
Startup CEO Takes PNY to Trial Over Soured Deal

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SAN FRANCISCO — Corporate marriages can be every bit as delicate as romantic unions. And the divorces, just as nasty.

The details of one tech marriage gone bad will play out this week in a San Mateo County trial that pits the CEO of a small Silicon Valley startup against New Jersey hardware manufacturer PNY Technologies.

In 2011, PNY brought in Silicon Valley Solutions CEO Lorenzo Salhi and a handful of his employees in what's come to be known among Valley businesses as an "acquihire." Both sides had high hopes that the union would mean more revenue, particularly from selling memory chips to Salhi's biggest customer, Cisco Systems Inc.

Six months later Salhi was fired for making "virtually no progress" in obtaining new business, and PNY revoked his $1.5 million payout. In the court cases that followed, both sides say they were misled at the bargaining table.

The trial is something of a cautionary tale for companies in the Valley's red-hot deal market, said Salhi's lawyer, Mark Molumphy of Burlingame's Cotchett, Pitre & McCarthy.

"In some ways it's symptomatic of things that are happening every day in Silicon Valley," he said, "when people who come up with good ideas are targeted by larger corporations. And then once they acquire the technology and/or ideas, they pretend that there was no deal."

Barring a last-minute settlement, a jury trial is set to begin early this week in San Mateo County Superior Court.

Molumphy says the case will largely be a "credibility contest" between Salhi and PNY CEO Gadi Cohen, the two principal parties in the transaction. Documents, including emails between Salhi and Cohen, will play a major role.

PNY's lawyers, Christopher Mayer and Pamela Moore of McCarter & English's New Jersey and Connecticut offices, did not respond to calls and emails seeking comment. The company's San Francisco lawyer, David Reis of Arnold & Porter, declined to comment on the case. A PNY spokeswoman didn't respond to an email and phone call seeking comment.

THE COURTSHIP

Salhi, a German-educated businessman, cofounded Silicon Valley Solutions in 2009 and became the company's CEO in 2011. The business sold customized memory drives, or, as Salhi's lawyer said, "the kind of chips that run everything these days."

Salhi relied on third-party manufacturers to build the chips. In 2011, the manufacturer that supplied Cisco, Salhi's biggest client, pulled out and he began hunting for a replacement. Enter PNY.

Cohen founded PNY in 1985, according to Bloomberg Businessweek, which also mentions that the 55-year-old served for seven years as an officer in the Israeli army.

According to PNY's lawyers, Salhi made the first move. He suggested a collaboration to PNY CEO Cohen over a 2009 lunch in New York City. When Salhi lost his manufacturer two years later, he became anxious to get a deal signed with PNY right away.

Lawyers for SVS tell a different story. They say that, by 2011, Cohen already had spent three years trying to recruit Salhi to expand PNY's client base and reach in California.

Cohen asked Salhi to meet him in PNY's San Jose office on July 13, 2011. When Cohen walked into the conference room, he asked a colleague to leave so he and Salhi could be alone, Salhi said in a deposition. Cohen sat down and told Salhi he was about to make an offer he had never made before: He wanted to acquire SVS.

Salhi was "positively surprised," he said in his deposition. Cohen even invited Salhi to fly on his private jet to New Jersey for a tour of the PNY plant. Salhi was busy, but sent a few of his team members.

Later, Salhi sent Cohen a gushing, two-page email thanking him and detailing reasons SVS would make a good partner. He promised $300 million a year in sales and double-digit profit margins in three to five years.

Cohen's reply was terse: "thank you for your detail[ed] email, I will share with you my thought[s] next week when we meet."

The deal was finalized about a month later, and Salhi became a PNY general manager, charged with expanding sales to original-equipment manufacturers. He was offered a $275,000 salary, quarterly bonuses of $25,000 and an attractive equity plan. PNY also agreed to pay Salhi $1.5 million in "consulting fees" as repayment for a personal loan he made to SVS.

THE BREAKUP

On Valentine's Day 2012, Salhi addressed PNY's international management. According to a lawsuit PNY filed against Salhi and SVS later that year in New Jersey federal court, Salhi's presentation was "completely without substance and reflected a total lack of effort." It "made Salhi look foolish," according to the complaint.

He was fired roughly a week later. In his first six months, according to PNY, Salhi had failed to achieve a single sale for the company or generate any new leads.

Citing a nonperformance clause in Salhi's contract, PNY moved to recoup $500,000 in consulting fees already paid to Salhi and refused to pay the remaining $1 million.

Salhi's lawyers argue if their client was underperforming, it was PNY's fault for failing to disclose critical information. Relations between PNY and Cisco, Salhi's biggest client, had broken down a decade earlier. PNY had threatened to sue Cisco and, as a result, landed on Cisco's "prohibited list of suppliers," according to Salhi's lawyers. But PNY hid the extent of the rift from Salhi, forcing him to spend months trying to rehabilitate the relationship.

PNY also lied about its manufacturing plant, according to Salhi's lawyers, claiming it would be operational by late 2011. In reality, the facility opened three months late, after weeks of work by Salhi's team, his lawyers contend.

On the other side, PNY accuses Salhi of misrepresenting what his team could bring to the table. Salhi knew the extent of the rift between PNY and Cisco, according to PNY's lawyers, and promised he could fix it. But, actually, Salhi's own relationship with Cisco was strained and his company was facing serious financial troubles.

Shortly before Salhi and Cohen began acquisition talks, Salhi received an email from his financial adviser warning, "currently, as you know, SVS is not an investable company."

The company's ownership and legal obligations weren't defined, the books and taxes weren't up to date, and outstanding loans weren't documented, the email continued.

Salhi responded that the company was cash-flow negative, but he was hoping to become profitable in late 2011.

"SVS would like to get financial support—however the likelihood of any … loan etc. is very slim," he wrote. "What SVS needs is revenue (which we are very well on the path of making)."

DIVORCE COURT

In May 2012, Salhi sued PNY, Cohen and Philip Berkowitz, PNY's California sales director, in San Mateo County Superior Court. A few months later, PNY slapped Salhi with a suit in New Jersey federal court. Both complaints allege fraud and breach of contract.

The California case has moved more rapidly. In March, PNY's attorneys filed a motion for sanctions, claiming the Cotchett Pitre lawyers "engaged in egregious misconduct" by concealing and destroying relevant emails on a third-party server. San Mateo County Judge Lisa Novak denied the motion, but reopened discovery spurring production of more than 32,000 new documents.

The records, including emails that address what Salhi knew about PNY's frayed relationship with Cisco, are sure to make an appearance during trial. The contract between Salhi and PNY also is likely to be scrutinized, including the provision requiring $1.5 million in "consulting fees" to be paid in three installments.

"That's not your standard 'I sold my startup to Google for $10 million,'" said David Goldenberg, founding partner of VLP Law Group.

Salhi, who has since started another technology company in the Bay Area, is seeking millions in damages from PNY, including the value of his stock options and the balance of his consulting fees.

Salhi is likely to testify at trial, Molumphy, his lawyer, said. PNY's lawyers wouldn't say whether Cohen would take the stand.

Rodger Cole, chairman of Fenwick & West's litigation group, said only about one in 20 of the business disputes he sees makes it to trial. The ones that do are often cases where emotions are running high on both sides. In this case, the CEOs must manage their emotions if they want to sway a jury.

"It's a difficult line to draw, because you do want empathy with the jury," Cole said, "but you don't want anger, for example, to come through in testimony."

That may be a struggle in the case where both parties are playing the role of jilted lover.

"From our client's perspective, it was a perfect marriage," SVS lawyer Molumphy said. "It was going to be a partnership. A win-win for both sides."

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