Confidentiality Agreement: Early-Stage Business (Pro-Discloser)

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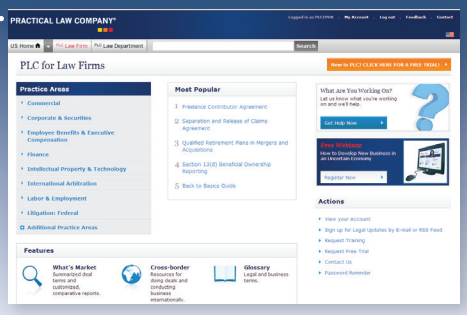

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A standard form that can be used as a starting point for drafting a confidentiality, or non-disclosure agreement (NDA), for use by a start-up or early-stage business preparing to disclose information to a prospective investor or other third party. This form has been drafted with terms favorable to the party disclosing confidential information. It has integrated notes with important explanations and drafting and negotiating tips.

NOTE: GENERAL

This standard form can be used as a starting point for drafting a confidentiality agreement (often called a non-disclosure agreement or NDA) for use by a start-up or early-stage business that is planning to disclose confidential information to a third party. It is primarily intended for use by a smaller business preparing to disclose information to a prospective investor or lender as part of a capital-raising transaction. It can also be adapted for use by a business planning to disclose information to a third party, such as a service provider, for operational reasons.

The provisions in this standard form have generally been drafted in favor of the disclosing party, but the draft aims to be relatively reasonable in order to reduce the time and expense that it takes to agree on the final version. When applicable, the drafting notes discuss compromise modifications to the standard provisions that may be appropriate in response to comments from the third party or its counsel.

This standard form is significantly less detailed than similar agreements typically used outside the start-up and small business environment. The aim of this relative conciseness is to provide an agreement that can be easily understood by non-lawyers. Counsel working with start-ups and smaller businesses must use their judgment and experience to strike a balance between:

- Including sufficient detail to protect the client's interest.
- Avoiding a level of detail that would disproportionately increase transaction costs or risk alienating either of the parties.

For a more detailed standard form NDA to be used in connection with an acquisition, see *Standard Document, Confidentiality Agreement: Mergers and Acquisitions*.

Before an early-stage business suggests that a prospective investor or lender execute an NDA, the business should be aware of several important considerations (see *Points to Consider Before Suggesting an NDA to Prospective Investors*).

For a general discussion of considerations for an early-stage business planning a capital-raising, see *Practice Note, Preparing for Start-up and Smaller-business Capital Raising*.

For convenience, the drafting notes in this document refer to the start-up or early-stage business planning to disclose information as the company, regardless of legal form. For more information on choosing an entity form, see *Choosing an Entity Comparison Chart* and *Practice Note, Choice of Entity: Tax Issues*. The drafting notes refer to the prospective investor, lender or other third party that will receive confidential information as the receiving party.

Importance of NDAs in the Early-Stage Business Context

A paramount consideration for a growing company is the pursuit of capital to fund its venture (for an overview of investments in growing companies, see *Practice Note, Minority Investments: Overview*). A key threshold question in the fund-seeking process is whether the company should propose that a prospective investor or lender enter into a confidentiality agreement before that party receives confidential or sensitive information about the company's business or business plan. This question is particularly important in the start-up world, because a start-up's main asset is often its business idea. A tailored NDA can be an effective means to help safeguard this asset.

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Growing companies may also share sensitive information with third parties in other contexts. For example, many start-ups outsource website and mobile application design to third parties, and as part of this process provide them access to sensitive information and concepts. It is equally important to effectively ensure that these parties keep company information confidential, especially considering that service providers often receive sensitive business information even earlier in a company's business cycle than prospective investors would. Therefore, it often makes sense for a company to enter into an NDA with these service providers.

Points to Consider Before Suggesting an NDA to Prospective Investors

Sophisticated investors and lenders, including venture capitalists and private equity funds have historically been reluctant to enter into NDAs. Examples of reasons these investors have given for this include:

- They are likely to be approached by multiple start-up founders with similar ideas in any given time period, and may eventually choose one founder over another based on that founder's ability to execute the idea, as opposed to the idea itself. Executing an NDA with each founder could potentially expose an investor to litigation if it decided to pursue a relationship with a founder who had a similar idea, even in the absence of any wrongdoing by the investor.
- Because so many start-ups approach them, it would be prohibitively expensive and time-consuming to negotiate, execute and monitor compliance with an NDA for each one.

As a result of this, some practitioners take the position that merely broaching the topic of an NDA with prospective investors (and, in particular, early-stage venture funds) will:

- Betray a start-up founder as unsophisticated.
- End the opportunity to secure financing from the investor.

This position may make sense in the early stages of discussions with a prospective investor. However, it is generally worth mentioning the company's desire to enter into an NDA with any prospective investor that:

- Will receive any sensitive, specific company information (such as key business contracts or customer lists).
- Is a competitor of the company.

Even at later stages of a negotiation, care should be taken before proposing an NDA. A company and its counsel should first carefully weigh the potential risks of proposing the NDA against the benefits it will offer, in light of the specific circumstances. Depending on the outcome of that analysis, a company and its counsel may decide to tailor an NDA to make it palatable to the counterparty, or to not propose it at all. The assistance of experienced counsel in these matters can guide a company through this careful weighing of considerations.

Lastly, to lessen the risk that simply proposing an NDA will make the company seem unsophisticated, companies should consider having their counsel be the individual to suggest the NDA to the investor. If the investor balks, the company's counsel can always inquire as to the specific objections and attempt to draft a more flexible NDA. If that approach does not produce an agreement, the company can then make the decision whether to proceed.

CONFIDENTIALITY AGREEMENT

This Confidentiality Agreement (this **"Agreement"**), dated as of [DATE], is by and between [NAME OF DISCLOSING PARTY], a [DISCLOSING PARTY'S STATE OF ORGANIZATION] [ENTITY TYPE] (the **"Company"**), and [NAME OF RECEIVING PARTY], a [RECEIVING PARTY'S STATE OF ORGANIZATION] [ENTITY TYPE] (the **"Receiving Party"**). Each of the Company and the Receiving Party is a "Party" and, together, the "Parties."

1. Confidential Information

1.1 The Parties wish to explore a possible investment by the Receiving Party in the Company (the **"Relationship"**) in connection with which the Company has disclosed and/or may further disclose its Confidential Information (as defined below) to the Receiving Party. This Agreement is intended to allow the Parties to continue to discuss and evaluate the Relationship while protecting the Company's Confidential Information (including Confidential Information previously disclosed to the Receiving Party) against unauthorized use or disclosure.

NOTE: PARTIES

Counsel should consider what specific entities are expected to receive and review the company's confidential information. This might include affiliated entities of the prospective investor.

This agreement prohibits disclosures of the company's confidential information by the receiving party's affiliates, whether or not the affiliates are party to the agreement (see *Drafting Note, Non-disclosure Obligation; Permissible Use*). However, if it is practical under the circumstances, the company should consider making any known or likely additional recipients party to the agreement.

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NOTE: DEFINITION OF RELATIONSHIP; PREVIOUSLY DISCLOSED INFORMATION

Definition of Relationship

Generally speaking, it is in the company's interest to describe the relationship as broadly as possible, as in the language above. This makes it less likely that the receiving party will be able to later claim that certain information was provided to it in the course of a separate arrangement between the parties, and therefore that information is not covered by the agreement. For example, over many months of negotiations, a transaction structure initially proposed may drastically change. In this situation, the company needs confidence that information it shared early on in the process is still covered by the NDA.

However, companies should consider that an overly broad definition of the relationship could permit the receiving party to use the confidential information more widely than the company intends. This is a particular concern if the parties are pursuing a relationship other than an investment by the receiving party in the company (for example, if the parties are competitors discussing a possible joint venture). In that situation, the clause defining the relationship could be revised to read:

> The Parties wish to explore a possible [DESCRIBE SPECIFIC BUSINESS OBJECTIVE, FOR EXAMPLE, JOINT VENTURE TO PURSUE INTERNATIONAL SALES OPPORTUNITIES] (the **"Relationship"**) in connection with which the Company has disclosed and/or may further disclose its Confidential Information (as defined below) to the Receiving Party.

Previously Disclosed Information

This provision is intended to cover confidential information that the company disclosed to the receiving party before execution of the agreement (in addition to any confidential information disclosed afterward). This is favorable to the company for two reasons:

- In the current relationship, information shared before the NDA is signed will be protected from disclosure by the receiving party.
- In future similar relationships with investors, the company may take some comfort that it can provide general information to prospective investors in initial conversations that take place before an NDA is signed. Should those initial conversations lead to the exchange of more sensitive information (and to an NDA), the general information shared in the initial meetings would also be covered by that eventual NDA.

1.2 The Parties hereby acknowledge that by virtue of this Agreement, the Receiving Party will have access to Confidential Information of the Company and that the communication of such Confidential Information to third parties could irreparably injure the business of the Company. Accordingly, the Receiving Party agrees that during the term of this Agreement (the **"Holding Period"**), the Receiving Party shall treat and safeguard, and shall cause its affiliates, directors, officers, employees, managing members, general partners, agents and consultants (including attorneys, financial advisors and accountants) (collectively, the **"Representatives"**) to treat and safeguard, as confidential and secret all Confidential Information received by the Receiving Party at any time, and that the Receiving Party shall not and shall not permit its Representatives to, without the prior written consent of the Company, disclose or reveal any Confidential Information or the fact that it has received Confidential Information, or that any discussions or negotiations are or were ongoing between the Parties, to any third party whatsoever or use the Confidential Information in any manner except in connection with the Relationship.

1.3 For the purposes of this Agreement, **"Confidential Information"** means any information not generally known to the public or recognized as standard industry practice, including, without limiting the generality of the foregoing, [any data, reports, interpretations, forecasts, know-how, technology, compositions, devices, plans, strategies, studies, employee information, intellectual property, the substance of agreements with clients, suppliers and others, marketing arrangements, strategic partnerships and the existence of the discussions between the Parties, customer lists, supplier lists, trade secrets, product development plans, research, inventions, ideas, concepts, designs, formulas, methods or processes, whether or not patented or patentable, channels of distribution, pricing policies and records, financial records and inventory records of the Company], and such other information normally understood to be confidential or otherwise designated as such in writing by the Company, as well as information discerned from, based on or relating to any of the foregoing which may be prepared by the Receiving Party, all of which the Receiving Party expressly acknowledges and agrees shall be confidential and proprietary information belonging to the Company. Confidential Information shall also include any other document or information (whether of the Company or of any supplier or customer of the Company or other person or entity with whom or which the Company has an agreement concerning the confidentiality of information) which comes into the Receiving Party's possession as a result of this Agreement.

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NOTE: NON-DISCLOSURE OBLIGATION; PERMISSIBLE USE

Details of the Non-disclosure Obligation

This provision is drafted in favor of the company. A receiving party might suggest modifying its obligation so that:

- Instead of a flat obligation to treat as confidential and safeguard the confidential information, the receiving party must do so "with the same degree of care that the receiving party maintains its own sensitive information." The company should generally resist this change, since there is often no simple way to verify the appropriateness of the receiving party's confidentiality protection processes. A compromise position is to agree to this modification, but to add a qualifier that the degree of care the receiving party uses "shall be no less than a commercially reasonable degree of care."
- Instead of being obligated to cause its representatives to treat as confidential and safeguard the confidential information, the receiving party must simply instruct or direct them to do so.

Definition of Representatives

Investment funds with multiple portfolio companies may want to tailor the definition of representatives to ensure that their portfolio companies are not inadvertently captured as affiliates (and therefore subject to the NDA's confidentiality obligations). It is also not uncommon for employees of an investment fund to be members of the boards of directors of potential competitors of the company. In these situations, these employees may arguably have fiduciary duties to the competing companies to disclose opportunities discovered while working with the company. Although compliance with any of these fiduciary duties is not the concern of the company, the reality is that the company may have to agree to carve-outs for these situations in order to access capital.

Permitted Disclosures

A receiving party may ask for certain exceptions to the non-disclosure obligation, which may be acceptable to the company assuming that they are narrowly tailored.

Disclosure to Receiving Party's Advisors

A receiving party may request that this provision be modified to allow the receiving party to provide confidential information to advisors such as its attorneys and accountants. This exception is typically not objectionable so long as:

- The category of individuals that may receive the information is as narrow as possible.
- The additional recipients are themselves bound by confidentiality obligations.

This can be accomplished by including additional language requiring the receiving party to:

- Only provide confidential information to parties that are subject to confidentiality obligations no less stringent that those in the NDA (known as a "back-to-back" confidentiality agreement).
- Inform the additional recipients, in writing, of the confidential nature of the information and in certain cases request that they also sign the NDA.

For example, the following clause could be added to the provision above:

> , except for disclosures to the Receiving Party's Representatives who:
>
> (i) need to know the Confidential Information to assist the Receiving Party, or act on its behalf, in relation to the Relationship;
>
> (ii) are informed in writing by the Receiving Party of the confidential nature of the Confidential Information; and
>
> (iii) are subject to confidentiality duties or obligations to the Receiving Party that are no less restrictive than the terms and conditions of this Agreement.

Information Becomes Public

NDAs often include language terminating the receiving party's confidentiality obligation with respect to confidential information that has become public through no fault of the receiving party. This type of provision should typically be acceptable to the company as long as it is drafted appropriately. A key concept to include is that the obligation should not fall away if the information becomes public as a result of the receiving party's or a third party's breach of a confidentiality obligation.

Disclosure Required by Law

A receiving party is likely to request that the agreement contain a provision permitting it to disclose confidential information if it is required to do so by law, regulation or a court order. This provision should typically be acceptable to the company. It should, however, require the receiving party to notify the company before disclosing the confidential information. This will allow the company to:

- Prepare for the disclosure.
- If necessary, use its own resources to contest the disclosure obligation or court order.

Information Not Sourced From Company

Finally, receiving parties also commonly request a provision excluding from the scope of the NDA information that was:

- Independently developed.
- Obtained by the receiving party from sources other than the company.

This provision should typically be acceptable to the company. It should be drafted to allow disclosure of this type of information so long as the information was not:

- Developed as a result of a breach of the NDA.
- Received from a source that was itself in breach of a confidentiality obligation.

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Confidentiality of Discussions

It is typically in the company's interest to keep the fact that it is having discussions with the receiving party confidential. The penultimate clause in this provision is intended to prevent the receiving party from revealing that discussions with the company are ongoing. This is intended to, for example:

- Prohibit the receiving party from publicizing the substance of negotiations to gain leverage over the company.
- Avoid causing premature concern about a potential transaction among the company's customers, employees and other investors.

Permissible Use of Information

The last clause in this provision restricts the receiving party from using the confidential information in any manner except in connection with the relationship (for a discussion of key considerations for drafting the definition of relationship, see *Drafting Note, Definition of Relationship; Previously Disclosed Information*).

NOTE: DEFINITION OF CONFIDENTIAL INFORMATION

This definition of Confidential Information is long and relatively exhaustive. In order to make the agreement as concise as possible, counsel should consider deleting any of the bracketed clauses that are clearly not relevant to the company's business or the type of information expected to be provided. However, if there is any doubt about whether a clause may become relevant, it should generally be included.

The clause immediately following the bracketed list is an important catch-all provision. Generally, it is in the company's interest to include the catch-all. The receiving party may ask that the catch-all be removed on the grounds it makes the definition overly vague. Deleting the catch-all may be acceptable if the company is confident that it has listed all possible types of information it may provide the receiving party.

Derivative Documents Created by Receiving Party

A receiving party might use the company's confidential information to create its own internal documents, such as financial models or other analyses of the company. Even though analyses of this type are produced by the receiving party, their disclosure could effectively constitute disclosure of the underlying confidential information. This provision includes a clause designed to protect the company from indirect disclosures of this type.

1.4 Upon termination of the Holding Period, the Receiving Party shall promptly return to the Company all documents and papers relating to the Company, including any Confidential Information, together with any copies thereof; provided that if either Party decides not to proceed with the Relationship and provides written notice to that effect to the other Party, the Receiving Party will promptly deliver or cause to be delivered to the Company all documents or other matter furnished by the Company or its agents or representatives to the Receiving Party or the Representatives constituting Confidential Information, together with all copies thereof in the possession of the Receiving Party or the Representatives.

NOTE: RETURN OF CONFIDENTIAL INFORMATION

It is important that the agreement specify what the receiving party must do with the confidential information at the end of the holding period. Generally, it is the most favorable to the company if the receiving party must return the confidential information to the company. The company should resist including language that would require it to request return of the information (in other words, the obligation should arise automatically at the end of the holding period).

However, receiving parties often ask for the option to destroy materials instead of returning them. A receiving party might be particularly concerned about not agreeing to "return" confidential information contained in the receiving party's own derivative documents containing confidential information. This generally should be acceptable to the company, and can be accomplished through the following clause:

> or destroy such documents and papers (including any held electronically) and certify in writing to the Company that they have been destroyed.

In addition, a receiving party may seek to add a provision allowing it to retain a copy of some or all of the confidential information in accordance with its record-keeping policy or similar policies, laws or regulations. Although ideally a company would resist this, it may agree to it so long as the provision requires the receiving party to maintain the strictest standards of confidentiality for the retained information.

It is important to specify the period in which the return or destruction of the confidential information must occur. A receiving party is unlikely to agree to comply "immediately," but may agree to comply "promptly." The parties can also agree to a fixed time period for compliance, such as five business days.

1.5 The Receiving Party further agrees that it shall:

(a) immediately notify the Company of any breach of this Agreement;

(b) fully cooperate with the Company to mitigate the effect of such breach; and

(c) be responsible for any breach of this Agreement caused by any of its Representatives or others to whom it has provided or given access to the Confidential Information.

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NOTE: DUTIES IN EVENT OF BREACH

This provision is intended to ensure that the receiving party is responsible for the dissemination of any confidential information by a third party to whom the receiving party has provided the information.

Although Section 1.2 requires the receiving party to take measures to ensure the security of the confidential information among its employees, advisors and the like, this provision is also included because the most effective means to ensure compliance by the receiving party is to make it liable for breaches by these parties (see *Drafting Note, Non-disclosure Obligation; Permissible Use*).

1.6 The Receiving Party, and any parties to whom it provides the Confidential Information, will comply with all applicable laws with respect to the use and maintenance of the Confidential Information, including without limitation any applicable data protection laws.

NOTE: COMPLIANCE WITH DATA PROTECTION LAWS

The Receiving Party may obtain, as part of the confidential information, personal information about various individuals, including employees of the Company. In light of heightened concerns about identity protection, it is important to put the onus on the receiving party to ensure it takes appropriate measures to maintain the confidentiality of this information.

2. Term and Termination

2.1 Each Party's rights and obligations under this Agreement shall commence on the date first written above and expire on the date that is the earlier of (i) [one] year from such date and (ii) any termination pursuant to Section 1.4 above, unless in either case any applicable privacy law requires a longer period. Notwithstanding anything to the contrary in this Agreement, each Party's rights and obligations pursuant to this Agreement shall survive the expiration or termination of this Agreement for a period of [two] years after such expiration or termination, even after the return of such Confidential Information by the Receiving Party.

NOTE: TERM

There are several options for the term of an NDA of this type:

- An indefinite term. This will generally be rejected by the receiving party.
- A fixed term, beginning on the date of the agreement. This is the approach taken by this provision. A term of one year is common, although a longer term is preferable to the company.
- A fixed term beginning after conclusion of the relationship. The relationship may end because the parties decide to proceed with a transaction and complete that transaction, or because the parties decide to end the relationship.

If the parties want to continue the term of the agreement beyond the point that they enter into the principal agreement for the investment in the company or other transaction, that new agreement can include a confidentiality provision that references or incorporates this agreement.

3. Additional Provisions

3.1 Neither the Company nor any of its representatives or other agents makes any representation or warranty, express or implied, as to the accuracy or completeness of the Confidential Information nor shall any of them be liable to the Receiving Party or any of its Representatives relating to the Receiving Party's use of the Confidential Information or any errors therein or omissions therefrom.

NOTE: NO DISCLOSING PARTY REPRESENTATIONS OR WARRANTIES

The purpose of this agreement is to allow the company to share sensitive information with the receiving party. The agreement is not intended to make any statements or assertions about the quality of that information. That subject would typically be covered instead in representations and warranties in the principal agreement for the investment or other transaction, if the parties reach that stage.

3.2 The Company hereby retains its entire right, title and interest, including all intellectual property rights, in and to all of the Confidential Information, and nothing herein shall be construed as an assignment or other transfer of any of the Company's rights in the Confidential Information to any other party.

NOTE: OWNERSHIP OF INFORMATION

This provision is intended to clarify that the Receiving Party is not granted any rights or license to use the confidential information for any purpose other than in connection with the relationship.

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3.3 The Parties agree that (a) this Agreement does not require the Company to provide any information to the Receiving Party or any of its Representatives and (b) neither Party is under any legal obligation to conduct or continue any discussions or negotiations with respect to, or enter into, any relationship, other agreement or transaction whatsoever, including without limitation the Relationship.

NOTE: NO OTHER OBLIGATION

The purpose of this agreement is to allow the company to share sensitive information with the receiving party. This provision clarifies that the agreement should not in any manner bind the parties to additional obligations.

3.4 The Receiving Party acknowledges and agrees that monetary damages might not be a sufficient remedy for any breach or threatened breach of this Agreement by the Receiving Party or its Representatives or other agents. As a result, in addition to all other remedies available at law (which the Company does not waive by the exercise of any rights hereunder), the Company shall be entitled to seek specific performance and injunctive and other equitable relief as a remedy for any such breach or threatened breach, and the Receiving Party hereby waives any requirement for the securing or posting of any bond or the showing of actual monetary damages in connection with such claim. In the event that either Party institutes any legal suit, action or proceeding against the other Party arising out of or relating to this Agreement, the prevailing Party in the suit, action or proceeding shall be entitled to receive, in addition to all other damages to which it may be entitled, the costs incurred by such Party in conducting the suit, action or proceeding, including reasonable attorneys' fees and expenses and court costs.

NOTE: REMEDIES

Disclosure of the company's confidential information in breach of this agreement could have severe consequences for the company. It may be complex or impossible to determine monetary damages for this type of breach. As a result, this provision allows the company to also seek injunctive relief against the receiving party in the event it breaches the agreement.

Attorneys' Fees and Costs

US courts do not generally award attorneys' fees to the winning party in a litigation. Since it is far more likely that the company, rather than the receiving party, will be the plaintiff in a suit regarding this agreement, it is to the company's advantage to include this provision regarding attorneys' fees and expenses and court costs.

3.5 Entire Agreement. This Agreement supersedes all prior oral or written agreements or understandings that may exist between any of the parties hereto in respect of any Relationship.

NOTE: ENTIRE AGREEMENT PROVISION

If the parties want the confidentiality agreement to survive the execution of an eventual principal agreement for an investment or other transaction, the parties should include a reference to this agreement in the entire agreement provision of that principal agreement.

3.6 Notices; Amendments and Assignments; Counterparts. All notices pursuant to this Agreement shall be delivered to the other Party at the address, fax number or e-mail address set forth on the signature page to this Agreement. This Agreement may not be amended or assigned without the prior written consent of each Party. This Agreement may be executed in counterparts, each of which shall be deemed an original, but all of which together shall be deemed to be one and the same agreement.

NOTE: MISCELLANEOUS PROVISIONS

To make this agreement short and clear enough that non-lawyers are likely to read and understand it, a shortened version of the following standard contract provisions are included:

- Notices.
- Amendments.
- Assignments.
- Counterparts.

If the parties are more sophisticated or desire lengthier and more specific provisions, these can be individually negotiated.

3.7 [**Non-solicitation.** The Receiving Party agrees that during the term of this Agreement and for a period of one year after, the Receiving Party will not encourage or solicit any employee of the Company to leave the Company for any reason.]

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NOTE: NON-SOLICITATION CLAUSE

The company may wish to consider including a simple non-solicitation clause to prevent the receiving party from poaching company employees with whom it comes into contact during the course of the relationship. This type of provision would more commonly be included when the receiving party is a competitor. However, it can be included if a similar risk exists with a prospective investor.

IN WITNESS WHEREOF, the parties have executed this Agreement effective as of the date first written above.

[DISCLOSING PARTY NAME]

By_____

Name:

Title:

Address:

Fax #:

E-mail:

[RECEIVING PARTY NAME]

By_____

Name:

Title:

Address:

Fax #:

E-mail:

For more information on considerations for early-stage business capital raising, search for the following resources on our website.

Practice Notes:

- *Choice of Entity: Tax Issues (http://us.practicallaw.com/topic1-382-9949)*
- *Confidentiality and Nondisclosure Agreements (http://us.practicallaw.com/topic7-501-7068)*
- *Preparing for Start-up and Smaller-business Capital Raising (http://us.practicallaw.com/topic7-520-3145)*
- *Road Map for Undertaking a Private Offering (http://us.practicallaw.com/topic4-501-6353)*

For the links to the resources referenced in this document, please visit our online version at http://us.practicallaw.com/5-523-2120.

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