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Delegations will find attached Commission document SWD(2013) 472 final.

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COMMISSION STAFF WORKING DOCUMENT

EXECUTIVE SUMMARY OF THE IMPACT ASSESSMENT

Accompanying the Document

**Proposal for a Directive of the European Parliament and of the Council
on the protection of undisclosed know-how and business information (trade secrets)
against their unlawful acquisition, use and disclosure**

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1. INTRODUCTION AND CONSULTATION

On 3 March 2010 the Commission adopted a strategy for smart, sustainable and inclusive growth (Europe 2020) which requires strengthening knowledge and innovation as drivers of the Union's economic growth. Under the flagship initiative "Innovation Union" the Commission undertook to improve the framework conditions for business to innovate, through, inter alia, the optimisation of Intellectual Property.

In this context, on 24 May 2011, the Commission adopted a comprehensive strategy to deliver a smooth functioning Internal Market for intellectual property.

Every patent and every design or trade mark starts as a secret (the launching of a new product, an upcoming revolutionary medicine, the prototype of a new car engine, etc.). Until an intellectual property right can be obtained, companies are vulnerable to theft of valuable research information and knowledge. Trade secret law minimises the risks faced by innovative companies and research bodies, by providing legal mechanisms of redress against unlawful appropriation of R&D results, know-how and other valuable data

Trade secrets are essential for collaborative research and open innovation within the Internal Market which requires sharing of valuable information by multiple partners across Member States. However, trade secrets are insufficiently protected in the Union. Innovative companies and research institutions are increasingly exposed to misappropriation, from within and outside the Union, and the lack of a common and sound legal environment impairs their ability to fulfil all their potential as drivers of economic growth and jobs.

This Impact Assessment analyses where the root causes of this problem lie and how they might be resolved.

The Commission services have used external expertise. Two external studies have assessed the legal protection granted to trade secrets in the EU and reviewed the related economics literature. 537 companies participated in a survey (2012 survey) in the context of one of these studies and the Commission services carried out a public consultation with 386 respondents.

2. POLICY CONTEXT, PROBLEM DEFINITION AND SUBSIDIARITY

There is evidence that companies, irrespective of their size, value trade secrets at least as much as patents, and other forms of intellectual property rights. Trade secrets are particularly important to SMEs and start-ups. Trade secrets are also important in protecting non-technological innovation. The services industry that accounts for more than 70% of EU GDP relies relatively more on trade secrets and less on patents than the manufacturing sector.

Considering the economic value of a trade secret, competitors may also try to unlawfully acquire it, e.g. through theft, unauthorised copying, breach of confidentiality requirements etc., and to subsequently misuse it. A number of trends (globalisation, outsourcing, longer supply chains, increased use of information and communications technologies, etc.) suggest that the risk of trade secret misappropriation is increasing over time. One in five businesses replying to a survey reported having suffered attempts or acts of misappropriation in the EU in the last 10 years.

Despite the importance of trade secrets and the threats affecting them, the legal framework in the EU pays little attention to this phenomenon. There are no EU rules and protection offered by national rules against the misappropriation of trade secrets is uneven. Few Member States specifically address trade secret misappropriation in their civil or criminal laws, while most of them rely on their general unfair competition or tort law, and some criminal provisions.

Differences in national laws result in a fragmented legal protection of trade secrets against misappropriation within the Internal Market. This is shown by the following table which compares Member State laws to several selected important measures that any such legal protection could be expected to offer:

<i>The fragmentation of the legal protection (selected measures)</i> <i>Source of data: Baker & McKenzie (2013).</i>																											
<i>Selected measures</i>	AT	BE	BG	CY	CZ	DE	DK	EE	EL	ES	FI	FR	HU	IE	IT	LT	LU	LV	MT	NL	PL	PT	RO	SE	SI	SK	UK
Definition of trade secret in civil law legislation																											
Availability of injunctions against third party in good faith																											
Injunctions not limited in time																											
Availability of orders on destruction of TS/resulting goods																											
Calculation of damages based on fair royalty fee																											
Performing rules on preservation of secrecy (civil proceedings)																											
Sufficient criminal legislation																											
<i>N.B. A blank cell means that the measure concerned is not provided for in national legislation</i>																											

- (a) scope of protection: few Member States define trade secrets and misappropriation and some do not have specific provisions on trade secrets at all;
- (b) remedies: the availability of injunctive relief to stop all types of third parties misusing a trade secret are not always available (e.g. when the misappropriated trade secret has been transferred to a third party in good faith; obtaining injunctions not limited in time is not always possible; orders on the destruction of resulting goods and on the destruction of the misappropriated information, or its return to the original trade secret holder, are not always available; traditional rules on the calculation of

damages (actual losses/lost profits) are often inadequate for trade secret misappropriation cases and alternative methods (e.g. amount of royalties that would have been due under a license agreement) are not available in all Member States;

- (c) ensuring the confidentiality of trade secrets during civil law proceedings: national rules most often are insufficient to ensure such confidentiality, which may result in definitive loss of the trade secret if the victim chooses to litigate. This risk deters victims of trade secret misappropriation from seeking redress; and
- (d) trade secret theft is a criminal offense in many, but not all, Member States, and sanctions can be substantially different.

This fragmented protection renders the use of litigation to protect trade secrets against third parties' misappropriation in a cross-border environment an unreliable tool for the protection of intellectual property. It also weakens the protection offered to EU innovators against goods produced using their stolen trade secrets and which originate from third countries. Practice confirms that national rules appear unattractive to trade secret holders as companies hardly defend their misappropriated trade secrets before courts.

Two **main problems** have been identified:

(1) Sub-optimal incentives for cross-border innovation activities. When trade secrets are under a risk of misappropriation with ineffective legal protection, incentives to undertake innovation activities (including at cross-border scale) are affected because of:

- (i) the lower expected value of innovation relying on trade secrets and the higher costs for protecting it. On the one hand, the higher the likelihood that a trade secret will one day be misappropriated without its owner having much hope to recover the damages this might cause to him, the lower the returns he can expect. On the other hand, the weaker the legal protection, the more each innovator has to invest in his own protective measures. 35% of respondents to the 2012 Survey identified “increased expenditure in protection measures” as a direct consequence of acts (or attempts) of misappropriation; and
- (ii) the higher business risk when sharing trade secrets. For instance, according to the 2012 survey, 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.

(2) Trade secret-based competitive advantages are at risk (reduced competitiveness): the fragmented legal protection within the EU does not guarantee a comparable scope of protection and level of redress within the Internal Market, thus putting trade-secret based competitive advantages, whether innovation-related or not, at risk and undermining trade secret owners' competitiveness. For instance, the European chemical industry, which strongly relies on process innovation secured by trade secrets, estimates that misappropriation of a trade secret could often entail a turnover reduction of up to 30%. This also compromises the innovator's ability to obtain appropriate returns from the exploitation of his trade secret.

Innovative businesses, in particular small and medium-sized enterprises (SMEs), are adversely affected and the cooperation in innovation in the **Internal Market** is undermined. Because of the different levels of protection, some companies are better equipped than others to face the challenge of an information-based economy and to exploit an efficient intellectual

property infrastructure. The fragmentation of the legal framework prevents innovators from exploiting the full potential across borders in the Internal Market. This has knock-on effects on investment, jobs and economic growth.

In the absence of EU action (**baseline scenario**), the adverse consequences resulting from cases of misappropriation of trade secrets will remain insufficiently addressed by the legal means made available by Member States to owners of trade secrets for their defence.

3. SUBSIDIARITY

EU action could be based on Article 114 of the Treaty on the Functioning of the EU, as the improvement of the conditions for innovation and enhancing the efficiency of intellectual property in the Internal Market is at the heart of the initiative. The **subsidiarity** principle would be respected as Member States alone could not achieve the objectives of the initiative. EU action is particularly needed to establish a legal framework which could protect and so enhance the cross-border flow of innovation-related trade secrets among research and business partners by ensuring that the benefits of any misappropriation of such information are minimised if not completely eliminated. This flow of information is paramount for the exploitation of innovation in the EU and for R&D.

4. OBJECTIVES

General objective: 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 improve the conditions/framework for the development and exploitation of innovation and for knowledge transfer within the Internal Market.

Specific objective: Improve the effectiveness of the legal protection of trade secrets against misappropriation within the Internal Market.

This specific objective is integrated in the wider EU strategy to promote and enhance the efficiency of the intellectual property infrastructure within the Internal Market, in view of the goals of Europe 2020 strategy regarding innovation (cf. Innovation Union).

It is consistent with international commitments of the EU and its Member States in this area (cf. Agreement on Trade-related aspects of intellectual property rights).

5. COMPARISON OF POLICY OPTIONS

<i>Summary comparison of options</i>	<i>Effectiveness* [by operational objective]</i>				<i>Efficiency & Costs**</i>	
	Comparable scope of protection	Sufficient and comparable level of redress	Preservation of confidentiality in litigation	Deterrence	Costs	Efficiency
Policy options						
1. Status quo.	0	0	0	0	0	0
2. Information/ awareness on existing redress tools in case of misappropriation of trade secrets.	0	0/+	0	0/+	H	L

3. Unlawfulness of acts of misappropriation of trade secrets.	++	+	+	+	M	M
4. Convergence of national civil law remedies against misappropriation of trade secrets.	++	++	++	++	M	H
5. Convergence of national civil law and criminal law remedies against the misappropriation of trade secrets.	+++	++	++	+++	H	M

* Comparison vis-à-vis Baseline: --- very significant deterioration of the situation; -- significant deterioration of the situation; - slight deterioration; 0 no relevant change; + slight improvement; ++ significant improvement; +++ very significant improvement.

** Overall assessment of the option with regard to the achievement of the objectives. L: Low; M: Medium; H: High.

Under Option 1, expenditure on protective measures would remain high and companies would be reticent to enter into collaborative cross-border innovation networks. Excessive focus on prevention would lead to stricter constraints on employees and reduced job mobility. Limited incentives to innovate would hinder job creation. Higher costs are proportionally stronger for SMEs. The EU economy would underperform in terms of jobs, innovation and growth and consumers would have limited access to innovative products or services.

Option 2 would improve creators and innovators' ability to face the challenge of trade secret misappropriation, thus creating more confidence. However, this option would not be fully effective in achieving the objective because: it generates additional costs and resources for the compilation, presentation and constant updating of information in all languages and regular awareness actions; trade secrets owners would still be in a weak position vis-à-vis misappropriation of trade secrets; the unequal protection throughout the EU would subsist; and goods manufactured in Member States with low level of protection would circulate across the Internal Market.

In Options 3, 4 and 5 the harmonised scope of trade secret protection would ensure equal legal protection and greater legal certainty. This will

- (i) reinforce business' competitiveness, because of the better cross-border protection of businesses' competitive advantages and the improve resource allocation as less investment in protective measures would be expected, freeing resources for more productive investment; and
- (ii) provide increased incentives to (cross-border) innovative activities, because of the expected greater value of trade secrets and the better protected cross-border knowledge sharing.

These impacts should lead to positive effects on innovation (increased investment in innovation, cross-border knowledge sharing and spill-overs) and the Internal Market for cross-border creativity and intellectual property-related activities. These impacts would eventually benefit economic growth and consumer's choice and access to new products and services. These options could also contribute to make it easier for (highly) skilled employees (those who create or have access to trade secrets) to change employer within the Internal Market or to set up their own business.

Option 3, merely calls Member States to provide for effective and proportionate remedies without specifying them and would therefore address only part of the provisions necessary to establish an effective legal framework for the protection of trade secrets against misappropriation. Additionally, it would not ensure significant harmonisation regarding the confidentiality of trade secrets during litigation. Potential plaintiffs would still have to carry

out different risk assessments in each Member State. Reduction of information costs would be limited.

Option 4, would share with 3 the above-described common positive impacts, but would in addition include harmonised measures to stop third parties from using/exploiting the misappropriated trade secrets including, where appropriate, imports from third countries. It would also provide greater certainty on the preservation of secrecy during litigation by establishing a common legal framework, avoiding the costs and risks associated with insufficient convergence and the drawbacks of Option 3. Better enforcement tools and improvements on damages recovery as well as better guarantees about the preservation of the confidentiality of trade secrets during litigation provide investors with better reassurance, thus favouring investments in innovation, in particular on a cross-border context, thus contributing to a smoother functioning of the Internal Market.

Option 5 would add criminal law convergence to Option 4, strengthening the deterrence effect of the rules and providing better access to evidence under the investigative powers of enforcement authorities. However, Option 5 would go beyond the current protection of intellectual property rights by criminal law, which is currently not harmonised at EU level. In addition, following the principle of proportionality, criminal law must always remain a measure of last resort, and it needs to be seen whether the proposed changes in civil law already suffice to achieve the objectives.

Option 4 is the preferred one.

Choice of legal instrument: since a non-binding legal instrument would not guarantee the positive impacts, this option would need to be implemented in a **directive**.

6. OVERALL IMPACTS OF THE PREFERRED OPTION

Convergence of civil law remedies would allow innovative businesses to defend their rightful trade secrets more effectively across the EU. Also, if trade secrets' owners could rely on confidentiality during proceedings, they would be more inclined to seek legal protection against potential damages through misappropriation of trade secrets. Increased **legal certainty and convergence of laws** from Option 4 would contribute to increasing the value of innovations companies try to protect as trade secrets, as the risk of misappropriation would be reduced.

This option would also have positive impacts on the functioning of the **Internal Market**; it should allow companies, SMEs in particular, and researchers to make better use of their innovative ideas by cooperating with the best partners across the EU. This incentive to **innovate**, and to do so more efficiently, as well as the cost savings resulting from current excessive protective measures would help increase private sector investment in R&D within the Internal Market.

The comparable level of protection of trade secrets across the EU would make sure that import of goods from **third countries**, when such goods have been produced using misappropriated trade secrets, could be stopped anywhere in the EU under equivalent conditions.

At the same time, **competition** should not be restricted as no exclusive rights are being granted and any competitor is free to independently acquire the knowledge protected by the

trade secret (including by reverse engineering). This should have, over time, positive effects on the competitiveness and growth of the EU economy.

There will be no direct **social impact** at a macro level, such as on the national employment levels, of the preferred options. Indirectly, however, there should be positive impacts on the facilitation of the mobility of highly skilled labour (those who have access to trade secrets) within the Internal Market and on the level of innovation-related jobs (thanks to increased innovative activity), thus contributing to the sustainability of employment within the EU.

The preferred option should not have direct impact on the **environment**.

This initiative does not negatively affect **fundamental rights**.

An EU action providing for effective and equivalent protection of trade secrets across the EU is supported by the industry stakeholders responding to the public consultation and the specific 2012 survey. On the contrary, non-industry stakeholders would not see the need for an EU initiative.

7. MONITORING AND EVALUATION OF THE PREFERRED POLICY OPTIONS

Three steps will be undertaken: (1) a transposition plan; (2) the Commission's regular monitoring on the timely adoption and correctness of the transposition measures and on their application; and (3) the evaluation of the effects of the policy, in the medium term.