

When NDA is A Four Letter Word

By Rachel Youens on Monday, November 2nd, 2009

It seems like a no-brainer, right? Why wouldn't you commit investors to signing a non-disclosure agreement before you tell the your million dollar idea? Unfortunately, this is a situation where investors and startups are coming from vastly different perspectives and an NDA can transform from something that secures you to something that sabotages you.

The fear with jumping into capital raising without using an NDA is that the information obtained by an investor during a meeting can be given to anyone, including competitors. In addition, a disclosure of your confidential information, trade secrets or IP can make it hard to file a patent application later. Unless the disclosure of this confidential information was made in confidence, the startup can lose its rights. Another strong reason to employ an NDA in your negotiations is when the investor or investment group has other investments that are very similar to yours. It's a much higher likelihood that this situation could result in your secrets being shared with the company in the investors portfolio and you should proceed with caution.

Knowing this, realize that most investors you meet with won't sign an NDA.

This isn't to say that they will never sign an NDA, but if you walk into a presentation on day one with an NDA in hand you can bet money on the fact they won't sign it. As a startup, you need to realize that this isn't necessarily because they are out to steal your idea, but because they see so many proposals come across their path and oftentimes they are very similar, it would be difficult for an investor to promise that there won't ever be another company like yours that they will be involved with. It's the same reason why publishers and studios don't directly accept scripts or manuscripts...it leaves them too open to liability for a person to accuse them of stealing a story and so they require writers to go through agents.

"If an investor sees quite a lot of startups, he or she would have to spend time reviewing the legalities of each NDA and keep track of each individual agreement," says Sydney-based tech investor [Alex Sparkes of Green Lane Digital](#). "It's time consuming and in my experience I have never seen or heard of an NDA being enforced. If you can't simply and clearly pitch to an investor without an NDA, chances are an investor is just going to lose interest and move onto the next opportunity."

Frequently a startup puts an NDA up as a gateway too early in the discussion and an investor can't ever get in deep enough to figure out the potential. It's true that most investors, if they are really interested, will sign an NDA, but you have to get them interested first and an NDA isn't exactly the type of foreplay they're looking for.

Basically, the challenge is to learn to tell as much about your product and the value proposition as you can without giving away IP. Furthermore, while you may be extremely precious about your idea, it is a just an idea and the idea alone is not what an investor looks at. Investors are likely to hear heaps of similar ideas, especially when it comes to the technology field where similar cloud computing, mobile applications, and retail sites abound. The only real differentiating factor is the team and the technology that powers those ideas. If all that your NDA is protecting is your idea, and not any extra special IP, then you are wasting an investor's time.

It's a good idea to meet with a patent attorney to find out the best way to speak about your business and to help you draw up an NDA should you need one. You're also more likely to have an investor sign your NDA if you construct it in a fashion that is friendly to them. It should be easy to understand, and protect both their interests and yours.

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Whilst an NDA may act as a detirent for an investor, it also says to the investor that you as the founder are doing things properly. In my experience it shows preparation and professionalism. Additionally, it give an investor the impression that you have valuable intellectual property and aren't prepared to give it away.

I have seen the opposite position where investors do take the time to read a confidentiality agreement and sign it, but care should be taken to ensure that a potential investor is presented with a short document. Theres no reason why a short document cannot create enforceable rights.

There is a significant volume of case law in this area, see for example *Coco v A N Clark (Engineers) Ltd* [1969]. However in the start up environment it may be more more problematic because of the extent (or lack thereof) of actual intellectual property.

I agree with Alan Jones. An idea generally has no value.

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