. 8 (2001), available at <http://hbswk.hbs.edu/archive/2569.html>.

Institutional venture capital came into being right after the war.<sup>86</sup> In late 1945, Jock Whitney started J. H. Whitney & Company with \$10 million of family money in New York.<sup>87</sup> Today venture firms spill that much money.<sup>88</sup> About that same time, Karl Compton, president of MIT, and Senator Ralph Flanders felt the need for a fund to finance the early stage technology<sup>89</sup> coming out of research in radar and vacuum tube electronics.<sup>90</sup> Remember that was before the semiconductor.<sup>91</sup> They wanted to back new ideas and finance young engineering people, and hired General George Doriot, a professor at the Harvard Business School to run it. These were the two original institutional venture capitalists.<sup>92</sup>

Whitney, looking for managers with entrepreneurial backgrounds, found me in 1950, and we had a 7-year courtship, involving several of their companies. I finally took the presidency of the fourth one in 1957 – the American licensee of a very small British multi-national, which we ultimately built into 57 corporations, manufacturing in 22 countries and warehousing and selling in about 75 countries.

Prior to 1945, venture capital had primarily come from wealthy families, corporations, and banks that made higher risk loans.<sup>93</sup> It had a very long history, of course. Sea voyages were financed by wealthy merchants who shared in the profits of the cargo, if the ship got back.<sup>94</sup> Fortunes were made by firms like the East India Company;<sup>95</sup> but, there were charlatans as well.<sup>96</sup> When I left school, I thought an entrepreneur was a French swindler. After 39 years as a venture capitalist, I've learned they're not all French.

Legend has it that Queen Isabella pawned her jewels to finance Columbus' voyages.<sup>97</sup> When U.S. Steel became public, a number of Andrew

<sup>86</sup> Duke K. Bristow & Lee R. Petillon, *Public Venture Capital Funds: New Relief from the Investment Company Act of 1940*, 18 ANN. REV. BANKING L. 393, 404 (1999).

<sup>87</sup> *Id.*

<sup>88</sup> *See, e.g., id.*

<sup>89</sup> *Id.* at n. 69 (explaining how they founded AR&D).

<sup>90</sup> *See* Hans Landström, *Research on Institutional Venture Capital: The Past, The Present, The Future*, LUND U. INST. OF ECON. RESEARCH, at 6-7, available at <http://www.snee.org/filer/papers/414.pdf>.

<sup>91</sup> *See Simnacher, supra* note 81.

<sup>92</sup> Bristow, *supra* note 86, at 404.

<sup>93</sup> *Id.* at n. 66.

<sup>94</sup> *See, e.g.,* Charlie Cray & Lee Drutman, *Corporations and the Public Purpose Restoring the Balance*, 4 SEA. J. SOC. JUST. 305, 309 (2005).

<sup>95</sup> *Id.*

<sup>96</sup> *See, e.g.,* Om Prakash, *The Transformation from a Pre-Colonial to a Colonial Order: The Case of India, 22* (Jan. 1, 2005) (unpublished manuscript on file with The London School of Economics and Political Science) available at <http://www.lse.ac.uk/collections/economicHistory/GEHN/GEHN%20PDF/Transformation%20from%20a%20Pre-Colonial%20-%20Om%20Prakash.pdf>.

<sup>97</sup> Bristow, *supra* note 86, at 404 n. 66.

Carnegie's partners became millionaires,<sup>98</sup> and Pittsburgh, for a time, became the venture capital center of the country.<sup>99</sup> Today, such people are called "Angel Investors."<sup>100</sup>

A few more facts about venture capital:

- There are about 700,000 new businesses started each year in the U.S., according to tax returns, including all the small 1- or 2-person service businesses.<sup>101</sup> Of those, a majority do not last 5 years.<sup>102</sup>
- Professional venture capital funds, like ours, finance only about 1,000 of these, or 1 in 700.<sup>103</sup> The number is not very precise, but whether it is 1 in 500 or 1 in 1,000 is not very important, we don't finance many.<sup>104</sup>
- The importance of venture capital institutions is that they finance most of the high growth, exciting companies that get started.

A few numbers about the industry:

- A large firm, like us, will see more than 1,000 business plans a year.<sup>105</sup>

<sup>98</sup> See generally Mark Skousen, *This Icon of Capitalism Had The Answers*, <http://www.mskousen.com/Books/Articles/0201icon.html> (last visited Oct. 2, 2007) (explaining how one of Carnegie's first acts after U.S. Steel went public was to create a \$5 million pension plan); see also Walter Adams & James W. Brock, *The New Learning and the Euthanasia of Anti-Trust*, 74 Cal. L. Rev. 1515, 1553 n. 171 (1986) (explaining how U.S. Steel was formed into "the nation's first billion dollar corporation.").

<sup>99</sup> John Cook, *Venture Capital: The Steel City bends into Seattle Mold*, SEA. POST-INTELLIGENCER, Feb. 3, 2006, available at [http://seattlepi.nwsource.com/venture/258150\\_vc03.html](http://seattlepi.nwsource.com/venture/258150_vc03.html) ("[Pittsburgh] has a history of entrepreneurialism. . . it helped shape the industries of the late 19th century.").

<sup>100</sup> Guy Kawasaki, *Who Exactly are Angel Investors?*, INC. MAGAZINE, Dec. 2000, available at <http://www.inc.com/articles/2000/12/21310.html> (stating angel investors are "high net-worth individuals who invest in entrepreneurial companies").

<sup>101</sup> Barnaby J. Feder, *EARNING IT; Good Product. Sound Plans. No Sure Thing.*, N.Y. TIMES, Jan. 18, 1998, available at <http://query.nytimes.com/gst/fullpage.html?res=9400EED71738F93BA25752C0A96E958260> (quoting "There are 600,000 to 700,000 new businesses created each year"); see also Karen E. Klein, *What's Behind High Small-Biz Failure Rates?*, BUS. WEEK, Sept. 30, 1999, available at <http://www.businessweek.com/smallbiz/news/coladvice/ask/sa990930.htm>.

<sup>102</sup> See *id.*; Tim Berry, *Planning, Startups, Stories: 20 Million Bootstrappers*, <http://blog.timberly.com/2007/07/20-million-boot.html> (last visited Oct. 2, 2007) ("[A]bout 700,000 new businesses start each year, and 550,000 close.").

<sup>103</sup> Angel Investing and Entrepreneurship, <http://www.thinkinglike.com/Essays/angel-investing.htm> (last visited Oct. 2, 2007) ("[O]nly one or two new companies in a thousand ever receives venture capital from professional venture capital firms.").

<sup>104</sup> *Id.*

<sup>105</sup> JOHN L. NESHEIM, *HIGH TECH START UP, REVISED AND UPDATED: THE COMPLETE HANDBOOK FOR CREATING SUCCESSFUL NEW HIGH TECH COMPANIES*, Dust Jacket (The Free

- Five years later – on national statistics – we will wish we had never seen 996 of the 1,000. Why? Because we will not invest in 990,<sup>106</sup> so we wasted our time. Of the 10 we did invest in, we will lose all our money in 3, plus more money we put in hoping to save the first money.<sup>107</sup> On another 3 we will make so little it was not worth the time and risk.<sup>108</sup> That is the 996 we wished we could have avoided.
- Three we will make a good return on,<sup>109</sup> and one will be a big winner, a gorilla, if we are lucky. It is these few big winners that keep us in the early-stage venture business.
- Private equity, the highly leveraged<sup>110</sup> purchase of mature businesses,<sup>111</sup> is a totally different activity.<sup>112</sup> Losses are much fewer.<sup>113</sup> The debt is the big risk,<sup>114</sup> and huge winners are extremely rare.<sup>115</sup> At the moment, this is highly popular and is

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Press 2000) (“A typical venture capital (VC) firm reviews 1,000 high tech business plans a year; it funds about six of them.”).

<sup>106</sup> See generally Angel Investing, *supra* note 103; see also MinorityFinance.com, <http://www.minorityfinance.com/vc.html> (“A VC firm may see 1,000 business plans in a year, and only fund 10.”).

<sup>107</sup> See Klein, *supra* note 101 (“30% lose money.”).

<sup>108</sup> See *id.* (“30% break even.”).

<sup>109</sup> See generally *id.* (“39% are profitable.”).

<sup>110</sup> Steve Rosenbush, *Private Equity’s Big Debt Burden*, BUS. WEEK, May 29, 2007, available

at [http://www.businessweek.com/bwdaily/dnflash/content/may2007/db20070529\\_241277.htm](http://www.businessweek.com/bwdaily/dnflash/content/may2007/db20070529_241277.htm)

(“[F]irms [are] borrowing once unimaginable sums to pay for their record deals.”); see also Ron Wilson, *Semiconductor Companies, Advanced Processes and Private Equity: It All Fits Together*, EDN, Jul. 25, 2007, [http://www.edn.com/index.asp?layout=blog&blog\\_id=1690000169&blog\\_post\\_id=1200012320](http://www.edn.com/index.asp?layout=blog&blog_id=1690000169&blog_post_id=1200012320) (describing “private equity in its pursuit of maximum leverage”).

<sup>111</sup> See *MPs Want Private Equity Tax Probe*, BBC NEWS, Jul. 29, 2007 available at <http://news.bbc.co.uk/1/hi/business/6919576.stm> (commenting on the “increase in the number of highly-leveraged private equity-owned firms.”); see generally GERALD T. LINS ET AL., *HEDGE FUNDS AND OTHER PRIVATE FUNDS: REGULATION AND COMPLIANCE*, ch. 12 pt. I (Thomson West 2006).

<sup>112</sup> LINS, *supra* note 111 (“[T]he nature of the investment process [for private equity] usually differs substantially from that of a hedge fund and other investment vehicles.”).

<sup>113</sup> See generally *id.*

<sup>114</sup> Jason Kelly, *Private Equity Moguls Feeling the Pinch*, BUS. REPORT, Oct. 2, 2007, available at <http://www.busrep.co.za/index.php?fSectionId=&fArticleId=4060473> (commenting on “the risky debt that private equity firms rely on to fund acquisitions.”).

<sup>115</sup> See John V. Duca & Mine K. Yücel, *Exploring the Economics of Biotechnology: An Overview* at 7, FED. RES. BANK OF DALLAS (2002), <http://www.dallasfed.org/research/pubs/science/intro.pdf> (“[M]ost venture firms directly invest in young companies, without intermediaries. The distribution of returns is highly skewed, with few big winners.”).

almost certainly being overdone.<sup>116</sup>

I wish I could say that venture capital institutions are the most important thing in regional economic development, but it simply isn't true. When Ohio became great in the late 1800s and early 1900s,<sup>117</sup> there were *no* institutional venture capitalists.<sup>118</sup> Silicon Valley took off when Bill Shockley took the semiconductor there in 1957,<sup>119</sup> and there were no institutional venture capitalists in that region either.<sup>120</sup> I looked at that region in 1949 and I found it was a lovely place to live, but I could pick fruit or raise vegetables for a living there.<sup>121</sup> There was relatively no high technology.<sup>122</sup> Fred Terman at Stanford was trying to get Bill Hewlett and people like that going, but they were very small.<sup>123</sup>

Silicon Valley was driven by the semiconductor.<sup>124</sup> Bill Shockley was financed by Arnold Beckman out of Los Angeles,<sup>125</sup> and they had a fight about whether or not it went to San Francisco or Los Angeles (where Arnold wanted to put it,) but Bill Shockley's mother lived in Palo Alto, and that's where he went.<sup>126</sup> He hired the so-called "traitorous 8"<sup>127</sup> – great men like

<sup>116</sup> See LINS, *supra* note 111 (“[A] growing number of financial institutions engage in private equity or merchant banking activities by establishing or investing in private equity funds.”).

<sup>117</sup> See generally George W. Knepper, *Ohio's Historic Properties*, OH. HISTORICAL SOC., Ch. 3, available at [www.ohiohistory.org/resource/histpres/docs/ThePlanCh3.pdf](http://www.ohiohistory.org/resource/histpres/docs/ThePlanCh3.pdf).

<sup>118</sup> Bristow, *supra* note 86.

<sup>119</sup> TIMOTHY J. STURGEON, UNDERSTANDING SILICON VALLEY: ANATOMY OF AN ENTREPRENEURIAL REGION, Ch. 1 (Martin Kenney, ed. Stanford University Press 2000) available at <http://ipc-lis.mit.edu/globalization/Silicon%20Valley.pdf> at 1.

<sup>120</sup> See generally *id.*

<sup>121</sup> Erin E. Dooley, *Silicon Valley Toxics Coalition*, 110 ENVTL. HEALTH PERSPECTIVE 4 (2002), available at <http://www.ehponline.org/docs/2002/110-4/forum.html#ehpnet> (“Silicon Valley was once an agricultural landscape covered in fruit orchards”).

<sup>122</sup> See *id.*; see also Where is Silicon Valley and How did it get its Name?, [http://www.brighternaming.com/Silicon\\_Valley\\_name.html](http://www.brighternaming.com/Silicon_Valley_name.html) (last visited Oct. 5, 2007) (“Before Silicon Valley got its moniker, it used to be a luscious fruit valley.”).

<sup>123</sup> Bill Hewlett, *The Human Side of Management*, 3 SMECC VINTAGE ELECTRICS 1, available at [http://www.smecc.org/the\\_human\\_side\\_of\\_management\\_-\\_bill\\_hewlett.htm](http://www.smecc.org/the_human_side_of_management_-_bill_hewlett.htm) (Hewlett admitting “we were very small and insignificant.”).

<sup>124</sup> Interview, Sanford Robertson (1997), <http://www.businessweek.com/1997/34/trans34/robertso.htm> (finding Silicon Valley's “technology was fueled by the semiconductor industry.”).

<sup>125</sup> The Time 100, Scientists and Thinkers, TIME MAGAZINE, <http://www.time.com/time/time100/scientist/profile/shockley03.html> (last visited Oct. 6, 2007).

<sup>126</sup> See MANUEL CASTELLS & PETER HALL, TECHNOPOLES OF THE WORLD: THE MAKING OF TWENTY-FIRST-CENTURY INDUSTRIAL COMPLEXES 16 (Routledge 1994) (“[Shockley] moved to Palo Alto – because, among other reasons, his aged mother lived there.”).

<sup>127</sup> The Traitorous Eight Traitorously Leave Shockley Semiconductor, PBS, <http://www.pbs.org/transistor/album1/eight/index.html> (last visited Oct. 28, 2007).

Bob Noyce<sup>128</sup> and Gordon Moore<sup>129</sup> – and two years later they spun out to form Fairchild Semiconductor.<sup>130</sup> They were financed by Sherman Fairchild out of New York.<sup>131</sup> His family had done early investing in IBM.<sup>132</sup> Most of the semiconductor firms then spun out of Fairchild,<sup>133</sup> including especially Intel.<sup>134</sup> So, venture capital does not cause innovation, it follows it – anywhere and everywhere it thinks there is a business opportunity and a way to fill it.

The automobile at the end of the 19<sup>th</sup> Century and in the early years of the 20<sup>th</sup> Century was the greatest innovation the country had ever seen.<sup>135</sup> It brought along the steel industry, tires, machine tools, glass, road building, gasoline, and a host of service industries, including insurance, finance, repair shops, etc.<sup>136</sup> The Rust Belt cities became rich on these mechanical industries<sup>137</sup> and rode them for far too long. They almost entirely missed the semiconductor industry,<sup>138</sup> which became the real driver of the economy after

<sup>128</sup> See Robert Noyce, Encyclopedia Britannica, <http://www.britannica.com/eb/article-214871/Robert-Noyce> (last visited Oct. 5, 2007).

<sup>129</sup> See generally Gordon Moore, PBS, <http://www.pbs.org/transistor/album1/moore/index.html> (last visited Oct 6, 2007).

<sup>130</sup> Fairchild Semiconductor, Answers.com, <http://www.answers.com/topic/fairchild-semiconductor-international?cat=biz-fin> (last visited Sept. 24, 2007).

<sup>131</sup> *Id.*

<sup>132</sup> Sherman M. Fairchild, Sherman Fairchild Library of Engineering and Applied Science, <http://library.caltech.edu/sherman/fairchild.htm> (last visited Sept. 24, 2007).

<sup>133</sup> See TIMOTHY J. STURGEON, UNDERSTANDING SILICON VALLEY: ANATOMY OF AN ENTREPRENEURIAL REGION Ch. 1, *How Silicon Valley Came to Be* at 1 (Martin Kenney ed., Stanford University Press, 2000) (“The spin-off of Fairchild Semiconductor from Shockley Transistor and the ‘Fairchildren’ that followed are widely believed to be the stimuli that set the Silicon Valley juggernaut in motion.”).

<sup>134</sup> Fairchild Semiconductor, PBS, <http://www.pbs.org/transistor/background1/corgs/fairchild.html> (last visited Oct. 25, 2007).

<sup>135</sup> See Randal O’Toole, America’s Greatest Invention, [http://www.i2i.org/main/article.php?article\\_id=1317](http://www.i2i.org/main/article.php?article_id=1317) (last visited Oct. 6, 2007) (explaining why “the automobile may be the greatest invention of the past 230 years.”); see generally History of American Automobile, Eastern Connecticut University, <http://www.easternct.edu/depts/edu/units/automobile.html> (last visited Sept. 25, 2007) (discussing the innovation of the automobile).

<sup>136</sup> See JAMES E. MCCLELLAN & HAROLD DORN, SCIENCE AND TECHNOLOGY IN WORLD HISTORY: AN INTRODUCTION 342 (JHU Press 2006) (explaining how the “automobile industry fostered technical innovations” and subsidiary work in steel, glass, rubber, gasoline, roads, etc.).

<sup>137</sup> See Rust Belt, <http://www.answers.com/topic/rust-belt?cat=biz-fin> (last visited Oct. 6, 2007) (“The phrase [rust belt] became synonymous with industrial decline in the once-dominant U.S. [cities with] heavy manufacturing and steel industries.”); see generally Pennsylvania: Emergence of the Modern State, Encyclopedia Britannica, <http://www.britannica.com/eb/article-78296/> (last visited Sept. 25 2007).

<sup>138</sup> See, e.g., John Markoff, *Gould to Be Acquired By Nippon Mining*, N. Y. TIMES, Aug 31, 1988, available at

1960,<sup>139</sup> enabling a huge number of other innovations.<sup>140</sup> The leadership of the Rust Belt cities did not realize they were missing the future, leading to the decline in their manufacturing jobs today.<sup>141</sup>

What is the future? We are all trying to guess what will be the new, *new thing*. What are the innovations that entrepreneurs will be pushing to create new jobs and new wealth? Is it nanotechnology – a technology looking for a market?<sup>142</sup> Is it alternative fuel – a huge market looking for economically viable technology?<sup>143</sup> Is it fuel cells? Is it some other new material, as yet undiscovered? Is it new medicines or medical devices – ones that will slow aging or cure major diseases? Or is it something no one has thought of yet? Will our space explorations bring back something that will change our lives in some important way? Or, will a huge number of new jobs be created in trying to stop global warming?

Nobody knows for sure. What we do feel is that the important new innovations will come out of technology<sup>144</sup> – most of the simple stuff has already been invented, and very few of us are likely to go to our basement workshops or out to our barns and come up with inventions that will change our lives and create thousands of jobs.

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<http://query.nytimes.com/gst/fullpage.html?res=940DE6DA133AF932A0575BC0A96E948260> (distinguishing between “a traditional Rust Belt manufacturer [and] a high-technology computer, semiconductor” business).

<sup>139</sup> See Economy, Semiconductor Industry Association, [http://www.sia-online.org/iss\\_economy.cfm](http://www.sia-online.org/iss_economy.cfm) (last visited Oct. 6, 2007) (“[T]he semiconductor sets the pace of global economic growth.”).

<sup>140</sup> See generally Thierry Weil, *Why and How European Companies Reach out to Silicon Valley*, INSTITUT FRANÇAIS DES RELATIONS INTERNATIONALES, available at THE NEW AMERICAN CHALLENGE: CORPORATE STRATEGIES AND EUROPEAN POLICIES 16 (IFRI 2000), also available at [http://www.ifri.org/files/Notes\\_Ifri/Notes\\_25\\_Weill.pdf](http://www.ifri.org/files/Notes_Ifri/Notes_25_Weill.pdf) (“[A]ccounts of Silicon Valley tell the impressive story of an area built on the numerous refinements and applications of semiconductors”).

<sup>141</sup> See Geography: USA, Chapter 7 – The Midwest Heartland, <http://www.geog.nau.edu/courses/alew/ggr346/text/chapters/ch7.html> (last visited Oct. 6, 2007) (citing “The decline in manufacturing jobs in the cities surrounding the Great Lakes”).

<sup>142</sup> See JOHN L. NESHEIM, *THE POWER OF UNFAIR ADVANTAGE: HOW TO CREATE IT, BUILD IT, AND USE IT TO MAXIMUM EFFECT* 164 (Simon and Schuster) (describing how many believe nanotechnology is “a technology looking for a market”); see generally, Ernie Hood, *Nanotechnology: Looking As We Leap*, 112 no. 13 ENVTL. HEALTH PERSPECTIVES (2004), available at <http://www.ehponline.org/members/2004/112-13/focus.html>.

<sup>143</sup> See, e.g., *Ethanol Industry Needs Technology, People: Scientist*, CBC NEWS, July 5, 2006, available at <http://www.cbc.ca/canada/manitoba/story/2006/07/05/ethanol-researcher.html>.

<sup>144</sup> See Tom Stevens, *High-Tech, High-Touch Paradox*, BUS. LEADER MAGAZINE, Sept. 2004, [http://www.businessleadermagazine.com/index.aspx?page=articles.sep04.sep04\\_hightouch](http://www.businessleadermagazine.com/index.aspx?page=articles.sep04.sep04_hightouch) (“Technology creates innovation”).

The most advanced countries, like the U.S., Canada, and Europe, have a concern. Back in the 1950s I spent a great deal of business time in Britain. We had long discussions on business development and when Britain's problems were pointed out, the answer – with a superior air – was, “Oh, Britain will always muddle through.”<sup>145</sup> We know it didn't<sup>146</sup> and Japan became the world's second largest economy.<sup>147</sup> Today, when this discussion is held in the U.S., all too often the answer comes back, “Yes, but Yankee ingenuity will save us.”<sup>148</sup>

In a world where most of the innovations are likely to be the products of complicated applied research and expensive semiconductor type fabrication plants,<sup>149</sup> the number of engineers and scientists China and India are training is really frightening.<sup>150</sup>

Am I too alarmist? Maybe. But, to quote the great Intel CEO, Andy Grove, “In the competitive world of today, only the paranoid survive.”<sup>151</sup>

DR. KING: That was excellent. We will have questions after our other speakers.

We have a man well known to many of you. He was here last year, and we welcome him back this year. His name is Douglas Barber. He is from McMaster University in Canada.<sup>152</sup> He has held about every office you can

<sup>145</sup> See generally Marina Hyde, *Britain Thrives in Adversity and Non-Combatant Strawberries*, GUARDIAN, Jul. 3, 2007, [http://blogs.guardian.co.uk/sport/2007/07/03/britain\\_thrives\\_in\\_adversity\\_a.html](http://blogs.guardian.co.uk/sport/2007/07/03/britain_thrives_in_adversity_a.html) (referencing the use of “the phrase ‘muddle through.’”).

<sup>146</sup> DONLEY T. STUDLAR, *GREAT BRITAIN: DECLINE OR RENEWAL* 26 (Westview Press 1996) (analyzing the “British economic decline, [a] relative economic decline to be sure”).

<sup>147</sup> U.S. DEPT. OF COMMERCE, U.S. Commercial Service: Japan, <http://www.buyusa.gov/japan/en/mom.html> (last visited Sept. 25, 2007).

<sup>148</sup> See generally, e.g., Dale Brown, *How to Help the Disabled Pay Their Own Way; Ingenuity Will Prevail*, N. Y. TIMES, Oct. 3, 1989, available at <http://query.nytimes.com/gst/fullpage.html?res=950DE2D6143DF930A35753C1A96F948260> (giving “opinion that American ingenuity will prevail”); see also Shelly K. Wong, *A Shining Example of Yankee Ingenuity*, PROVIDENCE J., Apr. 8, 2007, [http://www.projo.com/travel/getaways/TRV-GETAWAY-CONN-MINE\\_04-08-07\\_CC2257E.f0f19d.html](http://www.projo.com/travel/getaways/TRV-GETAWAY-CONN-MINE_04-08-07_CC2257E.f0f19d.html).

<sup>149</sup> See generally Patrick J. Buchanan, *Death of Manufacturing*, AM. CONSERVATIVE, Aug. 1, 2003, available at, [http://www.amconmag.com/08\\_11\\_03/cover.html](http://www.amconmag.com/08_11_03/cover.html).

<sup>150</sup> See Sheila Reily, *U.S. Holds Own Vs. China, India Engineer Grads*, <http://www.informationweek.com/outsourcing/showArticle.jhtml?articleID=188501208> (last visited Sept. 27, 2007) (finding 137,437 engineering graduates for the U.S. compared to 112,000 for India and 351,537 for China.)

<sup>151</sup> Andrew S. Grove, *Only The Paranoid Survive: Book Preface*, <http://www.intel.com/pressroom/kits/bios/grove/paranoid.htm> (last visited Sept. 27, 2007) (declaring “I'm often credited with the motto, ‘Only the paranoid survive.’”).

<sup>152</sup> Ontario Research and Innovation Council Biography of Douglas H. Barber, <http://www.mri.gov.on.ca/ORIC/english/bios/HDouglasBarber.asp> (last visited Oct. 13, 2007) [hereinafter Barber Biography] (“He is also continuing an academic career as a distinguished

hold at McMaster, and they are listed in the bio data,<sup>153</sup> so I will not read them. He is also the founder of Gennum Corporation,<sup>154</sup> which designs, manufactures, and markets microcircuits.<sup>155</sup> At present, it employs over 600 people.<sup>156</sup> He was president and CEO until his retirement in 2000, and he has continued until recently as a director.<sup>157</sup> So it is a great pleasure and honor to

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professor-in-residence at McMaster University”).

<sup>153</sup> See *id.* (“He formerly chaired and is currently a member of McMaster’s board of governors.”).

<sup>154</sup> *Id.* (“Dr. Douglas Barber is one of the founders of Gennum Corporation.”).

<sup>155</sup> Gennum Corporation, CHIPDOCS, <http://www.chipdocs.com/manufacturers/GENUM.html> (last visited Oct 28, 2007) (“Gennum Corporation is a Canadian high technology company which designs, manufactures and markets electronic components, primarily silicon integrated circuits (IC’s) and thick-film hybrid circuits, for specialized applications.”).

<sup>156</sup> See generally Gennum Corporate Profile, <http://www.gennum.com/about/index.php> (last visited Oct. 13, 2007) (“[Gennum e]mploys over 400 people worldwide”).

<sup>157</sup> Barber Biography, *supra* note 152.

\* H. Douglas Barber, born on a Saskatchewan farm, attended the University of Saskatchewan obtaining his B.Sc. with Great Distinction, the Governor General’s Gold Medal and a M.Sc. in Electrical Engineering. As an Athlone Fellow and NATO Scholar he received his Ph.D. from Imperial College, University of London in 1965. Dr. Barber began employment at Canadian Westinghouse, Hamilton, Ontario, Canada. In 1973 he was one of the founders of Linear Technology Inc., now known as Gennum Corporation, which designs, manufactures and markets microcircuits. Gennum has grown profitably at 20% per year and now employs about 650 people. Dr. Barber was President and CEO when he retired in 2000. He continues as a Director. He was a part-time Engineering Physics Professor at McMaster University from 1968 to 1994. In 2001 he was appointed Distinguished Professor-in-Residence. Dr. Barber authored 29 papers and several patents. He speaks frequently on business, technology, learning, innovation and economic development. Dr. Barber was actively involved in Microelectronics initiatives in Canada including the Canadian Semiconductor Technology Conference, the Canadian Microelectronics Corporation, the Sectoral Skills Council, the Canadian Semiconductor Design Association, Micronet and the Strategic Semiconductor Consortium. Dr. Barber’s honors include the APEO Engineering Medal, the University of Saskatchewan C.J. Mackenzie Distinguished Graduate Award, the Professional Engineers of Ontario Gold Medal, and Engineer of the Year Award of the Hamilton Engineering Institute. Dr. Barber has received an Honorary Doctorate of Engineering from the University of Waterloo, an Honorary Doctorate of Science from McMaster University, and in 1999 was named Ontario’s Technology Entrepreneur of the Year, receiving the National Citation for Innovation & Technology. This year Dr. Barber was appointed as an Officer of the Order of Canada. He was a Director of the Strategic Microelectronics Consortium, the Canadian Advanced Technology Association, the Hearing Industries Association and the Alberta Microelectronics Corp. He was a member of the Sectoral Skills Council, the Natural Sciences and Engineering Research Council of Canada, the National Innovation Strategy, the Ontario Postsecondary Education Quality Assessment Board and Vice Chair of the Ontario Science and Innovation Council. He was a founding co-chair of the National Information Technology Initiative that sponsored eMPOWER Canada Inc. in 2001, and is a past director of the Golden Horseshoe Venture Forum. He is a member of the Electrochemical Society, the Institute of Electrical and Electronic Engineers, the Hamilton Civic Coalition and the Burlington Post Secondary Task Force. At McMaster University, Dr. Barber is a member of the Board of

present Douglas Barber, again here, for this conference, and we look forward to what you have to say.

#### CANADIAN SPEAKER

*Dr. H. Douglas Barber\**

DR. BARBER: Thank you, Henry. And thank you, David, for really painting an impressive picture that really gives a great base for me to launch out on something that may be a little bit more academic. I may even wade into the world of law, which I know almost nothing about; what I have learned from a few fights in the courts is that legal fights can be very, very expensive!

Because I am in an academic institution these days, I can take a little bit more academic approach to things. Economic growth, wealth, and job creation come from specialization and trade.<sup>158</sup> Self-sufficiency, which is the opposite of specialization, has real limits, both in terms of what one person can do and what they have to do it with.<sup>159</sup>

I grew up on a pioneer farm in Saskatchewan, a province in Canada immediately north of Montana and North Dakota, where it gets cold in the winter and hot in the summer.<sup>160</sup> It was in the depression and drought of the 1930s.<sup>161</sup> Farms were less specialized then than they were in the 1920s

Governors, the Senate and the Directors College. He is Chair of the Engineering Dean's Advisory Board. He is a Director of Micralyne Inc., NetAccess Systems Inc., DALSA Corporation, and AllerGen NCE Inc. He is a member of the Conference Board of Canada Leader's Roundtable on Commercialization, the Ontario Ministry of Economic Development and Trade's Commercialization Advisory Council, the Institute of Quantum Computing and the Ontario Research and Innovation Council. Dr. Barber and his wife, June, have raised a family of four whose families now include eight grandchildren. He is a man of faith with over 30 years of active involvement in their church.

<sup>158</sup> USAID Guidebook: Foreign Aid in the National Interest, Ch. 2 Driving Economic Growth (2003), available at <http://www.usaid.gov/fani/ch02/newthinking.htm> ("Economists have conceptualized the process of economic growth around three basic models: specialization and trade, investment in machines, and increasing returns to knowledge.")

<sup>159</sup> See generally, Pedestrians Guide to the Economy, [http://www.amosweb.com/cgi-bin/awb\\_nav.pl?s=pdg&c=dsp&k=24](http://www.amosweb.com/cgi-bin/awb_nav.pl?s=pdg&c=dsp&k=24) (last visited, Oct. 13, 2007) (giving why an economy should forgo self sufficiency in favor of trade specialization).

<sup>160</sup> See The Weather Channel Monthly Averages for Saskatoon, Canada, <http://www.weather.com/outlook/travel/businesstraveler/wxclimatology/monthly/graph/CAXX0442?from=search> (last visited Oct. 15, 2007).

<sup>161</sup> See 1930s Drought, CBC News Online, In Depth: Agriculture, <http://www.cbc.ca/news/background/agriculture/drought1930s.html> (last visited Oct. 15, 2007) (discussing Canada in the 1930s and stating "1930 was the start of a 10-year period of drought").

because farmers in those conditions had little to trade.<sup>162</sup> They had to do everything they could for themselves to survive.

I learned that moving from self-sufficiency to more specialization is a move towards prosperity.<sup>163</sup> Prosperity is not an outcome of doing everything yourself. So you specialize to produce things of value for others, who have also specialized because they can't do everything for themselves either.<sup>164</sup> It is success in that choice of specialization and trade that changes the economy, creates wealth, and engages more people in specialized enterprises.<sup>165</sup>

To grow, you either have to create more value or expand your area of trade. Sustainable wealth and job creation must do both of those all the time.<sup>166</sup> You can see this at play in the developed world. Large economies like the United States can be more self-sufficient and very prosperous while trading less than ten percent of their economy outside of the nation.<sup>167</sup>

There is a lot of trade within the nation.<sup>168</sup> Canada and the other 11 or 12 countries that are above us today in the wealth of nations typically trade between 35 and 45 percent of our economies to prosper.<sup>169</sup> Each one has to

<sup>162</sup> See generally *id.*

<sup>163</sup> *Supra* note 159 (“Specialization makes us a lot better off than self-sufficiency.”).

<sup>164</sup> See *id.* (“[A]s a general rule, that each of us specializes in producing some stuff then exchanging for other.”).

<sup>165</sup> See generally *id.* (“When everyone in the economy specializes, we have a larger economic pie which (depending on how it's divided) can make everyone better off.”); see also, e.g., A Life Science Strategy for Saskatchewan, SUCCESS Spring 2007, Ag-West Bio Inc., available at <http://www.agwest.sk.ca/publications/success/SUCCESS%20Spring%2007-web.pdf> (“[A] small workforce makes it important for Saskatchewan to focus on a few priority areas to ensure a competitive advantage.”).

<sup>166</sup> See generally James K. Jackson, Trade Agreements: Impact on US Economy, CRS Report RL31932, at 9 n.17 (2007), available at <http://italy.usembassy.gov/pdf/other/RL31932.pdf> (“By specializing in the production of those goods and services in which it is most efficient, or in which it has a comparative advantage, a nation maximizes its total productive capability and national income.”).

<sup>167</sup> See generally Ben Wattenberg, *Get Over It, Folks*, JEWISH WORLD REV., Sept. 3, 1998, available at <http://www.jewishworldreview.com/cols/wattenberg090398.html> (“Imports and exports made up 10 percent of the economy in 1954.”).

<sup>168</sup> See generally Christopher Sands, *Canada's Problem: Domestic Trade Barriers*, THE AMERICAN, May 22, 2007, available at <http://www.american.com/archive/2007/may-0507/canada2019s-problem-domestic-trade-barriers> (article compares and contrasts differences between U.S. and Canadian domestic trade).

<sup>169</sup> See generally Trade as a Percentage of GDP, [http://wps.aw.com/aw\\_krgmnobstf\\_interecon\\_7/0,10540,2078562-content,00.html](http://wps.aw.com/aw_krgmnobstf_interecon_7/0,10540,2078562-content,00.html) (last visited Oct. 29, 2007) (follow “Data” hyperlink); see also Michael Spence, *The Economy: Engines of Growth*, WALL ST. J., Jan. 23-24, 2007, available at <http://www.hoover.org/publications/digest/8093682.html> (speaking generally about the factors that make economies successful).

focus on areas of value creation for the world where they can do that competitively.<sup>170</sup>

Of course, they trade in order to buy the things that they don't make and that they can't do competitively for themselves.<sup>171</sup> They generally work to live within their means. That means that their balance of trade, exports minus imports,<sup>172</sup> should be quite small. It is typically less than one percent of their GDP<sup>173</sup> and, to be sustainable, it needs to be positive over time.<sup>174</sup>

Over the last 30 years, most of those 11 or 12 countries that are today doing better than Canada have grown their economies and moved ahead of Canada in the prosperity of nations as we have slipped in that ranking.<sup>175</sup> Jobs in these prospering developed countries are typically about 75 percent in the services sector, about 20 percent in the goods production sector, and about five percent in primary industries.<sup>176</sup> They don't vary much on that.

<sup>170</sup> See generally Spence, *supra* note 169; see also OECD, *Moving Up the Value Chain: Staying Competitive in the Global Economy* (Main Findings, 2007), available at <http://www.oecd.org/dataoecd/24/35/38558080.pdf>; see, e.g., Why do Countries Trade? The Advantages of International Trade, TUTOR2U, [http://www.tutor2u.net/economics/content/topics/trade/free\\_trade.htm](http://www.tutor2u.net/economics/content/topics/trade/free_trade.htm) (last visited Oct. 29, 2007) (“Japan can produce camcorders at lower costs - its supply curve is lower than the UK. This means that Japan has a comparative advantage in producing camcorders.”).

<sup>171</sup> See Why do Countries Trade?, *supra* note 170 (“Britain needs to export goods and services to finance imports of those products we cannot produce in this country.”); see generally Spence, *supra* note 169 (discussing principals of sustaining economic growth).

<sup>172</sup> The Central Bank of the Republic of Armenia, Yerevan 10 V. Sargsyan 6, 53-54, available at <http://www.cba.am/publications/prog/annex.pdf> (explaining “balance of trade (written as imports minus exports)” and “balance of trade, or the proportion by which imports can exceed exports”).

<sup>173</sup> See generally U.S. Balance of Trade, TRADING ECONOMICS, <http://www.tradingeconomics.com/Economics/Balance-of-Trade.aspx?Symbol=USD> (last visited Oct. 26, 2007) (follow “compare with” hyperlinks); see also The Library of Economics and Liberty, *Balance of Trade and Balance of Payments*, <http://www.econlib.org/LIBRARY/Topics/HighSchool/BalanceofTradeandBalanceofPayments.html> (last visited Oct. 13, 2007) (defining the concept of balance of trade).

<sup>174</sup> See Gabor Steingart, *America and the Dollar Illusion*, SPIEGEL ONLINE, Oct. 25, 2006, available at <http://www.spiegel.de/international/0,1518,440054,00.html> (explaining how a negative balance of trade could produce a crisis); see also Balance of Trade and Balance of Payments, *supra* note 173 (infers that balance of trade would have to be sustained to have an impact).

<sup>175</sup> Heather Scoffield, *Canada's Slipping on the World Stage*, THE GLOBE & MAIL, Sept. 27, 2006, available at [http://www.competeprosper.ca/index.php/about/in\\_the\\_news/canadas\\_slipping\\_on\\_the\\_world\\_stage\\_wef\\_study\\_shows\\_switzerland\\_tops\\_compet/](http://www.competeprosper.ca/index.php/about/in_the_news/canadas_slipping_on_the_world_stage_wef_study_shows_switzerland_tops_compet/).

<sup>176</sup> See Steve Lohr, *Academia Dissects the Service Sector, but Is It a Science?*, N.Y. TIMES, Apr. 18, 2006, available at <http://www.nytimes.com/2006/04/18/business/18services.html?ex=1145678400&en=4175e9133eddb40&ei=5087> (discussing the importance of the service sector which “now employ more than 75 percent of American workers”).

In countries with a small work force, prosperity depends on being able to export in all of those areas. However, because most exports come from the goods producing enterprises that don't employ many people,<sup>177</sup> all of these countries have the challenge to act strategically. It is very easy to believe that your internal services are the basis of your economy and to not be sufficiently strategic about trade.

There is always competition. Trade is a value exchange. To sustain trade in the face of aggressive competition it is necessary to create better value at lower cost. That's the nature of productivity.<sup>178</sup> Productivity always has to be a concern in regard to prosperity.<sup>179</sup> Trade barriers are introduced to protect home enterprises.<sup>180</sup> These are acts of power, defense, and mistrust that impact the value exchange. I am going to talk more about that later. However, it remains true that economic growth, wealth, and job creation comes from specialization and trade – the value exchange.<sup>181</sup>

Now, let's consider the economy. The economy is the system through which we get our needs, and perhaps, some of our wants met.<sup>182</sup> Wants that get met regularly for some time do tend to evolve into needs.<sup>183</sup> So prosperity is always somewhat elusive.<sup>184</sup>

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<sup>177</sup> See generally Congressional Budget Office, Economic and Budget Issue Brief, *What Accounts for the Decline in Manufacturing Employment?*, Feb. 18, 2004, available at <http://www.cbo.gov/ftpdoc.cfm?index=5078&type=0>.

<sup>178</sup> See Jim Pinto, *Cheaper, Better, Faster – The Productivity Race*, <http://www.automation.com/sitepages/pid1939.php> (last visited Oct. 16, 2007).

<sup>179</sup> Productivity and Prosperity Project, ARIZ. ST. U., <http://www.asu.edu/president/p3/> (last visited Oct. 27, 2007) (“Enhancing productivity is the primary means of raising prosperity.”).

<sup>180</sup> David P. Bianco, *Trade Barriers*, <http://www.referenceforbusiness.com/encyclopedia/Thir-Val/Trade-Barriers.html> (last visited Oct. 15, 2007) (stating the protection of domestic producers is a reason for trade barriers).

<sup>181</sup> Jaime Ros, *Trade Specialization and Economic Growth*, IDRC, [http://www.idrc.ca/fr/ev-93559-201-1-DO\\_TOPIC.html#enh1](http://www.idrc.ca/fr/ev-93559-201-1-DO_TOPIC.html#enh1) (last visited Oct. 29, 2007) (analyzing how trade specialization can affect long-term economic growth performance); see also Pinto, *supra* note 178.

<sup>182</sup> See, Dr. Donald Schunk, *Ask an Economist*, <http://www.sces.org/LMI/data/trends/economist/quest2.asp> (last visited Oct. 13, 2007) (“[L]et us think about what an economy is. In any economic system, there must be a way for resources to be put to use to produce goods and services.”); see also ELLIOT ETTENBERG, *THE NEXT ECONOMY* (2001) (explaining the economy driven by customer wants).

<sup>183</sup> ETTENBERG, *supra* note 182; Kevin Sims, *Needs Must*, SALVATION ARMY, Apr. 1, 2004, [http://www1.salvationarmy.org/ihq%5Cwww\\_sa.nsf/vw-issue/2FD585720C4FD03380256EDC007FBF42?opendocument&id=46FE538284C7F60980256EDC007F2F6B](http://www1.salvationarmy.org/ihq%5Cwww_sa.nsf/vw-issue/2FD585720C4FD03380256EDC007FBF42?opendocument&id=46FE538284C7F60980256EDC007F2F6B) (“[W]ants turn into needs.”).

<sup>184</sup> Ralph Massey, Speech to the Nassau City Rotary: Prosperity, The Elusive Goal, Oct. 7, 2002, available at <http://www.nassauinstitute.org/wmview.php?ArtID=337> (discussing the difficulty in achieving national economic success and stating “prosperity is so elusive”).

The value exchange is a very human process, and I want to emphasize that.<sup>185</sup> I remember well the expression of Peter Drucker, who said at one point in his long life, “You know, in my whole life I have never seen a market place a purchase order.”<sup>186</sup> Guess what? Purchase orders are actually very human things. When you are getting one or giving one, it is people facing each other that determine whether that happens or not.<sup>187</sup>

The value exchange is a *very* human process.<sup>188</sup> Both what is valuable is determined by people, and their choices determine whether the exchange will occur or not.<sup>189</sup> What is valued is what people need or want on any level – physical, emotional, psychological, or spiritual.<sup>190</sup> Economic activity can occur on all of those levels.<sup>191</sup>

In the value exchange, there is always a competitive drive to provide value in a better way and to win the value away from other suppliers in the exchange. That is the nature of any business. We are actually all in a value exchange if we are getting paid.

This creates a continuous dynamic in commerce. There are always opportunities, both to offer better value and to offer new value. These are opportunities that can generate economic growth, wealth, and job creation. There are enterprises that arise to take those opportunities and there are those that disappear in this dynamic. It is the entrepreneurs that keep this dynamic moving.

In Canada, with a work force of 17 million people,<sup>192</sup> we have about 1 million business enterprises of all kinds<sup>193</sup> that employ about 13 and-a-half

<sup>185</sup> Stakeholder Value, CSR QUEST, <http://www.csrquest.net/default.aspx?articleID=13347&heading=The%204CR%20Framework> (last visited Oct. 28, 2007) (discussing “the human process of value creation”).

<sup>186</sup> H. D. Barber, Speech at The BEDC Mayor’s Luncheon: Succeeding in the Global Economy – A Canadian Perspective, Sept. 8, 2005, *available at* [http://www.careeradvancement.on.ca/news\\_detail.aspx?page\\_id=0&news\\_id=17](http://www.careeradvancement.on.ca/news_detail.aspx?page_id=0&news_id=17).

<sup>187</sup> *See generally, e.g.*, Institute for Business Integrity, Wright St. U., *Private Sector Consulting Firm Ethics Case Analysis and Proposed Resolution*, *available at* [http://www.wright.edu/rscob/ibi/ibi\\_consulting\\_firm\\_ethics\\_sample\\_analysis\\_and\\_resolution.doc](http://www.wright.edu/rscob/ibi/ibi_consulting_firm_ethics_sample_analysis_and_resolution.doc) (case study discussing ethics in client sales transactions).

<sup>188</sup> Stakeholder Value, *supra* note 185; *see also* Charles Hall, Cutler J. Cleveland & Robert Kaufmann, *Use and Exchange Value*, [http://www.eoearth.org/article/Value\\_theory](http://www.eoearth.org/article/Value_theory) (last visited Oct. 14, 2007) (discussing the development of various competing theories of value exchange and how those theories are based on societal values).

<sup>189</sup> Hall, *supra* note 188 (“In a general sense an entity. . . has value if it can be exchanged for another good. . . and/or if it is in some way deemed useful or important by its possessor.”).

<sup>190</sup> *See id.* (“[V]alue assumes that individual and societal tastes, preferences, and economic decisions are influenced and often directed by environmental factors . . .”).

<sup>191</sup> *See generally id.*

<sup>192</sup> Statistics Canada, *Labour Force Characteristics, Unadjusted, By Province (Monthly)*, <http://www40.statcan.ca/101/cst01/lfss02a.htm> (last visited Oct. 18, 2007) (Sept. 2007 Canada Labour Force: 17.9 million).

million of those 17 million workers.<sup>194</sup> The public sector employs the remainder.<sup>195</sup> The public sector employees are funded from treasuries and, therefore, are somewhat isolated from the value exchange, and that can create misunderstandings. In the business enterprises, the dynamic is clearer. About 13 percent disappear every year,<sup>196</sup> and that includes one percent that disappear because they go bankrupt.<sup>197</sup> So there are 12 percent that disappear for a whole variety of other reasons.<sup>198</sup> However, every year in Canada about 14 percent appear as new enterprises on the scene, giving rise to about a one percent per year growth in the enterprises of Canada.<sup>199</sup> Enterprises with less than 100 employees account for over 40 percent of the employment in Canada.<sup>200</sup> This dynamic and this churn require a lot of entrepreneurial skill to support it.

The churn does raise a good question: Couldn't we improve the success rate and decrease the amount of energy and talent needed in the churn? It is worthwhile here to ask another question: What is an entrepreneur? It is a word rooted in the French word *entreprendre*, which means to undertake.<sup>201</sup>

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<sup>193</sup> Sri Kanagarajah, *Business Dynamics in Canada*, STATISTICS CANADA, <http://www.statcan.ca/english/freepub/61-534-XIE/61-534-XIE2006001.htm> (last visited Oct 26, 2007) (“[T]here were just over one million businesses in Canada in 2003.”); *see also* Canadian Industry Statistics, *Establishments Canadian Economy*, INDUSTRY CANADA, [http://strategis.ic.gc.ca/sc\\_ecnmy/sio/ciseste.html](http://strategis.ic.gc.ca/sc_ecnmy/sio/ciseste.html) (last visited Oct. 15, 2007) (estimating less than 1.1 million Canadian employer establishments).

<sup>194</sup> *See generally id.*; *see also* Public Sector Statistics, STATISTICS CANADA, [http://www.statcan.ca/english/freepub/68-213-XIE/2006000/t005\\_en.htm](http://www.statcan.ca/english/freepub/68-213-XIE/2006000/t005_en.htm) (last visited Oct. 25, 2007).

<sup>195</sup> *See generally id.*

<sup>196</sup> *See generally* Canadian Market Research Made Fast and Easy, GDSOURCING, <http://www.gdsourcing.com/gdstart.htm> (last visited Oct 22, 2007); *see also* Key Small Business Statistics: How long do small businesses survive?, INDUSTRY CANADA, Apr. 2004, <http://www.ic.gc.ca/epic/site/sbrp-rppe.nsf/en/rd00865e.html>; Moya K. Mason, *Small Businesses*, nts. 1, 7, 14, <http://www.moyak.com/researcher/resume/papers/businesses2.html> (last visited Oct. 15, 2007) (discussing the average number Canadian businesses that start and fail annually).

<sup>197</sup> *But see* Mason, *supra* note 196 (“[A]bout 145,000 new businesses start up each year in this country, and about 137,000 businesses declare bankruptcy each year.”).

<sup>198</sup> *See generally id.* (discussing reasons businesses fail in many industrialized nations).

<sup>199</sup> *See generally id.*

<sup>200</sup> Industry Canada, *Small Business Quarterly*, Vol. 5, No. 2, Aug. 2003, *available at* [http://www.ic.gc.ca/epic/site/sbrp-rppe.nsf/vwapj/3367\\_SBQ\\_eng.pdf/\\$FILE/3367\\_SBQ\\_eng.pdf](http://www.ic.gc.ca/epic/site/sbrp-rppe.nsf/vwapj/3367_SBQ_eng.pdf/$FILE/3367_SBQ_eng.pdf) (describing small businesses creating 39% of net new jobs in Canada).

<sup>201</sup> *See* Enterprise, WEBSTER'S NEW INTERNATIONAL DICTIONARY 853 (2nd ed. 1959) (“[E]nterprise from the French *entreprendre*, meaning. . . an important undertaking”); *see also* Jeff Bailey, *Can You Teach Someone How To Grow a Business?*, WALL STREET J. ONLINE, *available at* <http://www.collegejournal.com/mbacenter/newstrends/20030819-bailey.html> (last visited Oct 29, 2007) (“The word entrepreneur [Webster's: from French *entreprendre*, to undertake: one who organizes, manages and assumes the risks of a business or enterprise]”).

In fact, enterprise is a word from the same root.<sup>202</sup> An entrepreneur then is one who initiates and undertakes a commercial enterprise.<sup>203</sup> That is a value exchange enterprise with all the associated organizational management and financial challenges and risks. A successful entrepreneur can't be weak in relation to any of those challenges.

The Entrepreneur of the Year Program<sup>204</sup> defines the entrepreneur as one who: firstly, undertakes a new business venture, as the founder of a business;<sup>205</sup> secondly, takes great risk, both personal and on behalf of others;<sup>206</sup> thirdly, succeeds in the business but may have failed a number of times before;<sup>207</sup> fourthly, demonstrates innovation,<sup>208</sup> where innovation is competitively meeting needs and desires in the value exchange;<sup>209</sup> fifthly, is a deliberate and capable planner;<sup>210</sup> and sixthly, manages people effectively;<sup>211</sup> and seventhly, leads and establishes an effective culture and values and gives direction and vision.<sup>212</sup> That's quite a list, but that's the one used to select the entrepreneur of the year.<sup>213</sup>

DR. KING: Which you were.

DR. BARBER: I was the Technology Entrepreneur of the Year, in Canada.<sup>214</sup>

<sup>202</sup> *Id.*

<sup>203</sup> See Jeff Bailey, *supra* note 201.

<sup>204</sup> Celebrating Entrepreneurial Achievement: Entrepreneur of the Year Awards, ERNST & YOUNG, [http://www.ey.com/global/content.nsf/US/EGCS\\_-\\_Entrepreneur\\_of\\_the\\_Year\\_Awards\\_-\\_Overview](http://www.ey.com/global/content.nsf/US/EGCS_-_Entrepreneur_of_the_Year_Awards_-_Overview) (last visited October 16, 2007).

<sup>205</sup> Entrepreneur of the Year Nominations, ERNST & YOUNG, [http://www.ey.com/GLOBAL/content.nsf/Canada/Entrepreneur\\_Of\\_The\\_Year\\_-\\_Awards\\_Process\\_-\\_Nominations](http://www.ey.com/GLOBAL/content.nsf/Canada/Entrepreneur_Of_The_Year_-_Awards_Process_-_Nominations) (last visited Oct. 19, 2007).

<sup>206</sup> See generally Entrepreneur of the Year Award: Recognizing the Best, ERNST & YOUNG, [http://www.ey.com/GLOBAL/content.nsf/Canada/Entrepreneur\\_Of\\_The\\_Year\\_-\\_Awards\\_Process\\_-\\_Post-Nominations](http://www.ey.com/GLOBAL/content.nsf/Canada/Entrepreneur_Of_The_Year_-_Awards_Process_-_Post-Nominations) (last visited Oct. 19, 2007).

<sup>207</sup> See generally *id.* (“Entrepreneurial Spirit/Corporate Culture: The nominee demonstrates perseverance in the face of adversity and overcoming obstacles, learns from experience, fosters teamwork and builds loyalty.”).

<sup>208</sup> *Id.* (“Innovation: What new approaches or technologies have been implemented? What investment has been made in R&D? How well does the nominee adapt to change and develop products/services ahead of the market?”).

<sup>209</sup> See generally Innovation, WEBSTER'S NEW INTERNATIONAL DICTIONARY 1282 (2nd ed. 1959) (stating it is the “introduction of something new”).

<sup>210</sup> See generally *supra* note 206 (“Strategic Direction/Market Position/Industry Impact”).

<sup>211</sup> See generally *id.* (“The nominee has earned respect from staff, competitors and advisers, is a strong communicator, influences others”).

<sup>212</sup> See generally *id.* (“Personal Integrity/Influence”).

<sup>213</sup> *Id.* (answering “What do the judges look for?”).

<sup>214</sup> Entrepreneur of the Year Award: Regional Award Recipients 1999, ERNST & YOUNG, [http://www.ey.com/global/Content.nsf/Canada/Entrepreneur\\_Of\\_The\\_Year\\_-\\_Recipients\\_-\\_Regional\\_-\\_1999](http://www.ey.com/global/Content.nsf/Canada/Entrepreneur_Of_The_Year_-_Recipients_-_Regional_-_1999) (last visited Oct. 19, 2007).

Clearly, the commercial competitive dynamic requires high quality entrepreneurs to collectively achieve the success that fuels economic growth, wealth, and job creation. There are several important factors that are determinates of sustainable success for these entrepreneurs.

The first is the scope of trade in their entrepreneurial vision. There are many enterprises obviously that operate very locally, and they do create wealth and prosperity, but that limits their scope for growth and increases substantially the risk that competition from outside their locality will wipe them out. For many enterprises, the customer world must be aggressively global.<sup>215</sup>

The second factor is the motivation or the purpose for the enterprise. It can be simply to make the entrepreneurs wealthy, and there probably has to be some aspect of that in the entrepreneurial drive, but that's not a sustainable enterprise if that is the vision or the motivation. A sustainable enterprise must focus on creating value for all its stakeholders and especially for its customers.

The book "Built to Last"<sup>216</sup> describes 18 visionary companies,<sup>217</sup> who today average about \$75 billion in revenues<sup>218</sup> with 175 thousand employees each.<sup>219</sup> They are, on average, just about 100 years old.<sup>220</sup> The only common elements the book found amongst them was that they all had highly articulated purposes and values,<sup>221</sup> where cultivating and sustaining these was a very important aspect of the leadership.<sup>222</sup>

<sup>215</sup> Cf. Anne Gaw & Steve Liu, *Corporate Entrepreneurship: Beyond Two Guys in a Garage* 4, Fall 2004, U. S. CAL. MARSHALL, available at [http://www.marshall.usc.edu/media/pressroom/pdf\\_short/STRAT\\_CorpEntrepreneur.pdf](http://www.marshall.usc.edu/media/pressroom/pdf_short/STRAT_CorpEntrepreneur.pdf) (stating Johnson and Johnson and 3M "have built a competitive advantage by focusing on innovation and the ability to develop products and services in a broad market scope."); see generally, e.g., CRM Today, *ClientLogic Bolsters Global Customer Care Outsourcing Leadership during 2004*, Jan. 12, 2005, <http://www.crm2day.com/news/crm/EEpVVEAuyArOuSfRlq.php> (customer care industry outsourcer discusses strategy: "we continued to aggressively execute our global business strategy-expanding our right-shore service options and developing new processes that help our clients reduce their operating costs and improve the overall customer experience").

<sup>216</sup> JAMES C. COLLINS & JERRY I. PORRAS, *BUILT TO LAST: SUCCESSFUL HABITS OF VISIONARY COMPANIES* (HARPER BUSINESS 2002) (1994).

<sup>217</sup> See *id.* at 3 (listing the companies studied as 3M, American Express, Boeing, Citicorp, Ford, General Electric, Hewlett-Packard, IBM, Johnson & Johnson, Marriott, Merck, Motorola, Nordstrom, Philip Morris, Proctor and Gamble, Sony, Wal-Mart, & Walt Disney).

<sup>218</sup> See generally *id.*

<sup>219</sup> See generally *id.*

<sup>220</sup> *Id.* at 13 ("The companies in our study averaged ninety-two years of age, with an average founding date of 1897.").

<sup>221</sup> *Id.* at 54 ("In nearly all cases, we found evidence of a core ideology that existed not merely as words but as a vital shaping force.").

<sup>222</sup> *Id.*

These 18 companies<sup>223</sup> have gone through five generations of people.<sup>224</sup> They are all in different businesses today, but they are all successful.<sup>225</sup> That says something. A successful enterprise has many different value exchanges occurring together, and all must be integrated for success. We have considered some of them.

The third factor is that innovation and continuous improvement are essential to sustainability. The competitors who are actively seeking a way to win away your customers or your employees or your shareholders are always present. That is a significant driver of the enterprise dynamic. Sustainable enterprises must be continually renewing and reinventing themselves,<sup>226</sup> and that requires entrepreneurial people.

The fourth factor is that successful entrepreneurs need broad learning. That is true even though the enterprise has to specialize. It is not sufficient just to know what you are going to do and how you are going to do it. Those are largely product or service and technology issues. The successful entrepreneur must also know who will do it and whom it will be done for. In the end, the commercial enterprise is a very human enterprise. It takes wisdom to succeed. Successful entrepreneurs have often gained wisdom through experience, perhaps in a good business or perhaps through their own failures.

Are entrepreneurs born or are they made? I always say the answer is yes. They are born and made.<sup>227</sup> There is opportunity to develop them better and sooner. They are significant shapers of our future. Commerce is a very human activity.<sup>228</sup> The value exchange occurs best where there is trust and freedom.<sup>229</sup>

<sup>223</sup> COLLINS, *supra* note 216.

<sup>224</sup> *See id.* at 13 (“The youngest companies in our study were founded in 1945”).

<sup>225</sup> *See id.* at 24-27 (confronting the misconception that successful companies start out with a great idea, where Merck started merely as an importer of chemicals, 3M started as a failed corundum mine, and Boeing’s first airplane failed, stating, “In all, *only three* of the visionary companies began life with the benefit of a specific, innovative, and highly successful initial product or service.”).

<sup>226</sup> *See id.* at 187 (“Visionary companies install powerful mechanisms to create *discomfort* – to obliterate complacency – and thereby stimulate change and improvement *before* the external world demands it.”).

<sup>227</sup> *Entrepreneurs Are Both Born and Made*, BUS. WEEK ONLINE, Oct. 10, 2000, [http://www.businessweek.com/smallbiz/content/oct2000/sb20001010\\_202.htm](http://www.businessweek.com/smallbiz/content/oct2000/sb20001010_202.htm) (interview with Bob Baum, professor of new program at University of Maryland, stating “I think that entrepreneurs are both born and made.”).

<sup>228</sup> Cf. Theodore W. Schultz, *The Value of the Ability to Deal with Disequilibria*, 13 J. ECON. LITERATURE 827, 827 (Sept. 1975) (“Behavior of human beings is governed by the criterion of optimization under constraints that are specific to circumstances confronting each person”).

<sup>229</sup> Stephen Knack & Paul J. Zak, *Building Trust: Public Policy, Interpersonal Trust, and Economic Development*, 10 S. CT. ECON. REV. 91, 92 (2002) (“[I]f trust is sufficiently low, so

We know free trade is good,<sup>230</sup> but not all humans, human organizations, communities, or countries can be trusted to be honest and ethical.<sup>231</sup> While entrepreneurs who can create value competitively are essential to economic growth, wealth, and job creation, they are not all honest and ethical.<sup>232</sup>

Philosophically, we interpret self-interest to be the best driver of competition and value creation.<sup>233</sup> Now, that's a belief that can easily be associated with free enterprise and private enterprise and words like that, which are roots for us.<sup>234</sup> While self-interest is part of ethical behavior, it can become the principal driver of unethical behavior.<sup>235</sup>

Ethics is about acting for the good of all who are affected by the act, including the entrepreneur.<sup>236</sup> All human activities are affected by the ethical tone and spirit present in the people. The challenge for each of us is how do

little investment will be undertaken that economic growth is unachievable," and that "interpersonal trust is a powerful economic stimulant"); *see also* Frank L. Jefferies & Richard Reed, *Trust and Adaptation in Relational Contracting*, 25 *ACAD. MGMT. REV.* 873, 879 (Oct. 2000) ("When there is high-affect based trust in the form of a belief that his or her opposites are concerned for the negotiator's well-being, there is a freedom to quickly share information and ideas.").

<sup>230</sup> MILTON FRIEDMAN & ROSE D. FRIEDMAN, *FREE TO CHOOSE: A PERSONAL STATEMENT* (HARCOURT BRACE JOVANOVICH 1980) *available at* <http://www.hoover.org/publications/digest/3550727.html> (adapted from "The Tyranny of Controls") ("Ever since Adam Smith there has been virtual unanimity among economists, whatever their ideological position on other issues, that international free trade is in the best interests of trading countries and of the world.").

<sup>231</sup> *See* Kurt Eichenwald, *In Enron Case, a Verdict on an Era*, *N.Y. TIMES*, May 26, 2006, *available at* <http://www.nytimes.com/2006/05/26/business/businessspecial3/26verdict.html>; Laurie Goodstein & Stephanie Strom, *Embezzlement is Found in Many Catholic Dioceses*, *N.Y. TIMES*, Jan. 5, 2007, *available at* <http://www.nytimes.com/2007/01/05/us/05church.html>.

<sup>232</sup> *E.g.* Eichenwald, *supra* note 231.

<sup>233</sup> Frederick C. Hicks, *Competition as a Basis of Economic Theory*, 10 *PUBLIC AFFAIRS AM. ECON. ASS'N* 82, 83 (Mar. 1895) ("Competition and combination, representing equally normal manifestations of self-interest, are equally necessary to economic science.").

<sup>234</sup> *See* William D. Grampp, *What Did Smith Mean by the Invisible Hand?*, 108 *J. POL. ECON.* 441, 455 (Jun. 2002) (discussing Smith's "invisible hand" theory, stating "The riches of the nation, then, are the product of self-conscious, self-interested effort," and "The merchant, when in competition with others, will place his capital where it adds most to the nation's wealth, and he does not have to be told where that is.").

<sup>235</sup> *See* James C. Wimbush & Jon M. Shepard, *Toward an Understanding of Ethical Climate: Its Relationship to Ethical Behavior and Supervisory Influence*, 13 *J. BUS. ETHICS* 637, 641 (1994), *reprinted in* Lynne L. Dallas, *A Preliminary Inquiry Into the Responsibility of Corporations and Their Officers and Directors for Corporate Climate: The Psychology of Enron's Demise*, 35 *RUTGERS L. J.* 1, 29-30 (Fall 2003) ("This [unethical behavior] is expected to occur because only in an ethical climate based on an egoistic decision-making criterion would persons most likely act in ways to promote their own exclusive self-interest regardless of law, rules, or the impact their decisions have on others.").

<sup>236</sup> *See* John Cottingham, *The Ethics of Self-Concern*, *ETHICS* 101, 798, 812 (July 1991) ("For Aristotle, ethics is about the good, or the good for man, or the "supreme good.").

we know what is good? And how do we act for the good of others and ourselves? That's a tough question.

Economic growth, good jobs, and wealth creation describes a situation of prosperity.<sup>237</sup> Prosperity is present where people thrive. People thrive where they are productive, healthy, and committed to the good of their community.<sup>238</sup> Prosperity means that their needs on all levels – physical, emotional, psychological, and spiritual – are being abundantly met.<sup>239</sup> It means people are balanced in their lives, and safe and confident in their environments.<sup>240</sup>

My reading of history and my experience of successful enterprise have convinced me that prosperity and ethical behavior are very strongly linked, certainly sustainable prosperity requires that.<sup>241</sup> Those 18 companies described in “Built to Last” have cultivated this kind of milieu.<sup>242</sup> Visit their websites;<sup>243</sup> you will sense that there is a difference about them.

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<sup>237</sup> See generally Stephen L. Carter, *A Symposium Commemorating the Bicentennial of the United States Constitution: The Constitution, the Uniqueness Puzzle, and the Economic Conditions of Democracy*, 56 GEO. WASH. L. REV. 136, 140 (Nov. 1987) (“The Theory of Democratic Prosperity explains the success of constitutional government in the United States by pointing to the growth over time of the economy, the generally improving standard of living, the existence of independent economic power as counterweight to government, and the continued flourishing of the middle class.”).

<sup>238</sup> See generally William Damon, *What is Positive Youth Development?*, 591 ANNALS AM. ACAD. POL. & SOC. SCI. 202, 207 (Christopher Peterson, ed., Jan. 2004) (“[Y]oung people thrive when we listen to them, respect them, and engage with them in meaningful investments in the community.”).

<sup>239</sup> Cf. Quentin Wray, *Prosperity Involves More than Just Economic Growth*, BUS. REPORT, Jul. 16, 2007, <http://www.busrep.co.za/index.php?fSectionId=3267&fArticleId=3935499> (arguing prosperity is about more than money and “company profits and the ongoing economic boom” alone cannot make “a truly prosperous society” when violence and instability plague South Africa).

<sup>240</sup> See *id.*; see also Ronald Bailey, *Peace and Prosperity Through Productivity*, REASON ONLINE, Aug. 1, 2007, <http://www.reason.com/news/printer/121697.html> (“[P]roductivity flourishes when people are free, safe, and justly treated”).

<sup>241</sup> See *Id.*

<sup>242</sup> See generally COLLINS, *supra* note 216.

<sup>243</sup> See 3M, <http://www.3m.com/>; American Express, [https://home.americanexpress.com/home/mt\\_personal.shtml?us\\_nu=globalbar](https://home.americanexpress.com/home/mt_personal.shtml?us_nu=globalbar); Boeing, <http://www.boeing.com/>; Citicorp, <http://www.citibank.com/us/index.htm>; Ford, <http://www.ford.com/>; General Electric, <http://www.ge.com/index.htm>; Hewlett-Packard, <http://www.hp.com/>; IBM, <http://www.ibm.com/us/>; Johnson & Johnson, <http://www.jnj.com/home.htm>; Marriott, <http://www.marriott.com/default.mi>; Merck, <http://www.merck.com/>; Motorola, <http://www.motorola.com/>; Nordstrom, <http://shop.nordstrom.com/C/2375500/0~2375500>; Philip Morris, <http://www.philipmorrisusa.com/en/home.asp>; Procter & Gamble, [http://www.pg.com/en\\_US/index.jhtml](http://www.pg.com/en_US/index.jhtml); Sony, <http://www.sony.com/index.php>; Wal-mart, <http://www.walmart.com/>; Walt Disney, <http://disney.go.com/index>.

How does unethical behavior appear, and what do we do to control it? In its most generic sense, unethical behavior exhibits itself in power and in greed.<sup>244</sup> Power gives the capability to control the choice of others. That has potential to limit freedom, which is an essential component of thriving commerce.<sup>245</sup> Power does corrupt commerce.<sup>246</sup> Power makes it possible to direct the value exchange unfairly in order to maintain power and to prosper at the expense of weaker trading partners.<sup>247</sup> That is a greedy and unethical stance.

What do we do about this? Well, we do two things: we introduce governance in government,<sup>248</sup> and we introduce rules and laws.<sup>249</sup> This brings it right into our conference. Both governance and law are created to circumscribe behavior in such a way as to ensure a prospering and sustainable society in the presence of corrupting elements.<sup>250</sup>

But there is an irony to this, and the irony is that governing involves essential powers, and so does law enforcement.<sup>251</sup> Thus, the corrupting potential exists in the mechanisms intended to ensure minimal corruption.<sup>252</sup> In democracies, we believe that the people should be given significant power

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<sup>244</sup> See Andrei Shleifer, *Does Competition Destroy Ethical Behavior?*, 94 AM. ECON. REV. 414, 414 (May 2004) (“[C]onduct described as unethical and blamed on ‘greed’ is sometimes a consequence of market competition.”).

<sup>245</sup> See FREIDMAN, *supra* note 230; see also Ronald Bailey, *supra* note 240.

<sup>246</sup> See generally Bryan W. Husted, *Wealth, Culture, and Corruption*, 30 J. INT’L BUS. STUD. 339, 344 (1999) (hypothesizing that “the higher the power distance in a country, the higher the level of corruption in a country,” where “power distance” means that less powerful members accept that power is distributed unequally).

<sup>247</sup> See generally *id.*; Cf. Ethan B. Kapstein, *The Political Economy of International Cooperation: a View from Fairness Economics* 7, INSEAD & CENTER FOR GLOBAL DEV., Dec. 2005, available at [www.ethankapstein.com/Art/peicrev.doc](http://www.ethankapstein.com/Art/peicrev.doc) (“Recognizing that the governments of smaller countries might fear that they would eventually be ‘held up’ at the bargaining table, the governments of powerful countries [i.e. the U.S. and Great Britain] effectively committed with a rules-based system not to exploit their weaker trading partners.”)

<sup>248</sup> See generally Carter, *supra* note 237, at 142 (“The provisions of the 1787 Constitution, together with the Bill of Rights, suggest a government designed to put into practice the Theory of Democratic Prosperity.”).

<sup>249</sup> See, e.g., REVISED UNIFORM PARTNERSHIP ACT §404 (General standards of a partner’s conduct).

<sup>250</sup> See JAMES SVARA, *The ETHICS PRIMER: FOR PUBLIC ADMINISTRATORS IN GOVERNMENT AND NONPROFIT ORGANIZATIONS* 145 (Jones and Bartlett Publishers 2006) (“Structural features and legal requirements have been established in national, state, and local government to promote ethics and reduce unethical behavior.”).

<sup>251</sup> Cf. SUSAN ROSE-ACKERMAN, *INTERNATIONAL HANDBOOK ON THE ECONOMICS OF CORRUPTION* 4 (Edward Elgar Publishing 2006) (“Research on corruption is difficult because many causes of corruption also seem to be consequences of corruption.”).

<sup>252</sup> See generally *id.*

over the governors, maybe not so much over the law enforcers, but over the governors.<sup>253</sup>

To date, this seems to have been more successful than other attempts, because we may have the possibility to change the governors who misuse their power.<sup>254</sup> However, we do have our moments of harmful behavior, and we are all aware of Enron,<sup>255</sup> Watergate,<sup>256</sup> and recently the activities associated with options.<sup>257</sup> In Canada we have had the sponsorship scandal,<sup>258</sup> the Nortel experience,<sup>259</sup> and the same kind of options world. Our entrepreneurs need, first of all, to be ethical. What do we do to prepare them for that?

Secondly, they need to be prepared to lead their ventures to success in the presence of barriers, of the barriers of governance and law that are intended to minimize the corruption that destroys value.<sup>260</sup> Unfortunately, these barriers are often heavy burdens to the honest ethical enterprises and not fully effective in deterring the exploitive actions of the self-serving enterprises.<sup>261</sup> How do we prepare our entrepreneurs to work in that

<sup>253</sup> See generally Carter, *supra* note 237 (“[E]xistence of independent economic power as counterweight to government”).

<sup>254</sup> U.S. CONST. art. II, §4 (“The President, Vice President and all civil officers of the United States, shall be removed from office on impeachment for, and conviction of, treason, bribery, or other high crimes and misdemeanors.”).

<sup>255</sup> See generally Eichenwald, *supra* note 231 (a scandal revealed in 2001 where Enron, a leading energy company, was charged with fraudulent activities, particularly with its accounting practices).

<sup>256</sup> See generally J. Anthony Lukas, *A New Explanation of Watergate*, N.Y. TIMES, Nov. 11, 1984, available at <http://query.nytimes.com/gst/fullpage.html?res=9D0DE4DC1139F932A25752C1A962948260> (a political scandal in 1972 where a break-in to the Democratic National Committee’s headquarters at the Watergate Office/Apartment Complex was eventually connected to President Nixon leading to his resignation).

<sup>257</sup> See generally Eric Dash, *Report Estimates the Costs of a Stock Options Scandal*, N.Y. TIMES, Sept. 6, 2006 (scandal where the discovery of backdating, the practice of marking a document with a date that precedes the actual date, led to a large decline in the stock market).

<sup>258</sup> See generally Clifford Krauss, *Canada’s Ex-Premier Denies Role in Quebec Fund Scandal*, N.Y. TIMES, Feb. 9, 2005, available at <http://www.nytimes.com/2005/02/09/international/americas/09canada.html?pagewanted=print&position=> (scandal involving the Liberal Party, where funds were illegally used as incentives to keep separatist forces at bay in Quebec).

<sup>259</sup> See generally Peter Brieger, *Nortel Scandal Deepens*, CANADA.COM, Sept. 13, 2007, <http://www.canada.com/nationalpost/financialpost/story.html?id=b63e74ea-87b1-438f-a3bf-9ff30ea0bff7&k=26724> (Nortel Network Corp. executives were charged by the Securities and Exchange Commission for manipulating the company’s accounting).

<sup>260</sup> See, e.g., Ann Bednarz, *Execs Tell Regulators Sarbanes-Oxley Costs Exceed Benefits*, NETWORKWORLD, May 11, 2006, <http://www.networkworld.com/news/2006/051106-sox-costs.html>.

<sup>261</sup> See generally *id.*

environment and to encourage them? This is not going to go away, and we do have to work with it.

Finally, what do we do about entrepreneurial enterprises that are designed to take value from the economy and deliver no value in return? Some of them exist in the world of intellectual property.<sup>262</sup> That's a world where proceedings are often very tough and costly. Some of these are the most hazardous to the young risking entrepreneurs whose competitive and confidence winning challenges are always pushing them to the limit. Here, the challenges often end up in the courts where the standards of ethics, justice, and rightness for the community or nation are to be maintained.

The responsibilities of governance and law are extremely important for entrepreneurs and for prosperity.<sup>263</sup> I am actually hoping during the hours of this conference that we gain some new insights and confidence about how we develop ethical entrepreneurs and ethical systems of governance and law in which they will function. I hope this conference is going to give me some new insights. Our prosperity, economic growth, job creation, and wealth creation depend upon how well we do this.

Thank you.

#### DISCUSSION FOLLOWING THE REMARKS OF DAVID T. MORGENTHALER AND DR. H. DOUGLAS BARBER

DR. KING: I had a few questions, which I wanted to start the session off with. I was intrigued by this point – that we have to have a sense of ethics. We have heard from David Morgenthaler and from Douglas Barber that entrepreneurship is the lifeblood of our two economies, and I want to speak, firstly, on this.

I was party to an entrepreneurship making disposable hypodermic needles. I had to get out when I went to the top government job because we were selling to the government, but my partner sold out to Pfizer, and he made a barrel of money, and what he did was he bought everybody in the company Cadillacs. He bought a plane and a place in Cape Cod and joined a fraternity, which was known for excessive drinking.

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<sup>262</sup> See, e.g., Morag Macdonald, *Beware of the Troll*, THELAWYER.COM, 26 Sept., 2005, available at <http://www.thelawyer.com/cgi-bin/item.cgi?id=116783&d=122&h=24&f=46> (explaining the “patent troll” as a company “that holds a portfolio of patents where the only business is . . . [legally] enforcing them against those who [have not] paid them for a licence [sic].”).

<sup>263</sup> See Bailey, *supra* note 240 (“[J]ustice is incredibly important to prosperity”); see also Steve Strauss, *Government's Role in Encouraging Small Business*, E-JOURNAL USA, <http://usinfo.state.gov/journals/ites/0106/ijee/strauss.htm> (last visited Oct. 29, 2007) (“Any government that wants to encourage small business needs to produce laws that protect the innovations of entrepreneurs.”).

What I am concerned about is the business of somebody putting something back. In other words, you are successful; should we have funds which these successful entrepreneurs may have to contribute to, because beyond a certain amount of wealth is corruptive, I think. It was corruptive in this case, and I am speaking from personal experience. And I think it is a natural interest to do something like this.

You said that entrepreneurship is the lifeblood of the economy, and I would like to get both of your thoughts how you bring that into play? Where you continue this stream of entrepreneurship that has kept us going so long? And what you think of this idea of possible voluntary contribution to a fund?

I know what it is to be an entrepreneur, because it causes domestic trouble when you attempt to put a second mortgage on the house. It was not easy for me, so I have been through it, personal experience. So perhaps you could comment on that. I like the idea of the concern about ethics, and I love the history of what made America great, but let's continue that.

Do either of you have any thoughts on that?

DR. BARBER: My first thought is, if you live your life exercising your self about what is good and right, how do you promote good things for all the people that you affect?

I know at Gennum we often talked about who are our stakeholders were, because we had statements of what we were going to do for our stakeholders. It is easy to identify your customers as a stakeholder. The big difficulty that we had was when we asked the question, do we affect our competitors? And the answer was yes, we do. Then they are a stakeholder. How do we act for the good of our competitors? When you get the stakeholder spectrum that broad, the concern about how to be good is enlarged.

We broadened it beyond the city that we live in to the province, the country, and the places we trade. We know we affect all of them. Certainly, for Gennum, we have been generous to our community and to our country,<sup>264</sup> even though we do almost no trade in the country.<sup>265</sup> So I think it is an issue of this broader consciousness. If you just think about the good as accumulating prosperity for oneself, something has gone wrong, I think.

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<sup>264</sup> See McMaster University – Who Contributes, <http://www.eng.mcmaster.ca/contributing/contributors.htm> (last visited Oct. 20, 2007) (“Doug Barber, an engineer, professor and entrepreneur, and Gennum Corp. of Burlington, Ont. Have donated \$1.3 million to McMaster University to create the Barber-Gennum Chair in Information Technology.”).

<sup>265</sup> See generally Gennum Reports 2006 Fourth Quarter and Year End Reports, available at [http://www.gennum.com/newsroom/pdfs/Q4\\_06.pdf](http://www.gennum.com/newsroom/pdfs/Q4_06.pdf) (last visited Oct. 29, 2007) (quoting revenue based by principal market for the three months ended Nov. 30, 2006, where \$6,922 in sales were to Canada, compared to \$30,084 worth to the United States, Europe, and the Pacific Rim).

DR. KING: I like Cadillacs, but I don't think in my case the partner worked out for the public good. But he did sell a lot of disposable hypodermic needles.

David?

MR. MORGENTHALER: Well, you have raised a two-part question, Henry: one is the question of ethics, which I am very glad to respond on, and the other is a question of putting back into society for the benefits we have had.

On ethics, we feel strongly about it for very practical reasons. We invested in something over 250 companies.<sup>266</sup> In those 250 companies we have had five cases of some kind of fraud that we know about. There may have been others that we haven't caught. Five out of 250 is very good. Any of you academics would give me a 98% or an A for something like getting it right that many times, so we must be pretty good about picking society, of picking people, but – and this is a big but – those five have cost us over \$100 million in attained, but not yet cashed-in, profits.

Now, I am a slow learner, but losing \$100 million, that I otherwise would have but lose because somebody cheats, that will teach even me a lesson. Now, I told this story before and the joke. Some of the entrepreneurs have gone to jail. One of them died. I was asked if I had him killed, and my answer was: no, he died before I could get the contract written.

But I do think playing by the rules is critical, and we totally agree that the important thing to us is that entrepreneurs will not lie to us. I have seen thousands of business plans over the years. I have very rarely seen one made. They are always too optimistic. You have to discount for some things, but when you have an entrepreneur that will deliberately lie to you about the facts, even on small matters – we had a case recently where we had a very attractive company, an interesting new technology that may just be a cure to an important disease, and heading one of the most desirable jobs that we have in our group. A man submitted an application for it, and on his application, he showed that he had attended a certain college. He showed he had graduated from it.

We were paying a recruiter over \$100,000 to recruit for this job, and the recruiter missed the fact that the man only attended the college; that he hadn't graduated. My young partner picked it up and came to me and said, "I am troubled by this." He said, "This man has lied to us, and I know how we feel about people lying to us, and what do you think in regard to it?"

I said, "It is very simple." I said that this man is going into a medical company. We couldn't care less whether he attended this college or

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<sup>266</sup> See About Morgenthaler, *supra* note 2 ("We have worked with entrepreneurs in more than 250 companies since the firm's founding.").

graduated. What we care about is: does he lie to us? Because graduating did not matter, it was trivial. If he said he didn't finish there are lots of good reasons. Bill Gates didn't finish college,<sup>267</sup> Steve Jobs, whom we backed, didn't finish college.<sup>268</sup>

I don't care whether they graduated or not. I care whether they learned. But I care a lot whether they lied to me, because the day will come that a clinical trial will come, and there will be some bad results on that trial. If he withholds that from us it may thoroughly affect the direction we take the company next. So if he lies, he will lie out of here, and we cancelled the man out immediately and didn't continue him.

Interestingly, he came out of a company where he was said to be one of the best of a company that had a very bad culture. An officer of that company has gone to jail for bad culture. We will absolutely not tolerate it. The venture business is one of the relatively cleanest businesses that I have ever been involved with, and I have been involved in a lot of industries. I have been in the scrap metal business to some degree, and God help you in that business.

I took over as chairman of our Mexican company in the early 1960s, about 40 years ago, and went down to Mexico and discovered that we had sent an Englishman down when we opened up Mexico, and I discovered that apparently his belief was that you had to bribe to do business in Mexico. So I think any time anybody put their hand out to shake hands he put money in it. We were bribing everybody we could see in Mexico. And actually, I got a Mexican president in, and we cleaned it up. So I have seen all kinds of sordid operations, but they are terrible from a business standpoint, and we won't have anything to do with them.

In the short-term, you can win sometimes – contract bidding, government contract bidding. Again, all kinds of things have been thrown, but we just won't touch it. And in venture capital, I have seen things in earlier days where venture capitalists behaved unethically. Back again many years ago, we had a major venture capitalist. At his request we showed him the business plan of one of our companies, and he showed that to one of his companies that was directly competitive. They were bidding against him on a job. They showed that plan to them, and the news got back to our company. It came

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<sup>267</sup> Stacy Perman, *Dropping Back In*, INC.COM, Jun. 2004, <http://www.inc.com/magazine/20040601/education.html> (“[A]fter all, college dropouts Bill Gates, Steve Jobs, and Michael Dell did just fine without a bachelor's degree”).

<sup>268</sup> See Tim Tankersley & Joshua Boak, *Investors Turn Away from Ohio as Heavy Use of Tax Dollars to Woo Jobs Doesn't Pay Off*, THE TOLEDO BLADE, Sept. 24, 2006, available at <http://www.toledoblade.com/apps/pbcs.dll/article?Date=20060924&Category=NEWS24&ArtNo=609240334&SectionCat=&Template=printart> (“Cleveland-based Morgenthaler Partners funded Apple, Nextel, and 250 other startups.”).

<sup>269</sup> See Perman, *supra* note 267.

back to us with very high indignation from one of the other major venture capitalists, who was a partner, and he had the attitude of, tough, that's the way things are done.

Well, the hell that's the way things are done! So we joined in a little conspiracy just to make sure among all the deals we got, he saw only the bad ones, and that went on for a while. He got the message. He was frozen out. The bad deals where we might lose money, show them to him by all means.

We take it seriously.

DR. KING: Okay. Are there other questions? I have plenty of questions. Yes, sir, right in the front row.

MR. GROETZINGER: Question for David Morgenthaler: Out of a thousand companies that you would look at, and you said three are excellent performers and one might be arguably a mega-performer, what are the characteristics of those four that make them so superior? Is there a common thread, or is it the product or service? Is it the market they are attempting to meet?

MR. MORGENTHALER: I wish I knew for sure and I doubly wish I knew when they walked in. The trouble, of course, and the reason that you see the thousand, is that I often describe our business as shoveling rock. We shovel a ton of rock to find an ounce of gold. And when you are shoveling it, you don't know what is going to be there. Inevitably, you get everything right though. One of the problems that I have had in this region, one of the things we ought to talk a little bit about – and it is an argument that comes up a great deal with the Silicon Valley people, whether the culture is a major factor, where a number of them love to believe it is the culture that does everything – is with the willingness to let people fail.

Well, culture is certainly a factor, but the critical factor is the basic opportunity – and I still like my three-legged stool. I like metaphors and I like the concept. The whole business is a horse, a rider, and a race. The concept, the technology is the horse. The entrepreneur is obviously the rider. The race is the market that you are going into. You absolutely have got to consider all three. You have got to get all the elements right. The venture capitalist is none of those. He is an owner, a trainer. He ends up owning the horse or a good deal of it, and he provides advice to the jockey. But you fundamentally will find that there is a market; there is a kind of race. Competitors are doing certain things; your horse will do certain things. If all of those come together at a point in time –

As I have said, the S-curve theory that came out in the late 1960s, which originally was applied to technology,<sup>270</sup> I think applies very much to

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<sup>270</sup> See generally S-Curves, INNOVATION ZEN, <http://innovationzen.com/blog/2006/08/17/innovation-management-theory-part-4/> (last visited Oct. 20, 2007) (“[T]he S-curve emerged as a mathematical model and was afterwards applied

businesses. Things mature, and we are trying to catch them down at the bottom of this flattened S-curve, when you have a long run up and catch them before they level off. The trouble with the region in the Rust Belt cities is they didn't realize the industries were at the top of their S-curves. But you catch a market. You catch a group of people who do it a little better or a little more energetically, and the competition doesn't move in as well as it should have, and they just end up winning.

We backed Apple Computer in our early careers.<sup>271</sup> We had figured out long since that this was going to be a huge market, and we were looking for the people that were going to win. I think we went through probably 25 companies. We were a little put off by Apple because of the two young men, Steve Jobs was a rather young promoter at that stage,<sup>272</sup> and Apple didn't have a lot of proprietary technology.<sup>273</sup>

And one of our fears was that the Asian companies would be a problem. These were fairly simple computers; and we were used to much more complicated computers, we were much more complicated. How was Apple going to win? Well, somehow it just became clear, these guys had just gotten out ahead, and they were doing the right thing, and they were going to win. So we backed it one round later, made a good deal of money out of it. We would have made ten times as much money if we had been earlier, if I hadn't been a little stubborn about not recognizing they were going to be the winner. I didn't like the name. I didn't like the immaturity of the entrepreneurs. I was wrong on a number of counts.

And then again, sometimes you just get all the elements right. One of the mistakes that is so often made in this part of the country – that is, in the older mature regions – is that people don't listen. And you tell them it takes all three elements. People fall in love with a person, and they say he or she is so wonderful he would back them in anything. That is absolute nonsense. I know some perfectly good executives in the steel industry in this country, some very fine people. If they were in some other industry, or they were at some other point in time in the steel industry, they would do very well. They are not stupid. They are not lazy. They just are in a tough time in that business and in that market. Not all the automobile executives are stupid. Some of their predecessors – I dumped General Motors out of my portfolio in personal investments back in 1965, and my investment adviser said that's un-American not to own General Motors, five percent dividend, and you should

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to a variety of fields including physics, biology and economics”).

<sup>271</sup> See Tankersley, *supra* note 268.

<sup>272</sup> See generally *Inventor of the Week, The Personal Computer, Lemelson – MIT Program*, <http://web.mit.edu/invent/iow/apple.html> (last visited Oct. 20, 2007) (Steve Jobs was born on Feb. 24, 1955, and Apple Computer began in 1976 with Steve Wozniak).

<sup>273</sup> See generally *id.*

own it. They have a 58 percent market share.<sup>274</sup> If they get any more the antitrust department will be on their backs;<sup>275</sup> we sell to them, their costs are extreme;<sup>276</sup> their unions are overpaid;<sup>277</sup> their management is arrogant.<sup>278</sup> Get it the hell out of my portfolio! They did, and the stocks have never done better. I picked a good time to exit. You have to get all the elements together. And that's the reason I was making the point earlier.

The lack of entrepreneurship is not a cause; it is a symptom. It tells you you have a later condition than you realize, and that is the point I want to leave here. You are lacking innovation because innovation creates the little horses. If the little horses are not being born, the entrepreneurs – the jockeys – don't hang around. They go to Silicon Valley.

We find a problem today. If we find an interesting company coming out of The Cleveland Clinic, or coming out of some other source around town, and we start to look for a jockey, we usually can't find someone in town who is qualified. We go out to recruit him. Where do you find him? You find him in Silicon Valley, or you find him in Boston. Then you have a hell of a time persuading him to move here because he says, "I like you and I like the place and everything else. But if I lose my job, I don't have another kind of job to go to there. When I am in a big industrial parking lot in San Jose or Mountain View or something of that kind, if I lose my job there, I can get two more jobs in the industrial area without changing my parking place." This is part of the reality of it.

DR. KING: Well, thank you very much. Marty Gelfand?

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<sup>274</sup> See The General Motors Branding Lesson, Branding Strategy Insider, Oct. 8, 2007, <http://www.brandingstrategyinsider.com/2007/10/of-branding-gm-.html> ("[S]trong brands allowed GM to capture more than 57% of the U.S. market by 1955."); cf. Jerry Dubrowski, *GM Retools for Cyberspace*, CNN MONEY, Aug. 24, 2000, [http://money.cnn.com/2000/08/24/companies/gm\\_overview/](http://money.cnn.com/2000/08/24/companies/gm_overview/) ("GM's U.S. market share stands at just over 28 percent today, down from almost 50 percent in 1965").

<sup>275</sup> See The General Motors Branding Lesson, *supra* note 274 ("Aware that pursuing more market share could lead to antitrust actions and the threat of a breakup, GM fatefully shifted its strategy").

<sup>276</sup> See Terry Box, *Automaker Cutting 30,000 Jobs, Closing Plants: Experts Say GM Needs New Designs, New Deals*, DALLAS MORNING NEWS, Nov. 22, 2005, available at <http://www6.lexisnexis.com/publisher/EndUser?Action=UserDisplayFullDocument&orgId=574&topicId=100021821&docId=l:334286713&start=21> ("With General Motors' dramatic plant closure announcement Monday, the embattled corporation is striving to cut some of its huge costs and shrink itself.").

<sup>277</sup> See Kathleen Hays, *Getting 'Intelligent' at GM*, CNN MONEY, Nov. 22, 2005, [http://money.cnn.com/2005/11/22/commentary/column\\_hays/hays/index.htm](http://money.cnn.com/2005/11/22/commentary/column_hays/hays/index.htm) ("Management can complain all it wants to about "overpaid" union workers").

<sup>278</sup> See John Holusha, *Humbler G.M. is Now Listening*, N.Y. TIMES, Jan. 30, 1988, available at <http://query.nytimes.com/gst/fullpage.html?res=940DE3D9133BF933A05752C0A96E948260> ("[O]nce arrogant G.M. executives speak today in humbler tones.").

MR. GELFAND: Yeah. Professor Barber, I liked how you described entrepreneurship as human, and I think Professor King illustrated that with his own second mortgage, and you illustrated it yourself by saying that successful entrepreneurs frequently have also failed in their previous businesses.

I wanted to ask anyone from the panel if they think that our bankruptcy laws, particularly on the recent revamping of the bankruptcy laws<sup>279</sup> making it more difficult to get out from an unsecured debt, have affected current efforts to be successful entrepreneurs, particularly in, you know, those stop-gap failures that inevitably happen?

DR. BARBER: I think we have to have David answer that. I keep on saying that I have been involved—

DR. KING: Did you hear the question?

DR. BARBER: Yes, I think I did. I have been involved in five startups. One hundred percent of them have been successful, which is not those kind of statistics, and I don't know where to lay the blame for that, but we have had no bankruptcies so I don't have any direct experience of that kind.

DR. KING: Do you have any experience, David, with respect to the bankruptcy laws?

MR. MORGENTHALER: Well, we usually try to sell them before they go bankrupt. But I want to talk to you, Doug, if you have got five out of five. Let's meet afterwards. Maybe we can make a deal.

I never lost money in a private company until I was over age 50, and I somehow thought I had a magic touch. I got in the venture business and made more investments, and I discovered I could lose money, and I did.

I don't think much about bankruptcy – no entrepreneur thinks about going bankrupt. That is something that happens to other people. That is not going to happen to him. He would not be a part of it. I think if you talk to factoring people – I was on a panel yesterday over at Case with their Research Data Center,<sup>280</sup> and they had factoring people – those people look at that kind of thing. They are concerned about it. I don't think we think much about the bankruptcy laws. We don't lend money. Even though we structure it in a

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<sup>279</sup> See generally Timothy Egan, *Debtors in Rush to Bankruptcy as Change Nears*, N.Y. TIMES, Aug. 21, 2005, available at <http://www.nytimes.com/2005/08/21/national/21bankruptcy.html?pagewanted=print> (“[U]nder the revised law, debtors who earn more than the median income in their state and who can repay at least \$6,000 will no longer be able to have their debts wiped out for a fresh start under the more generous provisions of Chapter 7 of the bankruptcy code. Instead, they will have to seek protection under Chapter 13, which requires a repayment schedule.”).

<sup>280</sup> See Case Western Reserve University Research Symposium, (research symposium held Apr. 11-12, 2007), available at <http://ora.ra.cwru.edu/showcase/program.html> (follow “Fast Forward -- The Future of Funding” hyperlink) (last visited Oct. 20, 2007).

convertible debt, it is basically equity, and we will end up losing it, and we just try to recover something in the end.

DR. KING: Well, I don't want to close this session. It has been a great session, but we have this clock to deal with, and as you know, I am well aware of the clock. I wanted to thank you, David Morgenthaler, for a wonderful presentation and also Douglas Barber for raising some very interesting questions. I thought this was a good session, and I thank you.

CREATING ENTREPRENEURSHIPS: FORM OF ENTITY;  
MANAGEMENT PROVISION CONCERNS; DISPUTE  
RESOLUTION PROVISIONS; GROWTH PROVISIONS –  
IDENTIFICATION OF RIGHTS AND RESPONSIBILITIES OF  
PARTICIPANTS IN ENTREPRENEURSHIP INCLUDING  
ALLOCATION OF RISKS

*Session Chair – Silvana Alzetta-Realì*  
*Canadian Speaker – Gail Lilley*  
*United States Speaker – Michael Wager*

INTRODUCTION

*Silvana Alzetta-Realì*

MS. ALZETTA-REALI: Good morning. The second panel discussion today is about creating entrepreneurship, and we have with us today Michael Wager and Gail Lilley. Both Ms. Lilley and Mr. Wager are frequent speakers at various conferences.

As our discussion of the morning topic evolves, the decision was to take a step back and look at the creation of entrepreneurship from a policy perspective first, and then focus on the actual processes involved, such as, the choice of entity, the allocation of risk, responsibilities, and the like.

So I will now pass the baton over to both Gail and Michael who will be presenting in a tag team formation.

## UNITED STATES SPEAKER

*Michael Wager\**

&amp;

## CANADIAN SPEAKER

*Gail Lilley\**

MR. WAGER: Silvy, yes, we are going to do this a little differently. Rather than having Gail and I present for 30 minutes each, on the entity choice issues, allocations, responsibilities and the prospectus on the American-Canadian side, we thought it would be interesting and more engaging if we presented on an interactive basis.

We also wanted to step back and talk about some of the underpinnings of the policies and laws as they relate to entrepreneurship. I did not realize, however, at the time we made that decision, that we would be following a distinguished panel, and, in a sense, we would be trying to enhance on observations of entrepreneurship after David Morgenthaler had made his presentation, but we will do the best we can.

When talking about the context for creating entrepreneurship, we ask the fundamental questions about what is, or who is, the entrepreneur, and what are the political, economic, and social environments in which entrepreneurs are grown.

Certainly, we embrace and celebrate the entrepreneur in American popular culture. However, I think David Morgenthaler said that was not always the case. I think he said early in his career that someone said that he was an entrepreneur, perhaps, because he could not hold a job. Today that is certainly not the case. From an academic perspective, and from the perspective of those of us that practice in the field of corporate law and, certainly, in the business world, entrepreneurs are, in fact, celebrated for not only the product of their labors but the way they engage in the world.

They are, if you will, the Evangelistic indigenous growth in America, and I expect the same in Canada. In historical and geopolitical laws, American capitalism has already been the counterpoint to centralized economies, which raises cross border questions of why entrepreneurs do not thrive in other types of economies.

It is clearly accepted wisdom that entrepreneurial activity equates to economic growth over the long-term. But it raises some chicken and egg

questions, which hopefully our presentation will begin to answer, or at least raise as an acute question. The first of those causality questions is: Does capital and access to capital attract entrepreneurs, or do entrepreneurs attract capital? And then another interesting question is: Does U.S. public policy and law drive, or even support, entrepreneurship?

With regard to U.S. public policy and legislative initiatives, or in my own view sometimes obstacles, we find that perhaps there is not a coherent strategy, either at the federal or state levels. I have observed that from a variety of different perspectives in my own career and experience.

Though, notwithstanding the fact I am a practicing lawyer, there was a tour of duty in my life as an entrepreneur, albeit it was at a time when it was not easy to be perceived as an entrepreneur. In the late 1990s, I was involved in a technology company in Denver, Colorado. I was the only fellow, of 300 people, that showed up with a tie. I became known as the tie guy. At this stage, I was not an entrepreneur, but I did observe that I was the oldest employee of the company, which was not yet 50 years old.

Dialogue with company employees in Colorado was different than my dialogue with people in Cleveland, and I think the reason for that was that the view of what an entrepreneur was was really quite different. In Colorado, companies talked to people in civic life or engaged in policy or politics.

If you asked some of the people in this region, or in mature rust belt cities, what an entrepreneur was, sometimes you got a simple response: an entrepreneur is an individual who is self-employed and wants to be his own boss. If you went back and looked at definitions in state addresses or other pronouncements by politicians, you got a list of definitions of an entrepreneur, which I will read to you.

Entrepreneurs are people who have different capital needs.<sup>1</sup> Entrepreneurs add value to the economy and generate a higher rate of return on public

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\* Michael Wager is a lawyer with Squire, Sanders & Dempsey. He shares his time between the New York and Cleveland offices. He focuses his practice on representation of private and publicly held companies in matters of securities regulation, corporate finance, corporate governance, mergers and acquisitions, and strategic growth. Mr. Wager has served as counsel and adviser to, and director of, several private and public companies. He is active in several civic and philanthropic organizations and is currently vice chairman and chair elect of the Board of Cleveland-Cuyahoga County Port Authority and a member of the Board of the Northeast Ohio Development Fund LLC. He serves on and has served on many other past boards and commissions and has served as the Chairman of a Cleveland-based private equity firm.

\* Gail Lilley has been a partner at Blake, Cassels, & Graydon since 1986. Her practice involves a wide range of corporate commercial transactions with a principal focus on mergers and acquisitions for both Canadian and multinational clients. Her particular expertise is in the Canadian aspects of global business transactions, including the cross border structuring and financing of those acquisitions. She also advises clients on corporate reorganization, private financing, and equity issues and other more commercial relationships. Ms. Lilley is involved

investment.<sup>2</sup> Entrepreneurial businesses expand rapidly, and entrepreneurs are more dependent on constantly changing technologies.<sup>3</sup> Entrepreneurial businesses have high growth potential.<sup>4</sup>

Also, taking a very local view, entrepreneurs are cash importers because they sell products and services outside of the state.<sup>5</sup> Entrepreneurial companies are defined by revenue growth, and their resource needs differ from small business in magnitude and kind.<sup>6</sup> Finally, entrepreneurs need greater access to research and development resources.<sup>7</sup> These are all different ways of looking at entrepreneurs.

From my own perspective, I think what would differentiate entrepreneurs ultimately from small businesses, is that they seem to be individuals who require some level of independence in the utilization of the resources made available to them. Also, there are risk barriers, which make them different from other kinds of small businesses. On that point, size probably does not matter.

One of the questions that we may address today is whether or not there are differences, cross border, in the characteristics of an entrepreneur. This is

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in many major transactions. In 2005, she was involved in Pernod Ricard's multi-billion-dollar takeover of Allied Domecq, acting as Canadian counsel to Fortune brands. She has also had a long time interest in educational issues and as a result has served on the Governing Council of the Ontario College of Teachers.

<sup>1</sup> See JAY KAYNE, KAUFFMAN CENTER FOR ENTREPRENEURIAL LEADERSHIP AT THE EWING MARION KAUFFMAN FOUNDATION, STATE ENTREPRENEURSHIP POLICIES AND PROGRAMS, at 8 (Nov. 1999), available at <http://www.publicforuminstitute.org/nde/sources/reports/ngastudy.pdf> (explaining that Nebraska and California's rationale for treating entrepreneurs differently from small businesses in state policies and programs is because "[e]ntrepreneurs have different capital needs").

<sup>2</sup> See *id.* (explaining Iowa's rationale for treating entrepreneurs and small businesses differently in state policies and programs is because "[e]ntrepreneurs add value to the economy and generate a higher rate of return on public investment").

<sup>3</sup> See *id.* (explaining Massachusetts's rationale for treating small businesses and entrepreneurs differently in state policies and programs, is because "[e]ntrepreneurial businesses expand rapidly and are more dependent on constantly changing technologies").

<sup>4</sup> See *id.* (explaining New Jersey and Michigan's rationale in treating small businesses and entrepreneurs differently in state policies and programs is because "[e]ntrepreneurial businesses have high-growth potential").

<sup>5</sup> See *id.* (explaining Missouri's rationale for treating small businesses and entrepreneurs differently in government policies and programs is because "[e]ntrepreneurs are cash importers as a result of selling products and services outside of the state").

<sup>6</sup> See *id.* (explaining North Carolina rationale in treating small businesses and entrepreneurs differently in state policies and programs is because "[e]ntrepreneurial companies are defined by revenue growth" and that "[t]heir resource needs differ from small business in magnitude and kind").

<sup>7</sup> See *id.* (explaining South Dakota's rationale for treating small businesses and entrepreneurs differently in state policies and programs is because "[e]ntrepreneurs need greater access to research and development resources").

something that I am not sure about with regard to the U.S. and Canada, but certainly, I have observed entrepreneurs during my experience in the U.S., and in experiences that our firm has had in emerging economies in Eastern Europe and other parts of the world.

But as we observed earlier, there are cultural and demographic differences even within the U.S. regarding the definition of an entrepreneur. I think this has had an effect on state and federal policy and law addressing entrepreneur activities. The general question that we perhaps want to raise in the backdrop is whether governmental intervention is, in particular government policy and law, effective. Is going beyond Adam's invisible market forces worthwhile?

Should government be involved in policy and law beyond mere encouragement? In fact, when government gets involved in going beyond statements, creating policy and programs, does it have the intended effect? In 1999, during the height of the tech boom on Wall Street, a study was done, which looked at the state addresses and inaugural speeches in 36 states in the United States.<sup>8</sup> Even at the height of that euphoria with regard to entrepreneurs and technology companies, only 25 percent of those speeches and political pronouncements talked about entrepreneurs and expanding businesses.<sup>9</sup>

And in those 36 states the programs that they had were inactive.<sup>10</sup> The tech transfer programs or capital programs, R & D programs and work force development programs, actually proceeded like the Small Business Administration ("SBA"),<sup>11</sup> which we will hear about in this conference. These were generally broadly based programs, which for me always raised a question of whether or not policy and law have an effect on entrepreneurial activity and the development of entrepreneurs.

Here in Ohio, the Department of Development has been involved on and off over a period of years in tax incentives, specifically identified as drivers of job creation.<sup>12</sup> Yet, in 2002, when a study was conducted on companies that were given job creation grants, it was found that for those companies, there was no net job increase as a result of the investments made by public

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<sup>8</sup> See *id.* at 10 (stating the results of a study that surveyed state addresses and inaugural speeches).

<sup>9</sup> See *id.* at 10 (explaining that in 1999, only 25% of policy statements by state governors addressed entrepreneurs).

<sup>10</sup> See *id.* at 12 (stating that entrepreneurial development in the states that were surveyed, received only .71% of the total state fund).

<sup>11</sup> See generally SBA Programs, Small Business Administration, <http://www.sba.gov/aboutsba/sbaprograms/index.html> (last visited Sept. 24, 2007) (discussing providing programs and services to help small businesses succeed in the United States).

<sup>12</sup> See Ohio Tax Reform, Ohio Department of Development (2006), <http://www.odod.state.oh.us/taxreform.htm> (discussing positive impacts of ongoing tax reform initiatives).

dollars.<sup>13</sup> So again, does government intervention, going beyond the invisible hand, have the effect we want in entrepreneurial activity?

As a counterpoint to those observations about U.S. policy and law, here is Gail Lilley with the Canadian experience. Gail, does Canada have anything different, or does it reflect the same?

MS. LILLEY: I just wanted to make two preliminary remarks, one being that I was fortunate enough to attend Case Western on the Case Western exchange program a number of years ago, and I think it was a very formative experience, and I think it is a wonderful program.

The preliminary comment I wanted to make, which I frequently make when I am speaking to Americans, is that the population of Canada is smaller than the population of the State of California.<sup>14</sup> So it is difficult to really have a true comparison of the U.S. and Canada, but I think this statistic is always important to keep that in mind.

When I started to think about the topic for this morning, I thought I would find out what our government is saying about entrepreneurship, and the quotes you see up on the screen are statements that were made by our Minister of Industry in September of 2006, "Features of the Value of Entrepreneurship."<sup>15</sup> Those are very strong statements. It is felt all Canadians want entrepreneurship. It is also a bit of a political statement, by supporting entrepreneurship through tax relief and red tape relief.

Now, there was a captive audience - speaking to a chamber of commerce group in Saskatchewan - but it was an important statement, which reflected

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<sup>13</sup> See generally ZACH SCHILLER, POLICY MATTERS OHIO, WAL-MART SPECIAL: OHIO JOB TAX CREDITS TO AMERICA'S RICHEST RETAILER (July 2002), available at <http://policymattersohio.org/pdf/wal-mart.pdf> (criticizing the effectiveness of Ohio job creation tax credits).

<sup>14</sup> See Population and Dwelling Counts for Canada Provinces and Territories, 2006 & 2001 Censuses, Statistics Canada (2007), <http://www12.statcan.ca/english/census06/data/popdwell/Table.cfm?T=101> (showing Canada's population in 2006 was 31,612); California QuickFacts from the US Census Bureau, U.S. Census Bureau (Aug. 31, 2007), <http://quickfacts.census.gov/qfd/states/06000.html> (showing California's estimated population in 2006 was 36,457,549).

<sup>15</sup> Maxime Bernier, Minister of Industry, Canada, The Value of Entrepreneurship, Address Before the Canadian Chamber of Commerce Annual General Meeting (Sept. 17 2006), available at <http://www.ic.gc.ca/cmb/welcomeic.nsf/cdd9dc973c4bf6bc852564ca006418a0/85256a5d006b9720852571ed005ba0d5!OpenDocument> (describing entrepreneurship as "[...] an outlook on life. It is the ability to see opportunities in your environment and exploit them to create something new or make something better"). See also Gail Lilley and Michael Wager, Creating Entrepreneurship, [http://cusli.org/conferences/annual/presentations/2WAGER\\_\\_Creating\\_Entrepreneurships\\_PowerPoint\\_Presentation.PPT](http://cusli.org/conferences/annual/presentations/2WAGER__Creating_Entrepreneurships_PowerPoint_Presentation.PPT) (last visited Nov. 7, 2007) ("Entrepreneurship is an outlook on life. It is the ability to see new opportunities in your environment and exploit them to create something new or make something better.").

government and entrepreneurship. I also thought it was interesting to look at a couple definitions of what an entrepreneur was, and I thought it was interesting I chose the same definition as Douglas Barber.

That may be a Canadian thing, or perhaps a French bilingual thing, but that route to undertake something is an interesting basis for this. The definition on the broader statement of what an entrepreneur is was also made by the Minister of Industry.<sup>16</sup> It obviously is a statement that goes beyond small business and what you think of as the individual creating a business for himself, to a sort of philosophy that can affect big business and large organizations. I like this definition because of its broader appeal.

So I think what we are going to talk about specifically as this program progresses, with respect to Canada, is what does our government do to help entrepreneurs do something? And this goes back to the earlier discussion about entrepreneurs: Are entrepreneurs born or made?

The early focus we have taken is that they may be born, but they also have to be helped and supported to be fully functional. So I thought we would look at four major policy areas in Canada: competition policies, tax policies, red tape reduction, and financial support.

Now, there are obviously a number of other policy areas that impact on entrepreneurship. There are immigration policies that encourage successful entrepreneurs to immigrate,<sup>17</sup> securities policies that broaden exemptions from registration,<sup>18</sup> and prospectus requirements to promote investments.<sup>19</sup> But as I say, I wanted to concentrate on these four.

MR. WAGER: From a U.S. public policy perspective, one of the fundamental initiatives that you often see is legislative action with regard to capital formation.<sup>20</sup> Obviously, new business requires access to capital, and one of the issues, particularly in regions like the North, other than Ohio, has

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<sup>16</sup> Bernier, *supra* note 15; *see also* Gail Lilley and Michael Wager, *supra* note 15.

<sup>17</sup> *See generally* Canada Immigration – Entrepreneur, CanadaVisa.com, <http://www.canadavisa.com/immigration-canada-entrepreneurs.html> (last visited Oct. 26, 2007) (describing an entrepreneur program that “seeks to attract people with business experience who have the intention and ability to actively manage a Canadian business that will positively impact the Canadian economy and create employment opportunities for Canadian residents.”).

<sup>18</sup> *See, e.g.*, Securities Rules, New Brunswick Securities Commission, [http://www.nbsc-cvmb.ca/nbsc/iam\\_content.jsp?id=19&pid=0](http://www.nbsc-cvmb.ca/nbsc/iam_content.jsp?id=19&pid=0) (last visited Nov. 6, 2007) (stating that for entrepreneurs there are certain exemptions from registration under New Brunswick securities law).

<sup>19</sup> *See e.g. id.* (stating that for entrepreneurs there are certain exemptions from prospectus requirements under New Brunswick securities law).

<sup>20</sup> *See generally* American Council for Capital Formation, ACCF Mission, <http://www.accf.org/about/index.html> (last visited Oct. 26, 2007) (stating that for nearly thirty years, the American Council for Capital Formation “brought the message to U.S. and international policymakers, the media and the public that a nation’s economic strength and stability depend on...policies to promote capital formation...”).

been that the limited access to capital may be a factor in why entrepreneurial businesses have not succeeded here.<sup>21</sup> But capital, as was stated earlier, is only one of the elements that creates entrepreneurship. Capital, skilled labor, technology, infrastructure, and a spectrum of resource availability, if not the cause, are also important to entrepreneurship.<sup>22</sup>

But when you look at the capital formation spectrum, how much of that is important to the creation of entrepreneurship? Earlier there was a discussion about the roles of angels and smaller capital providers, and certainly here in Cleveland we do not have that kind of load seed capital that we have seen, at least today, in other regions of the country. And as a result of that, we have seen increasing intervention by local not-for-profit or public entities, creating venture capital pools,<sup>23</sup> and this kind of intervention eases constraint.

Constraint on access to capital is really one of the issues that is important in driving or creating entrepreneurship. In Northeastern Ohio, venture capital, or seed capital, has been created by the actions of the not-for-profit or foundation community.<sup>24</sup> They provide either direct equity or forms of indirect equity.<sup>25</sup>

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<sup>21</sup> See generally INDIAN AND NORTHERN AFFAIRS CANADA, CANADA'S NEW GOVERNMENT INCREASES ACCESS TO CAPITAL FOR SMALL AND MEDIUM-SIZED BUSINESS IN YUKON, <http://www.ainc-inac.gc.ca/nr/prs/m-a2007/2-2900-eng.asp> (last visited Oct. 26, 2007) (stating the Canadian's government investment in Yukon businesses will help them "overcome challenges they are faced with because of a limited access to capital.").

<sup>22</sup> See generally Mark Drabenstott, Nancy Novack & Bridget Abraham, Main Streets of Tomorrow: Growing and Financing Rural Entrepreneurs – Conference Summary, Federal Reserve Bank of Kansas City, [http://findarticles.com/p/articles/mi\\_qa3699/is\\_200307/ai\\_n9267206/pg\\_2](http://findarticles.com/p/articles/mi_qa3699/is_200307/ai_n9267206/pg_2) (last visited Oct. 26, 2007) ("Ensuring access to capital is another key element of the entrepreneurial ecosystem," as well as "infrastructure and institutional support.").

<sup>23</sup> See generally *Background*, The Ohio Capital Fund, <http://www.ohiocapitalfund.com/background.asp> (last visited Sept. 24, 2007) (discussing the Ohio VC Statue, created "for the purpose of increasing the amount of private investment capital available in this state for Ohio-based business enterprises in the seed or early stages of business development and requiring initial or early stage funding").

<sup>24</sup> See generally THE GREATER CLEVELAND PARTNERSHIP, THE GREATER CLEVELAND VENTURE CAPITAL REPORT 5 (2006), <http://www.gcpartnership.com/uploadedFiles/Miscellaneous/2006%20Venture%20Capital%20Report.pdf> (describing initial seed investments as "typically \$250,000-\$1 million and provided by friends & families of the entrepreneur, nonprofit venture development groups, and grant funding sources").

<sup>25</sup> See generally About Case Technology Ventures, Case Technology Ventures, <http://ora.ra.cwru.edu/ctv/html/about.html> (last visited Sept. 30, 2007) (describing how Case Technology Ventures "invests in its portfolio companies in the form of convertible debt" and "[i]n the event of a successful external financing, CTV will generally convert its debt to equity in the company.").

We have had actions by the state government, in the form of county and local governments involved in microenterprise loans,<sup>26</sup> and local guarantees and bond funds by our port authorities and other county and city creatures.<sup>27</sup> I am not certain, however, that the policy behind these actions, are drivers of creating entrepreneurship. For instance, the increased access to capital generated by the government, the large private equity funds, and the private equity D.C. firms, have accelerated entrepreneurial activity in no particular location. Furthermore, there is reliance liquidity, and liquidity restraints are questionable.

The SBA, from a federal perspective, has been involved in providing capital to businesses,<sup>28</sup> which they view as socially productive businesses.<sup>29</sup> But again, is government policy accelerating activity, or is it, in fact, other resources and other elements that give rise to the creation of entrepreneurial businesses?

From the tax perspective, it is clear that tax policy does have some effect on business decision-making. The question is whether or not it has a big effect on startup and entrepreneurial businesses. Taxes do distort economic decision-making, and perhaps higher taxes do have some deterrence to entrepreneurial activity. However, I am not certain that tax policy, as opposed to tax planning, in creating entrepreneurship is an important part of the decision-making for creating entrepreneurial businesses.

Among the incentives, the business incentives in the tax codes that have effect are, of course, tax credits;<sup>30</sup> and certainly, they do have some involvement on the planning going into entrepreneurial businesses. Sales tax exemptions, particularly for machinery and equipment for certain kinds of startup businesses<sup>31</sup> and tax rates, as I say, do have some effect. I am just not

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<sup>26</sup> See generally *Access to Capital*, Economic and Community Development Institute, <http://www.econcdi.org/Capital.htm> (last visited Sept. 30, 2007) (describing microenterprise loan programs offered in Ohio by government and private entities).

<sup>27</sup> See generally *id.* (demonstrating that the City of Columbus and Franklin County provide “loans to clients who lack conventional collateral”).

<sup>28</sup> See Investment Division, Success Stories, United States Small Business Administration, [http://www.sba.gov/aboutsba/sbaprograms/inv/INV\\_SUCCESS\\_STORIES.html](http://www.sba.gov/aboutsba/sbaprograms/inv/INV_SUCCESS_STORIES.html) (last visited Sept. 30, 2007) (listing successful companies that have received investment from the United States Small Business Administration through the Small Business Investment Company).

<sup>29</sup> See generally *About Us*, United States Small Business Administration, <http://www.sba.gov/aboutsba/index.html> (last visited Oct. 26, 2007) (“[They] recognize that small business is critical to our economic recovery and strength, to building America’s future, and to helping the United States compete in today’s global marketplace.”).

<sup>30</sup> See *e.g.*, *Business Incentives Tax Credits*, State of Ohio Department of Development (2006), [http://www.odod.state.oh.us/EDD/Tax\\_Credit.htm](http://www.odod.state.oh.us/EDD/Tax_Credit.htm) (describing tax exemptions and credits available to entrepreneurs in Ohio).

<sup>31</sup> See Carl Horowitz, *New Life for Federal Enterprise Zone Legislation: Seven Lessons From the States*, The Heritage Foundation (1991), <http://www.heritage.org/Research/Regulation/BG833.cfm> (“Sales tax exemptions on

certain that in creating an entrepreneurial business that they are an important part of the decision-making. Certainly, the inheritance death tax part for more mature businesses and business owners<sup>32</sup> is an important part of planning and is certainly one of the issues that lawyers might speak to when talking to an entrepreneur. I am not certain that it would have that large of an effect on the actual creation of entrepreneurial business. There is, in fact, very little differentiation of the Tax Code between business generally and entrepreneurs or startup businesses specifically.<sup>33</sup>

On the regulatory side, there is a much greater cause and effect between entrepreneurs and what federal and state government does and the effect that policy and law has on entrepreneurs. In a recent survey, entrepreneurs were asked what regulatory policies they would like to see or what regulatory initiative they would like to see from state governments to increase their levels of activity or support for their activity.<sup>34</sup> This is the rank order of the things they want to see as a response from state government.<sup>35</sup>

First of all, they would like ease of getting through rules or regulatory red tape, one stop service centers for permitting other regulatory compliance, and paperwork reduction.<sup>36</sup> Essentially, they wanted government out of the way. The rank also showed utilities deregulation, securities regulation, and the cost and the time to get business started.<sup>37</sup>

Entrepreneurs by their very essence are market disruptive forces.<sup>38</sup> Therefore, they are free market risk takers and they view regulation accordingly. So I think as obstacles and status quo businesses, the ones that are being challenged by entrepreneurial differences are relying upon public policy, and they are lobbying for public policy and law to preserve their competitive position threatened by entrepreneurs.

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equipment purchases . . . have been the most successful forms of relief used by states to encourage business formation and job creation, particularly in small firms”).

<sup>32</sup> 26 U.S.C. § 2001 (2006).

<sup>33</sup> See e.g., Business Incentives Tax Credits, *supra* note 30 (showing only the Ohio Job Retention Tax Credit and the Technology Investment Tax Credit are awarded based on number of employees or value of the business.).

<sup>34</sup> Cf. KAYNE, *supra* note 1, at 18-19 (providing a survey of states on what state actions have been taken to assist entrepreneurs).

<sup>35</sup> Cf. *id.*

<sup>36</sup> Cf. *id.* (listing that one-stop service centers, regulatory reforms, regulatory and paperwork reductions are state policies that support entrepreneurs).

<sup>37</sup> Cf. *id.* (listing that utilities deregulation and establishing processing deadlines are state policies that support entrepreneurs).

<sup>38</sup> See generally RUSSELL SOBEL, ENTREPRENEURSHIP, at 2 <http://www.be.wvu.edu/divecon/econ/sobel/Entr/Papers/FortuneEncyc.pdf> (last visited Oct. 26, 2007) (stating that under the economist Joseph Schumpeter perspective of entrepreneurship, the “entrepreneur is a disruptive force in an economy.”).

The specific areas of law and regulation that provide some of the larger obstacles are labor law policy, minimum wage, unemployment, and insurance workers' compensation.<sup>39</sup> Immigration policy, particularly now in the technology world where some of the more skilled personnel are not in the U.S., or perhaps in Canada, needs regulatory reform,<sup>40</sup> and as I said, to a lesser degree, utility deregulation. And this is why it is not immediately apparent, because the capital raising under the U.S. and Canadian regimes include the issuance of securities.

MS. LILLEY: Before I talk a little more about the various policies to you, it would be interesting to see what people think about how Canada compares, and the first statement from the conference board report was actually referred to by Sheridan Scott, The Canadian Commissioner of Competition, in a speech that, not surprisingly, she also gave to a chamber of commerce group.<sup>41</sup> I will talk about this negative response later on.

Even though Canada is lagging behind in productivity, and certainly lagging well behind U.S. productivity,<sup>42</sup> I found a very interesting statement on an industry website about Canada being the most cost effective location to conduct sophisticated information computer technology research,<sup>43</sup> for three reasons: tax incentives, investments in R & D infrastructure, and the lowest rate of cost in the G-7.<sup>44</sup>

And the interesting thing about those low labor costs is that salaries of both scientists and technicians, which are obviously the largest labor cost

<sup>39</sup> See generally Naomi Lopez, *Barriers to Entrepreneurship: How Government Undermines Economic Opportunity*, INSTITUTE FOR POLICY INNOVATION (1999), [http://www.ipi.org/ipi/%5CIPublications.nsf/PublicationLookupFullTextPDF/5B85FADDF A72B382862567E300806F40/\\$File/Barriers149.pdf?OpenElement](http://www.ipi.org/ipi/%5CIPublications.nsf/PublicationLookupFullTextPDF/5B85FADDF A72B382862567E300806F40/$File/Barriers149.pdf?OpenElement) (describing the barriers to entrepreneurship created by the government).

<sup>40</sup> See generally Press Release, Electronic Industries Alliance, *Beyond the Jobs vs. Trade Debate: EIA Unveils Policy Playbook on Innovation* (May 5, 2004) available at <http://www.eia.org/news/pressreleases/2004-05-05.153.phtml> (on file with author) (stating that the United States visa and immigration policy will influence the future of the United States high-tech innovation economy).

<sup>41</sup> SHERIDAN SCOTT, COMMISSIONER OF COMPETITION, CANADA, REMARKS TO RABOBANK GROUP (Apr. 5, 2006), available at [http://www.competitionbureau.gc.ca/PDFs/Rabobankspeech\\_e\\_mod1.pdf](http://www.competitionbureau.gc.ca/PDFs/Rabobankspeech_e_mod1.pdf).

<sup>42</sup> See generally Canada/United States Perspective, Industry Canada, [http://www.ic.gc.ca/epic/site/dsib-logi.nsf/en/h\\_pj00163e.html](http://www.ic.gc.ca/epic/site/dsib-logi.nsf/en/h_pj00163e.html) (last visited Oct. 26, 2007) (stating that in key performance indicators, Canada is not as efficient in productivity and competitiveness as the United States).

<sup>43</sup> INDUSTRY CANADA, CANADA'S R&D LEADERSHIP IN INFORMATION & COMMUNICATIONS TECHNOLOGIES SIGNIFICANTLY LOWER R&D COSTS (June 10, 2005), <http://strategis.ic.gc.ca/epic/site/ict-tic.nsf/en/it07292e.html>.

<sup>44</sup> *Id.*

component, are the lowest.<sup>45</sup> I found a lot of surprising statistics when I started to research this program. So let us talk about Canadian competition policies.

This is a relatively recent speech that Sheridan Scott gave in April of 2006 in which it was stated that one of the ways to ensure that small and medium-sized enterprises have an equitable opportunity to participate in the Canadian economy is innovation as the crucial ingredient for economic success.<sup>46</sup> This statement is key here, because we are seeing that different people coming at this problem from different perspectives are all sort of focusing in on innovation.

The thrust of her speech was that the mission of the Chamber of Commerce and the mission of the Competition Bureau were similar,<sup>47</sup> but not having attended the speech, I don't know how successful she was in convincing them of that. I think it was interesting from your point, Michael, the importance of tax policy, because I think in Canada that tax policy is a very important driver for entrepreneurial activity.

There are three prongs to that. They want to reduce the tax burden for small business.<sup>48</sup> They want to create incentives for research and development,<sup>49</sup> and they want to create incentives for investment in small business.<sup>50</sup> Now, the importance of tax policy in Canada may be tied to the relatively high tax rates that Canadians pay and the desire to reduce taxes whenever possible. I thought I would see what Finance had to say about this on their website. The statement about entrepreneurs and small business "being a key source of jobs," is again a continuing government theme; that statement was made in August of 2003.<sup>51</sup>

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<sup>45</sup> *Id.*

<sup>46</sup> SCOTT, *supra* note 41, *see also* Gail Lilley and Michael Wager, *supra* note 17.

<sup>47</sup> SCOTT, *supra* note 41.

<sup>48</sup> *See* Promoting Entrepreneurship and Small Business, Department of Finance Canada (2003), [http://www.fin.gc.ca/toce/2003/entrepreneur\\_e.html](http://www.fin.gc.ca/toce/2003/entrepreneur_e.html) ("Government is strengthening support" for entrepreneurs and small businesses "by reducing taxes on small business income and capital gains").

<sup>49</sup> *See generally* Scientific Research and Experimental Development Program, Canada Revenue Agency (2007), [http://canadabusiness.gc.ca/servlet/ContentServer?pagename=CBSC\\_ON%2Fdisplay&lang=en&cid=1097152945354&c=Finance](http://canadabusiness.gc.ca/servlet/ContentServer?pagename=CBSC_ON%2Fdisplay&lang=en&cid=1097152945354&c=Finance) ("The Scientific Research and Experimental Development (SR&ED) program is a federal tax incentive program to encourage Canadian businesses of all sizes and in all sectors to conduct research and development (R&D) in Canada...").

<sup>50</sup> *See* Promoting Entrepreneurship, *supra* note 48, (explaining that the Canadian government introduced a number of tax measures to promote investment and entrepreneurship in Canada).

<sup>51</sup> *See id.* ("Entrepreneurs and small businesses are a key source of jobs and economic growth in Canada).

And after that time, there were some improvements in the tax burden for small businesses, the rates being lowered in certain circumstances,<sup>52</sup> and the amount of qualifying income for lower rates was raised.<sup>53</sup> But I thought it was interesting, these two examples from our recent March 9, 2007 budget, they really fell more in the red tape reduction and lowering the compliance burden.<sup>54</sup>

These seem like small contributions to these broad statements that they want to support small business, but what they are really doing? They are really lowering filing requirements. It is hard to see how that is going to kick start much economic activity.

Those of you from Canada may be familiar with the Fraser Institute and the Fraser Institute's publications.<sup>55</sup> I thought it was interesting that they came out quite strongly in one of their publications that these preferential tax rates for small businesses can actually act as a deterrent to growth and expansion, because the jump in tax rates is so significant when they pass the threshold of the eligible income.<sup>56</sup>

There were some interesting statistics in an article that in British Columbia and Ontario, which had the lowest incremental increase, the rates doubled, and in New Brunswick the actual increase was about 143 percent.<sup>57</sup> So you can see that this is probably a deterrent to expansion. And certainly, when you are looking at buying a small Canadian business or a Canadian controlled corporation, increased tax rates and reduced access to certain tax credit programs is something that people take into account in their economic

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<sup>52</sup> See generally Building on the Five-Year Reduction Plan, Department of Finance Canada (2003), <http://www.fin.gc.ca/budget03/bp/bpa2e.htm> (showing that in year 2004, there was 30 billion dollars in tax relief in Canada) [hereinafter Reduction Plan]; see generally Budget Information, Department of Finance Canada (2007), <http://www.fin.gc.ca/access/budinfoe.html> (Federal Budgets and Budget Speeches from 1995 to 2007 illustrating changing tax burden for small business).

<sup>53</sup> See generally Reduction Plan, *supra* note 52 (explaining that Canada had improvements in the tax burden for small businesses because the amount of qualifying income for lower rates was raised).

<sup>54</sup> See Gail Lilley and Michael Wager, *supra* note 15.

<sup>55</sup> The Fraser Institute: Competitive Market Solutions for Public Policy Problems, <http://www.fraserinstitute.org/>, (last visited Oct. 29, 2007) (The Fraser Institute is a non-profit research group that "measures and studies the impact of competitive markets and government interventions on individuals and society.")

<sup>56</sup> See Jason Clemens & Niels Vedhuis, *Growing Small Businesses in Canada: Removing the Tax Barrier*, The Fraser Institute (2005), available at [http://www.fraserinstitute.org/commerce.web/publication\\_details.aspx?pubID=3113](http://www.fraserinstitute.org/commerce.web/publication_details.aspx?pubID=3113) (stating that large increases in business income-tax rates are "strong disincentives for growth and expansion").

<sup>57</sup> See *id.* (stating that the largest increase in business tax rates were in New Brunswick, where "the statutory rate jumps 142.9%")

modeling, when trying to decide how profitable the business will be on a go-forward basis.

Also, not surprisingly, the solution for that problem proposed in the publication was to reduce all business tax rates and then to aggressively increase the eligible income for small business rates,<sup>58</sup> which is very consistent with the themes of the Fraser Institute.

One of the programs that had a lot of success in Canada for promoting investment in small businesses were our labor sponsored investment funds, and they began in the late 1990s.<sup>59</sup> These funds had to be sponsored by a trade union or a similar work organization,<sup>60</sup> and they provided significant tax benefits to investors.<sup>61</sup> Even though the investments were relatively small dollar values, the tax benefits for those investments were quite a bit.<sup>62</sup>

Now, I thought it was quite staggering that these funds, which were estimated to account for up to 40 percent of all venture capital raised in Canada,<sup>63</sup> had poor returns.<sup>64</sup> Many are microbusinesses. They are high risk,<sup>65</sup> and one out of a thousand brings success.<sup>66</sup>

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<sup>58</sup> See *id.* (“The optimal solution is to reduce the general business income-rate while aggressively increasing the small business income eligibility”).

<sup>59</sup> See generally *The Venture Capital Industry in Canada*, J. OF SMALL BUS. MGMT., at 4-5 (1997), available at <http://www.allbusiness.com/business-finance/equity-funding-private-equity/623199-1.html> (“The labor-sponsored funds (LBFs)... provide the greatest proportion of money invested by the Canadian venture capital industry, largely because of generous tax incentives.”).

<sup>60</sup> See generally *id.* at 5 (explaining how the Canadian Federation of Labour sponsors Working Ventures – an active type of labor-sponsored fund).

<sup>61</sup> See generally *id.* (explaining that labor-sponsored investment funds provide “generous tax incentives”).

<sup>62</sup> See generally *id.* (describing one labor-sponsored fund, which was started in 1990 and received “\$15 million in seed financing from the federal government,” and raised “the rest from individuals who received tax credit of up to 40 percent of the contribution amount.”).

<sup>63</sup> See *Labour-Sponsored Investment Funds*, CBC NEWS (2005), [http://www.cbc.ca/news/background/personalfinance/labour\\_investmentfunds.html](http://www.cbc.ca/news/background/personalfinance/labour_investmentfunds.html) (“By some estimates, labour-sponsored investment funds account for up to 40 per cent of all the venture capital raised in Canada”).

<sup>64</sup> See *id.* (“[P]oor returns have led many financial planners to stop recommending” labour-sponsored investments to their clients).

<sup>65</sup> See generally CANADIAN LABOUR AND BUSINESS CENTRE, *THE ROLE AND PERFORMANCE OF LABOUR-SPONSORED INVESTMENT FUNDS IN THE CANADIAN ECONOMY: AN INSTITUTIONAL PROFILE*, [http://www.clbc.ca/Research\\_and\\_Reports/Archive/archive12169501.asp](http://www.clbc.ca/Research_and_Reports/Archive/archive12169501.asp) (“Labour-sponsored fund tend to emphasize capital appreciation for shareholders as an overriding aim by which other social and economic goals are made possible. CLMPC research concludes that fund rates of returns must be considered in the context of venture capital investing which is long-term and high risk in nature.”).

<sup>66</sup> See generally *Labour-Sponsored Investment Funds: FAQs*, CBC NEWS, June 13, 2005 [http://www.cbc.ca/news/background/personalfinance/labour\\_investmentfunds.html](http://www.cbc.ca/news/background/personalfinance/labour_investmentfunds.html) (“For most LSIFs, the returns have been, shall we say, less than spectacular”).

The best success story is the early research in motion, our RIM, as we all know it.<sup>67</sup> Successful as this program has been, the program has been phased out over time.<sup>68</sup> The stated reason is that there has been such a proliferation of funds, that it is hard for funds to raise significant capital to make them meaningful to an investor and that some of the existing funds are too meaningful to investors. I think this is an example of, certainly in Canada, how tax incentives create capital for small businesses.<sup>69</sup>

The last tax policy is research and development credits. It is interesting that on the Canada website, there is a government statement which says that “innovation policy for the past 30 years” has been to “rely extensively on tax incentives to promote R & D;”<sup>70</sup> and this has been quite a successful program. It is a combination of programs at the federal level and the provincial level, providing tax deductions, accelerated write offs, and tax credits.<sup>71</sup>

So, in the best circumstances, the after-tax cost can be less than 44 cents on the dollar,<sup>72</sup> which is a very good incentive program overall. And again, Canadian small businesses receive the greatest business, so when they are being acquired by a foreign purchaser, you do have to take into account that you no longer will be entitled to those generous rates.

The last sort of policy initiative I would like to discuss is the government financial support for small business. There are many programs at various levels of government, but I just choose a program at random. The Canada Small Business Financing Program is a program that allows qualifying small businesses, which apply for a loan at a financial institution, to have the benefit of a government guarantee.<sup>73</sup>

<sup>67</sup> See generally Research In Motion Limited, *Innovation in Canada* (2003), <http://www.innovationstrategy.gc.ca/gol/innovation/site.nsf/en/in04212.html> (“Research In Motion Limited (RIM) is a leading designer, manufacturer and marketer of innovative wireless solutions for the worldwide mobile communications market”).

<sup>68</sup> See generally Eric Reguly, *RIM on Edge of Big Global Growth Story*, THE GLOBE AND MAIL, at B2 (“RIM stumbled in the fourth quarter, when the number of new subscribers came in about 100,000 below the company’s forecast.”).

<sup>69</sup> But see *id.* (explaining that the “barrage of stories about the potential shutdown of RIM’s U.S. service can probably take the blame for the slowdown (which only represents about two weeks’ worth of new subscribers). Rising competition, notably from Palm’s Treo, can take some of the blame, but only some.”).

<sup>70</sup> See generally Canada’s R&D Leadership in Information & Communications Technologies Significantly Lower R&D Costs, Industry Canada (2005), <http://strategis.ic.gc.ca/epic/site/ict-tic.nsf/en/it07292e.html> (“It has been Canada’s innovation policy for the past 30 years to rely extensively on tax incentives to promote R&D”).

<sup>71</sup> See *id.* (“One of the principal forces behind Canada’s success in attracting companies to perform Research and Development is a core tax incentive program”).

<sup>72</sup> See *id.* (“The net after-tax cost of R&D expenditures can be less than 0.44 cents for each dollar spent”).

<sup>73</sup> See generally Canada Small Business Financing Program, Industry Canada (2005),

They obtain the loan from the financial institution.<sup>74</sup> The federal government will reimburse 85 percent of the lender's losses in the event of a default.<sup>75</sup> Now, that sounds like a good program. There are apparently 1,500 participating financial institutions with 15,000 branches across Canada.<sup>76</sup> The maximum amount that can be borrowed is \$250,000.<sup>77</sup> The funds have to be used to purchase real estate, equipment, or leasehold improvements.<sup>78</sup> There are restrictions on what you can use the funds for, and you still have to meet the basic lender criteria for obtaining that money.<sup>79</sup> These hurdles may make the program relatively inaccessible to many small businesses.

MR. WAGER: With all that as a preface, the notion of creating an entrepreneurial business starts, at least as a legal matter, with a choice of entity. Choosing an entity is not a simple choice, but it can be reduced to certain determinants. For instance, some determinants in choosing an entity are the capital structure, risk management or limiting liability, taxation, and management and control issues.

We have talked about some policy and law behind that. In capital structure, it is a balancing of the differing objectives of the investor, and for the entrepreneur or the founder, these differing objectives would include time horizons. Most professional investors, on the day they are making that investment, are also thinking of their exit and certain rates of return.

Entrepreneurs, although certainly sensitive to the notion of creating wealth, also have a different feel for the business they are creating. Likewise, as we discussed earlier, the types of capital that go into entrepreneurial businesses from the perspective of the professional investor are different from that retained by the founder.<sup>80</sup> This is the question of common equity

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<http://strategis.ic.gc.ca/epic/site/csbfp-pfpec.nsf/en/Home> ("The Canada Small Business Financing Program seeks to increase the availability of loans... by encouraging financial institutions to make their financing available to small businesses").

<sup>74</sup> See *id.* (explaining that the Canada Small Business Financing program encourages "financial institutions to make their financing available to small businesses").

<sup>75</sup> See *id.*

<sup>76</sup> See generally Canada Small Business Financing Program, Industry Canada (2005), <http://strategis.ic.gc.ca/epic/site/csbfp-pfpec.nsf/en/la00054e.html>.

<sup>77</sup> See *id.*

<sup>78</sup> See Canada Small Business Financing Program, Industry Canada (2005), <http://strategis.ic.gc.ca/epic/site/csbfp-pfpec.nsf/en/la00231e.html> ("The services of an appraiser member of any professional association must be used for the purchase of real estate, improvements to real estate and leasehold improvements, there are no exceptions").

<sup>79</sup> See generally Canada Small Business Financing Program, Industry Canada (2005), <http://strategis.ic.gc.ca/epic/site/csbfp-pfpec.nsf/en/la00054e.html>, *supra* note 78 (explaining the lender's responsibilities under the program).

<sup>80</sup> See generally Tuck School of Business at Dartmouth, Center for Private Equity and Entrepreneurship, Private Equity Glossary, <http://mba.tuck.dartmouth.edu/pecenter/resources/glossary.html#convertiblepreferredstock> (discussing the difference between common stock and preferred stock, in which common

versus preferred equity or subordinated debt. Most preferred equity that is subordinated debt usually has convertibility features.<sup>81</sup> Everybody is essentially being valued on what the value is of common equity.

Management and control issues, are driven by the kind of business, the kinds of investors – professional investors – involved, and the stage of the business – early stage, mid stage, late stage.<sup>82</sup> As discussed earlier, the taxation policy is a driving force, but in this circumstance, it is the type of entity and the way taxation applies to that entity. Are our earnings going to be retained at least under U.S. law in the C Corporation<sup>83</sup> because of lower levels of taxation and earnings will be retained for future growth?

So the U.S. forms of organization are the sole proprietorship, which is not a legal entity but, in fact, an individual who does his business as an individual.<sup>84</sup> The sole proprietor has a relationship with the government primarily by contract,<sup>85</sup> if at all, and risk managed by insurance,<sup>86</sup> if at all. It is not a recommended form of doing business, as you might imagine.

A joint venture is not a form of partnership, corporation, or limited liability company, but rather a contractual relationship between parties that is

stock is held by “founders, management and employees,” and preferred stock is held by investors.).

<sup>81</sup> See generally *id.* (stating that convertible preferred stock “gives an owner the right to convert to common shares of stock. Usually, preferred stock has certain rights that common stock doesn’t have, such as decision-making management control, a promised return on investment (dividend), or senior priority in receiving proceeds from a sale or liquidation of the company. Typically, convertible preferred stock automatically converts to common stock if the company makes an initial public offering (IPO). Convertible preferred is the most common tool for private equity funds to invest in companies.”).

<sup>82</sup> See generally Rebecca Buckman, *Venture Capitalists Mentor Their Fledglings*, THE WALL ST. J., March 14, 2006, available at [http://www.kodiakvp.com/kodiak/news/?article=03\\_14\\_2006&id=06062818329991.php](http://www.kodiakvp.com/kodiak/news/?article=03_14_2006&id=06062818329991.php) (discussing that more venture capital investors are “trying to foster better management practices” in start-up companies.).

<sup>83</sup> See generally Invest in Canada: Selecting a Business Structure, Government of Canada [http://www.investincanada.com/en/809/Selecting\\_a\\_Business\\_Structure.html#corporation](http://www.investincanada.com/en/809/Selecting_a_Business_Structure.html#corporation) (last visited on Oct. 26, 2007) (describing the different entity structure available in Canada for businesses) [hereinafter *Selecting a Business Structure*].

<sup>84</sup> See generally Sole Proprietorship Basics, <http://smallbusiness.findlaw.com/business-structures/sole-proprietorship/sole-proprietorship-basics.html> (last visited Oct. 4, 2007) (explaining that a sole proprietorship is a “one-person business”).

<sup>85</sup> See generally Craig Miller, *Revised Ohio Campaign Finance Law*, World Services Group, (2007) <http://www.worldservicesgroup.com/publications.asp?action=article&artid=2049> (demonstrating that sole proprietorships can contract with the government).

<sup>86</sup> See generally Sole Proprietorships...Business Simplicity, LifeInsuranceHub.net (2005), <http://www.lifeinsurancehub.net/soleproprietorships.html> (explaining the need for insurance because in a sole-proprietorship “everything the proprietor and his family own is at risk”).

generally employed by corporations who are using contracts to do business with other corporations.<sup>87</sup>

The forms that are generally suggested or considered for the entrepreneurs are the limited partnership,<sup>88</sup> which is less likely to be used these days because of the regulations of the general partner, or the S Corp.<sup>89</sup> Oftentimes the decision does come down to a C Corp., which would be used for the efficiency of lower tax rates on retained earnings, or the LLC, which is the standard, because of pass-through taxable elements.<sup>90</sup>

From the Canadian perspective, I suspect it is similar, but there may, in fact, be some differentiation.

MS. LILLEY: Well, as you expected, the determinants for entity choice are quite similar in Canada.<sup>91</sup> The forms of organization are similar, but there are some differences, and I want to talk about three entities: LLCs, unlimited liability companies, and franchising. LLCs, I know, are very popular in the U.S, but they have proven to be a bit of a conundrum for cross border use because, to date, they have not been entitled to the benefits of the Canada-U.S. tax treaty, which is a problem.<sup>92</sup>

In the March 19th budget, the Minister of Finance in Canada announced that the Canadian and U.S. treaty representatives had agreed in principal on major elements of an updated tax treaty.<sup>93</sup> One of the elements of the treaty,

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<sup>87</sup> See generally, *Joint Ventures*, Encyclopedia of Small Business, <http://www.enotes.com/small-business-encyclopedia/joint-ventures> (last visited Sept. 26, 2007) (explaining that joint ventures use contracts to conduct business).

<sup>88</sup> See generally ELMER R. KIEHL & BRUCE W. MARION, *THE USE OF PUBLIC LIMITED PARTNERSHIP FINANCING IN AGRICULTURE FOR INCOME TAX SHELTER*, NORTH CENTRAL REGIONAL PROJECT 21, available at [http://www.aae.wisc.edu/fsrg/publications/mono1\(2\).pdf](http://www.aae.wisc.edu/fsrg/publications/mono1(2).pdf) (last visited Oct. 1, 2007) (“The limited partnership has been seized upon by these entrepreneurs as an opportunity to achieve rapid growth”); but see Michael Spadaccini, *The Legal Ins and Outs of Forming a Partnership*, ENTREPRENEUR.COM, <http://www.entrepreneur.com/startingabusiness/startupbasics/businessstructure/article77980.html> (last visited Oct. 1, 2007) (“Limited partnerships have fallen out of favor recently because of the rise of the limited liability company”).

<sup>89</sup> See generally Spadaccini, *supra* note 88.

<sup>90</sup> See generally *Why More Business Owners Choose LLCs*, LLC.COM, [http://www.llc.com/LLC\\_Benefits.html](http://www.llc.com/LLC_Benefits.html) (last visited Oct. 4, 2007) (explaining that one of the advantages of an LLC is the “pass through taxation”); see also 26 C.F.R. § 301.7701-2 (2007) (creating standards to determine the tax classification of a business organization).

<sup>91</sup> See generally *Selecting a Business Structure*, *supra* note 83 (describing the different entity structure available in Canada for businesses).

<sup>92</sup> See generally Allan R. Lanthier, *Treaty Benefits for LLCs?*, CANADIAN TAX FOUNDATION (1999), available at [http://www.ctf.ca/articles/News.asp?article\\_ID=968](http://www.ctf.ca/articles/News.asp?article_ID=968) (stating that using United States LLCs for investment into Canada “has been hampered by the lack of treaty protection”); see also Paul L. Barnicke & Phyllis R. Roy, *Treaties and Transparencies*, CANADIAN TAX FOUNDATION (2006) (“If similar changes are made to the Canada-US treaty, it is widely anticipated that Canada will extend treaty benefits to passthrough LLCs”).

<sup>93</sup> See generally ERNST & YOUNG, *TAX ALERT, FIFTH PROTOCOL TO CANADA-U.S. TREATY*,

which was announced, was the extension of treaty benefits to limited liability companies.<sup>94</sup> This is very helpful because many people want to hold their Canadian affiliate through an LLC. But that is a bit down the road.

The treaty has to be finalized and has to be approved by the Canadian government, and as I understand, the United States Congress as well.<sup>95</sup> I believe that January of 2008 is a very aggressive and optimistic time frame for passage, but at least we, in Canada, have come to grips with LLCs.

I am just going to touch briefly on franchising, and then I will come back to the unlimited liability company. Franchising is not, obviously, a form of entity, but it is very popular in Canada,<sup>96</sup> and I think it is also fairly popular in the U.S.

I always think of it as a bit of a hybrid entrepreneurial model, and I thought it was interesting that the Canadian Franchise Association website has a statement on it that says that “[i]f you would like to be in business for yourself but not by yourself, then franchising may be right for you.”<sup>97</sup> This is an interesting concept because the key is the innovation and the idea, because pretty much everything else is delivered to the franchisee, and the franchisee can be in business for him or herself. I think you cannot overlook franchising when talking about entrepreneurs.

Unlimited liability companies, is a bit of an entrepreneurial tail in itself. When U.S. tax law changed and it introduced the check-the-box rule,<sup>98</sup> U.S. tax professionals stumbled on an old part of the Nova Scotia Company’s Act

[http://www.ey.com/Global/assets.nsf/Canada/Tax\\_Alert\\_2007\\_No\\_11/\\$file/TaxAlert2007No11.pdf](http://www.ey.com/Global/assets.nsf/Canada/Tax_Alert_2007_No_11/$file/TaxAlert2007No11.pdf) (last visited Oct. 26, 2007) (describing the principal elements of the Canada-U.S. Tax Treaty).

<sup>94</sup> See Grant Thornton, *Transfer Pricing Update North America* (2007), <http://www.grantthornton.com/portal/site/gtcom/menuitem.8f5399f6096d695263012d28633841ca/?vgnextoid=ffd28971d74b2110VgnVCM1000003a8314acRCD&vgnnextfmt=default> (“The federal budget of March 19, 2007, included several international tax measures, including . . . extension of treaty benefits to U.S. limited liability companies”).

<sup>95</sup> See generally *id.* (“Budget proposals that relate to changes to Canadian domestic tax law will become effective following ratification by Parliament. The proposals relating to changes in the Canada-U.S. Income Tax Convention will become effective once agreed between the Canadian and U.S. negotiators and accepted by the respective governments and legislatively endorsed.”).

<sup>96</sup> See generally Susan Ward, *Franchising your Small Business*, <http://sbinfocanada.about.com/od/franchiseinfo/a/franchisingbiz.htm> (last visited Sept. 25, 2007) (describing that franchising is a very popular choice for people who want to start businesses).

<sup>97</sup> Making the Right Choice, Canadian Franchise Association (2007), <http://www.cfa.ca/Page.aspx?URL=MakingTheRightChoice.html>.

<sup>98</sup> See generally Debra Moses, *NSULCs: Made in Nova Scotia*, <http://www.camagazine.com/6/0/3/2/index1.shtml> (last visited Sept. 25, 2007) (“[T]he ‘check-the-box’ rules . . . permit a Canadian corporation, formed under federal or provincial law and whose members have unlimited liability, to be treated as a flow-through entity for US tax purposes.”).

that permitted the incorporation of a company where the liability of the members was unlimited.<sup>99</sup> During the dissolution of an unlimited liability company, if the assets of the company were not sufficient to satisfy the creditors, the shareholders had unlimited liability, which is the exact opposite of where you think you would want to be, but this type of legal entity proved to be very attractive to U.S. investors.<sup>100</sup> It is taxed as a corporation in Canada,<sup>101</sup> so you do not have to worry about all sorts of other cross border complication issues. The unlimited liability company also has a flow-through treatment in the U.S.<sup>102</sup> So, there was a huge stampede to incorporate these Nova Scotia unlimited liability companies.

The Nova Scotia government thought this was a wonderful opportunity, and increased the incorporation fee to \$6,000 Canadian,<sup>103</sup> which, anyone who is in practice would know, is way out of proportion to any other fee like that. Likewise, Alberta, which of course, is one of our most entrepreneurial provinces, saw the exodus of corporations to Nova Scotia and amended their corporation statute in the last year or two to permit the liability of shareholders to be unlimited.<sup>104</sup> Now, of course, there has been a bit of a flow-back of corporations to Alberta,<sup>105</sup> and just last week we received a

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<sup>99</sup> See generally *id.* (“[T]he Nova Scotia Companies Act is the only Canadian law that allows for incorporation by members having unlimited liability”).

<sup>100</sup> See generally TAX EFFICIENT INVESTING IN CANADA: DISPELLING THE MYTHS, TAX BULLETIN, MCMILLAN BINCH LLP (2004), available at <http://www.mcmblm.com/Upload/Publication/Tax-Efficient%20Investing%200704.pdf> (explaining that Special hybrid entities that can be formed in Canada, such as the Nova Scotia unlimited liability company is popular with foreign investing by affording a “flow through” status for the purposes of the domestic tax rules allowing non-resident investors to consolidate foreign and domestic profits and losses and thereby reduce the cumulative rate of tax imposed on the corporate group).

<sup>101</sup> See Moses, *supra* note 98 (stating that Nova Scotia unlimited liability companies are “regarded as a true corporation,” which allows for tax benefits for these companies).

<sup>102</sup> See *id.* (stating that Canadian corporations, whose members have unlimited liability are “treated as a flow-through entity for US tax purposes”).

<sup>103</sup> See Miller Thomson LLP, *Doing Business in Canada*, [http://www.millerthomson.com/mtweb.nsf/web\\_files/nmis6dnkad/\\$file/DBIC\\_FullBook\\_email.pdf?](http://www.millerthomson.com/mtweb.nsf/web_files/nmis6dnkad/$file/DBIC_FullBook_email.pdf?) (last visited Sept. 25, 2007) (“The Nova Scotia government currently charges CDN \$6,000 to establish a NSULC [Nova Scotia unlimited liability company].”).

<sup>104</sup> See Cassels Brock Lawyers, *Business Reorganization Group e-COMMUNIQUÉ* (2007), available at <http://casselsbrock.com/publicationdetail.asp?aid=1380&pid=> (“Alberta recently made provision for ULCs, a corporation where all liabilities flow through to shareholders and are not caught within the corporation itself”).

<sup>105</sup> See generally Robert Omura, *The Alberta Unlimited Liability Corporation*, Canon & Partners, [http://www.matrimoniallaw.ca/Practices/Corporate\\_Commercial/Articles/The%20Alberta%20Unlimited%20Liability%20Corporation%20\(Jan%203%202006\).htm](http://www.matrimoniallaw.ca/Practices/Corporate_Commercial/Articles/The%20Alberta%20Unlimited%20Liability%20Corporation%20(Jan%203%202006).htm) (last visited Oct. 28, 2007) (stating that the amendments to the Alberta Business Corporations Act will make “Alberta more attractive to foreign investors and business.”).

notification that the Nova Scotia corporation fee has been reduced to a thousand dollars<sup>106</sup> from a law firm in Nova Scotia we do business with. I think that is a nice little entrepreneurial story.

MR. WAGER: One additional thing – oftentimes there is a default to the LLC as the choice of entity for entrepreneurs because of its pass-through quality.<sup>107</sup> There is a downside to this, and this is a cautionary tale, that I observed firsthand, of a company that was capitalized through traditional professional investor capital and the common equity of the founder together with equity. The concept was attractive, and there was some traditional bank financing from GE Capital. This company was organized as an LLC, which was a bit unusual.

In the early years, there was expected to be losses, and those losses, of course, were enjoyed by the investors. Unfortunately, the business model did not evolve as expected by the entrepreneur and the funder, and there was a necessity to recapitalize and restructure the company, including a settlement of the senior debt.

Consequently, since this was a pass-through entity, which had seemed attractive at the outset, you had forgiveness of debt income, which flowed through as phantom income to the founder and the investors for the reduction of debt. This was something that was never anticipated at the outset and certainly not from the lenders. If this had been a C Corp., it would not have flowed through to the investor.

So oftentimes the LLC, which is almost a default standard for organizing startup entrepreneurial businesses, does have this feature, but again, there was something extraordinary about this where you had traditional senior debt financing at the outset.

Also, as part of the program elements that we were to cover today was an allocating list involving disputes between founders and funders in creating an entrepreneurial business. This is a relatively well-worn path on the terms and conditions of contracts, that is, the equity purchase or debt purchase agreements between an entrepreneur and its professional capital providers and are fairly well interested from contracting. The provisions of performance by the founder and funder depend on the circumstances, but in general, the funders are providing capital over a period of time at the outset,

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<sup>106</sup> See Stewart McKelvey, *Nova Scotia Incorporation*, <http://www.smss.com/en/home/corporateservices/services/novascotia.aspx> (last visited Sept. 25, 2007) (stating the price to incorporate for an unlimited company is \$1,000).

<sup>107</sup> See generally LLC Overview, INCNOW: Agents and Corporations, Inc., [http://www.incnw.com/about\\_llcs.shtml](http://www.incnw.com/about_llcs.shtml) (last visited Oct. 28, 2007) (“A common reason a business might choose to become an LLC is because of an LLC’s tax classification flexibility – A new LLC incurring losses or owning capital appreciation assets like real estate operates as a sole proprietorship or partnership so that losses and capital gains pass through to the owners.”).

according to the terms and conditions that are negotiated pursuant to the needs of the business.<sup>108</sup> The founder, or the entrepreneur, has certain performance obligations with regard to the growth of the business. However, failure to live up to either founder or funder obligations can give rise to breach.<sup>109</sup> These issues were generally dealt with under a relatively standard indemnification provision in the security purchase agreements; these indemnification provisions are generally the basis of the relationship between founders and funders.<sup>110</sup> The scope of the indemnity is rather basic. The limitations on indemnity can be negotiated and oftentimes are.<sup>111</sup> From the entrepreneur's perspective, the important aspect is to understand how dispute resolution is undertaken.

Entrepreneurs do not enter into relationships with funders expecting a dispute. In effect, they do arise, and from the perspective of an entrepreneur, arbitration is advisable as opposed to litigation, which is an expense. The determination issues between founders and funders, again, are usually a negotiated item.

At the point in time when businesses get in trouble, professional investors want control and the opportunity to change management. In some cases they take advantage of the opportunity to claw back or take control of the equity. This terminates the relationship between the investor and the entrepreneur.

Finally, before we get to questions, we come back to the chicken and egg issue we began this discussion with: Do entrepreneurs attract capital, or is it a multi-directional process, and does the process change across borders? The effects of policy and law on an entrepreneur's growing business are not clearly understood. However, capital alone does not do it, and a spectrum of resources are necessary.

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<sup>108</sup> See generally *Angel Groups Provide Funding Option for Business Start-Ups; Focus on Venture Capital an Achilles Heel for Entrepreneurs*, says Angel Capital Association, BUS. WIRE, Sept. 8, 2004, available at [http://findarticles.com/p/articles/mi\\_m0EIN/is\\_2004\\_Sept\\_8/ai\\_n6185522](http://findarticles.com/p/articles/mi_m0EIN/is_2004_Sept_8/ai_n6185522) ("Angel investment groups... are emerging as an attractive seed-stage funding alternative for start-up companies...").

<sup>109</sup> See generally *Suing for Breach of Contract*, AllBusiness, <http://www.allbusiness.com/legal/litigation/4141-1.html> (last visited Oct. 27, 2007) (describing contractual obligations and how they can give rise to breach).

<sup>110</sup> See generally *Legal Information for Entrepreneurs*, Gaebler Ventures, <http://www.gaebler.com/Understanding-Indemnification.htm> (last visited Oct. 28, 2007) (stating that entrepreneurs should understand indemnification, which is a "contractual promise in which one party agrees to protect another party from financial loss.").

<sup>111</sup> See generally Ken Clingen, *An Overview of the Business Acquisition Agreement*, DCBA BRIEF, <http://www.dcba.org/brief/janissue/2007/art20107.htm> (last visited Oct. 28, 2007) ("The parties often negotiate the indemnification provision's duration, any basket or deductible on indemnifiable claims, and the ceiling or cap on damages recoverable from the indemnifying party.").

I came across an article that was in the American Agricultural Economic Association Journal in 1988, which does answer the fundamental question, and according to this article, they concluded that the egg came first.<sup>112</sup>

With that, I turn to Gail to see if you have any concluding remarks as well.

MS. LILLEY: To respond to Michael's discussion about structuring the allocation of rights and obligations, I had a client early in practice who was a strategic buyer who made serial acquisitions. The client said that I should always keep in mind the KIS principal, which, I think everyone knows, is: Keep it simple. I thought this would help rationalize some of the complex things that we were discussing earlier.

So, we have the founder with the idea and we have the funder with the capital, and they have three common goals: they want to protect the idea, they want to create a tax efficient structure in which to carry on the business, and they want to have a simple operating model, which I think is important. Small businesses have very few resources and they have few executives. It is difficult for small businesses to thrive, when you have a complex operating model. I think one reason for this difficulty, sometimes, there are significant tensions between the founder and the funders. Founders really want to keep their ideas, whether it is a product or a service, if the business is not successful. Not surprisingly, funders are fairly unhappy with this notion because they paid to invest in the idea and they really do not want to see the founder run off with the idea if the business fails. Everyone wants to limit his or her risk as much as possible and everyone wants to retain as much as possible if the business is a success. Sometimes lawyers do not do small business people any favors when they are trying to structure these arrangements, because it takes a long time to sort out these arrangements, and the business operator takes his eye off the ball. The lawyer devotes a lot of his energy and attention to trying to settle these documents. I have seen circumstances where businesses have floundered immediately after the investment because of people not sticking to their commitment. I just think that has to be something that has to be kept in mind from a process point of view.

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<sup>112</sup> Walter N. Thurman & Mark E. Fisher, *Chickens, Eggs, and Causality, or Which Came First*, 70 AM. J. OF AGRIC. ECON. 237, 238 (1988), available at <http://links.jstor.org/sici?sici=0002-9092%28198805%2970%3A2%3C237%3ACEACOW%3E2.0.CO%3B2-1>.

DISCUSSION FOLLOWING THE REMARKS OF GAIL LILLEY AND  
MICHAEL WAGER

MS. ALZETTA-REALI: Okay. Before asking the audience if they have any questions, I actually have a question, which ran to my mind based on the chicken and egg casualty article and the answer to that question. I had no idea it was the egg, but keeping that in mind, then, with an entrepreneurial metaphor, what would be the chicken and what would be the egg and, therefore, what would be the answer?

MR. WAGER: Well that is interesting. I, as you said, served as vice chair of the Port Authority here in Cuyahoga County. There is a belief in this region, and not unlike the belief of many of us in the rust belt cities, that if we create capital, if we build pools of funds, that we will have the entrepreneurs come to us. That is, in fact, not what the literature says and, in effect, has not necessarily been the experience. This is not to say that pools of capital provided by government or by the NGO sector do not have a positive effect. I am just wondering whether it is transformative. I do not know whether it is an either/or because I think it is a multi-dimensional process.

You need all the resources together, as David Morgenthaler said, the jockey and the horse, and that is what is going to make it work. When you have fallen behind the curve of economic development, the way someone will mature, you try to replicate what, at least, the picture is of the healthy entrepreneurial environment. This includes a lot of seed capital and other investment capital, and ultimately this creates the glue of entrepreneurial activity.

MS. ALZETTA-REALI: I suppose the egg in this analogy is the capital for you, but we have the other answer, and I think David Morgenthaler actually said that capital may not necessarily follow entrepreneurs. I am not sure I have an answer, and it is a difficult question to answer. However, we will receive further questions from the audience. Any questions? Yes, Dr. King?

DR. KING: I noticed on the dispute resolution provisions there, you did not amplify it, is this a perfect case for mediation, or should that be arbitration? This is addressed to Michael Wager with comments by our Canadian friend also. What is the best way to resolve the disputes?

MR. WAGER: I have to make an admission here – the dispute resolutions part of the agreements in funding entrepreneurial businesses do not get that much attention from corporate and corporate finance lawyers. We think it is boilerplate.<sup>113</sup> It probably deserves more consideration by people involved in

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<sup>113</sup> See generally Boilerplate, InvestorWords.com, <http://www.investorwords.com/516/boilerplate.html> (last visited Oct. 27, 2007) (stating that

actual dispute negotiation and resolution. The mediation, arbitration, and litigation are all the potential bad outcomes that seem to be on the back of the agreements, so I do not know that I have a really insightful answer to the question.

DR. KING: Do you have any comments on that?

MS. LILLEY: Well, it is interesting. There was a great wave of enthusiasm for arbitration as an alternative to litigation in Canada because it was perceived as being speedier and less expensive.<sup>114</sup> However, I think as large complex disputes have moved into the arbitration field, arbitration has become as expensive and time consuming as litigation.

It is interesting – your comment about mediation. In our litigation process, if there is a lawsuit that the parties have to arbitrate, they can go to a nonbinding mediation process.<sup>115</sup> I recently had a situation where a client had been negotiating with a municipality for a number of years to finalize something, and they were just stuck. I had asked them whether they wanted to consider voluntary nonbinding mediation, and they were not enthusiastic about it. I thought it would have been a good idea.

MS. ALZETTA-REALI: At Coca-Cola, when I think about our joint venture negotiations, we do not place an executive committee amongst the joint venture partners. So, if we end up in a dispute, it will first go to an executive committee to negotiate the dispute. Consequently, since the negotiation is between the partners, the negotiation might go on for a long period of time.

However, there are designated officers and a designated time period to resolve the dispute. If these constraints do not work, we then attempt other methods of dispute resolution. This may involve bringing in a technical expert, depending on what the issue is, banker expertise, investment bankers, accounting firms, just about anything. The last resort is arbitration because it is expensive, but it may end up there.

DR. BARBER: This is a question about the funders. I have to sense that in Canada the amount of funding that supports new ventures from angels is about twice the amount that comes from venture capital. I do not know whether the angels have the same problems that venture capitalists have. I

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boilerplate language is a “standard form or template used in a contract or other legal document.”).

<sup>114</sup> See generally Tom Pedreira, *Arbitration*, LAWYERS.COM, <http://canada.lawyers.com/lawyers/C~1001557~CND/Arbitration.html> (last visited Oct. 28, 2007) (“Arbitration can be fast, quick and easy, whereas lawsuits can drag on for years and years.”).

<sup>115</sup> See generally News & Information, ADR Institute of Canada, <http://www.adrcanada.ca/news/faq.html> (last visited Oct. 27, 2007) (stating that one of many significant reasons to mediate, is because the “process is non-binding; the outcome is within the control of the parties.”).

have a sense that venture capitalists are very much more advanced in financing, legalities, and governance. Angels are big players and they are a group of financiers or funders. Any comments?

MS. LILLEY: Well, that is actually interesting because I do not know any statistics, but in my mind there are two kinds of angel groups: one being the family member angels and the other being sort of professional angels. Professional angels are people who have a pool of capital and are interested in making small and personal contributions. As family member angels, their investments are personal and small for startups, and I know for the family angels the documentation tends to be somewhat light, and the formality tends to be somewhat light. But in truth, the repercussions for a failed business involving family angels are fairly significant.

Whereas professional angels, with the documentation and the formality, are a little bit closer to a venture capital model, but there is no emotional investment. So, if the business fails, it is one of the 999 type deals that did not work out so well. You are right, there is a bottom layer, and it is just so much trouble to get money from professional funders, from banks, et cetera, even from government programs, and much easier to find people who are prepared to put a small amount of capital at a high risk.

MR. HERMAN: I realize we are discussing the appropriate form of business entity for entrepreneurial activity, and the availability of capital as the key ingredient, and we will be discussing some other aspects involved in entrepreneurial growth and in the encouragement of new forms of business later today and tomorrow. However, there are aspects missing, which we will discuss later in the program, but can you address the importance of the rule of law, the ability of the entrepreneur to have his or her intellectual property protected, the availability of appropriate infrastructure and a whole range of other things that affect entrepreneurial growth and development?

We take the issue that Michael talked about, development of entrepreneurial activity in this region, the United States. What role does infrastructure play? What role does the rule of law and the ability to protect entrepreneurial enterprise have on the growth of entrepreneurship in any particular area?

Let me just throw this out: It may be a lot easier to develop entrepreneurial activity in, say, the United States, than it might be in some country or some region in Eastern Europe where the rule of law does not allow entrepreneurial activity to flourish and grow without the appropriate protection.

MR. WAGER: That is a very good point. These aspects are not part of the program that we had planned for today, but as I look out in the audience, I see one of my colleagues, and she and I are now engaged in a new venture in [Eastern Europe] for very significant dollars.

While it is a very hotly negotiated transaction between two very sophisticated players who are creating a joint venture in the emerging Eastern European economy, the rule of law issue, as you put it, is something which is of great concern to both of the parties. It does not necessarily affect the negotiation between the operator and the funder, but it does certainly affect the decision-making with regard to embarking in this joint venture. For instance, it is uncertain what kind of returns you would expect for taking this kind of additional risk because you have less stable legal protection, a less mature legal system.

I think it affects the risk and reward decision-making. I do not know if it necessarily affects the kind of structural issues we were talking about for entrepreneurial businesses, except perhaps a recognition that you can set it up, use whatever best practice you want to establish the entity, and negotiate the relative rights of the parties. Nevertheless, if they are not enforceable in the local jurisdiction, I am not certain exactly what the benefit of the hard work will be on the front end.

MS. LILLEY: This is actually an interesting discussion because if I think about an entrepreneur, I am not sure in our current legal environment that small business people can really afford to enforce their rights to take advantage of the rule of law in their home jurisdiction. It is just so time consuming and expensive to enforce legal rights these days that I think unfortunately, it undermines the system a little bit. That is a bit of a controversial remark.

MR. GROETZINGER: In the written materials, I was surprised to come across things to avoid in setting up ventures, and one of the most common mistakes is asking potential investors to sign a nondisclosure agreement. They say it is a risky move, and they would not sign anyway. That is a surprising statement. I just wonder what you have to say about that.

MR. WAGER: Those are materials which I did not provide because it would be contrary to the advice that I would give an entrepreneur, sharing his or her proprietary observations and information, and I also do not think it is an unrealistic expectation. You have to find some level of confidentiality to be able to observe business.

I am struck by that, and I would love to have an argument to make if I am on the side of the professional investor, which I usually am, to say, “No, we do not sign confidentiality agreements,” but I do not think we are going to be seeing that many business plans if we do not.

MS. ALZETTA-REALI: I definitely agree with that.

MR. ABRAHAMS: Michael, on one of your earlier power point screens, there was a statement “Economic Freedom Drives Economic Activity Relating to Government Controls.”

I would like to know, are you advocating some type of laissez-faire capitalism or different government regulatory controls or scheme, depending on the size or innovative issues of small or startup companies?

MR. WAGER: I am going to give you a lawyer's answer. No. It is not a yes or no answer because, as relates to the issue of rule of law and protection of intellectual property, clearly we need rules. What I was making reference to, and I am really borrowing from the literature, is that we are sitting in a state that has this issue in starting businesses. Oftentimes, depending on what business you are in, there are so many levels of compliance that the issue becomes prohibitive or a decision is made to basically ignore the compliance, which is a liability that funders are not going to enjoy.

That is what I was getting at – there needs to be some level of regulatory and paperwork reduction or reform. So, starting new businesses will not be quite as burdensome and, frankly, as costly. For instance, entrepreneurs pay law firms in order to make sure they can start a business, without a dollar of revenue of profit that already has significant legal compliance costs.

MS. ALZETTA-REALI: Obviously, Coca-Cola is not a starting business, but one of the impediments I find working in the Canadian office, when it comes to the company attempting to continue to be entrepreneurial, is the innovation. Innovation is what is going to keep us being as productive as possible. What would be wonderful, furthermore, speaking from a North American perspective, would be to have some harmonization in rules; this lacking is an impediment for us in Canada.

It may not be our innovative idea, but it is an innovative idea coming from R & D, from another company, or it could be from Asia, Africa, or the U.S. When we try and create the innovative leverage in Canada, the regulations and the landscape is so different from that in the United States that we either take the air out of the balloon or just do not launch the product, because it takes too much time. So, some harmonization in laws, not necessarily less regulation, but harmonization, would really help the entrepreneurial spirit.

MR. WAGER: There is actually some good news on this front. There was a time when you raised capital in several states in the U.S., notwithstanding the fact that you met federal exemption, you still had a variety of filings.<sup>116</sup> There are still some filings for raising capital, like blue sky compliance.<sup>117</sup>

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<sup>116</sup> See generally Matt Storms, *Securities Compliance is Part of Raising Capital*, WIS. TECH. NETWORK (2006), <http://wistechnology.com/article.php?id=3495> (discussing the various federal securities exchange commissions requirements for companies that are raising capital).

<sup>117</sup> See generally Richard Alvarez & Mark Astarita, *Introduction to the Blue Sky Laws*, SEC LAW.COM, <http://www.seclaw.com/bluesky.htm> (last visited Oct. 28, 2007) (explaining that Blue Sky Laws are securities laws and rules of each state).

For the most part, if you need federal exemption today, you are likely to have an exemption at the state level.<sup>118</sup> A dozen or so years ago that was not the case.

MR. HERMAN: I have a question on dispute settlement. This always gets lawyers active and engaged on dispute settlement, and you touched on dispute settlement. I think mention was made of the lack of support for nonbinding mediation. I can understand that because why would the clients want to go through the cost of a process that ultimately was nonbinding? It really does not make sense, and I think in a commercial document it is probably something that, as counsel, I certainly would not recommend.

One of the problems in contractual dispute settlement like arbitration, lawyers advising clients to not pay enough attention to the bind. At the end of the negotiation, something is thrown in that says the parties will arbitrate in accordance with arbitration rules, without realizing those are very complex rules, and if they are not specifically tailored to the agreement, you can get into long and complex processes.

The lesson seems, and I would like to have comment from the panel, for counsel to address dispute settlement provisions and to make sure that they tailor the dispute settlement provisions to the needs of the clients and the entrepreneurial activity that is involved. In other words, you can construct fast, efficient, effective, and binding arbitration provisions. The issue that I see often is that you have to convince the clients that they need to pay a little more to get those provisions drafted, and that it is in their interests, particularly when we are talking about small businesses, it is in their interests to spend a bit of money, their money, to ensure the arbitration provisions are lean, effective and efficient, rather than just throwing in a boilerplate arbitration provision in the agreement. Comments?

MR. WAGER: I am guilty of the latter.

MS. LILLEY: That is a very interesting comment because obviously one of the approaches for arbitration is to effectively draft your own procedure and attach it as a schedule to the document, but it is kind of interesting because clients frequently don't have a lot of heart. That sometimes is the kind of thing that gets left to the end of the process.

It is important because, of course, when you have a cross border deal, your client will say, "What do you mean we have to go to New York to do our arbitration? It is going to cost us this. It is going to cost us that."

Moreover, if you are working with a foreign jurisdiction, "What do you mean we do not have a right to have it in English?" So your point is very well taken. What I think many law firms are doing is trying to create some standard documents that can be, at least, used as a template starting point so

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<sup>118</sup> See generally Storms, *supra* note 116 (describing federal and state Blue Sky securities laws for issues of securities).

you are not always reinventing the wheel, but where you can have a separate negotiation on the arbitration provision.

MR. ROBINSON: Just a small comment: Observation that harmonization would help between the U.S., Canada, and also certainly Mexico, entrepreneurship and everything else. I have been very disappointed to see that the committees and working groups under NAFTA, I think we have got twelve formal ones, do not meet and do not work and they were supposed to harmonize all kinds of things.

In 2005 with a lot of publicity, we created this Security and Prosperity Partnership between the three countries.<sup>119</sup> To the best of my knowledge, nobody yet can figure out what the heck it does, but maybe one of the things it could do is to get those committees and working groups to do what they are supposed to do and start harmonizing things. So call your MP and complain.

MS. ALZETTA-REALI: I will do.

DR. KING: It was a good session.

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<sup>119</sup> Security and Prosperity Partnership of North America, <http://www.spp.gov/> (last visited Nov. 6, 2007) (discussing the background of the formation and purpose of the Security and Prosperity Partnership of North America).

## WHAT IT MEANS TO BE AN ENTREPRENEUR

*Session Chair – Lawrence Herman*

*Speaker – A. Malachi Mixon, III*

### INTRODUCTION

*Lawrence Herman*

MR. HERMAN: I would like people to gather so we can start the afternoon. Please come in and be seated. Ladies and gentlemen, we want to start this afternoon's session.

My name is Larry Herman, and I have the privilege of presiding this afternoon and introducing our speaker. Those of you who are old hands at the Institute conferences and those that may be new this year, I think will appreciate not only the depth of the issues that we examine, but the quality of the presenters.

The Institute takes pride in seeking out and obtaining for those who attend the best people in the business and the best people we can find, people who will give presentations of quality, and today's speaker is no exception.

In fact, Mal Mixon is a person of extreme qualifications to speak on what it means to be an entrepreneur. And we have handed out biographies. They are in the material, and I don't mean to read in detail Mal's biography, his background, and experience, but let me tell you, if you look at the first paragraph in his biography, it tells the whole story.

As you know, he is the chairman and CEO of Invacare Corporation, a leading manufacturer and distributor of healthcare products in the healthcare industry.<sup>1</sup> But when he began with them 27 years ago, the annual sales were \$19 million, and today those sales have reached \$1.5 billion.<sup>2</sup>

So that tells you a lot about his ability to speak of entrepreneurship. He holds both his B.A. and M.B.A. from Harvard.<sup>3</sup> He is a director of a number

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<sup>1</sup> About Us, Invacare Corporation, [http://www.invacare.com/cgi-bin/imhqprd/inv\\_company/company\\_info.jsp?s=0&area=Main&WT.svl=topNavLink9](http://www.invacare.com/cgi-bin/imhqprd/inv_company/company_info.jsp?s=0&area=Main&WT.svl=topNavLink9) (last visited Oct. 12, 2007).

<sup>2</sup> *Id.*

<sup>3</sup> Our Officers, Invacare Corporation, <http://www.invacare.com/cgi->

of listed companies on the New York Stock Exchange and is someone who can lead us through the discussion this afternoon and tell us about what it means to be an entrepreneur.<sup>4</sup>

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bin/imhqprd/inv\_company/officers.jsp?s=0 (last visited Oct. 12, 2007).

<sup>4</sup> See Officers and Directors Detail of Invacare Corp IVC (NYSE), Reuters, <http://stocks.us.reuters.com/stocks/OfficersDirectorsDetails.asp?rpc=66&symbol=IVC&office rID=33635> (last visited Oct. 12, 2007).

\* A. Malachi (Mal) Mixon, III is Chairman of the Board and Chief Executive Officer of Invacare Corporate (IVC:NYSE), the leading worldwide manufacturer and distributor of medical product for the home health market. 2005 sales were \$1.5 billion. Mal led a leveraged buy-out of Invacare in 1979, when sales were \$19 million. Mal serves on the boards of The Sherwin-Williams Company (NYSE), The Lamson & Sessions Company (NYSE) and Primus Venture Partner, L.P, a Cleveland leveraged buy-out company. Additionally, Mal has been an active investor in several successful Cleveland-area ventures, which became public companies including Royal Appliance Manufacturing Company (NYSE) and STERIS Corporation (NYSE). The American Association for Homecare (AAHomecare) presented Mal with the 2006 Humanitarian Award in September, recognizing his industry leadership. Also, during 2006, Mal was honored by the NAACP Cleveland Branch as the recipient of the 2006 Freedom Fund Award and the Lorain County Urban League presented Mal with the Whitney M. Young Humanitarian Award. In November 2005, the National Conference for Community and Justice (NCCJ) presented Mal with its 2005 Humanitarian Award and the Juvenile Diabetes Research Foundation (JDRF) honored Mal with the 2005 Living and Giving Award. Mal and his wife, Barbara, were honored in November, 2003 by the Achievement Centers for Children for their civic and philanthropic contributions to Northeast Ohio. In 2002, Mal received the Business Statesman Award from the Harvard Business School Club of Northeastern Ohio. He received the American Association for Homecare Leadership Award in 2001 in recognition of his dedicated leadership in promoting sound public policy affecting homecare providers and manufacturers. In addition, he received the Distinguished Citizen Award from the Greater Cleveland Council, Boy Scouts of America. He was honored as the Master Innovator at the 2000 Anthem Blue Cross and Blue Shield/Small Business News Business Conference. In 1999 and 1992, Mal was awarded the International Business executive of the Year Award by The Cleveland World Trade Association. He was honored by the National Multiple Sclerosis Society with the Hope Award for distinguished civic and community service and the Student Free Enterprise (SIFE) organization presented him with the America Free Enterprise Legend Award in 1997. Mal was inducted in 1996 as a charter member into the Cleveland Business Hall of Fame. The Paralyzed Veterans of America honored him with the 1996 Corporate Patriot Award in recognition of his significant commitment to the PVA and to all those who have sacrificed in defense of our country. The National Society of Fund Raising Executives Greater Cleveland Chapter honored Mal in 1995 as Outstanding Philanthropist. In 1992, he was awarded the Inc. Magazine Master Entrepreneur of the Year Award for Northeast Ohio. The Harvard Business School Club of Cleveland honored Mal with the Dively Entrepreneurship Award in 1984. A graduate of Leadership Cleveland (1986), Mal's current civic activities include serving as Chairman of the Board of Trustees of The Cleveland Clinic Foundation and the Cleveland Institute of Music. He also serves on the Visiting Committee of the Harvard Business School and the boards of the BioEnterprise and MWV Pinnacle Capital Management, a fund investing in minority ventures. In 1992, Mal established a chair in entrepreneurial studies at the Weatherhead School of Management at Case Western Reserve University in Cleveland, Ohio. In 1997, he established a Mixon Scholarship in each new freshman class at Harvard College for student from Oklahoma and Northeast Ohio. Originally from Oklahoma, Mal is a graduate of Harvard

So without further ado, I will turn it over to Mal.

SPEAKER

*A. Malachi Mixon, III\**

MR. MIXON: Thank you very much, and it is a pleasure to be here this afternoon. Hopefully, I won't put you to sleep after your lunch. But, I want to start out by telling a little vignette about a father who had two sons, and both his sons turned out to be quite successful.

One turned out to be one of the world's great lawyers, and the other one turned out to be one of the world's great entrepreneurs. The lawyer was a pessimistic son. Every time the father gave the son a present that son would analyze it in such detail that he would find something wrong with the gift.

So this particular Christmas the father decided that he was going to try to help. Well, first, the other son was so optimistic he was unrealistic about the world, so the father decided on two special gifts to get these children to be a little more even keel in looking at life.

For the one that became the lawyer, he bought the most incredible, expensive home computer for his Christmas present. The son took the present, and about an hour later came back and said, "Dad, I like the present, but there are so many things this computer should be doing, that it is not doing, and here are some defects in the software."

For the other son, the father went down to Thistledown and got horse manure and put it in a box and wrapped it up and put a ribbon on the box. That son got his present out from under the Christmas tree and opened the box, jumped up with excitement, ran out the back door, and disappeared for about a half hour.

Finally the son came in and jumped up and gave his dad a big hug and said, "Dad, I can't thank you enough for my Christmas present."

And he said, "Son, I don't quite understand."

He said, "Daddy, I know there has to be a horse around here somewhere."

So I wanted to just lead into the subject of what is entrepreneurship, and I thought a lot about this. It is a word that gets thrown around loosely, but in my mind, an entrepreneur is a creator, a builder, not an administrator of

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Collece (BA) and Harvard Business School (MBA). Between degrees, Mal served four years in the U.S. Marines Corps, including a year in Vietnam, attaining the rank of Captain. Combat declarations include the Air Medal with Oak Leaf Cluster and Navy Commendation Medal with Combat "V". Mal and his wife Barbara, have two children, Elizabeth and Ki, six grandchildren, and live in Hunting Valley, Ohio. He enjoys hunting, golfing and playing the piano.

business and most certainly, he is an optimist. We can give any of you a corporation to oversee, and you can probably take it to the next level. Don't mess around with it a lot and keep the good people you have, and it will probably do pretty well on its own. And occasionally, we have some people who take over big companies doing quite well, and they go the other way because they don't listen to their good people.

And to my mind, the entrepreneur can take something that someone else doesn't see value in and create something. Entrepreneurs almost always have their total net worth at risk or a good part of their net worth at risk.<sup>5</sup> So when they go home at night, it is not about salary, wage – it is about losing everything or winning quite a bit.<sup>6</sup>

I think entrepreneurs understand capital creation, and that's something a lot of people don't understand. You know, they think that if I can make another hundred thousand dollars, that's going to put me in this particular economic class or vision I have of myself. Once you learn how to do it, it is a lot of fun.

And you obviously don't want to go back to the idea of wages or salary. I think an entrepreneur frequently can visualize value when others cannot. Frequently, it is a business that everybody else has given up on, that went bankrupt, et cetera. There are all types of entrepreneurs, but they are, as I say, creators or builders of a business. I think they tend to think outside the box and don't generally accept the conventional view.

Secondly, I want to talk about what causes an entrepreneur to succeed; I don't think anyone knows the answer to that question. But in my mind, it is really a collection of life's experiences. Many of the successful entrepreneurs I know started down the conventional path of working for someone else, working for another company. I always advise young people, and I say, "Make your mistakes on somebody else's money, and then learn, and then when you have your opportunity, you will have the skill-set to go along with your desire to be an entrepreneur."

And when I look back over my life – and I don't know how many of you remember this about your own education in grade school and high school – but I never once in my life ever had a teacher say to me, "Mal, are you going to own something?" They always said, "Mal, who are you going to work for and what do you want to be when you grow up?"

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<sup>5</sup> See GERALD A. BENJAMIN & JOEL B. MARGULIS, *ANGEL FINANCING: HOW TO FIND AND INVEST IN PRIVATE EQUITY* xxvii (Wiley Publishers 1999), available at <http://books.google.com/books?id=QbQfWTmHD-EC&pg=PR27&lpg=PR27&dq=entrepreneurs+are+risking+their+networth&source=web&ots=22wFR9AsWF&sig=7L1TRgpG4qgkReCJOgKmWALa-9Y#PPR5,M1>.

<sup>6</sup> See generally *id.*

In my mind, I never thought about owning a company or having a company all to myself. Most teachers don't understand capitalism, so there is no way that they can teach the subject.

So part of the reason we don't have more entrepreneurs is that teachers don't teach children what they can be, even without money. Certainly, as I tell my story, I had no money, and I will tell you in greater detail about that. I think their risk profile is different.

You know, a lot of people see me as a risk taker. I don't see myself as a risk taker. The things in which I get involved, I have a high confidence level that it will succeed. I launched my entrepreneurial career in 1979 after I had worked eleven years in industry; I didn't have any net worth. So I didn't have anything to lose really except maybe a job, and I knew I could get a job somewhere else.

I want to tell you about my background because I think it is relevant to the issue of why I am an entrepreneur and how you can become one. I grew up in Oklahoma in a small town – 1,100 people – real cow country. My grandfather was a country doctor and came to this town in the 1890s.

I was born in the same house as my father, delivered by my grandfather. My dad was away in World War II, and so I was around my grandfather a lot. Neither of my parents went to college. Fortunately, they were smart and well read, and we had a lot of intellectual conversations that I would come to appreciate later in life, but certainly, academically, I was not challenged in grades one to twelve in the little country school.

So because of that, I was able to do a lot of different things like play sports and ride in the rodeos. I was a good musician. But I rarely had to take a book home and was not really challenged until I got to college. Unbeknownst to me, my father submitted the application for me to attend Harvard. We went out to the superintendent of schools because Harvard said I had to take college boards. He had never heard of the college boards.

No one knew of them, and I was the first student ever to take the college boards from my high school. I learned by this time everybody took them as a junior, but I was already a senior. So somehow I got into Harvard. I always dreamed of going to the Naval Academy, since I had grown up in a very patriotic family. And I did get admitted to the Naval Academy my sophomore year at Harvard.

I decided to stay at Harvard, and that's another story in itself, but I was given a full scholarship by the Navy. I remember probably one of my proudest moments was my mom pinning on my second lieutenant bars as a United States Marine, and that has been a good part of my life as far as developing me as a leader and man.

I served in Vietnam for a year, and then on to Harvard Business School. I was 28 when I started to work for a Cleveland company. I came to Cleveland because I married a girl from Ohio. If I took you to this little dirt town I came

from, you would understand why I wanted to be in Cleveland, although I had a lot of fun growing up in the country.

And in my case, I worked for eleven years for Cleveland companies. During the last year, I was working out in Solon, Ohio for a company called Technicare. We were heavily into diagnostic imaging products, digital X-ray, magnetic resonance, nuclear medicine, and computed tomography, and Invacare was a little appendage that Technicare didn't keep.<sup>7</sup>

Actually, Johnson & Johnson bought Technicare and didn't want it either.<sup>8</sup> It had been for sale for three years – an orphan no one wanted.<sup>9</sup> It had a minor position in the wheelchair industry.<sup>10</sup> I had been thinking about having my own business, and unfortunately, at age 37, I had testicular cancer.

I survived that, but at the time I thought I was going to die when I heard the word 'cancer,' but it didn't happen. I had survived Vietnam and cancer, and at 39, I decided I wanted to buy this little company, and the company was for sale for \$8 million.<sup>11</sup> I had \$10,000, and all I needed was another seven million, nine hundred ninety thousand, simple math.

I put my house and both my cars in my wife's name, and I invested the \$10,000 in the company. We bought the company for \$8 million and borrowed \$7 million. So we had a million dollars of common equity, raised from friends and soon to be friends and friends of friends I met at the Harvard Business School Club in Cleveland.

And I borrowed another \$140,000 - \$40,000 from two friends and \$100,000 from the company, giving me a 15% stake in the company. There was \$10,000 of equity, \$140,000 of debt, which made up my 15% of the million. Then I had to sign a \$6.5 million guarantee at the bank. "Big deal," I thought, "I will sign that," since I had nothing to risk.

And then they wanted \$2 million of life insurance, and I remember thinking, "Oh, darn, I can't get life insurance. I just had cancer." But then, interestingly, I got a discount because I didn't smoke. I was happy about that. And so we bought the company. I had a partner, J. B. Richey,<sup>12</sup> who studied engineering at Case Western Reserve University. He is the technical brains of Invacare, and I am the salesman. We used to plot how we could buy it because we knew we didn't have much money.

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<sup>7</sup> See generally Our History, Invacare Corporation, [http://www.invacare.com/cgi-bin/imhqprd/inv\\_company/company\\_info.jsp?s=0&area=History](http://www.invacare.com/cgi-bin/imhqprd/inv_company/company_info.jsp?s=0&area=History) (last visited Oct. 12, 2007) [hereinafter Our History] (brief history of the company).

<sup>8</sup> *Id.*

<sup>9</sup> *Id.*

<sup>10</sup> *Id.*

<sup>11</sup> *Id.*

<sup>12</sup> *Id.*

I was unable to get it financed in Cleveland. No one would back me. No one would back me in Lorain County where the company is. I had to go outside. I finally was able to get it financed in Chicago. I will tell you a funny story. During my financing trips, I went to Aetna in Hartford, and I didn't raise money, but I came out of the Aetna building, and the sky was black and the wind was blowing.

I said to the cab driver, "I am from Oklahoma, and I would say you are going to have a tornado." He said, "We don't have them up in this part of the country."

I said, "Okay." So I am driving to the airport, and it is getting darker, and all of a sudden the wind is blowing like hell, and the front of the window of the cab pops out. And the cab spun around, and I noticed that the plane that was on the stand there at the Hartford Airport had flopped over on its side. We pulled up to a building next to a motel where the roof was gone; there was a little liquor store and wires and cables all over. So, I was in the only tornado that Hartford ever had.

I finally got to call my wife from a working payphone, and I said, "Honey, I am not going to be able to get home tonight. I have been in a tornado in Hartford." She said, "Sure you have." And I said, "Get on the TV and watch."

But anyway I was able to raise the money, and the rest of it has been easy. Buying the company was much harder. When you have no money, buying something is a lot tougher than running it. And running it has been a lot of fun and quite easy, but we have had our challenges.

First year sales were only \$25 million; we went public in 1984 when we were at \$90 million in sales.<sup>13</sup> Today we have 6,200 people and \$1.5 billion in sales.<sup>14</sup> Even though our stock has been down lately because of some challenges, the people who backed me at \$0.02 per share have shares that are worth \$25 today.<sup>15</sup> It has been up as high as \$48, and we will be back there again.<sup>16</sup>

But it has been a lot of fun, and I can spend the whole afternoon talking about it and many of the business challenges that every company has. But about two months after I bought Invacare, a friend named John Balch, whom I worked with at Invacare, said, "Mal, I want to buy a company like you did, will you help me?" And I said sure. John looked around and found a

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<sup>13</sup> See generally Invacare Corporation, FundingUniverse <http://www.fundinguniverse.com/company-histories/Invacare-Corporation-Company-History.html> (last visited Nov. 4, 2007) [hereinafter *Invacare Corporation*].

<sup>14</sup> *Id.*

<sup>15</sup> See generally Chart: Invacare Corp IVC (NYSE), Reuters, <http://stocks.us.reuters.com/stocks/charts.asp?symbol=IVC&WTmodLOC=L2-LeftNav-10-Charts> (last visited Oct. 12, 2007).

<sup>16</sup> *Id.*

company called Royal Appliance, maker of the Dirt Devil.<sup>17</sup> It was the world's best-kept secret, this Royal vacuum cleaner; they were all metal and sold exclusively through vacuum cleaner shops.

We bought it for \$4 million and borrowed \$3.8. That's the art of leverage buying. Use the bank's money to buy the thing, and you get all the upside.<sup>18</sup> If it goes the other way, you lose your \$200,000, but the bank, they put up a lot of risk.<sup>19</sup>

I said, "John, I will do this for \$20,000." I raised the investor group, I got the banking, but I didn't have any money because I just put my \$10,000 in Invacare. So we agreed that I would pay Royal \$2,000 a year for ten years, and I was asked to be chairman of the board. And about seven years down the road we took the company public, and I got \$30 million out. I had made only seven payments totaling \$14,000.

So that was a nice story, and that taught me a lesson about the difference between liquidity and net worth. Does anyone know the difference? High net worth is when you are rich but don't have the money to spend so you can't liquefy your net worth.<sup>20</sup> So Royal Appliance gave me liquidity, and I was able to buy some things. Joe Louis said money is not important unless you want to buy something.<sup>21</sup>

Then one night I ran into a guy that worked for a company called American Sterilizer. He was an engineer/scientist type, and he had an idea. Instead of using ethylene oxide where overnight you sterilize an endoscope with then current technology, why not come up with a faster sterilizer?<sup>22</sup> At this time, the first patient in the morning got the sterilized endoscope, but the rest of the patients got a disinfected endoscope during the day.<sup>23</sup> He had a new idea to sterilize the endoscope after each use. His company was not interested, so he left the company.

And I met him at Nighttown in Cleveland Heights. After my third Jack Daniels, we decided to back this guy. And we created a little incubator

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<sup>17</sup> See About TTI Floor Care North America, Dirt Devil, <http://www.dirtdevil.com/companyInfo.aspx> (last visited Nov. 3, 2007).

<sup>18</sup> See generally John Olsen, *Note on Leveraged Buyouts*, TUCK SCHOOL OF BUSINESS AT DARTMOUTH, CTR. FOR PRIVATE EQUITY AND ENTREPRENEURSHIP, (2003), [http://mba.tuck.dartmouth.edu/pecenter/research/pdfs/LBO\\_Note.pdf](http://mba.tuck.dartmouth.edu/pecenter/research/pdfs/LBO_Note.pdf).

<sup>19</sup> See generally *id.*

<sup>20</sup> Cf. High Net Worth Individual (HNWI), Investopedia, <http://www.investopedia.com/terms/h/hnwi.asp> (last visited Oct. 12, 2007).

<sup>21</sup> See "Money Ain't Everything", TIME, Mar. 3, 1947, available at <http://www.time.com/time/magazine/article/0,9171,854656,00.html> (quoting Joe Lewis saying "Money ain't everything, unless a poor guy ain't got it.").

<sup>22</sup> See generally Paul Davies, *Clinic Infections Put a Sterilizer of Lab Devices Under Microscope*, WALL ST. J., Dec. 24, 2004, at A1.

<sup>23</sup> See generally *id.*

company called STERIS Corporation.<sup>24</sup> I didn't have any money because I put my \$10,000 in Invacare, and I owed \$20,000 to John Balch. I had just been elected to the board of a new venture firm here in Cleveland called Primus Venture Partners, Inc.

I went to Loyal Wilson, managing partner of Primus, and said, "It is a great idea. You ought to invest in this idea to make a new sterilizer." Loyal didn't think it was a good idea, but he didn't want to insult me because I was on his board, so he hired a consultant to show it was not a good idea. Loyal Wilson hired Bill Stanford, who said not only did he think it was a good idea, but wanted to run the company.

I think it took \$20 million of equity before a dollar came in the door. As you know, Bill Stanford built STERIS into one of Cleveland's great medical device companies.<sup>25</sup> The two biggest Cleveland companies in medical devices in the last 30 years are really STERIS and Invacare.<sup>26</sup> I made a few million out of that one but nothing like I did out of Invacare and Royal Appliance.

Invacare put some money into STERIS, and that's how we created our foundation. Those are some special stories. I have got a lot of other little ones that aren't as exciting, but people kept coming to me with opportunities, and I didn't have the time to really analyze them because I was running Invacare.

Thus, I hired a young man, Mark Mansour, to look at these things, and eventually, we would fund deals on a deal-by-deal basis. In other words, I would find an opportunity and go around and say, "Mr. Jones, would you put a couple hundred thousand in?"

And I said, "Why don't we formalize MCM Capital Partners?" We have raised about \$100 million from individuals.<sup>27</sup> So now we have the money. When we find the deal, we can do the transaction and operate sort of beneath the radar of these big LBO funds, and unlike a lot of LBOs, we have a group of people that know what to do with it, like Royal.

We feel we can help the entrepreneur by putting the right people on the board. Bill Stanford is more like I am, a marketing guy, so I put J. B. Richey on the board, a brilliant scientist, and he helped them develop the product. So

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<sup>24</sup> Company Information: About STERIS, STERIS, <http://www.steris.com/about/history.cfm> (last visited Nov. 7, 2007).

<sup>25</sup> See generally John Mangels & Zach Schiller, *Building Up Biotech*, THE PLAIN DEALER, Feb. 4, 2001, available at <http://www.cleveland.com/indepth/biotech/index.ssf?/indepth/biotech/more/fs04econ.html>.

<sup>26</sup> See generally *id.*

<sup>27</sup> See MCM Capital Partners, <http://www.mcmcapital.com> (last visited Oct. 11, 2007) ("[A] private equity firm that manages committed capital funds on behalf of institutional investors and high net worth individuals for investments in businesses").

MCM Capital is an excellent LBO firm here in Cleveland, having double-digit returns, and continuing to buy companies and restructure them.<sup>28</sup>

Frequently, entrepreneurs turn their business over to a family member who doesn't have the same skills or the same drive.<sup>29</sup> And frequently, you will find the business, maybe a third generation business, where the entrepreneur dies, he or she turns it over to his son or grandson, and they become protectors of assets rather than builders.<sup>30</sup>

So I say, "Here, son, here is \$10 million," and the attitude is "I don't want to lose it" and risk very much, so frequently, a lot of these little companies don't advance.<sup>31</sup> And they get into a situation where the family ends up having to sell it, and that's the kind of situation that the leverage firms like MCM Capital are looking for.<sup>32</sup>

Recently, I raised \$25 million to create a company called MWV Pinnacle Capital Management (Minorities with Vision) here in Cleveland;<sup>33</sup> I invested the first \$1 million. We don't have enough minority businesses in Cleveland. There is the President's Council, an organization of minority-owned businesses in Cleveland, and I have tried – we raised \$25 million, and hired Eric Von Hendricks to run it.<sup>34</sup> He ran Shore Bank prior to MWV; we are looking and trying to create more capitalism in the minority community.<sup>35</sup>

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<sup>28</sup> See MCM Capital Partners Announces Initial Closing Of Second Private Equity Fund, MCM Capital Partners [http://64.233.167.104/search?q=cache:CTF0vOzuhCMJ:www.mcmcapital.com/n\\_initialclose.htm+MCM+Capital+Partners+Announces+Initial+Closing+Of+Second+Private+Equity+Fund&hl=en&ct=clnk&cd=1&gl=us](http://64.233.167.104/search?q=cache:CTF0vOzuhCMJ:www.mcmcapital.com/n_initialclose.htm+MCM+Capital+Partners+Announces+Initial+Closing+Of+Second+Private+Equity+Fund&hl=en&ct=clnk&cd=1&gl=us) (last visited Nov. 9, 2007).

<sup>29</sup> See generally Robert L. Wallace, *Preparing a Smooth Exit Strategy*, ENTREPRENEUR, July 1, 2003, available at <http://entrepreneur.com/management/familybusiness/successionplanning/article63392.html> (explaining the need for entrepreneurs to properly train family members before they exit the company).

<sup>30</sup> See generally Rhonda Abrams, *Strategies: Planning Your Exit Helps You Grow Your Business*, USA TODAY, Apr. 27, 2007, available at [http://www.usatoday.com/money/smallbusiness/columnist/abrams/2007-04-27-exit\\_N.htm](http://www.usatoday.com/money/smallbusiness/columnist/abrams/2007-04-27-exit_N.htm) (stating that family members may not be capable of running the company).

<sup>31</sup> See generally Wallace, *supra* note 29.

<sup>32</sup> See generally Olsen, *supra* note 18.

<sup>33</sup> See generally Melissa Monroe, *Untapped Capital*, BLACK ENTERPRISE, available at <http://www.blackenterprise.com/cms/exclusivesopen.aspx?id=455&p=0>.

<sup>34</sup> The President's Council, <http://www.thepresidentscouncil.com/> (last visited Oct. 11, 2003) ("The organization was established in 1996 to support entrepreneurial and economic development within the African American community, and to foster strategic alliances with CEOs of other major corporations...").

<sup>35</sup> Editorial, *Quiet Crisis: A Helpful Push*, THE PLAIN DEALER, Sept. 24, 2002, available at <http://www.cleveland.com/quietcrisis/index.ssf?/quietcrisis/more/1032859951204630.htm> (explaining that the Minorities With Vision Pinnacle Capital Fund "will help minority businesses start, expand, launch new product lines or acquire other companies. In some cases, the fund may itself purchase local firms and install minority management teams.").

We need more of that in Cleveland. Hopefully, some of these people come back and give back to their communities.

I have invested in Resilience Capital, where my son works, and these guys buy companies out of bankruptcy and turn them around.<sup>36</sup> In one of their investments, I put in \$120,000 and got back \$5 million in two years.

In addition, I have been involved with several startups. I have bought and sold approximately 40 companies. So let me just sort of wrap up by saying: What does an entrepreneur really enjoy in life? And I think the thing I enjoy the most is freedom. I don't have to work for anyone. I am not beholden to anyone. I don't have to wonder about getting fired.

Generally, I can do anything I want, go anywhere I want. Freedom to me is very, very important. And I don't have to kiss anybody's tail or tell my boss how great he is. I don't have to do any of that, and that's important to me. I know that when I worked in industry, I worked for some really talented people, and I worked for some eggheads. I was not very comfortable telling the egghead his idea was great. That's not me. I did very well when I reported to a great manager and didn't do well when someone was afraid that I would discover they weren't great.

You have to be able to deal with wild net worth swings, and you have to be prepared to have not every one of your ventures succeed, but that's where the tax collector is helpful. So when you lose money, you can offset the losses against your gains.<sup>37</sup>

I was at my Harvard College Class Reunion recently. I was the only businessman on the panel, and our class was asking what we had wanted to do with the remainder of our lives. I am 66. All the smart guys in my class went to the Peace Corps, wanted to work for the government, foundations or teach." They were going to solve all the world's problems, you know. And old Mal, I said, "I have to get a job and pay for my rent" and this sort of thing. So they asked us what we want to do with the rest of our lives, and the smart ones said they have no money, \$0 net worth. "How will I get financial security?" The guys like me who went to work; we said, "I want to solve the world's problems." It was complete role reversal. Perhaps I am exaggerating, but I wouldn't be here today if it weren't for Harvard.

I have funded four perpetual Harvard College scholarships for students from Oklahoma or Northeast Ohio.<sup>38</sup> These students always write me and tell

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<sup>36</sup> Resilience Capital Partners LLC, <http://www.rcpmb.com> (last visited Oct. 11, 2007) ("[A] private equity firm focused on principal investing in lower middle market underperforming and turnaround situations.").

<sup>37</sup> I.R.C. § 165 (a) (2004) (allowing deduction of any loss sustained during the taxable year).

<sup>38</sup> COMPARATIVE LEGAL ASPECTS OF ENTREPRENEURSHIP IN CANADA AND THE UNITED STATES CONFERENCE PROGRAM, CANADA-UNITED STATES LAW INSTITUTE 5 (2007), [http://cusli.org/conferences/annual/Conference\\_Program\\_\\_f\\_.pdf](http://cusli.org/conferences/annual/Conference_Program__f_.pdf).

me how they are doing. I just had a black female from Oklahoma who became a Rhodes Scholar from Harvard. That to me was so exciting. The fact that I got to go on a scholarship – my parents had no money – it makes me feel happy that I can help some of these same kids.

Recently, I was involved with creating what's called the Marine Corps Heritage Foundation in Quantico, Virginia. The State of Virginia donated land to it.<sup>39</sup> The Corps really doesn't have a place to bring it altogether, and that has been a very fulfilling project – I put the first dollars in and worked with the commandant of the Marine Corps and other great Marines to bring this to fruition. There are so many Marines out there running companies, it is unbelievable.<sup>40</sup> I might say that Cleveland's Al Lerner, one of my great, great friends, was a Marine.<sup>41</sup> And his son, Randy, after Al died, made a major contribution to this project in his father's name.<sup>42</sup>

I created the first entrepreneurship chair in Cleveland at the Weatherhead School of Management here at Case Western Reserve University, and Bob Hisrich from Tulsa, Oklahoma, filled the chair.<sup>43</sup> Scott Cowan, the former dean at Weatherhead, brought him here, and we spent a lot of time together. Bob Hisrich has the number one book in the world on entrepreneurship answering questions like "How do I write a business plan?"<sup>44</sup> I encourage everyone to buy a copy.

DR. HISRICH: Absolutely.

MR. MIXON: But it is published, and he traveled a lot to Russia, and taught, not the children but people, how to practice capitalism. The Chinese haven't forgotten. The Russians are having a tough time understanding

<sup>39</sup> See Marine Corps Heritage Foundation, <http://www.marineheritage.org/index.asp> (last visited Nov. 4, 2007).

<sup>40</sup> See *Military Experience & CEOs: Is There Link?*, KORN/FERRY INTERNATIONAL, 12 (2005), available at <http://www.kornferry.com/Library/ViewGallery.asp?CID=1741&LanguageID=1&RegionID=23> (listing CEOs with Marine Experience).

<sup>41</sup> *Alfred Lerner: Chairman & CEO of MBNA Corporation*, THE HORATIO ALGER ASSOCIATION OF DISTINGUISHED AMERICANS, [http://www.horatioalger.org/members/member\\_info.cfm?memberid=LER98](http://www.horatioalger.org/members/member_info.cfm?memberid=LER98) (last visited Oct. 13, 2007) (giving the biography of Alfred Lerner).

<sup>42</sup> Roll of Honor Donor: Mr. Randolph D. Lerner, Marine Corps Heritage Foundation, [http://www.marineheritage.org/RollHonor\\_donor\\_detail.asp?NAV=1&PageFrom=Y&PageVal=00001-593-0000104978&ROHName=Lerner&ROHFName=&ROHCity=&ROHState=&ROHQLevel=0](http://www.marineheritage.org/RollHonor_donor_detail.asp?NAV=1&PageFrom=Y&PageVal=00001-593-0000104978&ROHName=Lerner&ROHFName=&ROHCity=&ROHState=&ROHQLevel=0) (last visited Oct. 13, 2007).

<sup>43</sup> Robert D. Hisrich – Weatherhead Faculty, Case Western Reserve University Weatherhead School of Management, <http://webdev.case.edu/faculty/faculty.cfm?id=5380&view=yes> (last visited Nov. 4, 2007).

<sup>44</sup> ROBERT D. HISRICH, MICHAEL P. PETERS, & DEAN A. SHEPHERD, *ENTREPRENEURSHIP* (7th ed. 2006).

capitalism, and Bob can tell you some real stories about his teaching in Russia. In how many languages is the book now printed?

DR. HISRICH: Nine.<sup>45</sup>

MR. MIXON: Nine languages. So I was proud I could work with Bob, and since Bob has moved on to another school – and I will let him tell you about it later. I have been able to use my philanthropy at The Cleveland Clinic and the Cleveland Institute of Music. But I have enjoyed the satisfaction of being able to do those things, and to create businesses. It is a lot of fun.

I have to say, as I stand up here, I never had to work for a living other than my eleven years I was working for somebody else. I don't consider what I do as work; it is fun. I talk to people that say, "You know, I don't like what I do, and when I retire, I am really going to have some fun."

I said, "Why don't you do something you like?"

"I am making too much money. I would have to change careers and go back." But you know, we are not here on Earth very long. I am happy – I look forward to every day. When I was a young man, before I had cancer, I was never happy with the money I made, my position. Cancer really sobered me up in terms of enjoying every single day. When I get up each day, I am not afraid to die. I am not saving my life for something else out there.

Someone asked me once if I had a fantasy, and I said I really have this fantasy that I would like to be able to take a year off, not take any of my money, anything with me, and just go to a strange city like Phoenix. I have no money in my pocket. I will look in the jobs-wanted there, and I will get a job. And I believe I could do it again with no money because I know how to do it. So to me, that would be my fantasy.

So I am going to open this up for questions here in a second, but I wanted to read you a little poem that you all read in high school but I think best described my life, and I have asked my wife to put this poem on my tombstone. She has already selected our lots out in Hunting Valley.

But it is a poem by Robert Frost, and you have all heard it, but I want to read it to you because to me it really talks about the entrepreneur. It is called "The Road Not Taken."<sup>46</sup>

I believe you all know it – about the two roads that diverged, and I had taken the one less traveled by, and that has made all the difference.

Thank you.

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<sup>45</sup> Robert D. Hisrich, Thunderbird School of Global Management, [http://www.thunderbird.edu/about\\_thunderbird/ctrns\\_excellence/CGE/who\\_we\\_are/hisrich\\_bio.htm](http://www.thunderbird.edu/about_thunderbird/ctrns_excellence/CGE/who_we_are/hisrich_bio.htm) (last visited Oct. 13, 2007).

<sup>46</sup> Robert Frost, *The Road Not Taken* 1 (Bartleby.com, Inc. 1999) (1920), available at <http://www.bartleby.com/119/1.html> (last visited Oct. 13, 2007).

DISCUSSION FOLLOWING THE REMARKS OF A. MALACHI  
MIXON, III

MR. HERMAN: Well, how about that? Mal, thanks for a wonderful description of what it means to be an entrepreneur, how you succeed, the kinds of motivations and luck, I guess, that comes into play. Let's have some questions now.

I think we had a lot of interesting comments from Mr. Mixon. The first on the list is the honorable Henry King.

DR. KING: Well, thank you.

Mal, what I wanted to find out is, when you invest in companies, do you have any standard data equity ratio that you always target so that the entrepreneurs have some stake in the enterprise themselves?

MR. MIXON: I am going to answer that question with two parts. My debt to equity ratio is determined by how much I can borrow. Royal Appliance actually was an asset-based loan. You have income-based loans and asset-based loans.<sup>47</sup> Banks that are interested are willing to lend about 35 percent on the inventory, about 85 percent on the receivables, and that number came up to a little more than \$4 million.<sup>48</sup>

And the bank said, "Mal, you got to put something in it." So the answer is: I like to leverage as much as I can, put as little equity in as I can because that's the risk portion. If you grow the company and succeed, all that profit goes to you.

Now, the second thing is, I don't really care about ratios. If I am backing an entrepreneur, I don't care how much he puts in but I do care relative to what he has. If somebody is willing to put in all \$20,000 of his net worth and take a second mortgage, then he becomes a believer in my eyes.

I had a guy come to my house one night, and he is worth several million dollars. And he had decided he had to start a publication called "MBA." I didn't think there was a market for the publication. I don't see MBA's as a target market. He wanted me to invest in it, and I said, "How much are you putting in?" He told me \$50,000, and I said, "Get out of here. If all you are going to put in is \$50,000, given your net worth, I am not interested."

So what's really important is: Is the entrepreneur really committed? So that would be my answers to this. By the way, MBA made one publication, which was a beautiful publication; turned out they gave all the advertisers

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<sup>47</sup> Allen N. Berger & Gregory F. Udell, *Small Business Credit Availability and Relationship Lending: The Importance of Bank Organizational Structure*, *ECON. J.* 1, 22 (2002), available at <https://www.federalreserve.gov/Pubs/FEDS/2001/200136/200136pap.pdf>.

<sup>48</sup> See generally Hilary Rosenberg, *Mining the Balance Sheet*, *CFO MAG.*, May 2001, at 106, available at <http://www.dushkin.com/text-data/articles/29435/body.pdf>.

free space in the first publication, and that's the only one ever published. They lost so much they never published the second edition.

But when you are investing with someone, when you are going to back someone, what's important is: Are they committed? Otherwise forget it. It is not going to work.

MR. HERMAN: Mal, we have these reading materials and the people can have a look at what's in this book, because there is some very good reference documentation. In the tab for the discussion that Mal has been leading us on, there is an interesting survey, and I wanted to get his comments.

There was a discussion by Transetter, and they research entrepreneurs to find out what are the factors most critical to business success for fast growth private companies, and I wanted Mal's reaction to this. If you look at the last page of that survey in that tab, it shows the most critical factor in a new fast growing company is retaining key workers.<sup>49</sup> The second most important factor is hiring qualified workers. And in terms of the ranking of those two items, they rank well above, well above all of the other factors that go into business success.<sup>50</sup> I wondered what your comments were.

MR. MIXON: I wouldn't agree with that. I think far and away the most important principle is the customer and understanding what the customer really wants and providing what the customer wants. When I bought Invacare, I spent the first 30 days out in the field interviewing – actually, Invacare made a standard folding wheelchair – and I went out, and first of all, they would tell me how screwed up Invacare was.

And I said, “Well, if they were a good company, I could not have afforded to buy it.” Then they started describing the principal competitor and how they hated my competitor, Everest & Jennings. They are since bankrupt but had about 80% market share when I started.<sup>51</sup>

The Everest & Jennings chairs were institutional, heavy, ugly-looking wheelchairs.<sup>52</sup> I soon learned that people with disabilities were angry because, in those days, they had no access to society.<sup>53</sup>

MR. HERMAN: No ramps.

MR. MIXON: Right. So we were fighting legislatively to change it. And we now make one out of titanium aluminum that weighs 13 pounds.<sup>54</sup>

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<sup>49</sup> Trendsetter Barometer, Entrepreneur.com 4 (2007), available at <http://www.entrepreneur.com/misc/trendchart.pdf>.

<sup>50</sup> *Id.*

<sup>51</sup> See generally Press Release, Graham-Field Health Products, Everest and Jennings International LTD. to be Acquired by Graham-Field Health Products, Inc. (Jun. 19, 1996), available at <http://www.secinfo.com/d1112.93.d.htm>; see History of Wheelchairs and Power Add-On Units, [http://scholar.lib.vt.edu/theses/available/etd-12898-174432/unrestricted/literature\\_review.pdf](http://scholar.lib.vt.edu/theses/available/etd-12898-174432/unrestricted/literature_review.pdf) (last visited Nov. 4, 2007).

<sup>52</sup> See generally History of Wheelchairs, *supra* note 51.

<sup>53</sup> *Id.*

MR. HERMAN: This is new technology.

MR. MIXON: This is all new. We introduced the first microprocessor computer in the motorized wheelchair market.<sup>55</sup> You're all familiar with Christopher Reeve. He was a C-1, which is the highest level of spinal injury, and he used our chairs.<sup>56</sup> But every company I buy, I want to talk to the customer, and I guarantee you, if every one of you went with me, I will come back with a list of stuff you need to change about the product and the service.

When I entered this business of customized wheelchairs, it took six weeks to deliver it,<sup>57</sup> and today we deliver in five days. We invented one-stop shopping, which is we brought under the umbrella all these home-care products.<sup>58</sup> So when you go home today, you make one phone call to Invacare. Customers are what we are in business for, not ourselves. Profits are a result of achieving excellence.<sup>59</sup>

Every one of us has a choice: When you choose a wife, a car or house, you compare. Your job is to make sure that the customer's choice is what you have to offer.

MR. HERMAN: But that meant –

MR. MIXON: But give me a second. If you don't have a customer and you don't have a product, sure, you want to have good people, and you have to have good people and you want to be a good recruiter. We treat our people very, very well. They are paid well and treated well. We have no assigned parking places.

We eat in the same lunchroom; have casual dress and direct access to management. We don't care if you went to college, whether you have an MBA, doesn't matter. It is what you do, and that's the way the people feel, and that's more important to most people than whether they make an extra \$5,000.

MR. HERMAN: When you took over Invacare and saw the need to respond to the customer's needs, you have to develop a new product essentially or change.

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<sup>54</sup> Invacare A4 Titanium Ultralightweight Active Performance Rigid, [http://www.invacare.com/doc\\_files/P2002\\_104\\_TITANIUM\\_T4.pdf](http://www.invacare.com/doc_files/P2002_104_TITANIUM_T4.pdf) (last visited Oct. 13, 2007).

<sup>55</sup> See Invacare Corporation, *supra* note 13 (Invacare was the first firm to produce a motorized wheelchair with computerized controls).

<sup>56</sup> See, e.g., Kim Palmer, *Recharging Invacare*, SMART BUS. CLEV., Oct. 2003, available at [http://www.sbnonline.com/National/Article/124/5413/Recharging\\_Invacare.aspx](http://www.sbnonline.com/National/Article/124/5413/Recharging_Invacare.aspx).

<sup>57</sup> See generally *id.*

<sup>58</sup> *Id.*

<sup>59</sup> Cf. Werner J. Reinartz & V. Kumar, *The Impact of Customer Relationship Characteristics on Profitable Lifetime Duration* 5 (Insead R & D, Working Paper 2001/108/MKT), available at <http://www.caplrix.com/pdf/Profitable%20Customer%20Relationships.pdf>.

MR. MIXON: You have to change what you got because it changes – our product development cycle is now 14 months and it used to be two years. So we are trying to be faster in innovation. If you don't innovate and replace what you have, your competitor is going to eat your lunch.<sup>60</sup>

Sometimes the pioneers are the ones that get the arrows in the back, because the second guy comes in with something that is better. So you have to keep innovating, and there may be patent lawyers in the audience, but I think patents slow down the process. They don't stop anything. J. B. Richey can design around any patent I have ever seen. We try to patent things. But it is innovation, being first to market, having the thing you want. Everybody always wants it to do something more: smaller, cheaper, or another color. We make 60 different colors in wheelchairs.<sup>61</sup>

MR. HERMAN: But did you find when you took over the business, you had the in-house expertise, or did you have to get new people in the process?

MR. MIXON: I took what I had, which was only 300 people. I have 6,200 now. I recruited; I didn't summarily fire everyone. I had a strange event on day one. My background is sales and marketing – I had just purchased the company, and the sales manager had been canned from J & J. He comes in my office and says, "I want a bonus for the previous year."

And I said, "That's somebody else's responsibility, not mine. I am not paying bonuses yet." This was January of the year but he comes in and says, "I am going to resign in December. I said, "December of this year, 12 months out?"

And he said, "Yeah."

And I said, "It is thoughtful of you, but I don't need you that long."

He said, "How long do you need me?"

I said, "What time is it? It is 2:00 pm. How about 4:00 pm?"

So I lost my VP of sales, whom I would have fired anyway.

Today we are doing around \$6 million in sales per salesperson vs. \$1 million in 1979. They are extremely well paid, and nobody can pirate them. I pay them more than anybody so my competitors can't pirate them. I want them to make even more.

DR. BARBER: I enjoyed the Robert Frost analogy at the end, but it made me wonder if you take the path less traveled with those – all those entrepreneurial types, it seems to me there must be another cross in the road,

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<sup>60</sup> See e.g., Maria Vassalou & Kodjo Apedjinou, *Corporate Innovation and its Effects on Equity Returns* 3 (1<sup>st</sup> Annual UBC Finance Conference, 2003), available at <http://www2.gsb.columbia.edu/faculty/mvassalou/CI2.pdf>.

<sup>61</sup> Cf. Invacare, [http://www.invacare.com/doc\\_files/P1995\\_66\\_9000\\_XT.pdf](http://www.invacare.com/doc_files/P1995_66_9000_XT.pdf) (last visited Oct. 13, 2007) (Many different colors and frame options for wheelchairs are available from Invacare).

at least in Canada, and most of them would at that point take the path well traveled.

I wondered if you felt here in the United States that you have taken another step in a path less well traveled. The reason I ask this is because even amongst entrepreneurs in Canada, to talk the way you do about the customers does not happen. That's not a path that is taken.

MR. MIXON: Well, you know, I only know what I know and what has made me successful. And I can't say the entrepreneurial path is for everyone. If I talk about the entrepreneur, the next guy that takes over Eaton Corporation from Sandy Cutler, he is going to make a hell of a lot of money.

The guy that runs the corporation, they are making huge money. I am sure I would have been fired at least three times had I pursued that route in my career because I am just not a good organizational type. I think one in a hundred new businesses succeed in America.<sup>62</sup> I don't know what the Canadian ratio is.

Bob, what is the Canadian ratio?

MR. HIXON: Seventy percent.<sup>63</sup>

MR. MIXON: Seventy percent. That's a little off from my statistics, but I am glad I am under 30, but what is failing?

There is no such thing as failing. I know men and women who tried and didn't succeed the first time around. And I was 39, and I said to my wife – my wife was very supportive of me doing this – I said, “Honey, what's the worst thing that happens? I lose \$10,000. I know I can get a good paying job.”

DR. BARBER: And she has a house and car.

MR. MIXON: She still has it.

By the way, you have a great country in Canada. Invacare does very well there; number one market share in Canada.<sup>64</sup> As a matter of fact, Invacare is now number one market share in Europe, Canada, Australia and starting now just to market in the Far East.<sup>65</sup> We have factories now in China,<sup>66</sup> 40 factories around the world.<sup>67</sup> We market our products now to 80 countries.<sup>68</sup>

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<sup>62</sup> PETER F. DRUCKER, *INNOVATION AND ENTREPRENEURSHIP 3* (Collins 2003).

<sup>63</sup> See generally Moren Lévesque, *UW Researcher Studies Why Some Businesses Succeed, While Others Fail*, U. OF WATERLOO, Oct. 26, 2006, available at <http://newsrelease.uwaterloo.ca/news.php?id=4795>.

<sup>64</sup> See generally INVACARE CORPORATION 2005 ANNUAL REPORT ON FORM 10-K CONTENTS, <http://www.invacare.com/HQ/EDITORIAL/20060331/2005Form10K.pdf>.

<sup>65</sup> See generally *id.*

<sup>66</sup> See PUTTING IT ALL TOGETHER, SUMMARY ANNUAL REPORT 2004, available at <http://www.invacare.com/HQ/EDITORIAL/20050408/2004AnnualReport.pdf>

<sup>67</sup> See generally *id.*

<sup>68</sup> See generally *Our History*, *supra* note 7.

When I began, we sold only in the United States in 1980. We redefined our company as a world company, not just a U.S. company.

MR. HERMAN: Just can you tell me a little bit about China because it is something that we have addressed here at the Institute and what's the proper China strategy? It is a little bit off topic, but I thought we might address it.

MR. MIXON: I really pride Invacare on being the low-cost producer, and we are the highest profit company, and we put most of our U.S. competitors out of business, and suddenly we started seeing imports and knockoffs and copy cats from China at prices 25 percent below our prevailing prices.<sup>69</sup>

So we have had to – and probably we are a little late doing it, late in moving more of our manufacturing to China – we are in a free world economy. I don't have time to debate all the rules and whether you are going to have protectionism, but survival is what it is about. We have a huge purchasing office in Hong Kong where we procure over \$200 million per year, and I have two factories in China.<sup>70</sup>

Today about 20 percent of our cost of goods sold come from China, and within three years, 40 percent will come from China.<sup>71</sup> The Chinese government is more cooperative and capitalistic than Americans. I am talking about all the red tape you go through trying to get permits, and it is very easy.

My companies are in plants and parks that are far more attractive than anything you will see in Cleveland, and my labor rates vary from \$30 in Germany to about \$15 in Ohio to about \$3 in Mexico down to \$0.50 in China. If you want to know how much you can save, take a payroll and subtract it. But I have had to give it up in pricing. It has not been for profit but survival to compete with the Chinese companies.<sup>72</sup>

MR. CUNNINGHAM: Is any of your Chinese production coming back to the United States?

MR. MIXON: Oh, yes. It is all coming back to the States or to Europe. It is a worldwide production operation.<sup>73</sup>

MR. CUNNINGHAM: What does that do as far as production in the United States in terms of jobs and things like that?

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<sup>69</sup> Cf. Pete Engardio & Dexter Roberts, *The China Price*, BUS. WK., Dec. 6, 2004, available at [http://personal.georgiasouthern.edu/~mmcdonal/the\\_china\\_price.doc](http://personal.georgiasouthern.edu/~mmcdonal/the_china_price.doc) (China forcing certain manufactures to compete with lower prices).

<sup>70</sup> Cf. Peter Krouse, *Opening Plant here is a Walk in the Park*, CLEV. PLAIN DEALER, Dec. 11, 2005, available at <http://chinasourcenetwork.com/Plain%20Dealer%20SIP%20article%2005.htm> (Invacare has manufacturing facilities in China).

<sup>71</sup> *Id.*

<sup>72</sup> Engardio & Roberts, *supra* note 69, at 1.

<sup>73</sup> *Id.* at 3.

MR. MIXON: We reduced it and will keep reducing it, and we announced that publicly.<sup>74</sup> But I am just telling you manufacturing is in serious trouble in this country if you have international competition.<sup>75</sup> If you don't, you know, that's fine. But that's the way it is, and we are in a world business today.

MR. HERMAN: Well, the hour is upon us as Henry has reminded me, visually and otherwise. I would like to thank Mal Mixon for an excellent presentation. So please join me in a hardy round of applause.

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<sup>74</sup> Krouse, *supra* note 70.

<sup>75</sup> Engardio & Roberts, *supra* note 69, at 1-3.

PRIVATE FINANCING OF ENTREPRENEURSHIPS: SOURCES  
OF PRIVATE FINANCING; GUARANTEES (REQUIRED  
PERSONAL OR OTHERWISE); WHEN TO GO PUBLIC (PROS  
AND CONS); RIGHTS OF FINANCING PARTIES; DEFAULTS;  
CAPITAL FORMATION FOR ENTREPRENEURIAL VENTURES;  
TAX CONSIDERATIONS

*Session Chair – Michael Robinson*  
*Canadian Speaker – David Woolford*  
*United States Speaker – Morton A. Cohen*

INTRODUCTION

*Michael Robinson*

MR. ROBINSON: I am Michael Robinson. I am pleased to preside here, which means I do not have to do any hard work. I asked to do this because I represent the last of entrepreneurial financing lawyers.

When I started practicing in 1966, I did two things: Non-recourse project financing, mostly for mines, which was inventive in Canada, and IPOs, for what was then an unusual thing, for the service industry such as radio broadcasting and insurance brokerages that had no bricks and mortars. In other words, they were businesses that did not make “things.”

Now, our two speakers today represent the present and the future of entrepreneurial business financing, and I will briefly introduce them. Mr. Cohen is going first.

Morton A. Cohen is a closet Canadian born in Montreal, but not as Canadians are said to be, particularly shy. His bio of many achievements in Canada and U.S. in finance is almost a page and-a-half, but I am going to distill it for you. He owns Clarion Capital, which is a small business investment company, which does private placements in public companies. He founded Clarion Capital Corporation, which runs several domestic and offshore hedge funds, achieving a 15 percent overall return since its inception in 1994. That’s not quite up to Warren Buffet’s return rate I don’t think, but if you go to the last paragraph of his bio in which he details his healthcare and life sciences investment activities over the last eight years, and you will see that he achieved an internal rate of return of over 200

percent. Now, Warren Buffet has never done that and rarely has any investor that I know of. His background is a B.A. in Economics from Concordia University in Montreal, an M.B.A. in Finance from Wharton, and he is a certified financial analyst.

I hope Mr. Cohen will tell us something about how the local medical research establishment in Cleveland, which is so well known and primarily led by The Cleveland Clinic, contributes to his entrepreneurial activities in this field.

Mr. David Woolford is a closet Yank. He was born in the U.S. and ended up in Canada. He is a partner at Cassels, Brock & Blackwell LLP, a major Toronto firm and one of the sponsors of this organization, the Canada-U.S. Law Institute. He specializes in business law, corporate finance, e-business, privacy law, and securities law, and especially the development and financing of high tech companies, including many startups in Canada and abroad.

Indeed, David just returned from closing a deal in Germany between a Canadian technology company and a major German partner. He has published extensively on the subject of emerging developments in technology law. He is also an angel investor and a member of the Toronto Angel Group. So he puts his dollars where his legal advice is obviously, and he knows the entrepreneurial game from the inside out as well as just the legal aspect thereof. He is also Chairman and a director of Virox Technologies Inc., and holds various other private directorships and advisory board positions.

So without further ado, Morton, would you care to begin?

#### UNITED STATES SPEAKER

*Morton A. Cohen\**

MR. COHEN: Good afternoon. I really cannot thank you enough for the opportunity to follow Mal Mixon. It is like following Warren Buffet. Let me just say it is just nice to be here.

I walked in here, and the first couple of words I heard were “disputes,” and at lunch I heard “conflicts,” and that reminded me of an old story about a lawyer who goes hunting in rural Tennessee. The lawyer is duck hunting, and sure enough he shoots a duck, and the duck falls in the farmer’s field. The lawyer goes up over the fence to get the duck.

The farmer appears, and gets off his tractor and says, “this duck belongs to me; it is on my land.” The lawyer is absolutely indignant and he says, “I am going to sue you. I am a very famous lawyer, and I will sue you and take everything you have.” The farmer looks at him, says, “You know, we have a

way of settling disputes in Tennessee. We have this three-step rule.” The lawyer looks at him and thinks, “I can take on this old cogger.” So the farmer then proceeds, and he takes his steel boot and rams it right into the lawyer’s groin. And then he turns and rams his boot again into the lawyer’s mid drift. The farmer kicks him in the rear and the lawyer falls into a bunch of cow pod. The lawyer is absolutely shocked, and he manages to stagger to his feet and wipes his face on his sleeve, and he says, “So now it is my turn,” at which point the farmer says, “Yeah, but you can have the duck.”

I want to give you a panorama of American financing that is emerging today. First of all, let me say that we have financed private companies, and we spent about ten years in financing startups and developing companies before we got into private placements. Let me just start with the banking system.

The first place you go if you are an entrepreneur is a banking institution. The banking system is different in the United States than in Canada. Canada has major banks that really control the environment, whereas the United States has multiple banks and has a variety of loans, and recently a lot of them have had credits.

But banks are all the same: they want your right arm and sign. The one difference in Canada is, if you default, if you screw the bank, you do not get any more loans. In the United States, if you screw a bank, you can always move to Wyoming, Florida, or Southern California and start all over again.

So there is a difference in the way banks tend to treat entrepreneurial investors.

When you get to angel investors – and when I say this, I want you to know that I have the benefit of being in finance on both sides of the border, probably equal time in my business career – this country has a tremendous benefit. Perhaps one of the reasons why it is more entrepreneurial is because the angel investors have larger pools of capital,<sup>1</sup> they are high net worth

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\* Mort Cohen joined Clarion in 1981 as chairman of Clarion Capital Corporation, which was then a closed-end mutual fund investing in public and privately-held small companies through private placements. After becoming CEO and assuming sole management of the fund in 1982, he had the distinction of taking the only Small Business Investment Company out of bankruptcy in the history of the Program. Clarion Capital today is an active Small Business Investment Company specializing in private placements in public companies. Mr. Cohen purchased the fund in 1987 and took it private in a leveraged buyout in 1989. In 1994, Mr. Cohen started Clarion Management Ltd., which managed Clarion Partners, L.P., a domestic hedge fund, Clarion Offshore Fund Ltd., an offshore hedge fund, and Dynamic Equity Hedge Fund, a Canadian-based hedge fund. In 2006, Mr. Cohen liquidated Clarion Partners, L.P. and discontinued managing Dynamic Equity Hedge Fund. He continues to manage Clarion Offshore Fund, Ltd. The three hedge funds had approximately \$140 million in assets at their peak and generated an approximate 15% return since their inception. Between 1983 and 1989, Mr. Cohen also managed First City Technology Ventures, a venture fund investing in small public companies through private placements, for which he achieved an approximate annual

investors,<sup>2</sup> and the angel investing area is more pronounced and has more experience.<sup>3</sup> This country has a legacy of speculation. Canada does not have

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investment rate of return of 25 percent. Additionally, as chairman and CEO, Mr. Cohen took Childers Products, a specialty manufacturing company, from \$2 million in losses to \$5 million in profits and industry dominance before selling it in 1989 to a New York-based leveraged buyout group. Prior to joining Clarion, Mr. Cohen operated MAC Management, a Canadian-based mergers and acquisitions consulting practice. Among his clients were large Canadian companies, such as Reitman's, Ltd., Hiram Walker, Ivaco Industries, and First City Financial, Ltd. (the Belzberg Family) for which he researched major U.S. acquisition candidates. Earlier, Mr. Cohen was president of Yorkton Securities, then an institutional boutique, which is today one of Canada's leading securities firms. As such, he was responsible for the firm's research department and creation of an institutional research unit. During this time, he was named to the Canadian Institutional Investor All-Star List in Distilling two years running. Before that, Mr. Cohen managed research departments and serviced institutional brokerage clients for a number of Canadian securities firms including: Kippen & Co., which has since been acquired by Nesbitt Burns and is now the largest Canadian securities firm; Baker Weeks, for which he was vice president and the premier U.S. institutional salesman; and Merrill Lynch, for which he was the top performing salesperson in Canada. Mr. Cohen is currently a member of the board of directors of Cohesant Technologies, Inc. Formerly, he was governor of the Montreal Stock Exchange (1972-73), a member of the board of governors of the National Association of Small Business Investment Companies (1990-92), and a member of the boards of directors of Sanyo-Canada, Adac Laboratories, Abaxis Co., Alexander Energy, DHB Industries, Inc., and Zemex Corporation. He also served on a Senate committee that rewrote the legislation for the Small Business Investment Company Program. Mr. Cohen was a member of the Visiting Committee of the Weatherhead Business School of Case Western Reserve University in Cleveland, Ohio and a Trustee of The Jewish Federation of Cleveland. He has also been a major contributor to various Cleveland institutions and the Miriam Home Foundation of Montreal. Mr. Cohen is Chairman of the Investment Committee of the Jewish Community Federation of Cleveland, which has over \$500 million in investment assets. A Chartered Financial Analyst, Mr. Cohen holds an MBA in Finance from the Wharton School at the University of Pennsylvania and a BA in Economics from Concordia University in Montreal. Mr. Cohen has an extensive background in Healthcare and Life Sciences investments having focused the portfolio of Clarion Capital in these areas over the past eight years. Among his present and past investments are Conceptus, Genelabs, NexMed, Inc., Johnson & Johnson, ARIAD Pharmaceuticals, Cepheid, Intuitive Surgical, Abaxis, ADAC Laboratories, Maxim Pharmaceuticals, and a large number of other investments spanning the Healthcare field. During the past five years, Mr. Cohen's portfolio investments in this sector have generated an internal rate of return of over 200%. He is also the author of a number of financial articles and has been published and quoted over the years in *Barron's*, *Fortune*, *Business Week*, *The Canadian Financial Post*, *The Wall Street Journal*, *Crain's Cleveland Business*, and *The Cleveland Plain Dealer*.

<sup>1</sup> See generally David Rose, *Current Trends in Angel Investing*, AMERICAN VENTURE MAGAZINE.COM, <http://americanventuremagazine.com/articles/223> (last visited Oct. 19, 2007) ("Angel investments for the first half of 2005 alone totaled over \$11 billion" in the United States).

<sup>2</sup> See generally *id.* ("[T]he number of accredited investors who are entering the angel world is increasing each year by double-digit percentages.").

<sup>3</sup> See generally R.K. Honeyman, *The Benefits of Utilizing Automation for Efficient Deal Flow And Capital Procurement*, NUQUEST CAPITAL 3 (2007), [http://www.nuquestinc.com/UserDyn/NuQuest/white%20paper%20\\_3.pdf](http://www.nuquestinc.com/UserDyn/NuQuest/white%20paper%20_3.pdf) ("The angel

the same legacy of speculation. This is a country of the J. Goulds, the Fisks, the Mellons and the Carnegies.

Angel investing is changing. Groups are becoming more sophisticated. You have family offices. You have, to some degree, even ethnic partnerships that are emerging. For instance, in California, there is a strong ethnic partnership among ex-Indians - I don't mean Native Indians, I mean Indians who have immigrated - who tend to finance other Indians.

So you have the emergence of a professional angel class here, whereas in Canada, I am not sure if it exists, other than Calgary and the far west, where you have a large number of oil people who deal with finance companies.

In the United States we have less Government intervention that sustains entrepreneurship than in Canada,<sup>4</sup> but we do have something called the Small Business Association (“SBA”), which guarantees bank loans.<sup>5</sup>

The SBA provides guaranteed loans to corporations,<sup>6</sup> the government carries the banks 85 percent or 50 percent,<sup>7</sup> the latter being the norm because there is too much red tape to try to get the 85 percent loan. But the SBA program has been very good in terms of financing small entrepreneurs.<sup>8</sup>

How did the venture capital start in the United States? It started with the Small Business Investment Company (“SBIC”) program in 1958.<sup>9</sup> It nurtured

investor marketplace is robust, with substantial amounts of capital looking to find homes for worthy ventures.”).

<sup>4</sup> See generally Sound too Good To Be True? It Is!!, Fort Worth Business Assistance Center, <http://www.fwbac.com/index.asp?content=325> (last visited Oct. 25, 2007) (describing that opportunities for federal assistance in small business is limited).

<sup>5</sup> See Loan Fact Sheet, United States Small Business Administration, [http://www.sba.gov/idc/groups/public/documents/wa\\_seattle/sea2007loanfactsheetmar22.pdf](http://www.sba.gov/idc/groups/public/documents/wa_seattle/sea2007loanfactsheetmar22.pdf) (last visited Oct. 14, 2007) (explaining the process of Small Business Administration's guarantee loan program).

<sup>6</sup> See SBA and EX-IM Bank Co-Guarantee Program, United States Small Business Association, [http://www.sba.gov/idc/groups/public/documents/sba\\_program\\_office/oit\\_sba\\_im\\_desc.pdf](http://www.sba.gov/idc/groups/public/documents/sba_program_office/oit_sba_im_desc.pdf) (last visited Oct. 14, 2007) (“Any sole proprietorship, partnership or corporation, which operates as a going concern and meets SBA's definition of an eligible small business concern,” can receive guaranteed loans).

<sup>7</sup> SBA's Role: Guaranty Percents, United States Small Business Administration, [http://www.sba.gov/services/financialassistance/basics/sbarole/serv\\_7a\\_guarantyperc.html](http://www.sba.gov/services/financialassistance/basics/sbarole/serv_7a_guarantyperc.html) (last visited Nov. 3, 2007).

<sup>8</sup> See Will Kester, *SBA-backed loans: Good for entrepreneurs?*, HELIUM, <http://www.helium.com/tm/466307/small-business-assoc-backed> (last visited Oct. 22, 2007) (“The idea of SBA backed loans is a great concept in a country that encourages entrepreneurs, and it has allowed many start-up ventures that would have never had the chance to succeed without it”).

<sup>9</sup> See *Venture Capital Policy Review: United States 3*, (Organization for Economic Cooperation and Development, Working Paper No. 12, 2003) available at [http://www.oecd.org/olis/2003doc.nsf/809a2d78518a8277c125685d005300b2/c1a8e0ab81412decc1256d89004fd86f/\\$FILE/JT00148189.PDF](http://www.oecd.org/olis/2003doc.nsf/809a2d78518a8277c125685d005300b2/c1a8e0ab81412decc1256d89004fd86f/$FILE/JT00148189.PDF) (“The US government played a

venture capital, and produced the original venture capitalists. Today SBIC has made approximately 3,674 investments and has raised approximately \$2,797 billion in equity and debt capital investments.<sup>10</sup>

SBICs either pay interest to the Government,<sup>11</sup> or alternatively, the SBICs partner with the Government.<sup>12</sup> I was involved in writing the legislation for it. Up until this legislation, 44 percent of all the SBICs failed.

The Government supports entrepreneurship, but entrepreneurship does not necessarily ensure success. Venture capitalism in this country has a stellar, but varied record. If you go back to 2000, there were 7,812 venture capital deals and these deals raised approximately \$104,379 billion.<sup>13</sup> This number is staggering.

The year 2000 was absolutely a stellar year. Since then, we have had a decline, but recently, there has been a turn around. In 2004, we had approximately 3,072 venture capital deals with the average deal amounting to \$7 million.<sup>14</sup> The total amount of investment was short of the record set in the year 2000, but it is growing recently. The number of venture capital deals in existence has grown.<sup>15</sup> Currently, you have approximately 915 venture capital firms,<sup>16</sup> the number of first-time venture capital funds is

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significant role in the development of the venture capital market, starting in 1958 to encourage the private disbursement of large amounts of capital through the *Small Business Investment Company* (SBIC) program and various technology development schemes”).

<sup>10</sup> See generally An Introduction to the U.S. Small Business Administration (SBA), Office of Entrepreneurial Development, available at [http://www.sba.gov/idc/groups/public/documents/sba\\_homepage/serv\\_abt\\_overview\\_english.doc](http://www.sba.gov/idc/groups/public/documents/sba_homepage/serv_abt_overview_english.doc) (last visited Oct. 14, 2007) (“In Fiscal Year 2006, the SBIC Program produced \$2.9 billion in equity and debt capital investments during the year. The program’s licensed SBICs made approximately 4,000 investments in approximately 2,121 different small businesses”).

<sup>11</sup> See generally Finding Money! Small Business Investment Corporations, Abc’s of Small Business, [http://www.abcsmallbiz.com/bizbasics/moneymatters/finding\\_money.html](http://www.abcsmallbiz.com/bizbasics/moneymatters/finding_money.html) (last visited Oct. 14, 2007) (explaining the differences between SBICs and local banks are that local banks do not have the government investing with them).

<sup>12</sup> See generally The U.S. Small Business Investment Company Program: History and Current Highlights, National Association of Small Business Investment Companies, [http://www.nasbic.org/about/sbic\\_history\\_highlights.cfm](http://www.nasbic.org/about/sbic_history_highlights.cfm) (last visited Oct. 15, 2007) (“The SBIC program is a unique partnership between the public and private sectors”).

<sup>13</sup> See Eric Pakurar, *The New Next: Proceed With Caution*, MEDIADAILYNEWS, April 17, 2007, [http://blogs.mediapost.com/mdn\\_commentary/?p=937](http://blogs.mediapost.com/mdn_commentary/?p=937) (comparing venture capitalism in 2000 and 2006).

<sup>14</sup> See Industry Statistics, National Venture Capital Association, (2007), <http://www.nvca.org/ffax.html> (depicting venture capital statistics for years 2004 to 2007).

<sup>15</sup> See Pakurar, *supra* note 13 (“According to the National Venture Capital Association, some \$26 billion was invested in 2006 through VC channels; more deals were done than in any year since 2001”).

<sup>16</sup> See MONEYTREE SURVEY, NATIONAL VENTURE CAPITAL ASSOCIATION, PRICEWATERHOUSECOOPERS AND THOMSON FINANCIAL, Q2 2007 US RESULTS 1 (2007), <https://www.pwcmoneytree.com/MTPublic/ns/moneytree/filesource/exhibits/2Q07MoneyTree>

approximately 40,<sup>17</sup> and capital assets under management is approximately \$285 billion.<sup>18</sup> So we raised a lot of money. You can see 2000 was one heck of a vintage year.

And because of what happened, because so much money went in to venture capital, the rates of return went down. So as a consequence, we had a number of years where it just took the industry a long time to build up.

Consequently, early stage investing has diminished dramatically, and alternatively, expansion development and later stage investment has become more popular.<sup>19</sup> It has become harder to raise early stage money, even in the technology sector.<sup>20</sup> It has become more onerous. On the whole, venture capitalists are seen as more professional than angels, as we said here before, and to some extent angels are regarded as dumb money and venture capitalists as smart money. Venture capitalists, as we all know, tend to want more corporate governance and control in certain cases.<sup>21</sup> There are always constraints, but nevertheless, the venture capital industry has expanded over the years.

The number of dollars going into various segments of the industry has not changed significantly. In 2005, computer software was invested in significantly,<sup>22</sup> while biotechnology received a reasonable amount of

\_Report.pdf (stating that venture capitalists have invested \$7.1 billion dollars in 977 deals).

<sup>17</sup> See generally Emily Mendell, Matthew Toole & Sandy Anglin, *Venture Capital Fundraising Activity Slows in 3Q 2007*, NATIONAL VENTURE CAPITAL ASSOCIATION, THOMSON FINANCIAL 2 (2007) <http://www.nvca.org/pdf/Q307VCFundraisingFINAL.pdf> (showing the number of new funds in 2007 is 40).

<sup>18</sup> See Scott Evans, Executive Vice President TIAA-CREF, *Saving Investors Money: Reducing Excessive SEC Fees*, Testimony before the Subcommittee on Capital Markets, House Financial Services Committee 1 (Mar. 7, 2001), available at <http://financialservices.house.gov/media/pdf/030701ev.pdf> (“\$285 billion in assets under management”).

<sup>19</sup> See generally Bill Snyder, *Venture Capital Firm Swarming to Late-Stage Investment*, THE STREET.COM (2004), <http://www.thestreet.com/tech/billsnyder/10149100.html> (explaining that many venture capital firms are preferring to invest in last-stage investment opportunities).

<sup>20</sup> See generally John Cook, *Venture Capital: Angel Investors Guarding Money*, SEATTLEPI.COM, March 8, 2002, [http://seattlepi.nwsource.com/venture/61378\\_vc08.shtml](http://seattlepi.nwsource.com/venture/61378_vc08.shtml) (stating that companies are unable “to attract financing from early-stage angel investors and lacking the customers and revenues necessary to bring in venture capitalists.”).

<sup>21</sup> See generally Franklin Allen & Wei-ling Song, *Venture Capital and Corporate Governance*, WHARTON 18 (2002), <http://fic.wharton.upenn.edu/fic/papers/03/0305.pdf> (“It appears that governance matters for the level of venture capital activities across countries.”).

<sup>22</sup> See Lawrence M. Rausch, *Venture Capital Investment Trends in the United States and Europe*, NATIONAL SCIENCE FOUNDATION (1998), <http://www.nsf.gov/statistics/issuebrf/sib99303.htm> (stating that in 1995 and 1996, “software was far and away the most favored technology area for venture capital investments.”); see generally ALLEN & SONG *supra* note 21, at 18 (“In the US venture capital is primarily associated with high technology industries.”).

investment,<sup>23</sup> energy received a modest amount of investment,<sup>24</sup> and communications received the most investment.<sup>25</sup> One of the things that you have to understand about the venture capital industry is that as an entrepreneur your chances of raising money if you live in northern California are better than if you live in Cleveland. If you look at the percentage of money, 35.7 percent of all the venture capital deals were done in northern California.<sup>26</sup> That is a staggering amount.

The northeast followed closely, with approximately 27 percent.<sup>27</sup> The reason why the venture capital industry matured in California was due to Stanford University in the south and Berkeley University in the north. These two great learning institutions fed into the venture capital industry.

While you had the biotechnology industry emerging on the West Coast because of these great educational institutions, the same thing was happening in the northeast. The Boston area, needless to say, has a large number of major learning institutions. In order to engender venture capital, there needs to be a cooperation of learning institutions. This is where ideas and science are born.

The number of venture capital exits has changed dramatically. As a private entrepreneur, when you have taken venture capital money, you may wonder how you will exit. One way is to raise additional money the traditional way, with an initial public offering (“IPO”). This has changed dramatically because the merger and acquisition route has become the major route. As a result, the number of IPOs has not gone up; it has gone down.

And you are going to find out why. There is something that is going on in the United States that does not get much publicity; there is very little written in the press. Entrepreneurs basically do not really understand when they raise money what the exits are, and that the exits are changing dramatically.

We have a limited number of small IPOs in this country because the method of changing and financing small companies is changing dramatically. It is amazing that so few people have picked up on these changes. Companies

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<sup>23</sup> See generally Rausch, *supra* note 22 (“Medical/health-care-related companies have also attracted large amounts of venture capital.”).

<sup>24</sup> See *United States Top Target for VC Firms Worldwide*, DELOITTE & TOUCH LLP AND NATIONAL VENTURE CAPITAL ASSN. 4 (2005), <http://www.nvca.org/pdf/VC%20Survey%20PR%20FINAL%206-22-05.pdf> (“Twelve (12) percent of all VCs surveyed said they are currently focusing on investments in energy/environment.”).

<sup>25</sup> See Rausch, *supra* note 22 (stating that the telecommunications companies have “attracted large amounts of venture capital”).

<sup>26</sup> See MONEYTREE SURVEY, *supra* note 16, at 6 (“Silicon Valley continued to garner the bulk of venture capital dollars, capturing more than 35 percent of the \$7.1 billion distributed to US based companies.”).

<sup>27</sup> See *id.* (“[The] New England Region continued to show a robust market for venture activity.”).

are now doing private placements.<sup>28</sup> These private placements were marketing institutions,<sup>29</sup> and so this market is growing.<sup>30</sup>

You have had an increase in 2005 of something like 39 percent. This market raised \$27.83 billion, and that is small compared to the venture capital industry, but that is up from \$20 billion the year before. This market was almost nonexistent. There were many small companies founded by entrepreneurs who needed exits, and who were not doing the traditional IPO.<sup>31</sup> Rather, they do private investment in public entities or PIPE financing.<sup>32</sup>

These small venture capital backed companies are going one step further and doing reverse merges. Investment bankers in the United States are very creative. These bankers took these venture capital backed companies, and instead of going public through an IPO, found a shell and backed the existing company into it.<sup>33</sup> When these companies go up, you have raised PIPE money.

These new exit strategies for venture capital backed entrepreneurs have caused a huge bonanza for the legal profession. Companies like Shulte Roth have emerged as major players in the legal business. There are also major angel players who are literally unknown, like Feldman, Weinstein, Ballard and Spawn. These companies – Schulte Roth did 60 deals worth \$26 billion. As a result, many legal firms are receiving great legal fees. It also has become a new enterprising field for the legal profession.

By the same token, there are some small venture capital groups that are specialized in businesses. For example, a firm like Iroquois Capital did 117

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<sup>28</sup> See Darrell Zahorsky, *Financing Your Business by Private Placement*, ABOUT.COM, <http://sbinformation.about.com/cs/creditloans/a/prplacemt.htm> (last visited Oct. 14, 2007) (“Private placements are an attractive alternative for growing companies.”).

<sup>29</sup> See *id.* (explaining that private placements offer a private market for “business financing without the constraints of taking a company public and conceding control.”).

<sup>30</sup> See Zahorsky, *supra* note 28 (stating that private placements are an “attractive alternative”).

<sup>31</sup> See generally Jennifer Nasri, *Weekly Corporate Growth Report, Firms are Turning to Private Placements over IPOs for Funding*, THE WALL ST. J., May 22, 2000, available at [http://findarticles.com/p/articles/mi\\_qa3755/is\\_200005/ai\\_n8879800](http://findarticles.com/p/articles/mi_qa3755/is_200005/ai_n8879800) (explaining that firms are turning to private placements over IPOs for funding).

<sup>32</sup> See generally *Equity Financing Strategies for Micro-Cap and Small-Cap Publicly Traded Companies*, Friedland Capital Inc., 2 (2006), available at <http://www.friedlandcapital.com/PDFs/Equity%20Financing%20Strategies%20for%20Micro-%20and%20Small-Cap%20%20Companies.pdf> (explaining that private investment in public equities, or “PIPE” programs, is one strategy for private placement financing).

<sup>33</sup> See generally *Stocks-Reverse Mergers*, The Investment FAQ (2002), <http://invest-faq.com/articles/stock-reverse-merger.html> (describing how reverse mergers generally function).

deals last year worth \$1 million.<sup>34</sup> This has become a tremendous method of financing, and the rates of return have been substantial.

We have done a lot of medical deals, which do better in the public market, not through the local banks. These medical deals have had substantial rates of return because we were buying later stage companies at cheaper multiples than the venture capitalists further along the technological curve. For example, in Intuitive Surgical, which is a robotic method of surgery, our stock went from \$2 to \$120. These companies could not get financing in the conventional sense. In the beginning this path to financing was not crowded, so the rates of return were substantial. This has changed because there are new players. This is no longer a niche business. Mutual and venture funds are becoming involved.

We do a number of cross border energy deals. We look for Canadian companies that have expertise in the mining and energy fields and who also have U.S. properties. Using an SBIC, we are limited to companies that are either U.S. or have the majority of their assets in the United States. As a result, we back a number of Canadian companies. These small Canadian companies have a lot of expertise in either the mining or energy fields that you do not find in the United States. We were involved in 13 private placements of public companies last year, and we did two private groups.

Investment bankers have developed another method of financing, called Specialized Acquisition Companies (“SPAC”).<sup>35</sup> SPACs benefit the entrepreneur in numerous ways. SPACs are blank check companies, which the investment community has invented.<sup>36</sup> SPACs have three layers of promoters: the investment banking business; the directors and super managers who raise the money, sit on the board and guide the strategic

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<sup>34</sup> See generally Press Release, Sagient Research Systems, PlacementTracker Publishes Q3 2005 PIPE Market League Tables (Oct. 25, 2005) available at <http://www.sagientresearch.com/pt/News/PR10.25.05PTPublishesQ32005League1.htm> (“Iroquois Capital, L.P. topped the list of most active institutional investors during the third quarter of 2005.”).

<sup>35</sup> See generally Kit Roane, *Business Buffet*, U.S. NEWS & WORLD REPORT, Jan. 22, 2006, available at <http://www.usnews.com/usnews/biztech/articles/060130/30spacs.htm> (describing special purpose acquisition company); see generally Mike Bernstein, Geller & Company, *SPACs and Reverse Merger Offer Alternatives to Traditional IPOs*, FINANCE AND ACCOUNTING VIEW 1 (2006), [http://fandaview.com/archives/pdf/06Winter\\_CapitalTrends.pdf](http://fandaview.com/archives/pdf/06Winter_CapitalTrends.pdf) (“[With] the market for smaller initial public offerings relatively quiet in recent years, some companies are turning to alternatives such as Specified Purpose Acquisition Corporations (SPACs).”).

<sup>36</sup> See generally Richard Siklos, *Former Media Executives Give New Life to ‘Blank Check’ Corporations*, THE NEW YORK TIMES, April 13, 2007, at 1, available at [http://www.nytimes.com/2007/04/23/business/media/23blank.html?\\_r=2&oref=slogin&oref=slogin](http://www.nytimes.com/2007/04/23/business/media/23blank.html?_r=2&oref=slogin&oref=slogin) (describing that special purpose acquisition companies have a catch, where “investors do not actually know what their money is going to be spent on when they buy shares – hence the ‘blank check’ designation given by the Securities and Exchange Commission.”).

management of the company; and then there is the actual company that will be taken over, which is generally a small entrepreneurial company that wants to get a higher multiple for their stock.<sup>37</sup>

In 2005, SPACs raised \$1.2 billion in financing.<sup>38</sup> The prospectuses of these companies, like Cincore and Merrill Lynch, will likely double or probably triple this year. One of these deals went for \$276 million.<sup>39</sup>

Another trend in financing entrepreneurs is private equity. I am not sure what private equity really means, and I am not sure what the difference between private equity and leverage buyout is, but anyway, private equity raised \$160 billion in financing in 2005,<sup>40</sup> and \$190 billion in 2006.<sup>41</sup> The numbers are so staggering it is hard to believe. There are also leveraged buyout funds. They have raised \$197.6 billion in financing.<sup>42</sup> I am not sure what the crossover is. This is venture economics, and Money Tree combines these statistics, so the crossover is reasonably close.

How does private equity help entrepreneurs who want to exit? Well, the company is taken private, it is re-circulated, and it is sold back to the public at a higher price.<sup>43</sup> Hertz is an example.<sup>44</sup> Sooner or later this method of

<sup>37</sup> See generally Karen Richardson & Peter Lattman, *SPAC Investors are Asked to Buy In – on Faith*, THE WALL ST. J., Feb. 1, 2007, available at <http://www.post-gazette.com/pg/07032/758636-28.stm> (describing generally how special purpose acquisition companies function).

<sup>38</sup> See generally BLANK CHECK COMPANIES – AN EMERGING INVESTMENT VEHICLE, MAXIM GROUP [http://files.irwebpage.com/shipping/articles/BLANK\\_CHECK\\_COMPANIES.pdf](http://files.irwebpage.com/shipping/articles/BLANK_CHECK_COMPANIES.pdf) (last visited Oct. 14, 2007) (“2006 was the year in which the blank check market flourished, with over \$2.9 billion in 37 transactions raised, a 50% increase from 2005 with \$1.9 billion raised in 28 transactions.”).

<sup>39</sup> See generally Richardson & Lattman, *supra* note 37 (“[In] November, fruit-juice seller Jamba Juice Inc. went public on the Amex after it was purchased by Services Acquisition Corp., another SPAC, for \$265 million.”).

<sup>40</sup> See MONEYTREE SURVEY, NATIONAL VENTURE CAPITAL ASSOCIATION, PRICEWATERHOUSECOOPERS AND THOMSON FINANCIAL, PRIVATE EQUITY GOING PUBLIC 13 (2006),

[https://www.pwcmoneytree.com/MTPublic/ns/moneytree/filesource/exhibits/Global\\_PE\\_2006.pdf](https://www.pwcmoneytree.com/MTPublic/ns/moneytree/filesource/exhibits/Global_PE_2006.pdf) (“[The private equity funds] raised soared during 2005 to US\$ 160.5 billion”).

<sup>41</sup> See Brian Gormley, *Venture Capital Investment Surges In 2006 To \$25.7B*, THE WALL ST. J., Jan. 22, 2007, available at <http://www.atvcapital.com/news.php?id=460> (“[P]rivate equity funds of all types – venture capital, buyout, mezzanine, distressed debt, secondary funds, and funds of funds – raised a record total of \$215 billion in 2006, according to the Private Equity Analyst, a newsletter published by Dow Jones. Of that total, \$25 billion went into venture capital funds, the newsletter reported this month.”).

<sup>42</sup> See Shane McDaniel, *2006: Truly a Year for the Record Books*, PIPER JAFFRAY (2007), <http://www.piperjaffray.com/pdf/monitor031407.pdf> (“Accommodating debt markets were not the only factor driving LBO activity to record levels. Buyout shops raised more than \$197.6 billion in capital.”).

<sup>43</sup> See generally Grace Wong, *IPOs: Don't fear 'The Flip'*, CNN MONEY, May 16, 2006, [http://money.cnn.com/2006/05/15/markets/ipo/private\\_equity/index.htm](http://money.cnn.com/2006/05/15/markets/ipo/private_equity/index.htm) (“Private equity firms generally use their own money and borrowed funds to turnaround distressed companies. When

exiting will end, because the multiple is high. The rule generally is that, since the leverage is about five-and-a-half times to six,<sup>45</sup> you have to find the difference by some other financing. Currently, \$250 million deals are going for a domestic buyout purchase price multiple of 7.5, so the leverage is somewhat smaller.<sup>46</sup>

Entrepreneurs today can raise financing in many places. This is a seller's market. So, if you have a great company, you are golden. We have not seen this trend in a long time. There are liquidity opportunities out there. The problem sometimes is that can be extreme in either direction, so we have got to sit and hope this economy continues and that credit problems will be resolved.

#### CANADIAN SPEAKER

*David Woolford\**

MR. WOOLFORD: Good afternoon, ladies and gentlemen. I listened with interest as my friend Mr. Morton told the story about the lawyer and the farmer. I do a lot public speaking, and I normally try to dispel the widely held notion of the countless number of lawyer jokes that people always bring up. It is not true. There are only two. The rest are all true stories.

I have the benefit of not only being a lawyer but also being an investor, and I would like to approach my remarks today from that perspective. I will

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a firm has been overhauled, it's common for the investors to either sell the company to a corporate buyer or take it public.”).

<sup>44</sup> See generally Ford Completes Sale of The Hertz Corporation to Private Equity Group, PRNewswire, <http://www.prnewswire.com/cgi-bin/stories.pl?ACCT=104&STORY=/www/story/12-21-2005/0004237949&EDATE=> (last visited on Oct. 21, 2007) (stating that Ford completed a sale of Hertz to a private equity group).

<sup>45</sup> See generally Mitchell Presser, *Private Equity & Leveraged Buyouts*, 25th Annual Institute on Federal Securities (Feb. 7-9, 2007) 12-13, [www.westlegalworks.com/presentations/fedsec/presserprivate.pps](http://www.westlegalworks.com/presentations/fedsec/presserprivate.pps) (showing average debt multiples and equity contributions spanning from 1996 to 2006).

<sup>46</sup> See generally *id.* at 13 (showing that up to \$250 million-dollar deals in 2006 had 7.6 domestic buy out purchase price multiple).

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also try to bring an inspirational perspective like Mal Mixon, and then delve into and build upon, the profound remarks of Mr. Cohen.

If I can see a show of hands, who knows whom Zack Johnson is? Zack Johnson is one of the little guys. He is an entrepreneur, and he just beat Tiger Woods to win the Master's. The majority of the pro-golfers that go on the pro-tour toil in relative obscurity. They are in a constant fight in trying to secure sponsorship financing. These relatively obscure pro-golfers do not have the name recognition of Phil, Tiger, and Arnie such that everybody is jumping at the chance to be associated with it. This is true about all entrepreneurs. They do not have the money or the profile of the Intels, Ciscos, RIMs, Googles and the You Tubes of the world. These well known companies have investment bankers, merchant bankers, and traditional bankers jumping at the chance to do financing for them.

These unknown entrepreneurs have an insatiable need for capital in order to grow their businesses, in order to demonstrate traction, to gain market acceptance, to gain market approval, to penetrate the market, generate customer orders and customer sales. They have needs for continuous improvement in R & D, to continue to out perform and outpace the competition. This insatiable need can be a real chicken and egg dilemma, because they do not have the necessary organizational money, and the financiers will not finance them until they become a success. In other words, they will not finance these unknown entrepreneurs, until they actually have orders in hand, or actually have demonstrated that somebody wants to buy their product and buy it in sufficient quantities, so that the yields and returns are impressive and attractive. So, there is a fear among these entrepreneurs that they will lose everything. The constant fears are the inability to make payroll, sending the work force home, having to make payroll deductions, having to pay rent, the remittances, the statutory remittances for taxes and workers' compensation and other levies and assessments that have to be remitted to the local government. What can these entrepreneurs do? They will have to go to the landlord again with hat in hand and see what they can work out. Will the landlord take shares of the company? Another problem is not being able to meet the supplier's terms on a regular basis. So it is a real constant dilemma. It is a real constant struggle for entrepreneurs in order to be able to attract that capital.

Zack Johnson has a green jacket and he is a Master's champion. He can write his own ticket for the next ten or fifteen years, and that is what entrepreneurs in the tech and other emerging industry areas are striving towards: getting their company names known. Entrepreneurs want their companies known so that they can go out and attract sufficient capital on a regular basis to grow so that they can become the next RIM or You Tube.

I want to discuss the different types of financing, many of which are similar to the ones in the United States, but that represent opportunities at the

49th parallel for both domestic companies, U.S. companies, and other companies abroad. A couple of speakers have already touched on angel investors, so I will not go into more detail. I will note, however, that in Canada, the primary source of funding for companies that are looking for their initial seed rounds in the million-dollar range, are angels.<sup>47</sup> There are very few venture capital firms in Canada that have seed or commercialization funds.<sup>48</sup> There are a few. But when you get into the real criteria, many of them have criteria that make it not pre-revenue. It is not really startups they are interested in. The criteria constitute a risk profile allocation or assessment, and when you actually get into it, although they may publish criteria that suggests they will invest in that space, the number of opportunities or the number of instances where they actually do is a lot less than what one would initially believe.

There is also private equity venture capital, which, like in the United States, is really just a subset of private equity that focuses on a higher risk profile.<sup>49</sup> Again, there are a lot of venture capitalists. I think a comment was made earlier about the labor sponsor investment funds, and I have many of those clients and have done many deals where they have invested in clients of mine. They have represented a good source of funding for Canadian businesses over the years, but this is changing, and you are starting to see more private VC funds arise.<sup>50</sup> So, there is a proliferation of more VC funds into Canada to fill the gap.

I am glad Morton touched on the SPAC program. I am not that familiar with the SPAC program, but I will have a deal in that area soon. I have also been extensively involved in a program similar to SPAC that our venture established a few years ago called the Capital Pool Company program (“CPC”).<sup>51</sup>

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<sup>47</sup> See Expert Panel on Commercialization, Government of Canada (2006), <http://strategis.ic.gc.ca/epic/site/epc-gdc.nsf/en/tq00023e.html> (explaining that “much of the investment for early-stage firms is informal (personal savings, friends, family members and angel investors)” in Canada).

<sup>48</sup> See generally *id.* (“[The a]verage venture capital investment in a U.S. company is nearly four times that invested in a Canadian company.”).

<sup>49</sup> See generally Fraser Forum: Venture Capital: High-risk, High-return Financing, The Fraser Institute, [http://oldfraser.lexi.net/publications/forum/2000/07/section\\_04.html](http://oldfraser.lexi.net/publications/forum/2000/07/section_04.html) (explaining that venture capital is high risk, but also has high return financing).

<sup>50</sup> See generally About Garage Canada, Garage Technology Ventures Canada (2006), <http://www.garagecanada.com/about> (“One of Canada’s newest private, institutionally-backed, early-stage venture capital funds, whose close ties with Silicon Valley and other emerging global clusters provides a unique strategic perspective on business cycles, market trends, and technology that we bring to our portfolio companies.”).

<sup>51</sup> See generally Capital Pool Company Program, TSX Venture Exchange, <http://www.tsx.com/en/pdf/CPCBrochure.pdf> (last visited Oct. 16, 2007) (“The CPC program introduces investors with financial market experience to entrepreneurs whose growth and

In a CPC program, you establish a blind pool, set up a public company with a good board of directors and strong management team with a pool of capital,<sup>52</sup> and then go out and find a meritorious target company, and then you essentially do a reverse takeover and take it public on the venture exchange.<sup>53</sup> A case study is a solar tech company that we are bringing public here in Canada, which I will talk about in a minute.

Similar to in the United States, there are different types of debt financing alternatives available to entrepreneurs. Traditional debt, or bank debt, is very limited in terms of its access to most entrepreneurial companies because these companies typically do not have assets to put up as collateral.<sup>54</sup> Companies that are fortunate enough to get a credit line, it is probably in the quarter million-dollar range at the maximum, which really is quite limiting and puts further constraints on these companies and their ability to grow dramatically like the founders and entrepreneurs want to see it. There are also some venture debt players.<sup>55</sup> A client of ours, an innovation fund, has done quite well, but when you look at the profile of the businesses they invest in, the businesses are the traditional, rust bucket, bricks and mortar types. Our clients are not really investing in entrepreneurs, because these traditional businesses have a lower risk profile, and they have guaranteed returns, or as much guaranteed returns as they can.

Trade financing is available in some instances, but again, it requires the entrepreneur to have a stream of revenue.<sup>56</sup> For the companies that are ramping up in order to gain orders, gain customer acceptance, and gain demonstrable traction in the marketplace, this form of financing is typically limited.

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development-stage companies require capital and public company management expertise.”).

<sup>52</sup> See generally *id.* (“Unlike a traditional IPO, the CPC program enables seasoned directors and officers to form a “Capital Pool Company” with no assets other than cash and no commercial operations, list it on TSX Venture, and raise a pool of capital.”).

<sup>53</sup> See generally *id.* (“The CPC then uses these funds to seek out an investment opportunity in a growing business. Once the CPC has completed its ‘qualifying transaction’ and acquired an operating company which meets Exchange listing requirements, its shares continue trading as a regular listing on the Exchange.”).

<sup>54</sup> See generally Expert Panel on Commercialization, *supra* note 47 (“[M]uch of the investment for early-stage firms is informal (personal savings, friends, family members and angel investors)”).

<sup>55</sup> See generally EDC’s Invests CAD 10 Million in Venture Debt Fund to Benefit SME Exporters, Export Development Canada, (2006), [http://www.edc.ca/english/docs/news/2006/mediaroom\\_11687.htm](http://www.edc.ca/english/docs/news/2006/mediaroom_11687.htm) (describing a 10 million dollar investment “in the WF Fund III Limited Partnership, [which is] a \$125 million [venture debt] fund targeting companies in sectors with high export and growth potential.”).

<sup>56</sup> See generally Who We Are, NORTHSTAR Trade Finance, <http://www.northstar.ca/whoWeAre.php> (last visited Oct. 16, 2007) (describing a public-private partnership, “offering [trade] financing to credit worthy buyers of eligible Canadian goods and services.”).

From an equity investment point of view, I want to discuss the key integral aspects that prospective financiers – prospective investors – look for. One aspect, especially from an angel perspective, is the initial valuation of the company. As I tell most of my clients, the price has to feel good. It has to be a price that is compelling enough to cause a particular investor to write a check. If the investor is going to take a pass, it is likely not because they do not necessarily like the opportunity, like the space, or like the quality of the talent and the technology, but because over time they do not feel that they can garner returns that are sufficient enough either for their own personal investment habit or for, in the case of funds, the stakeholders who are expecting a certain rate of return.

Another aspect to look at is what other investors have taken a pass on. And there is a reason they have. Bay Street is not the size of Wall Street. It is still a fairly small community, and a lot of the groups like to co-invest. They like to syndicate their investments. They like to do that because, one, they like to share the risk allocation, and, two, they like to share and trade the benefits of the due diligence responsibilities, given the relevant strengths of each organization. If another investor has had an opportunity to invest and has passed, there is something typically wrong with the investment. There is some hair on the deal. As I say, it may be too highly priced, or maybe the management team does not have the credibility that the investment populous believes is necessary to drive that particular business, or their technology may not be attractive enough. It may also be a small-medium sized business, that is not going to garner sufficient returns to attract the excitement of people with money, both in the private equity and public markets. We have seen that with You Tube, and some of the companies that Nortel and Cisco have bought, that these companies have home run potentials in terms of multiples. Well, these are getting multiples of 10, 30, 50, a hundred times; it is tremendous.

There is proliferation in the Valley. The old Internet and web 2.0 funders, including the Sun Microsystems founders, are all into huge clean tech funds with money flowing into the solar technology and wind technology.<sup>57</sup> Money is flowing into environmental issues and biodiesel. A lot of the alternative fuel and alternative energy sectors are attracting considerable interest and, as we heard some comments earlier about, responsibilities. There are many

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<sup>57</sup> See generally ERIC MARTINOT, RENEWABLES, GLOBAL STATUS REPORT (2005), available at <http://www.worldwatch.org/brain/media/pdf/pubs/ren21/ren21-2.pdf> (“About \$30 billion was invested in renewable energy worldwide in 2004.... The fastest growing energy technology in the world is grid-connected solar photovoltaic (PV), which grew in existing capacity by 60 percent per year from 2000–2004, to cover more than 400,000 rooftops in Japan, Germany, and the United States. Second is wind power capacity, which grew by 28 percent per year, led by Germany, with almost 17 GW installed as of 2004.”).

corporations that are striving, especially in the more traditional businesses, to modify their businesses in a way to demonstrate that they are doing things to help the environment. Certainly, in the emerging, and in the entrepreneurial area, there are some tremendous opportunities both for the entrepreneurs and for the financiers in making investments in these environmental areas.

At this point, I would like to turn to a case study of one company that I have been involved in and of which I am the chairman. Virox is a company I established with a friend of mine who was a senior executive at Bausch & Lomb. Together, we raised a million dollars in love money, or family angel financing, as I heard somebody refer to it earlier.

You cannot pickup the paper, or listen to the news these days, without hearing about another threat of the pandemics. For instance, the bird flu or the avian flu – there is always news about another outbreak in the Middle East or another outbreak in Britain. Virox has an accelerated hydrogen peroxide program.<sup>58</sup> It is the technology of choice on most cruise ships worldwide, to fight the Norwalk virus, which many or all of you have heard about.<sup>59</sup> Think back two years ago with the SARs epidemic in Ontario. The accelerated hydrogen peroxide technology was exclusively recommended by the Ontario Government,<sup>60</sup> which is unheard of. Governments never, certainly not in our country, recommend a particular product. Usually, there will be a suite of products or family of products that is recommended. But because Virox is unique and has the only accelerated hydrogen peroxide technology out there, the Government of Ontario put in a million dollar order to outfit every worker on their ambulances and in their hospitals and daycare facilities when the SARS outbreak was at its zenith.<sup>61</sup> In the fall of 2006,

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<sup>58</sup> See Virox Technologies Inc., <http://www.virox.com/> (last visited Oct. 16, 2007) (“Virox Technologies Inc. has pioneered the broader acceptance of Hydrogen Peroxide based products with a patented technology known as Accelerated Hydrogen Peroxide (AHP). AHP is a synergistic blend of commonly used, safe ingredients that when combined with low levels of hydrogen peroxide produce exceptional potency as a germicide and performance as a cleaner.”).

<sup>59</sup> See generally Susan Candiotti, *Sailing the Sickening Seas*, CNN.COM, Dec. 2, 2002, <http://archives.cnn.com/2002/TRAVEL/12/02/sick.ships.wrap/> (“The Norwalk virus is one of the most common causes of gastrointestinal illness and tends to strike people in confined spaces.... Outbreaks occur regularly on land and cruise ship outbreaks occur several times a year...”).

<sup>60</sup> See Memorandum from Malcolm Bates, Director, Emergency Health Services Branch to Municipal EMS Directors and Managers (March 27, 2003) available at [http://www.virox.com/pdf/MinistryofHealthSARS\\_Vers1\\_1.pdf](http://www.virox.com/pdf/MinistryofHealthSARS_Vers1_1.pdf) (“Following the transport of a patient with suspected SARS, EMAs and Paramedics must decontaminate the vehicle, stretcher and any equipment used during the call. It is recommended that Virox-5TM, an accelerated hydrogen peroxide base formulation, be used as the disinfectant of choice for this purpose.”).

<sup>61</sup> See generally Kate MacNamara, *Germicide Maker: Virox, Winning in the Battle Against SARS*, NAT'L POST, Apr. 7, 2003, available at [http://www.virox.com/outbreaks/04\\_07\\_03.asp](http://www.virox.com/outbreaks/04_07_03.asp)

Virox won the prestigious Canadian-American Business Achievement Award in partnership with their largest trading partner and strategic investors, JohnsonDiversey, Inc., out of Wisconsin.<sup>62</sup>

You may be more familiar with their retail sister company, S.E. Johnson. S.E. Johnson has a host of retail products, and they have been a team strategic partner and investor of Virox since 2001.<sup>63</sup> I do not have a Robert Frost poem like Mal Mixon had, but I want to make my last point with a statement from the President and CEO of Virox, which is, “For entrepreneurs, stay the course. Don’t get off focus.” Entrepreneurs try to be too many things to too many people. Know your core competencies. Virox’s core competency is something I have already described and it is a pretty compelling mission statement. Infection control is at the heart of everybody these days and Virox could have done many other things. However, this is what Virox chose to do, and it has been a huge success.

There have been some worldwide partnerships that Virox has developed. As I mentioned Steris is in the high level – the endoscopes and the emergency cardiac wards of many hospitals.

Virox early on was the first foreign operation that received EPA approval for an Anthrax technology during the bioterrorism postal system problems.<sup>64</sup> It was a spray that was developed to be used throughout the U. S. Postal system to help deal with the pandemic.<sup>65</sup>

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(“[W]ith the outbreak of severe acute respiratory syndrome, or SARS, reaching crisis levels in Toronto, the firm’s disinfecting wipes are fast becoming a must-have commodity. Orders at the Mississauga, Ont.-based firm have more than doubled over the past couple of weeks as a result of the deadly new strain of pneumonia.”).

<sup>62</sup> See *Canada-US Partnership a “Clean” Sweep for 2006 Business Achievement Award*, CANADIAN NEWSWIRE, Oct. 23, 2006, <http://www.newswire.ca/en/releases/archive/October2006/23/c3426.html> (“The Canadian American Business Council... has selected Virox Technologies Inc., of Oakville, Ont., and JohnsonDiversey Inc., of Sturtevant, Wisconsin to be awarded the prestigious Business Achievement Award for their collaboration in developing and distributing, a safe and environmentally friendly hydrogen peroxide-based disinfectant.”).

<sup>63</sup> See Press Release, Virox, Johnson Wax Professional Becomes Global Leader in Accelerated Hydrogen Peroxide Technology (June 13, 2001), [http://www.virox.com/news/06\\_13\\_01.asp](http://www.virox.com/news/06_13_01.asp) (“Johnson Wax Professional has acquired the exclusive rights in the I & I market to the Accelerated Hydrogen Peroxide (AHP) technology. Additionally, it intends to purchase a minority stake in the Canadian company that invented it, Virox Technologies Inc., developing a relationship that will eventually bring the use of AHP across the globe.”).

<sup>64</sup> See Memorandum from Marianne Lamont Horinko, Assistant Administrator, Office of Solid Waste and Emergency Response to Stephen L. Johnson, Assistant Administrator, Office of Prevention, Pesticides and Toxic Substances (Jun. 25, 2002), *available at* <http://www.virox.com/pdf/JohnsonWaxCrisisExemption.pdf> (authorizing exemption and describing conditions).

<sup>65</sup> See *generally id.* (describing use of the spray by the United States Postal Service).

Time is kind of tight, so I will quickly run through my remaining slides, but I thought this slide would be of particular relevance and of interest to the entrepreneurs in the crowd. This slide sets out a chronology of how Virox has grown in terms of funding.<sup>66</sup> As I mentioned, in July of 1998, we put together a million-dollar seed round.<sup>67</sup> We had to bulk up that seed, with a rights offering a year later. We secured some bank financing, but again, it was more in the quarter million range. So it was not that significant to grow the company. One of the elements that was very significant was that we entered into these various partnership arrangements, including R & D contracts, and it was integral for the large partners, whether it was the Pharmas or the JohnsonDiverseys or the other partners. These large partners had to fund the research, the tailoring of our crown jewels into applications that were going to fit into their particular industry and into their distribution and food chain. We also did a funding round in D.C. in May 1999, which amounted to \$2.5 million.<sup>68</sup> We also entered into the big alliance with JohnsonDiversey in 2000.<sup>69</sup> Then Virox turned the corner, and started generating pretax flow, started to significantly enhance the bottom line so much so that in the last couple of years, we bought out all the seed investors and our venture capitalists, which is a unique story. You do not hear about many tech companies that can do that. This year Virox is trending towards close to \$17 - \$18 million on the top line, and \$6 or \$7 million on the bottom line. The margins are significant because 90 percent of the product is water. And the arrangement with Steris has not been completed yet. They are in the middle of the throws of their FDA submissions.

The EPA registrations have started to come through with JohnsonDiversey. Most of these figures in Canada and Europe and the Far East do not even include the biggest market in the world. To give you a quick idea of how the valuations have shot up, if there were a 2007 bar graph, the

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<sup>66</sup> See David Woolford, "Private Financing of Entrepreneurships: The Ongoing Challenges" – Comparative Legal Aspects of Entrepreneurship in Canada and the United States, [http://cusli.org/conferences/annual/presentations/4WOOLFORD\\_\\_PrivateFinancingbyEntrepreneurships\\_Apr1207.PPT](http://cusli.org/conferences/annual/presentations/4WOOLFORD__PrivateFinancingbyEntrepreneurships_Apr1207.PPT) (last visited Nov. 7, 2007); see also Morton A. Cohen, Private Financing of Entrepreneurships: Sources of Private Financing, [http://cusli.org/conferences/annual/presentations/4\\_COHEN\\_\\_\\_Private\\_Financing\\_of\\_Entrepreneurships.ppt](http://cusli.org/conferences/annual/presentations/4_COHEN___Private_Financing_of_Entrepreneurships.ppt) (last visited Nov. 7, 2007).

<sup>67</sup> See generally MacNamara, *supra* note 61 ("In 1998 [Mr. Pilon] was a vice-president for eye care giant Bausch & Lomb Canada. Long a 'thwarted entrepreneur,' a lawyer contact put him in touch with local chemist, Michael Rochon. Mr. Rochon had a formula for accelerating the germ killing action of hydrogen peroxide but no business plan. Mr. Pilon conceived a plan, and bought Mr. Rochon's firm, M&R Chemical. On the strength of Mr. Rochon's formula, Mr. Pilon cobbled together \$3-million in seed money.").

<sup>68</sup> See generally *id.* (describing total seed money obtained).

<sup>69</sup> See *id.* ("JohnsonDiversity [sic] even took a 10% equity stake in the company.").

bar would be much higher than the value of the seed shareholders and venture capitalists a couple years ago.

I will quickly touch on equity investments. The main agreements are subscription agreements. We set out the deal terms, the representations and warranties – which should be a full spectrum of the due diligence – and we set out the various remedies. We heard speakers talk earlier about limitations and baskets, and those are the things you want to make sure you have an experienced lawyer to talk to about. In a shareholder agreement, it is important to put in things to deal with preemptive rights, anti-dilution or full ratchets, and drag-along, tag-along, piggyback, board provisions.

This is the essence of what I do and the essence of the legal practice surrounding equity investments in private companies. It is important, as an entrepreneur, to make sure that you have experienced counsel, not just a lawyer who is very good in what he or she does, but one that knows the industry, because there are a lot of unique elements to venture capital investing and entrepreneurships. So, if the lawyer does not play, day in and day out, in the industry, then the lawyer will not be able to properly counsel the client.

There are pros and cons in going public. Virox is a keen example where we set up and operate like a public company already – compensation committees, governance committees, audit committees, and regular reporting to stakeholders and to banks. We have a data room that impresses investment bankers and other prospective partners.

I mentioned the CPC program. I will quickly touch on it. We just announced a press release last week. We are bringing the first non-North American, non-resource issuer to go public on the Toronto Stock Venture Exchange.<sup>70</sup> It is a German solar tech company.<sup>71</sup> Germany is universally regarded as the world leader along with Japan.<sup>72</sup> I've visited several times now. Almost every second home, barn, and commercial facility has solar panels. It is a green environment. This is a testament to the quality of the

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<sup>70</sup> See generally MarketWire News Releases, *Eminence Capital I Inc. Announces Executed Letter Agreement*, HOUS. CHRON., Apr. 5, 2007, <http://markets.chron.com/chron?GUID=1662999&Page=MediaViewer&Ticker=ECI> (describing plans to list a German solar power company on the Toronto Stock Venture Exchange).

<sup>71</sup> See generally *id.* (describing plans to list a German solar power company on the Toronto Stock Venture Exchange).

<sup>72</sup> See generally Robert Collier, *Germany Shines a Beam on the Future of Energy*, SAN FRANCISCO CHRON., Dec. 20, 2004, <http://www.sfgate.com/cgi-bin/article.cgi?file=/c/a/2004/12/20/MNGRAAEL4B1.DTL> (describing Germany as “the No. 1 world producer of wind energy, with more than 16,000 windmills generating 39 percent of the world total, and it is fast closing in on Japan for the lead in solar power.”).

program – here is a world leading company that is a real success in its own backyard coming to North America to establish operations here.

We see daily in the papers about wanting to establish solar parts. The LPA and government have brought in new incentive programs to help us establish solar technology.<sup>73</sup> It bodes well and provides for some opportunities cross-border between Canada-U.S. We are bringing this world-class technology from another jurisdiction, into North America, while at the same time going public and having access to the public markets here.

#### DISCUSSION FOLLOWING THE REMARKS OF MORTON A. COHEN AND DAVID WOOLFORD

MR. ROBINSON: Well, Henry and everybody else will be pleased to know that we have 22 and-a-half minutes left for questions, which is terrific. I would just like to say one thing before we do questions.

MR. WOOLFORD: Let me just ask one thing about SPACs. I recall, and maybe it was more than five, ten years ago, there was a similar type of program in the U.S., which initially garnered a lot of interest, but then I think it garnered some bad press as well. Either they were not making a lot of investments or the investments they were making were less than sterile quality and caused a lot of dissatisfaction, or caused the program to run into a lot of lack of interest because of that.

MR. COHEN: I will go back to my initial statement – that investment bankers in this country are extremely creative. They have come up with a different structure, which precludes these blank check companies from just making any old acquisition. The way this thing works is that the money is raised on certain conditions. One of those conditions is that 85 percent of the funds go into escrow, at which point you have 18 months to make an acquisition, supposedly within the domain of your prospectus. If 80 percent of the shareholders vote against this, they cannot approve the acquisition. If somebody wants to get their money out after the 18 months, they can get their money out of that program, minus the 15 percent that the investment bankers get.

So the structure is different, and it is supposed to be more protective. There are also warranties that go into these deals, and interestingly enough, the warranties are at the issue price and sometimes less than the issue price. It is not all worked out.

MR. ROBINSON: Dr. Barber had the first question, I believe.

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<sup>73</sup> See generally Government Incentives, The Canadian Solar Industries Association, <http://www.cansia.ca/government.asp> (last visited Oct. 16, 2007) (describing Canadian Federal, Provincial and Municipal incentives for the installation of solar technology).

DR. BARBER: David, help me understand why the venture capitalists in Virox would want to get out of such a successful story?

MR. WOOLFORD: That is a very good question, Doug. And the fact is that they did not want to get out. I was with a company called Canadian General Capital, a very successful company, much more so in the larger investments. We were the only investment in their microcap that actually made money, and they invested about \$2.5 million, and we returned about \$5.6 million. So, the venture capitalists did well from 2000 to 2005, but they had two main stakeholders: The Power Pension Fund and the Hydropension Fund and HOPF, the Hospital Pension Fund. And when the power generation facility in Ontario split into three, they essentially disbanded the source of funding for this particular venture capital fund and were ordered, over a span of two or three years to liquidate the funds.

So, Virox was the venture capitalists' last investment, and they would have loved to have held on, but it was not large enough for the pension funds. Either it would have been split 50-50 and then distributed right to the funds, or as we wanted to do, have a buyout. This was a good question, because if they were still around, I am sure they would still want to be in as an investor.

They did not have any rights, which was quite unique, but at the same time, we could only buy them out if they agreed to our price. It was a good return for them, and since they were in liquidation mode, they let us in.

MS. LILLEY: This is a question for Mr. Cohen. I wondered if you had a view as to the structure auction market that the investment bankers seem to have created, as well as some of the other things you created.

MR. COHEN: That is a product I really don't know that much about. And I really do not want to comment because I have not been involved in it. What I wanted to touch on, because I think it is interesting, is that we have another development in the American scene. We have these Chinese companies going public in the United States by using a shell vehicle and becoming a U.S. company where the stock is only traded in the United States.

Similarly, in Canada, you have many Chinese companies that are now traded only in Canada and have become Canadian companies. I do not know what this does to entrepreneurs in the United States and Canada. I will say that it diverts money out from an entrepreneurial company here to the Chinese companies.

This market is really growing. I am going to China in four weeks, and I believe that the number of companies that you are seeing in Canada are the smaller kind, and in China they are getting larger companies.

MR. WOOLFORD: I have been working, as I mentioned, on a program to bring companies from Germany public in Canada for the last two years. The real driving force is the international banking accord that many of the

European countries entered into, called Basel II,<sup>74</sup> in the last year or two, which significantly restricts access to capital in German companies unless they are public.<sup>75</sup> The problem is that the only exchange that is worthy to note in Germany is the Frankfurt Exchange, and you essentially have to be a company that has a market capital of \$1 hundred million Euros or above in order to be able to garner interest and go public on that exchange.

By taking them public on the Venture Exchange in Canada, you can apply for an inter-listing on the Frankfurt Exchange and secure it that way without having to meet the significant monetary criteria that many or most of those companies can't meet and will never be able to meet. So it is a very attractive feature that way.

MR. ROBINSON: Why do they not list on the AIM in London?

MR. WOOLFORD: The AIM is probably the largest competitor to the Venture Exchange. The AIM is at least three times more expensive and has been fraught with some problems. There have been some success stories. Sandvine Waterloo, which was a spin-off from Pick Stream, sold out to Cisco at a hugely significant multiple in the half billion-dollar range, they went public on the AIM about 12, 18 months ago.<sup>76</sup> They had \$15 million on the top line, and a \$3 million loss on the bottom line the first day, and their market was doubled.<sup>77</sup> They have recently started taking off again, and they are starting to get significant traction in the marketplace.

I was trying to steer our chief officer to at least consider AIM for Virox, but he does not want to be a public company. We believe our exit will be through our strategic partners. AIM was garnering significant interest and some significant multiples, and I was telling management of Virox to at least explore it because it could represent some considerable liquidity. But, the chief officer just has no interest in being a public company.

MR. ROBINSON: Well, if there is no hand up for a moment, I will just make a brief comment about the AIM. Our office does quite a bit of work in the mining game, and we find a lot of our mining clients - Canadian mining clients - who would seemingly be interested in the Toronto listing, which

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<sup>74</sup> See generally Basel II: Revised International Capital Framework, Bank for International Settlements, <http://www.bis.org/publ/bcbsca.htm> (last visited Oct. 16, 2007) (describing the framework of Basel II).

<sup>75</sup> See generally Basel II: International Convergence of Capital Measurement and Capital Standards, Bank for International Settlements (2004), <http://www.bis.org/publ/bcbs107a.pdf> (establishing higher risk ratings for corporations that are not public).

<sup>76</sup> See generally About Sandvine, Sandvine Inc., [http://www.sandvine.com/about\\_us/default.asp](http://www.sandvine.com/about_us/default.asp) (last visited October 16, 2007) (describing Sandvine's listing on the Toronto Stock Exchange ("TSX") and London Stock Exchange "AIM").

<sup>77</sup> See generally Stock Market Quotes: Sandvine Corporation, TSX Group, <http://www.tsx.com/> (enter "SVC" in Get Quote box) (last visited Oct. 16, 2007) (showing performance of Sandvine stock since its listing in October 2006).

traditionally was one of the best exchanges in the world for mining companies. Rather, they wanted to list on the AIM. So we have to do a joint venture with an AIM expert.

MR. WOOLFORD: I would love to have that capability in-house to advise our clients to consider a venture exchange or another listing, but as I said, I have not had anybody that wanted to explore that option. I think it is a tremendous competitive advantage for your firm and it certainly shows a lot of foresight.

MR. ROBINSON: They have that wonderful tradition in England where they have regular principles, the main principle being if you do not behave, you will not be spoken to at the club.

MR. WOOLFORD: One of our CPC clients from Montreal has a really neat idea. There is a lot of technology being developed these days in waste management systems, particularly the systems that apply significant amounts of heat to change the waste, whether it be energy or other types of materials, in order to re-circulate it back into the environment. This client had an abortive, and a very distressing experience with the AIM, and it has cost them \$900,000, and they are just starting to return from it. I am not sure if they had the best banking advice on the investment side, and perhaps were a bit naive in some other things. Nevertheless, it is like trying to take a company out and doing a full blown IPO, whether it be in Canada or the U.S., and then finding out that either the story was not well received or market conditions changed, and you are faced with significant dollars.

That is where something like the CPC program or the SPAC program has a lot of advantages that can dispel, or temper, those negatives.

MS. LUSENBURG: Some of the comments this morning about socially responsible investing and ethics in the context of the entrepreneurial community, I think it was Doug Barber that said the cost of governance, legal barriers, or compliance is significant when you are small operations. That is a problem. You do not have time for a lot of lawyers and people running around putting the right structures in place. So you are perceived to be under the coalition of good governance and it is an issue that increasingly comes forward. Do you have good principles, ethics? When you are an entrepreneur, a little guy, how do you deal with that, and with your clients? How do you bring that to the point of maturing? They have the right process but do not have the luxury or the vigor to do what they want. They are in a Catch-22 because you may not be attractive, and from my perspective, we do not do a lot of venture fund investing, but those are issues we look at. How do you get them there?

MR. COHEN: I could answer, but quite briefly and I am sure if it was addressed, I think the major thing that they are looking at is management. I do not quite agree with Mal Mixon. You have to look at the management and look at the integrity of management, and you have to decide whether it has a

social conscience. Can you make management have social conscience? That depends on the board of directors. I think the end result is that you will have a responsible management and entity.

MR. WOOLFORD: I would add from a professional advisory perspective that you can if you are prepared to put in the time. It is certainly a hallmark of my practice to help coach and advise these companies, whether I am an advisory board member or board member, I am spending a lot of time – beyond billable hours – and generating considerable legal fees, so the return is more than rewarding, because I believe in these companies, and many of them have turned out to be very good success stories. You really have to invest in the relationship, even if it means using your own personal time.

Picking up on the point that Morton mentioned, if you are dealing with a company that has management with unquestionable integrity, sound management, good strategic vision, and for which you cannot guarantee a rate of success of more than 50 percent. They will be a success, then you can distill those values, and you can work with them and spend the time and help make that part of the culture. You are not sort of docketing and charging them for all that because you are essentially enhancing your own client base as well.

MS. DOBREA: Question for David, what was the origin of the technology for your Virox company? What role did intellectual property play, particularly patent, if any?

MR. WOOLFORD: That's a very good question, and it is actually a very interesting and somewhat anxiety-ridden story. I first met the mad scientist. He is no longer with the company, but on the venture capital round, he and his wife got \$500,000 paid to them, which is almost unheard of, so it was a good deal. Over the course, they received more than a million dollars so they did quite well. I first met him through a contact at the Royal Bank, and he had heard that a fellow had few hundred thousand dollars on deposit. The company must be doing pretty well. You should go talk to him about being a client.

When the banker first went to see him, he hated bankers, and when I first went to see him, he hated lawyers. It took many greasy spoon restaurants and breakfasts and many conversations to get into his comfort zone, and then he said he was being courted by a group that he called the piranhas that wanted to buy him out, and ultimately, I introduced him to Randy, and he took a shine to Randy.

Randy wrote a business plan, and then the three of us got together, and we received a million dollars. Life was good, and we went to the venture capital financing and got him a half million dollars, and he was going to be the chief science officer. No sooner had the ink dried and the deal closed – all of a sudden he decided he wanted to run the company again and did not care what

the agreement said and basically wanted his gas card back. We had some interesting issues and had to ultimately iron them out.

Coming back to your question, he would not let anybody see the technology. In retrospect, we should have gotten access to the technology and done a technological assessment, but other than to show Randy all we had was four or five patents and several in the hopper. It was like your grandma's favorite muffin mix, and you had four, five, or six different ingredients, all of which you could go to your kitchen or anybody's kitchen, and you would all have those ingredients. It was unique, because of the way they were mixed and matched and how they were applied and at what temperatures. We think that he just fell on it. We were mortified because there was a paper that was published in a journal that looked like it came out about the same time that we first applied for the patent. We had to go to the publisher, and we had to get evidence and affidavits with the actual time issues. You know, the typical way the press comes out, they will say January of 2007, but the thing actually was December something, and it became really critical.

The other reason we think he just happened on it is because there is a group in Ontario called Ortech, which was a government funded research development agency. At this agency you could bring certain products, and you could get subsidized testing. This guy was a mad entrepreneur because he wanted to develop a liquid detergent that could compete against Tide. They priced it out and figured it was \$25,000. A few weeks into the test, they called him up and said we have done half the test and your product has failed miserably against Tide, and did he want them to continue. He decided not to continue, but he was just the kind that would tinker, and we think that ultimately he arrived at something, which spawned into a multi-billion dollar business.

It is a goodwill story, but when I look back at it and look at the risk profile, that if we were not able to secure the patent or if it turned out he had pilfered some of those ingredients, we could be out of business and would have been out a lot of investment money. It worked out for the best, but when you look back and say should I, as a lawyer, have done something differently, he never would have allowed us in. Had we not insisted upon that, we never would have done the deal. We would have walked and done something else.

I think it was lockup with Mal. There is some luck involved, but certainly since then, there has been a lot of value and top notch management and direction.

MR. COHEN: I have a question for the panel. One is, I do not think, and it has not been mentioned, what are the status of flow-through shares and flow-through vehicles available in Canada?

MR. ROBINSON: They are still around.

MR. COHEN: The second thing is, maybe with Canada, is the immigration policy. It has now been the source of a lot of creativity in entrepreneurship, and it is distinct from policies that we are not developing.

MR. WOOLFORD: Michael, you are the most esteemed member on our panel, so I will turn to you quickly on this question.

MR. ROBINSON: Quickly then, as you know, we do not have immigration quotas. We have a point system that is based on a number of things, including language skills, educational levels and ability to contribute, et cetera.

We do find that we are getting good quality immigrants. When Selma and I were practicing together years ago, a wonderful Russian immigrant – who, in effect, invented liquid ice – allowed certain prospective partners to come in and look at the technology. They all signed non-disclosure agreements, and then we found that they had taken out 14 patents in Japan based on his stuff. Fortunately, we caught them, and they agreed to assign the patents back.

Obviously, this can be a huge problem unless you have your patent base registered all over the world. This was a Japanese partner, and he did not register in Japan, and they just scooped him.

To answer the first question, flow-throughs are still around. I am certainly not a tax lawyer, but I know that people are trying to sell them to me all through December. It is like a trust or a partnership where the profits all flow directly to the investor, the shareholder. They are usually accompanied by wonderful incentives, in order to stimulate mining exploration, oil, gas in the far north. It was good in the old days but not so much any more.

MR. COHEN: Well they get a better tax break.

MR. ROBINSON: Oh, yeah, sure.

MR. COHEN: That is the incentive.

MR. ROBINSON: What occurs is that the government subsidy flows directly through to you as the shareholder so you could invest \$10,000 and get a \$12,000 tax write-off.

MR. WOOLFORD: One last comment around this German company, the solar tech company, although the volumes are not big enough yet, but with the Kyoto Accord and the carbon credits, we have been looking strategically and possibly a flow-through investment that includes the share and portion of the carbon credit that this company can develop.

MR. ROBINSON: Great idea. Sell them in China. Thank you very much panelists.



GOVERNMENT ASSISTANCE TO ENTREPRENEURSHIPS: ON  
LOCAL, STATE/PROVINCIAL, AND FEDERAL LEVELS

*Session Chair – Ron A. Straatsma*  
*Canadian Speaker – John Connell*  
*United States Speaker – Gilbert B. Goldberg*

INTRODUCTION

*Ron A. Straatsma*

MR. STRAATSMA: Well, good afternoon, everyone. My name is Ron Straatsma, and I will be your moderator for Session 5.

I am the Managing Director of the State of Ohio's Canadian Office based in Toronto, and for your information, you may note that the State of Ohio operates eleven international offices with Canada, being officially opened way back in 1990 at the advent of the original Canada-U.S. Trade Agreement. This afternoon we are featuring our panel on government assistance to entrepreneurships, talking about government supported – various levels of support from government, and today we have two speakers to help us go through that process.

The first speaker is Mr. Gilbert Goldberg, who is the director of the U.S. Small Business Administration, Cleveland District Office, locally based. As the District Director, Gilbert is responsible for the administration of a business portfolio of some 6,400 loans with a total book value of some \$604 million.

He has oversight of the Ohio Small Business Development Center and seventeen sub-centers and the coordination of five chapters of SCORE, which is a volunteer organization that provides free business counseling. Gil also serves as national SBA representative under the agency's lender liaison program for Key Bank and National City Bank.

And since his appointment as District Director in 1994, the office has focused its attention on putting the customer first and reducing red tape. In terms of the results of that, the bottom line focus on the customer has enabled Gil's office to outpace the nation in loan growth, and it did so over the last five years.

The District in 1999 also developed a campaign that enabled it to achieve record loan growth for minority-owned entrepreneurs, and in 2000 the Cleveland District Office developed a unique initiative for the economic revitalization for the City of Youngstown and did so by combining SBA resources, Project Sector Banking in the City of Youngstown.

Before coming to the SBA as District Director back in 1994, Mr. Goldberg spent 20 years in commercial banking of which the last ten were devoted to mid-market and entrepreneurial business development in Northern Ohio. He holds a Bachelor's Degree in Foreign Service from Georgetown University and Master's Degree in Business Administration from the University of Notre Dame, and he resides in Shaker Heights. So, Gil?

#### UNITED STATES SPEAKER

*Gilbert B. Goldberg\**

MR. GOLDBERG: Thank you, Ron, for the introduction. I don't have a Power Point presentation today. I will just come up here and talk a little bit if you don't mind. If you are wondering why I don't have a Power Point presentation, I don't believe in Power Point presentations. I was supposed to go second, and the other panel member came up to me and said "Gil, would you mind if you go first? We can't find my Power Point." Now you know why I don't believe in Power Point presentations.

I will try to make this as interactive and dynamic as possible, even though we don't have a Power Point.

One of the things I was wondering is why Henry King called me and said "Gil, can you be on this panel for the Canada-United States Law Institute?" And I thought maybe he was interested in my son who is an attorney in New York rather than myself, and then I started to look through the sessions for

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\* As District Director, Gil Goldberg is responsible for directing the activities of 11 permanent SBA employees; the administration of a business portfolio of over 6,400 individual loans for a total of more than \$604 million; oversight of the Ohio Small Business Development Center and 17 sub-centers; and the coordination for five chapters of SCORE, a volunteer organization that provides free business counseling. He is also responsible for the marketing efforts of the two SBA sponsored micro-lenders in the District as well as the delivery and oversight of the Agency's 8(a), SDB, and HUBZone government contracting programs for small business. Gil also serves as the National SBA representative under the Agency's Lender Liaison Program for Key Bank and National City Bank. In addition, he was a member of the Agency's Goals Team for four years. Before coming to the SBA in 1994, Mr. Goldberg spent 20 years in commercial banking. Mr. Goldberg holds a bachelor's degree in Foreign Service from Georgetown University and a master's degree in Business Administration from the University of Notre Dame.

today, and I saw “Session 1: The Importance of Entrepreneurship to Economic Growth,” “Session 2: Creating Entrepreneurships,” “Session 4: Financing Entrepreneurships” and so on. All the sessions had the word “entrepreneurship” in it, and I thought to myself that’s why we are here. You can’t think of entrepreneurship in the United States without thinking of the United States Small Business Administration and our programs.

Basically, we have four programs that entrepreneurs can use, and you in the room can also take advantage of, whether you are an entrepreneur, a lawyer, an accountant or advisor. I think our programs are something that can bring value to a small business. I will give you a quick little overview first.

Our first program, the program most people think about, is our loan program. We have two loan programs, 7(a) and 504 that provides funding to businesses.<sup>1</sup> On the panel before I came up to the podium to speak, I heard somebody say it is really hard to get financing because a lot of these startups lack hard assets.

Well, if you look at our programs, hard assets are not a requirement. Cash flow is a requirement. We think that Uncle Sam’s guarantee substitutes for the lack of hard asset – or even the soft asset. We look for cash flow, and if the cash flow is there and the asset is not, theoretically, you can get funding under our program to start your business.

There is another program we have to help businesses once they get in business: government contracting – contracting for small business.<sup>2</sup> We facilitate small business access to government procurement officers in every department and agency of the United States Government.<sup>3</sup>

And right now, the segment of government procurement that is devoted for small business by law or presidential proclamation is \$300 billion annually.<sup>4</sup> That’s a lot of money. And we will help you get the right contacts.

The third program we have is technical assistance.<sup>5</sup> That’s providing business plan assistance, marketing assistance, and problem solving assistance to any business that needs it. It is done gratis.<sup>6</sup> It is done through

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<sup>1</sup> Small Business Administration, <http://www.sba.gov/services/financialassistance/sbaloantopics/cdc504/index.html> (last visited Sept. 23, 2007).

<sup>2</sup> Small Business Administration, <http://www.sba.gov/services/contractingopportunities/basics/buys/index.html> (last visited (Sept. 23, 2007).

<sup>3</sup> *See id.*

<sup>4</sup> News Release, Richmond District Office of the U.S. Small Business Administration, The U.S. Small Business Administration and Mt. Gilead International Ministries to Conduct a Symposium for Small Business Owners (Sept. 7, 2007), *available at* [http://www.sba.gov/idc/groups/public/documents/va\\_do\\_files/va\\_october20\\_symposium.pdf](http://www.sba.gov/idc/groups/public/documents/va_do_files/va_october20_symposium.pdf) [hereinafter News Release, Richmond].

<sup>5</sup> *See* Small Business Administration, <http://www.sba.gov/services/training/onlinecourses/index.html> (last visited Sept. 23, 2007).

<sup>6</sup> *Id.*

our Small Business Development Centers around the state and also around the nation. It is also done through the Service Core of Retired Executives – which again is available to the entrepreneur free, individuals that actually have business experience in any given area.

And then our fourth area – which lot of VCs that are very familiar with permitting the SBA to fund Small Business Investment Company. We fund venture funds that specifically invest in small business.<sup>7</sup> Basically they make the decision on our behalf. They basically make the investment in the small business, and we take the risk with them.

Sometimes we win, and sometimes we lose on situations like that. But right now I would like to get back to one of our programs, and that's our lending program. Nationwide this year – we are about half way through our fiscal year (our fiscal year began October 1, so we are just a little over half way through our fiscal year) – if you analyze the data, the loan data, we will probably make over 110,000 loans nationwide<sup>8</sup> (or guarantee because we don't actually make them – the banks make them, and we guarantee them).

So, there are 110,000 nationwide loans this year and there will probably be about \$15 billion.<sup>9</sup> That's a lot of money to fund small business. Typically, about 20 to 25 percent of those 110,000 loans go to startups.<sup>10</sup>

These startups can be businesses that have just started in business or have been in business for two years because our definition right now is that any business that is two years or less we consider a startup or new business. So in that 25 percent of startup loans could be someone that has been in business six months or up to two years. That definition was changed probably about ten years ago.

Before that, before – let's say 1997 – we defined startups as true startups, someone who had never been in business before. And I have a question for everyone here in the group. Going back, if you look at the true startup, someone who has never been in business before, not someone who has been in business six months or two years, what do you think their success rate is? You people out there that work with startup companies, put money into startup businesses, new businesses, what do you think their success rate is?

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<sup>7</sup> Small Business Administration, [http://www.sba.gov/smallbusinessplanner/start/financestartup/SERV\\_FINANBASICS.html](http://www.sba.gov/smallbusinessplanner/start/financestartup/SERV_FINANBASICS.html) (last visited Sept. 23, 2007).

<sup>8</sup> *See generally* FY 2007, Budget of the United States Government, <http://www.whitehouse.gov/omb/budget/fy2007/sba.html> (stating that the Small Business Administration issued 89,000 loans under the 7(a) program alone) (last visited Sept. 23, 2007).

<sup>9</sup> *See generally* Small Business Administration, <http://www.sba.gov/aboutsba/history/index.html> (stating that the SBA backed more than \$12.3 billion in loans last year) (last visited Sept. 24, 2007).

<sup>10</sup> *See generally* Small Business Administration, <http://www.sba.gov/services/financialassistance/sbaloantopics/microloans/index.html> (discussing the Micro-Loan Program which provides small loans to start-ups) (last visited Sept. 24, 2007).

MR. ABRAHAMS: One percent.

MR. GOLDBERG: One percent. Okay. Anyone else? I like to throw out that question to groups such as yours. . I throw it out sometimes at a meeting with a group of accountants, and I would think the accountants are sharp once they get out their fine point pencil and know what they are doing. They usually respond 20 percent, 35 percent, five percent, or two percent.

Well, in the Cleveland District, which is really a small district – we run from the Pennsylvania line to the Indiana line and cover the northern 28 counties of Ohio<sup>11</sup> – back in 1994, we made 364 startup loans.<sup>12</sup> We tracked those startup loans, true starts, for a period of about six and-a-half years. We found after six and-a-half years that 78 percent were still in business.<sup>13</sup> That's a remarkable figure. It is even more remarkable when you think it is here in the rust belt – Northern Ohio. We started to ask questions: why was that so great?

Now, we basically came down to two reasons. One, we required 286 businesses to do a business plan, to work either with SCORE – The Service Corp of Retired Executives or the Small Business Development Center – and develop a business plan or a business model, and we think that was the road to success, and it really helped them.<sup>14</sup>

The other thing that contributed to this great success rate was having the right financial structure, the right amount of equity coming in – whether it is 20 percent or 30 percent – coupled with the right amount of funding. Contrary to that approach, typically what we see out there is someone who can't find access to venture funds or get the proper funding, relies on the credit card offerings in the mail, they fill out the application, call up the bank to get the money, and they open up for business without even thinking, without the business plan, without anyone realizing if they really have enough money to make the business work.

We think that having the proper financial structure – debt to equity – with a business plan is the reason why 78 percent of the businesses have succeeded. The 78% success rate that we had in Northern Ohio can be seen

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<sup>11</sup> Small Business Administration, <http://www.sba.gov/localresources/district/oh/cleveland/aboutus/index.html> (last visited Sept. 23, 2007).

<sup>12</sup> See generally *id.* (discussing the total number of loans made in 2004) (last visited Sept. 24, 2007).

<sup>13</sup> See generally Study Shows Start-ups Have High Rate of Success, <http://www.nfib.com/object/3678661.html> (citing a national SBA study which found that 67% of new ventures are successful after 4 years) (last visited Sept. 23, 2007).

<sup>14</sup> See generally Business Plan for a Startup Business, [http://www.score.org/downloads/Business%20Plan%20for%20a%20Startup%20Business\\_July.pdf](http://www.score.org/downloads/Business%20Plan%20for%20a%20Startup%20Business_July.pdf) (providing a guide to preparing a business plan by Service CORE) (last visited Sept. 23, 2007).

elsewhere in the Agency. We like to think that companies can say “I got my start with the SBA.”

Well, some of the companies that got their start with the SBA, some of them are not household names. Some of them are household names that we recognize: Outback Steakhouse, Compact Computer, Apple Computer, Staples, Intel and FedEx.<sup>15</sup> There is also one company that I am particularly fond of. I like ice cream and there is Ben and Jerry’s Ice Cream from Vermont. They got their start with an SBA loan in the Vermont office, and it was kind of a rocky start.<sup>16</sup>

I will let you know a little secret about Ben and Jerry’s. That loan had to be restructured three times before they made it.<sup>17</sup> The banker was running scared. We told the banker, “You got a guarantee, don’t worry about it. Let’s see if we can restructure to their cash flow and make it work.”

Three times it was restructured, and it did work, and everyone knows that it did work, and everyone knows of the success of Ben and Jerry’s.

Look here in Northern Ohio; look at what we do for startups. Last year in 2006, we made 737 startup loans for 34 percent of our total lending.<sup>18</sup> So we do have quite a commitment here. The banks do lend under our guarantee to startups, even though their first reaction will be, “We don’t lend to startups.”<sup>19</sup> They do, and they have done it. And once you get started, then I think after you’ve developed about a year track record, you are eligible to sell to the federal government under any of our contracting programs.<sup>20</sup> And as I said, that’s a \$300 billion market.<sup>21</sup>

In your handout that you have, there is a section on selling to the government. It looks like this. (Indicating.) It starts out with \$300 billion – you don’t need to go through it as we go through it, but on the second page

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<sup>15</sup> See CharlotteSteakHouses.com, <http://www.charlottesteakhouses.com/news.cfm/Article/37266/Outback-Steakhouse-SBA-Success-Story.html> (stating that the SBA provided \$151,000 of working capital which led to Outback Steakhouses success) (last visited Nov. 12, 2007).

<sup>16</sup> Jeff Moore, *Looking for Start-up Cash?*, DETROITER, Feb. 1, 2001, available at <http://www.allbusiness.com/north-america/united-states-michigan-metro-areas-detroit/810131-1.html>.

<sup>17</sup> See generally Glossary of Terms, <http://www.delawarecountybr.com/glossaryterms.htm> (providing a definition of restructuring a loan) (last visited Sept. 23, 2007).

<sup>18</sup> See Mary Vanac, *Charter One Gets Top SBA Lending Honor*, CLEV. PLAIN DEALER, December 12, 2006, available at [http://www.cleveland.com/weblogs/print.ssf?mtlogs/cleve\\_edition/archives/print214855.html](http://www.cleveland.com/weblogs/print.ssf?mtlogs/cleve_edition/archives/print214855.html).

<sup>19</sup> See Joseph Anthony, *6 Things to Know About Getting an SBA Loan*, MICROSOFT’S SMALL BUSINESS CENTER, [http://www.microsoft.com/smallbusiness/resources/startups/startup\\_financing/6\\_things\\_to\\_know\\_about\\_getting\\_an\\_sba\\_loan.msp](http://www.microsoft.com/smallbusiness/resources/startups/startup_financing/6_things_to_know_about_getting_an_sba_loan.msp) (last visited Sept. 24, 2007).

<sup>20</sup> See generally Small Business Administration, <http://www.sba.gov/services/contractingopportunities/certifications/index.html> (providing the requirements for doing business with the government) (last visited Sept. 23, 2007).

<sup>21</sup> News Release, Richmond, *supra* note 4.

of that handout, you will see that there are basically four designations of types of businesses that the government recognizes, that get special preference when it comes to selling to the federal government.

One is women-owned businesses.<sup>22</sup> There is no special certification you have to go through. You self-certify that you are a woman-owned business, that 51 percent of the business is owned by a woman, by a female. By presidential proclamation, by executive order, five percent of all government procurement has to go to a woman-owned business, and that translates to \$15 billion.<sup>23</sup> Again, that's a lot of money.

Another self-certification program is to service disabled veterans.<sup>24</sup> If you are disabled – if you are a disabled veteran – and again, it is self-certifying, there is \$9 billion, three percent by presidential proclamation or executive order.<sup>25</sup> Three percent is available, and procurement officers at these government agencies have this goal, and they are judged by the goal, whether they make it or don't make it.<sup>26</sup>

So there is a big incentive for them to help the business get the right contracts. Then we have two programs in which we do have to certify the business. One is a Small Disadvantaged Business, and the other is 8(a).<sup>27</sup> They have different qualifications. It is done by statute.<sup>28</sup> The statute defines minorities as being disadvantaged under the law (historically) and therefore, you can qualify for set-aside programs.<sup>29</sup> Again, this is five percent of that \$300 billion or \$15 billion.<sup>30</sup>

We also have another program that we certify – called the “HUBZone” – under utilized business area.<sup>31</sup> There is no presumption of historic discrimination.<sup>32</sup> It is just whether you are located in an area that has been

<sup>22</sup> Small Business Administration, <http://www.sba.gov/services/contractingopportunities/basics/identify/index.html> (last visited Sept. 23, 2007).

<sup>23</sup> *Id.*

<sup>24</sup> *Id.*

<sup>25</sup> Press Release, The White House, Executive Order: Service Disabled Veterans Executive Order (Oct. 21, 2004), *available at* <http://www.whitehouse.gov/news/releases/2004/10/20041021-5.html>.

<sup>26</sup> *See generally* Small Business Administration, <http://www.sba.gov/services/contractingopportunities/basics/identify/index.html> (discussing the goal of having 5% of contracting with women-owned small businesses) (last visited (Sept. 23, 2007)

<sup>27</sup> Small Business Administration, <http://www.sba.gov/aboutsba/sbaprograms/sdb/index.html> (last visited Sept. 23, 2007).

<sup>28</sup> 13 C.F.R. §§ 124.101-124.112 (2007).

<sup>29</sup> *See* 13 C.F.R. § 124.103 (2007) (discussing the statutory definition of ‘socially disadvantaged).

<sup>30</sup> JAYETTA HECKER, STATUS OF SMALL DISADVANTAGED BUSINESS CERTIFICATIONS 1 (Government Accountability Office 2001) *available at* <http://www.gao.gov/new.items/d01273.pdf>.

<sup>31</sup> GC/BD HUBZone, <http://www.sba.gov/hubzone/> (last visited Sept. 23, 2007).

<sup>32</sup> *See* HUBZone – Frequently Asked Questions, <https://eweb1.sba.gov/hubzone/internet/>

designated a labor surplus or low-moderate income area, and we call that a HUBZone.<sup>33</sup>

And if your business is located there, if the business is owned by an American citizen, and if the business employs 35 percent of its employees from a HUBZone, it can qualify for certain set-asides and preferences.<sup>34</sup> Again, it is three percent of that \$300 billion program, a lot of money. The rest of the packet that you have goes into some detail on those programs. I won't go over that at this time.

If you have any questions, I brought the brain trust from the Cleveland District Office that can answer those. I also brought as part of that brain trust an individual that can answer questions you might have on our lending programs. So at this time, I hope you found your Power Point. I can go on more and more – for a longer time if you haven't found your Power Point.

MR. STRAATSMA: No. That's great. Actually, thanks very much, Gil. Are there any questions at this point?

MR. ABRAHAMS: Just a quick one: Gil, are there any HUBZones in Cuyahoga County? Which ones, and where are they?

MR. GOLDBERG: There are quite a few HUBZones. How many would you say, John?

MR. RENNER: HUBZones are designated by census scribes,<sup>35</sup> and there are dozens,<sup>36</sup> virtually the entire east side of Cleveland,<sup>37</sup> and a lot of areas on the west side are also HUBZones.<sup>38</sup>

MR. ABRAHAMS: Within the City of Cleveland proper, Joe, Cleveland proper mainly?

MR. GOLDBERG: The easiest thing to do, if you have a company and you want to know whether or not you are in a HUBZone would be to go to the SBA website – sba.gov – and you click on HUBZone, and there a program will pop up. You can enter the address of your company and it will show whether you are in a HUBZone or not. As John said, you know, there are dozens within the City of Cleveland,<sup>39</sup> and let me give you another

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general/faqs.cfm#Q3 (last visited Sept. 23, 2007).

<sup>33</sup> *See id.*

<sup>34</sup> *See id.*

<sup>35</sup> *See generally* HUBZone – Frequently Asked Questions, <https://eweb1.sba.gov/hubzone/internet/general/faqs.cfm#Q16> (discussing qualified census tracts and four other qualifying geographic locations) (last visited Sept. 23, 2007).

<sup>36</sup> SBA HUBZone Locator, <http://map.sba.gov/hubzone/hzqry.asp?state=oh> (click the black dot representing Cleveland 3 times) (last visited Sept. 23, 2007).

<sup>37</sup> *Id.*

<sup>38</sup> *Id.*

<sup>39</sup> *Id.*

example: Ashtabula County, a little further east of Cuyahoga County, the entire county is designated a HUBZone.<sup>40</sup>

MR. STRAATSMA: Yes.

DR. BARBER: I just wondered, when you described the success of companies six and-a-half years down the pike, so to speak, how did you define success?

I guess my question is: I think often startups evolve, and there may well be just a small percentage that actually go bankrupt, but they get merged or acquired. Were they counted in the successes, or did they stay pure?

MR. GOLDBERG: We did not have the resources to track the company individually. What we looked at was, basically, the cost to the taxpayer since the taxpayer is supporting the loan via our guarantee program. If they made their payments in timely fashion and paid off the loan, they were a success. They didn't cost the taxpayer any money. So I don't know how many were acquired. I don't know how many grew to a plateau that is sexy enough for VCs, but we define success as the ability to pay off the loan in a timely fashion. One other thing if you don't mind.

MR. STRAATSMA: Please.

MR. GOLDBERG: We mentioned some of our economic development programs that we have with various entities in our district, and I will just briefly mention those because this is a way of attracting supplemental equity to your business – if I could ask Mark and John to hand it out.

We have done an economic development initiative in the City of Youngstown and one for Wards 1 and 3 here in the City of Cleveland on the southeast side; Wards 1 and 3 are on the south side. What we have found out – and I guess as most of you know – the hardest thing for a business to do is to attract equity.<sup>41</sup>

So we have come up with free money. But it is not a free lunch for the small business. If the small business has ten percent of their own equity in the business or is able to start the business with ten percent equity and can qualify for an SBA guaranteed loan and can develop a business plan through the assistance of either SCORE or the Small Business Development Centers.<sup>42</sup> Then the City of Youngstown will supply them with a 15 percent performance grant that – if they meet certain hurdles – that performance

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<sup>40</sup> SBA HUBZone Locator, <http://map.sba.gov/hubzone/hzqry.asp?CNTY=39007> (last visited Sept. 23, 2007).

<sup>41</sup> See generally Small Business Administration, <http://www.sba.gov/services/financialassistance/equitycapital/equity/index.html> (discussing equity capital) (last visited Sept. 23, 2007).

<sup>42</sup> But cf. Small Business Administration, <http://www.sba.gov/services/financialassistance/eligibility/requirements/index.html> (indicating that 20% equity is required to be eligible) (last visited Sept. 23, 2007).

grant or loan is forgiven over a three-year period and actually becomes true equity.<sup>43</sup>

The money that Youngstown supplies is subordinated and put on standby.<sup>44</sup> So, no payments are made during the three-year period. So, it actually is free money, and they don't have to service the debt.<sup>45</sup>

If you take their ten percent equity and couple it with the 15 percent supplemental equity from the city, you have a borrower that has 25 percent equity and can usually qualify, with a good business plan, for an SBA guaranteed loan.

Also, Youngstown is providing tax abatements, waiverable city permit fees, and a facade grant.<sup>46</sup> On the east side of Cleveland in Wards 1 and 3, it is limited to equity funding,<sup>47</sup> but again, it is free money that doesn't have to be paid back. But it is not a free lunch because you have to meet those pretty tough requirements.

Thank you.

MR. STRAATSMA: Any others?

Gil, with respect to the profile, your chart here, this identifies by percentages, and just going over your tenure for the last ten plus years, have the types of firms changed that you deal with, your client base?

MR. GOLDBERG: When I first came to the SBA in 1994, the majority of all the loans we did, the biggest bulk, went to manufacturing, both in numbers and in dollars. That held true until 1996.

In 1996 the largest number of loans went to manufacturers, that is no longer true. The service sector has become the largest segment in number of loans. But it was not until 1998 or 1999 that the dollar switched. Manufacturing took a few more dollars for a few more years, until probably 1997 or 1998.

And it is interesting, going back to the comment that was made on the last panel, (hard assets): it was very difficult to convert the banks from lending to manufacturing with hard assets to lending to service with either intellectual property or leasehold improvements. But I think they understand that lending now and realize that our guarantee along with the cash flow enables them to

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<sup>43</sup> THE YOUNGSTOWN INITIATIVE (City of Youngstown) available at [http://www.ytowndevelopment.com/docs/youngstown\\_city.PDF](http://www.ytowndevelopment.com/docs/youngstown_city.PDF) (last visited Sept. 23, 2007) [hereinafter YOUNGSTOWN INITIATIVE].

<sup>44</sup> See Youngstown/SBA Initiative, <http://www.ytowndevelopment.com/docs/YOSBAINITIATIVEAPP.pdf> (last visited Sept. 23, 2007).

<sup>45</sup> See *id.*

<sup>46</sup> YOUNGSTOWN INITIATIVE, *supra* note 43.

<sup>47</sup> *A Partnership for Economic Development in Southeast Cleveland*, SBA's REGION V OFFICE, Winter/Spring 2007, 4, available at [http://www.sba.gov/idc/groups/public/documents/region5/r5\\_finalsummer2006takefivenews.pdf](http://www.sba.gov/idc/groups/public/documents/region5/r5_finalsummer2006takefivenews.pdf).

lend to a service sector or intellectual property company that does not have hard assets.

MR. STRAATSMA: Thank you. Thank you very much, Gil.

Our next speaker is John Connell. He represents the Canadian side, and he is the Director General of Small Business Policy with Industry Canada, which is a federal government department.

John is a career public servant in Canada. His responsibilities include the creation of policies and programs, addressing small business development throughout the country, and between 1998 and 2003, he served as a senior chief, Industry Analogy Comment for Finance Canada,<sup>48</sup> which had a mandate of increasing industry productivity and competition in a knowledge-based economy.

Between 1995 and 1998, he served as a Privy Council Officer in the Economic and Regional Development Policies<sup>49</sup> of the period, and he now handles submissions from the Minister of Industry to that body.

John obtained his Bachelor of Arts and Master's Degrees at Queens University in Kingston, Ontario, with a concentration on political studies and public administration. This afternoon he would like to address some of the methods and some of the issues facing entrepreneurs in Canada and some of the actions that the federal government will respond to. John?

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<sup>48</sup> Driving Canada's Business Success, <http://www.cybf.ca/about-us/board-of-directors/bio-johnconnell.htm> (last visited Sept. 23, 2007).

<sup>49</sup> *Id.*

## CANADIAN SPEAKER

*John Connell\**

*(presentation unavailable for publication)*

DISCUSSION FOLLOWING THE REMARKS OF GILBERT GOLDBERG  
AND JOHN CONNELL

MR. STRAATSMA: Thank you very much, John. Any questions for either of our panelists?

DR. HISRICH: John, my question is for you. You made the point that going forward, sustaining economic development in Canada would depend on a high level of immigration. At the same time, it is clear that countries like China and India are beginning to develop – they will not come to Canada and, in fact, are here and are going back. Given high demand and the access to supply, has anybody been thinking how the government is going to deal with the reality of high demand, no supply?

MR. CARMODY: We have heard a lot about additional financing from what appears to be government with aided sources, and we heard in the previous session about the fact that one of the inhibitors to entrepreneurial development in Canada is the whole role of banks.

I was very impressed with Gil Goldberg's presentation and looking at the materials his people passed out, and it is evident there are a lot of financial institutions in this country who are willing to take a risk, and you are not necessarily going to be blackballed if you don't make it once.

How can we perhaps adopt some of those peaks in our own country and Canada to promote economic growth in the entrepreneurial spirit?

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\* John Connell is a career public servant with the Public Service of Canada. He is currently Director General, Small Business Policy, Industry Canada. His responsibilities include the development of policies and programs addressing small business development throughout Canada. Between 1998 and 2003, John served as Senior Chief, Industry and Knowledge Economy, Finance Canada. He was responsible for analysis and advice concerning microeconomic investments and policies aimed at increasing industry productivity and competitiveness in the knowledge-based economy. Between 1995-1998, John served as Privy Council Officer in the Economic Regional Development Policy Secretariat of the Privy Council Office. John handled submissions from the Minister of Industry to Cabinet and briefings on priorities and issues concerning the Industry Portfolio. Prior to 1995, Mr. Connell had a long and varied career in transportation policy with Transport Canada, with assignments in Ottawa, Vancouver and Canberra, Australia. John engaged in studies leading to Bachelor of Arts (Honours) and Master's degrees from Queen's University in 1979 and 1980, respectively, concentrating in history, political studies and public administration.

MR. KANTER: This is a kind of comment as well. Mr. Connell, you mentioned the importance of exports, especially to the Canadian companies. I am with the U.S. Department of Commerce Office U.S. Export Sector System. Bob Abrahams is here from the Toledo office and Henry Adams. Our focus is on small and medium-sized companies and to encourage exports around the world, but particularly to Canada because neighbors are the logical choice for small and medium-sized companies, particularly to work their counterparts in Canada, to move their products across the border and northward.

I am sure the consulate at Detroit is working very hard to match the Canadian clients that you have on the northern side of the border in Canada. So the role of exports in both directions is probably very important for small and medium-sized companies, especially in Northern Ohio as well as in Canada because a lot of the trade is more north and south than east and west.<sup>50</sup>

It is easier for an Ohio company to ship to Ontario than it would be to California.

MR. STRAATSMA: Any further questions or comments? Yes, sir.

DEAN ENTIN: I am just curious about the success rate on small businesses. I ask this because I know there have been studies in the U.S. suggesting that the failure rate of small businesses in the first couple of years is pretty high.

So I was struck, and I have two questions. One is for Mr. Connell: do you know what the corresponding figures are in Canada? And second, to Mr. Goldberg: granted, the data you have are based on defaults, but I wonder with the experience in your office in this area, if it is comparable to other SBA offices around the country? And if so, does that suggest that the SBA has figured out a way to pick the best risks for loans? It just seems like a notably higher success rate than some of the studies that I have seen more generally.

MR. GOLDBERG: On our statistics, please realize those statistics relate just to SBA financing, which may be a small percentage, even though I mentioned we are talking 110,000 loans, and \$16 billion annually. That's a lot of money but really is a small percentage of those businesses that are getting loans. Out of that 110,000, probably only 25,000 or so are what we would classify now as new businesses, two years or less.

But I think that businesses that do come to the SBA perform better, 1) because of that technical assistance portion, and 2) because of the proper

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<sup>50</sup> State Trade Fact Sheets 2006: Ohio, Government of Canada, [http://geo.international.gc.ca/can-am/washington/state\\_trade\\_2006/ohio-en.asp](http://geo.international.gc.ca/can-am/washington/state_trade_2006/ohio-en.asp) (last visited Sept. 29, 2007).

financial structure. They have the right amount of financing that they need with the right equity.

You know, too many times I think a business fails because they don't get the right amount of funding they need and start behind the eight ball to begin with, and I think they can make it up as they go along, but they get further and further and deeper and deeper into trouble.

I mentioned the Youngstown initiative, and again, that's one where there is supplemental equity coming in, and there is technical assistance. We made our first loan in Youngstown in the year 2000.<sup>51</sup> And it has been running constantly since that time, and we have helped approximately 70, 71, 72 companies in Youngstown.<sup>52</sup> Some of them are startups, some of them existing, and out of those 70 or so companies, only three have gone bad. One was restructured.

But I think that is a good track record, and that's in Youngstown, Ohio, probably one of the most severely hit areas in Northern Ohio, and those 70 companies represent about 17 or so million dollars in Youngstown.

One more thing I would like to say. In your packet, that blue and white folder, there are three handouts. One is the government contract they hand out. The other one has a 7(a) lending guide on it, and the last one was the 504, another loan program that we have. It has everything you need to know about the U.S. Government, SBA lending, but were afraid to ask. And if you do have any questions, I have two experts from the Cleveland District, Mark Hansel, if he could raise his hand on the finance side, and on the government contract side, I have John Renner. So if you have questions now or during the cocktail reception, those are the two gentlemen you could approach.

MR. STRAATSMA: Yes, sir.

DR. BARBER: We have had a lot of input on financing, mainly on financing, and what I want to say is that I have been involved in studies, startup of early stage companies where I have talked to the CEOs of companies that may have been in startup for over five or six years. And the one question that I want to raise, because it came out of those conversations, was that their issues were not generally about science or technology or the ability to understand the applied technology. They were generally not about money.

Some of them got more money than they needed, which created problems for them. Some of them got less, which created problems for them. The really successful ones were all foreigners who didn't expect any help of any sort, and they were making it.

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<sup>51</sup> See generally Cleveland District Office News, U.S. Small Business Administration, available at [http://www.sba.gov/idc/groups/public/documents/oh\\_cleveland/oh\\_cleveland\\_news07-06.pdf](http://www.sba.gov/idc/groups/public/documents/oh_cleveland/oh_cleveland_news07-06.pdf), 2 (last visited Oct. 6, 2007) (describing Youngstown initiative).

<sup>52</sup> *Id.*

But the point that came out about it was that the real weakness was about competence in commerce. None of them had much sense about how to make the value exchange happen, whether you are in finance or whether you are in technology. So the question that I want to ask is: what about the human competence to make enterprises work? Are there any shortcomings here, and if so, who deals with those?

MR. GOLDBERG: Just one empirical comment. I couldn't add anything from a conceptual standpoint to what John had to say. I think we see that in our loan application process and in our various initiatives. I think it bears out in reality that those that really have the desire, who really have the skills and the passion are the ones that actually come forward and make it a success.

And when we first announced the Youngstown initiative, we did it with a lot of fanfare. The three TV stations were there in Youngstown, as well as the newspapers. And what people heard from that announcement was free money. Free money!

The next day, the City of Youngstown got something like 800 calls, the day after that another 800, the day after that another 800. Maybe a few people came in, but as you see, it is self-selecting. Suddenly loans were made out over a couple thousand phone calls and people looking for that free money. When they realized there was no free money, that they had to have that desire, passion and ten percent of their own equity, it was self-selecting.

MR. BROWN: My question actually relates to Mr. Barber's question, and this is for Mr. Goldberg.

In Cleveland, they have organizations like Team NEO and Nordac. What kind of role do those organizations play in fostering these issues with entrepreneurship? Mr. Connell, can you respond with something similar in Canada?

MR. GOLDBERG: They play a very important role of providing financial assistance, either in the form of venture fund, grants or subordinated funding to businesses. I think their's is an important role for economic development in the area, and economic development is very fragmented. It takes a lot of different pieces coming together to make it work. To make it work and know what business is a success. Team NEO and the others out there are one part. If we fit our part to someone else's part, that works, fine, but it is fragmented, and we are all there to make sure, hopefully, that anyone that has a successful plan or idea and the right passion to do it so it won't fall through the cracks.

MR. STRAATSMA: Very good. Gil, John, thank you very much for your time this afternoon. And we will have time during an hour of discussion.

MR. UJCZO: Just a few logistical announcements. On behalf of the Institute, we do thank all our speakers for this afternoon. As a native Youngstown, we particularly appreciated the last session and as well the work of the SBA in Youngstown. We are on a half hour break. Cocktail hour will begin at 5:30 in the room directly above where we had lunch, so it is just

upstairs. You go to the light, the sunlight, and that's where the cocktail hour will be. Dinner will be started shortly thereafter and the presentation is upstairs this evening. If you are not joining us for dinner, we will meet promptly tomorrow morning at 9:00 a.m.

Thank you.

## A CASE STUDY OF A SUCCESSFUL PRIVATE ENTREPRENEURSHIP

*Session Chair – Richard Cunningham*  
*Speaker – William A. Davies*

### INTRODUCTION

*Richard Cunningham*

MR. CUNNINGHAM: The title that we have on the program is “A Case Study of Successful Private Entrepreneurship.”

This is one of the successful case studies of private entrepreneurship, but I am in a difficult position. I have been asked to introduce the senior executive of a company that destroyed my dream; that totally ruined my great ambition in life. Let me tell you a story that illustrates my ambition.

My law firm, Steptoe & Johnson – I am Dick Cunningham of Steptoe & Johnson, for those of you who didn’t know – there was sort of a grand old man in my law firm, Steve Ales. He was Secretary of Defense in the Kennedy Administration, head of the Association of American Railroads, famous litigator in Washington, and all of that.

Ales was, at one point, involved as one of the lead litigators in the battle for the takeover of Metro-Goldwyn-Mayer. Ales was an enthusiastic, manic fisherman, and in the second week of June every year, come what may, nuclear attack, whatever, Ales would go up to Maine to go salmon fishing.

So, in the year when the MGM battle was raging, come the second week of May, Ales went off to Maine. Sure enough, because the great law of nature dictates that this would happen, a crisis breaks out in the MGM takeover case. A younger lawyer – a fellow by the name of Smokey Miller, who Ales entrusted the case to – had run into Ales’s office and was shocked: no Ales. Smokey runs across the hall to Ales’s secretary and says, “Got to call Steve; crisis in the MGM case. Got to get him back.”

She says, “Mr. Miller, it is the second week of June. You know and I know that Mr. Ales has gone salmon fishing in Maine.”

Says Miller, “Call him back. Get him on the phone. Crisis in the MGM case. Got to get him back.”

“Mr. Miller, you know that Mr. Ales goes to a salmon fishing camp in the north woods of Maine, a hundred miles from the nearest telephone. I can’t call the boss.”

Miller says, “Call Western Union.”

The site of the story shifts: we are now in the north woods of Maine. Salmon were everywhere. Early one morning, Ales and others are out casting a fly for salmon, and out of the underbrush stumbles a Western Union messenger who I picture in one of these sort of Call-for-Phillip-Morris outfits with a cap and the gold brocade, except it is all torn to ribbons as he has gone through the underbrush looking for Ales.

And he says, “Are one of you guys named Steve Ales?”

And Ales says, “I am Ales.”

The kid says, “Telegram for you.” He hands him the telegram. Ales opens the telegram, and it says, “Imperative you return immediately, or MGM case is lost.” Signed, “Smokey Miller.” Ales looks at it, reaches into his pocket, takes out a \$20 bill, puts it on top of the telegram, hands it back to the messenger and says, “You couldn’t find Ales.”

It has always been my ambition to get to the point in my life where I would have sufficient prestige and grandiose and all that sort of stuff that I could say in a situation like that, “You couldn’t find Cunningham.”

But I can’t do that any more. As you can imagine from hearing that story, that ambition is no longer achievable, and it is this man’s company, Research in Motion, that is to blame. Today everybody is reachable everywhere, all the time, through their Blackberries.

So, what you are going to hear today is not just a story of a very successful private entrepreneurship. You are going to hear how a private entrepreneurship has changed all of our lives. The fellow we have here, Bill Davies, is going to tell you that story, but he is also going to talk about some intellectual property issues that I think are really important in our consideration of the viability – the travails of technology oriented entrepreneurship.

All of you who read the business section – I am not going to take a show of hands – but all of you who read the business section know that for weeks on end during the last year Research in Motion has been in the papers as a life and death struggle on intellectual property.

Bill Davies is the ideal guy to tell you about all this stuff. He is the General Manager and President of Research in Motion in their Barbados operation. This is not his first step in the technology world. He worked at several positions with Motorola, including as Vice-President and Director of Technology Transfer. Later he was the leader of their governed relations team for Latin America.

He is a lawyer. Sorry about that, guys, but this is, after all, the law school of Case Western Reserve and the Canada United States Law Institute.

His current assignment is to champion Research in Motion's efforts to reform intellectual property law. We were just discussing this. He told me that his major focus is those regulation-addicted Europeans, and what they do in this sort of thing, although God knows there are enough problems with that in the United States and Canada, too.

So let me ask Bill Davies to come on and talk to you about Research in Motion, about entrepreneurship, about intellectual property, and the travails that one goes through and what ought to be done with intellectual property to enhance entrepreneurship. And I think you are going to really enjoy this.

SPEAKER

*William A. Davies\**

MR. DAVIES: Okay. Well, after that sort of stirring introduction, I find it hard because the first thing that happened to me was Deborah said, "Well, give him about 15 minutes." So I got to get all of that in 15 minutes. And then she said – and this was the one that really hurt – "No Power Points."

I have been in the high-tech industry for 30-plus years, and I am not supposed to give a Power Point presentation? Well, okay. So I didn't do it. I was very good, and I don't have any Power Points. However, I did want to start off with a historical quote. A very intelligent, brilliant leader, Winston Churchill, once said, "The only statistics that you can believe are the ones that you fiddle yourself."

And I want to tell you some statistics that I gathered today. The first one is that I have met four Case Western students. So, I can tell you that 100 percent of them are beautiful women. Okay?

The second one is that 50 percent of them did not know where the law school was.

Now, the other two, one is a student here, and the other one was an alumnae. So there you have the statistics for today.

Well, I have been thinking that I was going to give you a long and rather boring lecture and talk about *E-Bay*, and we were going to talk about the different opinions and how some of them didn't make sense, and how did they get so many different ones to all come out unanimous?

But, that would be more boring than you could possibly take on Friday evening after cocktails. And so we are not going to do that. We will just talk a little bit about the way the world seems to be working on entrepreneurship.

[Phone rings.] And people call. I have no idea why they called that.

MR. CUNNINGHAM: You are proving the truth of my story. Someone is looking for Dick Cunningham.

MR. DAVIES: That's right. Absolutely. Didn't say that, but it probably was.

As a matter of fact, this is, by the way, not the absolutely newest version, but this is the first sort of consumer version of the Blackberry, and it actually has a camera in it. It actually has an MP3 player in it. I don't know how to use the MP3 player, and I can barely take a picture with it. But it does have those things.

I am very amazed at how they can manage to get all the stuff into these little tiny packages. I will also tell you one other thing. Now they have keyboards that are this thin and just a little bit bigger but with a full QWERTY keyboard. That's what I want. They haven't given me one of those yet.

So let's talk about entrepreneurship and the law, and we will get some anecdotes about how RIM is doing. As you know, RIM fell prey to somebody who could be described as a troll.<sup>1</sup> A patent troll is normally a

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\* Born in Argentina of an Irish Argentine family, he was raised in Brazil and educated in the United States. He speaks English, Spanish and Portuguese. He graduated from Purdue University in Economics and has a Degree of JD, cum laude, from Indiana University School of Law. During his professional life, William A. Davies has worked for a variety of private sector enterprises. After service in the United States Army he became a Reinsurance Representative of Lincoln National Life Insurance Company with responsibility for Latin America and the Caribbean, it is here that his interest in working with Governments for the benefit of private enterprise was developed as the Life Reinsurance business is highly regulated and a significant part of servicing the Life Insurance company clients was lobbying government on their behalf. He then pursued a legal career; First with Cahill Gordon Reindhel & Ohl a Wall Street law firm where he had the good fortune to work closely with the former legal adviser to the US State Department who was then a senior partner at the firm; Second with Motorola Inc. where he held successively positions of responsibility advising the business sectors. This included 5 years in Geneva Switzerland where he was very active with the fledgling European Commission in the lobbying of the necessary rules for the Common Market while not hindering the conduct of business. He served as Vice President and Assistant General Counsel and then as VP and Director of Technology Transfer. He also was the founder and architect of the Motorola Government Relations Team for Latin America, which he successfully led for 6 years. He then became a Senior Principal for the professional services firm of DeLevante y Asociados, Panama, R.P. where he consulted for clients throughout the Americas on spectrum, telecommunications and standards issues. He is currently a General Manager and President of Research in Motion (Barbados) Ltd. His current assignment is to champion RIM's efforts to reform of the IPR laws. During his career Davies has served on the Board of Standards Review of the American National Standards Institute, The Joint Government Private Committee of Experts on Electronic Commerce of the FTAA, and the Board of Trustees of Latin American Young Executives, he has been a member of the Argentine, Venezuelan and Canadian Delegations to the CITEL Permanent Consultative Committees I and II (formerly III), and has been a frequent speaker at industry Fora.

<sup>1</sup> Leslie T. Grab, Recent Development, *Equitable Concerns of eBay v. Mercexchange: Did the Supreme Court Successfully Balance Patent Protection Against Patent Trolls*, 8 N.C. J.L. & Tech. 81, 85-87 (2006).

patent-holder who does not develop technology on their own.<sup>2</sup> They go out and buy technology, or acquire it in some way, and then go around and sue people. Now, that is a fairly, you would think, innocuous sort of thing to do. I mean, that's what we do for a living, isn't it? We sue people.

However, the problem with a patent suit in the United States, at least, is that until the *E-Bay* case, injunctions were automatic.<sup>3</sup> There was no consideration. The normal equitable considerations for whether an injunction should flow or not were left out. So you had a Draconian remedy.

And so it became very easy to be a patent troll because you can easily put a company like RIM out of business. Before we really go further into that, though, I want to talk about why it is that these patent trolls exist. This wasn't a problem thirty years ago.<sup>4</sup>

There are two separate reasons why it wasn't a problem thirty years ago. One of them is the fact that North America, Europe, and Japan even, have started to de-industrialize.<sup>5</sup> We don't make things any more. China and the little tigers, India, have become our factories.

As a matter of fact, I made an interesting observation the other day. I saw that there is a real issue in Los Angeles about what to do with containers. Containers come over on ships and are big and 40 feet long and 20 feet wide. Well, they are heavy, and you don't send them back.

It is too expensive to send them back, so they end up piling up in Los Angeles. They have acres and acres of them in Los Angeles. They don't know what to do with them because we don't sell anything to China.<sup>6</sup> China sells to us. So it is kind of interesting.

There are some things that we do sell to China. And obviously, it is very high-tech things, which are, at the moment at least, still such small markets that only several firms can have the volume. For example, commercial aircraft, where you have four firms total that make up the entire market for

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<sup>2</sup> *Id.* at 83-84.

<sup>3</sup> *Id.* at 81.

<sup>4</sup> See Jason Rantanen, *Slaying the Troll: Litigation as an Effective Strategy Against Patent Threats*, 23 Santa Clara Computer & High Tech. L.J. 159, n.36 (“[P]atent trolling is a fairly recent phenomenon.”).

<sup>5</sup> See Robert Rowthorn & Ramana Ramsawamy, *Deindustrialization – Its Causes and Implications*, INTERNATIONAL MONETARY FUND, <http://www.imf.org/external/pubs/ft/issues10> (last visited Oct. 13, 2007) (“The trend [of deindustrialization], particularly evident in the United States and Europe is also apparent in Japan.”).

<sup>6</sup> See generally *Containers Pile Up as Imports from China Soar*, REUTERS, June 15, 2006, available at <http://kerryfoxlive.com/wordpress/?p=568> (“China is shipping so many goods to the United States that the Chinese often find it cheaper to build new containers . . . and leave the empty ones in the United States.”), see also Bruce Odessey, *While U.S. Exports to China Rise, Imports From China Rise Faster*, USINFO, <http://usinfo.state.gov/eap/Archive/2005/Mar/03-517799.html> (last visited Oct. 13, 2007) (shows trade volume for U.S. trade with China).

commercial aircraft – two that dominate it: Boeing and Airbus – and a couple of others like Embraer and Bombardier.<sup>7</sup>

As a matter of fact, I flew in a Bombardier jet up here from Dallas on the way here. It was a very nice plane, very nice plane. I liked it a lot. So, we still sell those kinds of things, but that's because that market is not big enough to have 50 competitors that are efficient. It is now consolidated, but it used to have 50 competitors.<sup>8</sup> And then, we also have some very high-tech things, which are still so closely tied to their markets that it is hard to replace them with just raw manufacturing capacity, like Blackberries. Believe it or not, every Blackberry here – and there are a lot of them I noticed – was made in Waterloo, Canada.<sup>9</sup>

It is amazing when you go there. I can't remember the last time I saw a real factory in North America, especially a high-tech factory. We still have the big heavy factories, but high-tech is kind of a rarity now.

And the other thing that has happened and it is something that may be part of the problem, is that more and more things are networked. This has obviously come about because of the Internet (which has expanded enormously) and also because the physical networks that carry the Internet have expanded enormously as well.<sup>10</sup>

Now, for example, the cellular industry is putting out things that have two or three megabytes throughput.<sup>11</sup> The other wireless things like Wi-Max are going to have even more. So we have an expansion of those networks, both the physical networks and the logical network, and we, therefore, get more and more equipment that makes our lives easy, that are networked.

In other words, now we have refrigerators that are networked.<sup>12</sup> And it is quite common now to have security systems that you can access anywhere in

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<sup>7</sup> *Id.* (China imports commercial aircraft from the U.S.).

<sup>8</sup> See generally Michael J. Harrison, *U.S. versus EU Competition Policy: The Boeing-McDonnell Douglas Merger*, AMERICAN CONSORTIUM ON EUROPEAN UNION STUDIES: CASES ON TRANSATLANTIC RELATIONS, NO. 2, 4 [http://www.american.edu/aces/Cases/ACES Competition Policy.doc](http://www.american.edu/aces/Cases/ACES%20Competition%20Policy.doc) (last visited Oct. 13, 2007) (refers to consolidation of commercial aircraft industry).

<sup>9</sup> See generally Company, RIM, <http://www.rim.net/company/index.shtml> (last visited Oct. 13, 2007) (RIM is based in Waterloo, Ontario).

<sup>10</sup> See generally Aggelos Bletsas, *Physical Limitation on the Expansion of Internet*, MIT MEDIA LAB <http://web.media.mit.edu/~aggelos/861.html> (last visited Oct. 13, 2007) (describes how the expansion of the Internet depends on the expansion of physical networks).

<sup>11</sup> See, e.g., Pascal Deriot, *XIM vs. Code Shadowing Architecture*, MICRON TECHNOLOGY <http://www.wirelessdesignmag.com/ShowPR.aspx?PUBCODE=055&ACCT=0030150&ISSUE=0312&ORIGRELTYP=FE&RELTYPE=PR&PRODCODE=00000&PRODLETT=B&CommonCount=0> (last visited Oct. 13, 2007) (discusses throughput capabilities of late model cell phones).

<sup>12</sup> See, e.g., *Samsung's Revolutionary Digital Network Refrigerator Keeps the Kitchen Connected*, BUSINESS WIRE, Apr. 4, 2002, available at [http://findarticles.com/p/articles/mi\\_m0EIN/is\\_2002\\_April\\_4/ai\\_84392672](http://findarticles.com/p/articles/mi_m0EIN/is_2002_April_4/ai_84392672) (discusses

the world.<sup>13</sup> You know, I have a beach house in Panama that has a camera in it. In my house in Barbados, I can look and see what's going on at my house because there is a little camera I can move and which I can look at through the Internet.

And that's just an example, but it happens with an awful lot of things, and it is getting cheaper. So, for example, as I understand, you can get coffee makers that are networked.<sup>14</sup> If you unload coffee in them a week ago, it will grind them tomorrow and brew it the day after, whatever. I don't know that you would want to do that with a coffee maker, but apparently, you can.

But what this brings about – and it is something that sometimes those of us who are not engineers forget – is that you have to have all these things play together. So we have to have networks. Networks require standards for their interfaces.<sup>15</sup> In other words, that refrigerator or that camera in Panama has got to somehow talk to my computer in Barbados or, for that matter, my hotel room over here. It has got to talk there, but it has to play with a set of standards.

And the standards have become very important because of the networking. When I first started in the high-tech business, they didn't do standards. What did they do? They did E-1s.<sup>16</sup> Who cares about E-1s, right? They did a few other things. The network standard they had was AT&T's Notes on the Network.<sup>17</sup> That was it, and nobody needed anything else.

Now, there is no AT&T, and Notes on a Network is someplace in the archives of some library; a mere famous historical document. But now, what we have instead is an enormous number of standards. All these standards are built by different organizations, some of which you may have heard of and some of which you wish you never have, like ISO, ITU, ANSI, all the ones

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example of a networked refrigerator).

<sup>13</sup> See generally George Jones, *Build a PC-based Home Security System*, BYTE.COM <http://www.byte.com/documents/s=9988/byt1151252609290> (last visited Oct. 13, 2007) (explains how to build a networked security system).

<sup>14</sup> See Russel Redman, 'Connected Kitchen' Product Line Debuts at CES, CRN, <http://www.crn.com/digital-home/18825238> (last visited Oct. 13, 2007) (describes networked kitchen appliances, including coffee maker).

<sup>15</sup> See generally Jim Duffy and Tim Green, *Dearth of Standard Stalls Ethernet Services*, NETWORK WORLD, June 13, 2005, 79 (lack of standard Ethernet interface impedes plans to extend networks).

<sup>16</sup> See generally *E1 Tutorial: An Overview of the Basics of the E1 Digital Transmission Telecommunications Link Standard Used Predominantly in Europe*, RADIO ELECTRONICS.COM, [http://www.radio-electronics.com/info/telecommunications\\_networks/telecommunications\\_standards/e1/e1.php](http://www.radio-electronics.com/info/telecommunications_networks/telecommunications_standards/e1/e1.php) (last visited Oct. 13, 2007) (overview of E1).

<sup>17</sup> See generally *AT&T Dumps Network Notes*, CNET, [http://www.news.com/ATT-dumps-Network-Notes/2100-1023\\_3-206380.html](http://www.news.com/ATT-dumps-Network-Notes/2100-1023_3-206380.html) (last visited Oct. 13, 2007) (discusses AT&T Notes).

that report to ANSI, ATIS,<sup>18</sup> et cetera, et cetera. All of these are acronyms, which you certainly don't need to remember.

But they are, in essence, organizations of private businesses that put together standards so that their equipment or their software can interoperate with the other equipment and software in a network.<sup>19</sup> This is an enormous effort. It goes on all the time, but one of the things that happens – and this is important also – is that every private company (as well as academia) is trying to make sure their patent is in the standard. Okay? So we have a couple of things.

First, the deindustrialization of the West – I hate to use that. It sounds so incredibly apocalyptic – none of us in the West have lost an inventive edge. We are still inventing away and producing intellectual property. Part of what we are doing is buying the stuff from the Chinese with our intellectual property. You know, to give you a good example of why our intellectual property is still very important is to look at the movie industry. Most of the movie industry is owned by the Japanese.<sup>20</sup> Not all of it. Part of it is owned by the Australians.

But the intellectual property that resides in Hollywood is such that that's where you make movies. That's where you find directors. That's where you find make-up people. That's where you find all of these people that make up the intellectual property that goes into a movie. That's very valuable.

And so what happens is that we are buying, oh, I don't know, this microphone from the Chinese by selling them movies, which is basically intellectual property. It is one of the reasons why people who are in that part of intellectual property are so interested in copyrights and piracy. That really is one of the major issues of our balance of trade<sup>21</sup> – the West's balance of trade, not just the United States.

I was once told that a company which you have probably never heard of, called Televisa, is the second largest foreign exchange earner in Mexico.<sup>22</sup>

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<sup>18</sup> See generally *Internet Related Standards Organizations*, FAQs.ORG, <http://www.faqs.org/rfcs/inet-standards.html> (last visited Oct. 13, 2007) (includes hyperlinks to Internet standards organization Web sites).

<sup>19</sup> See, e.g., *About Us: OpenOffice.org*, OPENOFFICE.ORG, <http://about.openoffice.org/index.html#history> (last visited Oct. 13, 2007) (example of a standards organization heavily backed by the private company Sun Microsystems).

<sup>20</sup> See, e.g., *Affiliated Companies (Outside Japan)*, SONY CORPORATION, <http://www.sony.net/SonyInfo/CorporateInfo/Subsidiaries/outside.html> (last visited Oct. 13, 2007) (Sony Global Corporation, with headquarters in Tokyo, lists Sony Pictures – major producer of movies – as one of its affiliated companies).

<sup>21</sup> See generally Moeen Qureshi, *Henry and Hank*, THE WALL STREET JOURNAL, Apr. 21, 2006, at A14 (“No doubt [China and the U.S.] have serious issues to resolve on monetary policy, balance of trade and protection of intellectual property.”).

<sup>22</sup> See generally Televisa, [http://www.televisa.com/index\\_eng.html](http://www.televisa.com/index_eng.html) (last visited Oct. 13, 2007) (refers to Televisa as the world's largest Spanish Language media corporation), see also

They put out these horrible but Copyrighted Telenovelas – which no one in their right mind would watch – which are the most popular thing on television all over the Spanish-speaking world, including the United States, by the way.<sup>23</sup>

But they are the second largest foreign exchanger in Mexico because of Telenovelas. So this is valuable stuff. It is very important to us, especially with, as I said, the deindustrialization of the West.

So what has happened is that an awful lot of the industrial giants of the West have become IPR houses. We patent, we copyright and we enforce patents. So you have to have standards in your product regardless of what product you make.

In other words, for example, let's take the Blackberry. We have a lot of nonstandard stuff in here and a lot of proprietary stuff, which makes it a Blackberry: your push e-mail, touch and feel, the ease of work and all that, that's all proprietary.

By the way, I will break off and tell you a story. My daughter – my oldest daughter – I gave her a Blackberry. About two weeks ago I got a message from her, which said, “I am finally using the Blackberry for what it is really meant for. I am sending this to you from under the table in a boring meeting.”

And it is a niche, and it is a nice niche. Now, any –

MR. CUNNINGHAM: We rehearsed this in advance by the way.

MR. DAVIES: But anyway, the fact is that all of these things that we have on here all ride on top of standard stuff. In other words, the radio, in the case of this GSM, GPRS and EDGE – none of which you need to understand, they are standards for making cellular networks work – are in the radio, and without them, it wouldn't work.<sup>24</sup>

So it is not like a stand alone PDA any more. I don't know if you remember Palm Pilots. They didn't need anything that was standard because they were not networked together. Now they do, by the way, because they

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GRUPO TELEVISIA, S.A., REPORT OF FOREIGN ISSUER (FORM 6-K) (2006), available at [http://sec.gov/Archives/edgar/data/912892/000089534506000596/am6k4\\_grupo.txt](http://sec.gov/Archives/edgar/data/912892/000089534506000596/am6k4_grupo.txt) (Televisa is the largest Spanish speaking media company in the world and equity owner the largest Spanish language media company in the U.S.).

<sup>23</sup> See generally *Telenovela*, THE MUSEUM OF BROADCAST COMMUNICATIONS, <http://www.museum.tv/archives/etv/T/htmlT/telenovela/telenovela.htm> (last visited Oct. 13, 2007) (describes Telenovela genre), see also Ronald Grover, *Televisa and Univision: Stay Tuned!*, BUSINESSWEEK, June 27, 2006, available at [http://www.businessweek.com/investor/content/jun2006/pi20060627\\_999458.htm?campaign\\_id=tbw](http://www.businessweek.com/investor/content/jun2006/pi20060627_999458.htm?campaign_id=tbw) (36% of Univision programming consists of telenovelas licensed from Televisa.)

<sup>24</sup> See *Enhanced Data Rates for GSM Evolution*, TELECOMSPACE, <http://www.telecomspace.com/datatech-edge.html> (discussing the EDGE enhancement to GPRS networks) (last visited Oct. 6, 2007).

have now started to have cellular and two-way paging in them. Now they have to have standard things, and that's because of the networking.

So what is really happening, because of these two trends, is that intellectual property has become very important to any entrepreneur, high-tech, obviously, but even not-so-high-tech. I think the movie industry and the television industry, even with things like Telenovelas, tells you that intellectual property is important.

And what has happened, therefore, is that people have become much more aware of it. There is a lot more patent activity going on. Everybody does their thing with copyrights. They are all worried about piracy, as they should be. What has happened with that is that, for every entrepreneur, we now have to run a gauntlet of the patents that are in the air, because that's what people do now. Instead of making things, they invent things and patent them and also the patents therein embedded in standards.

The patent troll is really a creature of these two environments, or these two changes. It is interesting, the Europeans, by the way, are trying to change their patent system radically. But one of the things they want to do is to have a new treaty. I don't know if you know what the European patent system is right now.

There is a patent system in almost all the countries, and there is also the European Patent Office.<sup>25</sup> The European Patent Office when it grants a patent – it is in Munich – when it grants a patent, you don't get anything except the right to take that patent and turn it into a national patent.<sup>26</sup> So, in essence, you get the right to have thirty-three national patents issued from a European patent. However, you have to enforce them in each country.

So, Europeans thought up a new idea, which they called the European Patent Litigation Agreement (EPLA), which was designed; it appears, in order to make life easy for the troll.<sup>27</sup> It will only use three languages.<sup>28</sup> Now, there is a reason for that. It is better to have three languages than thirty-three languages. But, what it does is it makes it very difficult for some poor schnook in Andalusia who has never heard English, French, or German to be able to defend himself. And, as all of you who are attorneys know, you have to have your client actively participate in and understand the litigation. Otherwise, it just doesn't work very well. Additionally, judges will all come from the European Patent Office, and their loyalty will be to the European

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<sup>25</sup> The European Patent Office Homepage, <http://www.epo.org/> (last visited Oct. 7, 2007).

<sup>26</sup> See How to Apply for a European Patent, <http://www.epo.org/patents/One-Stop-Page.html> (stating that a European patent is a "bundle" of national patents) (last visited Oct. 7, 2007).

<sup>27</sup> See generally EPLA – European Patent Litigation Agreement, <http://www.epo.org/patents/law/legislative-initiatives/epla.html> (discussing the history and some details of the EPLA) (last visited Oct. 7, 2007).

<sup>28</sup> *Id.*

Patent Office, the people who have issued the patents.<sup>29</sup> So finding one of them not valid is going to be a rare occasion under the European Patent Litigation Agreement.

A part of my job now is, as a matter of fact, to lobby against the EPLA. And fortunately for me, the French don't like it either.<sup>30</sup> As I made a comment to my boss when the French came out with their statement that they wanted something different than EPLA, he said, "I can still see Admiral d'Estang's fleet out on the horizon there. They came to our rescue again." However, he then reminded me that it was a Canadian company.

But the fact is that the EPLA is a bad approach.<sup>31</sup> And we hope that the community, rather than the EPO, will be the people in charge of the EPLA – or something like the EPLA – because you have more checks and balances at the European Court of Justice. And, you have the national judiciaries that can be tapped and those kinds of things.<sup>32</sup>

Oh, I only have five minutes? You could have just said five minutes. You were trying to be subtle, weren't you? Okay. Shall I go faster? I can just quit now. Okay. See, I switched to the last page of my notes. I hadn't even turned from the first page before that. All right?

That's the European problem, and I can talk for a couple of hours on that one, but I won't. In fact, I will really quit.

So what we are really talking about now is that every entrepreneur, especially new ones, has to do two things. One, they have to have an R & D department, an innovation department. And then they have to have a legal department. And everything else is superfluous. If you don't have those two, you are out of business.

And I think that that's something – well, it is good for the profession, it is delightful – it actually is not very efficient for the economies. And so we have to fix the problem of the IPR law. And I don't know how yet, but I am trying to figure it out. If anybody has any ideas, I will be happy to hear them. See, I am all done. Okay?

#### DISCUSSION FOLLOWING THE REMARKS OF WILLIAM A. DAVIES

MR. CUNNINGHAM: Okay. Great. You can't leave. We have questions and answers. You can't get out of here that quick.

MR. DAVIES: Okay.

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<sup>29</sup> Paul Meller, *European Parliament Wants Changes to Patent Agreement*, IDG NEWS SERVICE, Oct. 12, 2006, [http://open.itworld.com/5007/061012eupatent/page\\_1.html](http://open.itworld.com/5007/061012eupatent/page_1.html).

<sup>30</sup> *France: Why We Oppose the EPLA*, MANAGING INTELLECTUAL PROPERTY, Jan. 9, 2007, <http://new.managingip.com/Article.aspx?ArticleID=1257409>.

<sup>31</sup> See EPLA: Full Briefing, <http://epla.ffii.org/briefing> (listing a number of criticisms of the EPLA) (last visited Oct. 7, 2007).

<sup>32</sup> *Id.*

MR. CUNNINGHAM: I have to say in MC-ing the questions and answers, you have to understand how low-tech I am.

One of my associates put a “Dagwood and Blonde” cartoon on my door in my office, and it shows Dagwood going in to return a cell phone that he has bought. He is complaining that it is too complicated, and he can’t understand it. And that all he wants is a phone that sends and receives telephone calls. The young salesman just goes ballistic and says, “I don’t have time to deal with a lunatic like you.”

Let me begin with a question. We have talked about how the EU patent system and its conduciveness to trolls and things like that is not good – is counter productive for an entrepreneurial system. Is there anything you could single out about either the U.S. or the Canadian system that jumps to mind as something that really needs reform in terms of patent protection for entrepreneurs?

MR. DAVIES: First, let me correct that statement a little. The European system as is, is pretty good.

MR. CUNNINGHAM: As proposed, it is pretty bad.

MR. DAVIES: As proposed, it is awful.<sup>33</sup>

MR. CUNNINGHAM: Okay. That’s what is called progress.

MR. DAVIES: Yes, that’s right. What would I change in the U.S. system? I guess the Supreme Court did a pretty good job on *E-Bay*. But I guess I would make sure that there was always adequate time for review of a patent on validity, and I would put back some sort of connection between courts and the Patent Office. Right now, as you know, the Patent Office and the courts don’t necessarily pay attention to each other.<sup>34</sup>

And we need to put that connection back together, because if the Patent Office is at all good – we won’t go into that, that’s too much of a problem, whether they are good or not – but if they are doing their job, they can serve as a pretty good technical resource for the courts. But right now we have it pretty well disconnected. There is no way the Patent Office can serve as that resource.

DR. KING: What would you do, make them advisors? Is that it?

MR. DAVIES: Well, you know, the German system is pretty good. What the Germans do is – they don’t have a connection with their Patent Office, either – but what they have is, they have three judges. There are two legal judges and one technical judge for every patent case.<sup>35</sup> And the technical judge is drawn from that technology.<sup>36</sup>

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<sup>33</sup> *See Id.*

<sup>34</sup> *See generally* Justia: Patent Overview, <http://www.justia.com/intellectual-property/patents/> (discussing the roles of the United States Patent and Trademark Office and the federal courts in the patent system) (last visited Oct. 7, 2007).

<sup>35</sup> *But see* The Technical Judge in the German Patent Proceeding,

In other words, if it was an electronics case, it would be an electronics technical judge. It works pretty well. There are very little problems with judges who don't know what they are talking about on technology. I don't know if that would work here because we are so invested in our system – which by the way I think is a great system (the jury system) – that I doubt we could get away with changing to a technical judge.

But I think it is something that would give technical weight and advice to the courts and would be very, very useful.

MR. CUNNINGHAM: Interestingly, in the United States, in one part of our patent protection system, that is, Section 337, which is a device for protecting against imports that are violating patents and copyrights,<sup>37</sup> you do have a technical judge.

MR. DAVIES: Right.

MR. CUNNINGHAM: And I have known people who have said, “Boy that makes it much better.” Then, usually among people who have lost the cases, they say, “Boy, what you really need is a jury of good men and women.”

MR. DAVIES: That's an administrative remedy.

MR. CUNNINGHAM: That is an administrative remedy. Right.

MR. DAVIES: So you can get away with that, but not in the law, not in the courts.

MR. CUNNINGHAM: Right. You are drawing a distinction that some of my partners draw between what I do and practicing law. But can we have some questions from the audience here? Yes, sir.

MR. HICKS: You have talked about the importance of research and development and legal groups in your company working together. We kind of know a little about how the two groups interact. Could you comment on how the two groups interact, with what frequency? Is it a month later, a quarterly review of what is or is not patentable?

MR. DAVIES: Well, on the patent side, we have a patent committee, as every R & D based company does, and the patent committee meets every couple of weeks, actually. One of the things it does is to review for

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[http://www.bpatg.de/bpatg/das\\_gericht/techn\\_richter\\_englisch.html](http://www.bpatg.de/bpatg/das_gericht/techn_richter_englisch.html) (stating that Technical Boards of Appeal are composed of three technically qualified judges and one legally qualified judge and that Revocation Boards are composed of two legally qualified judges and three technically qualified judges) (last visited Oct. 7, 2007).

<sup>36</sup> *Cf. id.* (stating that technically qualified judges do not need to be experts in the specific field of expertise at issue in a case).

<sup>37</sup> Understanding Investigations Of Intellectual Property Infringement And Other Unfair Practices In Import Trade, [http://www.usitc.gov/ext\\_relations/about\\_itc/us337.htm](http://www.usitc.gov/ext_relations/about_itc/us337.htm) (last visited Oct. 7, 2007).

patentability, innovation, prior art, and those kinds of things – the usual things that a patent committee does.<sup>38</sup>

And the patent committee has a representative from the patent litigation people. So there is somebody who is part of the legal team that is on the patent committee. That's different from the normal patent committee, which is made up wholly of engineers.<sup>39</sup> Also, the engineers that are in it, almost all of them are ones who exhibited interest in doing that, who weren't shanghaied if they are interested.

For example, one of our people on the committee is probably one of our brightest young engineers, very creative, and he has also got the sort of mind that remembers everything. And so he is just wonderful because somebody comes up with a thing that everybody says, "Wow, how did you think of that?" And he says, "I think in 1947..." You know? And the engineer who thought it up had never heard of this 1947 thing and finds the prior art that way.

MR. CUNNINGHAM: I find all this to be refreshingly anti-Shakespearean. As you recall, he said, first thing we do, let's kill all the lawyers. And now the first thing we do is keep the lawyers, and one other group.

Doug, you had a question.

DR. BARBER: I was wondering if there hasn't been some significant change, which isn't just about globalization, shifting, manufacturing, and so on. I have been around long enough to remember when getting a patent approved was a pretty rigorous process, and it was a very rigorous process on prior art, and that kind of thing, and once you got it approved, you had this feeling that you had an airtight case with the patent itself.

Today, the impression I get is that you can patent anything because otherwise how do the trolls take patents? And it is kind of left up to the courts to decide whether it is valid or not. And then the issue of prior art is often just one of the elements in the argument. It may not be a significant one.

Is that a change that has taken place, and how did it happen?

MR. DAVIES: Well, I don't know exactly, but I think it has happened, and it has gotten a lot easier to come up with some pretty silly ideas.<sup>40</sup> The idea that you could patent business methods...<sup>41</sup>

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<sup>38</sup> See generally *Practical Tips for Managing a Biotechnology Patent Portfolio*, June 3, 1998, <http://www.townsend.com/resource/publication.asp?o=4358> (recommending the formation of a corporate patent committee and describing the responsibilities of such a committee).

<sup>39</sup> *But see id.* (suggesting that one of the members of a patent committee should be a patent attorney).

<sup>40</sup> See generally Teresa Riordan, *Patents: An Appeals Court Says a Mathematical Formula Can be Patented, if it is a Money-maker*, NEW YORK TIMES, Aug. 3, 1998 at D2, available at

MR. CUNNINGHAM: [Phone rings.] This is all designed to show that this audience is more important.

MR. JANSEN: Is that message saying he has got five minutes?

MR. CUNNINGHAM: I will handle that message.

MR. DAVIES: That was low-tech.

MR. CUNNINGHAM: This was the five-minute message.

MR. JANSEN: He wanted to know what the bank was offering.

MR. DAVIES: Yes. To answer the question, I think it has gotten easier. We changed the criteria when we allowed for computer-implemented inventions.<sup>42</sup> What happened was that they forgot about the fact that it has to be an invention, and there were an awful lot of computer-implemented things, which have nothing to do with the physical world.<sup>43</sup>

So, I think, that's one of the things that has happened. And also, the pace of patenting has gotten to the point where, for a while the Patent Office was overwhelmed, and they couldn't do anything. Now they just came out with something, by the way, which I am horrified about to a certain extent. It is a new streamlined procedure.<sup>44</sup> You are supposed to do certain things to get the streamlined procedures, but I can just see what's going to come out of that one.

MR. CUNNINGHAM: One of the things, one of the problems we dealt with when we were working with your old company, Motorola, was the Armageddon. Everyone was supposed to get buried by Japan, and then everyone was going to get buried by China.<sup>45</sup> That was a concept called patent flooding where the idea was that Japanese companies would see a valuable patent held by Motorola, or in your case by Research in Motion, although you didn't exist at that time, and they would do literally hundreds of patents all around that with tiny variations on your patent, such that whenever you went to Japan, you would encounter things that were almost

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<http://query.nytimes.com/gst/fullpage.html?res=9D0CE6DE1F38F930A3575BC0A96E958260> (quoting Richard H. Stern saying that "The direction the Federal Circuit has been moving is to say you can patent anything as long as it's economically valuable.").

<sup>41</sup> Patent Business Methods, <http://www.uspto.gov/web/menu/pbmethod/> (last visited Oct. 7, 2007).

<sup>42</sup> See *Diamond v. Diehr*, 450 U.S. 175 (1981) (holding that using an algorithm on a computer could be patentable).

<sup>43</sup> See generally Michael Guntersdorfer, *Software Patent Law: United States and Europe Compared*, 2003 DUKE L. & TECH. REV. 6 (2003) (stating that the U.S. unlike Europe does not require inventions to exist in the physical world to be patentable).

<sup>44</sup> See generally Patent Docs: An Analysis of the New Rules: 37 C.F.R. §§ 1.78(d)(1) and 1.14: Streamlined Examination, [http://www.patentdocs.us/patent\\_docs/2007/09/an-analysis-o-5.html](http://www.patentdocs.us/patent_docs/2007/09/an-analysis-o-5.html) (discussing the new streamlined procedure for continuation applications) (last visited Oct. 7, 2007).

<sup>45</sup> See Sri Krishna Sankaran, *Patent Flooding in the United States and Japan*, 40 IDEA 393 (2000) (discussing patent flooding in Japan).

entirely identical to yours, but they were patented. Indeed, sometimes they brought cases against you for infringing their patent.<sup>46</sup>

MR. DAVIES: Their patent.

MR. CUNNINGHAM: Is that still an issue?

MR. DAVIES: Not really.

MR. CUNNINGHAM: Why has that ceased to be an issue?

MR. DAVIES: Well, first of all, I think, because Japan has gotten freer in their imports.<sup>47</sup> And I think that was basically a non-tariff barrier that they were working. And MITI has stopped pushing – I'm sorry. Maybe it is –

MR. CUNNINGHAM: No. That's what we tried to get MITI to do. I mean, my God, we won, and we didn't know it.

MR. DAVIES: Well, I don't think we won. I think it is just the world changed.

MR. CUNNINGHAM: That's what I always say when we win. Henry?

DR. KING: Yeah. Is there much of a case for a North American patent system?

MR. DAVIES: Well, I suppose there could be. The issue, again, would be right now where we have – we only have one patent system in North America that anybody pays attention to, and that's the U.S. system. I know that both the Canadian and Mexican patent offices exist. People file there, but they don't file initially there. They file in the U.S. first.<sup>48</sup>

So it is really sort of an integrated one. I think it would be great if NAFTA had run a system. They were to get our reforms in through there.

MR. CUNNINGHAM: Other questions?

Well, I think this has been terrific. Certainly, I learned a lot, a terrific presentation.

And I got to say that your company stands out as the sort of thing that the West needs to look to as the model for how we are all going to preserve our economic role in the world rather than what the doomsayers say is going to happen to us.

If we can all give a hand to Bill here.

MR. UJCZO: And we are completed for today. The bar area will remain open for about another hour or so here, so we invite you to continue the

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<sup>46</sup> *Id.*

<sup>47</sup> See generally Michael Richardson, *Asia-Pacific Sees a Chance for Freer Trade*, INTERNATIONAL HERALD TRIBUNE, January 19, 2001 at 17, available at [http://www.ihl.com/articles/2001/01/19/trade.2.t\\_4.php](http://www.ihl.com/articles/2001/01/19/trade.2.t_4.php) (discussing bilateral trade negotiation involving Japan).

<sup>48</sup> See Patents, <http://www.graytown.ca/dbus/legal/patents.htm> (recommending that Canadian inventors in the United States file in the U.S. first or obtain a foreign filing license because otherwise a patent granted by the U.S. may be held invalid) (last visited Oct. 7, 2007).

professional and personal relationships and conversations that have been established throughout dinner.

For those members of the Canada-United States Law Institute Executive Committee, we will be meeting about 8:30 in the Dean's Conference Room, which is straight away down the hall, and just take a hard right when you get to the glass. Don't walk into the glass, please.

For those of you that are retiring for the evening, we will see you at 8:45 in the morning as we open with our first session. It will be a tough day to match, but I think that all of our panelists tomorrow are up to the challenge as well. So we thank you again. We thank all of our speakers today for their comments as well as for – to all of you for being here throughout the day today, and we look forward to seeing you in the morning. Take care.



PEOPLE ASPECTS OF ENTREPRENEURS: PERSONAL SERVICE  
CONTACTS WITH KEY PERSONNEL INCLUDING NON-  
COMPETE CLAUSES, METHODS OF REIMBURSEMENT FOR  
COMPANY SUCCESS, INCENTIVES (PROFIT-SHARING OR  
OTHER), AND EFFECT OF IMMIGRATION RESTRICTIONS ON  
ENTRANCE OF POSSIBLE ENTREPRENEURS INTO CANADA  
AND THE U.S.

*Session Chair – Gerald “Jerry” Torma*  
*Canadian Speaker – John D.R. Craig*  
*United States Speaker – Benjamin W. Jeffers*

INTRODUCTION

*Gerald “Jerry” Torma*

MR. TORMA: Good morning. Can everyone hear me all right? Can everyone hear me okay? Good morning to everyone.

My name is Jerry Torma from the Nordson Corporation, and I am very pleased to be here today. I would like to thank Henry King and the other advisors and other organizers for their kind invitation to be here to represent Nordson Corporation at this extremely valuable and worthwhile event.

I will introduce our two presenters in just a moment. Nordson Corporation was founded in 1954 by Walter G. Nord and his two sons, Evan Nord and Eric Nord.<sup>1</sup> All three of them received their engineering degrees here at the Case Institute of Technology. The first product was airless electrostatic painting established and founded by and developed and discovered by a person from Case.<sup>2</sup>

As early as 1965, when Nordson was a relatively small company, they began their operations in Canada, and it was still very entrepreneurial in nature. And ever since 1965, Canada has been a truly important source of road for Nordson in three ways:

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<sup>1</sup> Nordson History, <http://www.nordson.com/Corporate/History/> (last visited Nov. 10, 2007).

<sup>2</sup> *Id.*

Number one: it provides sales, number two: it is a source of executive and managerial talent, and, three: it has always been managerial rather than entrepreneurial. It has always been rather unique in its innovative and technological contributions.

All of you have there in front of you a brochure called Northeast Ohio, and if I could ask you to open up to the center and look on the right-hand side. It reminds us that Northeast Ohio is a link to international business. The graph or chart or map on the right-hand side, in the middle there, also is very illustrative in that it shows us that Ohio and Canada are inextricably tied together.

There is a mutual interdependency in business, and many of us consider the Southern Canadian, Northern Ohio region, Northern United States and Midwest region as one economic unit, not two. So I think it is very fitting that we have this conference and presentation today to reinforce the oneness of that economic unit.

We are very fortunate to have with us this morning two presenters who are extremely experienced and extremely knowledgeable. I am sure we will all benefit from them. One of the principals I like to see sometimes is what I call three-way communication. Hopefully, one way is, from the three of us to all of you. Equally important I think is from all of you to us – your questions – and then sharing three-way communication participant to participant. So with no further delay, I would like to ask Benjamin Jeffers to introduce himself and to give the appropriate background and presentation followed by John Craig, our visitor and guest, pleased to have him from Canada.

Ben?

#### UNITED STATES SPEAKER

*Benjamin W. Jeffers\**

MR. JEFFERS: Good morning. I am very happy to be here. I want to thank the Institute for letting me come and speak this morning.

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\* Mr. Jeffers has experience in complex business disputes for both plaintiffs and defendants, at trial and appellate levels of state and federal courts, as well as other forms of alternative dispute resolution. His practice focuses on commercial matters and class actions, with a particular emphasis on automotive OEM/supplier disputes, antitrust and other unfair trade practice claims, and franchise and distributorship cases. Mr. Jeffers also has significant expertise with insurance company guaranty fund laws. He has successfully represented clients in many areas of litigation. Mr. Jeffers received both B.A. and J.D. degrees from the University of Michigan.

I have a litigation background, and my specialization is in commercial litigation. I have experience in a lot of supply issues, particularly when they rise to a dispute level. I also spend a fair amount of time working with small businesses, dealing with issues of non-competes, employment situations, and company secrets. Hopefully – and part of what I enjoy – is counseling and providing guidance that helps them avoid litigation. Certainly, my specialization is getting involved when there is a dispute. I come from Detroit, and I am one of the few that can say when I look across the border to our colleagues, I am actually looking south. That is a little known fact that has tripped up a politician or two here and there, and it is a fun place to be.

The people aspect of entrepreneurs is potentially a very broad topic, and what I decided I would like to do this morning is just address a couple of distinct issues. All of these things are things that I think entrepreneurs or business venturers need to think about when they are dealing with personnel decisions.

Of the three things that I want to speak about, first, is very briefly some current events and immigration issues. Candidly, this is not my area of specialization, but I find it very fascinating and interesting – the policy debate going on involving immigration and some of the real world impact of that policy debate.

Second: protecting a venturer's trade secrets. Really I just want to touch upon the importance in an entrepreneurial setting, or any small business setting, of putting the right protections and measures in place to protect your company's secrets with respect to key employees and other stakeholders of your business.

And last, again, I am just going to touch upon an area that I have some familiarity with but certainly not expertise, which is compensation. I want to just address a few of the trends in U.S. executive compensation.

I recently read a little report that was published by a company called Interior Software Company. They were identifying some trends of small U.S. businesses. One of the trends that they had identified was classifying what they call a new breed of entrepreneurs, which they indicated would include people who are near retirement age –

lot of people. This is meaningful coming from Detroit – displaced from their jobs, leaving their jobs earlier than they had anticipated, earlier in their careers and starting something new.<sup>3</sup> More women are becoming entrepreneurs.<sup>4</sup>

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<sup>3</sup> Institute for the Future, *Intuit Future of Small Business Report, First Installment: Demographic Trends and Small Business* 3-5 (Jan. 2007), available at [http://http-download.intuit.com/http.intuit/CMO/intuit/futureofsmallbusiness/SR-1037\\_intuit\\_SmallBiz\\_Demog.pdf](http://http-download.intuit.com/http.intuit/CMO/intuit/futureofsmallbusiness/SR-1037_intuit_SmallBiz_Demog.pdf).

<sup>4</sup> *Id.* at 7-8.

Then the report also noted a continuing trend of immigrant entrepreneurs as being one of the fastest growing segments in, certainly, small business ownership.<sup>5</sup> It attributed this to a number of factors, some of which may include trying to steer around traditional barriers of employment when you come to the U.S., including not having corporate contacts, English language skill barriers, not having experience with large companies and really noting that starting a business in some respects may be easier than trying to get a job in your field in the US.<sup>6</sup> The report went on to comment that the trend may depend in large respect on how this policy debate plays out.<sup>7</sup> I think that is true to a degree. I think that whether or not immigrants to this country, or even Canada, can come here and establish an entrepreneurial venture I think is one topic.

One of the things in which I do see a potential problem is in establishing U.S. ventures or entrepreneurs trying to get access to highly skilled workers who are foreign born coming to the U.S. to work here, and the need for U.S. companies to attract these highly skilled workers.

I am going to get to just one example. Before I do, I also want to note that in Tab 3 of your materials – this is not material that was keyed for today’s preparation – but there was additional data. I believe it was called Trend Setter. And I noted in looking through it that in this Trend Setter barometer data they had polled some CEOs of vast growing businesses, and that one of the single most important challenges a business will face in 2007, number one on that list, was finding and entertaining qualified employees.<sup>8</sup>

The data went on to mention the top three wild card issues in 2007: 47 percent mentioned a shortage of qualified workers.<sup>9</sup> One example of this is somewhat recent, and this is the H1-B visa shortage<sup>10</sup>, my term.

U.S. businesses use H1-B visas as a means of employing foreign-born workers with specialized knowledge – scientists, engineers, and computer programmers.<sup>11</sup> Certainly, there are a myriad of other visa programs and mechanisms for non-immigrants and immigrants alike to come to the U.S. and work.<sup>12</sup> I am not going to go through all of them in any degree, but I

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<sup>5</sup> *Id.* at 8.

<sup>6</sup> *Id.*

<sup>7</sup> *Id.* at 9.

<sup>8</sup> PriceWaterhouseCoopers, TRENDSETTER BAROMETER: BUSINESS OUTLOOK 2Q 2007 3 (2007) available at <http://store.barometersurveys.com/docs/2Q%202007%20Trendsetter%20Business%20Outlook%20PricewaterhouseCoopers%20FINAL.pdf>.

<sup>9</sup> *Id.*

<sup>10</sup> See Jared Leung, *Understanding and Managing the H1B Visa Cap*, INDUSTRY WEEK (June 28, 2006), available at <http://www.industryweek.com/ReadArticle.aspx?ArticleID=12223>.

<sup>11</sup> *Id.*

<sup>12</sup> See *id.* (listing five options, including hiring within US).

wanted to touch on this example as perhaps being illustrative of some problems we have and how the policy debate needs to focus on it.

The key here for the H1-B visas is that there is an annual limit of 65,000 for new visas every year.<sup>13</sup> These applicants have to have a B.A. degree, and there are another 20,000 who have to have a U.S. Master's Degree.<sup>14</sup> Petitions are filed by U.S. businesses as of April 1st of every year for the following fiscal year – U.S. Government fiscal year, October 1 through September 20th.<sup>15</sup> So there is really a rush to file.

The date this year was April 2nd, which was a Monday, and the U.S. Citizenship and Immigration Services announced that they had received more than enough petitions on that very day to satisfy the count for the entire year.<sup>16</sup> I just picked up the press release, and it is notes they had received over 150,000 H1-B petitions on April 2nd, the day that you could actually file, so the cap was reached.<sup>17</sup> They will have a random selection process to determine which cases are actually accepted, and everyone else will have to wait another year.<sup>18</sup> I think this is really an interesting problem.

Talking with Jerry before the program, I asked him how his company deals with some of these issues. He said, well, you know, we are global and have facilities in so many different parts of the world, and if we want to bring people over here, there are other visa programs that might get by, the L1-B for example.<sup>19</sup> Or there may not be the need to bring workers over here to make products if, in fact, you have the facilities abroad and are going to have to hire workers there and make the product there.<sup>20</sup>

But if you are a U.S. business relying on skilled workers and you cannot find enough in the United States, this is going to be a real issue. I think what

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<sup>13</sup> *Id.*

<sup>14</sup> Press Release, U.S. Citizenship and Immigration Services, USCIS Update: Information to Help Complete and Submit I-129 Petitions to USCIS Services Centers for FY 2008 H-1B Cap Cases (March 27, 2007), *available at* [http://www.uscis.gov/files/pressrelease/H1B\\_I129Info\\_032707.pdf](http://www.uscis.gov/files/pressrelease/H1B_I129Info_032707.pdf).

<sup>15</sup> *Id.*

<sup>16</sup> Press Release, U.S. Citizenship and Immigration Services, USCIS Reaches FY 2008 H-1B Cap (April 3, 2007), *available at* <http://www.uscis.gov/files/pressrelease/H1BFY08Cap040307.pdf>.

<sup>17</sup> *Id.*

<sup>18</sup> *Id.*

<sup>19</sup> See Temporary Benefits Employment Categories and Required Documentation, U.S. Citizenship and Immigration SERVICES, <http://www.uscis.gov/portal/site/uscis/menuitem.5af9bb95919f35e66f614176543f6d1a/?vgnextoid=229c6138f898d010VgnVCM10000048f3d6a1RCRD&vgnnextchannel=91919c7755cb9010VgnVCM10000045f3d6a1RCRD> (last visited Nov. 11, 2007) (delineating the guidelines for the L-1B intra-company transfer visa).

<sup>20</sup> See Daniel Altman, *Managing Globalization: Economies Have a Stake in Where Companies Find Employees*, INT'L HERALD TRIBUNE (June 6, 2006), *available at* <http://www.iht.com/articles/2006/06/13/business/glob14.php> (describing how companies are finding workers they need by sending work abroad).

it says about the problem in the United States of U.S. citizens acquiring this sort of specialization education is something for another day, but that's certainly a sub-theme in there.<sup>21</sup>

So there is an obvious barrier here to businesses in the U.S. that need access to this skilled talent pool. Perhaps a little less obvious, but clearly related, is the notion that this sort of policy, if it continues, may force U.S. businesses to go abroad looking for this sort of skilled labor.<sup>22</sup> So this is perhaps another example of U.S. companies needing to go abroad, not necessarily looking for cheaper labor, although that may be true as well, but looking for the right sort of labor.

Particularly in industries and segments where the U.S. wants to champion high-tech industry and the information and technology industries, economic success is crucial.<sup>23</sup> Now, I didn't bring any hard and fast data for you on whether this H1-B shortage has had a sort of doomsday impact, but I did want to highlight for you something that is interesting. This is some testimony by Bill Gates before the Senate Committee on Health, Education, Labor, and Pensions. These were written comments submitted in March of this year. And he – I wanted to highlight some other things he said, and I am quoting:

America will find it infinitely more difficult to maintain its technological leadership if it shuts out the very people who are most able to help us compete. Other nations are recognizing and benefiting from this situation. They are crafting their immigration policies to attract highly talented students and professionals who would otherwise study and work here. Our lost opportunities are their gains.<sup>24</sup>

Mr. Gates goes on to highlight what he sees as the illogic of encouraging the best students from abroad to come over here and study and then taking the exact opposite approach if they want to stay.<sup>25</sup> He knows that, quote, "Foreign students who apply for a student visa to the United States today

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<sup>21</sup> See *Strengthening American Competitiveness for the 21<sup>st</sup> Century, Before the S. Comm. on Health, Education, Labor, and Pensions*, 110<sup>th</sup> Cong. (2007) available at [http://help.senate.gov/Hearings/2007\\_03\\_07/2007\\_03\\_07.html](http://help.senate.gov/Hearings/2007_03_07/2007_03_07.html) (statement of William H. Gates, Chairman, Microsoft Corporation).

<sup>22</sup> See generally Altman, *supra* note 20 (describing how US companies are already going abroad in search of additional skill sets due to the dearth in the US).

<sup>23</sup> See generally Bruce P. Mehlman, Assistant Sec'y for Tech. Policy, U.S. Dept. of Commerce, *Technology-led Development in the Post-Bubble, Post-9/11, Post-Enron America*, Address at the Louisiana Economic Outlook Conference (Nov. 15, 2002) (discussing why and how technology is vital to Louisiana's regional economic development).

<sup>24</sup> Gates, *supra* note 21, at 10.

<sup>25</sup> *Id.* at 10.

must prove that they *do not* intend to remain here once they receive their degrees. This makes no sense.”<sup>26</sup>

So he is highlighting sort of the obvious problem. He also goes on to address what I think is this notion of businesses needing to follow where the talent pool is. He says,

Barring high-skilled immigrants from entering into the U.S., and forcing the ones that are here because they cannot obtain a visa, ultimately forces U.S. employers to shift development work and other critical projects offshore. This can also force U.S. companies to fill related management, design, and business positions with foreign workers, thereby causing further lost U.S. job opportunities, even in areas where America is strong, allowing other countries to “bootstrap themselves” in these areas and further weakening our global strength.<sup>27</sup>

He concludes on that point by saying, in short, “[W]here innovation and innovators go, jobs are soon to follow.”<sup>28</sup>

I think that’s true, and I think that this issue is an example of the real tension here. We hear a lot in the policy debate about security issues, border issues, and illegal immigrant issues.<sup>29</sup> I certainly have not heard much, or nearly enough, about issues of how this may impact specific sectors, high-tech sectors, and access to skilled workers when U.S. companies desperately want to bring such skilled workers over here.

This is being addressed. Potential reform for this issue is, as I said, being carried out as part of the overall debate of immigration and is in Congress right now.<sup>30</sup> It is part of the STRIVE Act cap for H1-B visas.<sup>31</sup> Under the bill, they would go up.<sup>32</sup> They would eliminate the 20,000 cap for persons with

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<sup>26</sup> *Id.* at 11.

<sup>27</sup> *Id.*

<sup>28</sup> *Id.*

<sup>29</sup> See generally *id.* at 10 (describing that while national security and border security are important policy goals, Mr. Gates believes they can be done in a way that would do less damage to the US’s competitiveness and prosperity).

<sup>30</sup> See, e.g., *Protecting U.S. and Guest Workers: the Recruitment and Employment of Temporary Foreign Labor, Before the Comm. on House Education and Labor*, 110th Cong. (2007) available at <http://edworkforce.house.gov/hearings/fc060707.shtml> (statement of Jonathan P. Hiatt, General Counsel, American Federation of Labor and Congress of Industrial Organizations) (discussing labor issues related to the immigration debate).

<sup>31</sup> See generally *id.*

<sup>32</sup> *Summary of Security Through Regularized Immigration and a Vibrant Economy Act of 2007*, NAFSA: National Association of International Educators 8 (2007), available at [http://www.nafsa.org/\\_/File/\\_/strive\\_summary.pdf](http://www.nafsa.org/_/File/_/strive_summary.pdf).

advanced degrees, and like any other sort of massive overhaul or purported overhaul of any system, there will be political compromises, and there will be other issues.<sup>33</sup>

So it remains to be seen how this particular sub-issue will play out, but stay tuned because I think we will see more in the coming months. I did hear one commentator say that if immigration reform is not addressed this year, it is very unlikely that it will be addressed next year given presidential politics.<sup>34</sup>

Other issues the commentators have indicated need to be addressed. Certainly people who want to work here on a permanent basis are being subject to unnecessary barriers at U.S. consulates or embassies abroad.<sup>35</sup> The tension, of course, is related to security concerns in the post-9/11 world.<sup>36</sup>

Now I am going to switch gears. I want to address the issue of restricted covenants. I wanted to highlight the importance of restrictive covenants and agreements with key employees and stakeholders in your venture, particularly for a startup and the need for awareness.

Yesterday, I recall, Mr. Barber commented about entrepreneurship and how it is inherently relationship driven. He mentioned that the market doesn't issue a PO. People issue POs. Fundamentally, we rely on people. There is, or should be, a link between prosperity and ethics in the workplace.

Well, ethics is certainly – there is one form of honesty, pure and simple – but the people aspects of entrepreneurship as a topic means, unfortunately, that we will run into dishonesty and temptation in the marketplace. That's where you might find yourself talking to someone like John or myself.

I must say, as a litigator – and I was reflecting on another comment I heard yesterday – that perhaps entrepreneurs and bureaucrats don't mix, sort of like oil and water. Well, I can tell you, entrepreneurs and litigators do not make for a better combination either. The individuals that come to see me, the small businesses I worked for grudgingly would come to me, and it usually would be in one of two circumstances. One is where someone has taken something from them, a trade secret or intellectual property or perhaps

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<sup>33</sup> *Id.*

<sup>34</sup> See generally Farhana Hossain, Ben Werschkul, & Sarah Wheaton, *The Presidential Candidates on Immigration*, N.Y. TIMES, Sept. 28, 2007, available at <http://politics.nytimes.com/election-guide/2008/issues/immigration/index.html> (describing the prior positions on immigration reform of likely presidential candidates).

<sup>35</sup> See generally Jennifer Steinhauer, *Austrian Interns Run Into U.S. Visa Problems*, N.Y. TIMES, Aug. 22, 2007, available at <http://www.nytimes.com/2007/08/23/us/23holocaust.html?partner=rssnyt&emc=rss> (describing the problems an Austrian Holocaust museum worker had obtaining a visa).

<sup>36</sup> See NATL. COMM. ON TERRORIST ATTACKS UPON THE U.S., THE 9/11 COMMISSION REPORT, available at [http://www.9-11commission.gov/report/911Report\\_Ch12.htm](http://www.9-11commission.gov/report/911Report_Ch12.htm) (stating immigration was not a national security matter before 9/11).

brought something to them that they were unaware of in the sense of hiring someone who brought some knowledge and has unwittingly embroiled them in a dispute.

But this is certainly an issue in the increasing and noble workforce and the reality of the digital workforce. Gone are the good old days, perhaps, of photocopying the company's Rolodex and walking out with a customer list. Now you just need a little zip drive, and you can download half the company's information, and you are gone. And commenting on being careful when hiring, this works both ways. You need to be very careful and do your due diligence when hiring employees, who may be bringing trade secrets. Although you may not have done anything wrong, and may not end up being a party to an inevitable lawsuit, it certainly would be a distraction if the key employee just hired was now exposed to litigation risk. There is a myriad of ways to deal with this, covenants not to compete, confidentiality agreements, et cetera.<sup>37</sup> I will just touch upon it very quickly.

Covenants not to compete are agreements between an employer and employee where the employee agrees not to compete for a certain period of time within a certain geographic or industry segment following leaving the employer.<sup>38</sup> Confidentiality agreement, it is just that. It is maintaining company secrets.<sup>39</sup> This may apply when you are dealing with someone who may not be in a position to go out and compete with you after he or she leaves your company, but nonetheless might be in a position to provide company secrets in any event.

Non-solicitation agreements come in two forms: not to solicit customers and not to solicit other employees.<sup>40</sup> The former is harder to enforce, much like non-competes, because it is, in some respects, an inherent restraint on trade.<sup>41</sup> Agreements not to solicit co-employees, may be a little bit easier for the states to enforce.

Who needs this? Well, it depends. There is no one-size-fits-all. I say, at the bottom, not the janitor.<sup>42</sup> Believe it or not, we had a client come to us recently, and they wanted to hire some painters for the summer. And they wanted some non-compete agreements so that these student painters for the

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<sup>37</sup> See generally Victoria A. Cundiff, *How to Protect Confidential Business & Technical Information*, 719 PRACTICING LAW INST. 85, 87-92 (2002) (describing the different ways which a party can handle covenants not to compete and confidentiality agreements).

<sup>38</sup> See BLACK'S LAW DICTIONARY 392 (8th ed. 2004) (defining non-compete covenant).

<sup>39</sup> See 54A AM. JUR. 2D *Monopolies and Restraints of Trade* § 918 (2007).

<sup>40</sup> See BLACK'S LAW DICTIONARY 1084 (8th ed. 2004) (defining non-solicitation agreements).

<sup>41</sup> See generally 2 LOUIS ALTMAN AND MALLA POLLACK, *Callmann on Unfair Competition, Trademarks, and Monopolies* § 16:44 (4th ed. 2007).

<sup>42</sup> See TAMMY HINSHAW, ET. AL., 54A AM. JUR. 2D *Monopolies, Restraints of Trade, and Unfair Trade Practices* § 854 (2007).

summer couldn't go work for the competitor painting company for the balance of the summer, and we said, "No, no, no. You know, that's not going to work. There is no protected interest there, and it wouldn't be enforceable anyway."<sup>43</sup>

The key is that these need to be reasonable.<sup>44</sup> Non-compete agreements have problems all their own.<sup>45</sup> Generally, courts are loathe to enforce them if they perceive they are going to be un-employing someone who reasonably believed that they were complying. This is the sort of answer that business people can't stand when they come to me as a litigator and they say, "Fine, draft this thing for me. What do I need?"

Well, what's reasonable then? Well, it depends. So if you want to talk more about this with me, I will give you the "it depends" answer. Maybe we can talk about what your business entails. Keep in mind these are contracts, and so you need to check in your jurisdiction on what consideration is necessary.<sup>46</sup>

If you are starting a job with an employer, it is easy. A non-compete can be a condition for employment.<sup>47</sup> If you want to inject a non-compete, you can inject it. If you want to have existing employees sign one, it is a little more difficult.<sup>48</sup> In some jurisdictions, merely maintaining your employment is consideration enough.<sup>49</sup> In other jurisdictions, you need something else.<sup>50</sup>

There is an interesting problem, even in jurisdictions where maintaining your employment is enough. Consider the situation where you are a startup company. You are growing. You have ten employees, ten sales persons – you want them all to sign. Nine sign without a problem. The tenth – let's just say he is your best employee – doesn't want to. Now what do you do? Do

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<sup>43</sup> See generally RICHARD M. GALLAGHER, ET AL., 42 AM. JUR. 2D. *Injunctions* § 136 (2007).

<sup>44</sup> LAURA DIETZ, ET AL., 17A AM. JUR. 2D *Contracts* § 326 (2007).

<sup>45</sup> See generally Ann C. Hodges, Porcher L. Taylor, III, *The Business Fallout from the Rapid Obsolescence and Planned Obsolescence of High-Tech Products*, 6 COLUM. SCI. & TECH. L. REV. 3, 4 (2004-05) (describing how many commentators have recognized the problem of lack of predictability in interpreting non-compete agreements and how enforcement litigation is encouraged).

<sup>46</sup> See generally Norman D. Bishara, *Covenants Not to Compete in a Knowledge Economy: Balancing Innovation from Employee Mobility Against Legal Protection for Human Capital Investment*, 27 BERKELEY J. EMP. & LAB. L. 287, 317 (2006) ("There is no uniformity in the enforcement of post-employment non-competition agreements among states.").

<sup>47</sup> See generally Ferdinand S. Tinto, Annotation, *Sufficiency of Consideration for Employee's Covenant Not to Compete, Entered into after Inception*, 51 A.L.R.3d 825, 828 (1973) (stating that when the employee executes the covenant at the same time he accepts employment, the latter becomes the consideration for the covenant.)

<sup>48</sup> See generally *id.* (stating that some jurisdictions require additional benefits in consideration for a non-compete covenant for a current employee.)

<sup>49</sup> *Id.*

<sup>50</sup> See *id.*

you fire that employee for not signing that covenant not to compete? That may cause the very harm you are trying to avoid. Keep in mind this person doesn't have a non-compete yet. Yet, if you don't fire that person, or don't take some steps, it may call into question the validity of those other nine.

It is one of these issues where it is tough to have it both ways. So that's something to keep in mind. Again, it depends upon the jurisdiction in the United States how those are dealt with. In the event that you find yourself as an entrepreneur without the right agreements in place, there are some statutory protections: the Uniform Trade Secrets Act has been adopted in nearly all states.<sup>51</sup> It is fine to have these rights, but it is expensive to enforce them.

Having the right agreements and the right protections also doesn't prevent someone from stealing your secrets, and it won't ensure that you will not find yourself in a lawsuit.<sup>52</sup> But, at least, it gives you a framework to start to enforce your rights that may, in some respects, be cheaper than trying to do it merely through statutes.

As an aside, it can also be a criminal violation to steal trade secrets and send them abroad.<sup>53</sup> In Detroit last year, this is just a snippet from a press release involving some former Metaldyne employees – Metaldyne is an automotive supplier – and this is one of these horror stories where it plays out sort of like a novel, where some former employees conspire with a current employee to steal trade secrets and give them to, in this case, a Chinese company.<sup>54</sup> Metaldyne is in the powdered metals industry, and they have a great deal of specialization.<sup>55</sup>

Metaldyne found out that something was going on.<sup>56</sup> They sort of quickly did an internal investigation.<sup>57</sup> They put a package together and gave it to the FBI who arrested these individuals who, by the way, were not that smart.<sup>58</sup>

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<sup>51</sup> Michael L. Rustad, *The Negligent Enablement of Trade Secret Misappropriation*, 22 SANTA CLARA COMPUTER & HIGH TECH. L.J. 455, 516 (2006).

<sup>52</sup> See generally *id.*, at 481 (stating that federal law enforcement lacks the resources to successfully combat industrial espionage).

<sup>53</sup> *Id.*, at 465.

<sup>54</sup> Press Release, U.S. Dep't of Justice, U.S. Att'y, E. Dist. of Mich., Former Metaldyne Employees Indicted for Theft of Trade Secrets (July 5, 2006), available at <http://www.cybercrime.gov/lockwoodind.pdf>.

<sup>55</sup> See *id.*

<sup>56</sup> See generally Philip Burgert, *Metaldyne Execs Accused of Selling Secrets to China*, AMERICAN METAL MARKET, Feb. 5, 2005, available at [http://findarticles.com/p/articles/mi\\_m3MKT/is\\_44\\_113/ai\\_n9508273](http://findarticles.com/p/articles/mi_m3MKT/is_44_113/ai_n9508273) (stating that the incident came to light after Chongqing, a Chinese company formed by former Metaldyne Vice President of Sales Anne Lockwood, requested a quote from International Truck & Engine Corp. for equipment to make a new connecting rod prototype that had large metal design components created by Metaldyne).

<sup>57</sup> *Id.*

<sup>58</sup> *Id.*

There was access to their Yahoo accounts, which indicated, “Dear so and so: Please put these files in this room where company A can get them. This is just going to be great. There will be no way Metaldyne can compete after I take this stuff.” I tried to find out what the results of this were and haven’t been able to figure it out.

Very briefly, I just wanted to spend two minutes because that will, again, exhaust my expertise, talking about some trends and executive compensation. I think this is important for entrepreneurs to be aware of. Even though the press and a lot of the regulations are dealing with CEOs of the large public corporations, I think it is important for smaller and private companies to be aware of the trends.

There were comments yesterday – I think it was David Woolford who mentioned that a good entrepreneur is thinking like a public company in the sense that, if you act public, you will be putting yourself in positions where you are not surprising your stakeholders. Well, some of the regulations that may impact executive compensation may, in fact, end up being best practices for smaller companies or exempt companies.

Sarbanes-Oxley has had an impact. It has had boards of directors delegating responsibility for executive compensation-to-compensation committees of disinterested directors.<sup>59</sup> Enron, again, we see an impact there. You may know that many of Enron’s hiring executives received a substantial amount of preferred compensation.<sup>60</sup> They voluntarily terminated their employment and elected immediate payments of their corporate deferred compensation plans just before the scandal became public.<sup>61</sup> So there are new rules addressing the timing of when you can take advantage of that, and there is a six-month timing gap to try to avoid some of these things.<sup>62</sup>

Changes in SEC proxy rules – I read some comments by the SEC Commissioner that he composed in January of this year – and he just

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<sup>59</sup> See generally Dennis J. Block, *Public Company M&A: Recent Developments in Corporate Control, Protective Mechanisms, and Other Deal Techniques*, 1587 PRACTICING L. INST. 7, 151 (2007) (stating there is greater scrutiny of executive compensation due to the adoption of Sarbanes-Oxley).

<sup>60</sup> See generally Meredith Downes & Gail S. Russ, *Antecedents and Consequences of Failed Governance: the Enron Example*, 5 CORP. GOVERNANCE: THE INT’L J. OF BUS. IN SOC’Y 584 (2007), available at 2007 WLNR 18643296 (stating that board members at Enron were paid handsomely, and that Enron’s CFO Andrew Fastow earned \$30 million from partnerships enabled by Enron’s suspension of its code of ethics).

<sup>61</sup> See generally *id.* (stating that Fastow, CEO Jeff Skilling, and twenty-seven other Enron executives sold their shares before the company went bankrupt).

<sup>62</sup> See generally *id.*; see also Roel C. Campos, Comm’r, Sec. Exch. Comm’n, Remarks Before the 2007 Summit on Executive Compensation (Jan. 23, 2007), available at <http://www.sec.gov/news/speech/2007/spch012307rcc.htm> (stating that new executive compensation rules will have the effect of focusing executive compensation committees on the details of executive compensation packages).

highlighted that the SEC's focus is not going to necessarily interfere with the level of compensation, but should be in order to make less of it, but just to require more disclosure and more transparency.<sup>63</sup>

He gave a few tips regarding what boards should be thinking about regarding compensation and benefit packages for key individuals. One was to do your homework. As a compensation committee, he indicated that often these committees are not doing a good enough job to really appreciate the variations or the contingencies that may happen.<sup>64</sup> How much money is someone going to get when they walk out the door in various scenarios, change of control, firing, service, insolvency? Some of the new SEC guidance will require narrative explanations of what triggers these payments and exactly the estimated amount.<sup>65</sup> He was recommending negotiating teams for companies, to try to inject a process here and involve disinterested parties, decide what your parameters are, focus on long-term sustainable performance for these employees and less upon short-term benchmarks and really to focus on job jeopardy issues, service issues.<sup>66</sup> What are people getting when they leave?

He didn't use this example, but I think many of us are aware of it: the Walt Disney case, the Mike Ovitz case, where he was fired after fourteen months and walked away with \$130 million.<sup>67</sup> All of us wonder; how on earth can that happen? Well, it happened because that was the deal given to him on his way in.

It was not money handed to him on his way out.<sup>68</sup> Derivative litigation, shareholder litigation, ultimately the Delaware Supreme Court concluded that there was no breach of duty on the part of Disney there, but if you read the opinion, you certainly get the sense, as I did, that they were kind of holding their nose and voting for Disney as they say, begrudgingly saying that this just looked like kind of a sloppy process – how this compensation was decided.<sup>69</sup>

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<sup>63</sup> *See id.*

<sup>64</sup> *Id.*

<sup>65</sup> *See id.*

<sup>66</sup> *See id.*

<sup>67</sup> *See generally* James B. Stewart, *Partners*, THE NEW YORKER, Jan. 10, 2005, at 46, available at [http://www.newyorker.com/archive/2005/01/10/050110fa\\_fact\\_stewart](http://www.newyorker.com/archive/2005/01/10/050110fa_fact_stewart) (stating that Disney paid Ovitz \$140 million to settle his contract).

<sup>68</sup> *See generally* Brehm v. Eisner, 746 A.2d 244, 244 (Del. 2000), and *In re Walt Disney Co. Derivative Litig.*, 825 A.2d 275 (Del. Ch. 2003) (Disney original shareholder's derivative suit and subsequent history, stemming from Disney's \$130 million severance package to Michael Ovitz).

<sup>69</sup> *See generally* Brehm, *supra* note 68 at 267 (stating that it is understandable that Disney shareholders are upset over Ovitz's package, but ultimately dismissing their complaint without prejudice).

\* John Craig began his career as a law clerk to Chief Justice Antonio Lamer and Justice

So I will conclude my remarks now and just as I did not attempt to do throughout the presentation, I won't try to tie all those three topics together. But I wanted to highlight for you these are all people aspects of entrepreneurs.

MR. TORMA: Ben, thank you very much. You did a remarkable job of covering a myriad of topics in a short period of time. Thank you very much.

John?

MR. CRAIG: If I can do this.

MR. TORMA: While he is doing that, I will comment briefly on non-competes and then later perhaps give a lay person's view of them perhaps from a different viewpoint; that it is just common sense – and it is not as difficult as it could be – when you understand it is not just in the interests of the company; it is really more in the interests, collective interests, of the employees than just the company, and we can cover that later at this time. Thank you.

John?

#### CANADIAN SPEAKER

*John D. R. Craig\**

MR. CRAIG: Thanks. It is a great pleasure to be here. My colleague, Stan Friedman, who would otherwise be here but for a commitment that he could not get out of, suggested that this would be a great opportunity for me to share my thoughts on people issues to a joint Canadian-American audience, and it sounded fun and interesting.

By way of background, I am a partner at Heenan Blaikie, which is a Canadian law firm with a large management side employment practice. We have offices across the country in Vancouver, Calgary, Toronto, Montréal and smaller offices in Québec. We also act for North American and other multinational corporations and we are allied with firms across the globe. My practice includes both large and small American clients and I have a number of Canadian clients who are in the entrepreneurial category.

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Charles Gonthier of the Supreme Court of Canada in 1994. He joined Heenan Blaikie in 2001 after several years with another prominent Toronto firm. Mr. Craig practises exclusively in the area of labour law at the University of Western Ontario, where he has been teaching since 1999. He is the author of *Privacy & Employment Law* (Hart Publishing, 1999), a book based on his doctoral thesis. He has also published articles related to labour and employment law in the *McGill Law Journal*, the *Comparative Labour Law & Policy Journal*, the *Industrial Law Journal*, the *Review of Constitutional Studies*, the *European Human Rights Law Review*, and the *Canadian Labour and Employment Law Journal*.

As Ben mentioned, this topic is somewhat of a grab bag, but I do want to touch upon a few issues, namely doing business in Canada, employment law, independent contractors, the importance of contracts, compensation, and issues that arise when crossing the frontier between our two countries.

So first, the good news, there have been a number of recent studies discussing issues of doing business and the cost of doing business. The KPMG survey, “Guide to International Business Costs, 2006” indicated that Canada has the second lowest business costs among the countries surveyed, and Canada ranks behind only Singapore on employment and labor costs.<sup>70</sup> There is more good news from a report entitled “Doing Business in 2006”: Canada ranked number four in ease of doing business and number one in flexibility and working time.<sup>71</sup> This may be a surprise to those of us working in Canada, since every other country has less working hours than we do. What is notable, however, is that Canada ranks behind the United States in a number of important factors, including the difficulty of hiring employees, the difficulty of firing employees, and Canada ranks well below the United States in the flexibility of employment.<sup>72</sup> Therefore, expectations that small American companies or entrepreneurs have based on their own systems will not necessarily stand in good stead once they cross the border.

Now, the bad news: In my experience, entrepreneurs tend to approach a lot of issues with a certain “Wild West” mentality, a “take no prisoners” mentality. They try to find new ways to do things and sometimes that can get them in trouble, particularly when they are dealing with a context they may not be entirely familiar with. Moreover, they often do not have counsel or consultants providing them with the advice that they require to be successful. This leads me to a few points I would like to make on the topic of employment law.

First, employment law in Canada is primarily a matter of provincial jurisdiction. There are ten provinces in Canada, each of them having different laws on employment issues.<sup>73</sup> As a result, there are different laws: employment standards, human rights, occupational health and safety,

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<sup>70</sup> KPMG LLP, COMPETITIVE ALTERNATIVES: KPMG’S GUIDE TO INT’L BUS. COSTS i (2006), available at [http://www.kpmg.ca/en/industries/cib/consumer/documents/Competitive\\_Alternatives.pdf](http://www.kpmg.ca/en/industries/cib/consumer/documents/Competitive_Alternatives.pdf).

<sup>71</sup> See THE WORLD BANK GROUP, DOING BUS. IN 2006, at 3 tbl.1.2 (2006) (stating that Canada is number four in ease of doing business), and at 23 tbl.4.2. (stating that Canada has the least amount of rigidity regarding work hours).

<sup>72</sup> See *id.* at 22 tbl.4.1 (listing the U.S. as the third easiest country to hire and fire from; Canada is not listed), and at 23 tbl.4.2. (listing the U.S. as having the third least rigid employment environment; Canada is not listed).

<sup>73</sup> See generally John-Paul Alexandrowicz, *A Comparative Analysis of the Law Regulating Employment Agreements in the United States and Canada*, 23 COMP. LAB. L. & POL’Y J. 1007, 1028 (2005) (stating that Canadian workers are protected by a variety of provincial employment discrimination laws).

workers' compensation, and pension laws. There is only a narrow category of employers who are regulated nationally, which include companies like Air Canada and communication companies.<sup>74</sup> Otherwise, the general rule is that companies and employment relationships are regulated provincially.<sup>75</sup> So, if a company or entrepreneur wishes to employ individuals in Vancouver and Toronto, they will be required to comply with two different sets of employment laws, in British Columbia and Ontario.<sup>76</sup>

Second, there is no common law equivalent to the U.S. "at will" concept in Canada. I understand "at will" to be the ability of an employer to fire a person for any reason or no reason as long as it is done in compliance with human rights laws.<sup>77</sup> In Canada, it is true that you can be fired for any reason or no reason, but an employer has to provide working notice to employees.<sup>78</sup> This requires employers to give notice of a particular period of time or to pay the employee for the notice they would have otherwise received.<sup>79</sup> Typically, employment standards legislation in various provinces will set out notice periods.<sup>80</sup> In Ontario, which is probably the most relevant jurisdiction here, the general rule under the statute is one week to a maximum of eight weeks.<sup>81</sup> So if you have an employee who has been working for you for two years, you are required to give him about two weeks of notice.<sup>82</sup>

This is where it becomes more complicated. My third point is that, in addition to the statute, there is also a common law notice period.<sup>83</sup> My American clients refer to this as the "Canadian mystery notice period."<sup>84</sup> The

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<sup>74</sup> See generally *Overview: Discrimination and Harassment: Federally Regulated Organizations*, CANADIAN HUMAN RIGHTS COMMISSION, [http://www.chrc-ccdp.ca/discrimination/federally\\_regulated-en.asp](http://www.chrc-ccdp.ca/discrimination/federally_regulated-en.asp) (last visited Oct. 14, 2007) (listing Canadian federally regulated industries covered by the Canadian Human Rights Act).

<sup>75</sup> See generally Alexandrowicz, *supra* note 73, at 1030 (stating that employees are protected against discrimination on various prohibited grounds by provincial human rights statutes).

<sup>76</sup> See generally *id.* (stating that individual Canadian employees have significant rights at common law).

<sup>77</sup> See Marc Cote, *Getting Dooced: Employee Blogs and Employer Blogging Policies Under the National Labor Relations Act*, 82 WASH. L. REV. 121, 124 (2007).

<sup>78</sup> Walter Stella & Patricia Forte, *Employers Find a Different World Up (or Down) There: Workers' Rights Vary Dramatically North and South of the Border*, THE NAT'L L.J., Apr. 18, 2007, available at <http://www.law.com/jsp/ihc/PubArticleIHC.jsp?id=1176800663236>.

<sup>79</sup> *Id.*

<sup>80</sup> *Id.*

<sup>81</sup> Employment Standards Act, 2000 S.O., ch. 41 (Can.).

<sup>82</sup> See *id.* (requiring at least two weeks of notice if the employee's period of employment is one year or more and fewer than three years).

<sup>83</sup> See Stella & Forte, *supra* note 78 (stating that there is no formula to calculate a "reasonable notice" period in common law).

<sup>84</sup> See generally *id.* (describing common law notice as "an art rather than a science").

rule of thumb is about one month per year of service.<sup>85</sup> So if an employee decides to see you in Court because you fired them, you may be required to pay them considerably more in damages than you would under the statute.<sup>86</sup> For example, the employee who would get two weeks of notice under the statute may be entitled up to two months or more of common law notice.<sup>87</sup> This may be confusing because it is not written down anywhere.<sup>88</sup> This is one good reason why you need counsel in this area.

Finally, there is extensive statutory regulation. I suspect this is one of the reasons why Canada ranks lower than the United States on flexibility of employment. We have more extensive regulation in a number of areas including occupational health and safety, in which we take a slightly different approach, pension legislation and workers' compensation.<sup>89</sup> Additionally, there are many pitfalls.

Employment standards legislation sets this floor of rights.<sup>90</sup> You can't go below the floor,<sup>91</sup> you can't contract out of it,<sup>92</sup> and generally speaking, there are no exceptions for small employers, including the entrepreneur class, who may only have a very limited payroll or only a few employees.<sup>93</sup> Generally speaking, there is no exception.<sup>94</sup>

There are, however, a couple of areas where smaller employers are exempted. One important area in Ontario is the severance obligation. This is a separate obligation under Ontario legislation to pay employees for service when you fire them.<sup>95</sup> Generally speaking, it would be employees with five years or more of service, and the employer has to have a payroll of \$2.5

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<sup>85</sup> See *id.* (stating that judges and lawyers apply an unofficial guideline to assess the notice period for employees who have a lengthy tenure of employment in the range of about one month per year of service, but this guideline does not apply for employees with a shorter tenure of employment).

<sup>86</sup> See *id.* (stating that common law is often invoked to increase the minimum notice period prescribed by statute).

<sup>87</sup> *Id.*

<sup>88</sup> See generally *id.* (determining common law notice on a case-by-case basis).

<sup>89</sup> See THE WORLD BANK, DOING BUSINESS IN 2006: OECD-HIGH INCOME REGION 13 (2005), available at <http://www.doingbusiness.org/documents/2006-OECD.pdf> (ranking countries in OCED-high income region category, including the United States and Canada, in Rigidity of Employment Index).

<sup>90</sup> See Ontario Ministry of Labor: Employment Standards, <http://www.labour.gov.on.ca/english/es/> (last visited Nov. 10, 2007) (explaining that the Employment Standards Act, 2000 sets out the "minimum standards" that employers and employees must follow).

<sup>91</sup> *Id.*

<sup>92</sup> Employment Standards Act, *supra* note 81.

<sup>93</sup> *Cf. id.* (omitting small employers from the Exceptions section to whom the Act does not apply).

<sup>94</sup> *Id.*

<sup>95</sup> Employment Standards Act, S.O. 2000 S.O., ch. 41 (Can.).

million or more. So this is an exception available to a smaller employer or entrepreneur just starting up in Ontario. Another example is emergency leave entitlements. We have fairly extensive leave provisions in our employment standards legislation<sup>96</sup> that provide for ten days leave without pay due to personal or family illness.<sup>97</sup> This applies to employers with 50 or more employees.<sup>98</sup> Therefore, small employers and entrepreneurs starting out in Ontario would not have to provide that benefit under the employment standards legislation.<sup>99</sup>

I think the general rule is that employment standards are quite rigid. So how do companies, American companies, American entrepreneurs and small Canadian companies get around the rigidity? This brings me to my next topic: independent contractors. Companies will say, given all of the regulation that we are seeing across the country, “Why can’t we just make everybody an independent contractor and avoid the whole spectrum of employment laws?” I get this request all the time. And there are certain advantages to doing this, including a higher degree of flexibility and often tax advantages.<sup>100</sup> Given these tax benefits, you may find people who would be very happy to be independent contractors, at least at the initial stages. This is a situation where everybody initially thinks this is a great idea, they call me and I have to tell them that it is, in fact, a bad idea.

First of all, sometimes I find that clients, particularly those who do not know a great deal about employment law in Canada, think they can avoid the entire gamut of employment regulation by creating an independent contractor situation. In fact, occupational health and safety legislation applies whether people are employees or independent contractors.<sup>101</sup> Human rights laws also apply regardless.<sup>102</sup> With respect to common law notice periods, there has

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<sup>96</sup> See generally Employment Standards Act, 2000 S.O., ch. 41 (Can.) (listing all the different leave provisions, including pregnancy leave, parental leave, family medical leave, and emergency leave).

<sup>97</sup> *Id.*

<sup>98</sup> *Id.*

<sup>99</sup> *Cf. id.* (stating that an employee whose employer “regularly employs 50 or more employers” is entitled to emergency leave of 10 days).

<sup>100</sup> See Leanne E. Standryk, *Contracts and Self-Employment: A Workforce Perspective*, Lancaster, Brooks & Welch LLP, <http://www.lbwlawyers.com/publications/contractandselfemployment.php> (last visited Sept. 28, 2007) (describing the freedom of independent contractors to decide whom to work for, when to work and how to work, as well as their entitlement to business related tax deductions as advantages of being an independent contractor).

<sup>101</sup> See generally Health and Safety, Ontario Ministry of Labour, <http://www.labour.gov.on.ca/english/hs/> (last visited October 5, 2007) (explaining that the Occupational Health and Safety Act sets out the rights and duties of “all parties in the workplace,” including “every worker, supervisor, employer, constructor and workplace owner”).

<sup>102</sup> See generally Canadian Human Rights Act, R.S.C. ch. H-6 (1985) (stating that the Act

been recent case law that has confirmed that independent contractors may also be entitled to reasonable notice of termination.<sup>103</sup> So, if you fire an independent contractor and you think you avoided your month per year of obligation, you may be surprised to discover that, in fact, the independent contractor still has entitlement.

The other problem is that you need a true independent contractor relationship. What governs is substance rather than form. The fact that you paper it as an independent contractor relationship is not going to suffice if, in substance, what is really happening is a relationship of control where the person is truly an employee.<sup>104</sup> As a result, you may have an employment or tax authority taking a look at your relationship and declaring that you have not really created an independent contractor relationship. Penalties and problems may arise.<sup>105</sup>

If you want to create independent contractor relationship in Ontario to avoid rigid employment regulations that we in some cases have, the first thing I tell my clients is that you have to create a non-exclusive relationship.<sup>106</sup> You cannot require an individual to work exclusively for you and declare that they are an independent contractor.<sup>107</sup> This is the essence of the independent contractor; they work for a number of employers. That usually stops the discussion. Most companies and most entrepreneurs want exclusive relationships. For example, they do not want to have people on their sales team who are able to go off and work for other employers. Some of the other factors that are present in an independent contractor relationship include limited control and supervision and ownership of tools (generally independent contractors own their cars, their vans, their vehicles). Employers cannot provide benefits to independent contractors.<sup>108</sup> If you want to provide extended healthcare benefits to your independent contractors, they are

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extends to laws in Canada to give effect to the principle that “all individuals” should have equal opportunity and should not be prevented from doing so by discriminatory practices).

<sup>103</sup> *But cf.* JKC Enterprises Ltd. et al. v. Woolworth Canada Inc. et al., [2001] 300 A.R. 1 (Can.) (finding that notice is not required for independent contractors, but there are many cases of an “intermediate nature” that are neither one of employer-employee relationship nor employer-independent contractor relationship where a reasonable notice is implied).

<sup>104</sup> *See, e.g.*, Belton v. Liberty Ins. Co. of Canada, [2004] 72 O.R.3d 81 (Can.) (finding that an employer-employee relationship exists where the employer exerted much control over the agents, despite the explicit language of “independent contractor” in the employment agreement).

<sup>105</sup> *Id.*

<sup>106</sup> *See id.* (identifying the question of whether or not the agent was limited exclusively to the service of the principal as one of the four principles used to distinguish independent contractors from employees).

<sup>107</sup> *Id.*

<sup>108</sup> *See generally id.* (describing an independent contractor as having an investment or interest in “what are characterized as the ‘tools’ relating to his service”).

probably employees.<sup>109</sup> Independent contractors typically invoice a business, if you want to put them on payroll, they are probably not independent contractors. So, in theory, independent contractors are a great idea. But in practice, they are a bad idea.

Regardless of whether you are creating an employment relationship or independent contractor relationship, it is extremely important to have a well-drafted contract. It is remarkable how many employers or principals in Ontario do not have formal contracts. They have offer letters, very minimal documents. I suppose this is done with the hope that it will work out, that there will be no problems. However, the general recommendation that we make to companies starting out is that they ensure their contracts are well drafted and enforceable to avoid problems in the future.

What are some of the benefits of doing this? Well, the first benefit is that it is possible to contract out of common law obligations that an employer may have. The common law obligations in Ontario and other provinces are more onerous than American common law obligations. If you are trying to mirror more closely the American employment relationships, you need to contract out of our common law.<sup>110</sup> The notice period that an employer has to pay upon termination is a very good example of an area where you will wish to contract out. You need to do this explicitly. Be very clear because the courts do not like you to contract out of common law, and they will try to ensure that the common law survives and resurfaces unless you are very clear.<sup>111</sup>

You can also use a contract to protect against competition and loss of intellectual property. Often an entrepreneur is someone who has a new idea. Is it an innovative idea? Is it some process, some invention that is being brought across the border? The interest in protecting the intellectual property and preventing competition may be very high. This is one of the reasons why the contract, whether it is an employment contract or or a contract with an independent contractor, needs to be crystal clear.

There has been a very interesting recent 2006 decision from the Ontario Court of Appeals, *IT/Net Inc. v. Cameron*; it illustrates why you have to draft your restrictive covenants as clearly as possible.<sup>112</sup> What the employee did in this case was not a very nice thing to do,<sup>113</sup> and if the contract had been

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<sup>109</sup> Cf. Standryk, *supra* note 100 (stating that the independent contractor is not eligible for employment insurance benefits).

<sup>110</sup> See, e.g., *McDonald v. ADGA Sys. Int'l Ltd.*, [1999] 117 O.A.C. 95 (Can.) (upholding a contractual clause that rebutted the common law presumption of reasonable notice).

<sup>111</sup> See, e.g., *IT/NET Inc. v. Cameron*, [2006] 207 O.A.C. 26 (Can.) (finding that the employee did not breach the restrictive covenant in an employment contract because the covenant goes beyond what is needed to protect the proprietary interest of the employer).

<sup>112</sup> *Id.*

<sup>113</sup> *Id.*

drafted clearly, the court would have upheld it and would have awarded the employer damages for the employee's competition and solicitation.<sup>114</sup> However, the clause that the employer had drafted was too broad, had no temporal limitations, no geographical limitations and a degree of ambiguity.<sup>115</sup> The court concluded that the entire non-compete clause should be struck out.<sup>116</sup> The employer tried as a fallback to argue that the employee was a common law fiduciary who owed duties that would survive even if the clause was struck out.<sup>117</sup> The court did not agree.<sup>118</sup> The employer had turned its mind to this issue and, therefore, the clause was unenforceable. The common law would not come to the employer's rescue in this situation.<sup>119</sup> Even though the court was willing to concede what the employee had done was improper and could have been prevented by a contract, the court was not willing to award damages. So, the lesson is that the restrictive covenant must be drafted as clearly as possible in order to be enforceable.<sup>120</sup> Otherwise, it will be struck out, and the employer will be out of luck.

A few comments on compensation issues: The governing principles that tend to apply when companies are starting out are those of maximum flexibility and maximum discretion with respect to compensation. However, as Ben pointed out, attracting good workers and retaining them is very problematic in the current economy. So it is important for compensation to be competitive and to be consistent with the market.

I have had situations recently where I can honestly say that I felt my clients were being held hostage by employees who were so crucial to their operations that they could not afford to lose these employees. I will give you an example. One of my clients recently was in renegotiations with a CFO. This was a very small company, very entrepreneurial. The CFO wanted a golden parachute. She said, "If you fire me for any reason or no reason, I want \$100,000. If I decide to quit, I want \$100,000." My client called me and said they were thinking of agreeing to this because they hoped the clause would be unenforceable by a court due to unconscionability. First of all, I asked them why they would pay anybody \$100,000 for resigning. As soon as the employee signs the contract, she is going to quit and it is like winning the

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<sup>114</sup> *See id.* (holding that the restrictive covenant goes beyond what is needed to protect the proprietary interest of the employer, but it would have been entirely reasonable if it simply prohibited the employee from assisting employer's competitor to obtain a contract with a client of employer to fill the very position he had occupied with that client).

<sup>115</sup> *Id.*

<sup>116</sup> *Id.*

<sup>117</sup> *Id.*

<sup>118</sup> *Id.*

<sup>119</sup> *See id.* (holding that a restrictive covenant was unenforceable because it was not reasonable).

<sup>120</sup> *Cf. id.* (holding an ambiguous restrictive covenant unenforceable).

lottery. Why would they agree to that? Second, they are the employer. I do not think that a court is going to come to their rescue and find that this is some kind of provision contrary to public policy. I told them to rethink their position. If you can believe it, this employee was so valuable to the company they agreed to the \$100,000. It is in the contract. I am waiting to see what's going to happen, whether the CFO will simply quit next week, take her money, and run. That is an example of being held hostage because an employer is so reliant on a particular employee that they cannot afford to lose her.

We always think of employment as being this imbalance of power, and 99% of the time it is. The employer has all the cards, imposes the working terms and conditions. However, in rare cases, it works in reverse and the law does not contemplate this.<sup>121</sup> In fact, our Supreme Court of Canada has repeatedly said that it is a legal assumption that there is an inherent balance of power in every employment relationship.<sup>122</sup> It is probably true in most cases, but I have seen examples where the assumption does not hold. I do find that some people or employers can be held hostage in certain cases.

One of the good things for employers is the availability of the public healthcare system across the country. This means that healthcare is not a benefit that needs to be provided and not a basis upon which to attract employees.<sup>123</sup> Many employers will provide extended healthcare benefits such as dental, vision, drugs, etc. However, small companies starting out do not usually offer these kinds of benefits because they are quite expensive. The message that I have given to my clients who are starting up in Ontario, is to hold off on significant benefits. However, it is worthwhile to discuss the issue with consultants to find out what's being offered in any particular industry.

There may also be a benefit to be gained from considering employer contributions to RRSP, which is our individual pension plan,<sup>124</sup> rather than providing an employer-sponsored pension plan. Consider providing some

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<sup>121</sup> See generally Janis Sarra, *Labour Arbitration: Recent Developments in Judicial Review of Arbitration Decisions, Dancing the Two-Step in British Columbia*, 36 U.B.C.L. REV. 311, 311-12 (2003) (describing collective bargaining as a means through which unions enhance the terms and working conditions of employees, where the labor relations law recognizes the "inherent imbalance in power" between employers and employees).

<sup>122</sup> See, e.g., *Wallace v. United Grain Growers Ltd.*, [1997] 3 S.C.R. 701, 741 (Can.).

<sup>123</sup> See generally Canadian Health Care, <http://www.canadian-healthcare.org/> (last visited Nov. 10, 2007) (stating that Canada's public health care system is provided to all Canadian citizens); cf. Sherry A. Glied & Phyllis C. Borzi, *Devising Solutions: The Current State of Employment Based Health Coverage*, 32 J. L. MED. & ETHICS 404, 404 (2004) (explaining that during and after World War II, American employers sought to attract workers by offering health insurance in lieu of wage increases).

<sup>124</sup> RRSP – Glossary, Canada Revenue Agency, <http://www.cra-arc.gc.ca/tax/individuals/topics/rrsp/glossary-e.html> (last visited Nov. 10, 2007).

sort of flexible and efficient benefit that satisfies employees' pension needs. Employment lawyers can certainly help to create this. It is also important to consult with tax lawyers to determine the tax consequences of offering certain benefits rather than others.

I will now talk about crossing the border. It seems to me there are three scenarios that need to be considered. First is those individuals immigrating to Canada to become entrepreneurs. Second is Americans entering Canada to conduct business with the intention of returning to the U.S. after a short visit. Third is employers wishing to transfer employees to Canada.

Now, I would have thought that the idea of people immigrating to Canada as entrepreneurs from the U.S. would be a fairly rare occurrence, but last night as I drove in from the airport, my cab driver asked me where I was from. When I told him I was from Canada, he proceeded to tell me that he and his cousin in South Asia were thinking of establishing a PVC pipe business in British Columbia, and he would be moving there if this plan went ahead. He is an American citizen. I was convinced that the conference organizers set me up because it was just too much of a coincidence.

MR. JEFFERS: He needed investors.

MR. CRAIG: He had an idea that PVC would be great in the Vancouver climate, as it is similar to Seattle where a lot of PVC is needed. So there was an American entrepreneur who told me that he was thinking of moving to Vancouver. Naturally, I explained the requirements to him.

One of the things I thought was notable is that there is an entrepreneur class of immigrants. One has to commit to \$300,000 of investment in the country,<sup>125</sup> and it takes between 36 to 48 months, or three to four years before an entrepreneurial application will be processed.<sup>126</sup> I would have thought that an entrepreneur who wanted to come to Canada would lose interest quickly given the application time.<sup>127</sup> I wanted to investigate a little further because I find it hard to believe that we could have a system that is so inefficient. I have been told that only a thousand people have come in the last few years under this program.<sup>128</sup> Perhaps this is one of the reasons why.

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<sup>125</sup> See generally *Entrepreneurs: Definitions, Citizenship and Immigration Canada* <http://www.cic.gc.ca/english/immigrate/business/entrepreneurs/definitions.asp> (last visited Nov. 10, 2007) (stating that an entrepreneur must have a legally obtained minimum net worth of \$300,000).

<sup>126</sup> See generally *Canada Business and Investment Immigration Overview*, <http://www.immigration.ca/permres-business-overview.asp> (last visited Nov. 10, 2007) (explaining that the federal entrepreneur program application processing delays regularly exceed 2.5 years).

<sup>127</sup> See *id.* (stating the years of application processing delay).

<sup>128</sup> See generally *CITIZENSHIP AND IMMIGRATION CAN., ANNUAL REPORT TO PARLIAMENT ON IMMIGRATION 2006 18* (2006), available at [http://www.cic.gc.ca/english/pdf/pub/immigration2006\\_e.pdf](http://www.cic.gc.ca/english/pdf/pub/immigration2006_e.pdf) (reporting that the number of permanent residents in the Entrepreneurs Class for 2005 was 2,848).

The more common scenario is Americans crossing the border to conduct business for a day or a week and then returning. Our system is relatively flexible on this front. There are visas that can be obtained, and many of you are probably aware of this process. Where this becomes complex, it is important to have immigration consultants to assist you. I recently had a client in the U.S., an American media company, who was sending two of their journalists across the border to Toronto. The complicating factor was that both of these employees were minors and their parents were not able to travel with them. We had to figure out how we can get two 16 year-olds across the border with only two days notice. Finding the answer quickly was quite difficult because we found the materials that the immigration authorities in Canada provided to be impenetrable. There was a form that required the parents to grant consent and transfer guardianship of these two teenagers to a representative of the company for a narrow period of time. If something happened and these two teenagers had to stay in Canada longer, another form was required. The process was very complicated. The bottom line is to consult with experts when necessary.

Thank you very much.

DISCUSSION FOLLOWING THE REMARKS OF BENJAMIN W.  
JEFFERS AND JOHN D. R. CRAIG

MR. TORMA: John, thank you very much. It was an excellent presentation.

The closing comment is to remind us that we need to use the legal counsel that is available. We may ask ourselves, gee, isn't that rather expensive? Well, I use the analogy that education is expensive. The only thing more expensive than education is ignorance. So I think we would be penny wise and a pound foolish not to take that advice.

Are there any questions, a few comments? Let's see first from the audience if there are any questions.

Henry?

DR. KING: Yeah. I wanted to get the comments on the duration of non-compete clauses both in Canada and the United States. What is a reasonable point in time for a non-compete clause?

MR. JEFFERS: I won't give you the "depends" answer, but I will say if you are in a fast-moving industry where there is a lot of change, a lot of innovation, maybe six months in some jurisdictions would be considered reasonable.<sup>129</sup> That may be all that you really need in terms of trying to keep

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<sup>129</sup> See, e.g., *DoubleClick, Inc. v. Henderson*, No. 116914/97, 1997 N.Y. Misc. LEXIS 577, at \*23 (Sup. Ct. N.Y. Nov. 5, 1997) (enjoining defendants for six months because a one year restrictive covenant was too long given the dynamic nature of the internet industry).

a key former employee from competing against you; other industries, maybe a year.

I think as a rule of thumb in some of my – and some of my employment colleagues probably would agree with me – anything more than a year I think the court is really going to look at very closely, and you would have to have a very good reason.<sup>130</sup>

MR. TORMA: I would like to make a comment on it, if I may, absolutely non-legal, more from a practitioner's viewpoint. Nordson Corporation makes industrial application equipment.<sup>131</sup> As I indicated, we started with painting equipment, electrostatic for the most part, and now powder paint equipment.<sup>132</sup> That's about one third of our business.

Two thirds of our business is packaging, basically closing, sealing boxes, applying glue to products, et cetera, et cetera. So we are a relatively sophisticated but fairly not high-tech and not that fast moving technology. Over the more than 50 years that we have put in non-compete agreements, we have evolved, and it is different by country. But the U.S. and Canada are almost similar, and it is basically as we heard here, it is a matter of common sense, and it is a matter of reasonableness.

And the four factors that we keep in mind – and it has worked very well for us – as we heard about is, one, geographic scope. So if a person is a sales person, we normally restrict it only to the person's current geographic scope. And that has been seen as relatively reasonable by a court of law.<sup>133</sup>

The second one is the functional scope of how broad it can be. If a person is a sales person in a particular product line, we are very careful with that product line because in this day and age with the Internet, there is a lot of information that is already public domain. So we are only concerned about that which is not. So number one, it is a limited geographic scope.<sup>134</sup>

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<sup>130</sup> See, e.g., *Captain & Co., Inc. v. Towne*, 404 N.E. 2d 1159 (Ind. Ct. App. 1980) (holding a two-year covenant not enforceable).

<sup>131</sup> Nordson Corporate Profile, <http://www.nordson.com/Corporate> (last visited Nov. 10, 2007).

<sup>132</sup> Nordson History, *supra* note 1.

<sup>133</sup> Compare *New River Media Group, Inc. v. Knighton*, 245 Va. 367 (Va. 1993) (upholding a non-competition agreement that prohibited employee from engaging in competing business within sixty air miles of former employer's radio station where the radius of the station's signal strength was sixty air miles) with *Alston Studios, Inc. v. Lloyd V. Gress & Associates*, 492 F.2d 279 (4<sup>th</sup> Cir. 1974) (holding that a non-competition covenant was overbroad both as to geography and the activities of future employment in that it encompassed activities in which defendant was not engaged).

<sup>134</sup> Ann C. Hodges & Porcher L. Taylor, III, *The Business Fallout from the Rapid Obsolescence and Planned Obsolescence of High-Tech Products: Downsizing of Noncompetition Agreements*, 6 COLUM. SCI. & TECH. L. REV. 3 (2005).

Number two, it is a limited functional scope.<sup>135</sup> So if it is translated back to our product, if it is a glue application or adhesive application sales person, we narrow it down to probably just packaging as that is their specialty.

The third one is the length of time, and ours is almost always two years in the U.S. and Canada, different in different countries. I quickly go to the fourth one because it backtracks with the third one. What compensation is there in order to make it reasonable?

It would not be reasonable – and I am not an attorney, but it just makes sense that it is not reasonable – if you just prevent a person from working. What we do is, say, for up to two years, if that person makes a good faith effort to find a job and is not able to do so outside of the non-compete regulations, we will pay them 75 percent of their compensation for up to a two-year period based on a track record they have been looking for another job.<sup>136</sup> And that package, except for Minnesota one time, which we fixed that, other than that, we are pretty much in good shape in both the U.S. and Canada.

MR. SHANKER: How do you deal with former employees stealing your customers?

MR. TORMA: Okay. I would like to defer that to the attorneys if they don't mind.

MR. CRAIG: I have two categories of clients: the client who wants me to draft non-compete provisions who never intends to enforce them, they simply want to have them as deterrence. They will say, "We never would enforce it so make it five years." This is one attitude. The other client feels that non-compete provisions are important and do not want to risk losing business.

Generally speaking, non-compete provisions are unenforceable unless they are reasonable.<sup>137</sup> A non-compete provision will not be reasonable if a non-solicitation clause would be sufficient to accomplish the employer's objectives.<sup>138</sup> As a result, you only have a narrow category of employees who truly can be subject to non-competition provisions. In this category are those who are the face of the company. If they were to leave the company, clients would follow. One of the key cases that we have on this point involved a partner in an actuarial firm.<sup>139</sup> I should point out, that the court said that the rules apply similarly in employment. The partner had been at the firm for a long time and was subject to a non-compete provision. When she left, all of

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<sup>135</sup> *Id.*

<sup>136</sup> *See generally id.* (stating that employers should consider providing severance pay to employees in order to reduce litigations arising from non-compete agreements).

<sup>137</sup> *Lyons v. Multari*, [2000] 50 O.R.3d 526, 531 (Can.).

<sup>138</sup> *Id.* at 534.

<sup>139</sup> *Towers, Perrin, Forster & Crosby, Inc. et al. v. Cantin et al.* (1999), 46 O.R. (3d) 180 (S.C.J.)

her clients followed her. The court held that she was the kind of person who could be restrained by a non-compete provision because clients will simply follow her no matter what. So, generally speaking, I would think that for a person of that nature, 24 months would be the upper limit.

The point that Jerry made is very important because if you want to have a non-compete that is longer than that, you are probably going to have to provide compensation during that period of time. You may well be able to get away with compensation paralleling the length of the non-compete provision because there is very strong consideration for the limitation.<sup>140</sup>

MR. JEFFERS: I forgot the question. How do you prevent employees from stealing customers?

MR. SHANKER: yeah. That was – goes back decades ago that was our concern. Sometimes they take your customers with them, and sometimes the customers want to go, and how do you deal with that problem?

MR. JEFFERS: Yeah. It is very difficult, and I will be honest, in many instances you just can't solve that. You can try to enter into a non-solicitation agreement with an employee where they are agreeing not to solicit your customers for a period of time. That's going to be analyzed much along the lines of a non-compete because it has the functional equivalent.

In terms of whether there is any sort of inherent protection to your customer list, it would depend upon whether your customer list was considered a bona fide trade secret.<sup>141</sup> And under the Uniform Trade Secret Act, which has been adopted in most of the states in the U.S., a trade secret is sort of information or a pattern, a compilation that derives independent economic value, actual or potential, from not being known or ascertainable by proper means by others who could gain value.<sup>142</sup>

Now, essentially what that means, if this is just a public list, forget it. If your customers – if we are in Detroit and you are an automotive supplier and your customers are OEMs, there is absolutely nothing to seek further proprietary about that customer list. If you are in an industry where given the nature of your products or processes you have actually developed specific contacts and sort of niche customers, then perhaps you might get some protection. That's sort of the legal answer.

From a nuts and bolts perspective – and this goes to just stealing any sort of company secrets – some of the advice we give if you are letting an employee go is to do a couple things. First, do an exit interview. Don't

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<sup>140</sup> See generally Hodges & Taylor, *supra* note 134 (explaining that a provision for severance pay would greatly reduce litigation).

<sup>141</sup> See, e.g., *Holiday Pacific Ltd. v. Valhalla Custom Homes Ltd.*, [1990] 29 C.P.R.3d 1 (Can.) (finding that a customer list was information that the defendants would have been aware just from their employment, and as knowledge of an employee is not a trade secret, the court held for the defendants).

<sup>142</sup> Unif. Trade Secrets Act § 1(4) (1985).

discount the value of sitting in an office face to face with someone and asking, “Have you taken – are you taking anything as you walk out the door?”

If the person is dishonest enough to have stolen something, they may continue to be dishonest, but you may learn something during the course of that interview that at least raises some red flags. We suggest that you reaffirm to that employee what their agreement is, provide them sort of a reminder letter or perhaps even get them to sign it – that they received this reminder letter.

As a practical matter, in this day and age, I think one of the first steps that a lot of employers are going to do is they will have the IT department access and assist them in trying to determine whether or not that employee has downloaded any information.

There is an electronic paper trail, as it were, if you are copying data, and there would be what they call a meta data trail, for example, on April 9th at 10:33 in the morning, user No. 3936 copied the following files from the database. And so those are things where immediately you can try and ascertain whether there is a pattern here and something that looks odd.

MR. TORMA: In addition to our non-competition clause, our employment agreement has two other key clauses. One of those deals is right of invention, and we won't deal with that, and the other one is confidentiality.

And we will consider customer data, certain aspects of that, confidential. Even the reference was to ongoing companies – we had a case where they were selling to the Big Three, then the fact it is the Big Three is not the issue. Who the contacts are, whether they are e-mail addresses, the telephone numbers, but more importantly, what have they bought from us, and what prices with what contractor and so on.

And we do address that, and we do exactly as Ben recommended, and we remind them when they are going out the door, we send them a copy of their employee agreement, reminding them they signed that, and it is still valid, certain aspects of it for certain periods of time.

If it is a service type situation, which most of the time it is not, it is voluntary resignation, then there is an agreement, and part of that agreement is acknowledgement of their employment agreement. It is not always working, but for the most part, if you remind them they did sign it and for a period of time there is a sensitivity there, usually in our business three to six to nine months is sufficient for the information to be old enough for us to get in there with the contacts and do a preemptory strike; remind them that we can do that.

So again it goes to reasonableness and preparation in my opinion. I think there is another question.

MR. GROETZINGER: John, you had talked about entering Canada as an entrepreneur, and I am wondering then, if you knew of any visa classification where a Canadian or foreign citizen could enter the U.S. as an entrepreneur, given the fact as we started this conference yesterday, that entrepreneurship is the lifeblood of an economy. If not, what has been the rationale for the lack of that?

MR. CRAIG: That is a good question. Canadians are visa exempt under many classifications.<sup>143</sup> There are many programs and means by which Canadians can come to the U.S. to work, and, therefore, the H1-B visa issue may not impact the ability of U.S. companies to obtain highly skilled employees from Canada.<sup>144</sup> There is also the NAFTA visa status, whereby many individuals from Canada and Mexico can come to the U.S. fairly easily under a NAFTA visa.<sup>145</sup> There are 20 to 30 various classifications and programs<sup>146</sup> including visa exempt<sup>147</sup> and visa waiver programs.<sup>148</sup> Canadians do not face the same barriers when entering the U.S. that others face, such as employees coming from India or China.

MR. TORMA: What we are seeing coming from Eastern Europe, some of our former customers and others – in fact, one of my very first interns from Poland, who was with us in 1993, recently came to the U.S. with his family on an investor visa – and the threshold was much lower than I expected it to be. I want to say E-4 as indicated, but I am not sure, but if you let me know, I can certainly point you in that direction.

But the investor visa was a lot lower than I thought it would be, and I am seeing some entrepreneurs from Eastern Europe beginning to use that.

Question up front. We have five minutes left, probably two questions.

DR. BARBER: The discussion about common law, which John gave us, it gave me the impression, a good impression that law always and its clauses cover all the things that people can do or think about doing, and so there has to be a kind of common sense and reasonableness characteristic to the practice of law, I suppose.

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<sup>143</sup> Who from Canada, Mexico and Bermuda, Needs a Nonimmigrant Visa to Enter the United States Temporarily, U.S. Dept. of State, [http://travel.state.gov/visa/temp/without/without\\_1260.html](http://travel.state.gov/visa/temp/without/without_1260.html) (last visited Nov. 10, 2007).

<sup>144</sup> See *id.* (stating that Canadian citizens do not require a nonimmigrant visa to enter the U.S.).

<sup>145</sup> See Mexican and Canadian NAFTA Professional Worker, U.S. Dept. of State, [http://travel.state.gov/visa/temp/types/types\\_1274.html](http://travel.state.gov/visa/temp/types/types_1274.html) (last visited Oct. 14, 2007).

<sup>146</sup> Nonimmigrant Visas, U.S. Citizenship and Immigration Services, <http://www.uscis.gov/portal/site/uscis/> (last visited October 16, 2007) (follow “Education and Resources” hyperlink; then follow “Visa Resources” hyperlink; then follow “Nonimmigrant Visas” hyperlink).

<sup>147</sup> NAFTA, *supra* note 145.

<sup>148</sup> *Id.*

But the question that I have is: it sounded as though for the example you gave that, while common law of that sort with that kind of flexibleness or lack of definition, if you like, may actually be applicable, it sounded to me as though the courts don't have the option of using reasonableness and common sense in their decision, and so my question was: would they have been better not to have any kind of contract than to have one that didn't anticipate all the things that people could do because the courts can't rule on the basis of that kind of contract using the common sense and reasonableness?

I don't know if I am clear about what I am trying to get at.

MR. CRAIG: The problem arises because there are certain aspects of the common law as it relates to employment that are unfavorable to employers.<sup>149</sup> My view is that the courts are very concerned about the vulnerability of employees, and assuming this to be the case, they tend to err on the side of the employee.<sup>150</sup> Employers, therefore, must be very careful about how they frame contracts. The point I made is that if the contract fails in some respect, such as a covenant that is too broad, it may be struck out.<sup>151</sup> What you are left with is a default position that is unfavorable to the interest and concerns of the employer. That is why contracts have to be drafted carefully by someone with legal expertise. That being said, I do not want to leave you with the impression that the courts avoid a common sense approach; I think judges do understand the realities of the world. Virtually all of the major courts in the country have very prominent former labor lawyers who understand the realities and make an effort to ensure that the law evolves in a realistic way.

MR. TORMA: Before we get to our last question, very quickly, I would like to ask Ben to give us the nomenclature and quick executive summary of the treaty investor visa information that he found was off by two numbers.

MR. JEFFERS: Yeah. It was very good by the way. I think he was referring to the E-2 treaty investor in which someone would enter the U.S. solely to develop or direct operations of an enterprise, which a foreign employer has an active and substantial investment in.<sup>152</sup> So the individual

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<sup>149</sup> See, e.g., Lyons, *supra* note 137 at 531 (stating that non-competition provisions are unenforceable unless they are reasonable).

<sup>150</sup> See, e.g., Wallace v. United Grain Growers Ltd., [1997] 3 S.C.R. 701, 741 (Can.) (holding that the law should be mindful of the vulnerability of terminated employees and ensure their protection by encouraging proper conduct and preventing all injurious losses which might flow from acts of bad faith or unfair dealing, despite concerns that this imposes an onerous obligation on employers).

<sup>151</sup> See Hodges & Taylor, *supra* note 134 (stating that in states where courts cannot rewrite agreements that exceed the bounds of reasonableness, the covenant may simply be unenforceable).

<sup>152</sup> Treaty Traders and Treaty Investors, U.S. Dept of State, [http://travel.state.gov/visa/temp/types/types\\_1273.html#](http://travel.state.gov/visa/temp/types/types_1273.html#) (last visited Nov. 10, 2007).

that would be coming to the U.S. must have a significant or a managerial role, and that's a one-year visa.<sup>153</sup> So that's a means for entrepreneurs in Canada who have established businesses there.

MR. TORMA: Last question, Steve Petras from Baker Hostetler.

MR. PETRAS: I believe last time I looked under Ohio law – and I am not an employment lawyer – the Ohio Supreme Court allows what they call “blue-lining.” If your clause is too restrictive, the court can pare it back to something that is reasonable.

Is it true in Ontario or Canada? Do the courts do that? What if you had a clause in your contract that said, “We are too broad. Cut us back”?

MR. CRAIG: According to the Ontario Court of Appeals in the case I mentioned earlier, they are not prepared to do that.<sup>154</sup> You would have to have a severability clause,<sup>155</sup> which provides that if a non-compete provision is too broad and therefore struck out, a non-solicitation provision would still be enforceable.<sup>156</sup> In this way you will get to the same result, however, judges will not do it for you.

MR. TORMA: Thank you to Ben and John, and to all of you for participating. Excellent questions. Excellent questions.

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<sup>153</sup> *Id.*; see generally Treaty Trader & Treaty Investor, U-S-A Immigration.com, [http://www.u-s-a-immigration.com/INS/treaty\\_trader\\_visa.htm](http://www.u-s-a-immigration.com/INS/treaty_trader_visa.htm) (last visited Nov. 10, 2007) (explaining that the initial “E” visa period is for the term of one year, although the visa can be extended almost infinitely).

<sup>154</sup> IT/Net Inc., *supra* note 111.

<sup>155</sup> See, e.g., *Globex Foreign Exchange Corp. v. Kelcher*, No. 050108056, 2005 ABQB 676 (Alta. Q.B. Sept. 7, 2005), available at 2005 AB.C. LEXIS 1489 (employing severance where the agreement included a severability clause).

<sup>156</sup> *Cf. id.* (upholding the non-solicitation provision and modifying the overbroad restrictive covenant to a reasonable level).



## THE IMPORTANCE OF VENTURE CAPITAL IN PROMOTING ENTREPRENEURSHIP

*Session Chair – Daniel Sandler*  
*Canadian Speaker – Brad D. Cherniak*  
*United States Speaker – Cathy Horton-Panzica*

### INTRODUCTION

*Daniel Sandler*

DR. SANDLER: All right. Welcome back, everybody. Thank you very much for joining this session on the Importance of Venture Capital Promoting Entrepreneurship. Yesterday we heard a lot about the importance of entrepreneurship to the economy, and I think it is useful to go over some of the stats that we heard yesterday about the importance of small businesses to the economies in both Canada and the United States because the statistics are actually quite similar in both countries. In both countries, small businesses make up 99 percent – more than 99 percent – of all employers.<sup>1</sup> They employ about half of all employees in the country.<sup>2</sup> They significantly outperform large corporations in terms of job creation, and they carry on a significant amount of research and development.<sup>3</sup>

But, and this is an important but, as indicated yesterday, particularly in the Government session, not all small businesses are the same. A significant

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<sup>1</sup> Kenneth Hendricks, Raphael Amit, & Diana Whistler, *Business Taxation of Small and Medium-sized Enterprises in Canada*, at 1 (Canadian Technical Committee on Business Taxation, Working Paper 97-11, 1997) available at <http://www.fin.gc.ca/taxstudy/wp97-11e.pdf> (Canadian figures supporting the small business statistics); see also SMALL BUSINESS PROFILE: UNITED STATES, UNITED STATES SMALL BUSINESS ADMINISTRATION OFFICE OF ADVOCACY 2 (2004), available at <http://www.sba.gov/advo/stats/profiles/04us.pdf> (chart of number of employer firms in the United States).

<sup>2</sup> *Id.*

<sup>3</sup> See generally HANS LANDSTROM, PIONEERS IN ENTREPRENEURSHIP AND SMALL BUSINESS RESEARCH (Springer 2005), available at [http://books.google.com/books?id=20X5XIJzkYC&pg=PA150&dq=pioneer+entrepreneurship+and+small+business+research&sig=zPogILbAP-e3RZjAfAJ\\_HQ2ik4c](http://books.google.com/books?id=20X5XIJzkYC&pg=PA150&dq=pioneer+entrepreneurship+and+small+business+research&sig=zPogILbAP-e3RZjAfAJ_HQ2ik4c).

distinction has to be drawn between what I refer to as lifestyle businesses and rapid growth small businesses, sometimes referred to as “gazelles.”<sup>4</sup>

The vast majority of small businesses, over 90 percent, are lifestyle businesses.<sup>5</sup> They do not tend to be technological innovators or job creators. The most important small businesses in terms of economic development are gazelles, and they make up only four to eight percent of all small businesses.<sup>6</sup>

But it is these small businesses that are the important job creators, accounting for 70 to 75 percent of net new jobs.<sup>7</sup> These small businesses, particularly today, are concentrated in the high-tech sector, and despite their growth potential, these small businesses have the greatest difficulty attracting capital, particularly from traditional sources such as banks.<sup>8</sup>

They have long startup periods, and at their earliest stages, the only asset that these companies have in many cases is the intellectual capital of their founders.<sup>9</sup> These are not ideal circumstances for bank financing. Venture capital is fundamentally important for these companies. Consider companies like Hewlett-Packard, Apple, Microsoft, Netscape, and Google – these are all household names and all these companies got their start from venture capital.<sup>10</sup> The venture capitalist is willing to invest in startup companies. The rewards can be great, but the risk, as we heard about yesterday, can also be great.

I just want to stop and take a little informal poll that I think would be helpful for those on the panel. How many people here would call themselves entrepreneurs? Okay. And how many people are venture capitalists? All right. Well, for those that aren't venture capitalists, how many ever put money into a family business or a friend's business or an acquaintance's

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<sup>4</sup> Jere W. Glover, *Small Business Finance in Rural and Urban Regions*, OFFICE OF ECONOMIC RESEARCH IN THE OFFICE OF ADVOCACY, at 168, available at <http://www.sba.gov/ADVO/stats/fedsbfin.pdf>.

<sup>5</sup> See George Rodriguez, *Making a Profit Out of Passion: Lifestyle Entrepreneurship*, POWERHOMEBIZ.COM, <http://www.powerhomebiz.com/vol100/lifestyle.htm> (last visited Oct. 5, 2007).

<sup>6</sup> See generally Glover, *supra* note 4, at 168.

<sup>7</sup> Martin Wolk, *Small Business Having Big Impact on Jobs*, MSNBC, Feb. 3, 2004, <http://www.msnbc.msn.com/id/4142727> (last visited Nov. 8, 2007).

<sup>8</sup> See Private Sector Funding, U.S. Dept of Energy, [http://www.eere.energy.gov/inventions/energytechnet/funding/private\\_sector.html](http://www.eere.energy.gov/inventions/energytechnet/funding/private_sector.html) (last visited Oct. 4, 2007).

<sup>9</sup> See generally NERMEN AL-ALI, COMPREHENSIVE INTELLECTUAL CAPITAL MANAGEMENT: STEP-BY-STEP 19-20 (2003), available at [http://books.google.com/books?id=15wveJpXMeUC&pg=PA19&lpg=PA19&dq=startups+and+%22intellectual+capital%22&source=web&ots=Iqdkpn53xE&sig=Nqs6O1\\_yLNd90Po2NEQHif0HOc#PPA20,M1](http://books.google.com/books?id=15wveJpXMeUC&pg=PA19&lpg=PA19&dq=startups+and+%22intellectual+capital%22&source=web&ots=Iqdkpn53xE&sig=Nqs6O1_yLNd90Po2NEQHif0HOc#PPA20,M1).

<sup>10</sup> See generally VENTURE IMPACT: THE ECONOMIC IMPORTANCE OF VENTURE CAPITAL BACKED COMPANIES TO THE U.S. ECONOMY, NATIONAL VENTURE CAPITAL ASSOCIATION (2007), available at [http://www.nvca.org/pdf/NVCA\\_VentureCapital07-2nd.pdf](http://www.nvca.org/pdf/NVCA_VentureCapital07-2nd.pdf).

business? A few more hands. Keep those up for a minute. How many of you ever got your money out? How many got a lot more than their money out?

The formal venture capital industry – that’s what we are going to be focusing on more than the informal venture capital industry – is generally traced back, as you heard yesterday from David Morgenthaler, to just after World War II.<sup>11</sup> Most people trace it back to American Research and Development. ARD was the first non-family venture capital business, and it was started up, as you heard yesterday, by a number of businessmen, academics and university administrators in Boston in 1946.<sup>12</sup> ARD invested in businesses that sought to exploit military technology for commercial purposes.<sup>13</sup>

This is a good topic for another session: there is nothing like a war or the threat of a war to spark technological innovation and, therefore, economic growth. But that’s really, as I said, a talk for another time.

We won’t go there today, but I want to talk about ARD just a little bit because it illustrates a number of things about venture capital. ARD’s approach to venture capital is classic. It invested only in equity and invested for the long-term; it was prepared to live with losses and negative cash flow for the short-term.<sup>14</sup> Almost half of ARD’s success came from one single investment: just under \$70,000 invested in a company called Digital Equipment Corporation in 1957, grew to \$355 million in 1972 when ARD was sold to Textron.<sup>15</sup> That’s not a bad rate of return. That’s about 500 times.<sup>16</sup> You can compare that to the big news in the last few months when Google bought You Tube for \$1.7 billion.<sup>17</sup>

A number of venture capitalists backed You Tube, including Sequoia Capital, and I saw on one website that Sequoia Capital put in about \$11.5 million and was estimated to get back \$495 million on that investment.<sup>18</sup>

That was considered a huge home run. That’s around 35 times return compared to ARD’s return. ARD’s total return from 1946 to 1972, before it

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<sup>11</sup> See generally Glenn Rifkin, *A Generation Gap in Venture Capital*, THE NEW YORK TIMES, May 25, 1995, available at <http://query.nytimes.com/gst/fullpage.html?res=990CEED9153DF936A15756C0A96395826>.

<sup>12</sup> See David H. Hsu & Martin Kenney, *Organizing Venture Capital: The Rise and Demise of American Research & Development Corporation 1946-1973* (Univ. of California-Berkley, Working Paper No. 163, 2004) available at <http://repositories.cdlib.org/cgi/viewcontent.cgi?article=1128&context=brie>.

<sup>13</sup> See generally *id.*

<sup>14</sup> See generally *id.*

<sup>15</sup> *Id.*

<sup>16</sup> See generally *id.*

<sup>17</sup> See Google buys YouTube for \$1.65bn, BBC NEWS, Oct. 10, 2006, <http://news.bbc.co.uk/2/hi/business/6034577.stm> (last visited Nov. 8, 2007).

<sup>18</sup> Blogosphere probes ‘GooTube’ deal, BBC NEWS, Oct. 10, 2006, <http://news.bbc.co.uk/2/hi/technology/6036691.stm> (last visited Nov. 8, 2007).

was sold to Textron, was a 14.7 percent compounded rate of return; without Digital Equipment Corporation, the return would have been only 7.4 percent.<sup>19</sup>

What this session discusses is the importance of venture capital in promoting entrepreneurship, and like all good venture capitalists, the two individuals on the panel think outside the box. So we are going to run our panel differently from all the other panels that have run so far, and hopefully, it will be a success.

It is going to be innovative and will run like a dialogue. Brad Cherniak and Cathy Panzica will carry on a conversation about a series of topics and I will put up this series here. They will talk a little bit, but we would like to get as much audience participation all the way through the panel as possible. And so I hope that the people carrying the mikes will be nimble for this. Even though it says Q & A at the end, we would like to have Q & A all the way through.

Cathy Horton-Panzica has degrees from the University of Michigan, Ohio State College of Law, and the University of Kent's Canterbury Theological College. Cathy is an ordained Episcopal priest, and as you might expect, she brings both passion and compassion to venture capital investments. Cathy is the founder and leader of Red Room Revolution, a set of 20 economic development initiatives in the North Ohio region. She is the founder of Beta Strategy Group and Beta Opportunity Partners, a fund that intends to fund 24 companies in 18 to 36 months. To date, she has funded six companies and founded three companies herself. She envisioned and started the Beta Technology Park in Mayfield Village, Ohio, which transformed a decaying Industrial Park into a tech park for businesses that use a shared services platform to reduce overhead. One of her latest ventures is a children's workshop, which educates elementary school students in a creative play using technology. And when she is not doing these things, you may find her leading services as an associate priest at Trinity Cathedral here in Cleveland. I think she brings a new spin to the term "angel capital."

Brad Cherniak is not a member of the clergy, so I am not quite sure why we invited him. I think he may be here more to play devil's advocate. Brad graduated Summa Cum Laude from the University of Chicago's Graduate School of Business, which for those of you who know the Chicago GSB, they probably think they have their own theology. He is a co-founder and partner of Sapiient Capital Partners, a Toronto-based firm that advises mid-market and early stage companies in areas of growth and economic strategy, acquisitions and divestitures and the sourcing of capital. Brad has 20 years of experience in investment research, corporate and investment banking,

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<sup>19</sup> See generally Hsu & Kenney, *supra* note 12.

merchant banking, and private equity and venture capital, with firms like CIBC, Bank of America, Chemical Bank, and even First Ontario Fund, which is not noted in his bio, but is a labor-sponsored venture capital fund in Canada. So I think he is in a good place to comment on the pros and cons of that model of Government intervention. Brad specializes in small cap private and early stage companies both as an advisor and principal. He has served on a number of boards of directors and advisory boards for these companies.

Without any further ado, because I know Henry is getting a little impatient, I am going to turn to Brad to start the discussion on the first subject, the relationship of venture capitalists and entrepreneurs: the good, the bad and the ugly.

CANADIAN SPEAKER

*Brad D. Cherniak\**

&

UNITED STATES SPEAKER

*Cathy Horton-Panzica\**

MR. CHERNIAK: Let me start by saying that when I heard about this topic, I was actually quite excited to come here, because it is a topic quite near and dear to my heart. When I started in my field, my first deal was \$366 million, and my last deal in March was \$5 million . . . so either my career is in inexorable decline or I made the strategic decision, which I like to think I have, to focus on entrepreneurs and their companies – because I think it is a very challenging and rewarding world, and it is a great place to spend a career.

But I thought what we would do is discuss – first, can you hear me okay in the back? Is my voice carrying? Okay. We thought we would delve into the relationship between VCs and entrepreneurs . . . and that we might as well start with the dirt!

You know, if you are going to discuss a relationship, you want to start with the bad side rather than the good side. So I'm here to give you the straight goods – but, this being said, I have to say I feel a little bit duped and misled by Daniel and by this Institute, because I was brought here to sort of tell you the straight goods on deals and VCs and what really goes on in the trenches . . . but I find out I am sitting next to a reverend, and my every word

is being recorded by every media imaginable. So under advice of my counsel, I would like to conclude my remarks for today . . .

So the first section really discusses what each side doesn't like about the other. And to start with the VC as the first target, what are the beefs on venture capitalists? The first one, increasingly so, is "why are their term sheets so aggressive?"<sup>20</sup> Why are deals getting scarier and scarier, getting more complex?"

Frankly, it is the nature of the beast. It is a negotiation, with a lot at stake economically and otherwise.<sup>21</sup> So you are always looking for the upper hand,

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\* Brad Cherniak is Co-Founder and Partner of Sapient Capital Partners, a Toronto-based firm which advises mid-market and early stage companies in the areas of growth and corporate strategy, acquisitions and divestitures, and the sourcing of capital. Mr. Cherniak has close to 20 years of experience in investment research, corporate and investment banking, and merchant banking and private equity venture capital with such firms as CIBC Wood Gundy, Gordon Capital, Bank of America and Chemical Bank. Mr. Cherniak graduated Summa Cum Laude from the University of Chicago's Graduate School of Business.

\* After being educated in High School by the Quakers at George School in Philadelphia, Cathy went on to graduate from the University of Michigan in 1983, The Ohio State College of Law in 1986 and The University of Kent Canterbury Theological College in England in 1999. In 2000, she was ordained as an Episcopal priest. Cathy has spent over 20 years cultivating a global mergers & acquisitions and venture finance legal practice, serving a myriad of clients that range from the Fortune 100 companies to emerging and mid-market enterprises. She spent 15 years in London, where she developed a passion for technology in the emerging companies' market place. In Europe, she formed her own consulting practice and worked with global enterprises and start-ups to foster and capture the value of strategic technology innovation. Cathy has dedicated herself to transforming economies through the creation of truly innovative business strategies using technology. While in London, Cathy served as a trusted advisor to the Cabinet Office of the Prime Minister, Tony Blair, to help generate ways in which technology development could drive economic outcomes for Britain. After her years in London, Cathy recently returned to her native United States to continue her practice of law and consult with technology driven enterprises. Cathy is the founder and leader of the Red Room Revolution, a set of 20 economic development initiatives structured to transform the Northeast Ohio Region using a technology platform. She also is a founder of the Beta Strategy Group and Beta Opportunity Partners Fund which has made a commitment to fund 24 technology companies in 18-36 months. To date, Cathy has funded 6 companies and founded 3 of her own. She also envisioned and started the Beta Technology Park in Mayfield Village, Ohio which transformed a decaying industrial park into a tech home for early stage companies to grow using a shared services platform to lower overheads. She has recently renovated an old barn to headquarter her new business, Children's Technology Workshop, which educates second to eighth graders in creative play using technology. Finally, Cathy is an Associate Priest at Trinity Cathedral in Cleveland, Ohio.

<sup>20</sup> See, e.g., Joseph L. Lemon, *Venture Capitalism After the Burst of the Internet Bubble: Selecting Financing Terms with Care*, 2 MINN. J. BUS. L. & ENTREPRENEURSHIP 1, 5-6 (2003), available at <http://www.centerforbusinesslaw.org/journal/v2n1/lemon.pdf> (discussing aggressive term sheets).

<sup>21</sup> See generally Vivek Wadhwa, *Before You Accept VC Funding...A Veteran Entrepreneur Tells You What You Need to Look For in a Venture-Capital Firm Before You Agree to a Deal*, BUS. WK. (August 3, 2006), <http://www.businessweek.com/smallbiz/content/aug2006/>

and you are trying to get the best valuation possible, the best terms possible.<sup>22</sup>

It is also a natural, broad trend in business – as companies become more efficient, shareholders increase their expectations, all given a turbo boost by hedge funds and other activist shareholders, every side of every corporate relationship attempts to squeeze every last dime of value from their counterparties. You are forced in a sense to get more creative over time, to get more and more aggressive and scary going in.

I also think the lawyers should take their share of the blame! I have had some very creative counsels that thrilled me over the years as a venture capital fund manager, in giving me scary new implements with which to beat the entrepreneur over the head if necessary! So lawyers have to take their share of the blame!

All this being said, I think there is an interesting and even counter-intuitive sea change happening in the market. There is an interesting new trend towards simplicity and trust, and it is kind of driven by the developments I just described above. I can speak to that very well from my own experience – it is also driven by simple practical reality in such cases where you have companies where the venture capital funds are putting in multiple rounds of capital, possibly with new investors coming in on some of these different rounds. I have had these types of situations where the paper trail of documents and terms and rights and obligations becomes so complicated and convoluted and overlapping and conflicting that, despite having all these nuclear weapons, there is essentially no way to detonate them before you can get your own butt out of the room!

So what you have to do in this instance is frankly start with a blank sheet of paper and say, okay, all of us clever professionals have kind of painted ourselves into a strategic and intellectual corner here. We can't make decisions because we've got five different shareholders agreements – each more complex than the last – it becomes hard to say who trumps whom. So let's call it a draw and re-cut the pie. One can look at this situation and wonder what all the legal expense and effort was for. Simplicity is becoming more practical. It is becoming a practical thing as well as a trust-driven thing.

MS. HORTON-PANZICA: I find it interesting to blame the lawyers because during yesterday, making a list of the terms that pervade our space, and they come from lawyers: preference, drag, tag, ratchet, hatchet, laddering, pump and dump, underpricing, crowdouts, control, forced exit, rushed exit, later-stage blinders, piggyback, grand standing, flips.

MR. CHERNIAK: I have done every one of those . . . some twice!

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sb20060802\_804397.htm.

<sup>22</sup> See generally *id.*

MS. HORTON-PANZICA: If anybody doesn't know what any of that means, it is the dirty language that pervades what we are doing. And when we started talking about this session, I said, you know, why don't we talk about what we need to do as responsible professionals to change this?

I like to say that the trend that I have been trying to work with the investments that my group is doing, and in partnership with other people, is to simplify due diligence, so you don't have entrepreneurs who should be running their businesses and inventing and being creative fund people. They are spending nine months in due diligence for a million dollars that is not even spent, and having them review 15 drafts of 45 term sheets for the 45 people who are investing, and completely send them down side roads when they need to be straight ahead.

The investments that we have been doing – we don't even present the term sheet until all of the investors in the consortium agree. There is one term sheet that the entrepreneur is reviewing for everyone.

We also have a fixed due diligence program where we only do due diligence upfront on the things we really, really care about. So we are changing – actually, there are a few things we really, really care about – the intellectual property and how quickly are we going to cash flow based on the numbers we think are there.

Once we know when we are going to cash flow and whether the IP is commercially outside of the opportunity, then we have done a lot of the de-risking already. We will not have to spend nine months in due diligence. We don't have to get into 45 term sheets, and we don't have to get into ratchets and hatchets and preference. None of that stuff is really what's on the table; we have taken all that off.

So I sort of wanted to say, in this trend about where we are going in the common beefs, is why don't we as professionals try to get rid of some of this mystification of deals and the way that we treat one another and start simplifying things for the entrepreneur.

MR. CHERNIAK: Just on the second point, this is a question I get asked a lot by entrepreneurs, and part of it is just the nature of the business. You know, the entrepreneurs, they know they need capital, but frankly, they are not happy about needing it.<sup>23</sup> And some of them actually don't know they need it; they just know that they need something.<sup>24</sup>

Again it is the nature of the business. You are coming in, and you are taking a chunk of an entrepreneur's baby, their dream. So it is kind of a negative starting point almost in nature. I think, as well as the nature of the

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<sup>23</sup> See, e.g., Giacinta Cestone, *Venture Capital Meets Contract Theory: Risky Claims or Formal Control?* 3 (2001), available at <http://www.recercat.net/bitstream/2072/1967/1/48001.pdf>.

<sup>24</sup> Cf. *Id.*

business in venture capital, that the women and men in the venture capital business living with this are spread very thin, partly by design.<sup>25</sup>

One has to wonder why the venture capital funds couldn't add more VCs per dollar invested, just so they could spend a little more time, be a little less abrupt in their dealings with people – but at the end of the day, as a VC you really are forced to run from deal to deal, crisis to crisis, opportunity to opportunity, which kind of creates the incentive to be somewhat abrupt and very efficient with your time, so to speak.

I think success also does breed overconfidence in the industry. There certainly is an arrogance wafting through the industry. It is a dog-eat-dog industry, with little love lost between venture capitalists, each seeking to win their way through, compete against other venture capitalists, and get their money into the marquee companies.

You have got to be a sharp-elbowed tough man or woman to do it. The more and more successes you have as a fund, the more the VC becomes a caricature of what they were in the business to begin with--personality quirks get more and more pronounced, since there is no one to set them straight. You, as the VC, end up failing to recognize your own limitations, and you get into an operational groove in terms of the way your fund does business. You will slam a square peg into a round hole because you are a very successful square peg!

Funds tend to try to replicate their successes by doing what they did well in the past, like a pitcher with a good slider and not much else they are very confident in. Your fund may be particularly adept at some particular function like finding new sales channels for software companies or merging investments together or adding aggressive, operationally focused executives in their Rolodex to accelerate the pace of companies getting to the next level. You tend to go sort of back to the things that you are good at, and sometimes again it turns you again into pounding square pegs into round holes, whether your action is optimal or even needed at that moment, or whether the CEO recognizes the need or agrees, that's what you do anyway – turn your companies into the same sort of animal.

And then I think the last point is fairly commonly felt by entrepreneurs – I certainly have seen it. VCs can certainly lack a bit of respect for the effort and skill it has taken to create what has been built to date. This is a difficult and complex issue, and not easily summed up or solved.

MS. HORTON-PANZICA: Among the most frequent complaints that I have heard from entrepreneurs who are accepting venture money is that they end up feeling completely devalued in the process.<sup>26</sup> They are in a situation

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<sup>25</sup> See generally Lorin Cohen, *Writing your Business Plan*, BIOENTREPRENEUR 1 (2002), [http://www.nature.com/bioent/building/planning/012003/pf/nbt0602supp-BE33\\_pf.html](http://www.nature.com/bioent/building/planning/012003/pf/nbt0602supp-BE33_pf.html).

<sup>26</sup> See, e.g., Ralf Becker & Thomas F. Hellman, *The Genesis of Venture Capital: Lessons*

in which they created a seed of wealth for everybody, and investors lose sight of that.<sup>27</sup>

They created the seed of wealth from which the venture capitalists are going to make these astounding returns, we hope. And somehow in the process of the arrogance of having the money, we forget about the value of the person's creations. And so we set up an aggressive and some sense of animosity between the venture players and the person that has created them.<sup>28</sup>

And I like to think that what we certainly are trying to build into our environment is a different sense of conscience about how we treat entrepreneurs. Entrepreneurs are creative.<sup>29</sup> They are out of the box and they have this sense of creativity, and when you try and stamp it down and press it in and put it in a box and limit it, you have killed it. Until you get the venture capitalist with the right appreciation for that mind set – again back towards that mind set – and appreciating it and valuing it, I think we are trying to inject the wrong kind of personality next to the relationship of the entrepreneur.

DR. KING: Have you had any bad experiences with your new approach, which I think is a good one?

MS. HORTON-PANZICA: I haven't yet. The one situation, which I got back into a good resolution, was that I met a young chap from New York. He was talking about his company in a session that I was in, and I went up to him, and I said, "I am going to invest in you, and I like you. I like who you are, and I am going to let you run with what I see." And I did that, and he was bought six months later by a public company. And that was a good thing.

But as he was exiting, I had a right to take some additional warrants, and I gave that up because the investment was so short because I didn't feel good about taking them. I know that sounds really strange, but I actually didn't feel good about it. I made a huge return.

I gave up warrants, and he had to transfer money to my group, but he didn't pay it for about 90 days. I told him, "You know, I trusted you. I dealt with you with a certain ethic, and you are violating it." Once I sent that e-mail to this chap, we had the money wired within 24 hours.

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*from the German Experience*, CESifo Conference Centre 12-16 (Nov. 22-23, 2002) [http://www.cesifo-group.de/portal/page/portal/ifoContent/N/neucesifo/CONFERENCES/SC\\_CONF\\_1999-2006/VCE02/PAPERS/VCE02-HELLMANN.PDF](http://www.cesifo-group.de/portal/page/portal/ifoContent/N/neucesifo/CONFERENCES/SC_CONF_1999-2006/VCE02/PAPERS/VCE02-HELLMANN.PDF) (unpublished research paper used in CESifo Conference in Munich).

<sup>27</sup> *Id.* at 14.

<sup>28</sup> *Id.* at 12-13.

<sup>29</sup> Debora Markley & Don Mackey, *Community Environment for Entrepreneurship*, CENTER FOR RURAL ENTREPRENEURSHIP, June 2003, at 2, <http://www.ruraleship.org/content/content/pdf/Community.pdf>.

If you are going to work that way, you have to demand it in return, right, because it is not the environment. But it worked, but you have to keep it real. I am much happier operating that way. I don't want to be in this drag tag ratchet and hatchet. I am not interested.

MR. CHERNIAK: That's actually a good segue to this point, which is, do deal terms actually limit relationships between investors and entrepreneurs?<sup>30</sup> And I think the answer is actually yes. Although I hate to admit, I have done the same thing in terms of not exercising the rights that I legally have in my agreements. At the end of the day, you want to make sure you don't poison the relationship with your entrepreneur, to be penny-wise and pound-foolish.

Although you may be entitled to it under your agreements, if you strip the entrepreneur of too much of their equity and upside, either for underperformance or additional unforeseen capital requirements, the relationship and possibly the investment is eventually going to break down. The entrepreneur is going to lose interest and motivation. They are going to either break down or leave! By the end of the day, you start to wonder whether having all those rights are actually necessary.

Again, although I have to admit that looking forward in negotiating future deals I would probably *still* try to get these weapons. It would be hard to give them up, but I am not sure I would use them. And I think one of the key points in this discussion is that the personal relationship between the VC and the entrepreneur, the chemistry is absolutely paramount in successful investing.

You may have a big institutional fund name; you may have a high-profile, sexy company name with big dollars involved. However, at the end of the day, it is two people, and if it doesn't work, if they don't trust each other or they don't take each other's advice, if they don't listen, the relationship is screwed.

You are not going to be successful, no matter how good your technology is, how good or smart the entrepreneur is, or how smart the VC is. In my mind, it is the most critical aspect of venture capital and the linchpin of success, but it is also the least scientific and the toughest thing to nail. That is why, as I moved over to the advisory side of the relationship between these two animals, it was really to figure out the best way to make sure that match is there, and you are not just taking the best money at the best terms. You are putting together the women and men who fit best with that entrepreneur.

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<sup>30</sup> Cf. TONY BERRY, DAVID LEE, JIA MIAO & ROBERT SWEETING, ACCOUNTING AND ACCOUNTABILITY IN A VENTURE CAPITAL FUNDING PROCESS 2, available at [http://72.14.205.104/search?q=cache:hvsPNciy08YJ:www.licom.pt/ea2007/papers/EAA2007\\_0325\\_final.pdf+ACCOUNTING+AND+ACCOUNTABILITY+IN+A+VENTURE+CAPIT+AL+FUNDING+PROCESS+%22tony+berr%22&hl=en&ct=clnk&cd=1](http://72.14.205.104/search?q=cache:hvsPNciy08YJ:www.licom.pt/ea2007/papers/EAA2007_0325_final.pdf+ACCOUNTING+AND+ACCOUNTABILITY+IN+A+VENTURE+CAPIT+AL+FUNDING+PROCESS+%22tony+berr%22&hl=en&ct=clnk&cd=1) (Investee-entrepreneur relationships are similar to that of principal-agent relationships, where information asymmetry leads to agents limiting effort).

You know, with most of my clients I spent more time than I almost cared to in the trenches, really seeing how they function, how they think, what drives them, what scares the hell out of them, and what changes their behavior. And similarly dealing with a bunch of VCs, as either colleagues or competitors or friends, you see what their hot buttons are; the match is the critical thing.

I think “overly-nasty” agreements tend to keep the two at arms length. The CEO tends to go into a shell, probably for good reason! You know, they are scared to death of losing their company. So maintaining that chemistry is key to a good relationship, in my mind.

MS. HORTON-PANZICA: I think a lot of the relationships get off on the wrong foot because we don’t have the money right. So many times I have young entrepreneurs come into our group, and they are either asking for too much money, too little money, or they don’t need money when they are asking for it. So they are asking for an engagement with the venture world, when they don’t have the quality and quantity of what they actually need to finance.<sup>31</sup>

You automatically set up a situation where a venture capitalist is going to give too much money to an entity and want a deeper return, not enough money and risk wanting a deeper return, or putting money in when they don’t really need it and getting a better return, right?<sup>32</sup> So we are setting up the wrong chemistry.

So I think part of a professional’s job and part of the venture capitalist’s job is to stop that process and sit down with the entrepreneur and say, actually, do you have this quite right? I had a wonderful client from San Francisco, and she had great technology. I would invest tomorrow, but she doesn’t need me now. I sent her home and said you don’t want my money right now. Keep pressing with friends and family right now.

You are all right like this, and you are going to make it. Come back, and we will raise you around, but you don’t need it right now. That was the right thing to say. I think that if you create that sense of trust by taking a look at the mechanics of the money and when it is needed, that’s a much better relationship.

The other comment I had here is that rather than looking at the terms that I just read off to you in a basket of rights for the venture money, I like to say to the entrepreneur, this is our environment. I invite you to play in it with us, and if you achieve these three or four or five milestones, if you do this and you are exceptional, you will have rights and money and extra value coming back to you.

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<sup>31</sup> See, e.g., Rob Holland, *Planning Against a Business Failure*, AGRIC. DEV. CTR – U. TENN., ADC INFO #24, at 3 (1998) available at <http://cpa.utk.edu/pdffiles/adc24.pdf>.

<sup>32</sup> *Id.*

It is called in our business a clawback.<sup>33</sup> Do I give you a clawback of some of what you have given to me because you truly are exceptional and you can prove it? Then you have given a modicum of respect to this entrepreneur.

It is a different field than all these rights on their own in favor of the venture capitalist.

MR. McCREARY: Cathy, why do you call it a clawback and not an incentive?

MS. HORTON-PANZICA: That's a good point. You are saying you have a right to actually bring it back. The language should change. It is not really an incentive; it is a right to earn back what they had to give up in order to get the equity.<sup>34</sup>

MR. McCREARY: My follow-up question is whether most of the terms can be turned into positives rather than subtractions and negatives?

MS. HORTON-PANZICA: Absolutely.

MR. McCREARY: And if you get that environment, isn't that what happens in the ones that have been winners for you? Have you ever seen it not be the case where the relationship was very positive?

MS. HORTON-PANZICA: Absolutely.

MR. McCREARY: And once there are failures, you are always a failure.

MS. HORTON-PANZICA: There are negatives, and the industry calls it a clawback. I mean, we use these terms. We throw them out; it is aggressive.

The ones that stay when the chemical reaction is right, it is just on fire. It really creates an exciting, positive relationship.

I am going to Toronto next Sunday to go see these entrepreneurs in Toronto. I am counting the days since I am so excited.

So that's the kind of chemistry you want from the person putting money behind you, and I think when that changes, it is like any relationship, right? Once you interject negative comment or aggression into any relationship in your life, it is the same way, right?<sup>35</sup> So what's your conscience – why is your conscience any different when you invest in money? Is it money that makes us gorillas and ugly? I guess.

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<sup>33</sup> DAVID L. SCOTT, *WALL STREET WORDS: AN A TO Z GUIDE TO INVESTMENT TERMS FOR TODAY'S INVESTOR* (Houghton Mifflin Company 2003) available at <http://dictionary.reference.com/browse/clawback> (clawback is defined as “[e]xcessive management share of profits that must be refunded to investors of a venture capital fund. A clawback is required when managers of a venture capital fund take a contractual share of early investment gains that are subsequently reduced by losses”).

<sup>34</sup> *Id.*

<sup>35</sup> See e.g., Geraldine Downey & Scott I. Feldman, *Implications of Rejection Sensitivity for Intimate Relationships*, 70 J. PERSONALITY & SOC. PSYCHOL. 1327, 1329 (1996), available at <http://www.columbia.edu/cu/psychology/socialrelations/downloads/rspersonal.pdf>.

MR. McCREARY: No. I think it is a question of people not meshing well, and the chemical relationship between the venture capital and the entrepreneur is as important as the money relationship.<sup>36</sup>

MS. HORTON-PANZICA: Well, in our relationships with the people in our lives, we don't have all these ratchets and hatchets and claws and all that stuff going on, do we? We don't talk about it.

I guess what I am saying, why don't we create an environment where we don't have that language exist, and you change it, which is the point you are also making, so that those relationships are supportive and ones that induce success rather than failure.

MR. CHERNIAK: There are different nomenclatures for clawbacks. In my last deal, it was called an "earnback." I have also seen it referred to as a "reverse option," among other things. I have seen a whole bunch of different names, but for me, actually, I find as long as you are negotiating "straight up" with the entrepreneur, it doesn't matter. For example, one term that is in a lot of term sheets that I never accepted and never will is "investment multiplier," which kicks in when you sell a company.<sup>37</sup>

As an example, the venture capital fund puts \$5 million into a company. Under this term, the fund must receive or "earnback" \$15 million before the entrepreneur and other existing stakeholders get anything. I have always found that to be a backdoor way of negotiating more equity, sometimes without the entrepreneur even understanding the real economic meaning of the term. It is becoming less common these days, although it was very common in the venture capital boom times around 1999 and 2000.<sup>38</sup>

I find when you take out terms like that, that scare the entrepreneur into thinking, "I really need to understand how this REALLY works," if the agreement is more straightforward, you can still keep some aggressive terms in there.<sup>39</sup>

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<sup>36</sup> See, e.g., Olav Sorenson & Toby E. Stuart, *Syndication Networks and the Spatial Distribution of Venture Capital Investments*, 106 AM. J. OF SOC. 1546, 1549-1551 (2001), available at <http://leeds-faculty.colorado.edu/bhagat/syndicationnetworksvc-investments.pdf> ("Professional relationships provide one of the primary vehicles for accessing timely and reliable information about promising new ventures")

<sup>37</sup> JOHN MAYNARD KEYNES, *THE GENERAL THEORY OF EMPLOYMENT, INTEREST AND MONEY* 82 (Elizabeth Johnson ed., Harcourt, Inc. 1964) (1953) available at <http://www.unilibRARY.com/books/Keynes,%20John%20Maynard%20-%20The%20General%20Theory%20of%20Employment,%20Interest%20and%20Money.pdf>.

<sup>38</sup> Cf. Thomas Hellmann & Manju Puri, *The Interaction Between Product Market and Financing Strategy: The Role of Venture Capital*, 13 (4) THE REV. OF FIN. STUD. 959, 980-981 (2000) available at <http://strategy.sauder.ubc.ca/hellmann/pdfs/RFSofficial.pdf> (stating that the number of firms looking to use venture capital is increasing, thus type and terms of investment are more likely to favor entrepreneurs, which controls development path of companies).

<sup>39</sup> See, e.g., Lemon, *supra* note 20, at 6, 7.

If it is a clawback, it is a clawback. As long as it is straightforward, you hope the chemistry of that relationship is solid. It is the kind of stuff that really springs on you later, which the entrepreneur doesn't really understand the effects of it until it hits them in the head or their lawyer informs the what this thing really going to do to them that kills the chemistry and possibly the investment ultimately!

MR. McCREARY: Of course, no guarantee.

MR. CHERNIAK: Oh, you have those, too. But it is when you, as the entrepreneur, are surprised by terms that that were not really highlighted or fully explained in the negotiation, I find that poisons the relationship.

MR. SANDLER: Let's turn to the good, Brad.

MS. HORTON-PANZICA: That's actually a very worthwhile point, part of what poisons the relationship with the venture capitalist. One of my very dear friends who started a business – very successful, invested in by large houses in New York – he is going to leave in the next two or three months with five percent of this company, and he is so bitter.<sup>40</sup>

And the reason why he is going to do that is because he took on equity too soon, and he took on too much, and he didn't need it all, and he gave away the bank, literally. And so, you know, being penny-wise and kind of pound-foolish, giving up equity, he came to me, and he wants to do another company.<sup>41</sup>

He said, "I don't want any venture money at all. I don't want to see it again." This is a guy that is going to start three or four or five companies before he is finished with his career. Probably until he is gone he will be starting new companies, and this is his attitude now. That's sad.

That's why I think the negotiation of the amount of money we actually advise entrepreneurs to pay – and they even have a drawdown. I have done that. I had one deal where I had given him a drawdown and to take what they need, and I get a little richer because the money is drawn, because then they need more from me.

And I have more money at risk, but giving them a drawdown to take what they need as they need it in case things go wrong, that's a very civilized way of financing something.

MR. CHERNIAK: The flipside to that, both of these, to me, are such critical points in terms of how deals get done and whether deals end up being good or bad. To play the devil's advocate for a second – I like doing that.

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<sup>40</sup> See generally Malcolm Baker & Paul A. Gompers, *Executive Ownership and Control in Newly Public Firms: The Role of Venture Capitalists* (November 1999) (unpublished thesis, on file with the Harvard Business School), at 3, available at <http://www.people.hbs.edu/mbaker/cv/papers/Ownership.pdf>.

<sup>41</sup> See generally Douglas G. Baird & Edward R. Morrison, *Serial Entrepreneurs and Small Business Bankruptcies*, 105 COLUM. L. REV. 2310, 2329, available at [http://www.columbialawreview.org/pdf/Baird-Morrison\(Web\).pdf](http://www.columbialawreview.org/pdf/Baird-Morrison(Web).pdf).

MS. HORTON-PANZICA: Where is your fork?

MR. CHERNIAK: I think it was in the soup last night!

I recently put a deal on ice for an entrepreneur who was too much the other way, too equity-stingy – he could not accept the idea of taking any dilution at all, and, in fact, turned down money that was critically needed for his company. He is at the point where he is growing, but doesn't have a full appreciation of the effect of growth on cash flow. This is actually where most entrepreneurs kind of run off the rails, is not understanding that your business is booming, but it is not going to generate cash flow as quickly as it generates profit. Indeed, it will continue to consume cash in the form of working capital to sustain the growth.

So you *need* a balance sheet to grow your company. I have spent a lot of time on that topic with entrepreneurs, and with this one in particular, I just could not get the point across.<sup>42</sup> And frankly, he could lose his business because of it, for sort of the opposite reason, and that again is being *too* stingy on giving up equity.<sup>43</sup>

There is a balance between the two, not taking too much, not taking too little and the problem extends in both directions.<sup>44</sup>

But let's get to the good stuff! Bottom line, the situation is not so bad. Actually, overall, the relationship is working, and we will talk a little bit about the macro numbers.

But when it does work, I think you will agree it can be a fantastic relationship. VCs can and do fill in the gaps (or weaknesses or blind spots) that all entrepreneurs have to some extent. When they recognize they have these gaps, the relationship can work very well. As an example, a gap could be, you know, being a great operator but not being very good at managing people; or being visionaries in their businesses but not understanding really how to put a business together and make it work and earn sort of the money they need to make their investors happy. So the VCs can be perfect to just to fill in those gaps or blind spots.

Another critical aspect of the VC/entrepreneur relationship is in guiding the entrepreneur to pick the low hanging fruit – the basic elements of what makes a business successful, and sustainable. This blocking and tackling is something every company has to do. If you have been in the corporate finance/venture capital industry for as long as I have been, these points become second nature, but you realize they aren't necessarily as clear to an entrepreneur. You must keep them focused, hew to a flexible, proactive, and reactive strategic plan and use all the resources in the company to their

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<sup>42</sup> See, e.g., Lemon, *supra* note 20, at 8.

<sup>43</sup> *Id.*

<sup>44</sup> *Id.*

maximum. This can be, conceptually, fairly simple, but actually much harder said than done.

I think if entrepreneurs have a weakness: sometimes they don't know when to stop.<sup>45</sup> I had one, with a very successful, growing early stage enterprise, a software company for which we executed a financing for very recently. He is just at the cusp of breaking into the U.S. market – big enterprise customers.

His average unit sale going forward will likely be in excess of his total cumulative historical sales, and he will now be dealing with giants such as Boeing and Microsoft and Wal-Mart and those types. That's all fine and nice. You stretch to the max to meet their high expectations and short tempers. He is just barely keeping it together, and he gets a visit from a group of entrepreneurs from Dubai who are setting up sort of a venture capital incubator in the Middle East. Intriguing, but probably ten years away from fruition, and it is going to take a lot of work and a lot of pain, attention and travel – and money. They come to him saying, you know, we would like to incorporate your technology into our concept. All you need to do is provide us with technical and managerial and some executive expertise and some money.

So he brings me in and says, "This looks interesting." My reaction, if you edit out the expletives, was to say nothing! Again, the entrepreneur's creative engine just doesn't have brakes or, perhaps, a steering wheel. The insights of a VC were critical here to avoid a costly and potentially fatal dalliance caused by well-intentioned naivety coupled with endless energy and enthusiasm! The system worked here.

The Company ended up walking away from that opportunity because it was the prudent thing to do, and I think that's what a VC has to do, or an advisor in this case – to focus his efforts and make sure he is focused on his core business, which in this case is enterprise software business – moving from Canada to the U.S. I just don't know why he thought he had all this free time and bandwidth to spend in Dubai, but what are you going to do?

MS. HORTON-PANZICA: Before you go on to the governance piece, it would be interesting – I don't know how many companies you invested in your group – which you would say the entrepreneurs are? Good CEOs? And one of these CEOs, and I was sitting in the back trying to think about that before I spoke, and I am under 50 percent, and therefore, you got a massive blind spot because the point is the entrepreneur wants to be the CEO.

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<sup>45</sup> Cf. Morey Stettner, *CEO Peer Support Can Power a Firm's Business Growth*, INVESTOR'S BUS. DAILY, Mar. 5, 2007, at A11 (Entrepreneur dissuaded from expanding business in favor on focusing on existing firm).

MR. COHEN: I have a question in regards to your initial comment and a most recent comment. That pertains to one of the most important things you look at, and you stated you look at the IP and the cash flow.<sup>46</sup>

MS. HORTON-PANZICA: And the people.

MR. COHEN: That's the key.

MS. HORTON-PANZICA: And the people. I don't even get there until I like the people.

MR. COHEN: Many instances you recognize immediately that the entrepreneur doesn't have the management skill to take it further. And how often do you tell them that before you fund it, that you are going to have to bring in outside management? Do you tell them that initially? Do you wait? What's your process?

MS. HORTON-PANZICA: I don't even get to the IP and cash flow until I see the person is somebody that just excites me with the spark that they have and the drive and the ambition and the foresight for whatever market they are in to be able to drive and drive hard. Otherwise, I am not interested if I don't have that upfront.

I would say I am very honest. I say, "this is what you are good at, and what we need to do is get you this set of management skills. That's something we will do; we will even do it for you until we find the right person." I have done that.

I am doing that right now in a company that I invested in. I love their technology, and they now have been taken in by a large vendor as a software tool. It has been a great investment. The guys that developed the software, I told upfront, that they were going to need help. I put someone on the board, and I have the head of my investment fund actually working alongside these guys constantly on management issues and getting the right management team around them. So I say it upfront because if I am putting money in as a passive investor and see problems, I am actually not interested in that model because I know it is going to fail.

One time I did that recently where I went alongside other investors and stood back. Even though I loved the technology, but I had real doubts whether he could lead and didn't go with my instincts. It has been, at best, challenging.

I think you have to instinctively be very upfront and fill that gap if you are capable. If you managed the P & L and are worried about whether the employees can pay their mortgages, which I have, then, if you cut your teeth on that worry, you can drive management help into the VC environment, where the entrepreneurs never had to worry about that.

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<sup>46</sup> See generally Steven N. Kaplan & Per Strömberg, *How Do Venture Capitalists Choose Investments?* (August 2000) (unpublished thesis, on file with the Graduate School of Business, University of Chicago), available at <http://isc-capital.com/downloads/aic82k.pdf>.

They had just been inventing, right? And now they are taking on employees; they are taking on space; they are taking on cost; and where is the conscience about whether I can pay the bills? Where is my cash flow? Where is my customer base? How am I going to pay my people?

So if that's the mindset you have, you have to put the skills out there, and you have to be the one that sees the blind spot and say, "Here, if you want my money, then you also want this expertise because if you don't want this expertise and us to help you with the management side of this, then don't have my money."

MR. CHERNIAK: We spend a lot of time on transactions of earlier stage companies and the notion of being very upfront with, usually, a CEO or founder about what's likely going to happen after the institutional capital is in, and whether this scenario will be acceptable to them. What's the range of outcomes they are willing to accept in order for the company to be successful – which could be bringing someone in just under them, such as an experienced COO, or in some cases it could be bringing in a new CEO above the founder and putting them into a technology executive role or sales, second-in-command.

We spend a lot of time with the dynamics of what the team is going to look like before and after the money comes in.

MS. HORTON-PANZICA: What's your – you asked a question, what's your – do you agree with what I am saying, or do you have a different approach?

MR. COHEN: No. I agree with what you are saying. I just wonder how much you do with due diligence, use some tools like physiological testing?

MS. HORTON-PANZICA: Yeah.

MR. COHEN: Have you spent time interviewing the spouse?

MS. HORTON-PANZICA: I have not done that.

MR. COHEN: Because you are right, entrepreneurs are a special breed. The conflict you get between the institutional venture capitalist and the entrepreneur very often comes when you intrude on their management, when you try and put that skill set in.<sup>47</sup>

MS. HORTON-PANZICA: Yeah, I agree. It is interesting on the spouse side because I have an investor that is in trouble because the spouse is not supporting the entrepreneur. And it is very, very disappointing. The entrepreneur is a 24-7 pizza-under-the-door kind of guy and the spouse isn't willing to support such a lifestyle when the business requires it.

MR. COHEN: I will close it out. You don't want to hear my war story.

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<sup>47</sup> See, e.g., Thomas Hellmann, *The Allocation of Control Rights in Venture Capital Contracts*, 29 RAND. J. OF ECON. 57, 59 (1998), available at <http://strategy.sauder.ubc.ca/hellmann/pdfs/ControlRights.pdf>.

MS. HORTON-PANZICA: I love your war story, but that's very interesting. I wonder how violated one might feel saying I want to interview your spouse, but I would like to talk about that a bit more.

MR. CHERNIAK: It goes the other way as well in terms of delving into what the VCs are really like, talking to their investees, talking to their partners. That's a process that we spend a lot of time advising our clients to insist on – that they spend a lot of time with the individual VC that is going to be there going forward, as their director, their guide, and their institutional investor. Entrepreneurs should also meet the VC's partners in social settings, as well as some of their investees. The good funds are only too happy to facilitate this. If they are wary, you have something to worry about.

MS. HORTON-PANZICA: You know, when you are advising an entrepreneur about what type of venture capitalist you want to go to or should go to, it is very important to look at the track record of the money.<sup>48</sup> Those VCs that have great track records of staying in deals, the entrepreneur ought to be interviewing hugely the venture capitalist.

This should be a beauty contest both ways. How have you succeeded? What have you done? Let me interview your investments. Let me talk to the people you dealt with. Let me talk to management of companies because this is a marriage. It is a broker's marriage, and if you get the wrong chemistry, you know the marriage certificate, right?

So, you know, how are we setting up anything that is any different if we don't get the chemistry right between the entrepreneur and the VC? You know, if you have got a young venture firm that has a proven track record, they are going to grandstand investments. They are going to grandstand them. They are going to dump them early. They are going to do early exits to build their portfolios. Do you want to be with a grandstander or do you want to be with somebody that has got a little bit of experience and stayed in investments?

And they put money at risk, and they have been a long-term venture capitalist. They put their money where their mouth is, so it is very important that when you pair the entrepreneurs with the venture capitalists, it is the right kind of venture capitalists.<sup>49</sup>

MR. CHERNIAK: I think we have talked about a lot of these points, but I think one critical one – and again I think we kind of touched on this – but it is a horse sense of how to help the entrepreneur build his team. I think, when I was in the business, in my own mind, I spent half my time on what I call

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<sup>48</sup> See, e.g., Rafael Amit, James Brander, & Christoph Zott, *Why do Venture Capital Firms Exist? Theory and Canadian Evidence*, 12 J. OF BUS. VENTURING 441, 444 (1998), available at <http://strategy.sauder.ubc.ca/brander/papers/Why%20Do%20Venture%20Capital%20Firms%20Exist%201998.pdf>.

<sup>49</sup> See, e.g., Sorenson & Stuart, *supra* note 36, at 9.

human resource issues, because one of the biggest areas where a VC can add value is in helping the entrepreneur avoid making big mistakes in hires.<sup>50</sup> Speed them up the learning curve using your own experiences up the same learning curve.

You may have your team of three people, and you are bringing a sales executive or some other critical role, at this point the stakes are so high, an error in judgment could start the chain of events that could be fatal to your business.<sup>51</sup> Early stage companies are all about chemistry and positive momentum, and are not well positioned to recover from disruptions in these areas.

So I think one of the most critical things that a VC brings is not only qualified people to fill that key new role, but the horse sense to figure out whether the fit is mutually right, whether it is the right company for them, and whether they are going to stick it out.<sup>52</sup>

We had one client, a software company based in Montréal, which raided a high-ranking executive from a big public U.S. company, but without realizing how much they were going to have to pay to keep this guy happy in the medium term, in both cash and in common equity of the company – this person was very excited about the company’s concept and potential, but at the end of the day, the economics didn’t work – neither side really did their homework. This is a very costly mistake for companies.

But I guess I need to pick up the pace here. I would like to talk about the next point for a long time, but why don’t we just go on?

MS. HORTON-PANZICA: I think one thing that I would like to say is, as professionals, if you find that the entrepreneur or the venture capitalist has made a bad employment decision, the worst mistake is to try and fix it.<sup>53</sup> Get rid of it. I mean, I think what I have learned, if you try and fix a bad hire or a bad situation, it only gets worse.<sup>54</sup>

It is far better for all professionals involved to say we made a bad decision. Let’s go find the right person as soon as possible. You just fix it. Trying to nurse something along is detrimental to the younger business that

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<sup>50</sup> See, e.g., Robin Broadway & Motohiro Sato, *Entrepreneurship and Symmetric Information in Input Markets* (Sept. 2005) (unpublished paper, collaboration between Broadway of Queens University and Sato of Hitotsubashi University), available at [http://www.unicatt.it/Dottorati/Defap/Allegati/Boadway\\_Seminar.pdf](http://www.unicatt.it/Dottorati/Defap/Allegati/Boadway_Seminar.pdf).

<sup>51</sup> Cf. *id.*

<sup>52</sup> Cf. *id.*

<sup>53</sup> See generally RICHARD LUECKE, *HIRING AND KEEPING THE BEST PEOPLE* (Harvard Business School Press 2002), available at [http://slava.parma.ru/Doc/Unsorted/New/BOOKS/Harvard%20Hiring%20and%20Keeping%20the%20Best%20People%20\(2002\)%20Fly.pdf](http://slava.parma.ru/Doc/Unsorted/New/BOOKS/Harvard%20Hiring%20and%20Keeping%20the%20Best%20People%20(2002)%20Fly.pdf).

<sup>54</sup> Cf. Carolyn L. Rumpfelt, *You’re Fired, Twice!*, 11 KAN. EMP. L. LETTER, Nov. 2004.

is using its capital on someone that is not who they should be in the business.<sup>55</sup>

And that's not an unkind way of dealing with the world. It is just that your gifts didn't match what we wanted, so there is a very human way of dealing with it. You weren't what we expected, and we need to part ways.

MR. CHERNIAK: Briefly, I think one way to reduce the risk of having that bad one-on-one chemistry is to try to introduce small syndicates to early-stage deals, having two or three VCs rather than one.

Most VCs are not terribly open to a small investment. What can also happen is to sort of force capital down the entrepreneur's throat just to make the deal work. The entrepreneur can be forced to increase the size of the deal, take more capital than he or she perhaps needs, in order to allow each of the funds in the group to deploy enough capital to make the deal worth their while.

So, you know, you now have two or three VCs, with a nice relationship with the entrepreneur. The funds sort of keep each other honest, and they diffuse the power that a VC has going into a relationship with an entrepreneur. Usually one or more of the funds in the group ends up being the "good cop" in the relationship, giving the entrepreneur some needed psychological support.

And in this structure, the funds sort of keep each other in line – even though it might appear that the relationship would be two or three against one now, instead of one-on-one – but the structure again sort of balances things out, frankly, balances the relationship a bit. Really, it kind of diffuses the power, I guess. I encourage this for deals.

MS. HORTON-PANZICA: I love it, and it works beautifully when it is just a little more risk than I want to tolerate. If you think of the number of business plans that we look at, there are hundreds, and the few deals we actually do, it is not that some of the others didn't really take me away, I loved them, but they were just too much risk.<sup>56</sup>

And so the question is whether we can fund some of those opportunities by locking arms in our environment, and you know, we are talking about: do we need venture capital? Absolutely. And we need venture capitalists that are willing to lock on and say, "You know what? We want to share this risk and do it."

And that would enable more deals to be done if we can promote that collaboration amongst people and investors that have the same ethic.<sup>57</sup> You

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<sup>55</sup> See generally LUECKE, *supra* note 53.

<sup>56</sup> See generally Brett Nelson, *How to Increase Your Venture Odds*, VENTURE CAPITAL J., May 1, 2005, 2005 WLNR 6846743 (discussing how venture capitalists engage in probabilistic investing by balancing both risk and return).

<sup>57</sup> See generally Michael J. Robinson & Thomas J. Cottrell, *Investment Patterns of*

know, that would make a lot of sense to me. If there were ways to promote that, I would encourage us all as professionals to think about it because it would be a huge help to the entrepreneurial world.

MR. CHERNIAK: To address the Canada versus U.S. aspect, which is a key component for this conference, I have found that Canadian transactions are becoming much more like American transactions. There has been a definite convergence of the two, and I think it is both good and bad. Canadian deals and U.S. deals now are really hard to tell apart.<sup>58</sup>

Ten years ago it was vastly different. I could tell in two seconds looking at a term sheet, a letter of intent, or nondisclosure, or any other deal document, whether it was American or Canadian. Now the border is frankly irrelevant in my business. Our deals, we tend to look into geographic “pods,” which criss-cross the borders sort of blindly. Most of our analysis is done east-west. The north-south doesn’t really matter. The East Coast has its own sort of desires in terms of looking for investments and their own sort of operating styles. Central has one, and the West has one, but they all criss-cross the border.<sup>59</sup>

And the issue for Canada is that it is a small country, with a pretty small pool of capital overall, and that it is never going to have the critical mass that the U.S. market has on several levels.<sup>60</sup>

You know, there is around \$22 - 24 billion of venture capital in Canada in total, and last year in the U.S. they raised about \$27 billion just last year in the tech field.<sup>61</sup> In the 2000 “bubble” era, it was \$105 billion, and Canada raised about \$6 billion.<sup>62</sup> So the markets differ by orders of magnitude. I

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*Informal Investors in the Alberta Private Equity Market*. 45 J. SMALL BUS. MGMT 47 (2007), 2007 WLNR 4360035 (discussing that investors choosing to invest based on relationships provide a major source of capital for entrepreneurs).

<sup>58</sup> See e.g., Douglas J. Cumming & Jeffrey G. MacIntosh, *Venture Capital Exits in Canada and the United States*, 53 U. TORONTO L.J. 101, 101-200 (2002) available at [http://www.rotman.utoronto.ca/cmi/papers/Cummings\\_MacIntosh.pdf](http://www.rotman.utoronto.ca/cmi/papers/Cummings_MacIntosh.pdf).

<sup>59</sup> Cf. Symposium, Global Insight, *Venture Impact 2004 Venture Capital Benefits to the U.S. Economy*, NAT’L VENTURE CAPITAL ASS’N 45 (2004) available at [http://www.globalinsight.com/publicDownload/genericContent/07-20-04\\_fullstudy.pdf](http://www.globalinsight.com/publicDownload/genericContent/07-20-04_fullstudy.pdf)

(explaining that Canada and the U.S. have similar investment styles, operating mostly in early-stage investment, and Canada is largely financed by U.S. based venture funding).

<sup>60</sup> See generally SME FINANCING DATA INITIATIVE, SMALL AND MEDIUM-SIZED ENTERPRISE FINANCING IN CANADA – PART IV: PROFILE OF RISK CAPITAL FINANCING (2003), [http://strategis.ic.gc.ca/epic/site/sme\\_fdi-prf\\_pme.nsf/en/01063e.html](http://strategis.ic.gc.ca/epic/site/sme_fdi-prf_pme.nsf/en/01063e.html) (“[T]he regional concentration of venture capital activity in Canada is endemic to the industry.”).

<sup>61</sup> See JEAN-PHILIPPE CAYEN, VENTURE CAPITAL IN CANADA, BANK OF CANADA, (2001), available at <http://www.capitalderiesgo.secyt.gov.ar/pdfs/mundo/canada.pdf>.

<sup>62</sup> Cf. Press Release, National Venture Capital Association, Private Equity Fundraising Recedes in Fourth Quarter, (Jan. 16, 2007), available at <http://www.nvca.org/pdf/4Q2006Fundraisingfinal.pdf> (stating that in 2006 “venture capital saw the highest fundraising year since 2001 with 200 funds raising \$28.5 billion.”).

think that is a big reason why Canada has become much more like the U.S. and the borders have become really irrelevant.

MS. HORTON-PANZICA: It is really interesting for those people who look abroad. I tend to look at the world rather than the United States, and I think what's interesting is that the rollup strategies of specific VC funds that are industry based are really exciting. I think those are really fun. If you have got a client or an entrepreneur that is in a specialist industry, rolling up the industry globally, a specific fund set up for that purpose with no borders around it can be a good idea.<sup>63</sup>

If you are working entrepreneurs and you are advising entrepreneurs or you are looking for money or thinking about money the other way, I would encourage for you to look for these net-net funds you could pare into an investment. Co-invest, or look at a broader strategy that has got no borders to it.

The world doesn't operate any longer with borders, I believe. I think the way that business and industry works is by looking at the global trend of rolling up an industry and making the most of it and creating a back office for it.<sup>64</sup> What I love to do, the investments I am looking at, which interest me the most, are not only just a rollup of an industry but to roll up the industry and create a share back office for that industry using technology so that you have a complete infrastructure that is shared, lowering the cost of that rollup and leveraging the assets purely upfront.

Does that make sense to everybody? You are actually creating a back office for the industry. You are rolling up this complete shared services model and pulling all the SG & A out of the business, and you drop it into the back office, and then you have an interesting model. That's a great rollup model.

The funds doing that, if you find businesses you can do that with and invest in upfront and roll it up with venture money, that's fabulous, but I don't look at the border stuff any more. I don't think it makes any sense.

MR. SANDLER: Except for the lawyers to some extent, it is up to them to make those borders and to make it as transparent as possible. That's difficult in the U.S.-Canada situation.

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<sup>63</sup> See generally *Venture Capital Industry Shatters All Records in 2000*, Canada's Venture Capital and Private Equity Association, <http://www.cvca.ca/files/Resources/2000overview.pdf> (last visited Nov. 23, 2007) (discussing that in 2000 the U.S. invested a record-breaking \$103 billion, up by over 73% from 1999 and Canada invested \$ 6.3 billion, a 132% increase over the \$2.7 billion invested in 1999).

<sup>64</sup> See generally *DELOITTE, VENTURE CAPITAL GOES GLOBAL* (2006), [http://www.deloitte.com/dtt/cda/doc/content/dtt\\_tmt\\_vcreport\\_01262006%281%29.pdf](http://www.deloitte.com/dtt/cda/doc/content/dtt_tmt_vcreport_01262006%281%29.pdf) (stating that venture capital firms in every region of the world plan to increase their cross border investments).

MR. CHERNIAK: Practically speaking, the government goes out of its way to make sure there is a border, running counter to those flows. Canada has some rather curious laws in my mind that limit American capital going in.<sup>65</sup> We dealt with them for years in terms of the partnerships and limited liability corporations.

And that's a very popular structure in the U.S.<sup>66</sup> Venture capital and private equity funds are structured as partnerships.<sup>67</sup> And for whatever reason, Canada has always had in its mind that they want to limit the ability of those funds to invest in Canada.<sup>68</sup> I never understood this; there is no benefit in my mind.

I am just trying to compress the topic into a very brief statement. I guess it tends to affect VCs more because at the end of the day there are a lot of ways around it in terms of having the proper tax advice and doing all the filings and doing all these sorts of regulatory administrative things we need to do to make sure that you are on site.<sup>69</sup> All the partners can file tax returns and do all their certificates and things, but this adds time and cost to transactions, and the VC – for them it is much more critical because it is a very different business than the private equity business.<sup>70</sup> The dollars involved are much smaller, so the administrative and time and cost and risk of these barriers are much more onerous; they can and do kill venture capital transactions.<sup>71</sup>

MS. HORTON-PANZICA: Isn't the real barrier that you can't make as much money? I mean, the deals – and I am going to come back and be my

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<sup>65</sup> See THOMSON MACDONALD, *THE ACTIVITY OF AMERICAN VENTURE CAPITAL FUNDS IN THE ONTARIO MARKET: ISSUES, TRENDS AND PROSPECTS* (2005), <http://204.15.35.174/images/uploads/ThomsonMacdonald1105.pdf> (noting that American investors state that a range of tax issues arise when engaging in cross-border activity with Canada resulting in deals becoming too costly or complex).

<sup>66</sup> See William L. Megginson, *Towards a Global Model of Venture Capital?* 12 (The University of Oklahoma, Working Paper, 2001), available at <http://www.milkeninstitute.org/pdf/Megginson.pdf>.

<sup>67</sup> See *id.* at 8-9.

<sup>68</sup> See generally MACDONALD, *supra* note 65.

<sup>69</sup> See generally *id.* (discussing that under the *Canada-United States Tax Convention*, American LLCs are subject to taxes arising from their investments in Canada, thus some American corporations choose to affiliate with Delaware corporations and other non-Canadian corporate entities to avoid taxes and other strictures; further, non-resident investors must also file a Section 116 certification when disposing shares in a private Canadian firm – the process can be tedious and can jeopardize returns; other related disclosure requirements are also said to be intrusive).

<sup>70</sup> *Id.* (stating that despite the Delaware strategy and other methods used to facilitate cross-border activity, investors still see investing in Canadian companies as “complex, time-consuming and expensive.”).

<sup>71</sup> *Id.* (stating that investors interviewed argued that the costs of investing in Canadian companies “were prohibitive in certain transactions, leading them to consider only those opportunities where they can make exceptionally large investments in Canada.”).

own devil's advocate – but the perception of the VC opportunity in Canada is that you just don't have any ROI. The ROI is so much smaller than putting money at risk in the United States that you just can't drive U.S. dollars into the Canadian market.<sup>72</sup>

MR. CHERNIAK: Yeah, there are those perceptions.

MS. HORTON-PANZICA: Saying that, I did two deals in Toronto, so I am going to make money on those deals, but I chose those deals specifically.<sup>73</sup> I think the perception is you can't make money in Canada.

MR. CHERNIAK: Oh, yeah.

MS. HORTON-PANZICA: I think there is that whole piece, that, you know, you cannot put money to – if you put money to work there, you can't get it to work.

MR. CHERNIAK: No, I agree with you completely. Actually, look at the 20-year return on venture capital in Canada: it is low single digits; and in the U.S., it is about 20 percent.<sup>74</sup> And in the last five to ten years, after the 2000 bubble, those returns converged.<sup>75</sup>

The five-year U.S. return is low teens if I recall correctly, which is not bad, better than Canada but not a home run, on average. But by every measure, one-year, five-year, ten-year, twenty-year, Canada does trail the U.S. in venture capital returns.<sup>76</sup> And one of the reasons, frankly, is that it is a structural thing. I don't think it is necessarily fundamental to Canadian companies. It is issues like the labor-sponsored funds, which were government-incentive vehicles to, for reasons other than pure investment fundamentals, put capital into the capital markets.<sup>77</sup>

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<sup>72</sup> See generally CAYEN, *supra* note 61 (stating that in the Canadian venture-capital industry there is “a high risk of making little profit or even of incurring losses.”).

<sup>73</sup> *Id.*

<sup>74</sup> See generally Charles Plant, *Lightweights in a Heavyweight World*, RED CANARY, Aug. 20, 2006, <http://www.redcanary.ca/view/lightweights-in-a> (last visited Nov. 8, 2007) (“Rates of return for venture capital investments in Canada for all measurement periods and for all stages of investing are in single digits or negative.”); cf. Press Release, National Venture Capital Association, *Venture Capital Out Performance Holds Steady in Period Ending Q1 2007*, (Aug. 2, 2007), available at <http://www.nvca.org/pdf/Q107VCPerformanceFINAL.pdf> (stating that the U.S. venture capital twenty year returns of 16.4%).

<sup>75</sup> See generally Jim Casparie, *Raising Money – Can You Really Land Venture Capital?*, ENTREPRENEUR, Mar. 31, 2006, available at <http://www.entrepreneur.com/money/financing/raisingmoneycoachjimcasparie/article84246.html> (explaining that “when the ‘dot com’ bubble burst and the IPO and mergers and acquisitions (M&A) market virtually disappeared” venture capital firms experienced difficulty receiving a return on their investment).

<sup>76</sup> See generally Plant, *supra* note 74.

<sup>77</sup> See generally Douglas Cumming, *Financing Entrepreneurs: Better Canadian Policy for Venture Capital*, C.D. HOWE RES. INST., Apr. 15, 2007, 2007 WLNR 9872149 (stating that Labour-Sponsored Venture Capital Corporations (LSVCCs) are Canada's key venture capital initiative to facilitate entrepreneurial investment).

They thought the necessary risk capital to support the entrepreneurial underbelly of the economy was not going to come from the private sphere, so they initiated a 30% tax-credit incentive, in order to draw the capital in.<sup>78</sup> Every dollar you put in, you get 30 cents back via a tax credit, but the problem is the labor-sponsored world created specific rules that these funds had to maintain to keep their status.<sup>79</sup> Well-meaning rules that are, in some cases, silly. For example, one was called the “pacing rule,” which essentially meant that the government would dictate how quickly you have to spend the money you raised. And so every November, December typically in the Canadian capital markets, you have LSIFs running around like drunken sailors with their wallets open saying, “I’ve got to spend this money before year-end. I almost don’t care what I do with it. Is it even remotely a reasonable opportunity? If it is, here you go, take my money because it is December. I would have turned the deal away in May!” So there is no way to tell scientifically, but initiatives like these must have hurt returns in the Canadian markets.

MS. HORTON-PANZICA: I think that the statistic here, which you produced, I thought, was unbelievable. It was very great.

MR. CHERNIAK: Yeah, for ten years.

MS. HORTON-PANZICA: Yeah.

MR. CHERNIAK: No. That is skewed by the fact that in the bubble, U.S. investors were making returns that were just off the charts – “thousand percent” returns. If you look at the longer five-year or ten-year U.S. return, it is much more normal.<sup>80</sup> So 20 percent is not sort of a stable return, but it is still, again, big. The U.S. return is better.

MS. HORTON-PANZICA: What would really be interesting actually would be a study of returns on the specific industry sector funds because, if you looked at the returns that were specifically from the Canadian cluster, I bet those returns are fabulous.

So what we have is a mix of all invested monies. I presume that Canada could have an incredible forestry fund venture or whatever assets are up in Canada that I am not aware of, if you think about what assets Canada has and think about how they can be ventured and put into specialist funds and rolled

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<sup>78</sup> See Ayi Ayayi, *Public Policy and Venture Capital: the Canadian Labor-Sponsored Venture Capital Funds*. 42 J. SMALL BUS. MGMT 335 (2004), 2004 WLNR 9619980 (stating that a benefit to investing in a labor sponsored venture capital fund is a 30-percent tax credit on the investment).

<sup>79</sup> See generally Cumming, *supra* note 77 (stating that LSVCCs are bound by many statutory constraints, including “requirements to reinvest fixed percentages of contributed capital in private entrepreneurial companies within a stated period of time.”).

<sup>80</sup> See generally Press Release, National Venture Capital Association, *supra* note 74 (stating that five-year and ten-year returns on U.S. venture capital is 2.7% and 21% respectively).

up as a global industry. That's where Canada can make a mark. I mean, Canada can make a mark by using its asset base to petition for venture funds, and maybe that's why this is skewed.

MR. SANDLER: Part of the reason why it is skewed is because there is no breakdown between labor-sponsored funds and private venture funds.<sup>81</sup> I think the labor-sponsored funds return certain rollups.

MR. CHERNIAK: Yeah, absolutely. I did sort of a rough calculation on the fly when I was in the business and, absolutely, the overall return for the labor-sponsored returns is fairly dismal.<sup>82</sup>

MR. SANDLER: Negative in many cases.

MR. CHERNIAK: Yeah. In some cases, they were specially focused funds that had shackles that American funds or other sort of generalist venture capital funds didn't have.<sup>83</sup> The one, which I worked with, their charter was to invest in small, capital intensive, labor intensive businesses in the province of Ontario. And that was right around the time that the Indian and Chinese offshore manufacturing assault was hitting its peak. You did the best you could, but when your focus is that specialized and tragically flawed, frankly, let's just say that chunk of capital didn't do very well.

MR. SANDLER: That's labor.

MR. CHERNIAK: Yeah.

#### DISCUSSION FOLLOWING THE REMARKS OF BRAD D. CHERNIAK AND CATHY HORTON-PANZICA

MR. SANDLER: Aren't there a couple of questions or comments?

DR. KING: Yeah. I had a question. It seems to me the ultimate source of success or failure is technology, and I would like to ask Cathy and also Brad about technology reviews.

Do you have somebody on your staff – or do you have a group that reviews it before you take the plunge or before you take – or do take the entrepreneur's word for it?

MS. HORTON-PANZICA: It is interesting because my partner, he and I between us probably have 40 years of tech or technology experience. So we actually are very deep technologists. Between us, he covers very much

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<sup>81</sup> See generally Cumming, *supra* note 77 (arguing that labor sponsored funds "have become the dominant source of venture capital" in fact, "government tax subsidies to LSVCCs may crowd out private venture investment.").

<sup>82</sup> *Id.* ("[E]vidence suggests LSVCCs are inefficient investment vehicles, charging high fees and yielding disappointing results: very few funds generate positive returns.").

<sup>83</sup> *Id.* (explaining that statutory constraints on labor-sponsored venture funds "include limits on the geographical range of investment opportunities to within the sponsoring jurisdiction, [and] constraints on the size and nature of investment in any given entrepreneurial company.").

healthcare and bio and the alternative energy field, and I cover really systems.

I worked for a leading vendor for about ten years as a lead outside counsel, and they taught me everything to do with systems. I understand everything having to do with information technology and how systems can be improved and driven. Between us we can really hit the analytics and hit the patent world and really understand there is a place.

What is the patent world, and how do you analyze it? It is just like real estate: I think the easiest way to explain it for me as an investor is that it is just virtual real estate, and there is only so much of it.<sup>84</sup>

And do they have a parcel that is going to be worth something, or is it a parcel that is not situated well and doesn't have any beach view and doesn't have any sand? What are the amenities, and what is the possibility of this little piece of real estate they own, which is called intellectual property?

If you are blessed enough to be able to look at that intellectual property and say, "Oh, my gosh, I want to buy that," I think the people that understand intellectual property are just like real estate moguls. They get the property they are looking at, and they understand what it can be.

If for some reason I don't have the skill set in-house to determine whether that's a good investment because it is something that is really a specialty area, then, yes, I have outside people I retain. They will scrub it down for me and give me a response.

MR. CHERNIAK: Yeah. In Canada, it can be very difficult just given the size and lack of depth of investments in any specific vertical to have in-house expertise. For technology-related deals or IP-related deals, you tend to bring in a third party. However, you tend to lose something with that method.

They issue a report, and then it is not quite the same thing as having the sort of in-house talent, fully motivated to be right.<sup>85</sup> And that is what has driven so much of the specialization in the U.S., of funds that bring on software developers and bring in veteran entrepreneurs from specific companies that fit with their charter.<sup>86</sup>

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<sup>84</sup> Mario W. Cardullo, *Intellectual Property – The Basis for Venture Capital Investments*, WORLD INTELLECTUAL PROPERTY ORGANIZATION, available at [http://www.wipo.int/export/sites/www/sme/en/documents/pdf/venture\\_capital\\_investments.pdf](http://www.wipo.int/export/sites/www/sme/en/documents/pdf/venture_capital_investments.pdf) (explaining that venture capitalists should carefully analyze the economic value of a patent, a trademark, software, a domain name, and any intellectual property in order to determine when and whether to invest).

<sup>85</sup> See generally, Canadian Venture Capital Activity: An Analysis of Trends and Gaps (1996-2002), SME Financing Data Initiative, [http://strategis.ic.gc.ca/epic/site/sme\\_fdi-prf\\_pme.nsf/en/01182e.html](http://strategis.ic.gc.ca/epic/site/sme_fdi-prf_pme.nsf/en/01182e.html) (last visited Nov. 23, 2007) (arguing that in order for the Canadian venture capital industry to grow, the country needs skilled and experienced VC fund managers that can evaluate and identify potential high growth investment opportunities on their own).

<sup>86</sup> See, e.g., Paul Gompers et al., *Venture Capital Investment Cycles: The Role of*

You have companies in the U.S. who just do enterprise software or just marketing applications. And they bring in guys who have run those kind of companies and can assess the technology. In Canada, it is much more difficult. You are forced by the nature of the market to be more of a generalist.<sup>87</sup>

MR. DELAY: I am an attorney. When small businesses are setup somewhere in the United States, counsel will tell the ambitious founder that they have to remember that a new business could take twice as much money and five times as much time as they originally estimated, and they'll discuss with the attorney at that time about reaching a profit.<sup>88</sup> They try to curb the enthusiasm of the curve and let them know it will take longer and twice as much money.

In your experience, is that still a good rule-of-thumb in the American experience with the VC's capital? Is that a good rule-of-thumb?

MR. CHERNIAK: Absolutely. It is one of the key reasons why we started Sapient Capital. Probably the biggest chunk of time we spend with a client is to model in detail what the business is going to look like and not just kind of blue sky, not just sort of soft and meaningless numbers. We nail it down to a single employee and here we also apply current market principles as to what that person is going to cost you.<sup>89</sup>

So we spend a lot of time saying, "What do you really need to target the market you are going after?" and it is a detailed exercise because it often surprises them in terms of how much money they need. We help determine and prioritize strategic goals. We can help by using our experience to tell them how realistic is it to achieve, say, four of these goals within six months, or whatever.

You probably have to spread them over a longer period of time, be more conservative in terms of what it is going to cost you and what your sales ramp-up is going to be.<sup>90</sup>

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*Experience and Specialization* 24 (2004), available at <http://www.law.upenn.edu/ile/SeminarPapers/Gompers%2011.11.04.pdf>.

<sup>87</sup> Canadian Venture Capital Activity, *supra* note 85.

<sup>88</sup> See generally, Jeff Wuorio, *7 Good Reasons to Call a Lawyer*, MICROSOFT SMALL BUSINESS CTR., [http://www.microsoft.com/smallbusiness/resources/finance/legal\\_expenses/7\\_good\\_reasons\\_to\\_call\\_a\\_lawyer.aspx](http://www.microsoft.com/smallbusiness/resources/finance/legal_expenses/7_good_reasons_to_call_a_lawyer.aspx) (last visited Nov. 8, 2007) (explaining that attorneys are essential to any small business operation in reviewing the business structure, evaluating exit strategies and managing finances).

<sup>89</sup> *Id.*

<sup>90</sup> See generally Asheesh Advani, *How to Forecast Revenue and Growth*, ENTREPRENEUR, MAR. 7, 2005, <http://www.entrepreneur.com/money/financing/startupfinancingcolumnist/asheeshadvani/article76418.html> (explaining the need for business owners to "[f]orecast revenues using both a conservative case and an aggressive case.").

MS. HORTON-PANZICA: I think every investment is different. I like it when the venture capital world tailors investments to the circumstances. The investment we made in New York – and we were out in six months – was tragic. I wanted to be in that deal. It just depends, if the real estate is that hot, somebody is going to want it. I think about it like property. If you have got that corner lot sitting on the beach, somebody is going to buy it real fast. If you have one that is further down and a little bit back from the beach, it could be harder to sell.

Certainly, my specialty is technology companies. So I think it is a lot like that, and you have to look at how soon that property is going to be wanted in the marketplace. If you think about it like that, and analyze the IP like that, you actually can predict cash flow pretty well, and you can predict time to market pretty well.<sup>91</sup> Think about it like real estate.

MR. JEFFERS: I had a question. You have talked a lot about getting into deals and about working with your entrepreneurs. What happens when things go south and you have a failure on your hands? One among you is a priest. You know, is there a possibility of absolution?

I am just wondering if either of you, in your experience, follows a sort of template where you perhaps sit down, and you conduct a sort of autopsy of what went wrong.

Are there occasions when you, perhaps, will look at the individual and say this just didn't work for one or other reasons? It doesn't mean that you are a bad person. In fact, you may be a very good person, and, maybe in the future we will deal with you again.

Have you come across situations like that?

MR. CHERNIAK: Yeah. From my own experience, I find that I have seen several that turned into restructurings and ultimately disasters. And really it is a slow motion train wreck. It doesn't happen so quickly that you don't see it coming and you can't talk with the entrepreneur in the trenches over weeks or months. So you tend to see it coming. I think it depends on how you deal with it as you are going through it.

There is no need for a forensic post-event assessment, because you have gone through it live in terms of making sure everyone understands there is no fault here, that everyone has tried their best, but that in some cases you are dealing with exogenous factors, like the India/China manufacturing phenomenon, that simply eviscerates domestic manufacturers on cost. It is not that the failed entrepreneur is an idiot. And you just make that clear during the process.

MS. HORTON-PANZICA: That's a really interesting question because I have had a couple of entrepreneurs who, because they are so disappointed in

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<sup>91</sup> See generally Cardullo, *supra* note 84.

themselves, they just sort of exude that across everybody that has anything to do with them. And I tend to just take it.

There are a couple of young chaps I was thinking about in my London investment days where I sat down and really tried to help them see why they failed and why we failed. One in particular I am thinking about just didn't get the market position right. Today I am a different investor.

I think I very rarely just invest money to invest money anymore because I find that I can't effect when a business is getting into trouble. I had a business a couple weeks ago that was in trouble. They just weren't getting customers that they needed to get in the door. I just gave about two weeks of my time doing gorilla marketing. It is cash flowing as of last week. I mean, I just did it and gave my skill set. One of my skill sets happens to be customer attention and attraction, and I just went in and did it. If I didn't have that skill set in a business that I invested, we would get it. We would fix it.

I don't let things that I have invested in or groups I have invested in that I am responsible for get there. But you have to make investments where your investees will let you do that. They understand and respect you enough that they want you to come in and help.

I said, look, I have been in London. I came back. You are in trouble. You don't have enough feet through the door. You are in trouble. And I am just going to gorilla the market. What are you going to do? We sent out 4,000 flyers for this business and, you know, today it is cash flowing.

It was just simple street market. They were doing all this high-level stuff, radio, TV – expensive stuff. I said, “Look, what happened to shoe leather?” We corrected it.

I am into making investments where I can make a difference. I think different venture people are different. They want to give it time or they don't. Some of them are just hands off – they put in the money and think that they can walk away and not put a lot in it. I mean, the venture money is really, really important. Certainly, if you want the money of people I represent and people I work with, it would be to say, you know, it is an alternative, and we don't get to that point. We would intervene.

DR. KING: Dan, we are getting near the noon hour.

MR. SANDLER: Yeah. Is there a question right behind you?

MS. HORTON-PANZICA: It is also kind of nice because it is almost lunch.

MR. SANDLER: Do you have one more question?

MR. GROETZINGER: If you have an entrepreneur come to you with a great new idea, identified a niche market, looks like it will go but not terribly protective, being, in other words, it will be hard to patent it or trademark, whatever way you want to protect it – do you make up the fact that it is not so protectable by aggressive marketing, or does every investment you make

have to have some element that will prevent competitors from coming in and having significant barrier entry?

MS. HORTON-PANZICA: Are you asking me?

MR. GROETZINGER: Either.

MR. CHERNIAK: Yeah, I can answer that, or if you want to take it Cathy, please do.

MS. HORTON-PANZICA: I love intellectual property. I tend to look for stuff that I can see is going to make it because I can see the real estate. If it looks fun and exciting, I probably would get a bunch of people to put in some money and have a little fun with it, but it wouldn't be something that would turn me on.

I really love the world of intellectual property. I know we have that on the stage later, but I think intellectual property is incredibly exciting for venture capitalists. Why? If you understand the intellectual property, you can commercialize it.

If everything goes to hell-in-a-hand-basket, you still own the property, still own the corner with the beach view. You just didn't build a very nice house. So you tear down the house, and it is still the property, right? That's what I love, and that's what gets my boat floating, but you may have a different spin on that.

MR. CHERNIAK: I took a little bit of a different tack in the sense that you certainly want the intellectual property. I took the view that most businesses are really service business, and I go in it with the presumption that you are not going to be able to protect it, and that there may be, in a real practical sense, nothing to protect anyway. Companies had to constantly be innovating to stay ahead of the curve and spent too much time looking back protecting past initiatives rather than forward to the next initiative.

In that case, how well have you identified your customers, and what are you providing to them? And if you try like hell and you market like crazy and you do everything, you work as hard as you possibly can, can you defend that for any period of time? And if I see enough runway, I would probably do it because if you are successful in that regard, chances are you are going to be able to sell out to somebody that has more IP.

You become a tuck under to somebody else's technology in a sense. At the end of the day, as long as the business makes sense to me, that's the first order of defense and not the IP specifically, whether it is patented and what the prior art position is. That's a second level, but it is still critical and especially – I mean, I don't know what specific sector we are talking about. Also, it varies in terms of what type of business, but overall –

MS. HORTON-PANZICA: When I refer to intellectual property, I refer to intellectual property as a basket of intellectual capital. It is more than just a registered patent for me. I mean, is there something here that is protectable, that I can put up a fence on my property and keep you out?

MR. SANDLER: That's a good question that we can take up at 2:15 with the IP subject, but unfortunately, I think we have to draw this one to a close.

MR. UJCZO: Lunch will be held upstairs where we had dinner last evening for those of you that were here, but it is directly upstairs where we ate lunch yesterday.

WHERE DO THE UNITED STATES AND CANADA STAND  
VIS-A-VIS OTHER COUNTRIES REGARDING  
ENTREPRENEURSHIP?

*Session Chair – James McIlroy*

*Speaker – Dr. Robert Hisrich*

INTRODUCTION

*James McIlroy*

MR. McILROY: I would like to call this meeting to order again. As you know, this is the ninth session, so we are about three quarters of the way through our program. And in case you haven't noticed, the program is "The Comparative Legal Aspects of Entrepreneurship in Canada and the United States."

What I would like to do just to briefly kick off this session is to focus for a couple of moments on a couple of titles, and the first title I want to focus on is the title of this session, which is "Where Do the United States and Canada Stand vis-à-vis Other Countries Regarding Entrepreneurship?"

So in effect, what we are doing here, and what we have done for the last day and-a-half, is compare Canada, on the one hand, to the United States, on the other. We are going to go a little beyond that in this session in that Dr. Hisrich is also going to compare where Canada and the United States fit in vis-à-vis other countries around the world. So it is more of a comparative approach than we have seen thus far.

That's the title of the session; let me move to the title of our speaker: Dr. Hisrich. He is the Garvin Professor of Global Entrepreneurship and Director of the Center for Global Entrepreneurship at the Thunderbird School of Global Management. So you hear the word "global" there no less than three times. And, I think, just looking at his title you can tell that he is very, very qualified to speak on how Canada and the United States fit into the global order of entrepreneurship.

Now, as you may note, the Thunderbird School of Global Management is located in Arizona, and its mandate is: "We educate global leaders who create sustainable prosperity worldwide." So it is very much an institute that is in keeping with the theme of this program. And if you look at Dr. Hisrich's

background, you will see that he is eminently qualified, both from a scholarly perspective and also from a hands-on perspective.

Let me deal first with his scholarly background. Although he resides in Arizona now, Dr. Hisrich is no stranger to Ohio. He attended the University of Cincinnati where he obtained two degrees, his MBA and a Ph.D. He taught here for ten years, as some of you heard yesterday, and he built a very successful business program here at Case.

Now, in addition to his strong academic foundation, Dr. Hisrich has very extensive hands-on international experience, including his work in a couple of countries where you don't really think of entrepreneurship – that is a couple of countries that came out of the demise of the Soviet empire – and that is Russia and the Ukraine.

He is also a very prolific writer but he does not reside in an ivory tower. He has authored or co-authored over a dozen books, many of which are very successful, and they are listed in your program.

Given his expertise and his experience, we are going to be in for a very stimulating session. So I would ask you to please join me in welcoming Dr. Robert Hisrich.

#### SPEAKER

*Dr. Robert Hisrich\**

DR. HISRICH: Thank you, James. Thank you very much for a wonderful introduction. James forgot to tell you that one of my books is *How to Lie With Your Resume*.

It is really thrilling to be here for a couple of reasons; particularly, it is good to be back to Cleveland. I had ten great years here at Case Western

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\* Dr. Robert D. Hisrich is the Garvin Professor of Global Entrepreneurship and Director of the Center for Global Entrepreneurship at Thunderbird. In addition to his M.B.A. and Ph.D. degrees from the University of Cincinnati, Dr. Hisrich has honorary doctorates from Chuvash State University (Russia) and the University of Miskolc (Hungary), and held Fulbright Professorships at the International Management Center in Budapest and the Foundation for Small Enterprise Economic Development. He has authored or co-authored fourteen books, including *Entrepreneurship: Starting, Developing and Managing a New Enterprise* in its 7th edition and *Small Business Solutions: How to Fix and Prevent the 13 Biggest Problems That Derail Business*. Dr. Hisrich has served on the editorial boards of *The Journal of Business Venturing*, *Entrepreneurship Theory and Practice*, *Journal of Small Business Management*, and *Journal of International Business and Entrepreneurship*. He has instituted academic and training programs such as an entrepreneurship training program for high school teachers in Russia and college level programs at the Institute of International Entrepreneurship and Management in Russia and the Entrepreneurship Center in the Ukraine.

Reserve University creating what ended up to be ranked fifth in the world, an entrepreneurship program, before I left. And I have created two companies here that are doing very well, one in the medical software field and another one in medical devices.

And so I have really enjoyed my time here in Cleveland, and it is always good to be back to this part of the world. Similarly, it is always good to have Canadians here. I love your country. Basically, it is an economic love.

When I was at MIT, as a professor, we created a company called Polymer Technology, and we made the Boston lens, which was the first gas permeable hard contact lens in the world.<sup>1</sup> I had tremendously good patents on the lens – five patents that were almost unbreakable; we did not want to take the money to get FDA approval in the United States because we would have had to sell quite a bit of our company. So we went to Canada, and you made us a lot of money. I appreciate that a lot.

I particularly like Toronto because that's where we started. We obtained a distributor there – Boots Drugs and others distributed our solutions.

The company was later sold to Bausch & Lomb, so I am out of the lens business, but it was fun. When Henry called, two things concerned me: One, he said I want you to address this topic in 30 minutes. Of course, you know, you never say no to Henry, and never question how much time you are going to have; I thought how am I going to address global entrepreneurship in 30 minutes? Second, Henry indicated that I was on the program after lunch. I thought, “you never have a great audience after lunch, everybody is half asleep.” In spite of these two negatives, it is fun to be here, and I know we are going to have a good time exploring this very important topic.

I am more eager for your questions than my talk as I talk all over the world. But I want to set the stage for looking at this topic of global entrepreneurship around the world. Let's first think together what it takes to form a company, as that's what we do as entrepreneurs.

I am going to address this topic through three lenses: one, from the academic lens because I've studied this process all over the world; two, from the entrepreneur lens, having created multiple companies both here and in Hungary and Russia and now one in China; and three, from a theoretical lens as we should understand some of the theory behind it. What does it take to form a company? Four things.

Number one, you have to have the idea. That's number one. We heard that talked about today in terms of the venture people. You need an idea that makes sense; most ideas aren't a business. When Mal was speaking, he said one out of a hundred people fail. There is a high failure rate in business start

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<sup>1</sup> See Poly(ethylene oxide) coated surfaces, Patent Storm, <http://www.patentstorm.us/patents/6616982-description.html> (last visited Sept. 27, 2007).

ups and about one out of a hundred ideas I see actually could be the basis of a business. You need to have the right idea.

All around the world there are innovation and ideas. While some companies are a little more innovative than others, but even in Hungary, under socialism and Soviet control, there was the Rubik's Cube. When I was in Hungary in 1989 living under the Soviet days, I saw a woman retailer who had the most beautiful vegetable stand that would be an incredible merchandising tool anywhere in the world. There is some degree of creativity and innovation all over the world.

The second thing you have to have is money. I have had venture money behind two of my companies – which is a particularly interesting topic all on its own; you need money, particularly money for startup.

In the United States, we are very fortunate. It is not the venture capital industry that affects entrepreneurs in the U.S. at startup but it is what you heard yesterday: the angel market. These angels are private individuals investing in companies.<sup>2</sup>

We did a study of U.S. companies asking, “Outside of family and friends and your own money, where did you get your funding to start your venture?” Eighty-seven percent of those companies received their funding from private individuals.<sup>3</sup> That's the key to the U.S. economy. Are we entrepreneurial? Yes. Do we form more companies than anywhere else in the world? Yes.<sup>4</sup> But it is the angel money in the United States that is so critical to entrepreneurs. That's what I am trying to develop as a member of an advisory board in the country of Slovenia; the goal is to provide startup capital and help Slovenians understand the importance of investing in startup companies.

Private individuals investing in a startup company is not happening anywhere in Europe or other countries in the world.<sup>5</sup> And this money is available in every one of these countries. There is wealth in China.<sup>6</sup> There is

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<sup>2</sup> Clark S. Judge, *The Tax That Ate the Economy*, WALL ST. J., June 24, 1991, available at [http://www.whwg.com/thefirm/sample.php/60/Clark\\_S.\\_Judge](http://www.whwg.com/thefirm/sample.php/60/Clark_S._Judge).

<sup>3</sup> See generally, Stephen D. Prowse, *The Economics of the Private Equity Market*, ECON. & FIN. POL'Y REV., Q III 1998, 21, available at <http://ideas.repec.org/a/fip/fedder/y1998iqiip21-34.html#download>.

<sup>4</sup> See generally, Maria Minniti & William D. Bygrave, *National Entrepreneurship Assessment United States of America: 2003 Executive Report 7 2003 GLOBAL ENTREPRENEURSHIP MONITOR* available at [http://www.kauffman.org/pdf/gem\\_2003\\_us\\_report.pdf](http://www.kauffman.org/pdf/gem_2003_us_report.pdf).

<sup>5</sup> *Id.* at 10.

<sup>6</sup> Shi Li & Renwei Zhao, *Changes in the Distribution of Wealth in China, 1995-2002 19* (January 2007) (United Nations University – World Institute for Development Economics Research ed. 2007) available at <http://www.wider.unu.edu/publications/rps/rps2007/rp2007-03.pdf>.

wealth in Slovenia.<sup>7</sup> There is wealth in Croatia.<sup>8</sup> There is wealth in Hungary.<sup>9</sup> How do we get that money to work for the betterment of the country's economy, as well as the individual entrepreneur? A country needs to incentivize these individuals to invest a percentage of their wealth in startup companies. I don't see this occurring anywhere else I have been outside the U.S. You need money.

The third thing you need is the entrepreneur. The entrepreneur takes the idea (either his idea or from an inventor) to the marketplace. He or she is the driver of that particular product and idea.

I have studied entrepreneurs all over the world, and the interesting thing – which is really nice for entrepreneurs doing international business – is that they are more similar than different. We are “crazies” as I heard some venture people say. I am glad I am “crazy” because I love the process. I am passionate about the process. I understand the process and actually undertake the process. I meet entrepreneurs in China, Russia, Hungary or Ireland and they are very similar. We are more similar than different.

For example, in one study of entrepreneurs, we asked, “What motivated you to start your business?” The same comment was made, whether it was from a Russian or a German or an American entrepreneur: “We can't work for anyone else. We want to be independent.” You heard Mal Mixon mention this the other day. Entrepreneurs want independence; they want to be their own boss.

The second reason given in terms of motivation for starting a business was that they want to make money. The third reason was that they are passionate about the idea and want the product/service on the market. They are really passionate about their ideas. These two reasons were also similar all over the world.

The only difference between men and women, in terms of these motivators across countries, was women had passion about the idea as second, and money as the third. These three reasons accounted for around 70 percent of the responses.

Entrepreneurs are also similar in two other aspects. One is the decision process in becoming an entrepreneur. We have to make a decision to go from something to something, as is indicated in Table 1.

You have to change lifestyles if you are not presently an entrepreneur because it is a different way of life. You heard Mal talk about the fluctuations

<sup>7</sup> E.g., *Daily Says Mirko Tus the Wealthiest Slovenian*, Republic of Slovenia Government Communications Office, <http://www.ukom.gov.si/eng/slovenia/publications/slovenia-news/4445/4457/> (last visited Sept. 27, 2007).

<sup>8</sup> E.g., Mislav Šimatović, *Croatia's 50 Wealthiest*, 597 NACIONAL: NEOVISNI NEWS MAGAZIN, Apr. 4, 2007, available at <http://www.nacional.hr/en/articles/view/33809/18/>.

<sup>9</sup> E.g., Eszter Balázs, *Fotex Boss Tops List of Countries Richest*, BUDAPEST SUN, Nov. 28, 2002, available at <http://www.budapestsun.com/cikk.php?id=14776>.

in wealth and the fluctuations in security you have. That's all part of the process. The majority of people can't handle that. You need the ability to be flexible to form a new enterprise. What causes us to do this? It has to be desirable. What makes it desirable? This desirability is different for entrepreneurs in various countries.

One aspect of the country is that its culture needs to support entrepreneurship. The culture has to look at entrepreneurship as a positive element. Entrepreneurship is not looked at very positively in Austria.<sup>10</sup> It is looked at negatively in Russia.<sup>11</sup> The culture in the United States, and the culture in Canada, is pro-entrepreneurship.<sup>12</sup> But even in a pro-entrepreneurship culture, there will be pockets of entrepreneurship. A total culture isn't entrepreneurial; it contains pockets of entrepreneurship.

Look at the United States: we have pockets of entrepreneurship. Where are they? The major ones are: Silicon Valley, Route 128, and North Carolina Triangle.<sup>13</sup> That's where the heaviest emphasis on entrepreneurship is; entrepreneurs like to cluster together. So it is really the subcultures that drive entrepreneurship.

When I was in Ireland in 1984, the Irish economy was terrible. It was one of the worst economies in the European Union in 1984 – high debt ratio, something like 35 percent.<sup>14</sup> Some homes did not have telephones. The economy was in terrible shape.<sup>15</sup> We started teaching entrepreneurship at the University of Limerick, which is on the Limerick side, and in Dublin at the University College Dublin, then in Cork and in Galway.

Then a coalition between the government, the universities, and businesses was formed. Now the Irish economy, in just 20 years, is one of the strongest in Europe.<sup>16</sup> What a tremendous transformation. When a minister in the

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<sup>10</sup> See generally, Laura d'Andrea Tyson et al., *Promoting Entrepreneurship in Eastern Europe*, 6 SMALL BUS. ECON. 165 (1994).

<sup>11</sup> *Id.*

<sup>12</sup> DAVID BOLLIER, *THE GLOBAL WAVE OF ENTREPRENEURIALISM: HARNESSING THE SYNERGIES OF PERSONAL INITIATIVE, DIGITAL TECHNOLOGIES, AND GLOBAL COMMERCE* 14 (The Aspen Institute 1999) available at <http://www.bollier.org/pdf/globwave.pdf>; SHERRILL JOHNSON, *YOUNG SOCIAL ENTREPRENEURS IN CANADA* 4 (Canadian Centre for Social Entrepreneurship School of Business, University of Alberta 2003).

<sup>13</sup> See, Kurt Badenhausen, *Best Places for Businesses and Careers*, FORBES, May 5, 2005, available at <http://www.forbes.com/2005/05/05/05bestplaces.html>; Tyson, *supra* note 10, at 36, 38.

<sup>14</sup> Róisín Ní Mháille Battel, *Ireland's "Celtic Tiger" Economy*, 28 SCI., TECH., & HUM. VALUES 93 (2003).

<sup>15</sup> NAT'L COMPETITIVENESS COUNCIL, *OVERVIEW OF IRELAND'S PRODUCTIVE PERFORMANCE, 1980-2005* 6, [http://www.competitiveness.ie/ncc/reports/ncc\\_productivity\\_1980-2005/ncc\\_productivity\\_1980-2005.pdf](http://www.competitiveness.ie/ncc/reports/ncc_productivity_1980-2005/ncc_productivity_1980-2005.pdf) (Ireland is still behind the rest of the EU for many utilities).

<sup>16</sup> Battel, *supra* note 14, at 93.

government said, “Let’s have entrepreneurship throughout,” I said, “That will not be possible. There are going to be pockets of entrepreneurship,” and indeed, that is what has occurred today.

Families also make a difference. Entrepreneurial families beget entrepreneurs. Teachers make a difference; some exciting teachers really stimulate students to become entrepreneurs. Finally, entrepreneurial role models make a difference. Entrepreneurs like to associate with entrepreneurs.

You need an environment where entrepreneurs can get together and solve each other’s problems. That’s what we enjoy the best. That’s what makes it desirable. What makes it possible? The government. That’s what I want to focus on because that’s the biggest difference in various countries.

When you look at company formation in Canada, the United States, Germany, China, and Austria, it is the government and the infrastructure set up that makes the company formation process different, either easier or more difficult.

The background of the entrepreneur makes a difference, whether we are technology push or market pull. As you can tell from Mal’s talk yesterday, he is a market pull entrepreneur. I knew Kenny Olson (who founded DEC) when he and I were on a board of trustees together. Kenny Olson believed if he had the best technology, he would always win. Digital Equipment is not around today. There has to be a blend between the technology and the market to be successful.

So that’s the decision process that entrepreneurs go through, whether in Canada, the United States, Germany, China, or Russia.

The second thing that is the same is the four-stage entrepreneurial process we go through in forming a company (see Table 2). In the first stage, an entrepreneur needs to identify and evaluate the opportunity. It is all about the idea. We need to have an idea that is the basis for a business. If this idea can be protected, as talked about today in a previous session, it is even better. I try to obtain market protection on my products if they are not patentable. Most entrepreneurial concepts aren’t patentable.

You need to develop a business plan, particularly if you need outside capital. Venture funding – the VCs, the angels, the banks – will not seriously discuss things with you without at least a mini business plan. You have to obtain the resources. My companies never have enough money and we entrepreneurs never have enough time. These are the two biggest commodities that I wish I had more of. We just finished raising \$1.3 million this week to get FDA approval for a medical device company. You need resources such as capital, management, and sources of supply and distribution.

Finally, we need to manage the enterprise. Can entrepreneurs become managers? I think some can, some can’t. Sometimes entrepreneurs need to let

professional managers help grow the company. The process is the same all over the world.

A country needs ideas, money, and entrepreneurs. The last part of the formula of why companies are created is the infrastructure in the country itself. I have studied this all over the world. Here is a continuum between a poor entrepreneurial culture and a strong entrepreneurial culture (see Table 3).

These are several reasons why one culture or an economy is more entrepreneurial than another. One is ease in company formation. The easier it is to form companies, the more companies are going to be formed.<sup>17</sup> Just look at the laws and the rules in countries regarding what entrepreneurs have to do to form companies. Let us take three situations: forming a company in Austria, in Russia, and in the United States. In the United States you can form a company over the Internet with your credit card for about \$200.<sup>18</sup> In Austria, it requires 13 governmental agencies, 10,000 Euros in the bank, and 2,000 Euros in cost.<sup>19</sup> In Russia, it takes about one and a half years with significant costs.<sup>20</sup> Why is entrepreneurship so prevalent in the United States? It is easier to become one.

Number two is the tax rate on businesses. When I was in Norway speaking to a group of entrepreneurs and business people, the Minister of Industry was there. She was not very happy when I said, "Why would you bother to form a company in Norway? Do you know what your tax rate is?" It is extremely high because the country wants a social net.

Same with the tax rate on individuals. If you tax businesses or entrepreneurs heavily, why should they bother forming a company? If I am going to work all the hours, take the risks, I want some kind of return. I want to make some money, the second motivator. Countries need to monitor the tax rate on companies and individuals. Generally, the higher the tax rates, the less the entrepreneurial activity.<sup>21</sup>

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<sup>17</sup> *E.g.*, Index of Economic Freedom: Belarus, Heritage Foundation, <http://www.heritage.org/index/country.cfm?id=Belarus> (last visited Sept. 27, 2007) (stating that burdensome regulations inhibit business in Belarus).

<sup>18</sup> *E.g.*, The Company Corporation, <http://www.corporate.com/> (last visited Sept. 27, 2007).

<sup>19</sup> *See generally* STARTING A BUSINESS IN AUSTRIA, SCHONHERR RECHTSANWÄLTE 5, (Austrian Business Agency), available at <http://www.aba.gv.at/en/pages/download.asp?file=downloads/StartingBusiness.pdf>.

<sup>20</sup> *See* Establishing a Business in Russia: How to Set up and Register a Company in Russia, Company Formations, Way to Russia <http://www.waytorussia.net/business/startingup.html> (last visited Sept. 27, 2007).

<sup>21</sup> *See*, Edmund Andrews, *Paulson Says U.S. Hurt by High Tax Rates*, N.Y. TIMES, Jul. 25, 2007, available at [http://www.nytimes.com/2007/07/25/business/25tax.html?\\_r=1&oref=slogin](http://www.nytimes.com/2007/07/25/business/25tax.html?_r=1&oref=slogin) (demonstrating that high tax rates inhibiting economic growth in US).

Bankruptcy laws and being able to let people go make a difference in the amount of entrepreneurial activity. You know, in some countries, to fire someone takes about a year. You go through numerous problems trying to get someone off the payroll even if they haven't performed.<sup>22</sup> The better the bankruptcy laws and the easier it is to hire and fire people,<sup>23</sup> the more people are going to become entrepreneurs in a particular country.

The extent of the infrastructure – such things as incubators, government sponsored programs, government training programs, government providing seed capital, and the government providing guaranteed loan programs – can all help provide a positive infrastructure for entrepreneurship. These all affect people forming companies. When all these are available, there is a solid infrastructure for entrepreneurs to form companies.

Finally, there is the overall government attitude towards business and entrepreneurship. Is it pro or not? We have gone through ups and downs of government attitude in the United States, like other countries. The entire atmosphere established by the government for entrepreneurs forming businesses varies significantly across countries.

What makes things different in one country over another is not the people. The people are very similar. They have the same motivations. They have different demographics: more educated in some countries than others. Obviously, there is a difference between the sexes forming companies in various countries. However, the main differences are the atmosphere, the culture, and infrastructure of the country in forming businesses.

Basically, it is the government's responsibility to create the infrastructure to support company creation. When looking at Canada and the United States, the statistics were very interesting. In Table 4 there is information regarding new firm formation and bankrupt firms from Canadian government material. You will see that basically there has been an increasing formation rate over the last five years in firms that employ more than one individual.<sup>24</sup> If you add the one-person firms, this number would double or maybe triple. In firms that employ more than one individual, there was an increase from 19,500 up to

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<sup>22</sup> See Index of Economic Freedom: Austria, Heritage Foundation, <http://www.heritage.org/index/country.cfm?id=Austria> (last visited Sept. 27, 2007).

<sup>23</sup> See Nathalie Martin, *American Bankruptcy Laws Encouraging Risk-Taking and Entrepreneurship*, EJOURNAL U.S.A., <http://usinfo.state.gov/journals/ites/0106/ijee/martin.htm> (last visited Sept. 27, 2007); Indepth: France – Student Protests, CBC News Online, Mar. 28, 2006, <http://www.cbc.ca/news/background/france-studentprotests/> (stating that overly burdensome labor laws restricting liberty to hire and fire has discouraged business in France).

<sup>24</sup> See, BENJAMIN TAL, FOR LOVE OR MONEY? A STUDY OF ENTREPRENEURSHIP IN CANADA (CIBC World Markets, Inc. 2005) available at <http://www.cibc.com/ca/pdf/entrepreneurship-study.pdf>; see also Study: Trends in Business Bankruptcies, Statistics Canada, Oct. 12, 2006 <http://www.statcan.ca/Daily/English/061012/d061012c.htm>.

31,000 in 2005.<sup>25</sup> Interestingly, in Canada bankruptcy has decreased<sup>26</sup> down to its lowest level, 25 percent, below its high in 2001.<sup>27</sup> There were 787 bankrupt firms in 2005.<sup>28</sup> Canada is really moving in the right direction – increasing formation rates and decreasing bankruptcy rates.<sup>29</sup> That’s a very good sign.

Now, let’s look at the U.S. As is indicated in Table 5, the U.S. firm formation is now rising again.<sup>30</sup> Venture capital is increasing.<sup>31</sup> The IPO market is back.<sup>32</sup> There will probably be double the number of high-tech firms going public this year than last year, and new firms are being formed at an accelerated rate. Again, if firms employing more than one individual would be included, this number would triple.<sup>33</sup>

There were 671,000 firms formed in 2005. The U.S. is increasing its firm formation rate as the economy has improved.<sup>34</sup> Over the last three years firm closures have stayed about the same.<sup>35</sup> Remember, in the U.S. bankruptcy means that the firm isn’t yet dead. The firm can come back out of bankruptcy as occurred with Delta and Continental and other major corporations.<sup>36</sup> The

<sup>25</sup> See Hon. Maxime Bernier, Minister of Industry, Keynote Address for the Information Technology Association of Canada in Ottawa, Canada (Feb. 6, 2007).

<sup>26</sup> Statistics Canada, *supra* note 24.

<sup>27</sup> *Id.*

<sup>28</sup> See, TAL, *supra* note 24.

<sup>29</sup> OFFICE OF THE SUPERINTENDENT OF BANKRUPTCY CANADA, *INSOLVENCY IN CANADA IN 2006* (2007), available at [http://strategis.ic.gc.ca/epic/site/bsf-osb.nsf/vwapj/InsolvencyCanada2006\\_E.pdf/\\$FILE/InsolvencyCanada2006\\_E.pdf](http://strategis.ic.gc.ca/epic/site/bsf-osb.nsf/vwapj/InsolvencyCanada2006_E.pdf/$FILE/InsolvencyCanada2006_E.pdf).

<sup>30</sup> RICH PERLINE, ROBERT AXTELL, & DANIEL TEITELBAUM, *VOLATILITY AND ASYMMETRY OF SMALL FIRM GROWTH RATES OVER INCREASING TIME FRAMES* (SBA OFFICE OF ADVOCACY 2006), available at <http://www.sba.gov/advo/research/rs285tot.pdf>.

<sup>31</sup> See example, PRICEWATERHOUSECOOPERS AND NATIONAL VENTURE CAPITAL ASSOCIATION, *Q2 2006 VENTURE CAPITAL INVESTING REACHES HIGHEST LEVEL SINCE 2002 AT \$6.3 BILLION* (2006), available at <http://nvca.org/pdf/MoneytreeQ22006.pdf>.

<sup>32</sup> Daisy Sarma, *The Top 10 IPOs of 2006*, THE MONEY TIMES, Jan. 2, 2007, [http://www.themoneytimes.com/articles/20070101/the\\_top\\_10\\_ipos\\_of\\_2006-id-102586.html](http://www.themoneytimes.com/articles/20070101/the_top_10_ipos_of_2006-id-102586.html).

<sup>33</sup> See e.g., Robert Gavin, *Going public has gotten better in Massachusetts*, THE BOSTON GLOBE, May 16, 2006, available at [http://www.boston.com/business/globe/globe100/Globe\\_100\\_2006/articles/going\\_public\\_has\\_gotten\\_better\\_in\\_machusetts\\_ipo\\_growth\\_in\\_05\\_nearly\\_doubled/](http://www.boston.com/business/globe/globe100/Globe_100_2006/articles/going_public_has_gotten_better_in_machusetts_ipo_growth_in_05_nearly_doubled/); compare, Roy Harris, *Maybe Next Year*, CFO MAG., Oct. 1, 2005, available at <http://cfo.com/article.cfm/3220008?f=search>.

<sup>34</sup> SMALL BUSINESS ASSOCIATION, *THE SMALL BUSINESS ECONOMY FOR DATA YEAR 2005, A REPORT TO THE PRESIDENT 9* (United States Government Printing Office Dec. 2006), available at [http://leeds.colorado.edu/uploadedFiles/Faculty\\_and\\_Research/Research\\_Centers/Business\\_Research\\_Division/sb\\_econ2006.pdf](http://leeds.colorado.edu/uploadedFiles/Faculty_and_Research/Research_Centers/Business_Research_Division/sb_econ2006.pdf).

<sup>35</sup> Frequently Asked Questions, Small Business Association, <http://www.sba.gov/advo/stats/sbfaq.txt> (citing the U.S. Department of Commerce) (last visited Nov. 20, 2007).

<sup>36</sup> Aude Lagorce & Padraic Cassidy, *Delta Air Lines Exits Bankruptcy*, MARKET WATCH, Apr. 30, 2007, <http://www.marketwatch.com/news/story/delta-air-lines-emerges-bankruptcy/story.aspx?guid=%7B13D92E05-7633-4376-B8E8-3EE20E25D790%7D>; see also

U.S. had 544,000 bankrupt firm closures in 2005, which stayed constant for the last three years. The number in bankruptcy was high in 2000 and 2001, as you would expect, reflecting the bubble and the dot com problem.<sup>37</sup>

The interesting thing is that about the same number of firms form each year as fail. Maybe a small net gain of 30,000 to 40,000 companies a year. The failure rate is about 70 percent.<sup>38</sup> This is not totally accurate, as firms that form in the home and one-person companies are not tracked well. Only in Slovenia are all companies tracked well, as there are only about one-and-a-half million people in the country.

Basically, there is the same closure in terms of openings in the United States with about 70 to 80 percent of companies failing over a five-year period from startup.<sup>39</sup> The U.S. forms a lot more companies than Canada and will continue to do so.

The next table, Table 6, is World Bank statistics for Canada, China, the European Union, India, South Africa, and the United States and how they are doing in terms of entrepreneurship. First, the utility costs are very interesting. It is cheaper to run a company in the United States in terms of utilities;<sup>40</sup> only China, India, and Africa are cheaper. So companies in the U.S. have an advantage in terms of utility cost as well as basic construction costs. Canada has a very high cost of getting into business and operating a business because of construction and utility costs versus other countries in the world.<sup>41</sup>

You look at the percent in terms of contracts and how much it will cost to get started; this measure by the World Bank is a percent of debt. Another measure of the World Bank is the percent of debt. In the U.S., this is about 7.7 percent.<sup>42</sup> Canada has a very high debt ratio in terms of attorney cost.<sup>43</sup>

The tax rate is also a key issue. In the United States, the tax rate is 46 percent on average because of the progressive tax rate.<sup>44</sup> In Canada it is 43

Jennifer Bails, *How One Airline Survived – Twice*, PITTSBURGH TRIB.-REV., Oct. 10, 2004, [http://www.pittsburghlive.com/x/pittsburghtrib/s\\_260256.html](http://www.pittsburghlive.com/x/pittsburghtrib/s_260256.html).

<sup>37</sup> Compare, Bankruptcy Statistics, US Courts, <http://www.uscourts.gov/bnkrpctystats/statistics.htm> (last visited Nov. 20, 2007).

<sup>38</sup> WILLIAM SHANKLIN, *SIX TIMELESS MARKETING BLUNDERS* 6 (Lexington Books 1998).

<sup>39</sup> Adrienne Leigh, *Buying a Franchise: Go Into Business for Yourself, Not by Yourself*, HOUS. BUS. J., Aug. 24, 2007, <http://masshightech.bizjournals.com/masshightech/othercities/houston/stories/2007/08/27/focus11.html?b=1188187200%5E1511128>.

<sup>40</sup> Dealing with Licenses, The World Bank Group, (2007) <http://www.doingbusiness.org/ExploreTopics/DealingLicenses/>, (showing that the U.S. spends 13.4% of its income per capita on construction and utility costs).

<sup>41</sup> *Id.*

<sup>42</sup> Enforcing Contracts, The World Bank Group, (2007), <http://www.doingbusiness.org/ExploreTopics/EnforcingContracts/>. (U.S. is now at 9.4%).

<sup>43</sup> *Id.* (showing that Canada is now at 16.2%).

<sup>44</sup> Paying Taxes, The World Bank Group, (2007), <http://www.doingbusiness.org/ExploreTopics/PayingTaxes/>.

percent.<sup>45</sup> Look at the tax rate in China, India, and Austria. These countries place a tremendous tax burden on entrepreneurs setting up and running their companies, 56 percent, 77 percent, and 81 percent, respectively.<sup>46</sup>

Finally, the World Bank has a very unique system of rating countries in terms of starting a business and in terms of ease of doing business in 174 countries.<sup>47</sup> Canada was ranked number one by the World Bank in terms of starting a business, number one out of 174 countries.<sup>48</sup> The U.S. was four.<sup>49</sup>

And in terms of doing business, Canada was four, and the U.S. was three.<sup>50</sup> In terms of the World Bank looking at countries being entrepreneurial, the U.S. was in the top five, and Canada was number one in the category of starting a business.<sup>51</sup>

As expected, it is more difficult in the European Union. Even though they call themselves a union, they are not. It is different doing business in Austria versus Germany versus Ireland. It is very different doing business there, with Austria ranked 74.<sup>52</sup> It is generally more difficult to start and operate businesses in countries in the European Union.

China is extremely difficult, and I can vouch for that personally. India is 88<sup>53</sup> and South Africa 57.<sup>54</sup> You can see on a country-by-country comparison, it is very different in forming and starting and operating a business. What does this reflect? Mostly the infrastructure of the countries previously discussed: tax rates, ease of company formation, bankruptcy laws, government pro-business attitudes, incubators, guaranteed bank loans, or even providing equity.

These make a difference on a country basis in terms of whether it is going to be an entrepreneurial culture. In terms of entrepreneurship throughout the world, there are several things needed.

You have to have the idea. You need to have money available, particularly seed or startup capital, the most difficult capital to obtain.

You need to have entrepreneurs trained and willing and wanting to start new companies. These potential entrepreneurs need to feel it is desirable, and

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<sup>45</sup> *Id.* (showing that Canada now has a total tax rate of 45.9).

<sup>46</sup> *Id.* (showing that China now has a total tax rate of 73.9; India's is 70.6; Austria's is 54.6).

<sup>47</sup> Economy Rankings, The World Bank Group, (2007) <http://www.doingbusiness.org/economyrankings/>, (showing current rankings are from 1 – 174).

<sup>48</sup> *Id.* (showing that now Canada is ranked as #2).

<sup>49</sup> *Id.*

<sup>50</sup> *Id.* (showing that Canada is now ranked #7, but the U.S. is still ranked #3).

<sup>51</sup> WORLD BANK, DOING BUSINESS 2007: HOW TO REFORM 8 (2007), *available at* [http://www.doingbusiness.org/documents/DoingBusiness2007\\_FullReport.pdf](http://www.doingbusiness.org/documents/DoingBusiness2007_FullReport.pdf).

<sup>52</sup> *Id.* at 97.

<sup>53</sup> *Id.* at 118.

<sup>54</sup> *Id.* at 141.

possible. And you need the infrastructure available to start and operate companies. When these four things are available, what happens?

One, ideas and creativity turn into businesses. While there are some differences, with some nations being more creative than others, there is creativity and ideas present in every country. The United States is very innovative and creative. One thing I monitor is the number of patents filed by U.S. versus non-U.S. citizens. Only one time in the last 20 years have more patents been filed in the United States by foreigners than by U.S. citizens.<sup>55</sup> As long as the U.S. continues to be innovative, I am not as worried about our competitive position. As long as Canada and the United States remain innovative, creative, and entrepreneurial, China can do what it wants to do.

Second, both countries need to have seed capital available. Again, in the United States, there is a strong angel community, and they are now getting into what is called bands of angels. I really don't know how much impact this will have because I think the real wealth will never get into a group. They like to do things individually. But we will see what happens. There are bands of angel groups operating in the United States today.<sup>56</sup> There are two bands in Arizona.<sup>57</sup> On the other hand, there is little venture capital in Arizona. The six venture capital firms are all fully funded, fully vested.

Third, entrepreneurs are more similar than different. They are like Mal and myself. We are crazy and passionate. We love what we do, and we are going to do it, no matter what it is. And finally, entrepreneurship varies greatly reflecting the infrastructure, government attitudes, and culture of a country.

That's what makes the difference. You need to challenge your Canadian government. We need to challenge the U.S. government. How are you going to help build value? How are you going to stimulate and protect innovation? How are you going to support taking technology to the marketplace by entrepreneurs?

While I sent these slides in about three months ago, I did not know Mal was going to use the same closing as I am – a Robert Frost poem. What is

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<sup>55</sup> See generally Rachel Konrad, *Reverse Brain Drain Threatens U.S. Competitiveness, Study Says*, UNION TRIB., Aug. 21, 2007, available at <http://www.signonsandiego.com/news/business/20070821-2102-reversebraindrains.html> (discussing the increasing number of U.S. patents filed by foreigners).

<sup>56</sup> See generally JEFFREY SOHL, CTR. FOR VENTURE RESEARCH, *THE ANGEL INVESTOR MARKET IN 2006: THE ANGEL MARKET CONTINUES STEADY GROWTH* (2006), <http://unhinfo.unh.edu/news/docs/2006angelmarketanalysis.pdf> (overview of the angel investor market in the United States).

<sup>57</sup> See generally Arizona Angels, <http://www.arizonaangels.com> (last visited Sept. 26, 2007) (homepage for the Arizona Angels, an Arizona-based investment group); Desert Angels, <http://www.edesertangels.com> (last visited Sept. 26, 2007) (homepage for the Desert Angels, an Arizona-based investment group).

particularly interesting in the poem are the last two stanzas. You look down the road and you come to a fork. This is how Frost sets the stage in New England, one of my favorite parts of the world. Frost concludes: I looked at the fork – I knew I had a choice to take one branch or the other.<sup>58</sup>

We have all had what I call fork-in-the-road experiences. Look at your life. There may be five, six fork decisions that radically affected your life from then on. One of mine was going to Ireland in 1984. I spent eight months living in a country helping impact its economy – an incredibly life-changing experience.

Frost ends that poem saying: “I took the one (the fork) less traveled by, and that has made all the difference.”<sup>59</sup> That’s what entrepreneurs do. It is the passion we have.

It is crazy, you know, to go through this process and finally make something of it and think, “Why would I do that again?” Yet you go back and do it again, again, and again. That’s how entrepreneurs are.

Thank you very much. You have been very attentive. I will be glad to answer any questions.

#### DISCUSSION FOLLOWING THE REMARKS OF DR. ROBERT HISRICH

MR. McILROY: We are into our Q and A session now, and we have 22 minutes. The floor is open. Who is first on deck?

DR. HISRICH: I was either very stimulating or very boring, one of the two.

DR. BARBER: So far in our discussions here, we have been worrying most about helping entrepreneurs, and you have ended up with a line, which says our governments really need some help. How do you do that?

DR. HISRICH: That’s very hard. Starting companies is relatively easy compared to that. I think there are several ways that we can assist government in doing that. At least, I am trying to do that in Slovenia, Hungary, and Russia.

It was said very nicely today before lunch, who contributes the net employment? Who contributes the number of new products to the marketplace? It is mostly the small business/entrepreneurial sector. I think one thing we can do is help the government understand this sector’s economic development.

What can you do to change the government and the rules and laws to make people more interested in forming those companies? That is a long-

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<sup>58</sup> See ROBERT FROST, MOUNTAIN INTERVAL 75 (NEW YORK HENRY HOLD AND COMPANY 1999) (1920), <http://www.bartleby.com/119/1.html>.

<sup>59</sup> *Id.*

term process, which I am working on in Slovenia and Hungary where there is a lot of wealth to do this.<sup>60</sup>

How do I get wealth to invest, and how do I get the government to relax some of the rules? One thing I came up with is forming a venture fund with the government, matching each individual's investment dollar for dollar, and is giving 100 percent tax benefit for every dollar invested in this particular fund, established to invest in entrepreneurs.<sup>61</sup> Also, I am training people how to evaluate businesses in which to invest; they are feeling more security because they have other monies investing with them and they get a tax benefit. It is important to make the laws more positive for investing and entrepreneurial activity.

MR. McILROY: Daniel?

MR. SANDLER: One of the real difficulties in Canada and the United States is that we live in federal jurisdictions, and there is competition between states and provinces in Canada. And from a federal level, from a country level, do you just have to live with the fact there are going to be areas because we know entrepreneurs go into pockets, and that's just the way it will be, or is there enough to go around in all of the provinces and all of the states to have some piece of the body?

DR. HISRICH: That's a great question. I was asked that in Ireland in 1984 because they wanted to have a universal entrepreneurial society. I have never seen a universal entrepreneurial society. I would like to tell you we can do that but I have never seen it occur. I think what will happen is that there will be these pockets of predominance in Canada as in the United States, Ireland, Germany, and Austria. Austria will have one – Vienna.

And what do you do with any surplus money? We help these other areas develop through other mechanisms. I just don't think you are going to see entrepreneurship throughout any country.

MR. McILROY: Dr. King has a question.

DR. KING: What do we have to worry about from the developing world? In other words, who is catching up, and how can we protect our flanks?

DR. HISRICH: That's a great question, Henry. I thought you said the questions would be easy.

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<sup>60</sup> See The World Factbook: Hungary, CIA, <http://www.cia.gov/library/publications/the-world-factbook/geos/hu.html> (last visited Sept. 26, 2007) (complete profile of Hungary including an economic overview); The World Factbook: Slovenia, CIA, <http://www.cia.gov/library/publications/the-world-factbook/geos/si.html> (last visited Sept. 26, 2007) (complete profile of Slovenia including an economic overview).

<sup>61</sup> See generally Raphael Amit, James Brander & Christoph Zott, *Venture-Capital Financing of Entrepreneurship: Theory, Empirical Evidence, and a Research Agenda* (Draft: Feb. 1, 1999), available at <http://www-management.wharton.upenn.edu/amitresearch/docs/VCfeb1.pdf> (discusses venture funds financing entrepreneurial activity).

MR. McILROY: That's a love ball. That's about as soft a question you will get from Dr. King.

DR. HISRICH: Thank you, Henry.

Two of my books are in the Chinese language. My *Entrepreneurship*<sup>62</sup> book sold over 200,000 copies in the Chinese language. A friend of mine tells me that means it really sold 300,000. It still is not as bad as Iran where this professor e-mailed me and said, "We love your book. We are not part of the international copyright community. We are going to translate it. Would you write a letter?"

I thought, "Let me see what you are asking me. Write a letter for you to rip off my book, as I receive no royalty." I waited a few days, wrote him back saying, "I can't write the letter, but I would love a couple copies of the book when you publish it." Six months later two copies of the Iranian edition arrived.

Anyway, I am fortunate because that book and my *Thirteen Biggest Problems*<sup>63</sup> book are in Chinese. This has allowed me the opportunity to meet top government officials. I will never forget, I was in Beijing a few years ago with the president of one of the premier universities and we were at this wonderful table he hosted; he has absolute impeccable English. For every 500,000 Chinese studying English, one American is studying Chinese. I asked, "If you let people like myself into this country you are never going to be the same."

I had just lectured to thousands of students and entrepreneurs. My book is being sold. I had been interviewed by 150 people from the media, print, radio and television. He responded, "We know that. We also know we can't compete with the West with the economic situation the way it is; and we are going to compete."

So if I look around the world and ask who, ten years from today, are going to be the economic powerhouses? China is going to be one. They are powerful today and they will continue to be powerful in the future.

So if you look at a competitive threat, Henry, it is going to be China. Some people say India but I just haven't seen that. I have tried to do things in India. India just has its ups and downs. Theoretically, they should be ahead of China, but again, it's the government, the infrastructure, and the attitudes they have there.

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<sup>62</sup> See generally ROBERT D. HISRICH, MICHAEL P. PETERS, & DEAN A. SHEPARD, *ENTREPRENEURSHIP: Starting, Developing, and Managing a New Enterprise* (McGraw-Hill 2007) (1989).

<sup>63</sup> See generally ROBERT D. HISRICH, *SMALL BUSINESS SOLUTIONS: HOW TO FIX AND PREVENT THE THIRTEEN BIGGEST PROBLEMS THAT DERAILED BUSINESS* (McGraw-Hill 2004).

I don't see India becoming significant in the next few years. So it is going to be from China. As Mal said he is competing with Chinese products that are probably his design. China is here to stay.

MR. McILROY: We have a question at the back there, and then we have a question at the right.

MR. KERESTER: Is there an optimum tax rate that would not discourage entrepreneurship and still raise enough money for a business?

DR. HISRICH: Of course, zero.

MR. KERESTER: You really think that would contribute to it?

DR. HISRICH: No, not really. I am satisfied with the U.S. tax rate – but will not quoted be on that.

I think entrepreneurs are literally fair-minded people, and we need to pay to play. The problem is with a tax system that is unwieldy, when the government gets more than you get, or gets above 50 percent, that is close to the maximum.

While it bothers us to write tax checks, by the same token, we understand the needs and infrastructure, and most entrepreneurs, interestingly enough, give back. It is this giving back mentality they have, particularly in our two countries where you make money and give it back.

Look at all the foundations in the U.S. that now take care of some of the costs of the government, the museums, the art institutes, and things like what Mal is doing here in Cleveland. Entrepreneurs give back. That reminds me, in terms of Henry's question, Chinese entrepreneurs know how to give back.

That's very significant because that means they truly understand the entire entrepreneurial model, making money, giving it back; their entrepreneurs already have named buildings at Chinese universities.<sup>64</sup> Nowhere in Europe do you see that.<sup>65</sup> You don't see that in Japan.<sup>66</sup> You don't see that in Australia.<sup>67</sup>

China is a force to be reckoned with. Does that help? I don't know if the right tax amount is 15 percent or 20 percent, but it has to be below 50, and the lower it is the better. But a zero tax rate, I don't think that would be that beneficial.

MR. McILROY: Morris, we are just going to go to Brad Cherniak, and then you are next.

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<sup>64</sup> See generally Alan Hunter, Centre for Peace and Reconciliation Studies, Coventry University, China: Soft Power and Cultural Influence, <http://www.ipra2006.com/papers/CRPBC/ChinaSoftPowerAndCulturalInfluence.doc> (discussing the growing influence of Chinese entrepreneurs throughout China and the world).

<sup>65</sup> *Id.*

<sup>66</sup> *Id.*

<sup>67</sup> *Id.*

MR. CHERNIAK: With all that is going on in the world and in China and the emerging opportunities, is it becoming harder or easier to become an entrepreneur in America, say, ten years ago or 20 years ago than now?

DR. HISRICH: Do you take the hard questions?

MR. McILROY: No. I am just the moderator.

DR. HISRICH: You set me up for this, Henry. That's a very interesting question.

I don't think it is any more difficult today than it was; it is a very hypercompetitive world, but generally entrepreneurs are very competitive creatures anyway, so that doesn't bother us. In fact, I like it because that means I have to be smarter, better, and faster than anybody else. I would much rather have a competitive environment than a noncompetitive one.

When it really gets difficult for us is when there is not money available, so the era of 2000 to 2004 was tough. I mean, entrepreneurs just couldn't find money and we need money. And, banks aren't responsible for that because they are asset based lenders.

The trouble is, as somebody said, we have no assets except for intellectual property. Some ventures had no protection. So if money is available, then we are fine; I don't think it is any harder today. Today there is more money available than ever in the history of the world. Today it is sort of fun to be an entrepreneur.

I have had less trouble raising capital, and large public equity funds have significant monies. Some people worry about them but I like them. My companies are always up for sale. As long as we agree on valuation, you can buy any of them. I think it is the same in Canada. I have never done business in Canada except for my Boston Lens business and that was 20 years ago when I was an MIT professor.

MR. McILROY: Morris?

MR. SHANKER: I want to follow up on Henry's question. You suggested ten years from now China will be a big player to be worried about, words to that effect. Are you then suggesting the general prosperity of this country will then be diminished if China becomes the big player or any other country becomes the big player?

DR. HISRICH: I am sorry I didn't respond succinctly enough because I didn't mean that. No, I think China is a dominant economic power that is going to be here for the next decade.

The United States and Canada are fine. I don't worry about China. In fact, I think it is better to have another economic power. I don't think our two economies can carry the world any more. I think the world is too big and too complicated.

So I find what they are doing – low cost manufacturing – is very beneficial. I am a manufacturer, and I don't consider that a threat. I consider that a reality that they are going to be here as an economic power. I think our

prosperity is going to stay the same as long as we innovate and be entrepreneurial. Our countries are in an entirely different product/market space.

With about 80 percent of the economy of the U.S. in service-based business, low cost manufacturing is not a threat.<sup>68</sup> I would love to say manufacturing is coming back, but I just don't think it will at least, as we now know manufacturing today. China is also a big market, too. Wait till the people start making money over there.

MR. McILROY: We have another question I think from Daniel Sandler.

MR. SANDLER: I would like to come back to the angels, and they are the key both in Canada and the United States. A number of things, there has been a huge push in both countries to introduce a federal tax credit. It was deferred by the SBA and seems to have died in committee or is dying in committee.

Do you think, first of all, that is a good thing, an income tax credit at the federal level, and why do you think the governments are so adverse for that if you think it is a good thing?

DR. HISRICH: That's a great question. I never thought about that before. I think people, entrepreneurs, some of them angels now, have accumulated wealth through some means. I think some are going to be angels regardless of the tax credit.

Even if you raise the tax a bit, I would still be an entrepreneur. I am not sure it is going to stimulate any more investment. Maybe it would in Canada – I don't know your culture well enough. I don't think it significantly would in the United States.

Why do I think the governments of the two countries are not doing it? It is the same in every government. I am trying to convince Slovenia they should give 100 percent tax credit for these people to invest. The government doesn't like that. They want instantaneous money, not futuristic money. This money won't pay back anything until cash-out time, which may be seven to ten years.

I don't think governments in general are futuristic thinkers. Today it is better to have today's gratification rather than future gratification. However, I am not a politician. Ireland was interesting. When I was there in 1984, the Irish government tried to attract companies to manufacture there, feeling that would be the salvation of country. That was the policy for years and there are companies manufacturing there.<sup>69</sup> The Irish government gave huge tax

<sup>68</sup> Douglas G. Duncan, *Jobs in a Changing American Economy*, MORTGAGE BANKING, June 1, 2004, at 2, available at <http://www.allbusiness.com/personal-finance/real-estate-mortgage-loans/170082-1.html>.

<sup>69</sup> See John Bradley & Jonathan Wright, *Two Regional Economies in Ireland*, 26 J. OF THE STAT. & SOC. INQUIRY SOC'Y OF IRELAND 211, 218 (1993) (graph displays Ireland's manufacturing output on a steady rise throughout the 1980s), available at [http://www.tara.tcd.ie/bitstream/2262/2741/1/jssisiVolXXVI211\\_276.pdf](http://www.tara.tcd.ie/bitstream/2262/2741/1/jssisiVolXXVI211_276.pdf).

incentives,<sup>70</sup> and that didn't really stimulate the economy.<sup>71</sup> I am not sure taxes are ever the main issue.

MR. McILROY: Maybe I could just follow on that topic. One figure that really struck me, Bob, in your numbers was the number of firms that were formed in 2005 in comparison between Canada and the United States. Usually in Canada, there is the ten times rule.<sup>72</sup> Our population has been generally one tenth of yours, so we usually expect to see a number in the U.S. to be ten times what it is in Canada.

But in 2005, 30,000 new firms in Canada roughly;<sup>73</sup> the United States, 672,000.<sup>74</sup> So in other words, it was 20 times instead of ten times, and I see that as twice as high per capita, which is a significant difference. That sort of flies in the face, I think, of the World Bank numbers where they sort of seem to say we were the same.

I, as a Canadian, think that there are far fewer entrepreneurial firms formed in Canada, and your numbers seem to hold that out.<sup>75</sup> The World Bank numbers, I am not so sure, and I was wondering if you could comment on that, why you see more firms formed in the United States and more of an entrepreneurial spirit?

DR. HIRICH: Good question. These numbers came right from the government numbers. Remember these numbers reflect people that form a company and have at least one employee, not a single employee firm. That would really change these numbers if we add single employee firm formations. I think it will probably change the numbers equally in both countries.

The numbers would at least double. The U.S. has always had a culture (and I don't know Canada well enough except my experience in Canada with

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<sup>70</sup> See Kevin H. O'Rourke, *Industrial Policy, Employment Policy and the Non-Traded Sector*, 27 J. OF THE STAT. & SOC. INQUIRY SOC'Y OF IRELAND 61, 67 (1994) ("[W]hile manufacturing and traded-sector service companies pay 10 per cent corporation tax, firms in the non-traded services sector pay a 38 per cent rate."), available at [http://www.tara.tcd.ie/bitstream/2262/2104/1/jssisiVolXXVII\\_6192.pdf](http://www.tara.tcd.ie/bitstream/2262/2104/1/jssisiVolXXVII_6192.pdf).

<sup>71</sup> See Bradley & Wright, *supra* note 69, at 228 (graph displays an increase in Ireland's unemployment numbers throughout the 1980s).

<sup>72</sup> See Lukin Robinson, *Book Note*, MONTHLY REV., April 1999 at 1 (reviewing JOSEPH K. ROBERTS, *IN THE SHADOW OF EMPIRE: CANADA FOR AMERICANS* (1998)) ("In population, income and wealth, Canada is about one-tenth the size of the United States."), available at [http://findarticles.com/p/articles/mi\\_m1132/is\\_11\\_50/ai\\_54517447](http://findarticles.com/p/articles/mi_m1132/is_11_50/ai_54517447).

<sup>73</sup> See generally Geoff Lewis, *Who in the World is Entrepreneurial*, CNN Money, June 1, 2007, [http://money.cnn.com/magazines/fsb/fsb\\_archive/2007/06/01/100049637/index.htm](http://money.cnn.com/magazines/fsb/fsb_archive/2007/06/01/100049637/index.htm) (discusses the ease of starting a new business in various countries including the United States and Canada).

<sup>74</sup> *Id.*

<sup>75</sup> *Id.*

my Boston lens) forming things, being creative, and being our own boss. And we have this angel environment that makes money available.<sup>76</sup>

We have taught entrepreneurship in our schools a lot longer than Canada. Remember, teachers do have an impact.<sup>77</sup> This started in Canada at the university level about six years later than the U.S.<sup>78</sup> It started rigorously in the U.S. in about 1980.<sup>79</sup> Germany just started teaching entrepreneurship in their schools two years ago.<sup>80</sup>

So educationally, we have been more prone to create entrepreneurs, and our society is probably more open and supportive of entrepreneurs. It is just the culture that the U.S. has had throughout, which perhaps hasn't been quite as strong in Canada.

By the same token, the World Bank is talking about their overall measurement, so these are their rankings. The numbers in the United States and Canada versus other countries make relative sense to me.

MR. McILROY: I understand we are down to two minutes, but Henry has just given me the you-are-out-of-time sign. So I think we are going to call this to a close.

I would like to very much thank Dr. Hisrich for traveling from Arizona to join us. I think we can all agree that he brings a unique perspective to the topic of this Conference, and I would like you to join me in thanking him for his presentation.

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<sup>76</sup> See generally THE NATIONAL ASSOCIATION OF SEED AND VENTURE FUNDS ET AL., SEED AND VENTURE CAPITAL: STATE EXPERIENCE AND OPTIONS MAY 2006 1-4 (2006), [http://www.nasvf.org/web/nasvfinf.nsf/pages/svcp.html/\\$file/Seed%20and%20Venture%20Capital%20Report%20-%20Final.pdf](http://www.nasvf.org/web/nasvfinf.nsf/pages/svcp.html/$file/Seed%20and%20Venture%20Capital%20Report%20-%20Final.pdf) (discusses history and current state of the venture capital market).

<sup>77</sup> See generally Lena Lee, *Entrepreneurship Education – A Compendium of Related Issues* (NUS Entrepreneurship Centre, Working Paper No. WP2005-14, 2005), available at <http://unpan1.un.org/intradoc/groups/public/documents/APCITY/UNPAN023986.pdf> (discussing the recent trend of entrepreneurship being taught in universities worldwide).

<sup>78</sup> *Id.*

<sup>79</sup> *Id.*

<sup>80</sup> *Id.*



INTELLECTUAL PROPERTY ASPECTS OF  
ENTREPRENEURSHIP: PROTECTION IN PATENT AND  
TRADEMARK AREAS, AS WELL AS COPYRIGHT AND KNOW-  
HOW AREAS (LOCAL AND FOREIGN); PENETRATION OF  
OVERSEAS MARKETS (DIRECTLY OR THROUGH  
LICENSING); POSSIBLE INDUSTRIAL ESPIONAGE CONCERNS

*Session Chair – Raymond Ku*  
*Canadian Speaker – James Longwell*  
*United States Speaker – Diane H. Dobrea*

INTRODUCTION

*Raymond Ku*

DR. KING: Okay. We are ready. Let's go.

PROFESSOR KU: Welcome back, everyone. I am Raymond Ku. I teach Copyright and Constitutional law here at Case Western. I am also co-director for the Center for Law Technology and the Arts, which is why Henry asked me to chair our panel here on intellectual property aspects of entrepreneurship. I won't give you the boring summary of what the criteria for copyright, trademark, and patent law is. I will just tell you that, obviously, from the perspective of entrepreneurs, intellectual property is often viewed as having the attributes of a double-edged sword.

I think it is billed as a friend in the sense that it provides, often, the necessary incentive and the legal protection for entrepreneurs to actually make the investments that they do and engage in the business activities that they do. But it can also be an incredible barrier to entry. Just look at any newspaper today. The fight over patent law, copyright or trademark as intellectual property has expanded beyond the more traditional common law origins into, maybe, the respective regulatory regime. It can be quite difficult for entrepreneurs to navigate the regulatory waters.

We are fortunate to have our two distinguished panelists here with us today. They, unlike myself, come on the harder side of intellectual property. They are both attorneys and patent law experts. James Longwell, directly to my left, is partner at Gowling Lafleur Henderson in Canada where he specializes in information technology law, especially in the patent aspects of

that field. Further to my left is Diane Dobrea, a partner at Calfee, Halter & Griswold in Columbus, Ohio. She, again, is, as I said, a patent attorney whose primary focus is biotechnology law. And one brief note about Diane, she is also a graduate of Case Western Reserve University and an adjunct professor in our Center for Law Technology and the Arts.

Now we are going to adopt the format used by the venture capitalist panel earlier, and we will kind of leave it as a free form discussion both among the panelists and you in the audience.

UNITED STATES SPEAKER

*Diane H. Dobrea\**

&

CANADIAN SPEAKER

*James Longwell\**

MS. DOBREA: Okay. Well, I will pop in first and say thank you, thank you, Professor King, for inviting me here. I am actually a three-time alumnus of this university: undergrad, grad in biochemistry, and law.

DR. KING: Can you all hear Diane?

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\* Diane Dobrea is a partner in the Columbus office of the law firm Calfee, Halter & Griswold LLP. She practices in the area of intellectual property law, with a combined focus on intellectual property transactions, and preparation, prosecution and maintenance of patent and trademark cases. Though her technical background is in biotechnology, Ms. Dobrea's patent practice also includes nanotechnology, chemical, medical device, and consumer product portfolios. Ms. Dobrea oversees several large patent and trademark portfolios, working extensively with associates at law firms around the world on all aspects of intellectual property management. Serving both for-profit and not-for-profit entities, Ms. Dobrea provides due diligence and freedom to operate analyses, counsels clients on a wide range of research and intellectual property related transactions, and assists in litigation and dispute resolution concerning intellectual property. Along with her law degree, Ms. Dobrea also received her undergraduate and masters degree in Biochemistry from Case. She is a member of numerous Bar and Intellectual Property Law Associations and the Association of University Technology Managers, and has been an adjunct professor in Biotechnology Law and Policy at Case's Law School. Prior to joining Calfee, Ms. Dobrea served in the offices of the general counsel and technology transfer at the Cleveland Clinic and in the technology management office of Case's medical school.

\* Mr. Longwell practices in all areas of intellectual property law, particularly as it applies to computer and information technologies. He advises start-up companies, small businesses, universities and large corporations on intellectual property strategy, including acquisition, protection, exploitation and enforcement issues. Mr. Longwell is also involved in Canadian and foreign patent and trade mark agency, primarily preparing and prosecuting patent applications relating to computer software, hardware, enterprise computing, web development, telecommunications, medical devices, housewares and business methods. Mr. Longwell also provides strategic analysis and advice to business owners and investors for financing, joint ventures, technology procurements, development and commercialization transactions.

MS. DOBREA: It is just always a pleasure to come back to the University. Although I relocated a year ago down to Columbus with our law firm, I find my way up here a lot, so I am used to seeing the faces around here on the campus.

We are trying to be responsive to the sentiments and questions that have been raised over the last couple of days in terms of how IP factors into the entrepreneurial context. And I say entrepreneurial context because there have been a lot of conversations about entrepreneurs and individuals or a small team starting up and taking an innovation out into the marketplace. But from the standpoint of an IP attorney, we deal with entrepreneurs whether they are a business unit within an existing company that is trying to go after a new opportunity or an individual who has a concept and wants to figure out how the solution that he or she has found can also make it out in the marketplace to help other people be successful and maybe make some money, too.

That is the backdrop of how we deal with intellectual property. What we want to talk about today is the role of intellectual property in the entrepreneurial context in terms of making decisions about when to spend the money, when to spend the time to figure out what kind of real estate you have got to protect, and whether or not you are stepping on someone else's real estate – which is an important consideration that can't be overlooked. Also, what is your competitive strategy and how, if at all, does IP fit into that competitive strategy?

There certainly have been a number of people who have recognized that you can have an innovation that isn't capable of being protected by IP, at least in terms of patent and trade secrets. So what other IP vehicles are available, and how can they best be exploited, and what are the risks associated with going forward with those things or protection?

Just quickly, when we do our due diligence we are really looking at two components: What does the entrepreneur have that can be protected and how do you figure out how to capture that.<sup>1</sup>

But equally important, when that entrepreneur goes out into the marketplace with their innovation, what do they have to deal with in terms of somebody else who is already there? What ability do those other entities have to stop them from being productive? The bottom line is education is expensive and ignorance can cost more.

And I think that's definitely true. We, as IP attorneys, like to have all of the information at the earliest point in time so that we can pick it all apart and

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<sup>1</sup> See generally William J. Murphy, *Proposal for a Centralized and Integrated Registry for Security Interests in Intellectual Property, Appendix 6: Due Diligence*, 41 IDEA 445, 446 (2002) (“Due diligence involves the investigation to verify and establish the existence of the intellectual property asset and liability and to determine the extent of encumbrances or restrictions on the rights to use the property.”).

give you your best strategy. The reality is that the costs of us doing that are often so prohibitive that the best that an entrepreneur can do is understand enough about the context of the market they are going into to be able to weigh spending the money up front versus waiting and seeing what happens down the road.

We will then transition into covering how you protect your IP and talking a little bit about the differences on a global basis and certainly the differences in our IP schemes in the U.S. versus Canada.

MR. LONGWELL: I have been asked to focus more on the role and relevance of IP in the entrepreneurial context, and I think there are a lot of different facets to it that people tend to concentrate on, but there are many things they don't examine.

As Raymond mentioned at the beginning, I look at IP as both a friend and a foe. It is a friend, certainly, insofar as it attracts capital, which is really what every entrepreneur is chasing. IP doesn't follow money; money follows IP. It really brings in the money if it is there.

Why? Well, it is a vehicle that you can use to crystallize the knowledge that the inventor has, into a property right, which then can be held by a specific entity. Then those property rights endure for a certain life, usually 20 years for patents, longer for trademarks and so forth, but they are going to outlive that entrepreneur. So when the entrepreneur becomes disgruntled and wants to leave, the IP stays behind and continues to grow within another entity.

Most people see the acquisition of exclusive rights as the ultimate goal of IP. That's what the IP is supposed to be bringing to them. That's certainly one of the aspects. Sometimes they lose sight of what that really means.

An exclusive right might be great for trademark. I can use my trademark and I have a right to do so. But for patents, it is not always that way. It is a patent right and that gives you a right to stop others from making or using the invention that is claimed there.<sup>2</sup> But this is not a right that you can use.<sup>3</sup> It does not give you that opportunity.

It is subject to the third-party right of others that we talked about. You know what else you can do with the exclusive rights? Well, you can copy them yourself or enforce them, but obviously, there is a vehicle you can use to license to others. You can get other people involved. So we excite people

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<sup>2</sup> See 35 U.S.C.A. § 154(a)(1) (West 2002).

<sup>3</sup> See *id.*; See also *Little Mule Corp. v. Lug All Co.*, 254 F.2d 268, 273 (5th Cir. 1958) (“[A] patent is not the granting of a right to make, use or sell.”); see also *Crown Die & Tool Co. v. Nye Tool & Machine Works*, 261 U.S. 24, 36 (1923) (“The government is not granting the common-law right to make, use and vend, but it is granting the incident of exclusive ownership of that common-law right.”).

and are able to offer things within intellectual property, and you can work within your own market.

But look forward, where might you be ten years from now and who might be there to help you? Go to Europe. File a patent application. Secure rights in China. Maybe you will be licensing other partners to get you into that market sooner.

Then, of course, in the last few years of development, that intellectual property itself can be relegated to someone else. People don't want to practice. They don't want to go into the marketplace. Many are happy to own IT and sit back and wait for someone else to stumble upon it so that they can be that troll who jumps out from under the bridge and says, "Ha, ha, I need a toll for you to pass over." It is going to cost you a lot of money. Our experience with our neighbors in Waterloo for Research In Motion – it cost them a lot of money to pass over that bridge.

So, that's one of the attractive aspects if you are one of these people, but it is one of the foe aspects for new entrepreneurs coming into a new space. They have to be worried about the third-party IP that can be shaping the scope of the protection for whatever they wish to obtain as well as just being a barrier to entry into a particular market.

So that, of course, involves a due diligence exercise. We are going to talk a little bit about that in a few moments. How do you evaluate the rights of others when you want to take the IP? When do you want to take the opportunity to do that? Is that something you do earlier? Do you postpone that if you can? How much money are you going to spend, and in what markets are you going to do that because it can be a very costly exercise? And why is it costly?

Well, IP is complicated. I mean, it is science law, and the law puts you in institutions, and as much as we heard the money doesn't like to see borders. IP lives and dies, in a way, on borders and the nuances and the various laws. It is really important that when we see new entrepreneurs coming in, maybe the institutional context like universities where they had this great idea, they did their thesis, they had it published, everything looked great, and somebody told them that they should commercialize. They got some interest, and then they realize their entitlement has been lost in jurisdictions because they published first. They are no longer able to secure the adequate protection they thought they could get there. So borders exist.

The differences in law are very much apparent in intellectual property. It is costly because, well, we charge more for professional services. There are fees involved. You are moving into foreign markets whose translation costs are involved, and that's up, but also, we deal with hard data.

There are lots of opportunities where there is nothing you can do to extend it, and that's time and effort for entrepreneurs and innovators to take

out of what would otherwise be conducting their business to handle these issues and that can be costly.

The next thing, before we go on, I want to address the educational deficit that entrepreneurs often have in regards to their role in the IP and how IP is used. They are not really sure of the different types of rights available to them, the confusing copyright, for example, and patent rights, copyright and trademarks, for example.

So when they are engaging with others to do the types of work that they would normally do on their own, they are not setting themselves up to best protect their own innovation. So we have to spend a lot of time with them putting into place these proper procedures – the employment contracts, the ways that they can capture their innovation so they are protected going forward, to prove ventureship and other ownership issues. Those are big aspects to entrepreneurs looking for a gain with the lowest cost.

That has lasted awhile, and our institutional innovators, in particular, are facing increasing pressures to both innovate as well as to attempt to protect. And costs on the outside are very hard, tough to absorb, and we need, as professionals, to find ways that we can assist these institutional innovators to bring our costs into their budgets, educate them as to why we can't always do that. So we have to be careful to navigate IP policy issues with inventors and add a level of complexity that is costly.

MS. DOBREA: By the way, we are welcoming any kinds of questions so don't hesitate to interrupt.

But going off those comments, patent law is clearly very complex. It can be complex based on the kind of IP that you seek to protect, and the extent and quality, completeness of the disclosure especially in the research context. Those of us who work with university inventors know that they have great ideas that are developing, and they are going to be out there publishing. There is a big push in those institutions to protect transfer functions and take those ideas and get them to market.

What they lack in those organizations is the sophistication in a particular business area. So, you have got tech-transfer people handling technologies that span these very broad ranges.<sup>4</sup> And that's not even to mention the political dimension within an organization and who really calls the shots in terms of how technology is taken out to the marketplace.<sup>5</sup>

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<sup>4</sup> See generally University Technology Transfer: Questions and Answers – The Council on Governmental Relations, <http://www.cogr.edu/docs/BayhDoleQA.htm> (last visited, Nov. 13, 2007) (noting the “broad spectrum of organizations and individuals” to which universities license technology); see generally Jeff Karoub, *Industry experts shed light on technology transfer*, SMALL TIMES, Nov. 29, 2004, available at [http://www.smalltimes.com/Articles/Article\\_Display.cfm?ARTICLE\\_ID=269746&p=109](http://www.smalltimes.com/Articles/Article_Display.cfm?ARTICLE_ID=269746&p=109) (discussing the use of industry consultants during technology transfers).

<sup>5</sup> See generally Karoub, *supra* note 4 (discussing the internal conflicts universities face

DR. KING: Are you going to cover the competitive law aspects?

MS. DOBREA: Yes.

DR. KING: I was thinking about that troll under the bridge. I think it is a major concern in some cases, in both the United States and Canada. You could do it now or whenever you want to do it.

MS. DOBREA: Okay.

MR. ROBINSON: Following up on the comment about the university inventors, in my experience, it has been troublesome to do high-tech joint ventures with university people who were also affiliated with a private research institute. There was one connected with a hospital, and I understand that is very common, certainly here at the Cleveland Clinic.

The big problem was to figure out when the guy had his great insight. Was it while shaving in the morning? If so, was he was doing that for the university or the hospital? And, of course, my client was a bloody-minded commercial corporation who was going to grab this technology and do huge IPOs and make jillions of dollars. It was just a disaster.

We couldn't sort the thing out properly. I understand that in the U.S. there is a law or protocol that makes it clear how much of an ownership stake the university has in the innovations of its professors, and how much stake a professor has in the same.<sup>6</sup> Alternatively, I suppose a professor may be able to avoid this issue altogether by saying, "I did that for the private research institute." This is what the commercialization person wants to deal with.

So I guess the question is: is there such a law, and is there any way to deal with this in Canada, where there doesn't appear to be one?

MS. DOBREA: No such law exists. Maybe what you are thinking about is the Bayh-Dole Act. The Act can apply if there is federal funding in an institution. It can also apply in the context of a company that works under an SBPR grant, a small business type grant that focuses on driving innovation and has basically a feed into provisions that are equivalent to Bayh-Dole.<sup>7</sup>

Bayh-Dole doesn't prescribe the numbers for sharing. But Bayh-Dole does prescribe some fundamental concepts that the Government, by funding all or a portion of whatever work is done like innovation, has the right to have a disclosure of innovation. It also has some expectations of the university that wishes to elect title because the Government owns it in the first instance, so the institution has to elect title.<sup>8</sup> I mean there is a straightforward procedure and there is the underlying power of issues.

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when dealing with technology transfers).

<sup>6</sup> See generally 35 U.S.C.A. § 202 (West 2002) (noting the disposition of rights of each party to a funding agreement).

<sup>7</sup> See 35 U.S.C.A. ch. 18 (West 2002).

<sup>8</sup> *Id.*; see also Council on Governmental Relations, Intellectual Property and Technology Transfer: the Bayh-Dole Act: A Guide to the Law and Implementing Regulations,

The procedures are relatively simple to execute. Compliance is spotty.<sup>9</sup> You know, it just depends on how well situated an institution is to really capture and administer those steps. But at the end of the day, you know, they have identified the IP. They have notified the Government. They have elected title. They have granted back the confirmatory license to the Government so the Government can itself, on its behalf, have that technology factor.

The institution is expected to favor small businesses over larger ones. That's not an absolute. Favoring U.S. businesses over foreign ones is also not an absolute. Still, for a substantial manufacturer in the United States that is pretty big, getting over that hurdle is not the easiest. The Government reserves march-in rights.<sup>10</sup> So if compliance is not good with respect to making the best effort to get the technology, that taxpayers paid for, into the marketplace then the Government could conceivably march in, take those rights over, and hand them over to someone else.<sup>11</sup>

There have been a few forays into trying to get a federal agency to exercise march-in rights, but that hasn't really happened. So it looks onerous, but it really hasn't operated as such. One component of that is that a share of the revenue that comes back to the institution goes to the inventors. But what percentage is ultimately prescribed by that institution's policies? There are no guidelines, but pretty much across the board, it is a decent share at most of the institutions that I am familiar with.<sup>12</sup> There have been surveys done by the Association of University Technology Managers and Licensing Executives to support that.<sup>13</sup> They are two organizations that track innovation particularly out of funding institutions.<sup>14</sup> But if you are outside of the federal funding context, then it is sort of a free for all.

At most, it is up to the policies of that institution, and you have by then identified one of the important issues that can be a problem down the road.

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<http://www.mtsu.edu/~research/docs/TheBayh-DoleAct.pdf> (last visited Oct 21, 2007).

<sup>9</sup> See U.S. General Accounting Office, *Technology Transfer Reporting Requirements for Federally Sponsored Inventions Need Revision*, GAO/RCED-99-242 (Aug. 1999), at 2, available at <http://www.gao.gov/archive/1999/rc99242.pdf>.

<sup>10</sup> *Id.* at 5.

<sup>11</sup> *Id.*

<sup>12</sup> See generally The Association of University Technology Managers: Frequently Asked Questions, [http://www.autm.net/aboutTT/aboutTT\\_faqs.cfm#7](http://www.autm.net/aboutTT/aboutTT_faqs.cfm#7) (last visited Oct. 22, 2007) (discussing how universities use the revenues realized from licensing).

<sup>13</sup> See The Association of University Technology Managers: Licensing Surveys, [http://www.autm.net/about/dsp.licensing\\_surveys.cfm](http://www.autm.net/about/dsp.licensing_surveys.cfm) (last visited Oct. 22, 2007) (full surveys available for purchase).

<sup>14</sup> See The Association of University Technology Managers: About AUTM, <http://www.autm.net/about/> (last visited Oct. 22, 2007); see also Licensing Executives Society International: About LESI, <http://www.lesi.org/content/presidentsmessage.aspx#what> (last visited Oct. 22, 2007).

Do the due diligence at some early point to determine under what context an invention arose. Even if we are talking about an entrepreneur not associated with the university, you would be surprised to find out what their friends are working on. “Oh, yeah, this guy was a consultant, but he was actually a doctor of this hospital. And his contract stated that anything that he invents has to be assigned to the institution, even if he signed an agreement to the contrary.”

So sometimes you have to dig far enough to understand all the connections in order to identify what could be a problem. And it is a matter of when do you do that digging, because at some point you might be down the road trying to unload that technology per your exit strategy, and you don't want to find out then, when they do their due diligence, that you don't have claim to title.

Then you have somebody that says, “Sure, I would be happy to assign it for whatever.” But that's only one piece of it; identifying who are the rightful contributors, if there is an inventor, if there is a problem with somebody who claims to be an inventor, which would upset the validity of a patent down the road.

So it might not be something that is going to rear its ugly head for ten years after the entrepreneur started the company and got it going. When do you look at those issues, and how do you deal with them is a difficult question. Generally, it can certainly vary between the United States and Canada. I am absolutely certain in the United States that, except for an employment contract that someone may have or the Bayh-Dole Act that may impose certain obligations on a funded investigator, if somebody works for a company and comes up with an investigation there is no agreement that says they are obliged to assign that to the company, that they own it as an inventor.<sup>15</sup>

And there are plenty of relatively sophisticated, and in some instances large, clients that I dealt with who maybe know that and talked to some of the organizations. But they will do anything to implement it. They are really surprised, sometimes, when that really nice engineer says, “Yeah, I would be happy to assign it to you. I want my X amount of dollars or a percentage.”

Then the client calls up and says, “They can't do that. It is work for hire.” “No, that doesn't apply in the context of an invention whereas...”

MR. LONGWELL: Whereas in Canada, we generally have the rule that, if it is not in the employment contract, if you were hired to invent, it will be

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<sup>15</sup> See *National Development Co. v. Gray*, 316 Mass. 240, 246, 55 N.E.2d 783, 786-787 (1944) (“[The Court] looks upon an invention as the property of the one who conceived, developed and perfected it, and establishes, protects and enforces the inventor's rights in his invention unless he has contracted away those rights.”).

implied that your invention is owned by your employer.<sup>16</sup> So that is a remarkable difference between our two countries.

MS. DOBREA: So then it doesn't matter whether they say I am or am not an inventor if somebody asserts *inventorship* later and tries to upset the apple cart later.

MR. LONGWELL: Absolutely, as well as the misnaming in the patent, minimizes so the courts aren't quite so concerned. As long as they were up in the listing, the applicant was the one who was really entitled, whether they got the inventor's name correct or not is not a major concern. It can be costly to throw out the issues and get a ruling that, in fact, the invention claimed by the inventor, it doesn't really upset the apple cart, then so be it.

But to go back to Dr. King's question, we will talk a little bit more about IP strategy later, but there is a real difference I think in the culture in Canada and the litigation area and our laws in that area that have made trolls far more attractive in the U.S. context than they are in Canada. There are a number of reasons for that. One of them is the cost of litigation in Canada.

Successful parties are entitled to costs, and you can lose and still be entitled to costs by making proper settlement offers. We don't have jury trials in Canada in patent matters. They are almost exclusively really big trials and are all settled by federal court judges who have some expertise in this area.<sup>17</sup>

So again, there is no big award at the end of the day. We talked a little bit, Diane and I, about the differences of triple damage awards that are available here for people who acted out of willfulness when infringing. You don't have any of that opportunity.

So with a smaller market, with those big litigation differences, we don't have a troll issue, per se, in Canada. We have IP rights holders. We have universities, institutions that hold IP and don't exploit them, and they are troll-like in a way. They are ready to license, but they are not viewed with the same disrespect that private individuals or corporations, limited liabilities are when holding on to these IP rights and exploiting them. At the last moment. And, really, is that a problem with patents, or is it more a question of litigation culture? Maybe there is an inability there.

MR. McINTOSH: Just following up on Michael Robinson's question, I was interested in knowing if in Canada, if a business decides to work along with the university and enters into an arrangement with the university in essentially a work-for-hire type of contract, where the business has an idea, then goes to the university to make arrangements for that idea to be developed into a prototype – are there special concerns that need to be

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<sup>16</sup> Colleen Spring Zimmerman & Ziad J. Katul, *Patent Ownership in Canada*, THE LAW. WKLY., Apr. 21, 2006.

<sup>17</sup> Rudolf E. Hutz, *Where To Litigate Patent Infringement Cases*, 1 DEL. L. WKLY. n.4 (Dec. 1, 1998).

addressed in terms of making sure that the intellectual property is conveyed to a business that would be outside the normal course of a contract, saying this is work-for-hire, or is the university free to enter into those kinds of relationships in order to basically provide opportunities for their students?

MR. LONGWELL: Well, that's a good question, and I think you get different answers from different universities. I can use McMaster University as an example. Their IP policy would dictate that the university is supposed to benefit in these situations. They would allow professors to have ownership rights, but this doesn't mean they won't be able to come to an arrangement with the person in part of the trade or even other parties who might be paying a portion of that.

So that at the end of the day, the business owns what it needs to own to make sure it is exploited in a commercial manner. Universities are getting some credit getting their license back, and this is useful. Then you have another institution down the road where RIM is in Waterloo. The University of Waterloo's IP policy states that, as inventors, you own 100 percent, and we would love it if you would think of us when you are successful, to give us something in return. This is a very pro-inventor and pro-entrepreneur culture.

It depends who you are. Some institutions are a little more inflexible, and they retain ownership. They want their name on the IP. They think it is a barn and that can be difficult because of Canada's co-ownership law on patents.<sup>18</sup> It is very much more complicated than the United States.

MR. COHEN: This is off the topic but in line with the world of globalization, at what point do I file all of these foreign patents? Do you have a timeline chart covering this?

MS. DOBREA: Well, much of it is hardwired into the way the whole system works, except if you are outside of the treaty countries, which, you know, carry the wisdom of filing in a lot of those countries because of the market size and the great unpredictability of what you are going to encounter in their patent offices.

There are a couple of different levels on which to answer that question, but if the simple question is: what do I predict as my timeline once I file an application? It is pretty much etched in stone. With respect to what's within the four corners of a patent application, it is filed as your priority application.

Whether you file a U.S. provision or U.S. utility or file first in the Patent Cooperation Treaty (PCT), which is sort of a central place where you can file and get into all the treaty countries or file first in Canada, one way or the other, you have gotten yourself into the patent system.<sup>19</sup>

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<sup>18</sup> Francois Painchaud et al., *International Mergers & Acquisitions: The Canadian Perspective*, <http://robic.ca/publications/Pdf/277-FP.pdf> (last visited, Oct. 22, 2007).

<sup>19</sup> See generally Sheldon Mak Rose & Anderson, *First-to-File v. First-to-Invent: A Bone of Contention in the International Harmonization of U.S. Patent Law*,

And with respect to all the countries that are party to the Harris Convention and/or under the PCT, you are in the system. You can't change that application.<sup>20</sup> You can't add any new matter, which means you better hope you completed disclosure as you need, and that means to get the kind of claims you would like to get.

Twelve months out is usually the time frame where you have to jump off and get into the national, the PCT filing, the international filing and then depending on the jurisdiction, 30 months from the priority filing date, so that's the priority filing date. That's the provisional date.

That was your first application, which is when you have to make the first decision about jumping off into the various national jurisdictions you want it filed in. So it is hardwired, and that can be good or bad. If you have got no prior disclosure of your invention, forget right now about freedom to operate, but you have your invention captured, completely enabled in your disclosure, and if you have the opportunity to have some substantive examination within that initial 18 to 30-month period, then you are in the best position to make decisions about the viability of the kind of claims you would want to get in the jurisdictions that from a business standpoint you want to get perfection in. I am not sure if that's responsive to you.

MR. COHEN: That's pretty responsive.

MS. DOBREA: From the nuts and bolts standpoint, that's the easy answer. The harder answer is when do you first file, and that brings us into, under due diligence, what we were first talking about, when do you even try to figure out if what you've got can be protected? From a patent attorney's standpoint, I am certainly surprised at the timing of when entrepreneurs try to actually answer that question.

I say I am surprised because they will, a fairly long distance out, get a lot of their own money committed, friends and families' money committed, perhaps angel money committed, writing business plans, getting toilet pipes made, getting engineers doing things for them, and then they say let's sit down and talk to patent counsel.

And I laughed at that because sometimes you give them answers that they don't want in view of how much resource they already put into it. But we heard a good example yesterday about flying completely blind. The inventor, though, wasn't going to tell what was inside the black box; didn't want anyone to look, and on faith, the investors went forward, and that hydrogen peroxide sterilization technology is going to be a reality in the marketplace.

So presumably at some point, they got their heads around what there was to protect, and they also figured out whether or not they are going to step on

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<http://www.usip.com/articles/1st2fil.htm> (last visited, Oct. 22, 2007).

<sup>20</sup> See generally Garry E. Hunter, *Status of Intellectual Property Law in the Age of the Internet*, 38 L. TECH. 1, Jan. 1, 2005.

someone's toes and, at a minimum, have a lot of their money spent defending an infringement suit and potentially be knocked out of the market.

So that kind of timing, that's a little bit tougher to sort out, and from our standpoint, we can ultimately be the technical experts prosecuting patent applications. Both of us feel we do that pretty darn well. But the best thing we can do as patent counsel, and this is playing off some other comment that the venture capital people made, is finding a way to have a better, more informed strategic entrepreneur.

MR. LONGWELL: And there is the question: when are you legally ready, and when are you strategically ready? A lot of inventors are legally ready fairly quickly. They have enough knowledge of their invention. That's certainly my experience. You don't need a lot of data. You don't need a prototype. It is pretty easy to describe a lot of business methods and software communications inventions that I see.

So you can be legally ready to patent quite quickly. Because of that, there is a rush to patent, and in most of the world, we are still faced with first-to-file, where the first invention to file is entitled to the patent,<sup>21</sup> Within the United States, which remains the last reasonable first-to-invent country,<sup>22</sup> and then you are strategically ready. Sometimes they file their own provisional, or use other counsel before coming to us and looking for assistance.

Strategically, they weren't ready, but their deadlines are coming up. It is now the tenth month, and they have two more months to file a PCT, and they literally have no money left. The PCT application, it is on the order of \$6 to \$8,000, and they don't have that money and want to come to the bank of Jim.

Do I help you? Well, why? I don't know you from Adam. I can look at your technology, and I can try and get excited, but I have to sell this to my partners as well. I am not going to fund you until you find funding, and that's a tough, tough call. We are really not in the business of investing in our clients. It is not good from an ethical standpoint I don't think. We saw a lot of that in the 1999-2000 range, and law firms have been burned by that. And so it is a tough decision.

We have to be flexible and you have to come up with good payment plans to allow our clients to avail themselves of the IP provision, but we also have to be, sometimes, the gatekeeper and just say no.

MS. DOBREA: We don't want to forget, there are other forms of IP, right? To have an IP position, you have to have a trade secret, which may equate to know-how. You have to have something that can be patented or protected by its identification and goodwill, which would be trademark or trade dress or something that can be protected by copyright. Unless your

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<sup>21</sup> Rose & Anderson, *supra* note 19.

<sup>22</sup> *Id.*

business model is just to aggregate intellectual property rights so you can enforce them against others when they stumble across your field, they are not an end unto themselves.

While I believe that's a well-understood notion by investors and entrepreneurs who are great, wonderful people, who come up with these wonderful ideas and push the envelope, they don't necessarily appreciate what a patent is and what it isn't. Mostly we are going to talk about patents in that context, and then – that it is not an end unto itself, and it doesn't solve our problems.

And how you go about trying to secure protection – it is a decision best made after you have understood what that opportunity is. So going back to the earlier discussions, starting with David Morgenthaler, there has to be a business opportunity that makes sense. There has to be an innovation that plugs into that opportunity, but there has to be an opportunity.

There has to be money. Someone has got to underwrite it. Maybe it is not a lot, and you need to have all the resources in structure to carry forward, whatever that may be in the industry. But the mere recognition that there is an innovation doesn't automatically necessitate that you go to the Patent Office and file an application because, depending upon your business model, maybe the ability to market a patent pending when you are showing it over in Hong Kong is all you really need to keep your competitors far enough at bay before you go into the marketplace. Since you have already a presence there and recognition, it is going to carry itself and may be weak from a patent perspective, too.

That doesn't necessarily make money VCs excited because they think the payoff at the end isn't necessarily there, but that is a relevant strategic thought process for some of the entrepreneurs who deal with it. Others have a very complicated, and perhaps very robust position, from an IP standpoint, and making a decision as to how to understand that, how to capture what they have got and also sort through what their risks are in terms of stepping on someone else's toes can become a much more complicated and expensive undertaking. It can only be done most effectively if they really understand the opportunity, know the market they are going into, who is the competition, and are they a little guy.

And there are a bunch of big guys out there who have a bunch of patents, and that's maybe death to the idea, but maybe that's an entrepreneur's way in, in and of itself. You found a way to do something that the market hasn't figured out yet. You are not going to go nose to nose with Johnson & Johnson, but you may have found something that tucks nicely into their portfolio and it makes sense for your business to develop that to a certain point and then transition it off to them.

When do you contact them? Do you try to get cross licensing? Do you try to do a deal of strategic partnership? Those are the kinds of questions that

come out of thinking in the first instance about what the opportunity is, what space am I going into, how long is it going to take for me to get to market, how much is it going to cost, and what are the risks if I fly blind and I have no idea whose toes I am stepping on. How much money did I spend, and do I stand to lose, if I have to stop in my tracks and pull my products out or try to defend an infringement action and pay damages?

And that's really all there is to it. Patent attorneys, again, we love that you come early, you have an idea. You know, we do all the thinking upfront, get your patent applications filed, and at least, when we are prosecuting your case, the world is as controlled and encapsulated as it can be. But that whole process in and of itself can cost so much money that it would be cost prohibitive to a small entrepreneur who has got \$200,000 in his or her pocket to try to get out there and make something happen.

And so really, again, you know, the more we can help them sort through those questions and maybe give part answers – understanding we won't have certainty on this. You can't afford to have an opinion written on this, but we can see what the environment is.

We can understand that there may be some patents that could potentially block you; they could be invalid. The scope of the claims might not be as broad as they appear to be. They might be held by big competitors in the marketplace who can block you. But knowing that those rights out there exist creates the opportunity to develop business solutions, business strategies.

So it doesn't necessarily blow you out of the water. Again, flying blind and not knowing what's out there isn't necessarily a terrible thing to do as long as you figure out that you can afford to pull your product back. Whatever you put into it, worst-case scenario, you get back a cease and desist letter, or they file a lawsuit, you can just close up shop and move on and life goes on. You are willing to take that measure of risk.

Once you get money people involved, they are going to dictate a little bit as to how far they will go before those questions need answering.

MR. LONGWELL: I wonder, throwing the question back out to the audience, particularly the VCs, is there a difference do you think? I think there is, between due diligence in Canada and due diligence in the United States when you are making an investment? The placements in Canada tend to be significantly smaller.<sup>23</sup>

There is only so much in the VCs' hands to pay for transactional costs to make investments. They are going to try and shift the risk back to the people seeking the money to prove the respect of their IP. Most of the arrangements I see, due diligence is one of the areas, particularly in IP, that people talk

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<sup>23</sup> See generally Hilary Davidson, *Go Down the Road: Why are Canada's best Entrepreneurs Heading South? It's more than the Money*, PROFIT MAGAZINE, Oct. 1, 1999.

about, yet it is one of the first things that gets popped. And there is not a significant amount of freedom to operate type of analysis. It is not done in most places that I have worked in.

I don't know if that's the same for Diane or not.

MS. DOBREA: It varies, and it depends on the client. My university clients who have a license for technology, frankly, they don't care whether we do any searching or not. We will tend to do searching so we can write an application that best covers their invention and deals with the art that is out there.

Clients, existing firms, the firms are entrepreneurial by spirit but not entrepreneurial by some people's definition, and they want to know because they are planning to launch a product into the marketplace. They need to understand what their risks are. Frankly, some of them, and I, from a business standpoint, completely agree with the decision, will find a patent that looks like it falls exactly within the scope of its claims. It looks like there is a lot of good reason to think their patent would be invalid.

So you make a decision, take a risk, and there is a willfulness to it. So they want to look, and they are going to make a real business decision. There are also those who are not quite married to any particular concept. I am thinking about smaller companies in the marketplace who have got cash flow from existing products that have gotten things in their pipeline. They are trying to decide whether to spend the next \$50,000 on an FDA study on a lot of gut response. What do you think? And it is not a competent opinion. You can't be definitive until I do the complete analysis.

So the question is: can I find anything that is right in the middle of the road? And you make business decisions on where you are, and if it is not in the middle of the road, sometimes we identify points of novelty in the heart that people are inventing so we can focus and design around strategy if that is needed. So it varies.

In some of the transactions that I have dealt with, you know, we have done full-blown due diligence analysis and written full-blown opinions. But I would say as a general rule, irrespective of how small an entity is or how large and deep their pockets are, you just don't do it on most properties because it is, in and of itself, cost prohibitive no matter how wealthy the company is.

Their portfolio is that much bigger, which means they are going to be writing big checks for due diligence analysis. So at some point, it is just a gut decision, and if they are well established in the market and they know the marketplace well, what their own existing patent strategy is, and the knowledge of the players is probably going to help them a lot versus an entity that is going into a new area or a brand new startup that really is not familiar with going into it at all.

PROFESSOR KU: Since there are no other questions I wanted to ask one in particular, and that is, you have already pointed out some differences between U.S. and Canadian law and patents. Clearly, there are differences between the U.S.-Canada and internationally.

Are there any reasons from a patent law, or other intellectual property perspective, for an entrepreneur to consider forum shopping, for example, choose a regime that might be more favorable, or are they pretty much going to be stuck with, or governed by, the law and the nature of the jurisdiction in which they do business?

MR. LONGWELL: Yeah, I will chime in because that's something I do almost all the time – is forum shop. The Canadian Patent Office is not a major player in North America and, therefore, not in the world.<sup>24</sup> Most of our inventors look elsewhere to file their patent applications.

I worked for a company who filed their first application simultaneously in the United States and Europe, but they don't file in Canada until much later. So forum shopping is exactly what they do. Now, I think it is a little different in the United States because you have specific requirements to obtain a foreign filing license, primarily on security reasons, before you can file in another country.

We don't have that defined in Canada at all. You can file anywhere that you want.<sup>25</sup> Last year at this conference we heard about forum shopping on the litigation front and how prevalent that is and there are absolutely people doing it with regularity. They are sued in one country or didn't have a problem with a particular market, but their IP position there is not great. They are going to forum shop and possibly sue them in another jurisdiction where they can either impeach that patent – that might be in the United States and get the leg up on that litigation – or where they can use their own patents to their advantage in that other market and bring it to courts there.

And I think that was really interesting, the statistics that Mike Elmer had last year at this conference, and talking about forum shopping.

MS. DOBREA: The bottom line is, where you protect needs to be decided based on where you see your product going into the marketplace, where there is a market for it, so you are not going to protect everyone, and you are hardwired. Again, once you filed an application somewhere, you do it with a finite period of time, you have to make a decision as to whether or not you are going to avail yourself of the right in any other jurisdiction under their patent laws.

So forum shopping is certainly more relevant I think in the enforcement context or in order to use some leverage in one market to derive a result in

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<sup>24</sup> Marcus Gallie, *Canadian Patent Prosecution*, <http://www.ridoutmaybee.com/Pageasp?PageID=122&ContentID=779> (last visited, Oct. 22, 2007).

<sup>25</sup> See generally Rose & Anderson, *supra* note 19.

another. But in terms of taking advantage of the patent system, it all ends up running together. Then, of course, you can get vastly different results in the prosecution in different jurisdictions just based upon how the rules work.

We talked a little bit about what the government is doing to help, and I will temper my comments about the U.S. Patent Office, but it is expensive.

MR. LONGWELL: Is there a stop on this recording?

MS. DOBREA: It is getting more expensive. I am not sure of the extent of the audience's familiarity with pending rule changes at the Patent Office that have most U.S. Patent attorneys shaking in their shoes. We are stressed because of the amount of time and effort that we will have to put in to carry applications, think strategically about claims, and how many claims we have searched and how much art we need to cite, especially in view of Federal Circuit Court decisions about inequitable conduct and duties of disclosure. We have a very challenging patent system already, and it looks like it can get much more challenging and much more expensive, and that's in sharp contrast to Canada's system.

MR. LONGWELL: Absolutely. We sort of have the kinder, gentler patent system in a way. I don't know if that reference is appropriate, but costs in Canada tend to be lower historically at the filing stage and at subsequent stages. We don't have the rule requirements you have inherent in Canada – good faith, and the obligation to disclose what you know that might materially affect patentability to the Patent Office.<sup>26</sup>

We only have to tell what we know or are asked. That's one big difference, and it is a lot cheaper, obviously. We don't have the rule changes. We don't have fees for the different numbers or types of claims that you may have in a patent application. So it is a little easier. But the delays in our Patent Office even exceed the time in the United States Patent Office.

When you are looking at a software invention that might not issue for five plus years, or biotech, which can be six to seven plus years, this can dissuade people from even patenting in Canada because technology turns over so quickly. That's another reason.

But recent rule changes in Canada tend to go a little bit the other way. Proposed changes last January were arguing with the reduction and burden on applicants, and they are eliminating fees, or proposing to do so, and to make some difficult decisions. We presently have a reduced fee structure for small enterprises.

We are trying to enhance those and encourage more filings. We heard, earlier today, comments from Mr. Hisrich about the number of filings in the United States, and there was only one instance where the U.S. was outpaced by foreign filers. In Canada, it is, year in and year out, due to population, on

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<sup>26</sup> See generally Charles Lipsey, *Canadian Court Decision Places Broad Class of Patents in Jeopardy*, MONDAQ, Aug. 17, 2007.

a scale of anywhere from 7 to 1 to 9 or 10 to 1. This means that a good portion of my business involves acting for foreign IP owners. But it also means that our Canadians are not filing at anywhere near the same pace that inventors are and entrepreneurs are in other jurisdictions. That's a gap that we have to close if we are going to remain competitive. We are going to have to have to encourage the further development of our knowledge-based economy.

MR. ABRAHAMS: This is a quick question for Diane: is it not possible that the cost for patent filings in the United States has been pushed because the USPTO has been privatized, and that's how they get their revenue? It seems like there is entrepreneurial cost recovery, and the government has been that way for a while.

MS. DOBREA: Yes. I think there are other at least equally significant factors, including the diversion of fees to other federal government activities, which may be what underlies the Patent Office's push to what will significantly drive up costs for applicants.

MR. ABRAHAMS: Americans are considered privatized.

MS. DOBREA: I don't really think that's it. And I say it only in the nicest of senses. I mean, it is already really expensive, and the fees that our clients pay to file an application, to take modest extensions of time are pretty significant already, and we cost a lot of money, too. So that adds to it.

We also have a very active Federal Circuit Court that looks at patent questions and tends to confound what we thought were relatively clear rules, necessitating us to do exactly the things the Patent Office doesn't want, which is to file more prior art references.

And I say prior art; I never admit anything is prior art. Let them say that, but art references and the changes of the rules are going to necessitate that we either limit our disclosure to prior art to 20 references or start describing why we are not materially impacted by that art.

And that creates a mess when it gets to litigation down the road because we have spun those references, and we have made representations, or we have made admissions. Gosh knows what we have done.

MR. LONGWELL: Right. In Canada, for example, the activity in the Patent Office, unless it is fraudulent, is not a consideration of litigation.<sup>27</sup> So you can almost effectively suck a blow at the same time. You can tell the Patent Office one thing and get to court, and if what you said was not to your advantage, you can tell the court.

MS. DOBREA: Yeah. Whereas filing wrapper estoppel in U.S. litigation is a huge component.

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<sup>27</sup> See generally Damien McCotter, *Using Electronic Records in Patent Proceedings*, MONDAQ, June 6, 2007.

MR. LONGWELL: It complicates the process in the United States immensely where we don't have that in Canada or other parts of the world. It is a huge difference in cost. So cost per capita of obtaining IP in the United States is high and getting higher, whereas in Canada, it is relatively high, because we have a small population, but it is dirt cheap in China right now.

And you say, well, why would you file there? Well, China had no IP in 1980 and has an incredible amount of IP now.<sup>28</sup> Is it getting better? Yes. Where will they be in 20 years? Who knows, but it is likely only to get significantly better. The pace of their programs is astounding.

We can't get substantive rule changes through in Canada and are really needful in terms of changing IP law. We have a sit-on-your-hands kind of government approach to most of IP. Whereas in China, that's different.

MR. ROBINSON: Moving on to another kind of IP, I confess my own ignorance here, but I understood that Mexico has a trade secrets registration protection statutory regime in force, and we don't have that in Canada, and I don't think you have that in the U.S.

Has anybody had any interest in studying what the Mexicans have done? Under NAFTA, we were all supposed to provide a high level of protection for trade secrets, but it seems to me the only country that has done it is Mexico.

MR. LONGWELL: Well, I don't recall that the NAFTA treaty imperative – making us having equivalent treaties. We only had to provide comparables, and there was no obligation to add legislation. There were a lot of things grandfathered along the way in the way we were treating each other.

And I don't think I have heard of any study absent a registry for trade secrets. It is hard enough to get the trademark registry working properly, and that's something that is out in the open. So I would be very surprised to see a trade secret push.

PROFESSOR KU: In front.

MS. DOBREA: Douglas first and then –

DR. BARBER: I just want to ask a question about the defense of intellectual property claims, and I suppose it is a question probably principally about the trolls, and the trolls are probably not a big factor in entrepreneurial activity because they go for big fish, not minnows. Nevertheless, it ricochets into smaller companies, and I guess my question is: it seems as though, at least when you get into the courts with these trolls, which I have been involved in a number of times, that prior art doesn't seem to matter very much, and, in fact, they have settled out of court, recognizing that you may have a very low probability of making a case on prior art. And if you lose the case on prior art, your costs go way up because you can get

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<sup>28</sup> See generally *Under the Dragon's Breath*, BUS. & FIN., Sept. 27, 2007.

into penalties and all sorts of things. So, in fact, the trolls thrive on settlements, out of court where actually the owners of the IP or the people that are debating the IP believe that it has been a long time in practice, but that the prior art is so well established that they can't believe that this is even on the docket.

MS. DOBREA: It is transaction costs. I mean, quite simply, if you really feel you have a slam-dunk case, that you can blow their patent out and want to at least make a run at trying to do that, then I imagine that would make sense. But it is probably more likely that the troll just wants to exact a fee that falls just shy of what it would take to litigate. "We want your litigation cost less the dollar," right? Assault their patent. But the analysis would be no different than if you are, you know, up against a nose-to-nose competitor who wants to blow you out of the marketplace. The analysis with respect to enforceability or invalidity of that patent is going to be the same. And, yeah, it is a little bit of a roll of the dice, just as much as an examination of a patent can vary based on how familiar the patent examiner is with the rules of the Patent Office and whether they really understand the technology, and that depends.

Then you get into a court, and you are going to deal with the same uncertainty. But the difference is that the party who is in the marketplace with you, who wants to blow you out, is not just going to take a little fee, whereas the patent troll, that's what they do.

MR. LONGWELL: Eventually, they are going to march down to the other fish. I don't think you march to the fish.

MR. SHANKER: Everybody up until now has spoken about how good it is to have entrepreneurs, which makes it good for our economy, et cetera. Well, if a patent holder chooses not to be an entrepreneur or chooses not to be a very aggressive entrepreneur, I have two questions. First, is there anything in our patent law that permits other entrepreneurs to force this person at least to license, to use that, and second, as a matter of policy, should there be?

MS. DOBREA: Very good questions, but the answer to the first one is no. I mean, the patent law doesn't expect the patentee to be – it is not like real property where you are making good use of the land and if you are not someone who comes along and does make good use has the potential opportunity to take over that land and have title to it.

It doesn't work that way unless the technology was funded by the federal government. Then through the Bayh-Dole Act and its implementing regulations, there is some probability to yank that out of their hands.<sup>29</sup> This is

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<sup>29</sup> See generally Sandy Kleffman, *Debate Grows over Return from Stem Cell Program*, CONTRA COSTA TIMES, Nov. 1, 2005.

one reason why the clients that I counsel, who are university clients, in licensing, have to make sure that, assuming we met all the other requirements of the Bayh-Dole Act, that the licensees are not going to set the technology on the shelf just to take it out of competition where there already exists an IP position.

And that's a difficult negotiation sometimes. But that's just the way it has got to be, and for their own best interest, they have to give some meaningful thought to delivering on that promise because someone could potentially invoke marketing rights and take the technology away from them if they don't try to commercialize it.

As far as whether, you know, there should be some change by Congress to address this from a policy standpoint, I don't know.

MR. LONGWELL: Canada does have a compulsory licensing provision. So if you are not meeting demand, then there is a possibility.<sup>30</sup> You can meet all the criteria –

MR. SHANKER: Not meeting the demand of the marketplace?

MR. LONGWELL: Yes.

MS. DOBREA: So it is not just a matter of not actively commercializing it, but there is no other market alternative.

MR. LONGWELL: Yeah. There are a number of factors that are in place, that's right, but you can under certain circumstances infringe in a sense and pay a royalty.

MR. SHANKER: Of course, yes.

MR. LONGWELL: Yeah.

MS. DOBREA: No one mentioned this and we didn't really talk about it, but in the trade secret context – and it plays into what you just mentioned – just from a policy standpoint, higher using rights – there is pending legislation. Where the heck it will go, nobody knows, but there is pending legislation to create a safe harbor for prior users who are using, practicing secrets technology, whether it was a method or a composition embedded into trade secret because right now there is no right if you have a product.

I had a client recently who had this issue. The product was in the marketplace for over 30 years, and he maintained the formula as a trade secret, and a couple years ago – and just came to the kind of attention, if you don't go into the market for them, that one of their biggest competitors got a patent on that. And we analyzed it from a bunch of different fronts and concluded that it is entirely likely that the competitor derived the invention from our client, and the paper trail is that they submitted to the EPA this same information that our client submitted 30 years ago in order to put their product on this marketplace.

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<sup>30</sup> Michael I. Davis, *Uniformity Flows from IP Treaties and EU Law*, 19 NAT'L L.J. 37 (1997).

That's not proof, but we have some reason to believe if they ever try to assert their patent against our client, that we could take them down on a number of fronts. But there would be a big transaction associated with just doing that, and the client was stunned. How could somebody stop us from doing what we have been doing for 30 years, and the answer is there is no clear answer. There is case law. There are a couple of lines of case law.

One case law says you will probably be okay because it is putting that thing into the marketplace, and the possibility that it could have been reverse engineered would constitute a disclosure versus the case. Well, if you have a secret method in the current text agenda, we have got an executable code in the software package that is not being sold. You are allowing access to the sort of fine line, is there a disclosure.

Can anybody possibly reverse engineer, figure out what we are doing there, and if the answer is no, then it has been effectively maintained as a secret. Therefore, there was no prior art against that latecomer patentee, and therefore, that latecomer patentee can stop you.

So while trade secret is a perfectly appropriate and viable IP to put in your basket – an IP component to put in your basket of rights, there are some risks, and if the law doesn't change on that front, then there is risk it will continue and is an indication to spend a lot of money on your lawyer some day to try to sort that out.

MR. CHERNIAK: I don't know if this is a fair question or not, but I find a whole universe of patents – that patents are becoming much more abstract, much more technically focused, much finer to distinguish from other prior art or other innovations, particularly in the software world. Are you finding that you are having to tell your clients, who are maybe software clients, regardless of the strength of their patent, they will have to expect going forward to run into other patents on technologies that will converge, even stuff that is fairly distinct today, you may patent a chunk of a process, that new technologies could end up in somebody else's back seat. Are you having to tell small entrepreneurial clients today to be prepared for that kind of thing and to have the funds to defend that kind of thing? Again, I don't know if that's a fair question.

MS. DOBREA: There are a lot of private art areas. And every once in a while there is an innovation that comes along where you look at the patent landscape, and unless there is something that hasn't been published yet, there is nothing there. Okay. That's good. That's really good from a freedom to operate and from a patentability standpoint.

Now, maybe it is because there isn't enough to waive the disclosure so nobody is going to get a patent. But that's really seldom the experience. In Europe, we are, at least, taking disclosures that are in art areas where there is again the university researcher side. There is a whole host of publications

that, at least, lead up to and are, you know, fodder for the patent examiner to try to make out a case of obviousness.

But there are plenty of disclosures where either there are a lot of different patents, lots of different ways to try to solve the problem that come off with those few that our inventors come up with, and that's where the cost really is involved because you can't tell them there is nothing there, and you can't tell them that what they have come up with isn't the solution that is wanted in the marketplace.

But we are going to have to find a way to deal with these patents that are found, and it is simple enough to say the parties – maybe there is – maybe there is one party that owns five patents all in that space, never resolved the problem, but they may have a broad dominating set of claims that on its face the patent is valid.

If that party is able to be acquired or is willing to license, there is a business solution, so you can clear it up pretty quickly. If that's a huge nose-to-nose competitor in the marketplace, you know, they might not be so nice, but maybe they want to find a solution.

So maybe they want to find your solution. So maybe that's your exit strategy, is to get it into their hands. We always tell – almost always – tell inventors what they don't like. That's the reality. And the more they strategize and think about what to do, the better chance they have got at being successful.

Does that help?

DR. KING: Ray, one more question.

PROFESSOR KU: Okay.

MR. BROWN: I don't know if you have heard of the patent auction that has been proposed, but in Japan they are talking about a university-based patent auction system.<sup>31</sup> If you have heard of this, would this be a good thing for entrepreneurs or a bad thing?

MR. LONGWELL: I am trying to think. Is it a good thing or bad thing? It is not much different than homes that are real estate put up for auction. It is there. It is availability. It is an asset that should be freely traded. I can't really comment if it is a good thing or not.

Apparently, there are bargains to be had, and some people have been successful. If you read the promotions for these services, they have been successful, but I have not had experience.

MS. DOBREA: The real estate analogy is a good one. I can imagine that there are some points on which that analogy breaks down, but to the extent you have got a piece of real estate, to think of it as a real hard thing, then,

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<sup>31</sup> See generally Rick Merritt, *Bids Far, Few Between at First Patent Auction*, <http://www.eetimes.com/showArticle.jhtml?articleID=185301101> (last visited, Oct. 22, 2007).

however, you try to sell it, it is not going to change what you've actually got and not going to change what someone else has got.

It may alter the dynamics in the marketplace. It may make it harder or easier for someone else to be successful. It may overvalue or devalue property. It could with any other kind of property. It is not going to alter rights.

So is it good or bad? It is a shot at finding another way to meaningfully get technology transferred into the marketplace, and presumably if the buyers know what they are buying and have a plan to do something with it, then it is probably a good thing.

MR. LONGWELL: Just one last comment: The patent system is sort of like a bargain with the state. The idea is you disclose to the state which will present it and publish it as an application or as a patent, and we will teach the world how to use – to make and use – your invention with the idea that we are going to actually foster more knowledge; that we are going to create, put into some other entrepreneur's head a way to design around that patent right so that we are all smarter, so that we don't end up copying.

People say it is horrible. If there were software patents we would have no more innovation. Well, not actually, you would probably just have more copying because there wouldn't be any need to get around the patent.

So anything that brings forward the idea that there is more value to having a patent and, of course, being a patent practitioner, I think that is probably a good thing that people recognize what they are good for and how they can be used. So I don't really have a problem with auction.

PROFESSOR KU: All right. On that, I would like to thank Jim and Diane and also comment that, one, patents can be very valuable and serve these purposes, but then, Diane, your troubling comment that you often feel like you are telling inventors, no, they can't do these things or raising these problems.

MS. DOBREA: And, you know, because I try to deal with the inventors in a very business-like fashion, I try not to be the lawyer that says you can or can't do these things. The better they understand the landscape, the better they can make decisions. They are real.

Somebody has a patent that is in their space, it is real. Now, maybe you look at it and know who they are. You know you are not really directly in their competitive market space, and they will never come and do anything to you, but if you don't know they are there and they send you a cease and desist letter and you just spent millions of dollars on packaging and marketing and distribution just to pull that out and never be able to sell one product, that would be a pretty rude awakening.

So I don't tell them what they can or can't do. I tell them what the landscape is and help them to make strategic decisions.

PROFESSOR KU: Thank you both very much.

CAPITALIZING ON THE SUCCESS OF ENTREPRENEURSHIP:  
IPOS, PRIVATE SALES, TAX ASPECTS, RESIDUAL INTEREST  
OF ENTREPRENEURS AFTER SALES OF IPOS

*Session Chair – Richard Gordon*  
*Canadian Speaker – Anthony Penhale*  
*United States Speaker – Elizabeth Dellinger*

INTRODUCTION

*Richard Gordon*

PROFESSOR GORDON: Henry isn't here, and I may be the person who will start things off. I am Professor Richard Gordon. Those of you out there who are – and I guess down here as well – who are lawyers and not yourselves entrepreneurs, I don't know if you have had the same sort of reaction that I've had the past couple of days, hearing so many successful entrepreneurs speaking. I haven't even thought of myself as a lawyer, but as one of those other "L" words – "loser," because I haven't made a gazillion dollars and lost it and made it. And I am hearing constantly the descriptions about how special entrepreneurs are, and I have been feeling increasingly, well, diminished, I guess would be the best way to put it.

I was a tax lawyer when I was in practice, and I am very pleased – I was actually pleased to hear the previous panel as well because there are – we are hearing about the value added lawyers can bring to the process, specifics, and that made me feel a little bit better as a lawyer, talking about some tax issues, and that made me feel even better as we turn to what lawyers really do.

We are also getting to the fun part, which is capitalizing on success. That's always a good thing. So I am not going to actually make the introductions because I don't know either one of our distinguished panelists, although I know they are distinguished.

## UNITED STATES SPEAKER

*Elizabeth Dellinger\**

&amp;

## CANADIAN SPEAKER

*Anthony Penhale\**

MS. DELLINGER: Great. Well, my name is Betsy Dellinger. I am a partner at a law firm here in Cleveland by the name of Baker Hostetler. I chair our private capital practice. What that really means is my practice involves representing venture funds, representing startup businesses, representing what I often call emerging growth companies, privately held companies and basically working all sorts of capital formation. You look at a business, look at their capital needs, match up the two, do the legal work, do a lot of strategic counseling and let the companies grow but stay out of

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\* Elizabeth Dellinger focuses on transactional, capital formation, corporate and contract work for privately held companies, capital restructuring, executive contract and strategic business counseling. Her clients include investment fund portfolio companies, manufacturing, healthcare, aerospace, insurance, bank and non-bank providers of senior capital and institutional and individual providers of mezzanine and equity capital. Ms. Dellinger represents clients in capital restructuring and workout transactions, as well as counsel to secured lenders, equity stakeholders and corporate constituents. She is also active in the Negotiated Acquisitions Committee of the American Bar Association's Business Law Section.

\* Anthony Penhale is a partner and a member of the Business Development Committee in the Montreal office of Stikeman Elliott and a member of the Corporate/Commercial Group. His practice is focused primarily in the areas of securities transactions, corporate finance, mergers and acquisitions, privatizations and divestitures. Assignments have included advising a broad range of issuers and underwriters in the context of public offerings and private placements, counseling issuers in connection with securities matters, and advising entities in connection with public market or private acquisitions or divestitures. In addition to Canada, his work experience includes transactions in the United States, the United Kingdom and Eastern and Central Europe, particularly Hungary where he was seconded for a period of six months. Mr. Penhale is featured in the publication *The Best Lawyers in Canada*, 2008 edition in Corporate Law and Securities Law. Mr. Penhale is a member of the Quebec Bar, of the Canadian Bar Association and of the American Bar Association. In addition, he is a member of the Association for Corporate Growth.

their way and then helping them exit and realize on to other potential businesses.

Anthony will introduce himself, and then we will give a presentation where we sort of lead off, go back and forth between us and feel free to jump in with questions as we go.

MR. PENHALE: My name is Anthony Penhale and I am a partner in the Montreal office of Stikeman and Elliott. I principally deal ultimately with the tail end process of what we are talking about, once the company has been taken public or bought or sold, typically bought by somebody bigger or private equity in this context.

Our offices are throughout Canada, mainly in Toronto, Montreal, Vancouver, Ottawa, Calgary; we deal with a number of different capital raising functions and obviously a lot of tax planning for which I must put a disclaimer right away – I am not capable of explaining anything correctly when it comes to taxes.

MS. DELLINGER: We have a number of slides here, and I will loosely follow them. I will start with this one, “*Capitalizing on Successful Entrepreneurship: When and How*.” On the “when,” there are two times when you, as an entrepreneur, will not capitalize on your success. The first is when VC (venture capitalist) money comes in to fund the growth of the company.

Venture capitalists put a lot of money into the company, but they don’t want to see it spent on the management. They want management and the founders of the company to be tied in closely with them as co-investors in the growth of the business.<sup>1</sup>

The second instance in which you will not be able to capitalize on the success of your entrepreneurship is when some form of cash compensation is being drawn from the company during the growth stages of the business. I think entrepreneurs are uniquely the hardest working people out there for the lowest relative compensation, because their opportunities to realize success come closer to the back end of their activities than at the front end during the course of the entrepreneurship.

That said, in this presentation we really want to address when an entrepreneur will experience success and how best to achieve it. There are three basic categories of exits from a company. A liquidity event is really the definition of how the entrepreneur realizes the success of the business. As I say this, bear in mind that there could be two types of entrepreneurs growing the business coming in to a liquidity event. One is the person who started the company, a family-owned business that is now looking for an exit. The other

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<sup>1</sup> See generally DAVID GLADSTONE & LAURA GLADSTONE, VENTURE CAPITAL HANDBOOK: AN ENTREPRENEUR’S GUIDE TO RAISING VENTURE CAPITAL 103 (FT Press, rev. ed., 2001) (discussing how a venture capitalist evaluates management).

is a venture capital funded business. When venture money comes in, the control shifts in a variety of ways and timelines are sometimes more predetermined by the fund's particular commitments to its investors and when the fund plans to withdraw from its investment.<sup>2</sup> So these factors can have a bearing on what the exits are and how they happen.

Liquidity events can occur first in the form of a private sale. Such a sale could be to a strategic buyer, to someone else in the industry, or to a more mature equity fund or second state venture fund. Second, they can occur in the form of public sales, typically called "initial public offerings," or IPOs. A third type of liquidity event is a recapitalization event. We will drill down on each of these a bit, but recapitalizations are basically a way of selling part of the business and holding on to another part as the business continues to grow.

MR. PENHALE: All right. Just before you move on, there is perhaps a distinction we can make between what I think is a reality in the Canadian market in contrast to the U.S. market. In the Canadian market, at least in Quebec, if you look at the 50 largest companies, you would not be surprised to find that two thirds of them are either controlled by a group of shareholders – public and private – or controlled by the family that actually founded them.<sup>3</sup>

I remember a number of years ago we were involved in a cross-border IPO-related transaction. Our firm had been retained by counsel for the underwriters, and we had the U.S. counterpart. We were looking at a structure involving dual classes of shares, and you had half of the table literally scratching their heads trying to figure out why there would be one class of shares with more votes than the other class. How could you possibly take this to market and what had you been smoking to think that you could? And that's a reality. Increasing the market of people investing results in investors' recognition of all sorts of governance issues to do with a class. Still, even in an established public company in Canada, it would not be rare to find that there is a controlling shareholder, group of shareholders or family, who play a key role in decisions pertaining to liquidity.<sup>4</sup>

MS. DELLINGER: I will also add, and this ties into what Anthony said, that it seems to me after having practiced law for 20 years, that over that period of time, the exits for privately held companies, whether by private

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<sup>2</sup> See generally PAUL GOMPERS & JOSH LERNER, *THE VENTURE CAPITAL CYCLE* 346-347 (MIT Press, 3d ed. 2006) (1999) (discussing the exiting of venture capital investments).

<sup>3</sup> See generally Andrea Jezovit, Marlene Rego, Zena Olijnik, Andy Holloway & Tom Watson, *The Big 50*, CAN. BUS., May 21, 2007, at 28 (describing the top fifty Canadian businesses).

<sup>4</sup> See generally John C. Coffee, Jr., *The Future as History: The Prospects for Global Convergence in Corporate Governance and Its Implications*, 93 NW. U. L. REV. 641, 688 (1999) (discussing the potential for controlling shareholder threats of lost liquidity to public shareholders).

sale, public sale or otherwise, have almost become commoditized somewhat.<sup>5</sup> Nowadays, someone declares, “Well, I am thinking about selling my business,” and all of a sudden someone else jumps out in front of them and says, “Here are the three ways you can do it. Here are the valuation models and the agreements you are going to need, and this is how you are going to sell your company, and we also have a list of the 50 best candidates to sell your company to, and we are going to narrow that list at auction.”

There are virtues to that because, in some respects, that makes the market more efficient and some of the auction processes that have been created by investment banks, large or small, tend to increase valuation. On the other hand, when something is commoditized, there may be something lost in that process, too.

There is one thing that I always encourage an entrepreneur to do: look at the whole package of options, listen to what the professionals have to say, and pay close attention for the option that sounds prepackaged. They might be selling to the company you can compete with versus what is really, really important to your business that may look for the particular value proposition your business offers and really help promote that piece of it and actually got lost in the process.

The first method of exit that we will focus on is the private sale. There are two types of potential buyers out there when dealing in private sales. First, there are “strategic” buyers, who are people in the industry or companies looking to buy companies and equity funds.<sup>6</sup> Second, there are equity-fund buyers.<sup>7</sup>

It used to be that you had venture capital, and then you had traditional equity funds and it was somewhat uncommon to have an equity fund sell to an equity fund. The opposite is true today. Now this is one of the most common types of transactions being made.<sup>8</sup>

The other word you see flying around in the media is “hedge funds,” but from the entrepreneurial company standpoint, an equity fund and a hedge fund are really the same thing. An equity fund is a pile of money that is

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<sup>5</sup> See A business broker directory: Connecting business buyers and sellers, <http://www.businessbroker.net/> (last visited September 27, 2007).

<sup>6</sup> See Michael L. Sklar, *A Full-Court Press to Sell a Business*, MERGERS & ACQUISITIONS J., (2004); see also, ANDREW DOLBECK, COMPETITION FOR DEALS: THE RETURN OF THE STRATEGIC BUYER, WKLY. CORP. GROWTH REP., (2006).

<sup>7</sup> See generally Martin Sikora & Joan Harrison, *Gusher on the Sell Side: Massive liquidity is fueling selling ardor and high prices*, MERGERS & ACQUISITIONS J., (2005) (discussing business purchases by equity funds and others).

<sup>8</sup> See generally Press Release, PR Newswire, Private Equity Boom Over: Firms to Look to Smaller Deals, Distressed Opportunities, Say Keynotes of Today's Dow Jones Private Equity Analyst Conference (Sep. 19, 2007), available at <http://www.prnewswire.com/cgi-bin/stories.pl?ACCT=109&STORY=/www/story/09-19-2007/0004666114&EDATE=> (noting a company's return to all-equity deals).

funded, either by individuals or institutions or pension funds, that is looking for a place to make money outside of the traditional public market series of private investments.<sup>9</sup> They are looking for businesses that can run themselves and make money on their money, versus the strategic buyer who is really looking to have innovative business with its current operations.<sup>10</sup>

MR. PENHALE: There can also be some confusion between strategic and financial buyers because they can strap onto one of their foreign acquisitions, causing a party that is seemingly a financial buyer to behave like a strategic buyer.

MS. DELLINGER: Certainly, and I have another slide that will address that very issue. At this point, I would like to discuss the valuation of a business. It used to that a strategic buyer would almost invariably pay more than an equity fund in a private sale because there were synergies of the strategic buyer coming into the transaction.

They had more ways to reduce the costs of the business so they would be able to pay more upfront because of these cost savings. By contrast, what you find now is that there is so much money in these equity funds that they are forced to put out that money. If they don't, then they have commitments from investors that they are not rolling into investments. Those investments then aren't getting a return on capital, and so that impacts the total rate of return that the equity fund is producing.

So the equity funds are really motivated to put money out there, and they are paying multiples for businesses that would have been unheard of a decade ago. Was that your experience?

MR. PENHALE: It was. We had a phenomenon that sort of mimicked that in Canada, and you may have heard of it. It was called "income trust" or "income fund."<sup>11</sup> This was an absolutely efficient flow-through mechanism that a company would buy based on a multiple of the cash flows, thereafter distributing all of its available cash from operations.<sup>12</sup> In return, it would get, instead of the traditional, let's say, seven times or six and-a-half times, that might be rigid and might turn on a sale, they would get closer to seven, nine, and sometimes 12 times, depending on the business that they were in.

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<sup>9</sup> See generally CLIFFORD E. KIRSCH, FINANCIAL PRODUCT FUNDAMENTALS §15:2.1 (Practising Law Institute 2004) (defining equity funds).

<sup>10</sup> See generally JOHN LELSIE LIVINGSTONE & THEODORE GROSSMAN, THE PORTABLE MBA IN FINANCE AND ACCOUNTING 595 (John Wiley and Sons 3d ed. 2001) (1992) (discussing how a strategic buyer seeks to integrate its operations with the purchased business); see also DUNCAN HUGHES, ASSET MANAGEMENT IN THEORY AND PRACTICE 70 (Lessons Professional Publishing 2002) (stating that an equity fund manager seeks to provide an element of income for investors).

<sup>11</sup> See JILL BOOKER, WEALTH MANAGEMENT AND ESTATE PLANNING 16-77 (CCH Canadian Limited 2d ed. 2006).

<sup>12</sup> *Id.*

But if you take seven and nine on a \$10 million business, there is an automatic pickup of \$20 million in value. So this was very, very lucrative. It disappeared, or at least it is going to be disappearing because the Government changed the tax scheme with regard to these entities last fall by announcing that they will essentially tax them as corporations, much as they started to do with partnerships a number of years ago.<sup>13</sup>

This was such an efficient vehicle to buy and raise money and it also offered the ability, which was uncommon in Canada until then, to basically sell 100 percent of the business to the public. Normally, you would have a retained interest or concern of flash-in-the-pan and dealers telling you, “Oh, you got to have some skin in the game, or we won’t buy.”

With the income trust, you could buy 100 percent of the business and ultimately have no retained interest. At least with the equity buyers that we were seeing in Canada, you also had to up their valuation because, to be effective and competitive, they would offer more than the seven times, closer to the nine, which upped some of the funds.

MS. DELLINGER: Before we spend another minute talking about valuation, it is important to remember that you are getting this from two lawyers, not investment bankers. The valuations in private sales hinge on two timely factors that influence what I see.

One is the nature of the business, the industry, and the uniqueness and value of its technology. The second is the size of the business. In a smaller company that makes sort of commodity widgets, if they are going to sell the business, they may be talking about a multiple of four or four and-a-half times EBITDA, which is earnings adding back in tax and depreciation amortization, so sort of real net earnings of the company.<sup>14</sup> With a really tiny company, you start talking about a one-time revenue, but that pertains to companies that are coming in at \$100,000 or \$200,000, and EBITDA. This isn’t a relevant number for that, but for a company that has an operative history, EBITDA is sort of the commodity measure of valuation with a multiple attached to that.

In a company that employs a little bit more groundbreaking technology, that is in a little bit of a sexier industry, and that is a little larger, you are going to find multiples going up six, seven, eight, nine times. With a company that happens to be the jewel of the marketplace, like an aerospace company, an industry that is hot right now, you will see larger aerospace

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<sup>13</sup> See Press Release, Canadian Department of Finance, Canada’s New Government Announces Tax Fairness Plan (Oct. 31, 2006), available at <http://www.fin.gc.ca/news06/06-061e.html>.

<sup>14</sup> GUY LYNN, A DICTIONARY OF ACCOUNTING AND AUDITING 342 (Xlibris Corporation 2005); see also Ben McClure, *A Clear Look at EBITDA*, INVESTOPEDIA, A FORBES COMPANY, April 24, 2006, <http://www.investopedia.com/articles/06/ebitda.asp>.

deals being priced at nine and-a-half, ten, 11 and 11 and-a-half times EBITDA.

Two years from now aerospace won't be in the limelight. It will be something else, but that's what we are talking about in terms of valuation. You want to talk about big companies versus little companies. If a company has \$100 million in revenue, for the purposes of this presentation, that is what I consider a bigger company. With something smaller than that, you don't usually get even a little ding on the valuation in my experience.

MR. PENHALE: Except we have a lot of media stock right now.

MS. DELLINGER: The agency I am working with has an aerospace company, and that is why they are so popular. I would like to toss this out. In a private sale to a strategic buyer that is in the industry and will fold the business into the company, oftentimes there is just no room for the seller's management. This is when you are talking about entrepreneurial companies, usually the founders of the business going into the new company. Or, it may be that the target company's management is so much better than the management of the existing company that they will displace them. But there is certainly no assurance that the founders, the founders' family members, or the founders' management will find a home, necessarily, going forward in the long-term with the strategic buyer. With the equity fund, the equity fund is a bunch of people who went to Wharton and Stanford Business School, Harvard Business School and are good at crunching numbers and investing money. They are not operating people, so they are going to need the management and the founders, if that's the case, to have the company run. At times, we find that they have high growth plans for the company that they simply can't achieve. The entrepreneurs have taken the company as far as they can, so they may bring in, and this would usually be negotiated, a new CEO or some other skilled management to help the company hit the next level.

Lastly, if it is done right and done well, it will benefit everybody.

MR. PENHALE: One of the issues you often hear about in public and private companies is that, under Canadian law, if your venture fund investors or fund investors have, in fact, negotiated that condition at the board level in any context, private sales will occur, and your board will be asked to look at things and try to disassociate themselves from those who put them on the board to do what is best for the corporation or the entity.<sup>15</sup>

And when dealing with management and management's role, let's say in the sales end, you are selling to strategic, and in fact, your best negotiator is a

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<sup>15</sup> See MEL GILL, *GOVERNING FOR RESULTS: A DIRECTOR'S GUIDE TO GOOD GOVERNANCE* 103 (Trafford Publishing 2005)

member of management, you are going to have a possible conflict with their own interest.

Whether they have a deal or not, they can get a deal or look at the world and think, “You know what, some equity is not a big deal. I will get paid now, some of the business now, get a three to seven percent stake and make money as a salary, and make money down the road if they stay as well,” and that’s their decision process and how they view a transaction.

In conflicts of board members, at least under Canadian law, you must do everything that you can to act in the best interests of the corporation.<sup>16</sup> That’s a big generalization, but it assumes that the interest of the corporation does not necessarily at all times equate to the interests of the shareholders or the majority shareholders.

MR. GROETZINGER: I wonder if you could comment on the appropriate time or an ideal time to be thinking about sales as opposed to looking for more money to grow the business, and let me give you variables.

One is a group of entrepreneurs who come up and finally arrive at a valuable patent issue but don’t have the money to move it forward any more versus a company that is up and running and has a positive cash flow for the last three or four years. What is your counsel on what is a good time to sell out?

MR. PENHALE: I am glad I am just a lawyer. That’s what the bankers do. You pay them the fees to make those calls. And you’ll notice that the bankers have to do ten deals just to get paid on one of them. So they are probably wrong more than half of the time. I don’t think you can say that there is an objective “best time to sell.”

I think if you were to come into my office and ask me what I ought to do in those two scenarios, we would look realistically at what your needs are, what the cost to get to that capital is, and how realistic it is for you to get that capital at a cost that makes sense for your business.

It is surely the reason for equity in the public market versus no guarantee that you are going to get the valuation you want or that you are actually going to get a deal. I know that way too many companies file a prospectus, and somewhere through the process they allege that this is not going to happen. And maybe you have an aggregate, a big banner for sale in your company, and you are not in the driver’s seat any more. So you don’t have guarantees.

You don’t have chances for success. You can’t equate automatically the perceived cheaper cost of capital or cheaper cost to get the capital at a public offering versus, let’s say, another round of financing, or an alternative round of financing. And maybe, if you are looking to get VC financing, your

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<sup>16</sup> See *id.* at 39.

advisor probably ought to tell you that you may not be in the market or look at aims and alternatives but not as one of the conditions to it.

I am sorry if my answer is sort of “everything under the sun,” but I think it is the best answer that I can provide under the fact patterns that you have suggested.

MS. DELLINGER: I would say that it is not uncommon for me to have someone in my office ask me, “Should I sell my company, and what’s it worth?” – the two weightiest questions in any business. The entrepreneur knows more about what their company is worth than really anybody else out there. You need to help me as a counselor to put some structure around that, to help determine that answer. The way I usually answer that question is, “Let’s talk about what your company is worth.” Then we would talk a little bit about common methods of valuation, a multiple, and what multiples might be out there for their industry.

What do you think it is worth? If the multiple of EBITDA comes out and the company is worth \$10 million and you say to me, “I thought it was worth at least \$25 million,” we know the answer. You think it is a \$25 million company. You simply haven’t gotten the operations up to support that number yet.

Hold on to it. Keep running it, and find some additional investment capital. If you say “You know what, I am 63 years old, I have two good years left, I have a house in Florida that is screaming my name, and I think the company is probably worth \$25 to \$30 million; traditional analyses can support \$18 to \$20 million.” Maybe, with some good massaging and a decent investment banker in there to help fair market it, you can get there.

But you don’t want to say I need to sell it in the next day. You want to give yourself a meaningful period of time for whatever weaknesses there are in the business, and then you can key it up for a possible sale. The other thing you can say is that “I think it is worth \$25 million; let’s go test the market and see what I can sell the thing for, but if I don’t get the money, I don’t want to sell it.”

That’s a very dangerous proposition because once your company is on the market, all sorts of things happen that are completely outside of your control. Your customers may say “I was happy dealing with John Smith, but I will not necessarily be so happy dealing with someone else.” Your employees may get nervous, and competitors may see it as a sign of weakness. Your competitors may come in and say, “I want to buy it,” and walk away with information on the company, notwithstanding disclosure agreements that they won’t do it.

So once a company is for sale, I think, the commitment to sell it really has to be there. So that is sort of how I look at entrepreneurial companies.

Are there any other questions at this point before we continue on? What’s next?

Public sales and IPOs. These are sales on to the public market. In my experience, and Anthony's up in Canada, setting aside 1998 to about the first half of 2000 during the internet boom when reality was set aside for a period of time, my experience is that entrepreneurial companies much, much, more often through a series of new investments, partial sales and ultimately private sales, didn't ever really go to do public offerings.<sup>17</sup>

The number of registration rights agreements probably number in the hundreds. The number I have ever seen exercised is zero. So this is an exit that you've got to plan for, and as you are negotiating a sale exit from your business, you are always negotiating against the alternative. This is one of those alternatives that you are considering pursuing or negotiating against so it is always out there. But they are talked about much more than they are used in my experience.

MR. PENHALE: That would be true in Canada as well and as I mentioned the income trust earlier on, but as a fallout of the burst of that tech bubble in early 2000, investors were shell-shocked, and they were not looking for growth any more on the price of the stock but for a monthly return in cold cash every month.<sup>18</sup>

The tax lawyers and bankers came up with a structure, which was really efficient for taxes, and that's the only time we ever saw people really looking at it as a viable alternative to build a public market as a new liquidity event.

MS. DELLINGER: I will add a couple other tidbits. In the United States, I mentioned before how much money is sort of sitting in equity funds looking for a home and for private sales and businesses. There used to be a gap, and maybe you could sell your company in an eight times or six times multiple in private sale and 20 times sale on public markets. You had to really look at that meaningfully, but as multiples for private sales have gone up and as public markets have come down a little bit, that gap really isn't there anymore to the same extent that it was. So you have the private money out there really looking for good deals, on the one hand.

Secondly, in the United States, you have Sarbanes-Oxley, and depending who you talk to, I believe the New York Times has a negative story and The Plain Dealer has it as a positive story, but that Sarbanes-Oxley has done a great job of giving investors confidence.<sup>19</sup> And companies are thrilled about it versus it being an extremely burdensome level of responsibility to comply

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<sup>17</sup> See generally JILL ANDRESKY FRASER, *THE BUSINESS OWNER'S GUIDE TO PERSONAL FINANCE: WHEN YOUR BUSINESS IS YOUR PAYCHECK* 286 (Bloomberg Press 2002) (noting that public offerings are an option for only a select group of entrepreneurial companies).

<sup>18</sup> See generally Raymond Fazzi, *Investors Get Down To Earth*, FIN. ADVISOR MAG., June 2002, (discussing investor interests after the technology boom).

<sup>19</sup> Jonathan D. Glater, *Here It Comes: The Sarbanes-Oxley Backlash*, N.Y. TIMES, Apr. 17, 2005, at 5; Alison Grant & Mary Vanac, *The Hefty Costs of Compliance: Small, Midsize Public Companies Hit Hardest by Sarbanes-Oxley*, PLAIN DEALER, Mar. 15, 2005, at C1.

with the greater corporate governance and the corporate oversight rules that have come around in the United States since Enron.<sup>20</sup> So that's an impact.

MR. PENHALE: I was just going to say we are lucky in Canada; we have the benefit of having you as a neighbor, you being the U.S. capital markets. So we can take a look at legislation like Sarbanes-Oxley and see how things go and how people react and tailor it in our own environment, which is predominantly control companies smaller market cap.

So Sarbanes-Oxley, or the equivalent in Canada, surely is a pain but probably is a good thing in terms of disclosure and enhancement of corporate governance without the cost of annual million-dollar fees to do it. But it is nonetheless an issue, and you have got to really keep in mind, even absent Sarbanes-Oxley, that it is a million-dollar extra cost per year just to be public.<sup>21</sup>

So when you are talking valuations, if you factor in the cost of compliance and the cost of reporting transference requirements, suddenly it may not be worth it to do it, and the private bar may have a strong incentive to convince you to settle in.

MS. DELLINGER: One other thing I wanted to talk about is that there are opportunities out there presented to privately held companies, and usually technology based companies, faster growth companies that are looking for, particularly, extra capital, and that is to merge the company into a shell public company.

If someone calls our firm and says, "We have a company doing a merger, we are going to become public, we are going to represent the public companies and would love Baker and Hostetler to work with us," those transactions are just fraught with issues. They are usually some type of sham because if you don't have a company that could really get an underwriter to support and do a traditional public offering, it is never going to have the benefits of being public on the public market. There is not going to be a market maker. There is not going to be anybody who really wants that stock. The investors are not going to find liquidity. Usually on the public markets, if there is not a buyer, you can't be a seller. So, I'm sure there are one or two out there that have been great successes, but there is usually something in there that we run away from screaming.

Do you have something to add to that?

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<sup>20</sup> See generally Alwyn Scott, *Board Members Debate Whether Reforms Have Cleaned Up or Glossed Over Problems*, KNIGHT RIDDER TRIB. BUS. NEWS, Oct. 3, 2004, at 1 (noting that executives were glad to have everything out in the open).

<sup>21</sup> See generally Mary Crane, *Are You Ready To Go Public?*, FORBES.COM, Nov. 16, 2006 [http://www.forbes.com/entrepreneurs/2006/11/13/goldman-sachs-morgan-stanley-ipo-ent-fin-cx\\_mc\\_1113goingpublic.html](http://www.forbes.com/entrepreneurs/2006/11/13/goldman-sachs-morgan-stanley-ipo-ent-fin-cx_mc_1113goingpublic.html) (noting the costs of going public)

MR. PENHALE: We do. Some are good; some are bad. We have the TSX Stock Exchange, and if you compare it to your large American counterparts, TSX venture is really a junior exchange, but you have a lot of shell companies in there.<sup>22</sup>

And it is really amazing, sometimes, when you are doing due diligence for a tech company to try and raise capital, and you find out they have all sorts of environmental issues because at one point in their life, they were digging for oil. They really don't know what they did for the last ten years because they did nothing because it had a liability, potentially. If there is a nice way of making a dollar quickly with little risk, they will probably find it. These deals are more often than not too capital and too costly to market. They are there. Still, sometimes this is quite a legitimate way to become a public company.

You may have a private company that is the object. We call that a "reverse takeover," or "reverse merger," and there is a real operating entity in both companies.<sup>23</sup> It is not just a shell.

MS. DELLINGER: Right.

MR. PENHALE: And you are buying an asset and paying with your securities, and control changes as a result of that transaction. That's one thing. If there is just a shell to use the listing, you probably have more than half a chance that it is not workable.

MS. DELLINGER: I wanted to –

MR. PENHALE: Do you want to talk about auctions before you continue?

MS. DELLINGER: Yes, let's do that. We sort of talked about valuation, and I am going to hit on a couple of things. Valuations in public markets have traditionally been much higher than in private markets, but that's really worn away in the last couple of years.

Management's role, if you do a public company, you have your value – you are selling your shares. You are not selling to another company that has management keyed up. So to the extent you have a management team, the entrepreneur who still likes to work and wants to work just keeps you in that position with more liquidity and then lock it.

In an underwritten public offering, what you find is that the underwriter will say, "Great, you want to take the company public, and in the long run

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<sup>22</sup> See Angel Capital Education: Toronto Stock Exchange Group Offers Options for Growth, [http://www.angelcapitaleducation.org/dir\\_resources/news\\_detail.aspx?id=136](http://www.angelcapitaleducation.org/dir_resources/news_detail.aspx?id=136) (last visited September 27, 2007).

<sup>23</sup> DAVID N. FELDMAN, REVERSE MERGERS: TAKING A COMPANY PUBLIC WITHOUT AN IPO 20, 252 (Bloomberg Press 2006); see also GUY LYNN, A DICTIONARY OF ACCOUNTING AND AUDITING 342 (Xlibris Corporation 2005).

not only do you have better capital for the company, but you also will be able to sell shares in the public market. But don't do it on our watch."

So you see these companies that go out, and the IPO says that its stock is worth \$50 a share and the stock jumps to \$75 a share on the first day and stays up there for a little while. Then it hunkers down, and six months later the stock may be at \$49 a share and seems to be pretty stabilized.

Well, 180 days is sort of the standard management lockup so management didn't experience any of that initial hype. And when I say management, I really mean the entrepreneur in the business. Instead, once the company has come out, they will have an opportunity to sell their shares, and I won't bore you with the methods into the public markets to get personal liquidity that way. But the underwriters will look so that often investors are coming in, knowing that the people who founded the business, who are running the business are tied up and committed to the business for that initial period of time.

MR. PENHALE: Right. And to that very same comment, this is very rare, at least from what I have seen. As I said before, they sell a 100 percent stake. You do a public transaction unless it was a buy, but if you are going to stock exchange markets or listing, you can pop at 45 or 60 percent depending what the underwriters told you the market could bear.

While there is some liquidity of selling, in fact, originally by your stake, the company raised the capital that you didn't really get as the entrepreneur. You have a new currency that you show your banker that you can value daily, but you don't have a dollar more in your bank yet.

And as Betsy was saying, you have 180 days before you actually get a dollar more, and then there are a bunch of rules that preclude you from getting that dollar when you want it. One of the things that I find entrepreneur managers don't do when they think they are taking their company public, is put themselves in the shoes of someone who invented something, actually went through the VC analyst, still has a stake in it, is still happy about the business, has done relatively well, and has got all the financial metrics aligned so that you can come and get your brokers to call you to invest in it.

And then you have a bunch of bankers and lawyers and people doing due diligence of everything under the sun again and again and again. We describe these individuals as crazies and, while creative, they are not patient, I can tell you that.

More importantly, don't underestimate their ability to manage the business. The toughest part I think for members of the management team, senior officers in the context of an IPO, is how unlikely it is that they are going to be able to manage the business as they systematically underestimate needs, wants, the timing issues and the requests that people will make.

We talked earlier about how extensive due diligence on the intellectual property might have been throughout the different phases of the life of the company. But, when you get to the time to become an IPO, suddenly, especially with biotech companies that I looked at in Canada, you need to have good answers to everything that was perfectly fine not to have answers to until then.

So thinking of a biotech company that may have a product that is ready to be commercialized or has been commercialized, has some sales somewhere in the world – and let's say was ten years in the making from the time, the two days for ten years, nobody bothered me more than half the time, and you guys are in my office for two weeks and are still not convinced, that is the biggest thing of management.

MS. DELLINGER: We sort of touched on this, and my first point up on the slide was, "issue or sale versus secondary sale." I feel I would call it an issue or sale. Basically a company sells its shares to a capitalist so that the company then has more money to do whatever the company does. Usually a good portion is used to pay down debt to the bank because the public market is more flexible and cheaper money.

MR. PENHALE: Which in Canada typically happened to be the parent of the underwriter doing the offering.

MS. DELLINGER: I read that, yeah, the relationship. Secondary sales occur when you have a public offering, but the company isn't selling a single share.<sup>24</sup> Rather, usually it would be a venture fund because the person is management, and everything is locked up as the venture fund sells its interest in the public market, so the company doesn't necessarily walk away with a penny. But the venture fund investor has now gotten significant liquidity by doing an IPO.

That decision to do an IPO is going to be driven on to the venture-funded company and in that example by the venture funds.

MR. PENHALE: As well as timing.

MS. DELLINGER: And timing, right. In the public market, it is a pickle. There are also many situations where there is a hybrid, there is primary sale of companies getting money to restructure the balance sheet and at the same time some type of institutional investor selling shares to the IPO.

MR. PENHALE: Just a little anecdote in passing: the decision to become public is also one where you have to advise the managers, the entrepreneur, and the seller of the business that they are now subject to a fair amount of scrutiny and transparency.

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<sup>24</sup> See generally University of Denver Sturm College of Law: Dialogue with Professor on Capitalization, <http://www.law.du.edu/wduong/Capitalization.htm> (last visited on Sept. 27, 2007).

By way of example, there was an interesting issue concerning a biotech company that I was involved with. You can imagine you had people working in labs all wearing white coats and the doctors and what not. Because it involved farm hands, farm hands won't typically command the same kind of salary as your researchers or work on the same range of your projects.

As in any good business, there were discussions among employees about how the researchers wanted more, and then the farm hands wanted more, and I am not trying to berate what they did, but it was classic. Of course, there was a good management reason for allocating more money to one individual over another, especially if one is doing research and is going to create a product while the other is taking care of goats. We prepared the prospectus with a nice glossy cover, and it has a stapled back, not a glue back but stapled, and the prospectuses are commercial copies that the dealer used to market, and there is a certain amount of pride involved.

So when it comes off the press – and this is a preliminary prospectus in Canada equivalent to your reds – boxes of it are delivered to the company and management, including the president and chief executive officer, who is a founder and is very proud to distribute this to all the employees to show how good it was to have stuck around, to be part of a public company, and all the pride that goes with the sense of success of your transaction.

Take that prospectus and sort of put it on your table, and let it open on where it naturally opens. Guess what page it is? Compensation of the five senior highest paid officers of which the one guy has been saying, "Oh, you know, guys, I can't pay you more," and suddenly – he is not drawing millions of dollars by any stretch but substantially more than the people he was convincing that they shouldn't take another hike in salary despite what he was making.

Now, my point on that, and that happens and it is not law, but you have to drop that point on to the person. Suddenly there is more transparency. Another example would be a company doing perfectly well. They have a process, have nice news, and they are in an environment that is competitive, and suddenly they have to put out their financial statements. And lo and behold, their customers are capable of basically figuring out what kind of margins this company is making and what kind of product they are buying from them. You look at what the competitor is selling them for, they realize it is all profit and start to tell you, "I want a better deal."

So yesterday your business was making, let's say, \$100 million dollars of revenues and not particularly hard to do because you had good customers buying from you, and today you have a hard time making \$60 because all of them retaliated, because they know how much you are making.

So that is to demonstrate that you have to be aware that you no longer can keep secrets, and we are not talking intellectual property here. We are talking what your business is, how it is, what I am paying you, the fact that you get

to fly on a company jet, how many times you want to do it a year, suddenly your neighbor knows that.

MS. DELLINGER: And now it is disclosed as compensation with the comp table.

MR. PENHALE: Right. The fact that you know you have got three houses that the company pays for you, your neighbors know that or the fact that you don't, also. Maybe you are CFO of a company that never allowed you to get those kinds of perks, and you live in a neighborhood where everybody thinks you do.

MS. DELLINGER: Yeah. So I think both Anthony and I have indicated: don't enter into the IPO lightly. I think that's the message there. One other exit that I wanted to touch on – and I will not spend too much time on it – is recapitalization. I always like to toss it out, and I said earlier, so often it is easy to have people say, "Sell your business in sort of a commodity type sale." The recap is unique to every business. I call it the method by which the entrepreneurial business owner can sell his business twice.<sup>25</sup>

It is sort of a hedging strategy, and there are different ways to do it. Basically, let's say you have a family that built the business from scratch, good business, still has good growth potential ahead of it, the family may be wealthy, but it is all part in the business.

The recap would be a way of basically being in, you know, selling a portion of the equity. It could be 20 percent, 80 percent, selling a portion of the equity of the company and keeping a portion of it to enjoy future growth.<sup>26</sup> So you are looking for a passive investor, some type of equity fund if you are selling equity.

Another way to do it would be to layer the company up with a lot of debt.<sup>27</sup> Usually, the type of debt you would be looking for, you have to make sure the balance sheet and the performance for the company can support debt service, but the plan is that the entrepreneur pulls cash out of the business in connection with some type of leveraged or equity recapitalization of the business.

But they still own a good portion of the business and can still run the business if they need to grow the business. Five years down the road maybe they are ready for a sale to a private company or an equity fund or even an IPO. At that point, they sell the remaining portion of it or at least another

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<sup>25</sup> See generally Barbara Pellow, *Vertical Marketing: It Starts with Market Analysis*, available at <http://www.ondemandjournal.com/specialfeatures/pellow59.cfm> (last visited on Sept. 27, 2007).

<sup>26</sup> Beth Fitzgerald, *Colleges Buy into Entrepreneur Classes*, THE STAR-LEDGER, Nov. 10, 2004, at 50.

<sup>27</sup> See generally Siseko Njobeni, *Funds Still Biggest BEE Start-up Hurdle*, FIN. TIMES INFO. LIMITED: EUR. INTELLIGENCE WIRE, July 21, 2006, at 15.

portion of the business and experience, you know, a second part of the business.

The opportunity here, you get virtually cash out of the business earlier on, and you don't have all of your eggs in one basket.<sup>28</sup> If the business continues to grow tremendously and commands a multiple twice what you value the recap at, you will be kicking yourself down the road when you sell the second half and you realize \$100 million, but now you realize it could have been \$400 million.

If the business gets eaten up in the market or has competitors coming out of the woodwork and that performance in the second half as opposed to recap is less than you expected, you may be thanking your stars. So it is something that when I think I want to sell my business and, do you want to keep it, do you want to let go, it is something very much worthwhile exploring. Not every business can do one because it has to be something that you can layer debt on. It has to have through the asset base, has to be attractive if it is a leverage recap or has to have appeal to an equity fund, but it is something out there worth considering.

MR. PENHALE: It also could be worth it to think about a situation where you have, let's say, two partners 50-50 and they don't see eye to eye on the direction of the business or what it ought to be. Sometimes coming in what we would coin a thin ledge minority position puts a third player in. He gets some money out, allows them to enjoy life a little more perhaps and maybe also having a third person split some of that, well, I guess not seeing eye-to-eye and using debt in that context, convertible debt or debt that is an equity kicker can also prepare – further the interest in the business.

MS. DELLINGER: I want to make one comment on valuation in a leveraged and a debt heavy recapitalization. It is almost as if you don't have to figure out the true enterprise value or equity value of the business in a recap when you bring in debt because debt is going to look at pay me back with the rate of return that I am looking for.

If they wanted to move, trying to estimate some type of return on their equity, they want to get a good deal, but a debt is a fixed return instrument as long as they can cover those, going to be an ability to pay it back, fixed return and repay the principal. You can layer it that way.

So the true valuation, never going to be arguing about that, and that can have some pros or can be sensed there is really no way of valuing it or not prepared to hire an investment banker to do it, or you don't think the market, private or public, is going to respect what you think it is worth and this is another option.

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<sup>28</sup> See generally University of Akron School of Business Administration: Entrepreneurship Program, How to Get Financing, <http://www3.uakron.edu/cba/fitzgerald/startbusiness/financing/debt.htm> (last visited on Sept. 27, 2007).

This is a little bit of a recap. Private sales, pros and cons, I think the pros include flexible structures. The company can be very flexible post-sale and not subject to the scrutiny we have been talking about.<sup>29</sup> They are likely faster to be put together than any type of public offering.<sup>30</sup> No public reporting.<sup>31</sup> I am still in the limited shareholder group so you can still pick the partners in a private sale potentially as a seller if you choose who is going to be your buyer. Cons: there might be a lower valuation, I am not so sure. You know, future management, strategic buyer, there may be some displacement that goes on; access to future capital, not in the public market.

So if you want to go to public market for capital, you have to do an IPO at that point.<sup>32</sup> And probably the one that should have a star next to it, if you sell your company at private sale and you roll over, an entrepreneurial rollover the equity into the company, there is no public market liquidity,<sup>33</sup> so whatever shareholder agreement terms you have negotiated, that's now the terms you are going to be subject to for the next liquidity of the business,<sup>34</sup> which at this juncture is not within your control.

Public sale IPO, I think we hit the points here. Pros include a potentially higher multiple. Shareholder liquidities,<sup>35</sup> a number of bells and whistles, but it is out there. Continuing role for management, and you know once the company is public, it does have access to both the public debt and the public equity markets.<sup>36</sup> The cons include public scrutiny, the lockouts, and you are now subject to the whims of the market.<sup>37</sup>

MR. PENHALE: Yeah, you also probably tend to shift to a quarter view as opposed to the longer-term view, or at least you have the pressure to do so, which you never had to deal with before, just reporting and dealing with the analysts. On the pros, perhaps a new currency. If you are going quickly or sustaining growth, perhaps you can use your equity to finance that growth, either by financing or by using it to pay the consideration of any acquisition.

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<sup>29</sup> *Swapping Privacy for Growth*, 68 CAN. & WORLD BACKGROUNDER 6 (May 1, 2003).

<sup>30</sup> *Id.*

<sup>31</sup> *Id.*

<sup>32</sup> See generally Kristen Hays, *Oil Vessel is Designed to Ride Out Hurricanes: Houston-based Firm Going Public on Strength of its Innovative Platform*, HOUSTON CHRON., Aug. 27, 2007, at 1.

<sup>33</sup> See generally Fred Baldassaro, *Economy, 144 A Surge Drives Private Market to Shatter Record*, CORPORATE FINANCING WEEK, March 2, 1998, at 1.

<sup>34</sup> *Id.*

<sup>35</sup> See generally Laura Slattery, *Investors Deal in Shades of Grey as IPOs Loom*, IRISH TIMES, July 21, 2006, at 7.

<sup>36</sup> See generally T. Prescott Kessey, *Energy Finance 101*, OIL & GAS INVESTOR, June 1, 2003, at 5.

<sup>37</sup> Andrea Knox, *High Costs Send Dupont Out of the Drug Business*, PHILADELPHIA INQUIRER, Dec. 15, 2000, at C01.

Although perhaps with a little less relevance these days, maybe it is a means to attract and retain personnel that you couldn't afford to have before.<sup>38</sup> I say a little less because there are issues, options that we won't talk about, but it is still a way to align interest in your managers with the long-term growth and viability of the business.

The cons, one that does not appear on this list, there are costs to be public. There are real-time resources and real dollar costs. If you pick up a prospectus of any Canadian company in terms of the last five years, we did a lot of income trusts. This was a booming business, and there is also a line on any performer's financial statements of administrative cost.

The average is probably a million dollars a year, some two, some 700 but paying a million dollars is a lot of money every year to take off your top line to pay to be public. Sometimes you don't think about it, but it is a real cost. It is not money you are generating.

I am happy because now I have been retained to help you in your disclosures. I probably have the lead – the best interest in serving public companies when they do disclosure stuff, but I am not a profit center for them at all. I am a real expense. My tax partners are good because they help them save money. I am just an invoice.

Why do I need to say this again? Why do I need to explain it five times, and how many risks can you possibly think somebody would have to face for an investor?

Nobody has thought of his or her business like that before, and there is risk allocation between this is what you are not allowed to do. Now, they need to worry about strike suits, or if I miss one quarter, what's going to happen? Somebody is going to sue.

MS. DELLINGER: Right.

MR. PENHALE: It is more prevalent in the United States than Canada but nonetheless an issue.

MS. DELLINGER: In the U.S., obviously, you know, the legal fees increase for companies dramatically, but that's nothing compared to the accounting fees under the new rules. So you have those issues. The equity, you know, for finance that is newly public, an issue that came up pre-going public, it would be: we don't have to worry about that.

I know theoretically it is a risk, but nothing bad is ever going to come of it, and you know, I am comfortable even if it will cost a few more dollars. Now, they had that reaction, but then they go, "Oh, it is disclosable," and call their securities attorney and have to go through a whole analysis and get 17 other people in the company involved in discussing and deciding whether

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<sup>38</sup> See generally Kansas Technology Enterprise Corporation, Initial Public Offerings, [http://www.ktec.com/sec\\_business/section/erc/money/ipo.htm](http://www.ktec.com/sec_business/section/erc/money/ipo.htm) (last visited on Sept. 27, 2007).

they have an incentive in the prospectus or the 10(k) or the 10(q) about whatever the matter is, and then they have to talk to the accountants in protecting the reserve and numbers and financial statements about whatever this thing that the business owner or the business CEO prior to the IPO never would have cared about because he knew in his heart wasn't going to be a real issue.

So everything becomes a little more complex. I have a client that did a public offering about a year ago, and now they just know they need general counsel in the company, and they have a lead management team, the last thing in the world they want but they know they need. So that's the consequence of the IPO from a mere perspective.

MR. PENHALE: And it is not a big issue, but sometimes it is. It breaks your heart when you are an entrepreneur and think about it. In the recap, you sell your business or maybe will sell it twice. Maybe the valuation has gone down between the first and second time and so be it, and maybe it has gone up tremendously.

And you say, "Oh, I never should have sold it at that price the first time." But you didn't do too badly. The trouble with public companies, however good you are, if you don't have a big stake in it, you are really making money for someone else. It is no longer for you that you are –

and suddenly you become a balance to all these people that have not done anything in reality.

They just bought a piece of paper from you, and a lot of the accountability I find is what entrepreneurs have a lot of hard time with. They talk to VCs, talk to the angel. They talked to whoever was the money before, but it was someone with a face and name and was a half dozen to dozen people.

It didn't matter what, but they were someone with a name who they talked to. But now it is the market. I never met the market, but I hear about it everyday, and that's also not to mention management earnings, quarterly reporting, and the whole focus shifts from just one number four times a year, and that's how the business was managed before.

MS. DELLINGER: A lot of companies post their stock price in their lobbies for all the employees to see. It is going good. It is a great motivator, and employees have small options. But the stock is going bad, and there is not a good explanation for it. It is transparent to customers and so forth, so we sort of beat up on that point.

Recapitalization, again summary: a great opportunity for partial liquidity.<sup>39</sup> Have continuing investment in the company. Sell the company twice. The complex structure, having it structured once you get the right

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<sup>39</sup> See generally *BASF Chief's Letter Makes Case for Offer Shakers Marketplace*, INT'L HERALD TRIB., May 24, 2006, at 3.

partners in place. I put it under kind of hedge strategy, that's a pro and con as I discussed.

To the extent that it is a leverage recap, a company bringing on something that is in debt potentially and debt services, by definition expenses, but, you know, if you run a spreadsheet type show, rates of return on equity, there is some point where debt dramatically increases the rate of return on equity, and it is more important where it inflows. So the trick is to get that right balance.

MR. PENHALE: You talked about debt a little bit. Now, you are dealing with a bunch of covenants you didn't have before. You know, if it is purely financed on debt, you may have someone saying, "Hey, you got pretax with X, and I am going to get the first slice of whatever you make." And suddenly, it may impede your ability to say, "What do I do in three months time or nine months or three years time when I want to build my business further, but I don't have the pre-capital on servicing debt?" That's also in there.

MS. DELLINGER: Right. Liquidity drive, who makes the decision? To the extent that the entrepreneur who grew the company on the back of venture capital funding, the venture fund will more often dictate the time line.<sup>40</sup> Venture funds will say we looked it to be an investment two to four years, two to five years, something like that.

It can be longer, but they are going to be looking for an exit, and that exit either is to sell the company outright or bring in another round of venture funding that does take out some of the old venture funds.

Second, whoever it is, however the company is structured, the majority owners in a venture-funded company may be the entrepreneurs, but the venture fund is really going to drive the timing.<sup>41</sup> The family-owned businesses, you know, the majority owners, at the end of the day can push the buttons and make the decision.

The deal terms, to the extent that the deal terms of an entrepreneur raising outside money dictated certain outcomes, quick rights, for example, on the part of the shareholder, that may drive a decision to sell the company. And then for non-venture-funded companies, basically market conditions, you know, companies that make X right now are incredibly popular in the market, it is a good time to sell.

I want to retire in three years. It is a good time to sell. Those can become the driver's on decision-making. Anthony, do you have –

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<sup>40</sup> See generally Getting Through the Initial Venture Capital Screen, <http://www.amplifiernetwork.com/tabid/93/ctl/ArticleView/mid/399/articleId/276/Default.aspx> (last visited on Sept. 27, 2007).

<sup>41</sup> See generally Susan Schreter, *Founding CEO Wants to be There at the Finish, Too*, SEATTLE POST-INTELLIGENCER, Dec. 2, 2005, at E1.

MR. PENHALE: No. Growth ultimately, the source of capital needs.

MS. DELLINGER: And this ties into the question you asked earlier. When do you sell? How do you make that decision? Management equity, this could be a long, you know, 17-hour discussion on tax. Luckily, Anthony, I am not going to do that nor am I competent to.

But management equity, the entrepreneur equity in a growth company at the time of the exit as we put it enjoying the successes of entrepreneurship, you look for liquidity. For cash, you look for liquidity to pay your taxes on the growth of the business. You look for liquidity to diversify your personal investments if all your eggs are in the basket of the company, and there may very well be an opportunity to continue investment options to continue to grow with the business.

MR. PENHALE: I would add one point as well. At least in Canada, when you are a private company, there is perhaps certain tax treatment afforded, for example, with options that disappear and are less advantageous when you become public or a certain transaction happens.<sup>42</sup>

So depending how you compensated your managers or the people you are working with, they may have a nasty surprise as a result of the transaction. So bear that in mind.

MS. DELLINGER: Yeah. And it is well before an exit strategy, and I will get this on the last slide, as an entrepreneur and management of a company you want to talk to and have advice from legal counsel and experienced tax advisors prior to making – putting your pen to any piece of paper in connection with the structure of this transaction.

One thing that is tossed out – and I am sure you have some comments – equity rollovers. A deal comes to the table, the entrepreneur and management say, “Oh, great. Buy my company, and put a little cash out and do a tax free rollover.”

I will say this: nothing is ever tax-free; it is tax deferred. The tax will always catch up with you, and the trick is to try to do strategizing whether to pay the tax now or pay it later. I want to touch on taxable first and then hit a couple things on the tax question. Taxable, taxable rollovers, what does that mean?

Basically, the entrepreneur taking his or her options, taking his or her stock, cashing it out and reinvesting some or all of that money in the business, buying together with a new private equity fund, buying stock of the company, taking some cash out and putting it right back in the company.<sup>43</sup> It

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<sup>42</sup> TECHNICAL COMMITTEE ON BUSINESS TAXATION, REPORT OF THE TECHNICAL COMMITTEE ON BUSINESS TAXATION (1997) <http://dsp-psd.pwgsc.gc.ca/Collection/F32-5-1998E.pdf>.

<sup>43</sup> See generally Gary Klott, *The Rules of the Game Have Changed: IRS Reform Legislation Allows Greater Flexibility When you Convert a Traditional IRA to a New Roth*, CHI. TRIB., Sept. 15, 1998, at 5.

can be structured a whole lot of different ways. You may never see a penny of cash hitting the balance sheet, but you recognize the tax, and you realize you pull cash out of that deal to cover the tax liability when it hits, which is usually on, in the United States, April 15th following the transactions, or there may be other taxes that are due.

You want to be very cognizant of that time period and, again, furnish rolling money over, save enough of the cash you got out and pay the tax. Tax-free transaction. As I said, nothing is ever tax-free.

MR. PENHALE: We generally don't use the word "tax-free." We say, "No immediate adverse tax consequences."

MS. DELLINGER: That's what the lawyers think about it out there. We have the investment banker selling something out here and have to be flexible. In terms of any type of, you know, tax-free structuring, I will give you an example: you have options in company A. Company A is being bought by company B. You end up with options in company B, and you think, "Great, I now have option to purchase stock in this new company that is going to grow faster and bigger and have a lot more confidence, is going to be dramatically more valuable going forward with more assurance of some type of liquidity on my personal horizon."

You want to consider a tax break and the timing of tax liability. A couple of examples: tax break. You have a situation where right now, if you exercise that option, you would owe tax on the spread. Let's say the spread is \$100 between the option to exercise price and the value. You know, your tax net U.S. federal income tax rate roughly is 35 percent at the federal side and close to 40, 42 percent with everything else.

You paid \$35 on that, but now you own a share of stock in that new company, and you experience capital gains rate on any additional depreciation at roughly a 15 percent rate. You should be able to run through some type of spreadsheets and projections and see whether you are better off recognizing that tax credit now, having less money to reinvest in the new stock because you paid your tax but then having future depreciation at a dramatically lower tax rate.

Second, let's say you have options. Your options are expiring. The company is not selling. There is no liquidity event. You can exercise your option. You roll it over into the new company. Now, instead of that \$100, the company has been successful, now let's say that gain is \$200. You have another six months left to exercise the option.

The company is likely to have a liquidity event in two years. Okay. What do you do? Do you let it expire and lose that \$200 in value, or do you exercise your option, not just for that one share, but for all the shares and now have a very significant tax event but no cash because now you own equity?

But you have no way of selling it because you don't have a liquidity event, and that's being between a rock and a hard place. So I counsel clients in any liquidity event, think long and hard about choosing to defer that tax liability if you don't have complete control on the ability to raise cash concurrent with the timing of any tax liability, and think long and hard about the tax rates.

Everyone talks about tax rates may change. They don't change that much. They have been in the same ballpark for a long time and fluctuate in margins. Capital gain rates historically will continue to be in my prediction lower than ordinary tax rates.

MR. PENHALE: And the same would be true in Canada with the added nuance that, if we are talking private company as opposed to public company, you may lose advantages or include it in the income deductions or lose some capital gain, depending when that conversion would be done, and that would be important to speak to your tax advisors just to make sure you are not setting up yourself with the nightmare situation where you have no cash and taxes.

MS. DELLINGER: I think the next slide covers what I crossed out before and nothing new here, but you always want to be – management equity, you want to think long and hard how you do it and look at the numbers, look at the tax rates, run those numbers ahead of time, and don't think tax free is the way to go because it is definitely not tax free.

It is just a question of when. I guess the last thing I want to toss out there – and these are a couple of U.S. issues – any time you're dealing with entrepreneurs, equity in a business, management equity in a business, any type of exit, private company or public company – talk to that experienced tax advisor and legal advisor. 409 and legal issues are what we call the new “deferred compules.”<sup>44</sup>

Let me just say the summary that my law firm has done on this is enough to fill a notebook this big, and that's a summary. And all the rules and regulations aren't out yet, and it has been around for two years. So it is a nightmare. Okay.

The 280(g) issues, these are references to the tax law.<sup>45</sup> These are payment concerns, and you think parachute payments, you make \$50 million a year and up, no? The standard is much lower than that, and then good tax planning in terms of the tax effect on any potential tax shelter that might be out there, it is something the tax consultant wants to think about.

MR. PENHALE: And if the deal only exists because of tax laws or you have, more importantly, there is no reason to do any kind of transaction, you

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<sup>44</sup> See generally Claude Solnik, *Another Glance from Big Brother*, LONG ISLAND BUS. NEWS, May 25, 2007.

<sup>45</sup> See generally *Executive Compensation*, 61 EMP. BENEFIT PLAN REV. 12, June 1, 2007.

want to look long and hard. At least in this, in Canada, it disappears at least when the authorities look at it.

MS. DELLINGER: Whenever people get tax advice there are about three levels of tax advice. One is: this is absolutely consistent with the Tax Code. The second category is: it is a little aggressive. It is an audit risk. If you get audited, it could be challenged. It could be restructured, and X, Y, Z could happen, which would not be quite as favorable as what we are hoping.

The third category is what I call tax fraud. You simply can't justifiably take that position and file your return, but if you are caught, you are in big trouble. I think that sort of comes under the tax plans.

MR. PENHALE: You have nuances like will, should, could. You have got a filing position but no chance in hell to succeed. Best aspect is to ask the tax advisor for the glossary and what they mean in their opinion.

MS. DELLINGER: Those are all really sort of semi-prepared remarks. I would like to open it up for questions.

MR. PENHALE: Just before you do so, I would just draw one comment on going public. Don't forget, at least in Canada, you are going to become liable for what's in the prospectus, and much like in the U.S., also, we have secondary market liability.<sup>46</sup> So whenever you add a sentence in the public disclosure document that you thought was great when you put it in the confidential memorandum and you are trying to put your company in the best light possible, they don't have to even show they read it, that they relied on it.

It is in the book and they relied on it, then you are liable if it is a misrepresentation. It is a long, hard exercise before you start going public, or once you are public, pay attention to what you are saying because it may be wrong, and if it is wrong, it may cost you.

PROFESSOR GORDON: I would like to open it up for questions.

MR. PENHALE: Yes.

#### DISCUSSION FOLLOWING THE REMARKS OF ANTHONY PENHALE AND ELIZABETH DELLINGER

MR. GROETZINGER: What's your thought on earn out clauses if a seller has a business and neither party can agree on the current fee price and agree on some downstream multiple of earnings? What would you recommend?

MS. DELLINGER: I think they are great. I think that if you have a company and you have a willing buyer and seller but can't just get together on price and earn out a wonderful way to bridge that gap and align the two interests, that being said, there are a couple of nuances.

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<sup>46</sup> Gloria Gonzalez, *Quebec Latest Province to Mull Corporate Disclosure Law*, 41 BUS. INS. 31, July 30, 2007, at 4.

One, they always are and they should be heavily negotiated because you really got – they are tying to the performance of the company, and you really need to tie down what everybody needs. For example, the line of business is sold, and if a business is bought into the company, how does that impact you? What do we really mean by net operating income? And really drill down and have a lot of detail in what that means, whether it is on a schedule, a separate document, purchase agreement, wherever, but get a real clear understanding of what's intended.

Second, they frequently litigate. Of all the things that get litigated in a purchase agreement, earn-outs and working capital adjustments are probably the two biggest ones, so you have to be prepared for that. Have more clarity upfront.

Litigation usually happens not because someone lied but because somebody didn't have the advice. So the more work done upfront, the better. You don't see it all the time, but I tend to be a fan if you have a good deal as having purchase price issues.

MR. PENHALE: I think you can bridge that issue, and just to reinforce Betsy's point, those I have been involved in two lines of agreement, by the time all the advisors were through nobody understood it, and it was two or three pages, and then we show the end result. And they told us that just doesn't work so implementing them, making sure they are going to get the results you want and making sure if you don't get what you want you can't actually have a leg to stand on to demonstrate what it was you thought you were going to get. That's not as simple as saying why don't I just bridge that value gap.

MS. DELLINGER: I have had several occasions where we started negotiating the earn-out net drives, and that's so painful for the party on the purchase price.

DR. BARBER: I realize in your presentation you were expected to talk about capitalizing on results of IPOs and private sales and things like that and the impacts of tax and so on. But I thought you might comment as well on a successful company paying dividends. That's another way of capitalizing on success.

MR. PENHALE: Yeah. I touched on income trust earlier on, and this filled a need in Canada for high dividend paying corporations. In fact, that's what they were. I don't remember the exact statistics, but with the Canadian companies that are listed in the TSX, a staggeringly low percentage pay any kind of real dividend.<sup>47</sup>

I mean, they pay a dividend perhaps banks and telecoms, but anything in excess of five percent, I think I would be impressed to find one more

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<sup>47</sup> See *Definition of Terms*, GLOBE & MAIL: REP. ON BUS., June 29, 2007 (“Recently, the average dividend yield of companies in the S&P/TSX Equity Index was about 1.67%.”).

depending on time of year. So as a venue for an investor, at least in the Canadian market, you are not going to get any real dividend. You may have some private shares but, ultimately, not the type that one would look to get the return on that income trust in Canada, which were paying anywhere, the best company seven percent. They were not so great at 18 percent.

They were great investments from that perspective, but we don't have the equivalent. We thought when the government announced they were going to tax these corporate entities now, we thought that one of the things that would happen, in fact, would be that they become great targets for U.S. private equity to buy them and spin them out in a couple of years in the U.S. market as a high dividend paying stock.

DR. BARBER: But that's normally after you have done an IPO.

MR. PENHALE: You could.

DR. BARBER: And I am saying, I know private companies that paid out a big lump dividend.

MR. PENHALE: You could accomplish that with your cash on hand on your profit or using a lead account, increasing level of debt and using the debt to do that.

MS. DELLINGER: I was going to say I had two or three categories; one company experienced growth. It is not looking to reinvest tons of money because it is very stable and a very comfortable business.

The money just flows out and sort of not well known because it is a privately held company, but the family, everybody is driving better cars. Everybody is wearing nicer clothes, and oftentimes one of the relatives is doing the payroll. It is a great way for an entrepreneur to amass personal wealth, and you can do that, and you still would have the business.

It is sort of like selling the business twice. It is sort of like a recap without the recap in some respects. You bring a lot of value out of the company. A recap is often structured with dividend, but that's really structuring technique.

One real life example of ours – and it is a public company now so if anyone wanted to backtrack, they could probably find it, that it is public, founded by a couple of guys around 1990 who grew the company, did it a number of times, sold it to an equity fund, the equity fund sold it to a new equity fund.

Every time management pulled out millions of dollars and then rolled equity back in, and they did that three times. Then this was the same company that the year 2006 did an IPO. However, three months before the IPO, the equity fund – that equity fund pulled out a \$200 million dividend.

Management's equivalent share resulted in about close to a hundred million dollars in dividend coming out for management. Then three months later they sold the IPO, and everybody pulled out a bunch more money in the IPO with the equity fund selling completely on the secondary IPO.

You know, so dividends are a good way of getting money out of the business. You make yourself a lot of money, running a lot of – not that it is permitted, but the number of expenses, business expenses – in fact, there is a lot of value channeled through that.

MR. PENHALE: On dividends and just anecdotally, I am involved where there is 50-50 shareholders, founded a company 30 years ago; in its great days had about \$600 million of revenue. Now it is about \$225. I have been involved with IPOs now for almost four years, and the purpose why I am involved is because they cannot agree on what they want to do with the business: buy it, sell it, refinance it.

It is a great business to go public with, but it is paying out between \$50 million to a hundred million dollars a year. The only reason none of them have done anything in terms of litigation, they really don't like each other, and it is amazing from my perspective this business can still generate the numbers it does when two guys who are running it supposedly because they are not really running it, they are bickering and fighting, are not involved, and you sit back and look at my counterpart on the other side and say why are we here?

Every year they pay themselves a hundred million-dollar dividend. If they weren't fighting and arguing – their managers are running it. They are just going to make plus or minus \$10 million more. Why are they arguing? Why are we here? Four years in the making, and they were paying each other dividends way before we got there. They don't talk to each other any more. They just get their check and go away.

PROFESSOR GORDON: Before we thank the panelists, I just want to mention that cocktails start at 5:30, and I guess dinner is at 6:30.

And I thank you all for today. Thank you very much, panelists.



## ENTREPRENEURSHIP: BUSINESS AND GOVERNMENT

*Session Chair – Charles Magerman*

*Speaker – Hon. Eddie Francis*

### INTRODUCTION

*Charles Magerman*

MR MAGERMAN: Good evening. Sorry for interrupting the dessert portion of the meal, but can everyone in the back hear me? Is the microphone working back there? I don't know. Thank you. It is working? I am getting nods from the back, so I think it is working.

If you haven't met me already, or if you weren't paying attention when we met, my name is Chuck Magerman, and I practice corporate and finance law with Baker & McKenzie's Toronto office, where I head up the corporate finance practice group in Toronto.

I have been asked, and it is my pleasure to be here tonight, to introduce the Mayor of Windsor, Eddie Francis, who will be making comments to you about – I don't want to steal his wind – but about entrepreneurship and about government and the relationship between the two.

If you haven't read the bio in the book, I may add a little bit to that. Francis was elected as a councilor in 1999 in the City of Windsor, and he was the youngest ever elected at age 25.<sup>1</sup> You can do the math and figure out how old he is now.

He was re-elected as a councilor again with the largest majority ever in 2000,<sup>2</sup> and you may wonder why was he elected in such a short period, but the 1999 election is a by-election.<sup>3</sup> And then he was elected in May 2003.<sup>4</sup> After he was elected as a councilor, he entered law school at the University

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<sup>1</sup> Speaker Biographies, University of Michigan: Ford School of Public Policy IPE 2006, [http://sitemaker.umich.edu/ipe2006/speaker\\_biographies](http://sitemaker.umich.edu/ipe2006/speaker_biographies) (last visited Oct. 19, 2007).

<sup>2</sup> *Id.*

<sup>3</sup> *PM Calls By-Election in Windsor-St. Clair*, CBC NEWS, Mar. 7, 1999, available at <http://www.cbc.ca/canada/story/1999/03/07/windsorbye1xn990307.html>.

<sup>4</sup> Biography of the Mayor, The City of Windsor, <http://www.citywindsor.ca/000087.asp> (last visited Oct. 19, 2007).

of Windsor, and he was called to the bar and belongs to the Law Society in Canada and here in Ontario.

Before politics, however – and this is what makes him especially qualified to speak to us this evening – he, together with his brothers, successfully built a pita bread company that grew. This is Royal Pita that grew and was distributing to twelve states and various parts of the province.

And I think he is going to tell us a few stories about that and his experience with that business. And you may want to know one of the questions we were dealing with this afternoon is when do you decide when it is time to sell, and when do you know when it is a good price, at what multipliers. You can get into that if you like, Mayor.

So the question is: will he be talking to us tonight about entrepreneurship, business and government as the topic reads, or will he be talking about entrepreneurship leading to government positions or how entrepreneurs can access government funding?

We have many choices, but I leave it to the Mayor, and I welcome you.

#### SPEAKER

*Hon. Eddie Francis\**

MAYOR FRANCIS: Thank you, Chuck. Thank you for that kind and warm introduction.

And I have got to admit right off the bat, as a politician, having someone copy each and every single word makes me nervous, but it is good to be here. And part of my discussion this evening will be a discussion focused on, obviously, entrepreneurs, and given my position as Mayor of the City of Windsor, how entrepreneurs play a role in the government if it does have a role to play at all.

But first and foremost, I would like to recognize and thank Henry for having me and inviting me here. I know that you had a great couple of days of discussion, and it has been a great program thus far. Now, it is odd for me to be standing here, and I told my wife I was going to be here speaking to

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\* Prior to entering politics, Mayor Francis ran and operated Royal Pita Baking Company. His operation's distribution quickly grew to include Ontario and 12 U.S. states. In 2003, he was awarded the Windsor Chamber of Commerce Business Excellence Award as the Young Entrepreneur of the Year. Mayor Francis graduated from the University of Windsor Law School in 2002 and articulated with Miller, Canfield, Paddock, and Stone. Subsequently, Francis was called to the Bar of the Law Society of Upper Canada. Mayor Francis also holds a combined Honours Degree in Chemistry and Biochemistry from the University of Western Ontario.

each and every one of you. Here you have an individual that was in private business as an entrepreneur, then became a lawyer and ended up in politics – eating chicken dinners and spending long hours and low pay that attracted me to politics. And I told her there is going to be a group of lawyers, and she said, “Good. Get one of them to represent you to sue you for being a fool to go into politics.”

To give you some background in terms of how it all became possible for me to represent the City of Windsor – which is a true honor, something I enjoy every single day – I attended the University of Windsor Law School, and I did my undergrad at the University of Western Ontario.

Doing my undergrad at the University of Western Ontario in chemistry, biochemistry in my fourth year, I had intentions of going into practice and to research. Growing up in high school and grade school, I was a student of the sciences, and that’s why I did biochem.

But my parents had emigrated here from Lebanon in the early 1970s; and they immigrated to Windsor. My father, after putting in his time in Kelsey-Hayes and some of the plants, he was trying to find a meaningful way to make some money and raise a family, and he discovered there was something that was missing in the Southwestern Ontario area.

There is a large Arab population, both in Southwestern Ontario as well as in Michigan and even in Ohio.<sup>5</sup> But all of them were still making bread in their own kitchens and their own ovens. So my father established the first pita bread operation in Southwestern Ontario in the early 1970s, and he only catered to the Arab population because that’s all he knew.

In the 1990s, he decided to retire. Here is an individual who worked 16 hours a day, seven days a week, and he decided to retire. He had no hobbies; he knew nothing else but to work. Growing up, we grew up in the family business, so when we wanted to see our family, we went to the family business to see them. When our friends were doing things on the weekends or having parties or taking in extracurricular activities, we were growing up in the family business doing what we had to do as part of our responsibilities. So he retired for two years and then decided to get back into it in 1997 as I was deciding where my future career was going to be after my undergrad.

He bought the building. He bought the machines. He was about to get started again, and then he fell ill. So I was asked, being the oldest, to come down and run the family business. I thought it would be a summer job, which

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<sup>5</sup> See Federal Electoral District Profile of Windsor West-Windsor-Ouest, Ontario, (2003 Representation Order), 2001 Census Map, Statistics Canada <http://www12.statcan.ca/english/census01/products/standard/fedprofile/RetrieveTable.cfm?R=FED03&G=35102> (last visited Oct. 19, 2007); G. PATRICIA DE LA CRUZ & ANGELA BRITTINGHAM, *THE ARAB POPULATION: 2000*, 4 (U.S. Dept. of Com. 2003), available at <http://www.census.gov/prod/2003pubs/c2kbr-23.pdf>.

was great. And growing up in the family business is not that hard, right? I grew up in it. It seemed pretty easy. The machines did everything, and the workers were there, distributed the product. It was just flour and water, and the rest is simple. After all, for years he had been making a living doing this; he had taken care of us, raised three kids, and provided for us. It can't be that hard.

So I decided to come down, take a summer leave, graduated from Western, decided to come down and run the business, and that's when I discovered something. I discovered that, although my dad was very good at what he did, my father was very smart at what he did. He only catered to one aspect of the market, and that was the Arab market. You can't blame him for it because he did a good job.

So my brothers and I decided that we could take this to the next level. And again, that was 1997. This is 1998. This is before the Atkins diet. This is before the carb craze. This is when people were starting to discover pita. McDonald's even had pita on the menu.<sup>6</sup> Subway was getting into flatbreads.<sup>7</sup>

When I went to school, when I was growing up, I was the only kid with a rolled sandwich where everybody else had these thick-layered Italian sandwiches. Nobody knew about pita growing up. But in the late 1990s, when we decided to get into the business, everybody was starting to discover the health consciousness and the understanding in terms of what pita was.

So my brothers and I wanted to exploit that. We wanted to take it to the average citizen. We wanted to take it to the Canadian and American marketplace, outside of the traditional Mediterranean-Arab marketplace. So we said we are going to do that. So we got the business.

We started running it, and we ran into a couple of problems. Back then, when we first started – I was 22 years old, my next brother Roger was three years younger, and Frank was 16 years old. We ran into some problems.

Growing up in the family business wasn't as easy as it appeared to be. We couldn't find anybody to supply us with our raw materials. The flour companies did not want to give a group of young guys a credit line. They didn't even want to supply us with product. The banks didn't want to give us money.

We were going to make a pitch to the Costcos, to the Sam's Clubs, to the Wal-Marts, to the retail markets. A 23-year-old kid sitting across the table

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<sup>6</sup> *But see* David Leonhardt, *McDonald's Can it Regain its Golden Touch?*, BUS. WK., Mar. 9, 1998, <http://www.businessweek.com/1998/10/b3568001.htm> (stating that Wendy's was using pitas as a way to compete with McDonald's).

<sup>7</sup> *See* Bruce Horowitz, *Subway Wraps Up Deal With Atkins*, USA TODAY, Dec. 25, 2003, available at [http://www.usatoday.com/money/industries/food/2003-12-25-subway-atkins\\_x.htm](http://www.usatoday.com/money/industries/food/2003-12-25-subway-atkins_x.htm).

from you, you are not going to take him too seriously. You are not going to give him shelf space in your retail establishment, especially with all the competition.

So we came up with a pretty innovative product mix. What we did was we were going to take pita bread to the next level in the sense of recognizing that it was not a specialty product. It is only flour, water, sugar, salt and yeast. You go to the store and buy a pack of five of pita bread, it is like four dollars. It cost us 30 cents to manufacture and produce it. Yet, people were still selling it at four dollars, and that's because people were treating it as a specialty product. So we said we were going to go with a product that was an accurate reflection of the cost. We were going to market it, fresh every single day, and produce the product and get the pita into the stores.

Again, to go back to my original point – we didn't even have the flour. I couldn't get the flourmills to supply us with flour. So we approached Costco, and we said to Costco – you have all been at Costco, right? You know Costco sells flour? So we said we are going to go to Costco, and we are going to say to Costco, “We need some flour. Will you supply us?”

And in return, we are going to ask them to carry our product for us. So we went into Costco, we scheduled a meeting. It was the biggest meeting ever, again I was 23, 24, right? Put on our best suits. This is our first pitch we ever made, and we go to Costco and said to Costco, we are owners of Royal Pita. We want to buy flour from you. In return, we want you to carry our product in all of your stores. We want access to all of your stores, and I am going to guarantee that we will buy flour from you. Costco said okay, sounds good. How much flour do you guys need? I said one bag a month.

That was exactly their reaction.

I said to them, though, give us a chance, and I promise you that bag will turn into something larger. Within a matter of months, Costco let us in. We got access to their stores. Within a matter of months, we took that one bag and turned it into 22 tons of flour a week.

Because of Costco we were able to get into other retail outlets, and because of that, we grew on that same type of formula. And from the very day that I started till the day I sold my business, Costco was the only supplier of flour to our business, although the other flourmills started coming around. We used 22 tons a week.

We grew up on the same type of premise – whether it was in Windsor, Ontario; in Detroit, Michigan; in Toledo, Ohio; or in Atlanta, Georgia – we went in with the same type of philosophy. We are going to provide you with the best product there is at the best price.

And what we were able to do from a Windsor location, from a Windsor plant, was produce 7,000 packs an hour, ship them down to Atlanta in less than 24 hours and out-compete the bakeries that were in the Atlanta area.

I could get my product – anybody from Atlanta here? Farmer’s Market? Are you familiar with Farmer’s Market? I could get my product to Farmer’s Market quicker and cheaper and in better quality than the bakery around the corner could, and that –

(Applause.)

Thank you.

But it just didn’t happen overnight. And I will never forget how we started because when we were doing the first Costco lines, remember we are a new product and showed up with four or five bags. We were delivering in our Ford Escort backing up into loading docks with these big competitors, right? You got the Westins and the Dempster’s in Canada.<sup>8</sup> Here you have different Wonder Bread companies that distribute.<sup>9</sup> So these guys were backing up and piling up stacks and stacks and stacks of trays of bread, and we are just walking in with four packs of bread, and we knew we were going to out-compete them. But that’s the prize of entrepreneurs, and that’s what you have heard over the past few days – an entrepreneurial spirit that gets you up and wants to make you compete and makes you want to do better.

That’s the same thing that led us to get involved in Royal Pita and also led us to get involved in our community. Royal Pita in Windsor, I got involved in the community. I will never forget, I was at a wedding a couple months before we opened Royal Pita, and we opened up Royal Pita on a street called Wyandotte Street. Wyandotte Street traditionally didn’t have a good reputation. That’s where all the drug dealers were, where all the hookers were, the prostitutes. That’s how we got a good deal on the building. We bought the building with the vision that once we buy this and establish this business, we were going to be able to turn around the entire community.

And the wedding I was at, I remember someone asked, “What do you do?” and I said we were about to start a business. They asked where I was located, and I told him, and just like the people at Costco, they laughed. But we got involved in our community through our business. By one entrepreneur locating on a desolate corner that others would not even pay attention to, it served as a catalyst for other entrepreneurs to do the same thing, because it only takes one. It always takes that first person to lead to the other investment, for others to follow.

I am happy to report, today Wyandotte Street is a whole different street.<sup>10</sup> In a matter of six or seven years it is now known as Mediterranean Row.<sup>11</sup>

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<sup>8</sup> *E.g.*, Dempster’s, <http://www.dempsters.ca> (last visited Oct. 19, 2007).

<sup>9</sup> *E.g.*, Wonder Bread, <http://wonderbread.com/index.asp> (last visited Oct. 19, 2007).

<sup>10</sup> *See A Closer Look at Wyandotte Town Centre*, NEWS LETTER (Wyandotte Town Centre Bus. Improvement Ass’n, Windsor, Ont.) Oct. 2007, available at <http://www.wtc.cc/wtccpage1.htm>.

<sup>11</sup> *Id.* *See also* Business and Retail Zones: Zone 1 – Wyandotte Towne Centre, Windsor-

You have tons and tons and tons of storefronts that have been filled now by immigrants that, otherwise, would not have filled them – from bakeries to retail stores.<sup>12</sup>

So what happened was, in 1999, as we were doing that, as we were developing that, we got involved in the community, and we were fortunate enough, my brothers and I, to be recognized by the Chamber of Commerce. I recognized my brothers because they still give me grief, to this day, because I take all the accolades – but we were recognized as “Young Entrepreneur of the Year,” and that was in February of 1999.<sup>13</sup>

In June of 1999, there was an opening on city council and there was a bi-election that was open. This is a true story. Because of the profile that was gained through the “Young Entrepreneur of the Year” award and our work in the community, I was on my way to do a product pitch, and I got a call from a reporter at *The Windsor Star*.

She asked me if there was any truth to the rumor. And I said, “Truth to what rumor?” She said, “You are running for Windsor City Council.” I said, “Excuse me, who are you again?” She said, “My name is Granell – my name is Margaret Granell from *The Windsor Star*.” I said, “I don’t know what you are talking about. Thanks, good talking to you.” That was it.

Next day in *The Windsor Star* there was my picture with 15 others “Rumored to Run.” Well, I thought about politics, but I never thought about running for politics. I was 25 at the time. I just applied to Windsor Law School and just received my acceptance into Windsor Law. So my career was to go practice law in the City of Windsor, go be a lawyer and contribute to the community.

But then, it happened again – same thing that I experienced growing up, the same thing I had to deal with starting Royal Pita – goes back to people not leading young people, they are not investing in young entrepreneurs, and I started to hear that he is good. And so I decided to run, and fortunately for me, we put on a strong campaign.

My campaign team was a campaign team of three: myself and two other brothers. The business suffered those couple months, but we put on a strong campaign, and we were not supposed to win.

But then, fortunately, I was elected to represent Ward 5,<sup>14</sup> which is the east end of Windsor. I wanted to apply what I learned through the business to Windsor Council, and I did that, but at the same time I went to law school. And then I became a lawyer, and I had a decision to make.

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Essex County Development Commission, <http://choosewindsor.com/source/html/comm/zone01f.htm> (last visited Oct. 19, 2007).

<sup>12</sup> *Id.*

<sup>13</sup> Biography of the Mayor, *supra* note 4.

<sup>14</sup> Speaker Biographies, *supra* note 1.

The decision I had to make was whether I was going to be a lawyer or whether I was going to be mayor of the City of Windsor. My wife and I decided to go away for a vacation, decided to have this most important discussion while we were away, and I had made my decision.

I had four years under my belt as a political representative. Politics is interesting to say the best. It is not for everyone. My hats off to those individuals that can do it, that do it extremely well and do it consistently, but politics is a different sport. It is a different environment than in the business sector. It is different.

And I didn't expect it to be as different as it was. So the decision I had was: I wanted to go and practice law. And my wife looked at me and said, "That's fine. I am 100 percent behind you. I will support you in any endeavor you choose to undertake. But know this: if you decide to walk away, no 'what ifs,' no complaining, no watching councils, no sitting on the sidelines, no Monday-morning quarterbacking." And then she said, "You know, you could be a lawyer any day. You can't be Mayor of Windsor any day."

So I decided to run, and the reason I decided to run is because the City of Windsor – how many of you have been to Windsor? How many are from Windsor? There is always a connection. Thank you.

Windsor is an amazing city, and I am not saying that because I am the mayor. It is an amazing city because of its history, because of its location, and because of its potential. Here is a metropolitan area – 350,000 – and when I decided to run for mayor, I was facing some critical issues, and those critical issues would certainly set its course in what it would be in the future.

So I saw that as an opportunity to contribute. I wanted to bring my business background, my business acumen, I wanted to bring my experience to change the way things were traditionally done because it always seemed that it was going one way. So I decided to run for mayor, and one of the things I decided was to run on a platform with the same entrepreneurial spirit that carried me. And that spirit was a success for me and my family through the business, and that is: work hard, know what it is you are trying to accomplish, set out the plan to accomplish it, and go and do it – very simple. But I was 29. People don't elect 29-year-old mayors. They don't, right?

So that was the biggest challenge. I was running up against strong competition, years and years of experience on council. But I set a very specific plan. Just like in business, this is where we want to be. We want to be a city that is thriving, a city that is dynamic, a city that is diverse. That is how we are going to get there.

So I started off by mapping out the same thing you do when taking over a business that is going in the wrong direction. You have to get your financial house in order, right? You can't do anything if your financial house is not in order. So I set out, and I said in my campaign platform that I was going to reduce the city's debt by \$40 million.

Our long-term debt was projected to be about \$272 million by the end of 2006.<sup>15</sup> So I said for my term in 2003, I was going to reduce the debt by \$40 million. People looked at me and said there is no way you can do that. It is a ploy. It is a promise. No way. They were right. We didn't reduce it by \$40 million; we reduced it by \$115 million in our three-year term.<sup>16</sup>

Then we focused on making sure that we had the solvent infrastructure that we needed in place. And one of the most critical things that Windsor had to deal with, if you don't know, is that Windsor is in a strategic location. It is the most important and most valuable crossing point in North America;<sup>17</sup> crossing through the Detroit-Windsor border.

And 28 percent of all trade is between our two nations, Canada and the U.S., and crosses through that gate, \$150 billion.<sup>18</sup> It is explosive trade that has taken place over a series of years because of all the trade and the explosive things that have taken place. But it is trade that has taken place on infrastructure built by our grandparents.<sup>19</sup>

And one of the things that you do in business, and that we did in business, in our own business, and that entrepreneurs do all the time, that is, we invest in the business. You reinvest in the business and make sure you have the proper tools and proper equipment to produce a greater product. Why can't the same thing apply to government?

So the biggest challenge we had – we knew we needed a bigger, better infrastructure. Long before we started talking about infrastructure as a way to improve productivity in Canada and the U.S., the Chinese and now other Asian countries and India and all of them have been pouring millions and millions and billions and billions of dollars putting their infrastructure in place, long before anybody knew what they were doing. They were creating the critical supply chains, long before anybody knew why they were doing it. Today with the situation in North America, our ports, they are under extreme pressure.

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<sup>15</sup> *Compare*, Eddie Francis, Mayor, City of Windsor, Chamber of Commerce Mayor's Luncheon Address: Building a More Competitive Windsor, at 3 (May 31, 2006), available at <http://www.citywindsor.ca/documents/CouncilServices/Mayor/BuildingaMoreCompetitiveWindsor.pdf> (stating that at that time the debt was projected to be at \$276 million by the end of 2006).

<sup>16</sup> Biography of the Mayor, *supra* note 4.

<sup>17</sup> See Monica Davey, *Bridge's Private Ownership Raises Concerns*, NY TIMES, Oct. 12, 2007, available at <http://www.nytimes.com/2007/10/12/us/12bridge.html?ex=1349841600&en=1142494dabde901&ei=5088&partner=rssnyt&emc=rss>.

<sup>18</sup> See *id.*

<sup>19</sup> See *e.g.*, Construction, Ambassador Bridge – History, <http://www.ambassadorbridge.com/history/construction.html> (last visited Nov. 29, 2007).

The critical supply chain between Detroit and Windsor is still trying to do things the way they used to do things 75 years ago.<sup>20</sup> So the border was a key issue for us, and that's something we have been working towards and trying to work on.

I use that as an example in terms of where entrepreneurs can go. The private sector doesn't apply in government. In business, you invest in the infrastructure and get it up to speed, and you make it happen. In government, it has been now – how long, George? I have been there for about seven-and-a-half, eight years. I started there talking about the border, they are still talking about the border, and that has been the difficult challenge for me.

That's why I said earlier that politics is different than business. Politics has a way of really providing you a different perspective in terms of how to get things done. In business, you know what needs to get done. You get it done. In politics, you know what needs to get done; you can't get it done until you get everybody else on the same page, and that takes years and years and years.

I will give you an example: the most important things that we are dealing with, that I know you are dealing with in all cities in all regions in terms of time, from your areas in the cities – how many by a show of hands have all the support and everyone on the same page? By a showing of hands, how many economies are rich?

The way things used to be done, the way that companies used to locate in a city, the way that companies used to locate in towns, the old paper mills would come in, the flour mills would come in, the lumber mills would come in, and when they came in, they would locate and invest in it, and people would follow. People would always follow the jobs.

That no longer is the case. Today's global market, where technology and capital is shifted around the world at the push of a button, it is no longer people following jobs; it is jobs following people. That's where it becomes important for us as politicians and leaders of a community to recognize where the entrepreneurial spirit needs to be at play. Recognizing the change in the trend is important in terms of securing ourselves and moving forward.

People are now choosing where to live based on quality of life, and where the people are, the jobs are going to follow.<sup>21</sup> And this is where it is extremely important because our ability to compete as a city in Canada, or as a city in the United States, is primarily going to be driven on our ability to innovate, in our ability to come up with ideas because nobody else can

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<sup>20</sup> Davey, *supra* note 17 (stating that the Ambassador bridge is almost 80 years old); *see also* Construction, *supra* note 19.

<sup>21</sup> *See* Alexander C. Vias, *Jobs Follow People in the Rural Rocky Mountain West*, 14 RURAL DEV. PERSP. 14, (1999) available at <http://www.ers.usda.gov/publications/rdp/rdpsept99/rdpsept99c.pdf>.

compete with us there. Everybody else can produce the product, but not everybody can come up with the idea to produce that, right?

So how are we going to attract people to our cities? Because we need to attract these people to our cities. If they come to our cities, if they are living in our cities, if they are raising their families in our cities, then they are going to be coming up with the ideas in our cities.

If it is our cities that are coming up with the ideas, then we are going to have to do competitive damage as we compete with other global forces. The first thing we need to do is recognize that it is no longer city against city, city against town, or neighbor against neighbor. It is region against region, and I am happy to report that government is finally getting that. I think it maybe is two, three years too late, but I think they finally realize that they have to work together.

And I think the governor of Michigan uses a very, very good term in terms of describing that, and that's cooperation. And the cooperation that they use instead of the competition that used to be in place is now forcing the cities and towns to work together. So when I talk about Windsor's region, I include Ohio in all my discussions. I include London, Ontario. I include southwestern Ontario, southeastern Michigan, and the Ohio District because, as one region, we are powerful.

And what we have to do is send a message – just like we do in business – send a message, we are competing with other customers, right? We are competing with other companies to attract those people but sending the message to attract people to live in our cities because we are investing in a quality of life.

So now it is no longer at the municipal level talking about roads and sewers. It is talking about the arts and cultures, talking about the parks. It is talking about the amenities, talking about the facilities we have involved, because we want those people to come and live in our region.

One of the greatest examples we use is the Detroit-Windsor example. I am perhaps the only city of my size – I don't have professional sports teams, but a five-minute drive across the river, I have got access to all the professional sports. So by attracting those people to live in our city with those amenities gives us an advantage.

And the advantage is how do we take those people, and how do we tap into their ideas? And that's where the universities and the colleges and all these institutions come into play. That's where we come into play, and that's what you heard over the last two days. How do you foster that entrepreneurial spirit? How do you take those entrepreneurial ideas and turn them into product? It is that support mechanism that is required to turn it.

So if we can attract people as cities, we will do our job; we will make our city so livable, create so high a standard of a quality of life that they will come. They will raise their families and will come to live in our cities. Yet,

the issue then becomes what is going to be the support network to take those ideas, to turn that routine to product?

The university and colleges play an extremely critical role. Business is playing an extremely critical role. The problem we have at the city municipal level is that we cannot provide them with the type of incentive that they can live with. That's going to have to come from senior orders of government or from another type of collaboration that could take place between the institutions and the companies. That's the key.

On the American side, they are fortunate. On the American side, you have more access to that level of funding, that level of support, than we do on the Canadian side. I remember a story when I was growing up and doing our business, I was collaborating with a business in Boston, and I called up the owner.

And I said to her, "What are you up to, you know, we have got this customer and supply." She was on her way to the White House because she had received funding in the form of a grant to invest in a new line of manufacturing. She had the opportunity to find something.

Today we have, in Windsor, the Auto 21, the ARDC Center and the University all collaborating with each other.<sup>22</sup> Chrysler, GM and Ford, they are collaborating with each other.<sup>23</sup> That level of collaboration, that level of support is required, but the challenge for the municipality is we can't provide it. We will bring the people to our cities. We will bring the institutions to our cities, but that level of cooperation that has happened and is harnessed in an entrepreneurial way, that's going to really be driven by the organizations themselves.

And that's the challenge that we are going to have. That's the biggest challenge we are going to have. So, over the next little while, you are certainly going to hear about cities investing in quality of life, marketing themselves as the best place to live, marketing themselves as being the best place to do business.

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<sup>22</sup> See *example*, Discover Windsor, <http://www.visitwindsor.com/main.htm> (last visited Oct. 15, 2007); Ontario Yours to Discover, <http://www.ontariotravel.net/TcisCtrl?site=consumers&key1=home&language=EN> (last visited Oct. 15, 2007).

<sup>23</sup> See *e.g.*, U of W Hosts Auto21, University of Windsor, Engineering News, <http://www.uwindsor.ca/units/eng/news.nsf/tovr/10974A3C9ED28F1185256CD0004B0615> (last visited Oct. 15, 2007); see also University of Windsor/DaimlerChrysler Canada Automotive Research and Development Centre, DaimlerChrysler Canada, [http://www.chryslercanada.ca/CA/03/EN/CORPORATE/1,,CA-03-EN-CORPORATE-SOCIALRESPONSIBILITY-4\\_AUTOMOTIVERD.html](http://www.chryslercanada.ca/CA/03/EN/CORPORATE/1,,CA-03-EN-CORPORATE-SOCIALRESPONSIBILITY-4_AUTOMOTIVERD.html) (last visited Oct. 15, 2007); Welcome Auto 21 – A Network of Centres of Excellence, Auto 21, [http://www.auto21.ca/home\\_e.html](http://www.auto21.ca/home_e.html) (last visited Oct. 15, 2007).

You are going to hear about universities and colleges saying come to us, we will provide you with the best education. Come to us, we will provide you the skills and tools that you need, but what we need here, what we want to happen is that network that needs to be established, and that requires collaboration and cooperation.

And from a Canadian perspective, we have a long way to go to do that. I am not sure whether or not on the American side you are there yet. We do have a number of opportunities that are in existence, but I am not sure where that will go. But one thing I am certain of, in today's economic climate, today's environment of three percent growth – three percent new growth in a city in any region is done by 50 percent of the companies that are already in the region.

And that's what we need to have, and that's why cities are always looking to land a big plant – 1,500 to 2,000 jobs. That represents one percent of new growth, and you are lucky if you get a plant. So that's what we have to have start happening into what's existing in our own cities and regions. That's going to require this type of dialogue – this type of discussion. Do not expect government to do it.

If I can leave you with one message: do not expect government to do it. Government is too slow to respond to the needs of business, and I know that because it is the biggest frustration that I live with everyday in my capacity as a mayor. It takes way too much longer to bring everybody else on the same page to execute a decision than it does from the private sector.

So it needs to be driven by the entrepreneurs. It needs to be driven by the independent businesses in their respective communities. And that's the key.

And thank you, that's all.

I am perhaps the only mayor that I am aware of – we don't have term limits in Canada –

that is term limited. This will be my last term as mayor because I truly miss private business. I truly miss the flexibility, the ability to get things done as we do as entrepreneurs, and I am truly frustrated at the turtle pace of things in government and the challenges that we face with the gridlock of bureaucracy from time to time.

So moving forward, I would hope that with these types of discussions – and I think this is a wonderful opportunity when you bring people together. These types of discussions need to be held because this is how collaborations are established in the true spirit of entrepreneurs. The true spirit of entrepreneurs – the true spirit of businesses – the true spirit will really create the type of movement that we want.

And so I thank each and every one of you for taking time from your busy schedules to be here and participate. I know that you learned a lot and met new people. My hope for each and every one of you in moving forward is that you build on those relationships, and that we actually can work together

to get things done. I know I am depending on it as mayor of the city because, as the mayor of the city, it is your ideas and your cooperation that allow us to do it.

So I am available for questions. If you have any questions I would certainly be happy to answer them.

DISCUSSION FOLLOWING THE REMARKS OF HON. EDDIE  
FRANCIS

DR. KING: Do you plan to go higher?

MAYOR FRANCIS: Do I want to move up?

DR. KING: Do you want to move up?

MAYOR FRANCIS: I could have all the aspirations in the world, Henry, but my wife has other plans. You know, I get asked this question a lot, and my answer sometimes – I am 32.

DR. KING: You have got a long way to go.

AUDIENCE MEMBER: You talked about the enormous amount of trade between the two countries that crosses across the bridge. I was at a conference two weeks ago, and we pondered the thought that if that bridge were ever the target of an attack – what type of emergency preparedness or contingency plans do Detroit and Windsor have to guard against that if, God forbid, it would ever happen, to ensure that trade and commerce would continue flowing?

MAYOR FRANCIS: The issue of the bridge: the bridge in Detroit-Windsor is privately owned. I know that surprises a lot of people. But 28 percent of our trade crosses over a privately owned bridge,<sup>24</sup> and there was actually – there was a discussion group, I believe last year, and there was a question to one of the Coast Guards in terms of, if the bridge is knocked down, what happens to the economy, because we saw that post-9/11 everything came to a standstill.

Billions and billions of dollars were lost at the border because of that,<sup>25</sup> and the question to the Coast Guard official was: in the event that there was an event that took down the bridge or caused problems on the bridge, what would happen?

And I think the response was: we table topped this, and the table top exercise had shown that if the bridge was knocked down, there would be at least a minimum of two weeks of complete cessation of the economy. Think about that. The economy would come to a stop for a minimum of two weeks.

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<sup>24</sup> See Davey, *supra* note 17.

<sup>25</sup> See *id.*

I am not talking about the economy of Detroit-Windsor. The economy between the two countries would be at a stop for a minimum of two weeks. Right now there is a movement afoot to get a new crossing located.

Prior to 9/11, in 1999, the Government of Canada together with the province of Ontario, State of Michigan and Washington established what they call the Bi-National Partnership, and the Bi-National Partnership was charged with the responsibility of looking at the future trends – looking at current traffic to try and determine what would be required to meet future capacity for crossing the Detroit-Windsor corridor.<sup>26</sup>

Currently, there are approximately 9,000 trucks that cross that corridor every single day,<sup>27</sup> and as I mentioned, \$150 billion of trade.<sup>28</sup> By 2030, it is projected that 30,000 trucks will be crossing that corridor.<sup>29</sup>

And that's why they began the exercise in terms of trying to establish when the next crossing will be built. Since then, they made some progress. As I mentioned, some of my frustration has been the slow process. In business, you would have had a new bridge up and running. You wouldn't wait for all the things that take so much time.

In government, you have to have a plan, study it, and you have got politics. Right now they are projecting – this partnership is projecting to have a new crossing built by 2013,<sup>30</sup> and they hope to have all the studies done by 2010.<sup>31</sup> And hopefully, there will be a new crossing by 2013.

But again, the challenge that they are going to have – and I can say this because I am not part of the partnership – they have a private owner that is going to do everything to block it. Interestingly enough, there is another point, the Detroit-Windsor tunnel.

In 1930, the Detroit-Windsor tunnel was built as a connection between downtown Windsor and downtown Detroit.<sup>32</sup> When this was constructed in

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<sup>26</sup> See Canada and Ontario Improving Safety at Windsor Border, Government of Ontario, Canada, Ministry of Transportation, [http://ogov.newswire.ca/ontario/GONE/2005/05/27/c4137.html?lmatch=&lang=\\_e.html](http://ogov.newswire.ca/ontario/GONE/2005/05/27/c4137.html?lmatch=&lang=_e.html) (last visited Dec. 4, 2007).

<sup>27</sup> See generally OCC BORDERS AND TRADE DEVELOPMENT COMMITTEE, COST OF BORDER DELAYS TO ONTARIO (2004) available at <http://occ.on.ca/Policy/Reports/121> (discussing traffic and trade dollars crossing the United States, Ontario border including the Detroit-Windsor corridor).

<sup>28</sup> *Id.*

<sup>29</sup> *Id.*

<sup>30</sup> See Press Release, Ministry of Transportation, Windsor-Detroit International Crossing Canadian Environmental Assessment Phase Begins (Feb. 15, 2005), <http://www.tc.gc.ca/mediaroom/releases/nat/2005/05-gc003e.htm>.

<sup>31</sup> See generally *id.* (discussing the beginning of studies in regard to building a new Detroit-Windsor crossing).

<sup>32</sup> See A Vision for the Future, The Detroit and Windsor Tunnel Corp., <http://www.dwtunnel.com/history.html> (last visited Oct. 17, 2007).

1930, the individuals that constructed it invested or had the vesting charter 60 or 70 years later, half to Windsor, half to Detroit.<sup>33</sup>

So we own the Canadian half. The City of Windsor owns the Canadian half of the tunnel.<sup>34</sup> It is a vital link because over 5,000 people cross into Detroit every day: nurses, students and automotive employees go to work in Detroit and come back.<sup>35</sup> They use that facility to cross. It is an important aspect to have in our region.

A year-and-a-half ago there was an attempt to try to sell the American half to a private entity, same owner.<sup>36</sup> Perhaps just this past Friday there was an announcement that was made by Mayor Kilpatrick because for the past year we have been negotiating with Detroit.<sup>37</sup> The announcement that Kilpatrick made this past Friday was that we reached an agreement in principal between the City of Windsor and the City of Detroit. The City of Windsor will be acquiring Detroit rights to the operation and management of the tunnel – \$75 million for a term of 75 years.<sup>38</sup>

But here is the question that I leave you with, and again, this is where I struggle all the time in terms of being someone coming from the private sector background, from an entrepreneurial background, from a business perspective, you need to do this to protect your investment. If you don't do this, you lose your investment. If you don't do this, you don't provide for us, you won't be able to redirect the city into the future.

It becomes a challenge to communicate that to residents, to see that it is \$75 million, number one. That's one issue of struggle.

Number two, why is it that the city, a municipal jurisdiction, is responsible for securing a vital link of national importance? Why should the taxpayer in the city – because again, my revenues are supposed to go – it is very simple. I take in money from property tax. That money that I take in should be used to service that property. It should be used to service sewers, to service roads, to pickup garbage, to provide service to that property. The money isn't intended to provide for the national security of Canada and the

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<sup>33</sup> See generally *id.* (providing a detailed history of the Detroit-Windsor Tunnel).

<sup>34</sup> Surface Infrastructure [sic] Programs-Bridges, Transport Canada, <https://www.tc.gc.ca/Programs/Surface/bridges/menu.htm> (last visited Oct. 17, 2007).

<sup>35</sup> See *id.*

<sup>36</sup> See generally Firm Issues Bid for American Side of Detroit-Windsor Tunnel, Today's Trucking Online (June 1, 2007), <http://www.todaystrucking.com/newscenter.cfm?pageaction=story&intNewsCenterID=3&intDocID=17993> (discussing different bids for the Detroit side of the Detroit-Windsor Tunnel).

<sup>37</sup> Letter from Kwame M. Kilpatrick, Mayor, City of Detroit, to the Detroit City Council (Apr. 12, 2007) [http://www.ci.detroit.mi.us/budget/2007-08\\_Budget/Message/Mayors\\_%20Speech.pdf](http://www.ci.detroit.mi.us/budget/2007-08_Budget/Message/Mayors_%20Speech.pdf) (discussing Detroit's agreement with Windsor regarding the operations and use of the Detroit-Windsor Tunnel).

<sup>38</sup> *Id.*

U.S. So those border issues are real, and those are border issues that we deal with.

But going back to your point, the reason we do what we do is because when senior orders of government are slow to move, somebody has got to move, and that's where the entrepreneur's background comes into play.

I take donations, too, by the way.

AUDIENCE MEMBER: Thank you for taking the initiative.

MAYOR FRANCIS: Thank you.

AUDIENCE MEMBER: I am glad you included Ohio in the region you govern. We are very similar to Windsor and Detroit. We have a Ford casting plant – builds engines here – have two Ford assembly plants. We built a lot of automotive plants. We have Chrysler, GM, and a lot of people around here are worried because we don't know what's going on in Detroit.

We don't see that there are – people are afraid of losing their jobs, and you are a lot closer to Detroit. And one of the things you said was that there is a reduction in our manufacturing base. We see the CEO of Ford taking \$39 million for four months of work while people are losing jobs.<sup>39</sup> People are afraid for their jobs.

Being close to Detroit and being so tied in with the Detroit economy and the regional economy, what do you know about what's going on in Detroit? And how can we preserve some of the jobs – many of the jobs – that we have in this region?

MAYOR FRANCIS: I think our biggest – our challenge is similar to your challenges here because you are dependent on manufacturing and very dependent on the automotive sector. One of the things we have to recognize is that we have to diversify our economy. One thing I do not want to see in terms of all the challenges, all the struggles of the automotive manufacturing industries – one thing that you have to recognize is that this region has a qualified and a very highly-skilled work force.<sup>40</sup>

I don't know of any other people that can take a line change or a new product change and have it implemented in the time that you do it. It is unheard of. The reason they are able to do that is because of the skill set they have. So what we started doing in our city was try to diversify and also change the mindset.

That's a difficult thing to do, but we have gone to the advance manufacturers that otherwise would have been servicing the automotive industry, and we said to them, your skill set can be applied in other

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<sup>39</sup> See Ford CEO: \$28M for 4 Months Work, CNNMoney.com (Apr. 5, 2007), [http://money.cnn.com/2007/04/05/news/companies/ford\\_execpay/](http://money.cnn.com/2007/04/05/news/companies/ford_execpay/).

<sup>40</sup> See The Honorable Sandra Papatello, Ontario Minister of Economic Development and Trade, *Why Isn't Ontario, Canada, Facing a Skilled Labor Shortage?* INDUSTRY WK. (Apr. 4, 2007), <http://www.industryweek.com/ReadArticle.aspx?ArticleID=13882>.

industries. To date, we have applied manufacturers – advance manufacturers – that were once only supplying the automotive industry that are now supplying the aerospace industries, supplying airline industries, supplying the medical fields.

Those type of skill sets are applicable somewhere else. Just like in business, I would never give more than ten percent of my business to Costco. What would happen if Costco went down? I would go down. You never put all your eggs in the same basket. And the thing we need to do from an automotive rich region is recognize that we have skill sets that no one else has.

China doesn't have the skill set that our region has.<sup>41</sup> They don't have the same capacity and knowledge and innovation that we have here.<sup>42</sup> What we need to do is recognize that the automotive industry has gotten us this far, provided us with these skills, and just like in business when you change under different circumstances, we have to transition to applying those skill sets to others.

I know it is difficult, and I have had over a thousand laid off from Ford,<sup>43</sup> another thousand from Chrysler,<sup>44</sup> but it is transition we need to work together. One of the things we look for – and I apologize, I am not too familiar with what American programs are available – but one of the things we need to do on our side is take those individuals that have that skill set, allow them to provide the support for the transition, upgrade the skill set, and apply it somewhere else. Because, from our perspective, not only do we have individuals that are in the skill set right now, right now I am third behind Vancouver and Toronto.<sup>45</sup> That's unheard of.

And I have all these people coming into my city, and I need to be able to provide them skills, but I can't do it at the municipal level. R & D is a key thing. I am telling you R & D. You know why the automotive industry is struggling? It is very simple. It is all about product. Those companies that have hot products, those companies selling the product, they come up with great ideas. How do you come up with a great new product? R & D.

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<sup>41</sup> See generally Human Resources Trends, The US-China Business Council, [http://www.uschina.org/info/china-briefing-book/hr\\_backgrounder.html](http://www.uschina.org/info/china-briefing-book/hr_backgrounder.html) (last visited Oct. 17, 2007) (discussing China's shortage of skilled labor).

<sup>42</sup> *Id.*

<sup>43</sup> See Chris Vander Doelen, *1,275 Auto Jobs Wiped Out*, WINDSOR STAR, Apr. 5, 2007, available at <http://autos.canada.com/news/story.html?id=f3dce016-9f17-42f5-9cdf-e2c110d9baeb>.

<sup>44</sup> *Id.*

<sup>45</sup> See generally Allan Rock, Remarks at the Windsor Innovation Summit (Sept. 12, 2002), <http://www.innovationstrategy.gc.ca/gol/innovation/site.nsf/en/in02464.html> (discussing the Canadian government's plan to strengthen the economy in part through building and maintaining a skilled and knowledgeable workforce).

The idea goes back to what I was saying earlier. We need to attract people that can have the ability to develop the ideas and then have the facilities to take those ideas and turn them into a product. Those areas, and those regions, that can do that, and this is where the R & D comes in. You need to have the cooperation. I may have somebody that comes up with the idea, but I may need somebody in Ohio to produce it. That's where that cooperation and collaboration comes in because then we can compete.

AUDIENCE MEMBER: You were 23 when this whole thing started. You grew the business, went to law school, went on to council, and now you are a mayor. This is in nine years. So you have done all this at an unbelievable speed.

Do you have any interest in going back to the whole entrepreneurial thing? You keep going at this space, you are going to run out of life times, you know? But it would seem –

MAYOR FRANCIS: I feel like I am 72 on the inside.

AUDIENCE MEMBER: When did you sell the business?

MAYOR FRANCIS: I referenced in terms we have 10 or 11 months in a law firm. So when I went to interview for Articles, I interviewed with a law firm, and they said you are with city council. We are not going to give you a job unless something gives, and I couldn't get off council. I needed the Articles to get called to the bar.

When I began the business and set it up and established it with my brothers, we went in with a goal. Our goal was simple. Those people were out there, and the people we were talking to thought we couldn't do it. And our job was to take out as much of the competition, and we brought so much of that, and it came to a point that our competition was ready to buy us out.

AUDIENCE MEMBER: When did you sell?

MAYOR FRANCIS: In 2002.

AUDIENCE MEMBER: Is your father still alive?

MAYOR FRANCIS: Yes.

AUDIENCE MEMBER: What did he think about this?

MAYOR FRANCIS: My father is from the old country, and you still can't do it right.

AUDIENCE MEMBER: Would you go back to what I was saying, yourself as an entrepreneur?

MAYOR FRANCIS: I miss it, and what I was trying to convey, perhaps being in government right now when people ask you, there is no way to do it in two terms. I miss it because government restricts the entrepreneurial aspect. I feel so held back from doing what I normally do, and that's being an entrepreneur.

The thing I liked about being a lawyer, you get to be an entrepreneur in everybody else's business, so you learn about so many different clients and different businesses that you are an entrepreneur and in a different business

everyday. That's what I enjoyed about the law; it gave me that same type of opportunity to channel that energy.

AUDIENCE MEMBER: You are still young, and you have a chance to be prime minister, but it seems you have that ability.

MAYOR FRANCIS: You really have to meet my wife. She doesn't want any part of it.

AUDIENCE MEMBER: You may have a chance to make Canada, as an entrepreneur, as a great country of the world. Think about that.

MAYOR FRANCIS: And thank you. That's very kind, but go back to my earlier point: we cannot depend on government to do it. Government will not do it. And again, I am speaking from a very limited experience in terms of my perspective as a mayor. It just takes way too long.

The entrepreneurial spirit needs to be driven by entrepreneurs. It needs to be driven by business and small business, and they will do it. What we need to do as government is be able to provide them the type of support that otherwise they wouldn't be able to get.

I will give you an example. Shortly after being elected – and this is some of the conflicts I face – shortly after being elected, there was an opportunity for us to locate a company, International Truck. Are you all familiar with International Truck? To locate their new R & D center, and Windsor was one of the places, and International Truck was going to make a decision.

I think it was Windsor, Hamilton, London, and Toronto, and they had three R & D facilities they were going to locate. And I asked for a meeting with the powers that be, and I met with them. I just said, "What do you need?" They said, "What do you mean?" I said, "What do you need for you to make your decision?" They said, "We never heard that before."

I said, "Tell me what it is, and if I can do it, I will do it, but what do you need in terms of us providing the support?" They told us. They made their decision, and they are now located in Windsor. As government, we need to be able to approach business and not with the same cookie cutter approach – this is the way it needs to be done.

Their situation may be different than your situation, so what is it for you to do? What is it you need to do, and develop that type of a product, that type of idea, that type of entrepreneurial invention? And if we can provide the support, that's what we need to do. I think we are doing a good job in terms of getting there. Mark is a good example. He does it every day.

AUDIENCE MEMBER: I know that you might be frustrated by your job and how you feel you are constrained in what you could accomplish, but you probably are also saying to yourself, "I accomplished a hell of a lot in the term-and-a-half or almost two terms as mayor." Anybody can be proud of what you have accomplished and is going to be concerned about making sure that the next person who comes in takes what you have done and takes it to the next level. You want to get somebody in there even better than you.

So my question is: what's your sense of the landscape, the political landscape in the Windsor area, apart from your two brothers, in terms of talent that can make it look like you were only half as good?

MAYOR FRANCIS: You must have been talking to my two brothers.

I think the best – I am confident – let's put it that way. I think if anything, when somebody comes into the office and is able to accomplish something, set the bar high and hope somebody else will do better, I am confident that will happen. Any good person who steps into a political office sets things in place that you would hope would serve as the building blocks.

And if anything, I would hope that by being a nobody that was fortunate to be elected, that has inspired or has given reason for others to move forward that otherwise would not have considered politics but can now consider politics.

So I would hope that my example – and that's why every time I have an opportunity to speak I say you don't have to be a politician to run for office. You just have to have dedication and passion and the commitment to do a better job than the next guy. I hope that after I am done the next person that comes in, within a year they forget about me because the next person is that much better.

Questions.

AUDIENCE MEMBER: What personality traits attract you in succeeding, and if you don't have those, can you still have those by having a good plan and executing it?

MAYOR FRANCIS: It is a good question. Believe it or not I am a very shy individual. It is true. So the personality – you know what? I have never been asked that question in my career. The personality traits, I think, that have helped me are being able to be very – and this comes from my science background – science, they teach you to be very methodical, right? Know what your end result is going to be. Map out how you are going to get to your end result, and that's the same thing I applied in business.

The same thing I applied in my career as mayor. I am methodical in terms of establishing a long-term, direct, knowing where it is I think we need to be, developing a plan and sticking to it. Oftentimes you will get politicians that get swayed one way or the other, and it just doesn't happen.

You stick to it, and if you believe in your plan so much that it is the right thing to do, you just get it done. Patience is a key thing for me, and I still struggle with patience sometimes.

Thank you.



## WHERE DO WE GO FROM HERE?

### SPEAKER

*Dr. Henry T. King, Jr.*

DR. KING: We learned a lot tonight. Thank you very much, and we hope you will be back again.

MAYOR FRANCIS: Thank you.

DR. KING: And maybe you will be in a higher office.

Well, this is a time when we usually discuss the programs for the future. I am not going to do it tonight because the hour is late, but I would like to solicit your suggestions for next year's program. My feeling is to write me a quarterly or give me an e-mail. I think what we ought to be concerned about is the tightening of the Canada-U.S. border. After all, the European community is breaking down borders all over Europe, and we should be concerned about the tightening of the Canada-U.S. border. Another alternative would be the Canada-U.S. border problems and progress, so you can take both sides. This could cover various subjects like, certainly, border security, immigration, NAFTA, Great Lakes, and many other areas. It is a good umbrella topic. But there is nothing to do tonight but give me your suggestions, and I think that's very important because the Executive Committee of the Institute will be meeting on May 31 to discuss this.

But let's have your voice because you are our constituency. You are our market, and let's hear from you. But my feeling is the border ought to be the subject in some way or another and trade foes. I think it should be the product manufactured in Canada, how it goes across the border, what the barriers are, what concerns people have.

The work of the Institute could not happen without a number of people. I would like to thank our students, first Payal Deora. She served as Editor-in-Chief of the *Canada-U.S. Law Journal*. She ran the Niagara Moot Court. She was our Executive Student Director. We have never had a student like her. And we will miss her. Thank you, Payal. Thank you, again.

Chris Kringel was our Managing Editor of the *Canada-U.S. Law Journal*. He did a great job. The *Journal* has a new look, which you have seen. It is in color now. Our number of subscribers has increased and we now publish two issues per year. Thank you, Chris, and stand up. Good job.

Mark Bardwell has been a source of support as a Student Director as has Jerrick Ho. These two students were leaders of our conference as well as

worked on our programs in Toronto and Washington. Thank you, and please stand if you will. Mark, I want some of those photographs that you have been taking.

I thank Krista Neilson, Sara Paulett, Steve Rodini, and Mark Siegel for their services as student Executive Editors, and I want to thank the second year law students: Kyle McCoy, Pragati Nayak, Adam Roberts, Megan McCarthy, Kelly Schmidt, Monty Silley, Asim Khan, Will Randall, Matthew Weinbaum, and Michael Jones. I look forward to their involvement next year, and we thank them for their work this year. Will they stand?

We thank Tim Martin and David Wright for their work with the audiovisual equipment.

And we thank you, Deborah Turner. She is an outstanding asset of the institute. This was her first conference, and you all know her skill and talent. Thank you, Deb.

I thank Chi Carmody for his leadership as well as that of the Advisory Board and the Executive Committee as we continue to grow. We have new programs; and I thank you for your leadership.

We again thank Dean Brown who is right here, if you want to stand, Dean of University of Western Ontario, and Dean Simpson of Case for their efforts and support.

And above all, I want to pay high tribute to Dan Ujczko. He has been outstanding in every way, and he has been a wonderful right hand for me. I am now going to turn to Dan for a few announcements. Dan, don't make it too long. We want to get out of here.

MR. UJCZO: Well, good evening, and, again, we want to extend, on behalf of the Institute, our deepest appreciation to Mayor Francis for taking time from both his busy professional schedule as well as, with a new child on the way, personal schedule. So we express our deepest appreciation to you for coming down on a beautiful Saturday in Cleveland, Ohio.

Indeed, we express our heart felt thanks to all of other speakers, session chairs, and participants for a weekend – dare to say – one of the best conferences that we have had in the 30-year history of our Institute. That is, in large measure, due to your contributions throughout the weekend, both during the substantive portion of the program as well as a great deal of the networks that were established during meals and cocktails, et cetera. So we thank you.

We know that many of you will be going to your chiropractors this weekend. There was a theory here a decade ago, when I was in law school, that when they put the chairs in the moot courtroom they were designed so students wouldn't fall asleep. They haven't improved it in a decade. But I have been told there is going to be a massive renovation, so next year when you are back, hopefully, we will have some new chairs.

We again express our thanks to the Advisory Board as well as the Executive Committee for their leadership and support, financial and otherwise, for our programs, not just this program but for the entirety of the programs that we discussed over the past several days.

As Henry mentioned, the Executive Committee will be meeting in late May to map out our future programs in the next year, so if you do have any suggestions, please know that the phone, the e-mail and the fax lines are always open. We are here as the Institute staff to take the ideas and advice that you have and put them into implementation as well.

I would again like to thank Deborah – and I don't want to expound on Henry's comments – but the only thanks that I can give to you, Deborah, and the only way that I know how is: Deborah will not be in the office on Monday and Tuesday having a much deserved rest.

Now, Henry has gone through the list of students that we have thanked, and I want to introduce you to the student leadership for next year in a moment, but there are several announcements.

First and foremost, please remember – I know that several of you will be exploring the sights and sounds of Little Italy. The gate at the parking garage, I had a personal experience, but we had an incident with the University Circle Police Department who are not a fan of Dan right now after they got a call to get them to open the gate.

With your CLE materials, please ensure you see Deborah so she can get you entered for your 17 and-a-half credit hours.

Finally, Dick Getz mentioned he thinks the only thing we haven't done is put the Canada-U.S. logo brand on tennis shoes, and now we have. And I think we have the perfect audience to help figure out the business plan. We encourage you to take those for your personal and professional cabinets.

Again, it is, somewhat, tonight that I have mixed emotions. As you have you heard, we expanded our programs over the years, and it has largely been with the student group that are now third years advancing on into the real world. But we do wish our third-year students the best as you move on to finals for your third-year. You will have that exam in a few months. We all loved our bar exam experience. The only thing worse than that experience is the letter you get three months later explaining that your student loan is over, and you have to write the first check. I am extremely confident the Alumni Association calls a week later, also. But on behalf of the Canada-United States Law Institute, if there is anything we can do professionally, don't hesitate to give us a call, or any of the individuals on boards or our Executive Committee as well.

We will proceed publishing the proceedings in the annual *Canada - United States Law Journal*.

This weekend's issue should come out in the fall, and the students that I will now introduce will be those students for leadership for next year: The

Editor-in-Chief is Megan McCarthy, and the Managing Editor is Kelly Schmidt. The Special Issue Editor, which will be a book we are publishing on the joint working groups of CBA ABA; that three nations can produce and work in a collaborative manner, and that Special Issue Editor will be by Kyle McCoy.

And the following individuals will serve as our Executive Editors. They are Adam Roberts, Asim Khan, Matthew Weinbaum, Michael Jones, Pragati Nayak, Monty Silley, and Will Randall. If you could all stand up, they will be joined by 16 to 20 rising 2Ls. Those are students that are presently in their first year, and we don't talk to them at this time of the year because stress is at an all time high with those individuals. But they will be joining the *Journal* likewise.

Our staff at the University of Western Ontario, likewise, will be selecting students to be involved in those. We do have four students, which, as Henry mentioned, help run the Niagara Moot Court, and I am pleased to announce that the Executive Student Director will be Kyle McCoy. He will be joined by two associates who will be part of our exchange program next year. I assigned two associates to you that won't be here, but congratulations.

And there are legions of many other individuals who have assisted with our program.

And I want to thank my great friend, who is not only my professional friend, but I can tell you that the first phone call I get every Monday morning is from this individual, to ask me how my Ohio stay was, and that's my 87-year-old friend and former Nuremberg figure, and that's Henry King.

Henry, we just offer you our deepest and most heartfelt thanks.

DR. KING: Thank you very much.

MR. UJCZO: The bar area will be open for the next couple of hours, so don't hesitate again to socialize and enjoy the camaraderie that, of course, will take place.

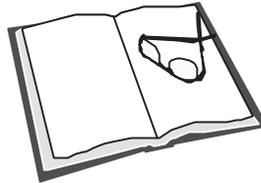
And without further ado by the powers vested in me, I hereby declare that the Annual Conference adjourned.

Thank you.

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