

iLINC Legal & Technology Briefs

Non- Disclosure Agreements For Start-Ups



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Start-ups value their business idea and intellectual property. Therefore, it is indispensable that start-ups ensure the confidentiality of corporate information and trade secrets. However, in order to translate the idea into a successful venture and bring the product to market, start-ups will invariably need to disclose their information with investors, suppliers, consultants and even new employees. For that reason start-ups are confronted with a challenging balancing act between keeping the business idea confidential and promoting the enterprise amongst third parties in order to grow. Evidently, start-ups need to restrict the amount of people they share their idea and value proposition with. If that's not feasible, start-ups should invest some time into drafting a non-disclosure agreement ('NDA') or a confidentiality agreement as it offers the possibility of protecting the information of being divulged further than anticipated. This brief highlights some of the key aspects that need to be taken into account when talking about and drafting NDAs. For instance, start-ups are highly advised to refrain from using NDAs when approaching investors.

What is an NDA?

A non-disclosure agreement ('NDA') or a confidentiality agreement, is a **legally binding contract in which the parties assure to protect the confidentiality of the information that is disclosed.** It establishes a confidential relationship between the holder of the information and the recipient to whom the information is disclosed. NDA's can be categorized as either unilateral or mutual. A unilateral NDA is used where there is only one party disclosing confidential information. For example when new employees are hired, the startup will naturally disclose confidential information to them; an NDA will refrain them from further divulging the shared information. A mutual NDA is one where there are multiple, generally two, parties that exchange confidential information and both are required to ensure the confidentiality of the shared information.

An NDA can be created orally, in written form and can even be implied from the conduct of the parties. However, a written agreement provides more legal certainty as it is easier to prove the existence of the confidential relationship.

The underlying idea of an NDA is that a startup can reveal their idea and any associated confidential information without having to worry for further disclosure. Should the recipient make use or disclose the confidential information in the NDA without prior authorization, the start-up would be able to either request a court order to halt the recipient from violating the NDA or claim compensation for any damage suffered as a result of the breach of confidentiality.

When to use it?

NDA's can be used in a variety of contexts. Generally an NDA can be of **added value during initial discussions with potential employees and contractors.** Whilst it is advisable not too disclose too much information in early discussions, it is evident that at least some information must be shared. An NDA can provide the assurance that these third parties will not further divulge the confidential information shared. **However, as a start-up it is also important to build relationships of trust, whereby the sharing of information does not necessarily depend on contracts.**

An NDA can also be used when approaching potential investors and venture capitalists. **However, it should be noted that investors and venture capitalists often decline to sign an NDA.** Their argument is that signing NDA's may restrict their ability to approach and evaluate other potential (and similar) investments and needlessly increase their liability, as they naturally come into contact with numerous startups. Moreover, investors often consider NDAs to be a sign of entrepreneurial immaturity.

"I think most entrepreneurs, at least the really good ones, realize that NDAs typically don't get signed, so you don't see them too much these days. I know when I do get an entrepreneur who wants an NDA, it puts a question mark in the good judgement category." – Scott Petty, Managing Director of Signal Peak Ventures.¹

What does it protect?

An NDA can be used to protect any type of information including trade secrets. Whereas intellectual property protection generally requires the idea or information to be made public, trade secrets are, by definition, secret. It is information that is not generally known, which typically offers a competitive advantage for the owner, i.e. a copyrighted software program, an invention design and even proprietary information. Because of their precarious nature trade secrets are often protected from becoming part of the public domain by an NDA.

What to include?

Since each start-up and every context where an NDA might be useful is different, drafting a generic NDA is not advisable. The type of NDA (mutual or unilateral) and the safeguarding clauses to include in the NDA, will depend on the nature of the information to be disclosed, who it is disclosed to and the underlying purpose of the disclosure. When drafting and/or negotiating an NDA a start-up should always keep the objective and requirements of the specific circumstances in mind.

Whether the start-up drafts its own NDA, uses a template or negotiates an existing NDA of another

business, it is essential that at least the following provisions are in one way or another addressed:

- **Confidential information** – The NDA should explicitly list the types or categories of information and/or trade secrets at issue in the agreement. This clause essentially establishes the boundaries or subject matter of the disclosure, without actually disclosing the information. It is essential that all forms of information which are to be disclosed (for example technical data, research data and financial projections) fall within this definition;

- **Exclusions from confidential information** – Some information cannot be legally protected by an NDA. The most important is information which is already part of the public domain. It generally also includes information which was created or discovered by the recipient prior to the negotiations of the NDA.

- **Duty of Confidentiality** - The recipient must hold and maintain the disclosed information in confidence and limit its use. In other words, the recipient cannot breach the confidentiality, induce another to breach the confidentiality, or induce another to acquire the confidential information by improper means. Moreover, the clause should ideally mention the purpose for which the recipient may use the confidential information. It is important that the purpose is not phrased too broad as that could effectively lead to the use of the information beyond the intended purpose.

- **Authorized disclosures & Permitted Use** – The agreement should specify if and when there is a legitimate need for the recipient to further disclose the information (i.e. to employees, lawyers,...). The NDA could require prior notice before the disclosure and that any third-party recipients must agree to confidentiality at least as strict as those stated in the NDA. Additionally, the agreement should also specify that the disclosed information may only be used for a specified purpose.

- **Time period** – The agreement should specify the time period for which the NDA will be valid and enforceable. Some NDA's may require that the recipient maintains the confidentiality of the information for a limited number of years.

- **Legal Remedies** – The agreement should specify the legal remedies available to the discloser in the event of a breach of confidentiality. Typically it includes court injunctions to prevent further disclosure and monetary compensation for damages.

- **Indemnification** - The disclosing startup would do well to include an indemnification clause in the event that a breach in confidentiality has been proven to have occurred. This entails that the recipient – responsible for the breach – agrees to indemnify the disclosing party for all legal fees and

expenses made in order to enforce the provisions of the NDA.

- **Miscellaneous provisions** – General terms such as the applicable law, the possibility for mediation/arbitration should be addressed here.

The use of templates is not recommended as a good NDA is heavily dependent upon several factors. Startups should however, take note of the NDA templates issued by the European Commission as a more detailed initiation¹.

It is important that an NDA is suitable for the specific circumstances and you should seek legal advice if you are unsure whether this particular NDA is applicable or if you have any queries on specific provisions.

References

1. See the IPR Helpdesk of the European Commission. <https://www.iprhelpdesk.eu/node/971>

2. Eric T. Wagner, 'Entrepreneur vs. Venture Capitalist: The Curse of the NDA' *Forbes* (27 August 2013)

<http://www.forbes.com/sites/ericwagner/2013/08/27/entrepreneur-vs-venture-capitalist-the-curse-of-the-nda/>

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