



EU Know-How Directive - Impact on M&A transactions

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Companies must protect their capital in the form of business and trade secrets from being lost to the competition. In Germany there has been no uniform law for the protection of trade secrets up to now. Rather, the provisions for the protection of trade secrets result from the criminal offences of Secs. 17 through 19 UWG (German Act against Unfair Competition) as well as the claims under tort law and injunctive relief (Secs. 823, 826 BGB and Sec. 1004 BGB (German Civil Code)). The protection of trade secrets provided for in these scattered provisions is considered insufficient.³ An important reason for this is that the owner of the secret finds himself in the dilemma as to whether he describes the infringed trade secret in detail as part of the necessary substantiation of his claim, without being able to ensure that the court prohibits the defendant or third parties and thus his competitors from exploiting these details for

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³ Dumont, BB 2018, 2441.



their own purposes, or whether he does not do so and thus risks losing the case.⁴ In light of this insufficient protection of trade secrets which are not protected as patents or under copyright laws, the European Parliament has adopted the Directive (EU) 2016/943 (dated June 8, 2016, the “Know-How Directive”) regarding the protection of Know-how and confidential business information. All member states of the EU are now obliged to implement the provisions of the Directive.

In view of the differences in the content of the national regulations on the protection of trade secrets in the EU member states, which have the effect of slowing down innovation and economic growth, the Know-How Directive also has created a minimum harmonization. For the purpose of implementing the Know-How Directive, the Federal Government passed a corresponding draft law (Draft Trade Secrets Act - DTSA) on in the middle of last year. As far as the status of the legislative procedure is concerned, the DTSA has undergone its first deliberation in the German Federal Parliament. The aim of this draft law is to replace the hitherto incomplete protection of trade secrets under German law with a new comprehensive statute, which regulates the claims for infringement of trade secrets as well as the framework conditions for their judicial enforcement.

In the past, companies have taken contractual as well as technical measures to protect their trade secrets. To prevent confidential information from falling into the hands of competitors in connection with the exchange of information in M&A

⁴ In detail Druschel/Jauch, BB 2018, 1218; Ohly/Sosnitza/Ohly, 7th edition 2016, UWG Sec. 17 Rn. 56 ff; Dumont, BB 2018, 2441, 2442.



transactions or from being used by recipients outside the purpose of disclosure of such documents and information, the partners regularly enter into confidentiality agreements. This article is intended to examine the question of whether the implementation of the Know-how Directive in Germany should change this practice and what advantages the DTSA offers to the parties of M&A transactions? To this end, the previous practice of confidentiality agreements in M&A transactions will first be presented. Then the main features of the DTSA, which are essential for this contribution, will be described in order to then examine the question of the relationship between the current practice and the legal regime under the DTSA, i.e. whether the current practice is superseded or meaningfully supplemented by the new legal regime? As far as both approaches can be applied in parallel, a recommendation will then be made on the basis of a comparison of the contractual practice and the statutory regime.

I. Current practice of confidentiality agreements

In the practice of M&A transactions to date, the conclusion of confidentiality agreements is common. These agreements require the prospective buyer to keep the information exchanged secret both during and after the termination of the contract negotiations and not to use the knowledge gained for purposes other than the intended transaction. This obligation is often backed up by a contractual penalty. These penalty clauses are very important for the party that discloses the information, as the concrete material damages of a breach of confidentiality are difficult to calculate. Further essential features of such an agreement are provisions on



permissible disclosures, the obligation to secure the information and, in the event of the failure of the transaction or in any case upon written request by the party disclosing information, the obligation to return or destroy the documents to the extent technically possible. Furthermore, provisions on the group of permitted recipients are typical, i.e. who within the recipient party may receive the confidential information, e.g. management and the group of employees who are involved in the transaction and therefore reasonably need the confidential information to implement the intended transaction. There are also provisions on the extent to which employees of the recipient entity's affiliates (only on a need-to-know basis), consultants (yes, if bound by the obligation to observe confidentiality under their professional law) and other third parties (only with the prior written consent of the disclosing party) may be provided with confidential information. Finally, clauses, which are intended to make it easier for the holder of the trade secret to obtain interim judicial relief, are used in contracts governed by German law, although their origin is under common law.⁵

⁵ See Kästle/Oberbracht, *Company Purchase - Share Purchase Agreement*, 3rd edition 2018, 13.4. („The Parties understand and agree that in the case of a breach by Purchaser of the obligations in this Section, the remedies available to Seller under this Agreement may not be sufficient to indemnify Seller and the Group Entities fully against all damage, and that therefore Seller shall be entitled to enforce any claims for specific performance (Unterlassungs- und Beseitigungsansprüche) by injunctive relief (einstweiliger Rechtsschutz) without having to establish irreparable harm and without having to provide a bond or other collateral (ohne Sicherheitsleistung).“)



II. Implementation of the Know-how Directive in Germany

In the following, the main features of the TSA that are essential for this contribution will be presented. These are the legal definition of trade secrets, the regulation on the protection of secrets within the framework of procedural enforcement and a penal provision relevant to the constellation of a confidentiality agreement.

1. Legal definition of trade secrets in the sense of DTSA

Starting point for the legal protection of trade secrets according to this draft law is their legal definition in Sec. 2 DTSA. According to this provision a trade secret is an information which *(a) is not, either in its entirety or in the precise arrangement and composition of its components, generally known or readily accessible to persons in the circles which normally deal with this type of information, and is therefore of economic value; and (b) is subject to appropriate confidentiality measures by its lawful holder under the circumstances.*

The explanatory memorandum to the DTSA on page 22 provides a certain orientation in this respect:

"The specific types of confidentiality measures to be taken depend on the nature of the trade secret and the specific circumstances of its use. Both physical access restrictions and precautions as well as contractual security mechanisms can be considered. It is not necessary to mark each piece of confidential information separately, but in principle measures can be taken for certain categories of information (e.g. technical barriers to access) or can be specified by



general internal guidelines and instructions or also in employment contracts. In assessing the adequacy of the protective measures, particular consideration may be given to the value of the trade secret and its development costs, the nature of the information, its importance to the enterprise, the size of the enterprise, the confidentiality measures customary in the enterprise, the way the information is identified and contractual arrangements agreed with employees and business partners. “

A three-stage model has been developed in the literature to assess the appropriateness of confidentiality measures⁶:

1. Stage 1: Real key know-how: loss endangering the existence of the company; extensive and cost-intensive protective measures required (e.g. for corporate strategy or R&D activities).
2. Stage 2: Strategically particularly important know-how: loss noticeable for the company; extensive and cost-generating protective measures required (e.g. customer data).
3. Stage 3: Other know-how: loss manageable for the company; protective measures are a compromise between effectiveness and manageability (e.g. business calculations).

The legal definition of trade secrets in Sec. 2 DTSA places considerably stricter requirements on the protection of trade secrets by their holders than the previous definition in German case law. According to the criteria of the case-law, in contrast to the

⁶ Dumont, BB 2018, 2441, 2443.



appropriate secrecy measures within the meaning of Sec. 2 DTSA, only an intention to keep the information secret was required, the existence of which was subject to only minor requirements⁷. On the other hand, according to Sec. 2 DTSA, secrecy measures which are appropriate under the given circumstances are required in order to enjoy the protection of the new statutory provisions. In this respect, personnel, physical and technical access restrictions (e.g. against hacking and industrial espionage), the agreement of confidentiality obligations under employment contracts and the conclusion of confidentiality agreements with business partners are useful instruments to implement protective measures.⁸

2. Protection of confidentiality in the context of procedural enforcement

As stated above, the holder of a trade secret has an interest in not having to disclose the trade secret in question to the other party - usually a competitor - in civil proceedings. The list of claims available under the DTSA (elimination and omission; destruction, surrender, recall, removal and withdrawal from the market; information about infringing products and damages) will only represents a sharp sword if effective protection of trade secrets is guaranteed in its judicial enforcement.

This concept is supported by the fact that Secs. 16 and 19 DTSA provides for the possibility for the court seized with the matter to

⁷ Köhler, in: Köhler/Bornkamm/Feddersen, UWG, 37th ed. 2019, Preamble to Secs. 17-19 marginal 17.

⁸ Köhler, in: Köhler/Bornkamm/Feddersen, UWG, 37th ed. 2019, Preamble to Secs. 17-19 marginal 17.



take measures to maintain secrecy in the trial at the request of one of the parties. Thus, the Court of First Instance may classify information in dispute as confidential with the result that it may not be used or disclosed by the parties and their legal representatives and other persons involved in the litigation concerning trade secrets. In the event of breaches of this obligation, the court may impose a fine of up to EUR 100,000 or imprisonment for up to six months. In addition, the court may limit access only to a certain number of persons. This applies to documents which may contain trade secrets and to oral proceedings at which trade secrets may be disclosed. In this context, the DTSA clarifies that, however, at least one natural person must be granted access for each party and its legal representatives. Therefore, for reasons of procedural fairness, there is no procedure to the complete exclusion of the other party. But the person that needs to be granted access could be the party's lawyer who could be put under a special duty of confidentiality with respect to the pending procedures.

In the legislative text the scope of application of the provision on secrecy in trade secrecy disputes (Sec. 16 DTSA) is limited to "actions". This could be used as an argument against the effectiveness of the trade secrets in other judicial proceedings, like injunctions. The question arises whether this provision also applies to proceedings for interim relief.⁹ In this respect, there is still enough time to acknowledge this deficiency of protection and amend the legislative text accordingly.

⁹ For possible solutions *de lege lata* and *de lege ferenda* in detail Druschel/Jauch, BB 2018, 1794 ff.



3. The penal provision in Sec. 23 Abs. 3 DTSA

Finally, Section 23 (3) DTSA contains a criminal provision which is relevant in the context of a confidentiality agreement. According to this provision, a prison sentence of up to two years or a fine shall be imposed on anyone who uses or discloses a trade secret – but only if it qualifies as a confidential document or regulation of a technical nature entrusted to him in the course of business - for the purpose of promoting his own or others' competitive activities or for his own benefit contrary to Sec. 4 (2) No. 2 or No. 3 DTSA. According to Sec. 4 para. 2 no. 2 or no. 3 TDSA, a trade secret may not be used or disclosed by someone who violates an obligation to restrict the use of the trade secret or violates an obligation not to disclose the trade secret. It is quite conceivable that a contractual party entrusts the other with secret documents or technical regulations within the meaning of Sec. 23 (3) DTSA on the basis of a confidentiality agreement in the context of a M&A transaction. If such information is then used or disclosed to promote one's own or a third-party's competitor's business or for one's own benefit contrary to the confidentiality agreement, criminal liability pursuant to Section 23 (3) DTSA may also be triggered.

III. Coexistence of previous practice with the new legal regime

Furthermore, the question arises whether this new statutory regime according to the DTSA supersedes the previous practice of confidentiality agreements. It can be assumed that the current practice of protecting know-how will continue even after the



implementation of the Know-how Directive in Germany.¹⁰ This coexistence of the current practice with the new legal regime is supported not least by the fact that the DTSA also assumes that the previous practice will continue to exist. According to Section 4 (2) No. 3 DTSA, a trade secret may not be used or disclosed by anyone who violates an obligation not to disclose the trade secret. It follows from this that the statutory provisions on claims for breach of a trade secret also apply within a contractual legal relationship, e.g. between the parties to a confidentiality agreement. The TSA also in no way restricts the contractual freedom with regard to confidentiality agreements.

IV. Comparison of contractual practice and legal regime according to the DTSA

Against this background, the question arises as to whether it is appropriate not only to rely on the contractual protection of trade secrets, but also to strive to meet the requirements for the application of the statutory regime under the DTSA. The disadvantage of traditional contractual protection of trade secrets is that proof of infringement and damage can be difficult. On the other hand, if the legal requirements under the DTSA are met, the owner of a trade secret can use the so-called inspection procedure (“Besichtigungsverfahren”) for the purposes of preserving evidence in the event of a **suspected** infringement. This inspection procedure is a combination of an independent evidence procedure (“Beweissicherungsverfahren”) and an accompanying interim

¹⁰ See Steinmann/Schubmehl, CCZ 2017, 194, 198.



injunction (“Einstweilige Verfügung”). To this extent, however, it is still unclear how the protection of trade secrets can be guaranteed in this procedure¹¹, since according to the text of the statute the scope of application of the provision on secrecy in trade secret litigation (Sec. 16 DTSA) is, as mentioned above, limited to "actions". If, however, it is assumed that the protection of trade secrets can also be guaranteed in the so-called inspection procedure, it seems appropriate to endeavour to fulfil the requirements for the application of the legal regime according to the DTSA. To this end, companies must take the measures to protect the confidentiality of their information and data as is appropriate in the circumstances, as discussed earlier in this article. In general, this includes entering into confidentiality agreements with business partners¹² in ordinary sales and distribution agreements or in any other context allowing the other party to obtain access to the Company's business secrets, thus also outside the context of entering into an M&A transaction. Against this background, the question arises whether there is a need to adapt confidentiality agreements in M&A transactions in order to meet the requirements

¹¹ See in detail Druschel/Jauch, BB 2018, 1794 ff.

¹² Sec. Sec. The exploitation of confidential information by the recipient may give rise to copyright for which the disclosing party claims a right of use. However, this may not extend beyond the purpose of the disclosure. In addition, the question of appropriate remuneration arises (Section 32 (1) sentence 1 UrhG). However, rights of use granted within the framework of participation in private invitations to tender, i.e. procedures in which several interested parties apply for a contract, do not need to be remunerated (cf. BeckOK UrhR/Soppe, 22. Ed. 15.10.2018, UrhG Sec. 32 marginal 97). It can therefore be assumed that in connection with such tendering procedures a non-disclosure agreement can be effectively concluded for the granting of rights of use free of charge.



of the legal definition of trade secrets in Sec. 2 DTSA, thus making sure that within the framework of an M&A transaction the protection as provided for in the DTSA will be available to the Parties of the transaction.

V. Recommendation

The legal definition of a trade secret in Sec. 2 DTSA places higher requirements than the previous legal situation¹³. In this respect, two provisions typically contained in confidentiality agreements, which could tempt courts to deny the quality of the information concerned as a trade secret within the meaning of Sec. 2 TSA, appear to be particularly critical: On the one hand, the extension of the scope of permitted recipients of the confidential information to include personnel of entities affiliated with the party disclosing the relevant information and, on the other hand, the (lack of) sufficient certainty in confidentiality agreements as to what information qualifies as confidential information.¹⁴ As regards the first point, it is argued that disclosure to an allegedly indeterminate group of recipients could cause courts to deny to such information the quality of a trade secret to the information in question.¹⁵ In order to protect against this risk, it is appropriate to insert into the confidentiality agreement a clause providing for an obligation of the party receiving the confidential information to enter into

¹³ See above and Steinmann/Schubmehl, CCZ 2017, 194, 197; Freckmann/Schmoll, BB 2017, 1780, 1782.

¹⁴ Steinmann/Schubmehl, CCZ 2017, 194, 198.

¹⁵ Steinmann/Schubmehl, CCZ 2017, 194, 198.



appropriate confidentiality agreements with its affiliates which shall receive the confidential information. As a supporting measure, it should be stipulated that the party receiving the confidential information is responsible for ensuring that its affiliates will comply with the recipient party's obligations resulting from the confidentiality agreement.¹⁶ As far as the second aspect – avoiding a too broad definition of confidential information in confidentiality agreements - is concerned, the definition should be limited as needed if one wishes to benefit from the future legal regime. There is no need to limit confidential information protected by the confidentiality agreement to information identified as confidential by the disclosing party.¹⁷ The specific information must, however, be distinguishable from information of a non-confidential nature. Thus, it is too broad to have all information exchanged between the parties protected by the Confidentiality Agreements. It is enough, however, if the information can be identified as being protected by the confidentiality agreement (“bestimmbar”), but must not all be listed in detail.¹⁸ Such sufficient certainty can be achieved, for example, by defining categories which if contravened trigger the contractual consequences, thus allowing the recipient party to also benefit from the statutory regime. For example, it is recommended that the confidentiality agreement be based on the three-step model described above and that the confidential information be classified according to certain categories such as importance for the

¹⁶ Thurn/Ziegenhain, in: Beck'sches Formularbuch Zivil-, Wirtschafts- und Unternehmensrecht, 4th edition 2018 Confidentiality Agreement, Note 4.

¹⁷ Steinmann/Schubmehl, CCZ 2017, 194, 198.

¹⁸ Steinmann/Schubmehl, CCZ 2017, 194, 198.



holder of the confidential information.

VI. Summary of results

1. The new legal regime for the protection of trade secrets under the DTSA provides for possibilities which are of relevance for the practice of confidentiality agreements in M&A transactions in order to protect the holder of trade secrets against unlawful acts of infringement.
2. The previous practice of confidentiality agreements in M&A transactions will not be superseded by the new legal regime under the DTSA.
3. The option of "dual-track driving", i.e. striving for legal protection in addition to contractual protection, which will be available in future as a result of the new legal regulation, appears to be appropriate.
4. However, compared to the previous legal situation, companies must comply with stricter requirements when fulfilling the legal definition of trade secrets in Sec. 2 TSA.
5. This also affects the drafting of confidentiality agreements.

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