

Confidential Information and Intellectual Property Protection for Start-Ups

A Practical Guidance® Practice Note by
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This practice note will assist you in providing advice and assistance to your start-up client regarding protecting its intellectual property (IP) and confidential information. Alongside the founder's stock purchase agreement and employment agreement, the agreements necessary to protect the start-up's intellectual property are among the most important documents that the start-up will execute after incorporation.

As counsel, your attention to every aspect of these agreements will limit employees and outside contractors from injuring the start-up's business by disclosing secrets,

stealing intellectual property, competing with the start-up, or recruiting away the start-up's key employees. Your goal is to help your client ensure the sanctity and secrecy of the important business resources needed for future success and to secure venture capital investment.

For additional start-up formation resources, please see the following practice notes and forms:

- [Incorporation Documents and Actions for Start-Ups](#)
- [Start-Up Companies - Avoiding Key Legal Mistakes Checklist](#)
- [Pre-seed and Seed Stage Equity Investment Transactions](#)
- [Confidential Information And Invention Assignment Agreement \(Employee\)](#)
- [Confidential Information and Invention Assignment Agreement \(Independent Contractor\)](#)

Overview

In general, agreements that protect a start-up's intellectual property may include provisions that:

- Require a recipient of the start-up's confidential information and trade secrets to maintain the confidentiality of those items and prohibit the recipient's disclosure of their contents to anyone other than persons whom the start-up has designated as authorized to receive it;
- Impose an obligation not to solicit the start-up's employees or customers if the signatory to the agreement leaves the start-up's employ or ends their independent contractor arrangement with the start-up;

- Impose restrictions on a signatory from competing with the start-up or attempting to circumvent the agreement's non-disclosure, non-compete, and non-solicitation covenants; and

Confidentiality Agreements and Restrictive Covenants

Start-ups, particularly technology start-ups, have product and service offerings that frequently incorporate important intellectual property and confidential information elements. You should advise your start-up client to protect such resources by entering into confidentiality agreements (also called non-disclosure agreements or NDAs) with those that will have access to such intellectual property and confidential information. Such agreements when entered into with employees and independent contractors may also contain non-compete, non-circumvent, and non-solicitation restrictive covenants in the body of the agreement, or set forth such covenants in a separate agreement, depending on your client's wishes. While invention assignments (discussed below) are often included in a confidentiality agreement, this practice note discusses them separately from the confidentiality obligation and other restrictive covenants. See [Confidential Information And Invention Assignment Agreement \(Employee\)](#), and [Confidential Information and Invention Assignment Agreement \(Independent Contractor\)](#).

Purpose of a Confidentiality Agreement

Confidentiality agreements are standard in the world of venture capital financed start-ups and, customarily, are entered into in connection with the commencement of any founder's employment, as well as the employment of key (if not all) employees and independent contractors who work for, or with, the start-up. These types of agreements serve three main purposes:

1. They represent important contractual constraints against an employee (including the founder) or independent contractor who provides any of the start-up's confidential information to a third party, thus lessening the danger that such information could find its way to competitors or to the market at-large;
2. They keep information confidential that may not otherwise be subject to (or not yet be subject to) patent, trademark, copyright, or trade secret protection, under either federal or state intellectual property protection laws. Allowing disclosure of inventions or other intellectual property to people outside the start-up, or even those inside the start-up who have not yet signed a similar agreement, may compromise the start-up's efforts to protect its valuable assets. Similarly, any disclosure

of trade secrets always raises the specter that, unless adequate steps are taken to protect the trade secrets, such trade secrets may be deemed non-protectable under the law and established legal precedents. By requiring every potential recipient of trade secret information to execute agreements containing reasonable confidentiality requirements, the start-up can demonstrate that it has taken reasonable steps, as a matter of law, to protect such trade secrets; and

3. Lastly, they convert what would otherwise be a tort action (theft of intellectual property) into a contract action, resulting in significant benefits to the start-up in terms of the length of the applicable statute of limitations and available remedies for any breach.

Confidentiality Agreement Elements

A well-drafted confidentiality agreement will include, among other things, provisions requiring the recipient to:

- Protect and keep confidential all proprietary information and trade secrets of the start-up;
- Refrain from disclosure of the existence of the information and secrets, as well as their contents to any, unauthorized (as determined by the start-up) third person or entity;
- Refrain from using the confidential information (including any and all of the inventions, discoveries, concepts, and ideas that they themselves may create or generate during the period of their employment or engagement) for any reason or purpose except in furtherance of the start-up's business;
- Acknowledge that all documents, data, records, and other materials containing any confidential information, and all other documents, data, records, or materials developed by them during the course of their employment or engagement, are the property of the start-up and that upon termination of their employment or other relationship with the start-up, all such data, records, and other materials will be returned to the start-up (or destroyed, as applicable); and
- Represent that: (i) with respect to employees, their employment with the start-up does not violate any agreement, duty, or understanding that they may have to, or with, anyone else, and (ii) they will not disclose to the start-up or use on the start-up's behalf any confidential information belonging to any third party.

What Constitutes Confidential Information

The confidentiality agreement should define confidential information very broadly in order to include all information concerning the start-up (and those it does business with)

that may be disclosed (both written and orally) to the recipient. The definition should include information that might not rise to the level of a trade secret under common or statutory law, but for which the start-up would still like contractual protection. In addition, as indicated above, there may be situations in which confidential information might be able to be protected in the future, but the necessary legal steps have not yet been taken (or perhaps, cannot yet be taken) to protect it under intellectual property law (e.g. a yet-to-be-filed patent application). Definitions of confidential information should not be limited to the start-up's confidential information, but also confidential information of third parties that is in the start-ups possession and that it is required to protect.

On the other hand, the agreement should include standard exceptions from the definition of confidential information: (1) information which could be obtained publicly or was available in the public domain prior to the time of disclosure to the recipient, (2) information made available through no wrongful act of the recipient, (3) information already in the possession of the recipient, without confidentiality restrictions, and (4) information lawfully disclosed to the recipient by a third party without such third party breaching any confidentiality obligation.

When applicable, the definition of confidential information should also include anything created by an employee or independent contractor during their relationship with the start-up. This serves to buttress the claim that intellectual property created by the employee or independent contractor in the course of the relationship with the start-up is the property of the start-up, and helps to ensure that the confidentiality of such intellectual property will be maintained.

A prior obligations representation should also be included to protect the start-up against third-party claims such as tortious interference with contract or intellectual property infringement by putting the employee or independent contractor on notice and by creating a cause of action against the employee or independent contractor in such situations. Start-ups should periodically remind employees and independent contractors of this requirement to ensure such employees/independent contractors do not utilize third-party intellectual property in the years following their execution of these agreements.

Limitations on Use of Confidential Information

Any confidentiality agreement should explicitly state that the confidential information can only be used to the extent necessary to perform obligations of the recipient (whether it be an employee performing services, or a potential

customer that may enter into a transaction with the start-up) and cannot be disclosed to others without the prior written authorization of the start-up's management or board of directors. Please note that, in order to be classified as a trade secret under most federal and state laws, a start-up must use reasonable efforts to protect the relevant information. For example, under California law information must be "the subject of efforts that are reasonable under the circumstances to maintain its secrecy." Limitations on the use of confidential information will help the start-up to maintain trade secret status for the confidential information.

Returning Company Documents

A well-drafted confidentiality agreement will provide that upon termination of the recipient's relationship with the start-up, all documents related to the start-up should immediately be returned to the start-up. Alternative language could provide for the destruction of the materials, along with the delivery of a certificate itemizing the documents destroyed and confirming their destruction.

Solicitation of Employees, Independent Contractors, and Other Parties

Be aware that under the law in some states, like California (see California Business and Professional Code 16600 et. seq.), noncompetition agreements are unenforceable as a matter of public policy (except in connection with the sale of a business and certain other limited situations not typically applicable to start-up clients). In addition, even where there is no absolute prohibition against such restrictive covenants, most states limit their applicability both as to scope (i.e., the extent of the prohibited competitive activities), geography (e.g., limited to one or more specific geographic markets), and duration (e.g., not more than two years). For example, non-solicitation of employees for up to 24 months can be enforceable in California (see *Loral Corp. v. Moyes*, 174 Cal. App. 3d 268 (Ca. App. 1985)), although one year durations are also common.

Restraining the ability to hire former employees (where there has been no prior solicitation) may also not be enforceable in California and other states with similar laws and case-law precedents. For example, the *Loral* case states, "Equity will not enjoin a former employee from receiving and considering applications from employees of his former employer, even though the circumstances be such that he should be enjoined from soliciting their applications." Other cases, such as *Ingle Co. v. VideoTours*, 1997 U.S. App. LEXIS 423, (that asserted that bans on hiring former employees were void in California because they violated California public policy), have raised doubts about the enforceability of no-hire provisions in California.

Notwithstanding the foregoing, noncompetition agreements and broader non-solicitation agreements are enforceable in many states. However, you should consult the laws on noncompetition and other restrictive covenants of the applicable state to ensure compliance.

Remedies for Breach

Essential for inclusion in a confidentiality agreement is a provision whereby the recipient acknowledges that the start-up has a right to injunctive relief and that monetary damages are not sufficient in the event of a breach of the agreement by the recipient. This will facilitate the start-up's ability to obtain a temporary or permanent injunction if necessary. However, any such language in the agreement should contain an acknowledgement that an injunction is not the sole and exclusive remedy, so as not to prevent the start-up from being able to seek monetary damages as well if applicable. A well drafted equitable relief clause will also specify that the party seeking relief will not be required to post any bond or other security in connection with the granting of an injunction, as may otherwise be required.

Employment or Consulting Relationship; Duties

When drafting confidentiality agreements, whether or not other restrictive covenants and invention assignments are to be included, you should draft separate standard forms to be used for employees, on the one hand, versus independent contractors, on the other hand. See [Confidential Information And Invention Assignment Agreement \(Employee\)](#), and see [Confidential Information and Invention Assignment Agreement \(Independent Contractor\)](#).

The employee form of the confidentiality agreement should not be used for independent contractors, nor should the phrase "works made for hire" be contained in any such agreement because independent contractors may be incorrectly classified as employees for unemployment or workers' compensation purposes as a result. For more information regarding misclassification of employees, see [Independent Contractor Tests and Risks of Worker Misclassification — Understanding the Risks of Independent Contractor Misclassification](#).

Because some states require additional consideration (or compensation) in order for a confidentiality agreement with an already engaged employee/contractor to be effective, it is important that all employees and independent contractors sign confidentiality agreements immediately upon commencement of their relationships (or, in the case of independent contractors, immediately upon commencement of or changes in their relationships with the start-up), or, more prudently, prior to receiving any confidential information from the start-up (if that may occur

prior to engagement). Under California law, for example, consideration is usually not a concern because employment is at-will and continued employment and wages paid is probably sufficient. In any case, as added protection, the confidentiality agreement should state that the employee's or independent contractor's execution of the agreement is a condition to the employment or consulting offer (or as a condition for receipt of any confidential information if executed prior to engagement).

For more general information regarding confidential information and restrictive covenants, see [Restrictive Covenants and Confidential Information Protection](#).

Invention Assignments

Employee invention assignment agreements are among the most common types of agreements into which most start-ups enter. Innovative technology is central to most venture capital funded start-up businesses and, consequently, its protection by the start-up is of paramount importance.

In spite of their pervasiveness, however, there are a number of pitfalls and issues that can be encountered in the agreements that may jeopardize a start-up's reliance on them, including:

- Does it contain potentially critical language that has been acknowledged as effective by the applicable courts?
- Was the assignment language included broad enough to apply to the intellectual property in question, and, conversely, was the assignment language too broad to be void under applicable law?
- Does it continue to protect a start-up's current needs after a sale of the start-up or a change in its operational structure?
- Does it include any representations by the employee or independent contractor regarding the nature or quality of any developed intellectual property (e.g. non-usage of "copyleft" open source software, originality of materials, and/or non-infringement of third-party intellectual property)?
- Does it address choice-of-law uncertainties in connection with the assignment of unpatented trade secrets?

These questions, as well as a host of other issues, underscore the need for you to remind your client to review its personnel files periodically to ensure that executed invention assignment agreements between the start-up and its employees and independent contractors actually exist and can be readily located, and ensure that the agreements continue to preserve the rights and obligations that are

necessary to protect the start-up's current situation and needs.

Purpose of Invention Assignment Agreements

The purpose of invention assignments and assignment agreements is to unequivocally vest in the start-up, ownership of all intellectual property developed by any employee (including the founder(s)) or any independent contractor during the course of their relationship with the start-up, even if developed offsite or with their own resources as long as it is of the type and nature of intellectual property pertinent to the start-up's business. In many cases, the technology covered by the start-up's patents and other intellectual property registrations, such as trademark and copyright registrations, are first created for the start-up by an employee or independent contractor during the period of their employment or retention by the start-up. Unfortunately, despite the start-up's claim to ownership buttressed by invention assignment agreements, patents, and other intellectual property registrations, courts frequently interpret situations involving intellectual property created by an employee or contractor in a way that tilts toward the employee or independent contractor.

Thus, in the absence of a clear, written, unequivocal assignment of the intellectual property rights by the employee or independent contractor, courts usually rule that those rights are the property of the individuals who created them. These agreements should not only specify that an employee or independent contractor *will* assign such developed in the performance of services for the start-up, but also that the employee or independent contractor prospectively assigns such intellectual property at the time of entering into the agreement (e.g. *"I agree to assign, and hereby assign..."*)

Note that in California, an invention assignment agreement is invalid for inventions created entirely on the employee's own time and without use of employer resources (i.e., without using the employer's equipment, supplies, facilities, or trade secret information). See California Labor Code Sections 2870. However, inventions that relate to the company's business or anticipated research and development or that result from any work performed by the employee for the employer can be validly assigned under an invention assignment agreement. California employees must receive a written notification of these rules at the time they are asked to sign an invention assignment agreement, so inclusion of the text of this law is advisable for invention assignment agreements with California employees.

Inventions Retained and Licensed

Under a properly-drafted inventions assignment agreement, the start-up will be given the opportunity to learn of any inventions that conflict with the employee's or independent contractor's obligations to past, concurrent, or future employers, or that the employee or independent contractor seeks to retain ownership of, but plans to use in connection with the performance of services for the start-up. In addition, where the appropriate language is included (usually in an invention assignment agreement and reflected on an attached schedule), it will ensure that the start-up will have the right to use intellectual property that an employee or independent contractor may include in any work they do for the start-up, but which they have not expressly assigned to the start-up and seek to retain.

Assignment of Inventions

Other than with respect to any limitations and restrictions that may be imposed on enforceability by law (see below), the assignment language should be drafted in such a manner as to make it as broad as possible and to even extend to inventions developed during an employee's free time if such employee uses start-up resources in connection with such inventions development, or if the invention is related to the start-up's actual or anticipated research and development.

Exceptions to the Enforceability of Invention Assignments

As previously stated with respect to the reach and enforceability of restrictive covenants under confidentiality and noncompetition agreements, invention assignments are also subject to restrictions under prevailing law. For example, California Labor Code Section 2870 (as discussed above and which has counterparts in a number of other states) seeks to protect employees and independent contractors by imposing limits on invention assignments. Under the California law, the employee or independent contractor can still be contractually compelled to disclose such inventions so the start-up is aware of them and can independently assess whether they fall within the scope of the type of intellectual property that the statute requires be excluded from assignment to the start-up. Many start-ups tailor their agreements to strictly adhere to the limitations of these laws (by including such limitations as the only carve-outs from the invention assignment requirements), and even include references to these laws as exhibits to any invention assignment agreement in order to comply with applicable notice obligations as noted above.

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Bryan offers intellectual property, technology, and data security-related advice and counsel to clients across a broad spectrum of industries, including the financial, media, and advertising sectors. He works diligently with clients on the full range of intellectual property issues that arise in M&A and licensing contracts, as well as counsels global and national funds (including private equity, hedge, and distressed funds) and other clients on the IP and IT issues involved in complex public and private asset or stock acquisitions, LBOs, and divestitures. He also advises clients on transition and long-term services agreements in connection with carve-out transactions for seamless transitions at closing.

Bryan negotiates the intellectual property provisions of M&A/private equity transactional documents. He also negotiates, drafts, and reviews technology licensing and master service agreements, collaborating closely with clients and vendors to craft such contracts. Bryan's work on both the licensor and licensee side of transactions gives him a broad perspective and allows him to craft creative solutions to meet client needs.

His background also includes drafting license agreements, Uniform Domain Name Dispute Resolution Policy (UDRP) complaints, trademark applications, statements of use, consent agreements, and cease-and-desist letters. He has also performed trademark searches and managed client trademark portfolios.

Bryan's data security and privacy experience includes counseling clients on an array of cybersecurity and privacy issues. This advice includes SEC-mandated data security and cybersecurity vendor management practices and policies, U.S. and EU standards for processing personally identifiable information (PII), requirements governing data scraping and other data access practices, and appropriate responses to data breaches involving the release of PII.

Jenna-Marie Tracy, Associate, Lowenstein Sandler LLP

Jenna works with established and emerging companies on their formation, financing, and intellectual property protection.

Her practice focuses on the licensing, maintenance, enforcement of trademarks and copyrights. She counsels a wide range of businesses on issues ranging from trademark clearance, selection and brand portfolio management. Jenna helps clients protect their valuable trademarks online through domain name dispute proceedings and responding to phishing attacks. She manages customs registrations and enforcement for a major consumer brand client. Jenna also advises on advertising claims substantiation, and counsels clients on false advertising risks, marketing approaches, and branding.

With a background in biology and chemistry, Jenna assists clients across the pharmaceutical, animal health, tech, financial services, consumer products and other industries in fast-paced mergers, acquisitions, and financings by conducting intellectual property and technology due diligence evaluations and negotiating key intellectual property terms and ancillary documents.

She has published on the subject of the right to publicity, and taught Continuing Legal Education courses on trademark law.

Matt Savare, Partner, Lowenstein Sandler LLP

A veteran of high-profile representations in the digital advertising, media, and entertainment sectors, Matt brings a proven track record to his work for a broad range of clients.

Matt has represented clients in copyright, trademark, trade secret, and right-of-publicity matters—with a particular emphasis on how new and emerging technologies are disrupting traditional businesses—in the following sectors:

- Blockchain and Cryptocurrencies
- Software (SaaS, PaaS, development, services)
- Big data
- Social media
- Advertising, financial, and education technology
- Media and entertainment
- Life sciences
- Retail (online and brick and mortar)
- Beauty and fashion
- Food and beverage
- Government contracting
- Investment management

His work also includes counseling clients on information privacy and data security issues (including the California Consumer Privacy Act [CCPA]), cybersquatting, domain name disputes, and technology licensing. He represents The Estée Lauder Companies Inc. in connection with various investments and acquisitions, with a particular emphasis on intellectual property and right-of-publicity issues. He also represents News Corp. in connection with its digital advertising initiatives, and regularly drafts and negotiates endorsement, sponsorship, and personal appearance deals for athletes, celebrities, and major brands.

During his time as a litigator, Matt handled various entertainment, intellectual property, false advertising, right-of-publicity, and privacy disputes, including defending a copyright infringement suit filed by the Estate of Frank Zappa and assisting in the successful defense of David Chase in connection with *The Sopranos*.

Prior to joining Lowenstein, Matt worked for the Department of the Army, negotiating and drafting multi-million dollar procurements for communications and electronics equipment and related services, with an expertise with the FAR, DFARS, and AFARS.

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