

### Protection of trade secrets

*Impact Assessment (SWD (2013) 471, SWD (2013) 472 (summary) for a Commission proposal for a Directive of the European Parliament and the Council on the **protection of undisclosed know-how and business information (trade secrets) against their unlawful acquisition, use and disclosure** (COM (2013) 813).*

#### Background

This note seeks to provide an initial analysis of the strengths and weaknesses of the European Commission's Impact Assessment (IA) accompanying its proposal which was adopted on 28 November 2013.

As part of the Europe 2020 strategy and its commitment to improve conditions for innovative business activity, the Commission undertook to look at the issue of trade secrets, both in the 2011 Intellectual Property Strategy and in its 2012 Communication on industrial policy. Trade secrets, or know-how and business information 'that is kept confidential in order to preserve competitive gains'<sup>1</sup>, are the most common form of innovative knowledge. 'Whenever a business holds information of economic value that is not generally known and treats it as confidential, this business owns a trade secret' (IA, p. 12). Such information can consist of technical or scientific information or information of a commercial nature. Trade secrets are essential for collaborative research and innovation within the Internal Market. They are also an important means for businesses to benefit from first mover competitive advantages. Evidence shows that companies, and in particular SMEs and start-ups, value them as much as patents and other forms of intellectual property rights. However, while they may represent an attractive alternative to avoid the costs inherently associated with Intellectual Property Rights, which also have a limited scope of application, trade secrets are probably the form of information that is least protected against unlawful misappropriation inside the European Union, where different legal regimes co-exist. This could discourage investment in research and development (R&D), both at national and EU level, which could in turn increase the gap between the EU and major third countries, such as the US, Japan or South Korea. In addition, trends such as globalization, outsourcing, longer supply chains, and information and communication technology prevalence, mean that the danger of misappropriation of trade secrets may be on the increase.

#### Problem definition

According to the IA, differences in national laws mean that legal protection of trade secrets within the EU is uneven and fragmented. Current global developments and insufficient protection mean that companies and research institutions are increasingly exposed to misappropriation through theft, unauthorized copying or breach of confidentiality requirements from within and outside the EU. The IA identifies two problems resulting from this risk of misappropriation and ineffective legal protection: i) sub-optimal incentives for cross-border innovation activities and ii) reduced competitiveness.

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<sup>1</sup> COM (2013) 813, p. 2

Even if one third of the actual length of the IA deals with the problem definition, this is probably the weakest part of the document. While it appears to imply that sub-optimal incentives for cross-border innovation activities and reduced business competitiveness are the main root problems, these issues might arguably be seen rather to be *consequences* of the over-arching problem to be addressed, which is the current fragmented legal protection of trade secrets within the EU against misappropriation. The link between the legal fragmentation and the resulting problems as presented in the IA could have been more clearly and simply presented, and therefore more convincing and less confusing. The figure presenting the problem definition is particularly difficult to follow. In addition, the magnitude of the problems remains rather uncertain.

## Objectives of the legislative proposal

The *general* objective of the Commission proposal is 'to ensure that the competitiveness of European businesses and research bodies, which is based on undisclosed know-how and business information (trade secrets), is adequately protected and to improve the conditions/framework for the development and exploitation of innovation and for knowledge transfer within the Internal Market'. The *specific* objective is 'to improve the effectiveness of the legal protection of trade secrets against misappropriation within the Internal Market' (IA, p. 41). This is to be achieved by four *operational* objectives. However, these do not seem to correspond to 'specific objects of action' in their own right which could be linked to 'output indicators', as recommended in the Commission IA Guidelines.

## Range of options considered

The Commission examines the potential impact of a wide range of options, including the option of retention of the status quo. Annex 20 presents policy options which have been initially considered but were then discarded for lack of effectiveness or proportionality. The five policy options retained and presented in the IA are:

**Option 1 – Status quo**, no further action at EU level.

**Option 2 - Soft law (non-legislative action): provide information on and raise awareness of the existing scope of protection** of trade secrets and available redress tools in case of misappropriation. This would include promoting the use of arbitration and mediation procedures to solve disputes.

**Option 3 - Harmonization of laws** regarding the unlawfulness of acts of misappropriation of trade secrets. This option consists in defining trade secrets and establishing that certain acts of acquisition, use and disclosure of trade secrets are unlawful.

**Option 4 - Harmonization of civil law remedies** against misappropriation of trade secrets. This includes the elements of Option 3, with the addition of rules on preservation of confidentiality of trade secrets during and after legal proceedings. Member States would be required to establish:

- principles-based minimum harmonization rules on civil law remedies allowing to obtain relief in case of misappropriation of trade secrets;
- minimum harmonization rules on the preservation of confidentiality during and after litigation on misappropriation of trade secrets;
- specific safeguards to ensure a proportionate application of the law by juridical authorities.

**Option 5 - Harmonization of national civil law and criminal law remedies** against the misappropriation of trade secrets.

Options 3, 4 and 5 are in principle legislative options. The first two would need the adoption of a single legal instrument while Option 5 would require the adoption of two legal instruments, one on civil matters and a

second on criminal matters. However, a non-legislative solution could also be conceivable for all these options, e.g. a Recommendation to Member States. In the event, the proposal is for a Directive.

The **preferred option** is Option 4, which the IA qualifies as 'the most balanced option in terms of effectiveness and efficiency and [which] receives significant support in the surveys' (IA, p. 64). As, following the proportionality principle, criminal law must remain a measure of last resort, the Commission decides to focus on the implementation of the changes in *civil* law, and later to evaluate whether they are sufficient to reach the proposed objectives.

## **Scope of the Impact Assessment**

The IA departs somewhat from the more traditional presentation and categorisation of impacts. It does however consistently assess all options for their impact on the following aspects: Member States' legal frameworks; trade secret owners; perspective of economic growth in the EU (innovation, internal market and competition); social impacts (employment levels, income, mobility of employees); consumers; third countries and fundamental rights. It also briefly considers potential impacts on the environment, administrative burden, and transparency of public administrations, including European institutions and bodies as holder of third parties' trade secrets. As far as administrative burden is concerned, the conclusion that this would be non-existent for businesses and administrations does not appear to be substantiated. Almost no quantification of the costs or benefits for the EU or the Member States of adopting the presented policy options is provided, except Annex 22 which calculates, to a limited extent, the implementation costs of Option 2 (which is not the preferred option). Moreover, the IA could have better assessed the European added value of the proposed EU intervention and its effectiveness in addressing the identified problems.

When comparing the options, the IA analyses the comparable scope of protection for each option, sufficient and comparable level of redress, preservation of confidentiality in litigation and deterrence as concerns effectiveness and efficiency and costs.

## **Subsidiarity / proportionality**

The proposal is based on Art 114 TFEU, allowing the adoption of EU rules harmonizing national legislation if they are necessary for the smooth functioning of the internal market. The IA argues that the subsidiarity principle is respected because the objectives of this proposal cannot be achieved by Member States alone, especially establishing a legal framework to protect and enhance the flow of trade secrets. Annex 18 is dedicated to a detailed analysis of the subsidiarity question. The initiative appears to be proportional to the problems and the set objectives. Annex 23 presents the reasoning behind the choice of legal instrument.

There have been no Reasoned Opinions from national parliaments.

## **Budgetary or public finance implications**

According to the IA, there are no direct implications for the EU budget or other EU or Member States' public finance, other than the transposition of the proposed Directive into law. The actions proposed by the Commission are said to be consistent and compatible with the Multiannual Financial Framework 2014-2020.

## **SME test / Competitiveness**

Studies show that SMEs rely more than big enterprises on trade secrets to protect their competitive advantages, as they often lack the specialized human resources and financial capacities to pursue, manage, enforce and defend intellectual property rights. Therefore SMEs are considered to be the main beneficiaries of this legislative proposal. A large majority of SMEs were in favour of EU action during the public consultation (IA, p. 41). Protecting the competitiveness of EU businesses is one of the main objectives of the proposed action.

## **Relations with third countries**

While it is expected that Option 2 will not have a direct impact on third countries, this is changing for Options 3, 4 and 5 as economic actors from outside the EU, who might try to misappropriate trade secrets from European companies, would be negatively affected. In addition, common rules on trade secrets in the EU could encourage third countries to establish similar regimes, and thereby raise the level of protection of trade secrets against misappropriation, which could result in increased knowledge transfer and investment to those third countries.

## **Quality of data, research and analysis**

The assessments seem to be reasonable and based on sound research and analysis. The Commission services used external expertise. Two external studies produced a snapshot of EU national legal frameworks concerning the protection of trade secrets against misappropriation and gathered economic evidence on the positive and negative impacts of the protection of trade secrets against misappropriation. Aside from these, the IA mentions a multitude of empirical studies (in the EU, US, Switzerland, etc.) which contributed to this analysis. The lack of quantification is partly explained by the lack of official statistics on trade secrets misappropriation trends and the scarcity of data within the EU. Some attempt to extrapolate indicative figures on the basis of the limited information available might nevertheless have been helpful. The twenty-five annexes provide a considerable amount of useful information to complement that presented in the report itself. In some cases, more direct references to this data would have enhanced understanding of the justification of the arguments presented.

## **Stakeholder consultation**

As the IA points out, stakeholders were consulted throughout the whole preparation of this document. A well-attended public hearing took place in June 2012. A public on-line consultation, organized within reasonable time frames for replies, took place and focussed on the possible policy options and their impacts. A detailed presentation of the results obtained following this public consultation is given in Annex 2. Most replies came from individual citizens and businesses. It would seem that some Member States' authorities also participated. This is not explicitly reflected in the breakdown of respondents presented in the body of the IA, but details are provided in Annex 2. An industry survey was also undertaken as part of one of the external studies and in addition, other surveys were considered and cited. The drafting team of the IA met with stakeholder representatives (industry, non-industry, academic and national administrations). The opinions of interested parties are presented rigorously throughout the IA.

While the majority of businesses, including SMEs, believe that the uneven legal protection of trade secrets against misappropriation is weak in the EU and reduces the incentive to invest in cross-border innovation and research, therefore supporting an EU initiative in this field, many non-industry stakeholders replying to the public consultation consider that no EU action is required (75 per cent of the 152 citizens participating). This figure might be slightly misleading, given the low number of participants in the citizens' category.

## **Monitoring and evaluation**

The IA concludes that transposition at national level should not be complicated and that this should facilitate monitoring. It presents the administrative steps of the monitoring and evaluation of the proposal as being: a Transposition Period Plan; the regular monitoring activity by the Commission assisted by the Member States, and the evaluation of the effects of the policy. Although Annex 25 provides some details on monitoring and evaluation and presents some preliminary indicators, specific benchmarks that can be used in ex-post evaluation are not identified in the body of the report. The IA argues that selecting the appropriate indicators is challenging and proposes to 'define data needs in cooperation with the European Observatory

during the transposition period' (IA, p. 67). . Other than a reference to the report on litigation trends in Article 17, this intention does not, however, appear to be fully reflected in the legislative proposal.

## Commission Impact Assessment Board

The IA Board issued a negative opinion on a draft of the IA on 27 March 2013. A revised draft report was subsequently submitted on which the Board issued a positive opinion on 24 June 2013. It nevertheless still called for further improvements in a number of respects, notably demonstrating, possibly with factual evidence, the link between the presented fragmented legal protection of trade secrets against misappropriation, on the one hand, and the identified problems on the other; determining the size of the problems, and the added-value and proportionality of addressing them by EU action. These concerns do not all appear to have been fully addressed in the final version of the IA. The IA Board's request that the report should strengthen the analysis of the impacts of the proposed options seems to have been covered, to some extent at least, especially concerning labour mobility.

## Coherence between the Commission's legislative proposal and IA

The legislative proposal of the Commission appears to follow the recommendations expressed in the IA, although the only reflection of the procedure foreseen for the establishment of monitoring indicators appears to be the reference in Article 17 to the report on litigation trends to be prepared by the European Observatory on Infringements of Intellectual Property Rights.

## Conclusions

Overall, the IA is of reasonable quality, with a wealth of background information, especially in the annexes. One of its weaknesses, however, is the over-complication of the presentation of the problem definition. The link to the defined objectives and the extent and nature of the problem is not always clear. The difficulty in defining monitoring indicators already at this stage, might suggest a possible flaw, notably in the initial definition of the problem and objectives. The IA is, however, at pains to point out some of the understandable difficulties inherent in the nature of the problem being addressed in this respect (IA, Annex 25, p. 272). Nevertheless, this is an aspect which might arguably have been more usefully addressed in more detail in the body of the IA, and, in any case, prior to the adoption of the legislation, rather than during the transposition phase.

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*This note, prepared by the Ex-Ante Impact Assessment Unit for the Committee on Legal Affairs (JURI) of the European Parliament, analyses whether the principal criteria laid down in the Commission's own Impact Assessment Guidelines, as well as additional factors identified by the Parliament in its Impact Assessment Handbook, appear to be met by the IA. It does not attempt to deal with the substance of the proposal. It is drafted for informational and background purposes to assist the relevant parliamentary committee(s) and Members more widely in their work.*

This document is also available on the internet at: [www.europarl.europa.eu/committees/en/studies.html](http://www.europarl.europa.eu/committees/en/studies.html)

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