

# The Trade Secrets Directive

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## 1. Introduction and general issues

The European Commission has published a proposal for a Trade Secrets Directive on 28 November 2013.<sup>1</sup> This is a big step forward in the long-desired harmonization of trade secret law throughout Europe. It has the potential to bring protection to the same level as in the US, where the Uniform Trade Secrets Act has been around for quite a while. It was also necessary since so far most Member States have not taken sufficient steps to implement Article 39 TRIPs, which requires a minimum level of trade secret protection.

The proposed Directive is quite comprehensive and aims at full harmonization, not a minimum level of harmonization. However, from a legal perspective, not all decisions made in drafting this Directive have been equally fortunate and further improvements would be desirable.

I will not be explaining all of the provisions of the Directive; the Commission itself says in the Explanatory Memorandum that from a technical perspective, the Directive is not particularly complex and that it contains only a limited number of legal obligations. Instead, I will focus on those issues and provisions that could use some improvement.

The title of the Directive says that it is “on the protection of undisclosed know-how and business information (trade secrets) against their unlawful acquisition, use and disclosure”. The terms “know-how and business information” are used in the explanatory memorandum and in some of the recitals, but not in the provisions of the Directive. The term generally used in the provisions is “trade secret”, which is intended to have the same meaning as “undisclosed information” in Article 39 TRIPs. The title is intended to make it clear that these trade secrets include know-how and business information, but is not intended to limit the scope of the Directive.

The urgency of the project is clearly demonstrated by the impact assessment, according to which “40% of EU companies would refrain from sharing trade secrets with other parties because of fear of losing the confidentiality of the information through misuse or release without their authorisation”. This negatively affects innovation. Besides, the divergence in protection throughout Europe, and to a certain extent the current lack of protection, means that

valuation of trade secrets is very difficult. In some cases this leads to filing patent applications before the technology at hand is completely developed, just to be able to raise funds for further research and development. This may result in patents that do not fully protect the relevant technology. The Commission also found that the lack in uniform protection undermines competitiveness. Also, due to the lack of protection, knowledge is shared less.

At the same time, the Commission felt that no exclusive rights should be granted, meaning that anyone remains free to acquire the knowledge that is protected by the trade secret, including through reverse engineering. In addition, hiring of highly skilled labour should also not be negatively impacted, where it is obvious that these people will take their knowledge and skills with them when moving from one company to another.

The Commission claims that the proposal is consistent with the TRIPs Agreement.<sup>2</sup> Recital 4 also states that both the member states and the Union are bound by TRIPs. However, TRIPs itself does not make any difference between various categories of intellectual property rights; they are all treated in the same way in Article 1 section 2. That was a highly debated political compromise within WTO, but it is the law now. This raises the question whether the proposal really is in conformity with TRIPs. The Agreement itself does not contain a general definition of intellectual property rights and does not state that they are by definition exclusive rights; it only states that they are private rights. In TRIPs, various rights are indeed identified as being exclusive,<sup>3</sup> but not trade secrets. Article 39 does not contain the word “exclusive”. It only says that undisclosed information should be protected against unfair competition. So TRIPs itself is ambiguous as to the nature of trade secrets as an intellectual property right and it indeed seems permitted to treat them as non-exclusive rights in the way it is done in the proposal for the Directive.

However, another issue is whether it is allowed under TRIPs to have separate systems of enforcement of intellectual property rights, where trade secrets de facto enjoy less protection against illegal disclosure, acquisition or use. This will be the result in Europe, since the Trade Secret Directive according to recital 28 will take priority over the Enforcement Directive and will have its own, more limited

<sup>1</sup> COM(2013) 813 final, 2013/0402 (COD), see <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2013:0813:FIN:EN:PDF>

<sup>2</sup> WTO Agreement on Trade-related aspects of Intellectual Property rights.

<sup>3</sup> This applies to copyrights (Article 11, 13 and 14), trade marks (Article 16) and patents (Article 28 and 30).

enforcement system. Some tools for collecting evidence that are available under the Enforcement Directive for other intellectual property rights are lacking in the Trade Secrets Directive. That is all the more problematic, since trade secrets are not exclusive rights, so the fact that identical information is used is not sufficient for finding infringement; there must be some kind of illegal disclosure, acquisition or use and that always requires additional evidence, especially in respect of the way in which the alleged infringer has acquired his information. Article 41 section 1 TRIPs provides that “Members shall ensure that enforcement procedures as specified in this Part are available under their law so as to permit effective action against any act of infringement of intellectual property rights”, but it is not clear from this provision whether the same procedures should be available for all types of intellectual property rights. Nevertheless, since the difference in available tools makes the enforcement of trade secret protection considerably less effective, the Directive might not be in compliance with TRIPs.

This difference in means of protection cannot merely be explained by the difference in status of trade secrets and other intellectual property rights. It is a political compromise that was necessary to obtain the cooperation of all member states. It seems that some member states feared an interference with their procedural laws. That of course could also have been an issue with the Enforcement Directive, but apparently the use of the word “may”, like in Article 6 of the Enforcement Directive, which inter alia states that judicial authorities “may” order evidence to be disclosed to the opposing parties, solved that issue. But even then, it remains unclear why similar provisions using similar relatively vague wordings could not have been included in the Trade Secrets Directive.

Although the Trade Secrets Directive provides for full harmonization, that is probably only the case for the provisions specifically contained in the Directive. For provisions that could have been included but were not, like on the means for gathering evidence, further national legislation should not be prohibited, especially if such provisions were not included because they would constitute an undesirable interference with national procedural law. Thus, it should be possible under national law to extend the scope of the implementation of the Enforcement Directive to trade secrets. In fact, in my view this would be highly desirable, since such tools are really necessary for an effective protection of trade secrets.

Recital 27 provides that the Directive should not affect the application of competition law rules, in particular Articles 101 and 102 of the Treaty on the Functioning of the European Union and that the measures provided for in this

Directive should not be used to restrict competition unduly in a manner contrary to that Treaty. The Court of Justice has already developed a careful approach towards intellectual property rights, striking a balance between the protection of intellectual property and free competition. According to that case law, the scope of intellectual property rights is not to be extended beyond their specific subject of protection. The same apparently applies to trade secrets, which of course is no surprise.

The proposed Directive consists of .. chapters. The first chapter deals with subject matter and scope and thus contains the substantive law on the trade secrets themselves, including an extensive set of limitations. The second chapter deals with what constitutes an infringement, again with lots of limitations. The third chapter deals with enforcement. This is where the Directive seriously deviates from the Enforcement Directive and provides a much weaker system. The fourth and final chapter contains the rules for the implementation. In addition to this there are 28 recitals and an Explanatory Memorandum.

## **2. Substantive law**

Article 2 contains the definition of trade secrets and of some other crucial terms. The definition of trade secrets is identical to that in Article 39 TRIPs. All other elements of Article 39(2) TRIPs can also be found here. The definition of “trade secret holder” implies that only someone who legitimately holds a trade secret qualifies, but on the other hand includes licensees, meaning that they can take action themselves. That is not always the case for other intellectual property rights, certainly not for non-exclusive licensees.

The concept of infringing goods is quite broad and actually enables reach through claims. Action can be taken against goods that for instance are produced through an infringing manufacturing process, if they significantly benefit from the use of that process. If that test is passed, measures can be taken that directly affect those goods. This would not be as easy under patent law, so if reverse engineering is not possible, relying on trade secrets might have an advantage over relying on patent protection. The disadvantage for society of this is twofold: the term of protection for trade secrets is without limits and trade secrets are by definition not published. Patents are published and thereby enable further development of the technology by third parties.

Infringement of a trade secret is any unlawful acquisition, use or disclosure of the trade secret. According to the Explanatory Memorandum the key element for those acts to be unlawful simply is the absence of consent of the trade

secret holder. Nevertheless, a third party only infringes if he should have been aware or has been given notice of the original unlawful act. However, for the acquisition of a trade secret to be unlawful Article 3(2) currently requires intent or gross negligence. It is hard to understand why this limitation had to be added to the requirement of unlawfulness. It would of course have been much better to leave it up to the courts to decide when an acquisition has to be regarded as unlawful. And why is a simply negligent acquisition not sufficient? In fact, this requirement will make it very hard to bring action, as it will require that intent or gross negligence is proven by the claimant, which will be very difficult, especially since the Directive does not provide tools for gathering evidence. This may seriously damage the effective protection and enforcement of trade secrets in Europe and therefore should be changed.

The acquisition of a trade secret is considered to be unlawful if it is contrary to honest commercial practices (and is done intentionally or with gross negligence). Subsequent use or disclosure is also unlawful. However, if the acquisition is not unlawful, the use or disclosure will only be unlawful if it is in breach of a confidentiality agreement or any other duty to maintain the secrecy of the trade secret, or if it is in breach of a contractual or any other duty to limit the use of the trade secret. This seems to be more limited than the criterion of being contrary to honest commercial practices. At least this creates ambiguity. What is the difference between “honest commercial practices” and “any other duty”? Is there an intended difference or not?

Under Article 3(4) subsequent use or disclosure is also unlawful if the subsequent user knew or should, under the circumstances, have known that the prior use or disclosure was unlawful. This may prove to be a far-reaching protection for third parties who act in good faith. If that third party initially acted in good faith but obtains knowledge of the infringement later on, an injunction might cause disproportionate harm according to recital 18 and damages would be the preferred remedy, which is developed further in Article 12(3). Of course, in that case the question arises what would be the ground for awarding damages. Thus it seems that the Directive carries the risk that trade secret protection might be lost by selling trade secrets to innocent third parties. In that case, trade secrets would in practice enjoy far less protection than other intellectual property right.

Article 4(1)(b) makes it clear that reverse engineering is allowed, which apparently was an issue in some countries. Article 4(2)(a) provides for a general exception for making legitimate use of the right to freedom of expression and information. As such this is fine, but in practice it should be

applied rather limited; there should at least be a public interest at stake, otherwise it could be abused to distort competition. However, public interest is mentioned in subsection (b), but not in subsection (a).

Article 4(2)(c) is somewhat alarming. There is no infringement in acquisition, use or even disclosure if the trade secret was disclosed by workers to their representatives as part of the legitimate exercise of their representative functions.<sup>4</sup> I can understand that, if the representative uses the trade secret in the course of a legitimate exercise of his representative functions, this would not be an infringement. However, even in doing so, he should maintain the secrecy, so disclosure should still constitute an infringement. Of course, there may be a case where such disclosure would really be necessary in the performance of such representative functions, but that would fall within the exception of Article 4(2)(b) – which includes legitimate “whistle-blowing”<sup>5</sup> – and should also be limited to such situations. This is yet another example that trade secrets are treated as some second rate right; nobody ever needed or even thought of a provision that a patent cannot be infringed by a workers’ representative.

Article 4(2) even adds non-contractual obligations and legitimate interests as exceptions. Why should any non-contractual obligation, whatever its nature, overrule trade secret protection? Why could this not be limited to court orders and orders from competent authorities, which is the prevailing practice in non-disclosure agreements around the world?

### 3. Enforcement

The chapter on enforcement almost starts with a provision that any measure should be proportionate, not create barriers to legitimate trade and provide safeguards against abuse. Who could disagree, but on the other hand, why do we need this in the text of the Directive? It seems that the concept of abuse is not harmonized, but it is safe to assume that any EU member state has options to redress abuse of legal remedies. The Trade Mark Directive and the Design Right Directive do not contain provisions on the possible abuse of those rights and Directive 2001/29/EC on the harmonisation of certain aspects of copyright and related rights in the information society only mentions a possible abuse of right in its recitals. Again, the TRIPs Agreement does not support such a suspicious approach of trade secrets.

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<sup>4</sup> The European Commission felt a need for this exception as a consequence of Directive 2002/14/EC.

<sup>5</sup> See for this issue for instance [http://ec.europa.eu/justice/policies/privacy/docs/wpdocs/2006/wp117\\_en.pdf](http://ec.europa.eu/justice/policies/privacy/docs/wpdocs/2006/wp117_en.pdf)

Article 7 provides for a limitation period for bringing action of no more than 2 years after the claimant became aware of the infringement. Member states may even set it at just one year. This is far too short. An action takes preparation. Besides, it may require a global strategy. Let's assume the Coca-Cola recipe is stolen and used by a competitor. Coca-Cola may want to deal with this in the US courts before bringing action in Europe, but such timing will not be possible under this Directive. It seems most member states normally apply a five year deadline, whereas the UK has six. Five or six years would be much more reasonable, especially since Article 5(2)(a) requires that remedies should be fair and equitable anyway, which allows the court to take into consideration the amount of time that has lapsed in view of all relevant circumstances of the case at hand.

Article 8 contains provisions aimed at preserving the confidentiality of trade secrets in litigation. These are certainly necessary, but also contain a dilemma, especially in Article 8(2). It is questionable whether a court is entitled to restrict access to a document to a party's lawyer while excluding the party itself from such access. Also, it is at least doubtful whether a court can base a ruling on a document that has been kept secret for any of the parties. At least in some member states this is not possible. Of course, a party may agree to setting up a confidentiality club, but if he refuses to cooperate, that should not be held against him. This article therefore needs some more work.

There is also an error in Article 8 that will probably be corrected: section (b) refers to "legal representatives" where actually external lawyers are intended. Companies are normally legally represented by their management and that is certainly not the intention here.

Article 9 provides for interim measures aimed at stopping the infringement. The wording of Article 9(2) is not very fortunate, since it seems to presuppose the continuation of possibly infringing activities. It would have been better to speak of "continuation if any" than of plain continuation. This would have better covered the intentions of the Directive.

Article 10 provides that a claimant, when applying for interim measures, can be ordered to provide further evidence of his rights and of the alleged infringement. That is fair enough; it would seem that any judge in the EU can apply such conditions when an application for an interim injunction is filed and refuse the injunction if these are not met. On the other hand, the fact this is included so explicitly in the Directive makes it even more conspicuous that the other side of the coin is missing; the court is not entitled, at least not under the Directive, to require the

defendant to produce evidence or even to allow the claimant to seize such evidence at the defendant's premises, as provided for in Article 6 and 7 of the Enforcement Directive. Again, this is wrong and may render the protection of trade secrets in Europe insufficient.

Article 11 deals with final remedies. Section 3 includes the possibility of donating infringing goods to charity. Recital 17 says that "corrective measures should not necessarily entail the destruction of the goods when other viable options are present, such as depriving the good of its infringing quality or the disposal of the goods outside the market, for example, by means of donations to by charitable organisations". The term outside the market – as opposed to the internal market – is probably meant to mean outside the course of trade, not outside Europe, since if a good is infringing in Europe, it should be infringing in any country that is a party to the TRIPs agreement.

An issue not dealt with by the Directive is the unlawful acquisition and use of a trade secret that could have been uncovered by legitimate reverse engineering. In a 2012 judgment a Dutch court held that in such a situation a temporary injunction could be imposed that would compensate for the illegal advantage in entering the market at an earlier stage by stealing the trade secret instead of reverse engineering the technology.<sup>6</sup> The Trade Secrets Directive is sufficiently flexible to allow for such solutions; a limitation of the duration of an injunction is even explicitly mentioned in Article 12(1).

Article 12(2) provides that injunctions should be terminated once the trade secret has entered the public domain, which seems logical. However, this should have been limited to the situation where the trade secret has lawfully entered the public domain. Now it already applies if this cannot be attributed to the defendant, but that is too broad, because then it also applies if the trade secret became publicly available through a third party infringement, which should of course not serve to acquit the first infringer.

The Directive does not aim to introduce punitive damages, but does allow for reclaiming the costs of identification and research in addition to the actual damage to the business of the trade secret holder. Article 13 mentions various methods of calculation of damages, including the amount of royalties or fees which would have been due if the infringer had requested authorisation to use the trade secret in question. The latter may be not as easy as the Commission might think. Many trade secret owners are not willing to licence their trade secrets at all and of course they

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<sup>6</sup> District Court 's-Hertogenbosch 21-11-2012, LJN BY4122, JMK Heating, [IEF 12051](#).

are not obliged to do so. In such a case it would not be possible to determine an amount of royalties.

#### **4. Conclusion**

The proposal for the Trade Secret Directive certainly is a big step forward towards effective protection. It contains a lot of useful tools and provides a comprehensive, though not perfect, delimitation of the scope of trade secrets. At the same time it is an imperfect proposal with a fundamental flaw. It denies trade secrets their full protection as intellectual property rights as required by TRIPs. The fear for too much protection has led to some provision that might render the law rather ineffective. The choice not to have trade secrets covered by the Enforcement Directive means that different sets of tools apply and essential tools for collecting evidence are missing.

It is clear that the commission also has not appreciated, or chosen not to appreciate, the problems this causes in litigation practice. Any patented invention starts with a trade secret, but even once patent protection is granted, trade secret protection is still required. Not every bit of know-how meets the requirements for patentability and not every further development or technology involved in implementing the patent can be patented, either for legal or for economic reasons. However, if the invention is then copied by an infringer, this may be a combination of patent and trade secret infringement, which the owner might want to address in a single action. Because of the diverging rules for enforcement, that might prove to be quite difficult.

The current proposal is not the final text. Some of the problems are a result of political compromise and very hard to repair. Others are more up for debate, also by legal professionals. There will be lots of opportunities for industry to have this debate in the near future. The Directive is not expected to be enacted in the very near future, probably at least not before the end of this year. It is worthwhile to have these discussions and share views with the Commission, in order to create a good system that brings Europe to the same level as the US.

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