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How to protect your IP during fundraising so you don't get ripped off

By Alison Miller | December 28, 2022

The most important asset early- stage companies possess is their intellectual property. But IP can be difficult to protect during fundraising, because venture firms reviewing confidential pitch materials do not regularly sign NDAs as is traditional in other industries, and applicants lack leverage to push for them.

Venture firms are often involved in multiple deals, so the need to protect one's IP during early fundraising is far from theoretical. Let's say that Company A pitches a healthcare- focused fund for pre-seed or seed funding and the fund declines to invest. The fund later receives a pitch from Company B, a healthcare company in a similar space, and this time decides to invest.

Because Company A and Company B do similar things, the fund might be incentivized to provide some of Company A's ideas to Company B. This leaves Company A with the difficult choice of fighting a competitor in the marketplace or courtroom.

What steps can startups take to protect their IP during fundraising so that they do not end up like Company A? Below is a broad strokes overview of the legal landscape as well as a few considerations and strategies to mitigate the risk of IP theft.

What material is protectable

Not all concepts developed by startups are legally protectable, even if a founder would consider them confidential or proprietary.

Trade secrets are the most well-recognized category of protectable information. These are defined under federal law and many state laws as tangible and intangible "financial, business, scientific, technical, economic, or engineering information, including patterns, plans, compilations, program devices, formulas, designs, prototypes, methods, techniques, processes, procedures, programs, or codes."

While the trade secret definition captures many types of information, that information must be relatively concrete. Some jurisdictions, most notably New York and California, additionally protect more abstract business "ideas." Generally speaking, a startup's business ideas will be protected if it has any operations or engages in fundraising activities in these jurisdictions. While New York requires a business idea to be "novel," California does not.

The more you do, the better you fare

When an NDA is not a realistic option, the next best thing founders can do is to signal as much as possible that pitch materials shared with funders are confidential. While nothing will be as ironclad as an NDA, the law looks favorably on instances where the holder of confidential information tells the recipient that the material is not to be used or shared, especially when these directives are in writing.

To that end, founders might do the following:

- Label pitch materials "proprietary and confidential, not to be disclosed."
- Share pitch materials through secure software such as DocSend that empowers companies to restrict, monitor, and terminate access to pitch materials.
- State orally at the outset of the pitch that the material presented is confidential and proprietary.
- Emphasize the novelty of a business idea in pitch materials and presentations, especially if the company operates in New York.

What to do if your IP's been stolen

Cash-strapped startups with stolen IP are often understandably averse to pursuing costly litigation to protect their market position. But litigation need not always break the bank.

The first step toward damage control is to send a cease-and-desist letter instructing a fund to immediately refrain from using your IP.

These are simple documents that raise the specter of litigation, and merely sending one can sometimes be enough to halt the misuse.

If a letter does not do the trick, the company must decide whether litigation makes sense. Early-stage companies should consider retaining lawyers open to non- hourly fee arrangements, such as contingency fee billing that turns on the outcome of the litigation. They might also consider engaging a litigation funder to front legal fees in exchange for obtaining a cut of any recovery.

Not all litigation needs to drag on interminably. It is often possible to settle a misappropriation case based on the outcome of the court's initial rulings. Startups may seek expedited, emergency relief of a temporary restraining order and/or a preliminary injunction ordering that the funder or competitor immediately refrain from misusing the information.

Courts rule quickly on these applications, and part of the legal analysis requires consideration of the strength of the startup's claims. These preliminary rulings signal the court's thinking and can provide a strong impetus for settlement early on in litigation.

Conclusion
Even without NDAs, startups undergoing fundraising have at their disposal means to protect their IP.

Remember that the best protection is prophylactic — to mitigate the risk of IP theft, early-stage companies should convey during fundraising that their ideas and pitch materials are to be kept confidential.

Disclaimer: The information in this article is general information and should not be construed as legal advice.

Alison Miller, *trial lawyer at Holwell Shuster & Goldberg LLP in New York, litigates commercial disputes at all stages in subjects such as securities, contract, antitrust, IP misappropriation, and corporate M&A law.*