



March/April 2015

## Intellectual Property: Crowdfunding and Confidentiality for Tech Start-Ups

By: [Gregory Perleberg](#)

I recently attended Launch Festival 2015 ([www.launchfestival.com](http://www.launchfestival.com)) in San Francisco and Angel Launch's LaunchFEST Mixer: Doing Deals with Silicon Valley—Attracting Funding, Angels, and Tech Trends ([www.angellaunch.com](http://www.angellaunch.com)) in downtown Los Angeles. The events were very different in terms of size and scope, but each showcased new technologies with an eye toward connecting business owners with investors looking to fund start-ups. As expected, there was a lot of chatter about the importance of intellectual property, such as whether or not software apps are patentable, the importance of branding, etc. (at each of the events, investors definitely tended to gravitate towards companies with strong, and protectable IP portfolios). But, the big topic of conversation with start-up owners was how to lure-in and legally raise money as a start-up business.

### **Crowdfunding: Fact or Fiction**

Finding suitable financing for a start-up tech venture can be difficult, and that is perhaps why many companies turn to private funding sources for their new venture. When private funds are sought, federal and state securities laws must be complied with (the Securities and Exchange Commission (SEC), directly and through its oversight of the NASD and the various Exchanges, is the main enforcer of the nation's securities laws, and each individual state has its own securities laws and rules – these state rules are known as "Blue Sky Laws"). The definition of a "security" is very broad and is not limited to shares of stock. It includes partnership and limited liability company (LLC) interests, promissory notes and many other financing instruments. Securities must either be "registered" or "exempt" from the registration

requirements of state and federal laws, and certain written disclosures and information must be made, or made available, to investors so they can have the appropriate information to make an investment decision.

Whenever possible, focus on "accredited investors," which are essentially those persons who have one million dollar net worth excluding their house. The disclosure requirements are the least for these sophisticated investors. Even if you have an exemption from registration, liability for any fraud by the issuer still remains. While new technology and social networks may make raising capital easier, securities laws still prohibit certain activities in order to protect unsophisticated investors. So, if you are trying to raise funds via postings on social media websites such as Facebook, Twitter or LinkedIn, only approach friends and connections with whom you have "substantive, pre-existing relationship." The consequences for not complying with federal and state securities laws are severe and can include administrative, civil and criminal penalties.

In 2012, President Obama signed the Jumpstart Our Business Start-ups Act, otherwise known as the JOBS Act. The law purported to open up the capital markets and create jobs by loosening regulations on initial public offerings and allowing for "crowdfunding." Approximately three years later, the SEC still has not published the final rules, and it may be well into 2016 or beyond before we have crowdfunding under the JOBS Act. In the interim, a number of services (often times referred to as "collaborative funding via the web") exist to help raise money, each subject to their own separate terms and conditions. A number of the more popular services



March/April 2015

include: CROWDFUNDER, CROWDRISE, GOFUNDME, INDIEGOGO, INVESTEDIN, KICKSTARTER, PATREON, ROCKETHUB, SOMOLEND, and TEESPRING.

### Top Secrets for Protecting Trade Secrets

Both recent tech events featured great presentations, product demonstrations, fun giveaways, and plenty of meet and greet opportunities. The conversations were rich with entrepreneurial spirit and innovation, but there were also questions and answers about product development, market opportunity, investor strategies, and the like—often within the earshot of others, including potential competitors.

Trade secrets have moved from the background into the foreground of business legal issues (considered the fourth prong of IP—but, unlike other IP which requires public disclosure to protect/enforce, trade secret law requires precisely the opposite – no public disclosure). For many clients, trade secrets are their greatest asset. Unlike patents, copyrights, etc., which are governed exclusively by federal statutes, regulations and case law, trade secrets are regulated by state law. Unlike other IP, there is also no formal requirement related to “novelty” or “tangibility.” No federal legislation directly addresses trade secret protection.

Although the definition varies from state to state, trade secrets include “information” that is generally not known and is “not readily ascertainable” through proper means (and generally must be protected and have economic value):

- formulas, methods of treating chemicals of foods, methods of doing business, customer lists, special customer needs, credit ratings, blueprints, architectural plans, tables of data, information on manufacturing

techniques, designs, marketing analyses and plans, computer software, marketing plans, business plans.

- Information not readily available by proper means – others must not be able to obtain otherwise secret information simply by examining a product or information available to the public.
- Information must be protected – a plaintiff must take reasonable steps to protect the secrecy of the information. Secrecy efforts do not have to be perfect. They do not require extreme measures (e.g., recipes for Coca-Cola, Big Mac secret sauce, KFC Original Recipe, Angostura Bitters).
- Information must derive economic value from secrecy.

### Here are a few tips related to confidentiality:

- Confidential information should never be disclosed without an appropriate written agreement (including non-circumvention obligations), which can provide for either one-way or mutual disclosures.
- Patent applications, assuming publication was not requested, should remain secret unless and until the applicable patent issues.
- Review presentations, publications, etc., for inadvertent disclosures.
- Unsolicited ideas—companies receive these all the time—consider a responsive letter to turn unsolicited ideas into solicited ones to protect from the uncertainties associated with this area of law.
- Restrict access to confidential information, and apply labeling (e.g., Confidential & Proprietary”), and physical security and technical safeguards.
- Employee education programs—emphasizing the importance of trade secrets.
- Document and data handling policies, and memorialize trade secret protection plan.



March/April 2015

- Termination procedures and wind-down processes (send follow-up reminder related to non-disclosure agreements and specific duty to not disclose).

Trade secret status may be lost forever by any disclosure of the secret. Many companies refuse signing confidentiality agreements—or significantly modify them (e.g., disclaimer or caps related to liability, to avoid the risks associated with disclosure (including inadvertent and negligent disclosures) by employees or contractors). Many clients consider utilizing patent rights where feasible. It is important to note the following:

- There is no affirmative protection against the use of the same IP that is independently derived or reverse engineered by a competitor.
- If a trade secret is published in such a way that it may be “translated into practical application,” then it will not be protected as a trade secret.
- If the information can be obtained by starting with a publicly available product and working backwards, the information will not be protected as a trade secret (reverse engineering). In such cases, it is advisable to get a patent (providing twenty years of monopolistic protection). On the other hand, if, for instance, the method of manufacturing cannot be determined from examination, the best way to protect the IP may be to treat it as a trade secret.
- If the trade secret information is used or displayed in public, it is not a trade secret.
- If an independent inventor acquires the same information and discloses it to the public, trade secret status is lost for all who possessed the information.

The famous humorist and writer Will Rogers once said, “Letting the cat out of the bag is a whole lot easier than putting it back in.” This idiom is especially applicable in

the area of trade secrets. Using confidentiality agreements may not put the cat bag in the bag, but they do provide a roadmap for disputes and damages in the event of misappropriation.

### Conclusion

Before seeking financing for your new venture, be sure to consult with an attorney who is qualified to handle securities matters. This includes loans from friends and family, and offering ownership interests in your newly formed business venture. Choose your business partners carefully, and understand the ramifications of soliciting, taking-in and spending investor monies. When disclosing information about your company and its products, be mindful of situations where confidentiality may be lost, potentially devaluing, and consider protections available to you under copyright, patent and trademark laws. In many cases, to recover damages, registration may be required, but must also be balanced against the potentially long term protection available under trade secret laws. The ever-changing legal requirements for properly launching a new technology venture are numerous and complex, and if not careful, they can become a distraction, both time-wise and financially, and pull you away from core business operations if not handled properly. Again, working with an attorney knowledgeable in these areas is essential, and allows you to focus on launching and growing your business.



*Gregory Perleberg is an attorney in the firm's Intellectual Property and Corporate Practice Groups in the Los Angeles office. He can be reached at 213.891.5106 or [gperleberg@buchalter.com](mailto:gperleberg@buchalter.com).*