TAKING OUT THE TRAITORS

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ABSTRACT

Employees join startup ventures to participate in the financial upside of a future acquisition of the company through the equity ownership stake they are granted upon hire. However, startups and their founders are beginning to break the age-old deal they have made with rank-and-file employees that ensures the value of employee equity remains high in an acquisition. Founders have broken this deal by allowing acquirers to hire the startup's star talent and purchase rights to the company's core technology for the bulk of the would-be purchase price of the company (the Traitor Transactions). These Traitor Transactions leave behind rank-and-file employees, along with the remains of the company itself, to be acquired by a different suitor for far less than expected. This shift in acquisition structure threatens the future viability of human-built startups by discouraging employees from joining companies that will abandon their financial interests come acquisition time.

This Article builds on existing research on equity compensation contracts and, further, provides a first-of-its-kind account of how startup founders and acquirers are beginning to break the deal they have made for decades with startup employees. Additionally, this Article makes significant contributions to the existing literature by exposing the rise of these Traitor Transactions in the startup context;

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connecting the onset of artificial intelligence to these Traitor Transactions; and proposing a Traitor Clause, which can be added to the corporate charter and all equity-granting contracts between the company and its employees. This Traitor Clause is designed to protect the financial interests of the employees left behind in Traitor Transactions and, more importantly, to appeal to the interests of all typical stakeholders of new ventures with the goal of fostering widespread adoption of the proposal.

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INTRODUCTION

During the summer of 2025, two transactions took place related to the agentic artificial intelligence (AI) startup Windsurf.[1] These transactions rocked the foundation of how startups acquire, motivate, and retain human resources.[2] In the first transaction, Google acquired a non-exclusive license to Windsurf's key intellectual property,[3] which provides a tool for software developers to deploy AI agents—automated programs that perform tasks, including writing software code on behalf of a human who provides the AI agent with instructions.[4] In this same deal, Google also hired a group of key employees from Windsurf, including its founding team and the company's most skilled AI developers.[5] Importantly, Google did not acquire any ownership stake in Windsurf,and it left about 200 Windsurf employees behind after the deal.[6] Within days, the remains of Windsurf were acquired by another startup that produces an agentic AI solution for software coding, Cognition.[7] Cognition acquired Windsurf's most valuable assets, including its "[intellectual property], product, trademark and brand, and strong business,"[8] for

1. *See* Gyana Swain, *Google Snatches Windsurf Execs in a $2.4B Deal, Derailing OpenAI's Biggest Acquisition Yet*, COMPUTERWORLD (July 14, 2025), https://www.computerworld.com/article/4021763/google-snatches-windsurf-execs-in-a-2-4b-deal-derailing-openais-biggest-acquisition-yet.html [https://perma.cc/T67T-32D4]; Scott Wu, *Cognition's Acquisition of Windsurf*, COGNITION (July 14, 2025), https://cognition.ai/blog/windsurf [https://perma.cc/8QED-NB7K].

2. *See infra* Part III.

3. *See* Kenrick Cai, Krystal Hu & Kritika Lamba, *Google Hires Windsurf Execs in $2.4 Billion Deal to Advance AI Coding Ambitions*, REUTERS (July 11, 2025, at 23:22 ET), https://www.reuters.com/business/google-hires-windsurf-ceo-researchers-advance-ai-ambitions-2025-07-11/ [https://perma.cc/BF6B-CEW6].

4. *See* Cade Metz & Karen Weise, *How 'A.I. Agents' That Roam the Internet Could One Day Replace Workers*, N.Y. TIMES (Oct. 16, 2023), https://www.nytimes.com/2023/10/16/technology/ai-agents-workers-replace.html [https://perma.cc/DR2X-JHA5] ("[AI] agents can do more than chat. They can use software apps, websites and other online tools, including spreadsheets, online calendars, travel sites and more."); Swain, *supra* note 1.

5. *See* Swain, *supra* note 1.

6. *See* Cai, Hu & Lamba, *supra* note 3.

7. *See* Wu, *supra* note 1.

8. *Id.*; *see* Ashley Capoot, *Cognition to Buy AI Startup Windsurf Days After Google Poached CEO in $2.4 Billion Licensing Deal*, CNBC (July 14, 2025, at 16:22 ET), https://www.cnbc.com/2025/07/14/cognition-to-buy-ai-startup-windsurf-days-after-google-poached-ceo.html [https://perma.cc/22XR-K5NU].

an estimated $250 million.[9] Given that the terms of this deal were not further disclosed, we do not know with certainty whether the acquisition was an asset purchase, or rather a purchase of the remaining stock of Windsurf.[10] Three weeks later, Cognition issued an ultimatum to each of the roughly 200 Windsurf employees it had recently onboarded: work eighty hours per week, or take a buyout.[11]

While these transactions seem ordinary on their surface, the way in which these deals were structured created a windfall for Google, Cognition, and the key Windsurf employees hired by Google at the expense of Windsurf's rank-and-file employees.[12] The key to understanding why lies in the traditional equity compensation structure of startup employees, a practice that has been widely adopted across Silicon Valley and around the world as a best practice in company structure.[13] Startups have a difficult time competing with more established firms in making a high salary offer to a prospective employee, and equity compensation helps them to make up the salary gap.[14] Startups like Windsurf offer employees either grants of common stock in the company or options to buy common stock in

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9. *See* Marina Temkin, *More Details Emerge on How Windsurf's VCs and Founders Got Paid from the Google Deal*, TECHCRUNCH (Aug. 1, 2025, at 09:00 PT), https://techcrunch.com/2025/08/01/more-details-emerge-on-how-windsurfs-vcs-and-founders-got-paid-from-the-google-deal/ [https://perma.cc/3ZQ4-8XXD].

10. *See* Capoot, *supra* note 8.

11. *See* Sherin Shibu, *'We Don't Believe in Work-Life Balance': A Newly Acquired Startup Just Offered Its 200-Person Team a Choice—Work Weekends or Take a Buyout*, ENTREPRENEUR (Aug. 6, 2025), https://www.entrepreneur.com/business-news/ai-windsurf-take-the-9-month-pay-buyout-or-work-6-days/495554 [https://perma.cc/A4W9-RD5Y]; *see also* Rebecca Bellan, *Three Weeks After Acquiring Windsurf, Cognition Offers Staff the Exit Door*, TECHCRUNCH (Aug. 5, 2025, at 08:24 PT), https://techcrunch.com/2025/08/05/three-weeks-after-acquiring-windsurf-cognition-offers-staff-the-exit-door/ [https://perma.cc/Y5UH-RJDL] (labeling these conditions "draconian").

12. *See infra* Part II.

13. *See infra* Part I; *see also* Elizabeth Pollman, *Startup Governance*, 168 U. PA. L. REV. 155, 193 (2019) ("Startup employees participate in equity arrangements and often represent part of the essential value of the company and influence its decisionmaking.").

14. *See* Abraham J.B. Cable, *Stock Options of Adhesion*, 50 J. CORP. L. 1371, 1372 (2025) ("These employee-investors are considered a key element of the Silicon Valley ecosystem and equity compensation is considered a valuable tool for cash-strapped startups to motivate and retain this workforce." (footnote omitted)); *see also* Yifat Aran, Note, *Beyond Covenants Not to Compete: Equilibrium in High-Tech Startup Labor Markets*, 70 STAN. L. REV. 1235, 1238 (2018) ("[E]mployee stock options are considered a legitimate carrot [to induce workplace loyalty]. The retention function of private firms' employee stock options is common knowledge among practitioners." (footnote omitted)).

the company, along with their salary, as an additional form of compensation.[15] These grants of stock or stock options are contractual in nature between the company and employee, and the contract contains restrictive provisions in favor of the company, which allow the company to take back unearned shares through vesting provisions and repurchase earned shares at fair market value upon an employee's departure from the company.[16] Typically, these provisions, when coupled with traditional startup exits, create fair economic outcomes for all parties.[17] This web of standardized contracts and deals has been an implicit promise in the startup world for decades, allowing for employees to rely on the promises of their employers in working hard to build an enterprise that will financially reward any success to which they contribute.[18]

The Windsurf deals were the first to clearly and explicitly break this promise in a way that transferred hundreds of millions of

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15. *See* Katie Black, Note, *Unvested: How Equity and the Deferred Payment Gamble in Startups Shortchange Employees Targeted by Discrimination*, 75 U. MIA. L. REV. 301, 311 (2020) ("Despite the lack of a one-size-fits-all method for giving out equity, it commonly fits two general forms, either 'outright grants of stock' or 'grants of stock options at the current market price.'" (quoting Richard A. Booth, *Give Me Equity or Give Me Death—The Role of Competition and Compensation in Silicon Valley*, 1 ENTREPRENEURIAL BUS. L.J. 265, 271 (2006))).

16. *See* Jeff Thomas, *Equity Crowdfunding Portals Should Join and Enhance the Crowd by Providing Venture Formation Resources*, 42 NOVA L. REV. 375, 397 (2018) ("[V]enture capital-backed companies understand the importance of making founder and employee equity sticky through the use of repurchase options and vesting provisions, respectively. Repurchase options and vesting provisions do more than protect investors—they help employees who stay at firms after others depart." (footnote omitted) (citing FENWICK & WEST LLP, *Guide to Starting a Corporation*, *in* LEGAL RESOURCE GUIDE FOR STARTUP ENTREPRENEURS 1, 8, https://www.fenwick.com/FenwickDocuments/Legal-Resource-Guide-April-2017.pdf [https://perma.cc/B6YG-8GBV])); *see also* Mira Ganor, *Startups in the Whirlpool of Divorce*, 12 MICH. BUS. & ENTREPRENEURIAL L. REV. 1, 9 (2023) ("[V]esting schedules discourage employees from leaving the company immediately after receiving equity compensation since they vest full ownership in the equity over time unless the employment relationship is terminated." (footnote omitted)).

17. *See* Olufunmilayo B. Arewa & Matt Stahl, *Prospecting, Sharecropping, and the Recording Industry*, 25 VAND. J. ENT. & TECH. L. 267, 284 (2023) ("[F]ounders typically own stock in the start-up companies they establish. Employees of such companies also frequently receive equity ownership in such companies. This means that returns from successful start-ups are shared with non-investor employees who typically contribute not money but hard work—an arrangement based on so-called 'sweat equity.'" (footnotes omitted) (quoting Will Kenton, *Sweat Equity: What It Is, How It Works, and Example*, INVESTOPEDIA (June 27, 2022), https://www.investopedia.com/terms/s/sweatequity.asp [https://perma.cc/C4JU-8KV5])).

18. *See id.*

dollars or more of value to the winners at the expense of the losers, rank-and-file startup employees.[19] This was accomplished largely through the timing of the transactions, as well as the timing of the exit of Windsurf's key employees first, followed by its rank-and-file employees a month later as employees of Cognition.[20] As this Article will show, Windsurf employees who were expecting a personal windfall of somewhere in the $7-12 million range on average were left with a financial windfall in the hundreds of thousands instead.[21]

This type of transaction, if replicated at scale, will be the end of entrepreneurial teams with well-aligned incentives.[22] This is because prospective employees of new entrepreneurial ventures will no longer be lured away from the Googles of the world by equity ownership in a new startup if a future deal structure can eviscerate the value of their equity.[23] Instead, these prospective employees will accept the job with the highest salary offer, which will almost always be at a well-resourced company like Google, Amazon, Alphabet, or Tesla instead of a new venture looking to create new value in the world. This will leave new startups with a few choices: (1) hire inferior talent; (2) spend valuable early-stage investor capital on higher employee salaries; or (3) utilize technological advances, like agentic AI, to replace large portions of their workforce. Unfortunately for the future of innovation, this Article will demonstrate that relying on AI to replace workers is the only option with any hope of working, but, even if it does, this option is suboptimal on a societal level.[24]

Given this looming bad outcome, this Article makes a simple proposal that could solve this incentive-alignment issue and be implemented through contract law at the outset of a new venture's launch. In short, this Article proposes that startups universally

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19. *See infra* Part II.

20. *See infra* Part II.

21. *See infra* Part II.

22. *See* Matthew Wansley, *Beach Money Exits*, 45 J. CORP. L. 151, 155 (2019) ("An acquirer can destroy value by weakening the strong equity incentives of former startup employees prematurely.").

23. *See* Thomas A. Smith, *The Zynga Clawback: Shoring Up the Central Pillar of Innovation*, 53 SANTA CLARA L. REV. 577, 609-11 (2013) (discussing the economic "gamble" startup employees take in choosing a lower salary plus an equity grant over a higher salary alternative).

24. *See infra* Part III.

adopt a Traitor Clause: a clause in all Restricted Stock Purchase Agreements (RSPAs) and stock option contracts that would determine the value of a founder or employee's stock at the time of their departure from the company. Importantly, this Traitor Clause would effectively nullify *any* anticipated financial gains from a founder or employee's shares of stock should they enter into a windfall acqui-hire transaction at the expense of most of the company's other employees.[25] Because these contracts are private to the parties who enter into them, this Article also proposes that startups embed this policy in a public document, like their corporate charter, to make their commitment to fairness publicly available to all prospective employees.[26]

This pair of proposals would have two important effects. First, it would restore employee confidence in the promise of equity ownership in a startup, which would ensure that high-quality human talent continues to flow to innovative startups rather than to the highest bidder.[27] Second, these proposals would shift transaction costs in atypical deal structures, like the Traitor Transactions, away from rank-and-file employees and to the large company making the acquisition.[28] This would disincentivize acquirers from seeking a discounted acquisition price at the expense of rank-and-file employees and, instead, would push these deals back into traditional acquisition structures, like stock purchases.[29] In both cases, this pair of proposals seeks to restore the traditional web of contracts that aligns the incentives of startup founders, investors, and employees with one another as they built the next generation of innovations.[30] Further, these proposals disincentivize incumbent large companies from engaging in deal structures that stifle competition for future talent.[31] In total, these simple contractual solutions, if adopted at scale like other contractual agreements in the startup world, preserve innovation, increase competition in markets, and benefit society writ large.

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25. *See infra* Part IV.
26. *See infra* Part IV.
27. *See infra* Part IV.
28. *See infra* Part IV.
29. *See infra* Part IV.
30. *See infra* Part IV.
31. *See infra* text accompanying notes 309-10.

This Article proceeds in four parts. First, Part I will thoroughly describe how equity compensation for employees works in the startup setting. This Part will include a detailed discussion on the concepts of equity grants, stock options, share vesting, and repurchase options. Next, in Part II, the Article will provide the facts and structure of the Windsurf transactions. Embedded in this discussion is an analysis of how these transactions depart from the traditional norms surrounding equity compensation that are expected by all parties in the startup ecosystem. Part III will then analyze the impact of the Windsurf deals on entrepreneurship and innovation as a whole. This discussion will focus on the impact of broken promises regarding employee equity, especially as those broken promises relate to three issues: (1) which companies top talent flows; (2) investor expectations of how startups use investor funding; and (3) the looming possibility that agentic AI will serve as a replacement for large swaths of the startup workforce in the near future. Lastly, Part IV proposes a contractual solution to the issues exposed by the Windsurf transactions. This contractual solution, the Traitor Clause, could be implemented by a few simple changes to the language in a corporation's charter as well as all of its standard RSPAs or stock option contracts used when employees are hired by the startup.

I. HOW EQUITY COMPENSATION WORKS IN STARTUPS

Early-stage startups operate under significant financial constraints that shape how they compensate employees.[32] These constraints stem from two structural realities. First, venture capitalists and other early investors typically fund startups in milestone-based funding rounds.[33] Rather than providing a large lump sum investment upfront, investors provide new ventures with capital incrementally.[34] This approach allows for investors to make future investment decisions later, once they have more information

32. *See* Ryan A. Ashburn, Comment, *Venture Capital's ESG Problem*, 58 U. RICH. L. REV. 513, 523 (2024) (discussing milestone-based funding of startups by investors).

33. *See* Pollman, *supra* note 13, at 186 (describing milestone-based financing and the strategy behind it for venture capitalists).

34. *See id.*; David Nows, *Equity Crowdfunding and the Lead Investor*, 24 N.C. J.L. & TECH. 33, 36-37 (2023).

about the company's progress and prospects for success.[35] For example, subsequent rounds of investor financing are typically contingent on the startup achieving specific developmental goals such as building a prototype, launching a product, or acquiring initial customers.[36] This staged financing model allows investors to monitor company progress and limit downside risk.[37] However, it also means startups must operate leanly between funding rounds, focusing on the exact objectives they have set out to achieve to reach the milestones promised to investors.[38]

Second, even when startups generate revenue, they rarely prioritize profitability in the new venture's early years.[39] Instead, the startup will typically reinvest nearly all income into growth: things like hiring, product development, marketing, and infrastructure.[40] This growth-first strategy is a hallmark of venture-backed entrepreneurship.[41] In pursuing this traditional strategy, new ventures set goals of scaling the company rapidly and capturing market share before competitors.[42] As a result of this approach, startups often lack the liquidity to offer competitive salaries to their rank-and-file employees, especially when compared to established tech companies or other mature employers.

Startups struggle to compete with the salaries offered to prospective employees by more mature companies, in part because these companies have stable revenue streams, positive cash flow, and

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35. *See* Nows, *supra* note 34.

36. *See* David Nows, *Funding Futurist Ideas*, 102 NEB. L. REV. 849, 861 (2024) ("[L]ater-stage startup ventures will typically look to venture capital after the company proves itself by achieving the initial goals and milestones it set out to accomplish with its early-stage funding.").

37. *See* Pollman, *supra* note 13, at 186.

38. *See id.*

39. *See* Brian J. Broughman & Matthew T. Wansley, *Risk-Seeking Governance*, 76 VAND. L. REV. 1299, 1347 (2023) ("For [venture capitalists], the fact that the startup has dug itself into a financial hole that it can only climb out of by becoming extremely profitable can be a feature, not a bug. The early losses align the founders' interests with the [venture capitalists'] by making modest profitability less attractive. Therefore, [venture capitalists] have an incentive to encourage startups to pursue underwater expansion." (footnote omitted)).

40. *See* J. Brad Bernthal, *The Evolution of Entrepreneurial Finance: A New Typology*, 2018 B.Y.U. L. REV. 773, 839 ("[S]tartup cash flows are minimal and, to the extent a startup generates profits, managers desire to reinvest profits with a goal of rapid company growth.").

41. *See* Broughman & Wansley, *supra* note 39.

42. For a real-life account of these ideas, see generally PHIL KNIGHT, SHOE DOG (2016).

access to public or private capital markets.[43] Conversely, early-stage startups have uncertain revenue streams, reinvesting their profits into growth, and have limited access to private-market investors through the staged financings mentioned above.[44] These qualities allow mature companies to allocate a larger number of dollars to employee salaries, bonuses, and benefits when compared to startups. Moreover, mature companies often have access to debt financing and retained earnings, giving them greater flexibility in managing payroll.[45] These factors structurally position mature companies to offer higher cash compensation to prospective employees.

To overcome their cash limitations and attract top-tier talent, startups rely heavily on equity compensation.[46] Equity serves as a powerful recruitment and retention tool, offering employees a stake in the company's future success.[47] The logic is simple but

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43. *See* Jack Wilson, *Startups vs Established Firms: How Financial Statement Analysis Differs*, NERDBOT (Feb. 7, 2025), https://nerdbot.com/2025/02/07/startups-vs-established-firms-how-financial-statement-analysis-differs/ [https://perma.cc/3TYC-AUZS].

44. *See id.*

45. *Cf.* Nows, *supra* note 36, at 858 ("These angel investors fill a gap left by more traditional investors and lenders like banks, who rarely will lend to an early-stage, idea-based business venture because of lack of collateral and lack of retained earnings. Because angel investors solve this funding gap for new ventures, they are a critical resource for founders when they are most in need of capital to get their nascent company off the ground." (footnote omitted)); Patrick McCarney, *False Start: Carving a Niche for Established Small Business Participation in Regulation Crowdfunding Rules Designed for Startups*, 51 IND. L. REV. 277, 299 (2018) (stating that loans are often unavailable to startups); Andrew A. Schwartz, *Rural Crowdfunding*, 13 U.C. DAVIS BUS. L.J. 283, 286 (2013) ("[B]ank loans are generally unavailable, due to the high-risk nature of nearly all startups, leaving many entrepreneurs to depend primarily on personal savings and credit cards." (citing Andrew A. Schwartz, *Old Enough to Fight, Old Enough to Swipe: A Critique of the Infancy Rule in the Federal Credit Card Act*, 2011 UTAH L. REV. 407, 430-31)).

46. *See* Aran, *supra* note 14, at 1263; Joseph Bankman, *The Structure of Silicon Valley Start-Ups*, 41 UCLA L. REV. 1737, 1750 (1994) ("In exchange for this contingent [equity] compensation, employees sacrifice the higher cash salary and security of more established companies."); Elizabeth Pollman, *Private Company Lies*, 109 GEO. L.J. 353, 382 (2020) ("Startups may convince employees to accept relatively meager salaries with the promise of stock options and to keep them in their jobs to vest or receive refresh grants.").

47. *See* Thuy Nguyen, Note, *Employee Perks in Silicon Valley: Technology Companies Lead the "Arms Race" as Corporate Law Trails in Representing Shareholder Interests*, 12 HASTINGS BUS. L.J. 51, 57 (2015) (discussing equity grants as an "employee perk" and stating that "[d]espite the significant costs associated from these employee perks, companies nonetheless justify the practice on three main grounds: the perks serve to increase productivity, recruit talent, and retain valuable human resources"); *see, e.g.*, Anat Alon-Beck, *Unicorn Stock*

compelling: While a startup may not be able to match the salary offered by a large corporation, it can offer something with the potential for higher long-term value via ownership in the startup.[48]

A. Grants of Common Stock

Employees receiving equity from their startup employer are typically granted shares of common stock, which represent a residual ownership interest in the company.[49] Common shareholders are entitled to a portion of the company's value after all debts and preferred shareholder obligations have been satisfied.[50] In other words, common shareholders are the last to be paid in a liquidation event but stand to gain the most if the company is extremely successful.[51] This structure makes common stock inherently risky but potentially lucrative.[52] For employees, common stock offers unlimited financial upside.[53] If the company grows significantly in

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Options—Golden Goose or Trojan Horse?, 2019 COLUM. BUS. L. REV. 107, 140 (describing Uber's use of stock options to recruit and retain employees).

48. *See, e.g.*, Smith, *supra* note 23.

49. *See* Charles R. Korsmo, *Venture Capital and Preferred Stock*, 78 BROOK. L. REV. 1163, 1173-75 (2013) (discussing the differences between preferred stock and common stock, and stating that employees receive common stock grants in the typical startup); *see also* FRANK PARTNOY & ELIZABETH POLLMAN, BUSINESS ORGANIZATIONS: A CONTEMPORARY APPROACH 138 (4th ed. 2023) (discussing the residual claimant concept); Jonathan C. Lipson, *When Churches Fail: The Diocesan Debtor Dilemmas*, 79 S. CAL. L. REV. 363, 380 (2006) ("Under a standard theory of priority, and assuming a solvent corporation, the residual claimants would be the holders of shares of the corporate debtor's common stock, who are generally viewed as the most junior class of claimants.").

50. *See* PARTNOY & POLLMAN, *supra* note 49.

51. *See id.*; *see also* David Nows, *Making Immigration Entrepreneurial*, 77 RUTGERS U. L. REV. 1377, 1386-87 (2025) (discussing common stockholders as residual claimants in startup setting).

52. *See* PARTNOY & POLLMAN, *supra* note 49; *see also* Abraham J.B. Cable, *Opportunity-Cost Conflicts in Corporate Law*, 66 CASE W. RSRV. L. REV. 51, 61 (2015) (discussing tension between the residual claimants and the fixed claimants of a corporation); Equity-Linked Invs., L.P. v. Adams, 705 A.2d 1040, 1042, 1057-58 (Del. Ch. 1997) (addressing the tension between the economic interests of residual claimants versus those interests of preferred stockholders).

53. *See* PARTNOY & POLLMAN, *supra* note 49; *see also* Nows, *supra* note 51 ("Shares of common stock are valuable to the employee because they represent unlimited financial upside, once the company has paid back creditors and any investors with preferred dividends. This is because common stockholders are the residual claimants of the company, meaning any value remaining after the creditors and investors are paid back lies with the common stockholders. Thus, common stockholders stand to build immense wealth if the company becomes the next billion-dollar company." (footnotes omitted)).

value, common shares can grow from their original purchase price of a fraction of a penny per share to a large dollar amount. This potential for wealth creation is a central part of the startup pitch to prospective hires and serves as a key incentive for employees to invest their time and energy in building the company.[54]

Moreover, common stock aligns employee interests with those of the company and its investors.[55] As the company grows and its valuation increases, so too does the value of the employee's equity stake. This alignment fosters a long-term commitment to the company, encouraging employees to think and act like stakeholders rather than mere wage earners.[56] In this way, equity compensation is not just a financial tool; it is a cultural and strategic mechanism that helps startups build cohesive, mission-driven teams.

Equity compensation granted to employees in early-stage startups is typically formalized through an RSPA.[57] This agreement governs the terms under which an employee acquires shares of common stock in the company.[58] An RSPA involves an immediate purchase of shares by the employee at the then-current fair market value (FMV) of a share of company stock.[59] When the company is first formed, but before it engages in meaningful economic activity, the common stock share price for founders and employees can be one

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54. *See* Smith, *supra* note 23.

55. *See* David Nows & Jeff Thomas, *Delaware's Public Benefit Corporation: The Traditional VC-Backed Company's Mission-Driven Twin*, 88 UMKC L. REV. 873, 887 (2020) (discussing the alignment of goals between employees and venture capitalists when employees are granted equity).

56. *See, e.g.*, Sean M. Anderson, *Risky Retirement Business: How ESOPs Harm the Workers They Are Supposed to Help*, 41 LOY. U. CHI. L.J. 1, 25 (2009) (discussing an analogous concept, employees of ESOP companies, and stating that "[w]orkers ... come to believe that the ESOP company is 'their' company and that their good is bound up with that of the employer; as a result, they work harder to help the company do well. ESOP participants ... are more likely to take 'ownership' over their work and to feel satisfied in their jobs. In addition, advocates claim that ESOPs encourage a more peaceful coexistence between workers and managers. According to one prominent pro-ESOP book, a company with a properly-implemented ESOP can 'eliminate the sense of "us" and "them" that pervades traditional companies.'" (footnotes omitted) (quoting COREY ROSEN, JOHN CASE & MARTIN STAUBUS, EQUITY: WHY EMPLOYEE OWNERSHIP IS GOOD FOR BUSINESS 35 (2005))).

57. *See* Nows & Thomas, *supra* note 55, at 892.

58. *See What is a Restricted Stock Purchase Agreement and Why Have One?*, AXIS LEGAL COUNS. (Mar. 17, 2015), https://axislc.com/public/what-is-a-restricted-stock-purchase-agreement-and-why-have-one/ [https://perma.cc/GV7K-CRVU].

59. *See* Nows & Thomas, *supra* note 55, at 892-93, 892 n.106.

cent per share or less.[60] The purchase of common stock by employees is a real transaction in which the employee exchanges cash for ownership in the company, even if the amount paid is minimal.

The RSPA is a foundational document in startup equity compensation because it establishes the employee as a shareholder in the company from the outset. However, the agreement also includes restrictive provisions that limit the employee's rights in the shares of stock.[61] Chief among these restrictive provisions is the vesting schedule and the repurchase option in favor of the company.[62] These mechanisms are designed to ensure that equity rewards are tied to continued service and meaningful contributions to the company's growth.[63]

B. The Contractual Vesting Provision

First, vesting is one of the most important and misunderstood concepts in startup equity compensation. At its core, vesting is a contractual mechanism that determines when an employee earns the right to keep and benefit from the equity they have been granted.[64] Without vesting, an employee could be hired, receive a large equity grant, and then leave the company shortly thereafter while retaining full ownership of their shares.[65] This would

60. *See id.* at 887.

61. *See id.* at 887-88.

62. *See id.*

63. *See* Thomas, *supra* note 16 ("Repurchase options and vesting provisions do more than protect investors—they help employees who stay at firms after others depart. Without these provisions, co-founders and other employees[ ] who quit would take more shares with them and, thus, free ride off the hard work of those who stay. This would allow former employees to benefit too much from the sweat of others and, thereby, demotivate the remaining team members. Thus, venture capitalists require these provisions before investing funds in a company." (footnotes omitted) (citing CONSTANCE E. BAGLEY & CRAIG E. DAUCHY, THE ENTREPRENEUR'S GUIDE TO LAW AND STRATEGY 101 (5th ed. 2017))).

64. *See* Nows, *supra* note 51, at 1387 ("[V]esting schedules allow for employees to earn the right to the economic value of the shares they have been granted over time. Thus, the contract granting shares will stipulate when the shares of stock become vested, meaning their value has been earned by the employee." (footnote omitted)).

65. *See* Thomas, *supra* note 16 (discussing vesting provisions and stating that "[w]ithout these provisions, co-founders and other employees[ ] who quit would take more shares with them and, thus, free ride off the hard work of those who stay").

undermine the purpose of equity compensation, which is to reward long-term contributions to the company's growth.[66]

Thus, the vesting schedule contained in an RSPA specifies when the employee earns the right to the economic value of the shares of stock they have been granted by the company.[67] Until shares are vested, the company retains the contractual right to repurchase them if the employee leaves the company at the lower of the original purchase price or the shares' current FMV.[68] This protects the company from an employee experiencing a financial benefit via their ownership in the company when the employee did not contribute to the company meaningfully.[69] Conversely, once shares vest, the employee shareholder is entitled to the higher of the FMV or the purchase price for each share of stock owned upon selling the shares.[70] Typically, that employee liquidity event occurs subject to the company's repurchase option when the employee leaves the company.[71]

In this way, the RSPA serves as both a motivational tool for employees and a protective mechanism for the company. It incentivizes long-term commitment from employees by offering ownership, while also preserving the company's ability to reclaim equity from short-term hires.[72] The vesting portion of the RSPA reflects a careful balance between employee incentives and corporate control, and it is central to the startup's strategy for attracting and retaining talent without relying on high cash compensation.[73]

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66. *See* Nows, *supra* note 51, at 1388 (discussing repurchase options and vesting provisions and stating that "[t]hese contractual mechanisms, in tandem, allow for early-stage startups to share in the growth of the company with employees during the period of time in which they are making contributions, then, repurchase the shares of stock upon the employee's departure").

67. *Id.* at 1387 ("[V]esting schedules allow for employees to earn the right to the economic value of the shares they have been granted over time.").

68. *See id.* at 1388 ("For any unvested shares of stock held by the employee, the company retains the right to repurchase those shares at termination as well, but typically at the low cost the employee paid for them on their hire date.").

69. *See* Thomas, *supra* note 16.

70. *See* Nows, *supra* note 51, at 1388 ("Employees cash out on the growth on these vested shares on termination, when the company exercises a repurchase option to buy back vested shares from the employee at the current fair market value of those shares.").

71. *See id.*

72. *See* Thomas, *supra* note 16.

73. *See id.*

Given that vesting schedules are a bargained-for contractual right between startup and employee, best practices have emerged for creating a vesting schedule. Most startup equity grants follow a standard vesting schedule: four years of total vesting with a one-year cliff at the beginning.[74] This schedule has two distinct phases:

> *The Cliff Period (Year 1):* During the first year of employment, none of the shares granted vest. This is known as the "cliff." If the employee leaves before completing one full year of service to the company, they walk away with no economic right to the equity they were granted. However, if they stay for the full year, a lump sum, typically 25 percent of the total share grant, vests all at once.[75] This structure ensures that only employees who make a meaningful initial contribution, measured through the employee's time in service to the company, receive an economic right to equity.
>
> *Post-Cliff Vesting (Years 2-4):* After the cliff, the remaining 75 percent of the shares vest gradually, usually "on a monthly or quarterly basis over the next three years."[76] For example, if an employee is granted ninety-six shares, twenty-four shares vest at the one-year mark, and the remaining seventy-two shares vest in equal monthly increments, two shares per month, over the next thirty-six months. This gradual vesting reflects the idea that the employee has now demonstrated commitment and value to the employer, and should continue to earn the economic value of the equity they were granted as they make more incremental contributions to the company's growth.[77]

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74. *See* Alec Galustian, *Stock-Based Compensation in Startups: Employee Implications & Potential Solutions*, 20 U.C. L. BUS. J. 239, 245 (2024) ("The most prevalent vesting schedule is known as 'cliff-vesting,' where one-fourth of options become available at the end of the first year, and the remainder becomes exercisable monthly over the next three years." (citing Alon-Beck, *supra* note 47, at 127)); *see also* Aran, *supra* note 14, at 1269 (discussing a scenario in which the vesting process may not be fully complete); Black, *supra* note 15, at 314 (discussing cliff vesting).

75. *See* Galustian, *supra* note 74; Black, *supra* note 15, at 314.

76. Nows, *supra* note 51, at 1388 ("After the cliff has been reached, the remaining shares typically vest on a monthly or quarterly basis over the next three years, which correspond with years 2 to 4 of the employee's employment with the company. This more regular vesting schedule reflects the fact that the employee has now met the minimum contribution required to receive value from the equity, and further, should have the ability to lock in the value of their contributions on a more regular basis moving forward." (footnote omitted)).

77. *See id.* at 1387.

Once shares of common stock vest, the employee has earned the economic value of those shares.[78] If the company's FMV has increased, the employee stands to gain significantly. For example, if the employee paid $0.01 per share and the FMV is now $5.00 per share, the employee has earned $4.99 per share in value. This gain is then multiplied by the number of shares of common stock held by the employee, which can be in the thousands. The gain itself is typically realized when the company repurchases the vested shares at FMV upon the employee's departure or, alternatively, upon the company's acquisition by a strategic acquirer.

C. The Contractual Repurchase Option

Next, the repurchase option in favor of the company and contained in the RSPA is conceptually separate from the idea of vesting, but the concepts operate in tandem. When an employee leaves the company (whether voluntarily or involuntarily), the company typically exercises its repurchase option.[79] For vested shares, the company may repurchase those shares at the higher of the shares' FMV at the time of termination or of the employee's original purchase price.[80] In scenarios where the value of the company has risen, this allows the employee to realize the economic gain from the appreciation of the company's stock during their tenure. Per the previous example, if the employee purchased shares at $0.01 each and the FMV upon separation is $5.00, the employee receives a substantial return for each share of common stock owned. For unvested shares, however, the company has the right to repurchase them at the lower of the original purchase price (often pennies per share) or at the current FMV.[81] This means the employee breaks even on those shares in situations where the value

78. *Id.*

79. *See id.* at 1388 ("These contractual mechanisms, in tandem, allow for early-stage startups to share in the growth of the company with employees during the period of time in which they are making contributions, then, repurchase the shares of stock upon the employee's departure.").

80. *See id.*

81. *See id.* ("For any unvested shares of stock held by the employee, the company retains the right to repurchase those shares at termination as well, but typically at the low cost the employee paid for them on their hire date.").

of the company has risen, receiving no gain but also incurring no loss.

The repurchase option also serves a broader corporate governance function: It allows the company to recycle equity.[82] Once shares are repurchased from a departing employee, they can be reissued to a new hire replacing the departing employee at the then-current FMV.[83] This ensures that equity remains available as a compensation tool to new employees, even if they will have a higher purchase price than their predecessor based on the company's growth.[84] This cycle of grant, repurchase, and reissuance is central to how startups manage their capitalization tables and maintain flexibility in talent acquisition. It also reinforces the idea that equity is not a gift made forever, but rather a tool for aligning incentives with the company's employees at any given time in the company's lifecycle.

D. When Stock Options Replace Stock Grants

As a startup matures and its valuation increases, the FMV of its common stock often rises to a point "where it becomes prohibitively expensive for new employees to purchase" shares of common stock outright at the date of hire.[85] In such cases, startups frequently shift from granting restricted stock to granting stock options.[86] A stock option is a contractual right that allows an employee to purchase a specific number of shares of common stock at a fixed price, known as the exercise price or strike price, at some point in the future.[87]

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82. *See id.* at 1388-89 ("From there, the company can rehire the departing employee's role and re-issue those same shares of stock to a new employee, this time with the then-current fair market value as the purchase price. From here, the cycle begins anew, allowing for the second employee to financially benefit from the contributions they have made to the company's growth, subject to vesting restrictions and the repurchase agreement." (footnote omitted)).

83. *See id.* at 1388.

84. *See id.* at 1388-89.

85. *Id.* at 1389 ("[I]n cases where the fair market value of the company's stock has risen to a level where it becomes prohibitively expensive for new employees to purchase the shares upon hire, the company can grant the employee stock options instead of the shares of common stock.").

86. *Id.* at 1388-89.

87. *See* Eric L. Johnson, Note, *Waste Not, Want Not: An Analysis of Stock Option Plans, Executive Compensation, and the Proper Standard of Waste*, 26 J. CORP. L. 145, 146-47 (2000)

This strike price is typically set at the FMV of the company's common stock on the date the option is granted.[88]

Unlike restricted stock, which involves an immediate transfer of ownership (albeit with restrictions), stock options do not confer ownership until exercised.[89] The employee holds a right, not an asset.[90] This makes future equity ownership more accessible to employees who may not have the cash on hand to purchase shares of common stock at the time of hire. Stock options allow employees to defer the purchase decision until a later date. Given this ability to wait, employees will only exercise the stock options when the company has grown in value.[91] This is because the employee can purchase shares of common stock at the strike price, which becomes lower than the current FMV of the shares of common stock when the value of the enterprise increases during their employ.[92] The economic appeal of stock options for employees lies in this asymmetric payoff structure. If the company's common stock price increases, the employee can exercise the option and realize an immediate gain by purchasing shares at the lower, fixed strike

("When stock options are used as compensation, it simply means that an employee, usually an executive or a director, is granted an option to buy stock at a certain price from the company at some future time." (citing BLACK'S LAW DICTIONARY 988 (6th ed. 1991))).

88. *See* Jesse M. Fried, *Option Backdating and Its Implications*, 65 WASH. & LEE L. REV. 853, 857 (2008) ("[M]ost stock options have been granted to executives at-the-money (with a strike price set to the grant-date market price) rather than in-the-money (with a strike price set below the grant-date market price)."); *see also* David I. Walker, *Unpacking Backdating: Economic Analysis and Observations on the Stock Option Scandal*, 87 B.U. L. REV. 561, 567 (2007) ("Compensatory stock options provide an employee with the right to purchase shares of her employer's stock at a predetermined exercise (or strike) price. The options issued by publicly traded companies in the United States tend to be extremely uniform in design. Generally, the options are issued with an exercise price equal to the fair market value of the employer's stock on the date of the grant (known as an 'at-the-money' option).").

89. *See* Kristy Watson, Note, *Acting in the Best Interests of the Child: A Solution to the Problem of Characterizing Stock Options as Income*, 69 FORDHAM L. REV. 1523, 1536 (2001) ("The owner of the option has a right (but not an obligation) to purchase the stock at the specified strike price—the price that the option owner has agreed to pay the option writer in order to acquire the underlying stock." (citing Robert W. Jones, *Understanding Option Contract Terminology in Order to Properly Value Stock Options*, THE MATRIM. STRATEGIST, Jan. 2000, at 6)).

90. *See id.*

91. *See* James J. Park, *Rule 10b-5 and the Rise of the Unjust Enrichment Principle*, 60 DUKE L.J. 345, 383 (2010) ("[S]tock options give workers and executives an incentive to increase the value of the firm so that they can exercise their stock options and profit from the differential between the strike price and the increased market price.").

92. *Id.*

price.[93] If the stock price falls below the strike price, the employee simply lets the option expire, incurring no loss.[94] This makes the stock option a no-lose scenario for the employees holding them.[95]

E. Liquidity Events

While an employee's departure from the new venture can be the event that leads to them exchanging their shares of common stock in the company for the increased value of the shares, employees can also experience a liquidity event when a startup is acquired by a third party.[96] In these scenarios, the structure of the acquisition plays a critical role in determining how equity holders like employees are compensated. While this Article stops short of exploring transaction structures in depth, as this treatment is simply beyond the Article's scope, this section reviews the basic elements of two of the most common acquisition structures: stock purchases and asset purchases. Both of these transactional structures carry distinct implications for equity holders. Those implications become relevant as we then review the series of transactions experienced by Windsurf in Part II of this Article.

1. Stock Purchase Acquisitions

First, in an acquisition structured as a stock purchase, the acquiring company purchases the outstanding shares of the target company directly from its shareholders.[97] The end result of this transaction is that the target company has been purchased in full

93. *Id.*

94. *See* Michael B. Dorff, *The Group Dynamics Theory of Executive Compensation*, 28 CARDOZO L. REV. 2025, 2034 (2007) ("If ... the stock price remains at the same level or has declined, the option holders cannot make money by exercising the stock options.").

95. *See* Watson, *supra* note 89 ("The value of the option itself, therefore, can never fall below zero because the option owner has no obligation to buy when the stock price is less than the strike price." (citing Jones, *supra* note 89)).

96. *See* Gary Dushnitsky & D. Daniel Sokol, *Mergers, Antitrust, and the Interplay of Entrepreneurial Activity and the Investments That Fund It*, 24 VAND. J. ENT. & TECH. L. 255, 267 (2022) ("The ultimate payoff to the founders, LPs, and VCs is in the form of a 'liquidity event,' (also known as an 'exit') where shareholders can turn their equity stake into cash either when the venture is acquired or goes public." (citation modified)).

97. *See generally* PARTNOY & POLLMAN, *supra* note 49, at 685-93 (describing different transactional structures in business acquisitions).

by the acquirer and becomes fully owned by the acquirer (assuming 100 percent of the target company's outstanding stock was purchased).[98] From there, the acquirer assumes control of the target company with the full benefit of the target company's existing infrastructure, like employees, contracts, and real estate.[99] The acquirer also assumes control of all of the target company's liabilities.[100] For the shareholders of the acquired company, the effect of this transaction is that they receive consideration, typically cash, directly from the acquirer in exchange for their shares of stock in the target company.[101] To illustrate this concept through a simple example, if the target company has 100 shares of stock outstanding and is purchased by the acquirer for $1 million, each share of stock is worth $10,000. Shareholders will receive their pro rata share of the purchase price, which is calculated as shares of stock held times $10,000. For example, a shareholder holding five shares of the company's common stock would receive $50,000 in this transaction with the acquirer.

Careful readers of this Section of the Article may wonder how easy it is to determine the number of outstanding shares of the acquired company's stock upon an acquisition. After all, the concept of vested and unvested shares seems to bring into question whether every share issued by the company has truly been "earned"—providing for a flow of economic value to the shareholder in question.[102] A couple of quick clarifications will help to resolve these issues. First, any vested shares provide economic value to the shareholder, meaning that share will provide the shareholder with a portion of the payout from the acquisition.[103] Further, unvested shares may be subject to either single-trigger or double-trigger accelerated vesting based on the terms outlined in the RSPA.[104] In RSPAs with single-

98. *See id.* at 693 (referring to this as "tender offers").

99. *See id.*

100. *See id.*

101. This is done through a stock purchase agreement. *See generally Stock Purchase Agreement*, LEGAL INFO. INST.: WEX (July 2021), https://www.law.cornell.edu/wex/stock_purchase_agreement [https://perma.cc/DVN6-KKF6] (defining a stock purchase agreement as "a contract under which a seller transfers stock of a corporation to a buyer").

102. *See supra* Part I.B.

103. *See* Nows, *supra* note 51, at 1388 ("Employees cash out on the growth on these vested shares on termination, when the company exercises a repurchase option to buy back vested shares from the employee at the current fair market value of those shares.").

104. *See* Craig Jacoby, *Pulling the Trigger(s): What Are Single-Trigger and Double-Trigger*

trigger accelerated vesting, all unvested shares of common stock automatically vest upon the occurrence of a single event, in this case the sale of the company.[105] Under these facts, all shares of common stock granted to an employee shareholder under an RSPA with a single-trigger acceleration clause would be vested at the sale of the company. Single-trigger acceleration clauses are fairly uncommon for most founders and all rank-and-file employees.[106]

Conversely, RSPAs are more likely to provide for double-trigger accelerated vesting, which makes the accelerated vesting of unvested shares contingent on two events—both of which need to occur in order for the accelerated vesting to take place.[107] These two events are typically enumerated as follows: (1) the sale of the company; and (2) the involuntary termination of the employee within a specified time period after closing.[108] In these cases, the first trigger (the sale of the company) is always met. However, the accelerated vesting only occurs once the second trigger is also satisfied. Importantly, this would require the acquirer to assume the equity grant, made by the target company, in the acquisition beyond the closing date, something that is somewhat rare.[109] Instead, acquirers often allow the employee to cash in on their vested shares of the target on the date of the acquisition; then, the employee receives a new stock grant from the acquirer of the acquirer's common stock that restarts the employee's vesting clock.[110] In effect, when double-trigger vesting is present, the employee is out of luck with respect to their unvested shares in the target company and they begin the process of earning through equity ownership anew on day one of employment with the acquirer.

Stock options also present an issue in calculating the number of outstanding shares of the target company, but this issue is also

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Acceleration and How Do They Work?, COOLEY GO (Apr. 20, 2022), https://www.cooleygo.com/what-are-single-and-double-trigger-acceleration-and-how-do-they-work/ [https://perma.cc/SWP6-Q2VE].

105. *Id.*

106. *Id.*

107. *Id.*

108. *Id.*

109. *Id.*

110. *See* Kristin McKenna, *What Happens to Your Stock When a Company is Bought?*, DARROW WEALTH MGMT.:BLOG (Apr. 2026), https://darrowwealthmanagement.com/blog/asset-management-employee-stock-options-after-acquisition/ [https://perma.cc/7WRU-3G37].

easily resolved by contract. Typical stock option contracts call for the automatic exercise of "in-the-money" options, meaning that if an employee's strike price is lower than the price per share being paid by the acquirer, the employee's stock option will automatically be exercised at the time of the acquisition.[111] This results in a payout for option holders as if they were shareholders all along. Of course, stock option grants are also subject to vesting restrictions, so "in-the-money" options are only exercised and paid out if they are vested or subject to single-trigger acceleration.[112] Unvested options or those subject to double-trigger acceleration are not exercised or paid out to the shareholder upon the acquisition taking place.[113]

2. Asset Purchase Acquisitions

Asset purchases are an alternative for acquirers who prefer not to buy all of the target company's assets and liabilities as in a stock purchase.[114] Instead, in an asset purchase, the acquiring company buys specific assets of the target company like intellectual property, customer contracts, or physical infrastructure, rather than the target company itself.[115] For the acquirer, the benefit of this transaction structure is that it can limit the assets it acquires from the target company to only those that will add value to the acquirer's

111. *See* Michael A. Woronoff & Jonathan A. Rosen, *Understanding Anti-Dilution Provisions in Convertible Securities*, 74 FORDHAM L. REV. 129, 149 (2005) (addressing the concept of "fully diluted," which assumes all options have been exercised, and stating that "[b]road-based formulae take into account all common stock outstanding on a 'fully-diluted basis,' giving effect to the exercise or conversion of all outstanding warrants, options, and convertible securities" (quoting ALEX WILMERDING, DEAL TERMS: THE FINER POINTS OF VENTURE CAPITAL DEAL STRUCTURES, VALUATIONS, TERM SHEETS, STOCK OPTIONS AND GETTING DEALS DONE 75 (2003))); *see also* Afra Afsharipour, *A Shareholders' Put Option: Counteracting the Acquirer Overpayment Problem*, 96 MINN. L. REV. 1018, 1077 (2012) (addressing what a shareholder would do if the options were not automatically exercised and stating that "[i]f the option remains in-the-money at the time of the closing of the acquisition, there is a high likelihood that shareholders who purchased the option would exercise the option and force the acquirer's management to use free cash to purchase the shares put to the company. If, on the other hand, the deal enhances the acquirer firm's value, the premium is 'expensive,' and existing shareholders would not purchase the option").

112. *See* Jacoby, *supra* note 104.

113. *Id.*

114. *See* PARTNOY & POLLMAN, *supra* note 49, at 691-92.

115. *See id.* at 691.

operations.[116] Of course, the drawback is that in situations where the acquirer leaves behind significant liabilities with the target entity, the purchase price paid for the assets acquired is likely to be higher than if the acquirer simply acquired both the good and the bad of the target company through a stock sale.

The result of this transactional structure for the target company is that it remains intact as a legal entity but is stripped of its most valuable components: the assets that have been sold to the acquirer. The target company then remains a legal entity as a going concern and holds the undesirable assets and liabilities of the target company into the future.[117] Of course, this is not all that the target company holds moving forward. It has acquired one valuable asset in the transaction: the purchase price in the asset purchase agreement. The target company must then use this value received to extinguish its outstanding liabilities before it can distribute the value of the transaction to its shareholders.[118]

Further, asset purchases provide more surface-level flexibility with respect to the acquirer hiring the team of the target company.[119] For example, asset purchases often involve selective hiring in which only certain employees, like founders or key technical talent, are offered roles at the acquiring company.[120] Those key employees depart the target company and cash out their shares of common stock in the target company; then, they join the acquirer on

116. *See Asset Purchase vs Stock Purchase*, CORP. FIN. INST. (Oct. 28, 2019), https://corporatefinanceinstitute.com/resources/valuation/asset-purchase-vs-stock-purchase/ [https://perma.cc/RC9H-ABE7] ("The buyer can dictate what, if any, liabilities it is going to assume in the transaction. This limits the buyer's exposure to liabilities that are large, unknown, or not stated by the seller. The buyer can also dictate which assets it is not going to purchase.").

117. *Id.* ("The seller still needs to liquidate any assets not purchased, pay any liabilities that have not been assumed, and take care of any leases that need to be terminated.").

118. *See What Happens to Contracts When a Company Is Acquired?*, LEGALCLARITY (July 7, 2025), https://legalclarity.org/what-happens-to-contracts-when-a-company-is-acquired/ [https://perma.cc/8MWU-EUSQ] ("Unless the buyer explicitly agrees to take on a specific contract in the purchase agreement, the contract is not transferred and remains the obligation of the selling company, which may eventually dissolve.").

119. *See* Tyler T. Manley, *Navigating Labor and Employment Considerations in Mergers and Acquisitions*, AXLEY (May 29, 2024), https://www.axley.com/publication_article/labor-employment-mergers-acquisitions/ [https://perma.cc/LA64-X5HB] ("In an asset purchase, the Buyer typically has the option to selectively hire employees from the Seller or hire no employees whatsoever.").

120. *Id.*

new employment terms. The employees left behind with the target company, typically rank-and-file employees, can face diminished prospects as target companies are sometimes wound up and do not continue as going concerns.[121] Further, the left-behind employees can experience a lower financial upside from the transaction as the departing employees have cashed out their shares of stock in the target at the high-water mark of the target company's value (immediately after the asset purchase's proceeds have been received).

In both stock purchases and asset purchases, the distribution of acquisition proceeds is further complicated by the liquidation and dividend preferences granted to preferred shareholders. Preferred shareholders are the financial investors who have provided the startup with necessary growth capital along its journey. These preferred shareholders receive a separate class of stock as compared to the common stockholders.[122] This separate class of stock holds senior claims on the company's assets and earnings, meaning that preferred shareholders are paid before common shareholders in the event of a sale or liquidation.[123] The liquidation preference is often structured as a 1x liquidation preference, entitling investors to receive back their original investment before any proceeds are distributed to common shareholders.[124] In some cases, preferred shares may also have participation rights, which allow preferred shareholders to share in the remaining proceeds of the sale alongside common shareholders as if their shares of preferred stock were common stock.[125] This can significantly dilute the payout available to employees and other common stockholders.

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121. *See* LEGALCLARITY, *supra* note 118.

122. *See* PARTNOY & POLLMAN, *supra* note 49.

123. *See id.*

124. *See* Michael A. Woronoff & Jonathan A. Rosen, *Effective vs Nominal Valuations in Venture Capital Investing*, 2 N.Y.U. J.L. & BUS. 199, 208 (2005) ("In its simplest form, the liquidation preference is equal to the initial purchase price, insuring the investor will receive its money back before any value goes to junior stockholders. In a downside scenario, where the liquidation preference is greater than the holder's percentage ownership interest of the exit proceeds, this protection can be quite valuable." (footnote omitted) (citing CONSTANCE E. BAGLEY & CRAIG E. DAUCHY, THE ENTREPRENEUR'S GUIDE TO BUSINESS LAW 449 (2003))).

125. *Id.* at 214 ("In some venture capital transactions, upon a liquidation, after receiving their liquidation preference, the holders of preferred stock 'participate' in the distribution of the remaining assets of the company as if they had converted their shares of preferred stock into common stock." (citing Timothy J. Harris, *Modeling the Conversion Decisions of Preferred Stock*, 58 BUS. LAW. 587, 589 (2003))).

Dividend preferences also play a role in shaping the distribution of proceeds when a startup venture is acquired. In short, dividend preferences ensure that preferred shareholders are paid all promised dividends before common shareholders have the right to any cash distributions.[126] These provisions are helpful to preferred shareholders because startups may choose to skip dividend payments to preferred shareholders during their growth phase in an effort to reinvest more capital into the new venture's growth.[127] Dividend preferences provide preferred shareholders with a contractual right to these skipped dividend payments, which then must be paid out upon a liquidity event before common shareholders receive any of the transaction's proceeds.[128] Of course, these dividends to preferred shareholders further reduce the pool of funds available to common shareholders. In high-value acquisitions, these dividend preferences may be absorbed without much impact.[129] But in lower-value acquisitions, dividend preferences can effectively wipe out the financial upside for common shareholders, like employees, even if their equity is fully vested.

3. Liquidity Events and Impact on Employee Shareholders

The above contractual and transactional structures create circumstances in which the value of an employee's equity compensation is not only contingent on the company's success but also on the form and

126. *See* Ronald J. Gilson & David M. Schizer, *Understanding Venture Capital Structure: A Tax Explanation for Convertible Preferred Stock*, 116 HARV. L. REV. 874, 882 (2003) ("[A] dividend preference in favor of preferred stock prohibits the payment of a common dividend before the payment of a preferred dividend.").

127. *See* Frederic A. Rubinstein & Marc H. Morgenstern, *Balancing the Deal: Private Placements—What They Can Mean to Your Client*, BUS. L. TODAY, Nov./Dec. 1995, at 27, 29 ("The investors may agree that payment may be deferred for a period of years to avoid a cash drain on the company in early stages of operations.").

128. *See* Gilson & Schizer, *supra* note 126 ("To be effective, the dividend preference must be cumulative, so that preferred dividends will accrue even if not currently paid. In that event, the barrier to paying a common dividend will grow with time.").

129. *See, e.g.*, Melissa M. McEllin, Note, *Rethinking* Jedwab*: A Revised Approach to Preferred Shareholder Rights*, 2010 COLUM. BUS. L. REV. 895, 899-900 ("[P]referred stock ownership does not offer the same opportunity as common stock ownership to directly benefit from company growth or improved corporate performance, because while the value of common stock is tied to the performance of the company, preferred stock returns come primarily from the fixed dividends provided for by their certificate's dividend preference terms, with any additional value improvements based on interest rates.").

terms of the RSPA and acquisition itself. A startup may grow significantly in value and attract a high-profile acquirer, but certain deal structures can significantly reduce the value left over for rank-and-file employees once they have the opportunity to cash out their common stock. For example, if the deal is structured as an asset purchase and the company's capital stack is heavily weighted toward preferred stock, rank-and-file employees may walk away with little to show for their contributions.[130]

In the best-case scenario, employees who hold vested equity in a startup that is acquired in a traditional stock purchase receive a payout based on the fair market value of their shares.[131] This payout reflects the growth of the company during their tenure and serves as the financial reward for their risk and effort. In such cases, equity compensation fulfills its promise: It allows employees to share in the upside of the venture they helped build. However, in the worst-case scenario, particularly in asset purchases where only the company's intellectual property and star talent are acquired, rank-and-file employees may be left behind financially.[132] In this instance, employee equity may be tied to a shell of a remaining company that no longer holds assets capable of experiencing meaningful growth, and their shares may be repurchased at nominal value compared to the shares of the key employees who left the startup for the acquirer in the asset purchase.[133] Here, the equity compensation model fails to deliver on its core promise, raising serious questions about fairness, incentive alignment, and the future of startup employment.

II. THE WINDSURF DEAL AND HOW IT IMPACTED EMPLOYEE EQUITY COMPENSATION

This Part of the Article addresses recent transactions that have widely disseminated the concept of Traitor Transactions to the startup community. The company at the center of this story, Windsurf, works in the agentic artificial intelligence space.[134] Agentic

130. *See infra* Part II.E.
131. *See* Nows, *supra* note 51, at 1388.
132. *See infra* Part II.E.
133. *See infra* Part II.E.
134. *See What is Windsurf?*, WINDSURF, https://windsurf.com/editor [https://perma.cc/S6HY-

artificial intelligence essentially weaves two separate technologies together: generative AI and automation.[135] Generative AI crafts brilliant language and insights, but it cannot take action on its own.[136] When paired with an automation sequence, however, AI can take action on its principal's behalf in a limited set of preprogrammed ways.[137] More specifically, Windsurf has developed an autonomous software code editing tool that helps software engineers review, edit, and iterate on their coding efforts.[138] The generative piece of Windsurf's artificial intelligence is its code writing and editing capabilities (much like a more novice user might use ChatGPT or Copilot to assist).[139] The automation aspect of the artificial intelligence deployed by Windsurf is its ability to learn the context of a given software project through its set of code, make suggestions that would further the project, debug software code errors, and iterate on current work product to advance the project.[140]

With the above value proposition, Windsurf's business was scaling rapidly. As of summer 2025, the company had "several hundred thousand daily active users and approximately $100 million in annual recurring revenue."[141] Additionally, it had raised four investment rounds of capital since its founding in 2021, including two separate rounds of funding for a total of $215 million in 2024 alone—one of which was led by well-known Silicon Valley investment firm Kleiner Perkins.[142] This rapid scaling effort,

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6QMR].

135. *See generally* PASCAL BORNET, JOCHEN WIRTZ, THOMAS H. DAVENPORT, DAVID DE CREMER, BRIAN EVERGREEN, PHIL FERSHT, RAKESH GOHEL & SHAIL KHIYARA, AGENTIC ARTIFICIAL INTELLIGENCE: HARNESSING AI AGENTS TO REINVENT BUSINESS, WORK, AND LIFE 35-44 (2025) (describing agentic AI as the convergence of large language models and automation, providing background on each technology, and discussing how both technologies are ready to contribute to a powerful set of agentic AI technologies).

136. *Id.* at 35.

137. *Id.* at 41.

138. *See* WINDSURF, *supra* note 134.

139. *See What Is Windsurf AI and Why Use It?*, EDUCATIVE, https://www.educative.io/courses/getting-started-with-windsurf-ai/what-is-windsurf-ai-and-why-use-it [https://perma.cc/8Q3E-86K5].

140. *Id.*

141. Swain, *supra* note 1.

142. *See Windsurf-Crunchbase Company Profile & Funding*, CRUNCHBASE, https://www.crunchbase.com/organization/windsurf-codeium [https://perma.cc/8NRW-6ZN9]; *see also Windsurf—Funding & Investors*, TRACXN (June 6, 2026), https://tracxn.com/d/ companies/windsurf/ [https://perma.cc/8DZU-L568] (itemizing the dates of funding and funding amounts).

coupled with the company being viewed as a leader in the agentic AI coding space, led large technology companies to have a significant interest in acquiring Windsurf.

A. The First Suitor: OpenAI

The first and most likely suitor for Windsurf was OpenAI. OpenAI, the company behind ChatGPT, is well known in the artificial intelligence space for being the first to publicly release a generative AI model.[143] In many respects, OpenAI has maintained that first-mover advantage since ChatGPT's launch in late 2022.[144] Given Windsurf's high-quality product in an area that OpenAI would surely have liked to improve its business in, there was a proposed deal for $3 billion to acquire Windsurf outright.[145] Had the acquisition gone through, it would have been OpenAI's largest acquisition to date.[146]

The deal fell apart due to an internal dispute between OpenAI and its strategic partner, Microsoft.[147] OpenAI was originally structured as a nonprofit entity, an atypical arrangement for an entity resembling a large technology company.[148] This is because OpenAI described itself at its founding as:

> [A] non-profit artificial intelligence research company. Our goal is to advance digital intelligence in the way that is most likely to benefit humanity as a whole, unconstrained by a need to generate financial return. Since our research is free from financial obligations, we can better focus on a positive human impact.[149]

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143. *See ChatGPT, the Generative AI Chatbot, Is Released*, HISTORY (Nov. 25, 2025), https://www.history.com/this-day-in-history/november-30/chatgpt-released-openai [https://perma.cc/EQR2-4WEX].

144. *See id.*

145. *See* Hayden Field, *OpenAI in Talks to Pay About $3 Billion to Acquire AI Coding Startup Windsurf*, CNBC (Apr. 16, 2025, at 16:20 ET), https://www.cnbc.com/2025/04/16/openai-in-talks-to-pay-about-3-billion-to-acquire-startup-windsurf.html [https://perma.cc/5BZC-FTMJ].

146. *Id.*

147. *See* Swain, *supra* note 1.

148. *See* Rebecca Bellan, *Microsoft in Talks to Maintain Access to OpenAI's Tech Beyond AGI Milestone*, TECHCRUNCH (July 29, 2025, at 07:44 PT), https://techcrunch.com/2025/07/29/microsoft-in-talks-to-maintain-access-to-openais-tech-beyond-agi-milestone/ [https://perma.cc/7YC6-LRRY].

149. *Introducing OpenAI*, OPENAI (Dec. 11, 2015), https://openai.com/index/introducing-

Things change when large sums of money are involved. First, OpenAI altered its structure in 2019 to create a "capped-profit" subsidiary of the nonprofit holding company.[150] Under this structure, both investors and employees are contractually entitled to a capped return on their time or cash investment should the company have commercial success.[151] Financial returns in excess of these caps revert to the original nonprofit holding company.[152] This structural change was important for OpenAI to remain competitive in a burgeoning generative AI space, as significant amounts of capital are required to build, test, and run a technology that requires expert-level talent and consumes immense amounts of energy. That capital could now come from financial investors who would hold a stake in the capped-profit entity.[153]

Further, after the capped-profit company structure was announced, OpenAI entered into a strategic partnership with Microsoft.[154] In this partnership, OpenAI's capped-profit company received $13.75 billion in capital investment from Microsoft, as well as cloud computing resources, in exchange for equity in the capped-profit company and rights to its intellectual property (with carveouts for technologies that achieve artificial general intelligence (AGI)).[155] The partnership was revisited twice, in 2021 and 2023, when Microsoft made additional investments into the capped-profit entity.[156]

Reports in 2025 stated that OpenAI was abandoning its nonprofit structure to become a for-profit entity.[157] These reports were not quite accurate. Instead, OpenAI converted its capped-profit entity to a Public Benefit Corporation (PBC) in Delaware.[158] PBCs are

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openai/ [https://perma.cc/WQS6-FYL2].

150. *OpenAI LP*, OPENAI (Mar. 11, 2019), https://openai.com/index/openai-lp/ [https://perma.cc/66QY-2H72].

151. *Id.*

152. *Id.*

153. *See id.*

154. *See* Bellan, *supra* note 148.

155. *See id.*; *see also Our Structure*, OPENAI, https://openai.com/our-structure/ [https://perma.cc/X4UV-2VH5] ("Microsoft holds roughly 27% of OpenAI Group, and the remaining 47% is held by current and former employees and investors.").

156. *See OpenAI and Microsoft Extend Partnership*, OPENAI (Jan. 23, 2023), https://openai.com/index/openai-and-microsoft-extend-partnership/ [https://perma.cc/NYX4-QA2V].

157. *See* Bellan, *supra* note 148.

158. *See Evolving OpenAI's Structure*, OPENAI (May 5, 2025), https://openai.com/

hybrid entities that function just like typical corporations with an added set of requirements for the entity to "produce a public benefit or public benefits and to operate in a responsible and sustainable manner."[159] To achieve this lofty goal, PBCs must "be managed in a manner that balances the shareholders' pecuniary interests, the best interests of those materially affected by the corporation's conduct, and the public benefit or public benefits identified in its certificate of incorporation."[160]

The effect of this conversion from a capped-profit LLC to a PBC is that investors in the new PBC entity, including Microsoft, will not have capped profits with respect to their investment.[161] However, the original nonprofit is still the parent company of the new PBC entity and still holds an equity stake in the PBC.[162] Ultimately, this means that more of the revenue generated from OpenAI's products and services will flow to investors and employees, and less of it will flow to the governing nonprofit meant to safeguard humanity from artificial intelligence. Thus, it is fair to conclude that this structure weakens the protections provided by the nonprofit parent company while stopping short of abandoning the concept altogether.

The piece of this corporate structure that led to the demise of the OpenAI deal with Windsurf was Microsoft's holding of significant rights to any intellectual property acquired by OpenAI (excluding that which achieves AGI).[163] Given this contractual agreement, Microsoft had an expectation that Windsurf's intellectual property would be acquired by OpenAI, providing Microsoft with significant contractual rights to the intellectual property.[164] However, OpenAI was not comfortable with that arrangement, in large part due to Microsoft's development of a competitive coding tool.[165] While the OpenAI and Microsoft partnership remains an evolving one, with

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index/evolving-our-structure/ [https://perma.cc/7W92-26LT].

159. DEL. CODE ANN. tit. 8, § 362(a) (2026); *see also* Nows & Thomas, *supra* note 55, at 876-81 (discussing the legal requirements for Delaware Public Benefit Corporations); David Nows, *The Local Nature of Equity Crowdfunding*, 24 U. PA. J. BUS. L. 475, 509-11 (2022) (describing 25 Bough Street, a public benefit corporation).

160. § 362(a).

161. *See Our Structure*, *supra* note 155.

162. *See Evolving OpenAI's Structure*, *supra* note 158.

163. *See* Swain, *supra* note 1.

164. *Id.*

165. *Id.*

discussions on allowing Microsoft to maintain access to OpenAI's intellectual property once AGI is achieved now on the table, Windsurf was not a party that was willing to wait for a deal.[166] Thus, once the exclusivity period for negotiations between OpenAI and Windsurf ended, Google quickly swept in to acquire key talent from Windsurf and a license to its intellectual property.[167]

B. The Next Suitor: Google

The structure of the Google deal was far different from the outright acquisition of Windsurf previously agreed upon by OpenAI. The proposed deal between OpenAI and Windsurf would have been a stock purchase, in which OpenAI purchased all of the outstanding stock of Windsurf for a fixed sum of cash. In this case, each of Windsurf's shareholders, including vested shareholders and holders of stock options, would receive their share of the sum of cash paid by OpenAI's capped-profit company.[168] With respect to unvested shares of stock, those may automatically vest upon a takeover event when the company has a single-trigger vesting acceleration clause in its equity grant contracts.[169] This means that any employee with a stock grant would hold the economic right to the value of all vested and unvested shares of stock, regardless of how long they had been employed by Windsurf.[170] For holders of stock options, all options that have value at the time of acquisition are automatically exercised in a standard stock option contract.[171] This means that if the purchase price for a share of Windsurf stock was higher than the strike price for the employee to purchase that share of stock, it would be automatically exercised at the time of acquisition, and the employee would have the right to the increase in value (that is, the price paid by OpenAI minus the strike price of the option).[172]

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166. *See* Bellan, *supra* note 148.
167. *See* Swain, *supra* note 1.
168. *See supra* Part I.E.1.
169. *See supra* Part I.E.1.
170. *See supra* Part I.E.1.
171. *See supra* Part I.E.1.
172. *See* Lucas Downey, *Understanding Automatic Exercise: Definition and Key Details*, INVESTOPEDIA (Mar. 4, 2026), https://www.investopedia.com/terms/a/automaticexercise.asp [https://perma.cc/M9LL-VYFD].

Google's deal with Windsurf was different in a few key ways. First, Google did not purchase any stock in Windsurf, meaning that the company was still a going concern separate from Google after the transaction.[173] Further, both Windsurf's investors and Windsurf's remaining employees remained shareholders of Windsurf and gained no equity in Google.[174] Next, the main asset acquired by Google in its deal with Windsurf was a non-exclusive license to use some of Windsurf's existing intellectual property at the price of $2.4 billion.[175] Lastly, Google hired Windsurf's CEO, a co-founder of the company, and select members of Windsurf's research and development teams.[176]

C. The Impact of the Google Deal

The effects of this transaction are far-reaching for both Google and the remains of the Windsurf entity. First, Google achieved the main goals most companies set out to achieve in an acquisition effort: acquiring the target company's most valuable assets and securing commitments for the talent needed to access the true value of the acquired enterprise.[177] Second, Google avoided paying for Windsurf's assets (other than use of its intellectual property) and taking on any of Windsurf's liabilities.[178] Third, Google was able to selectively acquire Windsurf's talent, taking on valuable employees and leaving behind those who could easily be replaced by Google's large, skilled team of existing employees.[179]

For the departing key employees, leaving Windsurf for Google was a massive financial win. This is for a few reasons. First, Google offered each Windsurf employee an employment contract to work at

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173. *See* Swain, *supra* note 1 ("Google will not take an equity stake in Windsurf, instead paying $2.4 billion in licensing fees and compensation. This 'acquihire' structure allows Google to secure talent and technology access while avoiding the regulatory scrutiny that a full acquisition would attract.").

174. *Id.* (quoting Windsurf's interim CEO after the Google deal as stating, "Most of Windsurf's world-class team will continue to build the Windsurf product with the goal of maximizing its impact in the enterprise").

175. *See* Cai, Hu & Lamba, *supra* note 3.

176. *Id.*

177. *Id.*

178. *Id.*

179. *See id.*

Google on one of its core projects related to artificial intelligence.[180] While we do not have exact figures on how much these individuals are being paid by Google going forward, we can assume it is a healthy amount. Second, by departing from Windsurf, these employees were able to cash out their Windsurf equity grants via the built-in repurchase option.[181] For founders, their stock was likely fully vested, meaning that for each share of stock they were granted, the price would have experienced a massive increase from the purchase price of one cent per share or less that they were given on day one of the company's legal life.[182] For other key employees, this cashing out may have been less extreme. This is because employees who joined the company later were granted shares at a higher price per share later in the startup's lifecycle or, alternatively, were granted stock options which allowed the employee to exercise the vested options upon their departure for any positive difference in share price.[183] Third, for all of these new Google employees, they may have received equity compensation in the form of Google stock options as a part of their compensation package, allowing the equity compensation lifecycle to begin anew.[184]

For the remains of Windsurf, an immediate leadership vacuum needed to be filled as the company lost most of its key contributors overnight.[185] Additionally, given that departing Windsurf employees, including the company's founders, would have cashed out their vested equity upon leaving for Google, the remaining shareholders of Windsurf, mainly Windsurf's remaining employees, were left with a claim to a much different company than before. Previously, Windsurf had full rights in its intellectual property and the potential economic growth it represented, which was a strong motivating factor for employee shareholders to work hard. Now, however,

180. *See* Swain, *supra* note 1 ("Google will hire Windsurf CEO Varun Mohan and co-founder Douglas Chen, along with select research and development staff, for its DeepMind AI division.").

181. *See supra* Part I.C.

182. *See supra* Part I.B.

183. *See supra* Part I.

184. *See supra* Part I.D.

185. *See* Cai, Hu & Lamba, *supra* note 3 ("Google has hired several key staff members from AI code generation startup Windsurf, the companies announced on Friday, in a surprise move following an attempt by its rival OpenAI to acquire the startup.").

Windsurf was left with a reasonably small pile of cash as the main source of the enterprise's value.

This is because most of the $2.4 billion paid by Google in the asset purchase was immediately paid out to investors and the Windsurf employees hired by Google.[186] Given that the transaction was private, there are not exact numbers available. However, sources have said that the financial investors in Windsurf walked away with roughly $1.2 billion collectively, providing for a 4x return on capital for later-stage venture capitalists.[187] With respect to the departing founders and employees, Google paid them approximately $1.2 billion to work for Google in the form of compensation packages.[188] Sources also say that the final $100 million from the Google deal was left behind for the remaining Windsurf employees as the value of their equity; however, the company was not in a financial position to distribute that money to the remaining employees and remain a going concern.[189] This means that in the immediate aftermath of the Google deal, Windsurf's remaining employees still had their jobs and did not participate financially in the transaction.

The other potential valuable asset Windsurf retained was its intellectual property.[190] It seems likely that this ownership of intellectual property was a valuable asset in the sense that Windsurf retained significant rights in the intellectual property that could be monetized. This is because Windsurf granted Google a non-exclusive license to the intellectual property, leaving the remaining value with Windsurf.[191] The value of this intellectual property is important because it informs whether Windsurf's enterprise value had potential for growth in the future or, alternatively, whether its current $100 million in cash provided for the best valuation the company might have going forward. If the Windsurf venture is truly one of diminishing returns moving forward, employee shareholders are incentivized to quit and cash out their vested shares as soon as possible.[192] The reasons for this incentive are two-fold: A dollar

186. *See* Temkin, *supra* note 9.

187. *Id.*

188. *Id.*

189. *Id.*

190. *See* Cai, Hu & Lamba, *supra* note 3 ("Google is paying $2.4 billion in license fees as part of the deal to use some of Windsurf's technology under non-exclusive terms.").

191. *Id.*

192. *See supra* Part I.C and note 75.

today is worth more than a dollar tomorrow and, further, the value of a share of Windsurf stock may never be higher than it was on the day of the Google deal.

D. The Cognition Deal

This immediate incentive for all Windsurf employees to jump ship presented a real challenge for the remaining Windsurf entity as a going concern. Other potential acquirers recognized this vulnerability, and soon a second acquirer emerged. Just a few days after the Google deal, the key remains of Windsurf, its "[intellectual property], product, trademark and brand, and strong business," were acquired by competitor Cognition for $250 million.[193] Given the private nature of the deal, we do not know for sure whether Cognition acquired Windsurf's remaining valuable assets or if it acquired the remaining stock in Windsurf, though sources believe it was a stock sale.[194] Supporting the stock sale theory is the fact that this deal included the ability for Windsurf's remaining employees to become Cognition employees and to have their time employed at Windsurf count for vesting purposes toward any stock grants the new Cognition employees received.[195] On its face, this seemed like a lucky break for Windsurf's team, as it went from holding stock in a company with limited future prospects to holding stock in a rapidly growing enterprise.

However, this good fortune was short-lived. Three weeks after the Cognition acquisition, Cognition laid off 30 new employees from the Windsurf deal and offered the other 200 employees a choice: commit to eighty-hour workweeks or take a buyout valued at nine months' pay.[196] In communicating the offer to the Windsurf-turned-Cognition employees, Cognition CEO Scott Wu wrote, "We don't believe in work-life balance—building the future of software engineering is a

193. Wu, *supra* note 1; *see also* Temkin, *supra* note 9 (discussing the amount paid by Cognition to purchase Windsurf and providing speculation that the transaction structure took the form of a stock sale).

194. *See* Temkin, *supra* note 9.

195. *See* Wu, *supra* note 1.

196. *See* Bellan, *supra* note 11.

mission we all care so deeply about that we couldn't possibly separate the two."[197]

E. The Impact of the Cognition Deal

Assuming an employee took the buyout and the Cognition transaction was a stock sale, the employee likely walked away from Cognition with little more than the nine months' pay. This is because in its press releases, Cognition committed to honoring any time an employee worked at Windsurf for vesting purposes of their stock (or stock option) grant.[198] The implication of this statement is that the employees did not receive the increase in value from the Windsurf stock grant on the date of the company's purchase by Cognition but instead received Cognition stock in exchange for their Windsurf stock (with time employed at Windsurf counting for vesting purposes).[199] That would mean that Windsurf employees "participated financially" in the Cognition deal through their equity grant in Cognition and vesting credit, and not through the repurchase of their Windsurf stock. If true, this implies that Cognition essentially erased the increase in stock value these employees would have been entitled to on July 14, 2025, via the repurchase option, a stock price increase they contributed to between their date of hire at Windsurf and the date of the Windsurf acquisition by Cognition. This is because Cognition could not promise employees that the increase in Windsurf's value they helped create during that time period would also transfer to the new Cognition stock grant.[200] Instead, the IRS specifically disallows stock grants at lower than fair market value at the time of the grant

197. *Id.*

198. *See* Wu, *supra* note 1 ("100% of Windsurf employees will participate financially in this deal ... 100% of Windsurf employees will have vesting cliffs waived for their work to date ... [and] 100% of Windsurf employees will receive fully accelerated vesting for their work to date.").

199. *See* Beatrice Sainz, *What Happens to Call Options When a Company Is Acquired*, UPCOUNSEL (Apr. 14, 2025), https://www.upcounsel.com/what-happens-to-options-in-a-buyout [https://perma.cc/PT43-GWW4] (providing likely outcomes for employee equity when the employee would remain employed by the acquirer post-acquisition).

200. *See* David I. Walker, *The Non-Option: Understanding the Dearth of Discounted Employee Stock Options*, 89 B.U. L. REV. 1505, 1520 (2009).

as doing so would essentially hide compensation behind the stock grant.[201]

Thus, given that Windsurf-turned-Cognition employees would have worked at Cognition for roughly a month prior to the buyout taking effect, any time counted toward vesting has little value, as the value of the enterprise's stock is unlikely to have increased meaningfully. The law behind this conclusion is complicated, but involves a blend of the Internal Revenue Code (IRC) and the common contractual provisions governing stock grants. First, private company stock valuations, as they pertain to the value of the company's shares of stock held by founders and employees, are governed by section 409A of the IRC.[202] For purposes of IRC section 409A, companies like Cognition need a new valuation only once per year, or sooner only if a material event occurs in the interim.[203] The acquisition of Windsurf was likely a material event,[204] but note that the employee's stock grant would have taken place after the deal (and subsequent new 409A valuation). Thus, the value of an employee's stock would not have increased unless another material event occurred in the three weeks between Cognition's acquisition of Windsurf and the buyout offer. The effect of this conclusion is that when an employee takes the buyout, they receive their money

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201. *See id.* ("[R]ules and regulations under I.R.C. § 409A, do distinguish between discounted and non-discounted options, as did the accounting rules in force prior to 2005. These specific rules arguably have distorted compensation design, blocking the use of explicit in-the-money options and channeling equity compensation into the distinct streams documented in Part I — stock grants and at-the-money options."); *see also* Alison Wright, *Granting Stock Options at Fair Market Value*, HANSONBRIDGETT (July 20, 2016), https://www.hansonbridgett.com/Publications/articles/2016-07-technology-stock-options-value [https://perma.cc/S4FX-CSN7] ("The general rule is that the exercise price of the stock option cannot be less than the fair market value of the stock underlying the option determined on the date of grant. If an option is granted with a discounted exercise price, the tax consequences for the employee or advisor receiving the option can be severe.").

202. *See generally* I.R.C. § 409A (covering broadly "gross income of deferred compensation under nonqualified deferred compensation plans").

203. *See* Kristoffer Warren, *A Founder's Guide to the 409A Valuation*, CARTA (Nov. 6, 2025), https://carta.com/learn/startups/equity-management/409a-valuation/ [https://perma.cc/CJ6Q-P4EA] ("Here's when you will need a 409A valuation: Before you issue your first stock options to employees or advisors[, a]fter a material event occurs that could change your company's value[, and a]t least once every 12 months to maintain compliance and continue issuing options.").

204. *See id.* ("A material event is any significant business change that could reasonably affect your company's stock price.").

back for all shares of stock granted to them.[205] This is because vested shares are valued at the higher of FMV and the purchase price, and unvested shares are valued at the lower of FMV and the purchase price.[206] In this example, FMV and purchase price are the same, so the employees simply get their money back for the stock granted to them by Cognition, with not a penny of gain. The same result occurs if Cognition utilized stock option grants for the employees. This is because the employees would only exercise the option for the vested shares if FMV, at the time of the buyout, was higher than the strike price of the option. Because FMV and the strike price would be the same amount, the options become valueless at the time of the buyout.[207]

The above results would vary, however, based on whether the Windsurf/Cognition transaction was a stock sale or an asset sale.[208] In a stock sale, the time-in-service at Windsurf that counted toward vesting at Cognition was likely bargained for by Cognition in exchange for the Windsurf employees not receiving a liquidity event upon the transaction taking place.[209] Of course, if the transaction was a stock sale, there would be real value remaining in the Windsurf entity for its employees, to the tune of $350 million from the two transactions.[210] This would be enough of a reason for Cognition to provide vesting credit in Cognition stock grants to Windsurf employees in exchange for their Windsurf equity. Alternatively, if the transaction was structured as an asset purchase, the remaining $350 million would be used to extinguish Windsurf's remaining liabilities first, but would then be available to be distributed to Windsurf's remaining shareholders—its final group of employees.[211] Given that the stock sale transaction format creates a better outcome for Cognition, it was likely the transaction structure used.

Taken as a whole, these transactions transferred significant economic value to Google, Windsurf's founders, and Cognition at the expense of Windsurf's rank-and-file employees. The below chart

205. *See supra* Part I.C.
206. *See supra* Part I.B.
207. *See supra* Part I.D.
208. *See supra* Part I.E.
209. *See supra* Part I.E.
210. *See supra* Part I.E.
211. *See supra* Part I.E.

illustrates this value transfer and the difference between: (1) the proposed OpenAI deal; (2) the Google/Cognition deal combination with the Cognition deal as a stock sale; and (3) the Google/Cognition deal combination with the Cognition deal as an asset sale.

Table 1: Payouts for proposed OpenAI transaction[212]

Party	Payout	Per person average return
All Windsurf employees	$1.5B	$12.5M
Investors	$1.5B	5x return on investment

Table 2: Payouts for the Google/Cognition deal combination with the Cognition deal as a stock sale[213]

Party	Payout	Per person average return
Departing key employees	$1.2B	$30M
Investors	$1.2B	4x return on investment
Left-behind employees	Nine months' pay	$0

Table 3: Payouts for the Google/Cognition deal combination with the Cognition deal as an asset sale[214]

Party	Payout	Per person average return
Departing key employees	$1.2B	$30M
Investors	$1.2B	4x return on investment
Left-behind employees	$350M	$1.75M

212. *See* Field, *supra* note 145 (providing for transaction amount). An assumption built into these calculations comes from the ultimate 50/50 split between Windsurf's departing employees and its investors in the Google deal. *See* Temkin, *supra* note 9.

213. *See* Temkin, *supra* note 9; *see also supra* Part II.E (discussing how employees would be financially impacted by the Cognition deal).

214. *See* Temkin, *supra* note 9.

As the above charts demonstrate, the average Windsurf employee would have received $12.5 million in the OpenAI deal, but only received $1.75 million in a best-case scenario in the Google and Cognition deals. It would not be dramatic to say that any person considering working for a startup, in which a significant portion of their compensation is employer equity, should view the Windsurf story as a cautionary tale. Google, Windsurf's founders, and Cognition all shattered long-standing norms in startup equity compensation by entering into these transactions at the expense of Windsurf's rank-and-file employees.[215] Contract law governs these equity grants to startup employees, but for any contract to be worth the paper it is written on, all parties must honor those deals in good faith and not seek to work around the original contract through complex transactional structures that avoid honoring it.

Unfortunately, the number of deals structured like the Windsurf deals is likely to increase in the near future as more AI startups mature. AI startups are particularly susceptible to this transaction structure because of the current arms race between giant technology companies to develop the best AI technology and recruit the best talent to gain or maintain any advantages.[216] The main drivers behind established technology companies entering into a purchase of an AI startup are the acquisition of talent and intellectual property.[217] Those are the only two assets mature companies truly want to acquire from the startup.[218] If large technology companies can acquire these things quickly and at a cost discount, they will do it. This creates conditions that are likely to perpetuate the issues seen in the Windsurf deals for rank-and-file startup employees everywhere.

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215. *See* Walker, *supra* note 200, at 1507.

216. *See* Lakshmi Varanasi, *Cognition CEO Scott Wu Describes the Sleepless Weekend That Led to the Windsurf Deal: 'I Live for These Moments'*, BUS. INSIDER (Aug. 28, 2025), https://www.msn.com/en-us/money/companies/cognition-ceo-scott-wu-describes-the-sleepless-weekend-that-led-to-the-windsurf-deal-i-live-for-these-moments/ar-AA1Lq6zB?ocid=BingNewsSerp [https://perma.cc/D44P-AQ7J] ("As the industry grows, [Cognition CEO Scott] Wu said, the speed and scale of dealmaking will only increase.").

217. *See* Mike Isaac, *Cognition AI Buys Windsurf as A.I. Frenzy Escalates*, N.Y. TIMES (July 14, 2025), https://www.nytimes.com/2025/07/14/technology/cognition-ai-windsurf.html [https://perma.cc/256Q-FE6P] (describing a recent "flurry of activity by Meta, Google and OpenAI, which are racing against one another to scoop up a small pool of top technology talent in an increasingly competitive space").

218. *See id.*

III. THE IMPACT OF THE WINDSURF TRANSACTIONS ON THE FUTURE OF ENTREPRENEURSHIP

Transactions like the Windsurf deals and the related fallout, if replicated writ large in the innovation ecosystems in the United States, threaten to destabilize all new ventures and their relationships with potential employees. Prospective employees who cannot trust an employer to honor the expected outcome of their equity grant in the event of the startup's success may as well demand more cash upfront to work for these startups.[219] More cash required to hire employees means either fewer employees for the startup, which limits growth, or that more investor funding will be required for the startup to hire the same number of employees and achieve similar results to before.[220] Investors are unlikely to bear the costs of the new norms which favor greedy founders.[221] This means that startups are likely to hire fewer employees in the future if those employees demand greater cash compensation, a trend that will only accelerate if agentic AI proves to be an adequate replacement for the average rank-and-file employee in the coming years.

Part III of the Article seeks to provide a summary of the existential challenges facing entrepreneurship and innovation now that a blueprint exists for allowing founders to take more than their fair share in an acquisition at the expense of rank-and-file employees.[222] First, this Part will address the basic deal between startups and employees as it relates to equity grants, and, further, it will emphasize the common use of the standardized transaction structures discussed in Part I. Next, this Part will address three potential scenarios if Windsurf-like deals continue at the expense of rank-and-file employees. This Part concludes with a call for reform given the likely negative outcomes for innovation stemming from all three scenarios. This call for reform is novel in the sense that it does not

219. *See* Bankman, *supra* note 46; Pollman, *supra* note 46.

220. *See supra* Part I (discussing milestone funding, reinvesting in growth, and hiring in the startup context).

221. *See* GUY KAWASAKI, REALITY CHECK: THE IRREVERENT GUIDE TO OUTSMARTING, OUTMANAGING, AND OUTMARKETING YOUR COMPETITION 49 (2008) (discussing how investors care about earning a return on their capital).

222. *See, e.g.*, *supra* Part II (discussing the Windsurf transactions and their impact on the financial outcomes of rank-and-file employees).

call on regulators or legislators to make a change, but rather the party who sets the standard deal terms in entrepreneurship via contract: investors.

As contemplated in Part I of this Article, there is a standard deal between startup employers and employees as it relates to equity compensation. This deal, structured around the idea of aligning the interests of employees and the company, allows employees to financially participate in the growth in value of the enterprise while they are employed with the startup.[223] Early-stage companies grant employees common stock while the company's stock price is low.[224] Once the stock prices rises sufficiently, companies shift to granting employees stock options.[225] In both cases, the equity grants are typically subject to vesting provisions which require the employee to work for the company for between one and four years to have "earned" the economic upside of their equity grants.[226] Further, these equity grants are subject to repurchase options, which give the company the right to repurchase the equity granted to the employee upon their departure from the company.[227] Overall, these standard provisions have been desired by founders, employees, and investors over the span of decades because of their ability to align interests, motivate teams, encourage employee retention, and protect intellectual property from competitors.[228] Further, all parties involved, including rank-and-file employees, have enjoyed positive and fair financial outcomes when a startup has had success.

The Windsurf deals clearly demonstrate how the expected positive outcome for employees can easily be circumvented by those in charge of the corporation, namely its officers (typically consisting of the company's founders) and directors (typically consisting of the company's founders and investors).[229] By allowing for founders and

223. *See supra* Part I.A.

224. *See supra* Part I.A.

225. *See supra* Part I.D.

226. *See supra* Part I.B.

227. *See supra* Part I.C.

228. *See* Josh Steinfeld, *Equity Compensation*, CARTA (Mar. 13, 2024), https://carta.com/learn/equity/compensation/ [https://perma.cc/2EQC-775J] ("Company stock can appreciate as your business grows. By offering equity, you can align recipients' interests with the business's success. This type of compensation can also help attract and retain talent when cash flow might be tight in your startup's early days.").

229. *See, e.g.*, *supra* Part II (discussing the Windsurf transactions, their impact on the financial outcomes of rank-and-file employees, and how the decision to enter into the Google

investors to cash out on their equity first, and by structuring a transaction as an acqui-hire deal where key employees are one of the main assets transferred to the purchaser, startups can ensure that an unexpectedly large amount of the deal's financial value will flow to founders and key employees at the expense of rank-and-file employees.[230] If this transactional trend continues and grows in the future, it is likely to change the decision-making process for prospective employees considering a job offer from a startup. First, prospective employees, who have traditionally viewed the equity grant a startup provides as a potential lottery ticket, will need to assign a lower value to that lottery ticket if employee equity grants have the potential to be undercut by greedy founders in the future.[231] Second, because the total compensation offer from the startup now looks less attractive, prospective employees with other options, like being paid more at an established company, will choose those alternatives with regularity. Lastly, some prospective employees may be deterred away from working at a startup altogether if equity grants become less certain, given the inherent drawbacks like a less stable job and long hours.[232] These challenges recruiting talent, combined with the early extinction startups may face by selling off key assets like intellectual property earlier in their lifecycle to larger competitors, will have tremendous chilling effects on innovation.

Three outcomes are possible in a situation where prospective employees rationally react to the lower value, on average, of the equity they will be granted by their startup employer. Because prospective startup employees may no longer value equity grants in the same way they have in the past, they are likely to demand higher salaries to make up the perceived difference in compensation.[233] When the usual group of prospective employees for a startup require higher salaries, the three likely outcomes are (1) teams made up of fewer, more expensive employees (an equal salary spend

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transaction was made by the company's founders and its investors).

230. *See supra* Part II.E (comparing the financial outcomes for all parties in the Windsurf deals based on different deal structures).

231. *See* Smith, *supra* note 23.

232. *See, e.g.*, Shibu, *supra* note 11; Bellan, *supra* note 11 (discussing the demands made by Cognition of its employees, including to work eighty hours per week or leave the company).

233. *See* Bankman, *supra* note 46; Pollman, *supra* note 46.

by the startup); (2) teams made up of the same number of employees at a higher cost to the company; or (3) teams made up of less talented employees who are willing to accept the standard compensation package of a low salary and a potentially devalued equity grant. In all three cases, advances in agentic AI technologies are likely to mean that this technology will supplement the startup's workforce with respect to certain tasks going forward.[234]

The first listed scenario, where startups assemble teams made up of fewer, more expensive employees and spend an equal amount on employee salaries as before, is a likely outcome. Here, the startup must hope that technological advances like agentic AI can make up for the negative difference in productivity the company will experience with fewer employees.[235] Otherwise, the startup will have a higher likelihood of failure. This higher failure rate will be a big issue for investors, who already tolerate a 75 percent failure rate in venture-backed startups.[236] It seems unlikely that investors will allow founders to create a world where investments become riskier because founders want a greater payday if the venture succeeds. Thus, investors may become increasingly wary of investing in startups generally, but especially in founders who have the option of entering into a Windsurf-like deal as an exit.

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234. *See* BORNET ET AL., *supra* note 135, at 47-50 (discussing how AI agents operate to complete business functions today).

235. *See* Dan Priest, *PwC's AI Agent Survey*, PWC (May 16, 2025), https://www.pwc.com/us/en/tech-effect/ai-analytics/ai-agent-survey.html [https://perma.cc/GN6B-7UTE] ("[O]f those [executives surveyed] adopting AI agents, two-thirds (66%) say that they're delivering measurable value through increased productivity.").

236. *See* Elizabeth Pollman, *Startup Failure*, 73 DUKE L.J. 327, 329-30 (2023) ("Approximately 75 percent of venture-backed startups fail—the number is difficult to measure, however, and by some estimates it is far greater." (first citing *452 Startup Failure Post-Mortems*, CB INSIGHTS (Apr. 18, 2023), https://www.cbinsights.com/research/startup-failure-post-mortem [https://perma.cc/AEZ5-D7TF]; and then citing Faisal Hoque, *Why Most Venture-Backed Companies Fail*, FAST CO. (Dec. 10, 2012), https://www.fastcompany.com/3003827/why-most-venture-backed-companies-fail [https://perma.cc/JGS8-3VN5])); *see also* John L. Orcutt, *Valuing Young Startups Is Unavoidably Difficult: Using (and Misusing) Deferred-Equity Instruments for Seed Investing*, 55 TULSA L. REV. 469, 487 (2020) (estimating that "[t]hirty to forty percent of startups will end up liquidating their assets with investors losing all (or most) of their investment[,] [s]eventy to eighty percent of startups will fail to generate investors' projected return on investment[, and] [n]inety to ninety-five percent of startups will fail to generate the profit projections provided at the time of the investment" (citing Carmen Noble, *Why Companies Fail—and How Their Founders Can Bounce Back*, HARV. BUS. SCH. WORKING KNOWLEDGE (Mar. 7, 2011), https://hbswk.hbs.edu/item/why-companies-failand-how-their-founders-can-bounce-back [https://perma.cc/5XRB-RXKJ])).

A second possibility is that startups will assemble teams made up of the same number of employees at higher salaries and at a higher overall cost to the company. Given that startups typically reinvest all profits into growth, the likely source of this additional capital for wages would be investors.[237] This will be especially true for those startups at early stages that have yet to generate meaningful revenue.[238] This scenario is even less likely to be tolerated by investors as they will view their additional capital upfront as yielding no value added for them but, rather, as value added for founders on the back end of the company's lifecycle when they are able to create a superior financial exit for themselves. Given this clear, losing tradeoff for financial investors, this scenario also provides them with a substantial incentive to discourage Windsurf-like exits at scale.

Lastly, startups could respond by hiring teams made up of less talented employees who are willing to accept the historical standard compensation package of a lower salary (compared to established companies) and an equity grant under the standard terms. This strategy is the worst of the three options for founders, investors, and innovation efforts generally. This is because startups fail often, even with the best talent and resources available.[239] In fact, financial investors regularly care about the quality of the team implementing the business concept more than the business concept itself when deciding which new ventures deserve an investment.[240] Thus, hiring a less capable workforce will result in making a company far less attractive to investors, which will substantially decrease its chances of ever finding the funding needed to open the door for success.

One factor that could mitigate, or even eliminate, the perceived downsides above is the rapid advancement of agentic AI. In fact, it is possible that the reason we are seeing the age-old deal in startup employee equity breaking down at this moment is that founders feel that they are on the verge of no longer needing a robust

237. *See* Bernthal, *supra* note 40.

238. *Id.* at 841-42.

239. *See* Pollman, *supra* note 236; Orcutt, *supra* note 236.

240. *See, e.g.*, KAWASAKI, *supra* note 221, at 41 (discussing why investors might choose to invest in a startup because of the team of workers assembled).

workforce.[241] If founders are correct, it would require artificial intelligence to reach a stage called artificial general intelligence (AGI), which "is a hypothetical stage in the development of machine learning ... in which an artificial intelligence ... system can match or exceed the cognitive abilities of human beings across any task."[242] Certainly, an artificial intelligence system that is as capable as a human and can be automated to work independently, as agentic AI promises, poses a real threat to the human workforce. However, even if AGI is not achieved in the near future, startup jobs are threatened if founders believe agentic AI is good enough to replace workers in building the company.

AGI and its effect on startup jobs generally is the wild card in this analysis, and, as of this writing, we simply do not know how this story will end. However, many commenters and scholars have concerns about an outcome in which AGI arrives and agentic AI displaces large swaths of the human workforce.[243] While unrelated to the issue this Article focuses on, future research on the workforce (including startup employees) may focus on issues like the sense of dignity humans receive from meaningful work or, alternatively, the ways in which a human workforce should have agency over agentic AI programs completing work on behalf of a company.[244] These are emerging issues that are certain to have a legal component as regulators and legislators react to the impact artificial intelligence has on society and, further, as businesses, investors, and individuals work to best position themselves via private ordering.

Each of these emerging issues in the employment relationship between startups and their employees has the potential to create an erosion of culture and trust in the workplace. Both investors and prospective employees may now have reason to be skeptical of the

241. Somewhat ironically, Windsurf builds an agentic AI tool that, in theory, helps software companies replace junior coders at scale. *See* WINDSURF, *supra* note 134.

242. *What Is Artificial General Intelligence (AGI)?*, IBM, https://www.ibm.com/think/topics/artificial-general-intelligence [https://perma.cc/5HQR-R8AK].

243. *See, e.g.*, Filippo Santoni de Sio, *Artificial Intelligence and the Future of Work: Mapping the Ethical Issues*, 28 J. ETHICS 407, 408-23 (2024).

244. *See, e.g.*, *The Delta Network: Faith-Based Ethical Formation for a World of Powerful AI*, U. NOTRE DAME: INST. FOR ETHICS AND THE COMMON GOOD, https://ethics.nd.edu/programs/faith-based-frameworks-for-ai-ethics/delta/ [https://perma.cc/2QRB-GWRL] (sharing information on the University of Notre Dame's Institute for Ethics and the Common Good, which has created the "DELTA" framework for dealing with issues related to artificial intelligence).

intentions of startup founders as those intentions relate to issues like following through on employee expectations related to equity grants, maintaining a largely human workforce, and being wise stewards of investor capital. If these tensions become significant enough, the result could be reduced investor funding of new ventures, challenges in recruiting and retaining a talented workforce, or both for early-stage ventures. When faced with large-scale challenges in the past, the startup ecosystem of founders and investors has turned to contract-based solutions, which can help preserve innovation itself as well as the interests of all parties involved.[245] Those solutions then become widely adopted as a best practice that requires a good reason from one or more of the parties before a contract will deviate from the standard.[246]

IV. THE TRAITOR PROVISIONS

This Part of the Article proposes a contract-based solution that solves the broken promise of robust equity compensation for employees, as well as the problems outlined in Part III. Specifically, Part IV calls on investors to demand changes to the vesting terms of typical founder and employee equity grants to reduce the value of vested shares of common stock in situations where a founder or employee benefits themselves financially at the expense of rank-and-file employees in an exit transaction or acqui-hire transaction (the Traitor Transactions). A contractual provision that accomplishes this goal would be positive because it would shift the economic costs of compensating the departing founders and employees (the Traitors) from the rank-and-file employees to the acquirer, forcing the acquirer to compensate the Traitors for the lost value of their vested shares of common stock. Further, investors in new ventures are perfectly situated to demand these terms from the companies in

245. *See* David Nows & Lawrence J. Trautman, *The Growing Role of Venture Studios in Startup Finance*, 76 CASE W. RSRV. L. REV. 525, 541-42 (2025) (discussing the simple agreement for future equity (SAFE), an investment structure created by startup accelerator and investor Y Combinator, and explaining the innovation of the SAFE is an example of contractual innovation as it provided companies with capital while deferring valuations until later, solving the problem of early-stage company valuations).

246. *See* Nows & Thomas, *supra* note 55, at 912 (discussing the National Venture Capital Association's model transactional documents for startup investments, which are used as the default set of terms in most startup investment deals).

which they invest because they regularly communicate with one another to create a set of contractual norms in all deals across an entrepreneurial ecosystem.[247] Over time, these consistent contractual norms and provisions become the default, which could easily happen with this proposal if adopted by well-known investors in new ventures.[248]

A. The Traitor Clause and Traitor Transactions

For purposes of these provisions, a Traitor Transaction is defined as a transaction in which less than 33 percent of the company's employees experience an exit event and a key asset of the company is sold or licensed to the acquirer. The term *key asset* requires some flexibility as different companies will have different conceptions of which assets represent a crucial element of the company's business. As an example, Windsurf's non-exclusive license of its core intellectual property to Google would qualify as a license of a key asset, triggering a Traitor Transaction if less than 33 percent of the company's employees experience an exit event in the deal.[249]

The contractual provisions themselves are appropriately named the Traitor Clause. This Traitor Clause has the core goal of creating a diminished economic value of vested shares of common stock held by departing founders and employees (Traitors) in Traitor Transactions. Thus, this Clause will shift the costs of compensating Traitors away from rank-and-file employees and to the acquirer entirely. This structure would allow startups to honor the rightful

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247. *See* David Nows, *Getting It Just Right: The Goldilocks Level of Securities Regulation*, 26 NEV. L.J. 111, 115 (2025) ("[C]apital-raising transactions for startups in the United States are structured in a very standardized way. For early-stage ventures, the most typical modes of financing the company's first round of capital are through either: (1) a Simple Agreement for Future Equity (SAFE), a convertible note, or similar document; or (2) through a Series Seed or Series A stock issuance. In both cases, investors and issuers have created standardized investment structures that are largely followed by both parties, with very few points left up for negotiation." (footnotes omitted) (first citing Abraham J.B. Cable, *Mad Money: Rethinking Private Placements*, 71 WASH. & LEE L. REV. 2253, 2277 (2014); and then citing John F. Coyle & Joseph M. Green, *The SAFE, the KISS, and the Note: A Survey of Startup Seed Financing Contracts*, 103 MINN. L. REV. HEADNOTES 42, 43-58 (2018))).

248. *See, e.g.*, *id.* at 115-16 (describing standard deals between startups and investors like Y Combinator's Simple Agreement for Future Equity and the National Venture Capital Association's Series A fundraising documents).

249. *See* Cai, Hu & Lamba, *supra* note 3.

financial expectations of employees as they relate to equity compensation agreements when a Windsurf-like acquisition takes place.

More specifically, the Traitor Clause itself would live in two places: the corporate charter and each RSPA or stock option contract granted to a founder or employee receiving an equity interest in the company. Within the RSPA or stock option contract itself, the vesting terms would be modified to provide for a determination of the value of vested shares of common stock upon the shareholder's departure from the company and, further, a different valuation of vested common stock in the event of a Traitor Transaction. Instead of providing for the value of vested stock to be the greater of the employee's purchase price or the FMV at the time of departure, the value of all vested shares in a Traitor Transaction would be the lower of the employee's purchase price or the FMV at the time of departure.[250] Further, the repurchase option contained in the RSPA or stock option contract would allow the company to repurchase both vested and unvested shares at the lower of the employee's purchase price or the FMV at the time of departure.[251] In effect, this means that departing founders and employees must abandon any value they have built in the equity of the company to take the deal proposed by the acquirer in the Traitor Transaction. The Traitor Clause creates a massive disincentive for both acquirers and potential Traitors to enter into a Traitor Transaction.

Of course, this Traitor Clause contrasts with how vesting provisions ordinarily operate in RSPAs and stock option contracts.[252] In those typical circumstances, departing founders and employees receive the greater of the current FMV of a share of common stock and the purchase price paid at the time of grant for a share of common stock for all vested shares of common stock.[253] For founders and employees who have worked for the company for a few years, this means that most, or all, of their shares of common stock are vested and, further, that they will receive the benefit of the growth in the venture's value for those shares.[254] For any unvested shares of common stock, founders and employees receive the lower of the

250. *See supra* Part I.B (for standard vesting terms).
251. *See supra* Part I.C (for standard repurchase option terms).
252. *See supra* Part I.B.
253. *See supra* Part I.B.
254. *See supra* Part I.B.

current FMV and purchase price, which can be as low as one cent per share if the shares are granted at the company's founding when the company's stock was essentially valueless.[255]

This change in valuing vested shares of common stock held by Traitors in Traitor Transactions would shift substantial costs from rank-and-file employees remaining with the target company to the acquirer. For example, if a founder of a company holds 1 million vested shares of common stock, equaling 25 percent equity in the company, and, further, the founder was granted those shares at one cent per share at the company's founding, they would walk away with $10,000 for this equity in a Traitor Transaction. This is the amount they would have paid to receive the stock at the company's founding, representing the founder's initial capital contribution to the company. Now, imagine this company is valued at $1 billion at the time of the Traitor Transaction. Twenty-five percent of the company's equity would have an FMV of $250 million on the date of the founder's departure. No rational founder would leave $249.99 million on the table to leave the company in a Traitor Transaction unless the acquirer is willing to make the founder economically whole for this loss, in addition to the compensation promised by the acquirer to leave. This is the power of the Traitor Clause: It allows Traitor Transactions to proceed but makes them considerably more expensive for acquirers and negates the negative financial impact felt by rank-and-file employees.

The Traitor Clause would also live within the corporate charter itself. This is important for two reasons. First, the corporate charter is a public document, meaning that any prospective employee of the corporation could look to the corporate charter to identify whether a Traitor Clause is present.[256] This is an important element of the Traitor Clause: It is only effective if it is public in some way. Prospective employees must be able to easily identify employers who have implemented the Traitor Clause, and those who have not, so they can express a preference for those employers who have implemented a Traitor Clause and protected the financial interests of employees. Otherwise, the talent market will not be able to punish companies that refuse to implement this important safeguard.

255. *See supra* Part I.B.

256. *See* DEL. CODE ANN. tit. 8, § 103(c)(8) (2026).

Interestingly, Delaware is currently one of the least-friendly states with respect to making the corporate charter easily and freely accessible.[257] While a state like California allows anyone to download a copy of any corporate charter for free online, it would cost a prospective employee of a startup between $50 and $1,000 to obtain the same document for a Delaware corporation, depending on how quickly they need to receive it.[258]

Second, all states require the corporate charter to state the authorized number of shares in the corporation and, further, to state the different rights, preferences, and limitations of each class of stock should more than one class of stock be authorized.[259] Thus, the limitations related to vesting of shares of common stock must be stated in the corporate charter, regardless of whether a Traitor Clause is present. In this case, it would be important for corporate counsel to clearly outline the different valuations of vested stock based on whether a shareholder's departure from the company occurred via a Traitor Transaction or otherwise. It is important for counsel to express these two different approaches for valuing vested stock in this way, by presenting the value of the vested shares as of the date of the founder or employee's departure from the company. This is a better approach than defining vested shares as having the greater value of today's FMV or the original purchase price unless a Traitor Transaction occurs, in which case the value of the shares is reduced.[260] This is likely a requirement of Delaware law, made clear by the discussion below.[261]

B. Relevant Delaware Statutes and Case Law

Parties have an expansive freedom of contract that allows them to freely enter into RSPAs and stock option contracts.[262] Further,

257. *See* Abraham J.B. Cable, *Why Charters?*, 2025 WASH. U. L. REV. ONLINE 1, 14-15, https://wustllawreview.org/wp-content/uploads/2025/07/Why-Charters-final-version.pdf [https://perma.cc/GUD2-HS5J] (discussing the requirements and fees to receive a copy of a Delaware corporation's charter).

258. *Id.*

259. *See, e.g.*, § 102(a)(4).

260. *See infra* Part IV.B.

261. *See infra* Part IV.B.

262. *See, e.g.*, Stephen M. Bainbridge & M. Todd Henderson, *Boards-R-Us: Reconceptualizing Corporate Boards*, 66 STAN. L. REV. 1051, 1057 (2014) (discussing the

parties are able to freely amend those private contracts with the consent of all parties to the contract.[263] In this sense, the above proposal of a Traitor Clause is uncontroversial. Thus, new RSPAs and stock option contracts may be executed with a Traitor Clause, and existing RSPAs and stock option contracts, without a Traitor Clause, may be amended to include a Traitor Clause with the consent of all parties.

The law supports this same general framework for the drafting of an initial corporate charter and for the amending of corporate charters. In cases where the original corporate charter provides for a Traitor Clause that impacts all common shareholders, it will be binding on all common shareholders.[264] Further, in cases where a corporate charter is amended to include a Traitor Clause, and there is unanimous consent of all affected parties, that amendment will be permissible.[265] However, Delaware corporate law, much like contract law, restricts retroactive impairments of vested rights that occur through corporate charter amendments.[266] Said differently, prospective modifications that affect future rights or create new classes with different priorities are generally permissible under the broad charter amendment power.[267] However, retroactive

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freedom of contract permitted by corporate law statutes to contract around default rules).

263. *See* Mohsen Manesh, *Creatures of Contract: A Half-Truth About LLCs*, 42 DEL. J. CORP. L. 391, 412 (2018) ("Under traditional contract law principles, to modify the terms of an existing contract requires the mutual assent of the parties bound by that contract." (citing ROBERT L. SYMONDS, JR. & MATTHEW J. O'TOOLE, SYMONDS & O'TOOLE ON DELAWARE LIMITED LIABILITY COMPANIES § 4.06[A][3][b] (2d ed. 2017))); *see also* Richard P. Wolfe, *Minority Shares Under the Louisiana Business Corporation Act: Expulsion, Oppression, and Fiduciary Duty*, 64 LOY. L. REV. 25, 33 (2018) ("Under the law of contract, all parties must consent to any amendment of their agreement.").

264. *See* DEL. CODE ANN. tit. 8, § 102(a)(4).

265. *See* Bay Newfoundland Co. v. Wilson & Co., 37 A.2d 59, 62 (Del. 1944) (contrasting the instant case from *Keller* and stating that "[a]n attempt, however, by a corporation to revise its capital structure and thereby to cancel arrearages of dividends accumulated on its preference stock is a matter of concern to the stockholders only; and if all of the interested stockholders should consent, only an abstract question would remain. No question of public policy is involved; and it was not held in the Keller case, nor in any subsequent case, that the charter amendment necessary for the purpose is utterly void in any and all circumstances").

266. *See, e.g.*, Keller v. Wilson & Co., 190 A. 115, 125 (Del. 1936) ("The cancellation of cumulative dividends already accrued through passage of time is not an amendment of a charter. It is the destruction of a right in the nature of a debt, a matter not within the purview of the section.").

267. *See id.*

modifications that destroy or impair already-vested contractual rights are typically limited or prohibited outright.[268]

This Part focuses on Delaware law to demonstrate that the Traitor Clause would be read as a permissible charter amendment under most circumstances. Delaware law is emphasized in this Part because Delaware is considered the preeminent jurisdiction for corporation formation in the United States; further, many startup investors require the companies that they invest in to be formed in Delaware to allow for a formulaic set of legal rules across all companies held by the investor.[269] However, Delaware's dominance has begun to fade in recent years due to a number of high-profile conflicts with well-known entrepreneurs. In one case, a well-known entrepreneur preferred to reincorporate some of his suite of companies in Nevada due to an adverse ruling related to the legality of his pay package (which was later overturned).[270] In another example, a well-known entrepreneur advocated for significant changes to Delaware law, leading to quick and substantial revisions of the Delaware corporate code.[271] Both examples have demonstrated that Delaware's lead as the corporate capital of America may be dwindling, and other jurisdictions have stepped up to

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268. *See id.*

269. *See* Frances Mosley, *Where to Incorporate Your Business: California or Delaware?*, DLA PIPER (Aug. 4, 2025), https://www.dlapiper.com/en-us/insights/publications/accelerate/formation/where-to-incorporate-your-business-california-or-delaware [https://perma.cc/6HRN-RV7M] ("Delaware is the preferred (and often, required) state of incorporation by venture capitalists for a number of reasons."); Nows & Thomas, *supra* note 55, at 881; *see also* Lucian Arye Bebchuk & Assaf Hamdani, *Vigorous Race or Leisurely Walk: Reconsidering the Competition over Corporate Charters*, 112 YALE L.J. 553, 553 (2002) (proffering Delaware as "[t]he dominant state in attracting the incorporations of publicly traded companies"); David Nows, *Supporting Rural Entrepreneurship with Legal Technology*, 17 N.Y.U. J.L. & BUS. 391, 411-12, 427-30 (2021) (discussing how technology tools geared toward entity formation for legal ventures all use the Delaware corporation as their entity of choice).

270. *See* Wendy Gerwick Couture, *Nevadaware Divergence in Corporate Law*, 19 VA. L. & BUS. REV. 145, 147 (2025) ("[A]fter a 'long history of legal disputes in Delaware, which is known as the country's incorporation capital,' Elon Musk reincorporated X Corp. (formerly Twitter, Inc.) and Neuralink Corp. in Nevada." (quoting Sarah McBride, *Musk's Neuralink Ditches Delaware, Reincorporates in Nevada*, BLOOMBERG NEWS (Feb. 9, 2024, at 18:19 ET), https://www.bloomberg.com/news/articles/2024-02-09/musk-s-neuralink-ditches-delaware-reincorporates-in-nevada [https://perma.cc/E94L-QBLQ])).

271. *See* Dorothy S. Lund & Eric L. Talley, *Should Corporate Law Go Private?* 1-3 (Eur. Corp. Governance Inst., Working Paper No. 877/2025, 2025), https://ssrn.com/abstract_id=5534959 [https://perma.cc/LVR5-46TH] (describing the drafting of, and circumstances surrounding, Delaware's Senate Bill 21 in 2025).

become more competitive with Delaware through statutes that are more management-friendly and the creation of business courts that may rival those in Delaware over time.[272] That said, as of this writing, Delaware remains the undisputed leader in incorporation for major companies and startup ventures.[273] This Article proceeds with that fact in mind.

Two Delaware statutes and a host of cases support the above reading of the law. First, Delaware General Corporation Law (DGCL) section 102(a)(4) provides expansive authorization for charter provisions defining stock rights and economic arrangements. The statute requires corporations to specify in their certificate of incorporation "the designations and the powers, preferences and rights, and the qualifications, limitations or restrictions thereof," for any class or series of stock.[274] This broad language permits charter provisions that fundamentally modify traditional stock rights, subject to the limitations imposed by section 151 of the Delaware Code. More specifically, section 151(a) grants corporations the authority to issue multiple classes and series of stock with varying voting powers, designations, preferences, and special rights, as well as qualifications, limitations, and restrictions.[275]

Many cases further interpret these statutes. For example, the case law supports the conclusion that Delaware recognizes corporations' broad power to modify stockholder rights through charter amendments.[276] That power ends, however, when a charter amendment impairs significant vested contractual rights. In three separate cases, the courts have disallowed charter amendments that negatively impact shareholders economically based on the rescission of already vested economic rights, like cumulative but

272. *See generally* Couture, *supra* note 270 (exploring Nevada's corporate law in comparison with Delaware's).

273. *See, e.g.*, Benjamin P. Edwards, *Reincorporation Update—December 2025*, BUS. L. PROF BLOG (Dec. 5, 2025), https://www.businesslawprofessors.com/2025/12/reincorporation-update-december-2025/ [https://perma.cc/89AC-7BNH] (listing companies that have reincorporated in Nevada or Texas after previously being incorporated in Delaware). The list is not particularly long. *See id.*

274. DEL. CODE ANN. tit. 8, § 102(a)(4) (2026).

275. *See* § 151(a).

276. *See* Hartford Accident & Indem. Co. v. W. S. Dickey Clay Mfg. Co., 24 A.2d 315, 322 (Del. 1942) (concluding that corporations have the right to affect the position of an existing class of stock by the creation of a class or classes having preferred rights or superior positions and that this broad amendment power extends to fundamental changes in capital structure).

unpaid dividends and accrued dividend preferences.[277] An additional requirement of the courts states that all relevant restrictions on a class of stock must be stated in the corporate charter itself, and stockholder agreement terms cannot be incorporated into the charter by reference.[278]

Of course, the above restrictions from the case law exist in scenarios where a shareholder disputes their loss of economic rights or benefits due to the charter amendment. Thus, corporations run the risk of litigation and liability if any shareholder disputes this type of charter amendment. However, in scenarios where there is unanimous stockholder consent to a charter amendment reducing vested economic rights, the corporation would be taking a legally defensible course of action in executing the charter amendment. Delaware law recognizes that stockholders can waive their contractual rights through informed consent, even when those rights have already vested.[279] This consent must be both truly informed and uncoerced in order to be effective.[280] The consent process must also

277. *See* Keller v. Wilson & Co., 190 A. 115, 125 (Del. 1936) ("The cancellation of cumulative dividends already accrued through passage of time is not an amendment of a charter. It is the destruction of a right in the nature of a debt, a matter not within the purview of the section."); Consol. Film Indus. v. Johnson, 197 A. 489, 493 (Del. 1937) ("Many interrelations of the State, the corporation, and the shareholders may be changed. But he, who contends that the State has conferred a power upon corporations, by charter amendment, to change such a substantial contractual right as the right to dividends on cumulative preferred stock accrued under the contract through time, should be able to point to statutory language so clear and precise as to permit of no reasonable doubt that a retrospective operation was intended."); Morris v. Am. Pub. Util. Co., 122 A. 696, 701-04 (Del. Ch. 1923) (holding that charter amendments cannot disturb preferred stockholders' rights to accrued dividend preferences because they constitute vested property interests with debt-like characteristics, and noting that such amendments would violate contractual obligations created by the stock certificate).

278. *See* Seavitt v. N-Able, Inc., 321 A.3d 516, 524 (Del. Ch. 2024) ("The public nature of a charter also means it cannot incorporate a private agreement by reference. The DGCL requires companies to publicly file their charters with the Delaware Secretary of State. Any amendments must be filed too. That requirement ensures easy public access to the charter so that anyone can determine what the charter authorizes, prohibits, or limits. Permitting a charter to incorporate a private agreement by reference undermines the public nature of a charter, particularly for private companies.").

279. *See* Bay Newfoundland Co. v. Wilson & Co., 37 A.2d 59, 62 (Del. 1944).

280. *See* § 242(b)(2) (providing that amendments to a certificate of incorporation to alter or change the preferences or special rights of a class of stock may be made with the approval of a majority of the outstanding shares of that class or such greater vote as the certificate requires); *see also* Williams v. Geier, 671 A.2d 1368, 1379-81 (Del. 1996) (discussing informed and uncoerced consent).

comply with statutory procedures under section 242, requiring both board approval and stockholder approval in proper sequence.[281]

C. Which Companies Can Legally Implement the Traitor Clause?

Companies wishing to implement the Traitor Clause via their corporate charter and RSPA would need to do so in a legally compliant way. For new startups, this is an easy task. These companies have the benefit of contracting with shareholders with the Traitor Clause in mind from the very beginning; thus, the company can simply place the Traitor Clause as a term to holding common stock in the corporation's initial charter before any shares of stock are granted to founders and employees.[282] Further, these startups can place the Traitor Clause in all RSPAs and stock option contracts entered into between the company and its founders or employees.[283] The only obstacle to implementing the Traitor Clause at scale for new startups is adoption of the principle at scale by investors, counsel, and founders.[284]

Implementation of the Traitor Clause gets a bit more complicated once common stock has been granted to founders and employees without the Traitor Clause present in the corporate charter or relevant RSPA or stock option contract. In this scenario, companies

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281. *See* AGR Halifax Fund, Inc. v. Fiscina, 743 A.2d 1188, 1192 (Del. Ch. 1999).

282. *See* THERESE H. MAYNARD & SHANNON TREVIÑO, BUSINESS PLANNING: FINANCING THE START-UP BUSINESS AND VENTURE CAPITAL FINANCING 280 (4th ed. 2022) ("In addition to the mandatory provisions, the Charter *may* contain a broad range of other provisions, generally known as the 'optional' provisions. The transaction planner will often include these optional provisions in order to 'customize' the structure of the newly organized corporation to meet the particular needs of the participants in the new business. In this way, the transaction planner can vary the default rule that is set forth in the corporation statute and which would otherwise apply. As a result of this flexibility, modern corporation statutes are broadly referred to as 'enabling,' meaning that the statutory provisions apply in the event that the corporation does not specify otherwise, usually by including an appropriate provision in the Charter or the bylaws. Modern corporation statutes thereby allow for 'private ordering,' although certain provisions of the statute may be made mandatory and not subject to customization or modification.").

283. *See* Manesh, *supra* note 263, at 393-95.

284. *See generally* Robert Bartlett, *Standardization and Innovation in Venture Capital Contracting: Evidence from Startup Company Charters*, 55 J. LEGAL STUD. 83, 85 (2026) ("Overall, these analyses reveal a striking increase in the adoption rate of the NVCA model form, along with a concomitant increase in the overall similarity of Series A charters between 2004 and 2022. Indeed, for sample charters filed in 2022, nearly 84 percent appear to be based on the NVCA model, up from just 2 percent of 2004 charters.").

must ensure that the shareholder receives full disclosure of the relevant changes to the equity-granting contract and corporate charter, and, further, that the shareholder provides their uncoerced consent to the changes.[285] Only when all relevant shareholders receive such disclosure and provide such consent can the company feel confident it will avoid legal issues associated with the implementation of the Traitor Clause.

When a company has not implemented the Traitor Clause from its formation, the next best time to implement the Traitor Clause will be when a round of investment capital is provided to the company from financial investors. When a new investment round occurs, it is likely that the corporation's charter is already being amended to account for the new class of preferred stock being issued to the investors in exchange for their capital.[286] Further, investors have negotiation power at this stage in the investment transaction as the holders of capital that the company needs. Thus, the investors can make their investment contingent on the implementation of the Traitor Clause, impacting common stockholders through both the corporate charter and all existing RSPAs and stock option contracts.[287] Under these facts, it becomes easier for the company to fully inform common stockholders of their options, while also ensuring that the common stockholders see the value in accepting the new terms of the Traitor Clause in an uncoerced manner. This is because the investors present the company and its common shareholders with a clear binary choice: (1) take the investor capital and give up an economic right under limited circumstances; or (2) keep the economic right but starve the

285. *See* Bay Newfoundland Co. v. Wilson & Co., 37 A.2d 59, 62 (Del. 1944); *see also* § 242(b)(2) (explaining the required process of amendments).

286. *See* Jason Chimon, Lior Zorea, Andrew Pearce & Tim Sharkey, *Understanding the Charter in Venture Financing*, NIXON PEABODY (Dec. 12, 2025), https://www.nixonpeabody.com/insights/articles/nvca-charter-document [https://perma.cc/UUE9-CAQK] ("As companies evolve and raise additional capital, the charter is amended to authorize new shares and adjust terms accordingly. While early amendments may be straightforward, later-stage changes can become administratively complex due to the need for board, stockholder, and class approvals.").

287. *See Contract*, LEGAL INFO. INST.: WEX (Oct. 2025), https://www.law.cornell.edu/wex/contract [https://perma.cc/ZNJ7-A7ZA] (discussing the elements of a contract, including the idea of a bargain, and stating that "[c]onsideration exists when the promisor makes a promise in exchange for something given by the promisee to induce that promise. The focus is on the parties' intent and the reciprocal nature of the exchange").

company of the capital it needs to grow the value of said common stock.

Given that additional capital is almost always required to grow the company (and the value of the common stock), and also may be required to keep the company a going concern and its employees employed, the common stockholders are likely to accept the new terms that include the Traitor Clause.[288] Assuming the investors require 100 percent of the common shareholders to vote in favor of the charter amendment that includes the Traitor Clause, there should be no lingering litigation risk and the charter amendment should be permissible.[289] In limited cases, some common shareholders may not be willing to accept the sets of amendments that include the Traitor Clause. This creates a scenario where the company is exposed to litigation risk, and it likely prevents the existing company from implementing the Traitor Clause.[290] This is a limitation of the proposal made in this Article.

CONCLUSION

This Article has established how key players in the startup ecosystem—such as investors, founders, and employees—value uniform approaches to contract.[291] Whether it be investors providing a new venture with a round of capital, or employees purchasing common stock of their employer upon hire, the contracts that govern these key relationships are consistent.[292] Further, it often takes a significant player in the startup ecosystem to advocate for a change to the standard contractual terms adopted across all new ventures.[293]

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288. *See* David Nows, *Corporate Innovation: One Path to More Sustainable Big Business*, 91 U. CIN. L. REV. 437, 437-38 (2022) ("Entrepreneurs seek capital from investors early and often in their journey toward building a successful new venture. In fact, accelerator programs, business mentors, and academic courses teach budding entrepreneurs that seeking capital is a make-or-break task for the early-stage entrepreneur. Given this emphasis, entrepreneurs build their company's narrative with the investor in mind." (footnotes omitted)).

289. *See supra* Part IV.B.

290. *See supra* Part IV.B.

291. *See* Nows & Trautman, *supra* note 245, at 549-50 (discussing the SAFE as a standardized investment contract in the startup context).

292. *Id.*; *see also supra* Part I (discussing the standardized structure of equity compensation for startup employees).

293. *See* Nows & Trautman, *supra* note 245, at 539-43, 569 (discussing how major investor and startup accelerator Y Combinator led the charge to implement the SAFE as a main form

This Article argued that all key groups of a startup ecosystem should want to see the Traitor Clause implemented as a standard term across all new venture corporate charters and within all RSPAs and stock option contracts.[294] If these stakeholders do not take swift action, the viability of new ventures, new venture investments, and innovation more broadly may come under threat by Traitor Transactions like the ones entered into by Windsurf in 2025.[295]

In order to achieve broad adoption of the Traitor Clause, the most important constituency is financial investors.[296] These investors will play a key role in getting startups to adopt the Traitor Clause via the corporate charter provision, all RSPAs, and all stock option contracts.[297] This is because investors control the flow of capital to nascent companies that need that capital desperately to grow.[298] In fact, it will be investors acting in unison with one another that will create the "snowball effect" that leads to widespread adoption of the Traitor Clause, much like other market contracts or provisions that have emerged in startup finance.[299] For this reason, it is important to conclude with why financial investors should prefer to see the Traitor Clause in place.

In short, investors should prefer the companies in which they invest to have a Traitor Clause in place because the contractual provision helps preserve the future of innovation through startup ventures writ large by ensuring these nascent companies have continued access to the talent that drives them forward.[300] As addressed in Part III, if startups begin pursuing Traitor Transactions on a more frequent basis, talented prospective startup employees will respond rationally by demanding more cash compensation in lieu of equity compensation or, alternatively, by

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of early-stage investment contract).

294. *See supra* Part III.

295. *See supra* Part III.

296. *See supra* Part IV.C, especially notes 282-90 and accompanying text (discussing the ability for financial investors to bargain for important terms prior to providing capital to a new venture).

297. *See supra* Part IV.C.

298. *See supra* Part IV.C.

299. *See* Nows, *supra* note 34, at 36-43 (discussing the lead investor model and how additional investors will typically "follow the leader" and invest once the lead investor has committed to terms and performed due diligence on a new venture).

300. *See supra* Part III.

forgoing working for startups altogether in favor of more lucrative opportunities at established companies.[301] Both of these outcomes are negative for financial investors.[302] If talented prospective employees are willing to work for startups but require more cash compensation, that cash compensation is likely to come from the pockets of financial investors.[303] Investing more dollars for the same amount of employee production ensures that investors can expect lower returns on their future investments.[304]

That is a bad outcome for investors, but a scenario where talented prospective employees forgo working for startups altogether is even worse.[305] This is because new ventures will no longer have access to the best talent and will be placed at an even greater competitive disadvantage compared to the established, mature companies with which they compete.[306] Investors are even less likely to experience acceptable returns on their investment in these situations.[307] Further, investors should have real concerns that Traitor Transactions, if left unchecked, would ultimately lead to a decimation of future investment opportunities by severely limiting the number of new ventures that they would perceive to be investable.[308]

Lastly, investors should take note of the acquirers present in these Traitor Transactions. In the Windsurf case specifically, the acquirer was Google.[309] Google competes with new technology companies in all product and service categories and has an interest in eliminating their competition for customers and employees by any legal means. Traitor Transactions, so far, have been a way for these large companies to avoid the wrath of antitrust regulators.[310] Thus, they are likely to persist, and even increase in frequency, if things are left up to the acquirers. Startup investors are best situated to

301. *See supra* Part III.
302. *See supra* Part III.
303. *See supra* Part III.
304. *See supra* Part III.
305. *See supra* Part III.
306. *See supra* Part III.
307. *See supra* Part III.
308. *See supra* Part III.
309. *See* Swain, *supra* note 1.
310. *See id.* ("Google will not take an equity stake in Windsurf, instead paying $2.4 billion in licensing fees and compensation. This 'acquihire' structure allows Google to secure talent and technology access while avoiding the regulatory scrutiny that a full acquisition would attract.").

put a stop to these transactions, and the Traitor Clause is the perfect tool for doing so.

For founders and employees, the value proposition of the Traitor Clause is much more straightforward. For employees, the Traitor Clause is useful because it protects the value of any equity they are granted by their employer, ensuring that the equity will be valued in the way they anticipated when they signed on to work for the new venture.[311] Equity is still highly likely to be valueless given the high failure rates of new ventures.[312] However, if the company succeeds, the value of the employee's equity will not go from significant to decimated due to a Traitor Transaction.[313] This is a valuable assurance for talented employees to receive prior to dedicating their limited time and effort to the new venture.

For founders, adopting the Traitor Clause from the company's founding is a massive recruiting tool.[314] Most, if not all, new ventures will require significant efforts from persons who are not founders even if AGI is achieved, meaning that talented employees will need to believe working for the startup is their best employment option. Given the incredible persuasive value equity compensation has on the typical startup employee, preserving its value through the implementation of a Traitor Clause will make a startup stand out from the pack to prospective employees.[315] Of course, that advantage will erode as more companies opt-in to having a Traitor Clause, shifting it from an advantage to an expected term of employment.

Over time, the Traitor Clause thus moves from providing a good outcome for founders through a competitive advantage in recruiting, to a good outcome for innovation as a whole through a more fair and equitable set of terms for all parties. This trait, creating a successful environment for investors, founders, and employees, is the hallmark of a successful standard term in new venture contracts. The Traitor Clause is a win-win-win for each of these parties.

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311. *See supra* Part I (discussing the standard terms of startup employee equity compensation and its value).

312. *See* Pollman, *supra* note 236, at 335.

313. *See, e.g.*, Tables 1-3.

314. *See* Alon-Beck, *supra* note 47.

315. *See* Smith, *supra* note 23.