

Confidential Information and Intellectual Property Protection for Start-Ups

A Practical Guidance® Practice Note by Michael J. Allen, Carruthers & Roth, P.A.



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This practice note is to assist you in providing advice and guidance to your start-up client regarding protecting its intellectual property (IP) and confidential information. Along with the founder's stock purchase agreement and employment agreement, 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 help prevent employees and outside contractors from injuring the start-up's business by disclosing or misappropriating trade secrets or other proprietary information, stealing or failing to assign intellectual property to the start-up, competing with the start-up, or recruiting away the start-up's key employees. Your goal is to help ensure that your start-up client takes all appropriate steps to retain and maintain ownership of, and otherwise protect, its IP as well as its critical business relationships. It comes as no surprise that IP rights are often among a start-up's most important business assets and resources, and often critical to your client's success and ability to secure venture capital investment. Note that while this practice note often discusses issues and contracts in terms of the start-up's relationships and agreements with its employees and independent contractors, such issues may very well apply to the start-up's other business/contractual relationships.

For additional information, see [Confidential Information Protections](#) and [Confidentiality and Non-disclosure Agreements Resource Kit](#).

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 used to protect a start-up's intellectual property include provisions that:

- Require a recipient of the start-up's trade secrets and confidential information to confirm the start-up's ownership of those items, require the recipient to maintain the confidentiality of those items, prohibit the recipient's use of any of those items except as expressly authorized by the start-up, and prohibit the recipient's disclosure of any of those items to anyone except as expressly authorized by the start-up and then, only for the purposes expressly authorized;
- Impose an obligation prohibiting a signatory from soliciting, inducing, or encouraging the start-up's employees and independent contractors to end their employment or independent contractor arrangement (as the case may be) with the start-up;

- Impose obligations prohibiting a signatory from competing with the start-up, from soliciting or otherwise interfering with the start-up's relationships with its customers and vendors, and from attempting to circumvent the agreement's non-disclosure, non-compete, and non-solicitation covenants; and
- Provide for and memorialize the transfer of all relevant inventions, technology, and other intellectual property from the start-up's founders to the start-up in partial consideration for the issuance of shares of the start-up's common stock to the founders, and document the assignment/future assignment of any intellectual property that may have been and/or may subsequently be created by any of the start-up's directors, officers, employees or outside independent contractors during the term of their relationship with the start-up.

The contractual protections/provisions essential to protecting the start-up's IP and other proprietary rights can be incorporated into one or more agreements, as deemed appropriate under the circumstances. For example, it is not unusual for counsel to prepare a single agreement for each particular type of contracting party (e.g., one for employees, one for independent contractors, one for vendors) that encompasses all essential IP protection provisions as well as other provisions needed to properly govern the relationship. The focus in this note is on the types of general protections needed rather than how best to arrange them.

Confidentiality Agreements and Restrictive Covenants

Generally speaking, the interpretation and enforceability of confidentiality provisions and restrictive covenants is governed primarily by state law. The interpretation and enforceability of these provisions, especially restrictive covenants such as noncompetition and non-solicitation provisions, can vary dramatically depending on which state's substantive law will govern them. When dealing with these types of clauses, the concern is not just how they will be interpreted and enforced, but whether they will be enforced at all. It is not unusual for a restrictive covenant to be fully enforceable under the law of one state yet fully unenforceable under the law of another. As such, it is critical for you to know and understand fully the potentially applicable law and, to the extent possible under choice of law rules, wisely select the most appropriate law to apply by means of a choice of law provision.

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 employees and independent contractors that may also contain non-compete, non-circumvention, non-interference, and non-solicitation 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 both the founder's employment, as well as the employment of both employees and independent contractors who work for, or with, the start-up. A start-up also should be encouraged to enter into confidentiality agreements with other parties (such as vendors and customers) with whom the start-up may share confidential information in the course of their relationship. Confidentiality agreements serve the following primary purposes:

1. They represent important contractual constraints against (and often impose penalties for any breach of the agreement as to) the unauthorized use and/or disclosure to third parties of the start-up's confidential information by an employee (including the founder), independent contractor, or other information recipient, thus lessening the danger that such information could find its way to competitors or to the market in general;
2. They keep information confidential that either is not otherwise subject (or, at the very least, not yet subject) to adequate protection, whether by means of patents, registered trademarks, federally-registered copyrights, or as trade secrets, under either federal or state intellectual property protection laws. In this regard, 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 them under the law. 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 established legal precedents. By forcing every potential recipient of trade secret information to sign one of these types of agreements, the start-up can demonstrate that it has taken the steps necessary to protect such trade secrets; and

3. They convert what would otherwise be only a tort action (theft/misappropriation of intellectual property) into a contract action, potentially resulting in significant benefits to the start-up in terms of the length of the applicable statute of limitations, available remedies for any breach, and issues as to proof. This distinction can take critical importance in those jurisdictions which allow greater protection of confidential information under contract law than under tort law or any applicable statutes.

Confidentiality Agreement Elements

A well-drafted confidentiality agreement will include, among other things, provisions requiring the employee or independent contractor (or other recipient, as applicable) 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 person or entity not expressly authorized by the start-up to receive them;
- 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;
- Disclose any and all inventions they conceive, make or develop during the period of their employment or engagement, irrespective of whether conceived, made or developed at the start-up's facilities or utilizing the start-up's resources or utilizing their own facilities and resources, and acknowledging thereby that all such inventions are the property of the start-up;
- Acknowledge that all confidential information and 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, further, 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; and

- Represent that: (i) with respect to employees (and independent contractors, as applicable), their employment/engagement with the start-up does not and will not violate any agreement, duty, or understanding that they may have to, or with, anyone else, including former employers; and (ii) they will not disclose to the start-up or use on its behalf any confidential information belonging to any third party (sometimes referred to as a "prior obligations" representation).

In addition, the confidentiality agreement should contain an "immunity" notice called for by the federal Defend Trade Secrets Act of 2016 (see 18 U.S.C. §§ 1831-1836), along the following lines:

Pursuant to 18 USC § 1833(b), (a) an individual may not be held criminally or civilly liable under any federal or state trade secret law for the disclosure of a trade secret that (i) is made in confidence to a federal, state, or local government official, either directly or indirectly, or to an attorney, and solely for the purpose of reporting or investigating a suspected violation of law; or (ii) is made in a complaint or other document filed in a lawsuit or other proceeding, if such filing is made under seal; and (b) an individual who files a lawsuit for retaliation by an employer for reporting a suspected violation of law may disclose the trade secret to the attorney of the individual and use the trade secret information in the court proceeding, if the individual (i) files any document containing the trade secret under seal; and (ii) does not disclose the trade secret, except pursuant to court order.

What Constitutes Confidential Information

The confidentiality agreement should define confidential information broadly in order to include all information concerning the start-up that may be disclosed (both written and orally) to an employee during their employment or an independent contractor during their engagement. 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 later be able to be protected by other means (such as under patent law), but the necessary legal steps have not yet been taken (or perhaps, cannot yet be taken) to protect it on such other basis.

The definition should also contain specific examples of start-up confidential information. It is wise to include among these examples those types of information which the particular start-up considers to be the “heart” of its critical proprietary information. Doing so serves to put the recipient on notice that they will have access to such confidential information and that their duty to treat it as such will be triggered, and later can be helpful in any litigation involving misappropriation of such information (e.g., showing that the recipient clearly was forewarned that this information was protected).

The definition of confidential information should also include anything that is created by the employee or independent contractor (and, as applicable under the circumstances, other contracting parties) during their relationship with the start-up, and make clear that such information is owned by the start-up. Doing so serves to buttress the start-up’s position 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.

On the other hand, you should consider excluding from the definition of confidential information the following: (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 or others; (3) information already in possession of the recipient (without confidentiality restrictions, and other than from or through their relationship with the start-up); and (4) information lawfully disclosed to the employee or independent contractor by a third party (i.e., not the start-up) without any confidentiality breach. Such exceptions are standard. Note that in some jurisdictions an overly broad confidentiality agreement/definition of confidential information can result in judicial treatment of the provisions as a restrictive covenant which, if found unreasonable, the court might choose not to enforce. The drafter should take special care in those jurisdictions to not overreach; including exceptions along the lines above become all the more critical.

You should include a “prior obligations” representation in the agreement 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. You should also consider including a provision that the employee or independent

contractor agrees to indemnify and defend the start-up and hold it harmless in the event of the representation is breached. A third-party information provision should also be included in the agreement to protect against breach of contract claims for confidentiality clauses or for agreements between the start-up and others. Again, putting in such a paragraph puts the employee or independent contractor on notice and creates a cause of action against the employee or independent contractor in the event the start-up is found liable for breach.

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 employment or consulting relationship with the start-up (or other specified purpose), and cannot be disclosed to others without the prior written authorization of the start-up’s management or board of directors. For example, in order to be classified as a trade secret under the law of many jurisdictions, 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. Also, requiring all employees and others who might be exposed to any of the start-up’s trade secrets and confidential information helps to show “reasonable efforts” were taken.

Returning Company Documents

A well-drafted confidentiality agreement will provide that upon termination of the employee’s employment, or the independent contractor’s (or other contracting party’s) engagement, 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. Including a phrase such as “developed by me pursuant to the relationship or otherwise belonging to the start-up” will render moot carve-outs such as personal copies of employment or compensation files (including the confidentiality agreement itself), stockholder materials, or other personal items. For a form certificate of destruction, see [Certificate of Destruction of Confidential Information](#).

Solicitation of Employees, Independent Contractors, and Other Parties

Be aware that under the laws of some states, such as 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 and the scope of which third parties are deemed “off limits” under the covenant), geography (e.g., limited to one or more specific geographic markets), and duration (e.g., not more than two years). Again, before drafting these agreements, you need to consult the laws on confidentiality and on noncompetition and other restrictive covenants of the applicable state(s) to ensure compliance. For further guidance, see [Non-competition and Non-solicitation Clauses](#).

Remedies for Breach

The confidentiality agreement should include a provision whereby the employee or independent contractor acknowledges and agrees that the start-up has a right to injunctive relief and that recovery of monetary damages alone is an inadequate remedy in the event of a breach of the agreement by the employee or independent contractor. This will facilitate the start-up’s ability to obtain an injunction if necessary. In addition, 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 obtain monetary damages in lieu of or in addition to the injunction.

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 vis-a-vis 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 \(Independent Contractor\)](#).

Among other things, 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](#).

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), as many states require additional consideration for invention assignments or for execution of confidentiality agreements and restrictive covenant agreements after the relationship with the start-up has commenced. In fact, in some jurisdictions, “new” employment will not be deemed to constitute adequate consideration for such agreements where the employee was not advised of such agreements and the employee’s need to sign them before job offer acceptance. In any case, as added protection, the confidentiality agreement and any restrictive covenant agreement should state that the employee’s or independent contractor’s execution of the agreement is a condition to the employment or consulting offer.

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 that start-ups enter into in the course of their business. Innovative technology is at the center of 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 an invention assignment agreement actually exist?
- Does it contain potentially critical language that has been blessed by the courts?
- 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 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. The easiest way for you to help prevent some of these problems from arising is by recommending to your client that the invention assignment language be included in the same agreement that contains the employee or independent contractor's confidentiality obligation. In addition, consider including the other restrictive covenants to which the employee or independent contractor will become subject in these types of agreements. See [Confidential Information And Invention Assignment Agreement \(Employee\)](#), [Confidential Information and Invention Assignment Agreement \(Independent Contractor\)](#), and [Confidentiality Agreement \(with Inventions Assignment\)](#).

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 often 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 written, unequivocal assignment of the intellectual property rights by the employee or independent contractor, courts often rule that those rights are the property of the individuals who created them.

In addition to clear language confirming work made for hire status and, in any event, assignment of all covered inventions and all rights thereto to the start-up, you should consider including the following:

- Representations that the employee (or other contracting party) (a) has not incorporated any third-party-owned or -created materials into any assigned inventions, and (b) has not incorporated any of the employee's unassigned work product/materials into any assigned

inventions and, further, if it has, it grants the start-up a nonexclusive, royalty-free, irrevocable, perpetual, worldwide license as to the same;

- A clause requiring the employee to retain and provide to the start-up all records and other materials concerning any covered inventions, and acknowledging that all of the same are owned by the start-up;
- A "further assurances" clause pursuant to which the employee agrees, without additional compensation, (a) to assist the start-up to secure the start-up's rights in the inventions (including the disclosure to the start-up of all pertinent information and data, the execution of all applications, specifications, oaths, assignments and all other instruments which the start-up deems necessary in order to apply for and obtain such rights and in order to assign to the start-up the rights, title and interest in and to such inventions), and (b) that these obligations survive and continue after any termination of employment;
- The employee's designation and appointment of the start-up and its duly authorized officers and agents as the employee's agent and attorney in fact to take all lawfully permitted steps pursuant to the further assurances obligation, if the start-up is unable, because of the employee's incapacity or otherwise, to secure employee's performance of the same.

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. In certain states, an invention assignment agreement is invalid as applied to inventions created entirely on the employee's own time and with an employee's own facilities (i.e., without using the employer's equipment, supplies, facilities, or trade secret information). 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. Again, knowing and understanding (and, as applicable, choosing) the law applicable to the agreement is critical before preparing or providing and agreements for the start-up's use.

For example, many states (such as California) have enacted statutes that seek to protect employees and independent contractors by imposing limits on invention assignments. Under the law, the employee or independent contractor can still be 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.

Assignment of Inventions

In most instances, notwithstanding the limitations and restrictions imposed on enforceability by applicable law, the assignment language should be drafted in such a manner as to make it as broad as possible and to have it extend to inventions developed by employees during their free time that either use start-up resources or are related to actual or anticipated start-up research and development. Of course, this approach should not be taken where, under applicable law, an overbroad assignment provision is rendered altogether unenforceable, as opposed to just ineffective to the extent deemed overbroad.

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. In addition, where the appropriate language is included (usually in a confidentiality 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.

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Mike Allen dedicates his practice to protecting clients' rights and assets, including their contract rights, intellectual property rights, shareholder rights, estate rights, and creditors' rights. His unique blend of experience in negotiating, contracting, counseling, and litigation helps him provide meaningful insight to clients at any stage of their business relationships.

Though Mike's goal is to protect each client's interests without the need for litigation, he is poised to litigate vigorously when necessary. He has 30 years of litigation and dispute resolution experience and has been recognized among the "Best Lawyers in America" and North Carolina's "Legal Elite." He also holds an "AV" rating from Martindale-Hubbell, the highest rating awarded.

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