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**New Challenges for International Franchising**

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**ITALY: NEW RULES ON TRADE SECRETS (KNOW-HOW)**

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## 1. The implementation of the EU Directive on trade secrets in Italy.

Companies are increasingly investing in developing and applying know-how and commercial information related to clients, suppliers, business plans, and market strategies; indeed, technical and commercial information represent intellectual capital, which may significantly affect companies' competitiveness and innovation-related performance in the market.

On June 8, 2016, the European Parliament and the Council adopted the Directive on the protection of undisclosed know-how and business information (trade secrets) against their unlawful acquisition, use and disclosure (Directive (EU) 2016/943, hereafter the "Directive").

On June 22, 2018 Legislative Decree No. 63 of May 11, 2018 (hereafter "Legislative Decree 63/2018"), which implemented the Directive, became effective in Italy.

## 2. The main contents of the new provisions.

Unlike most European Member States, even before the implementation of the Directive, trade secrets and know-how had a comprehensive and advanced set of rules under Italian legislative law and case-law. In fact, Legislative Decree 63/2018 confirmed most of the principles already established by law or developed by case-law; however, some new provisions, in line with the recent international trends, were also introduced.

**Articles 98 and 99 of the Italian Code of Industrial Property** (Legislative Decree No. 30 of February 10, 2005, hereafter "the Italian CIP"), as amended by Legislative Decree 63/2018, provide the main principles of substantive law applicable to trade secrets.

### ***"Art. 98 - Scope of protection.***

*1. Protection is granted to trade secrets. Trade secrets are business information and technical-industrial experiences, including the commercial ones, which are subject to the legitimate control of the owner, as long as that information:*

- a) is secret in the sense that it is not, as a body or in the precise configuration and assembly of its components, generally known among or readily accessible to experts and operators of the field;*
- b) has an economic value because it is secret;*
- c) is subject to measures to be considered reasonably adequate to keep it secret, by the person lawfully in control of the information.*

*2. (Omissis)"*

### ***"Art. 99 - Protection.***

*1. Without prejudice to the provisions on unfair competition, the legitimate owner of the trade secrets referred to in Article 98, has the right to prohibit third parties, subject to his consent, from acquiring, disclosing to third parties or using such secrets in an abusive manner, except for cases in which they have been obtained in an independent manner by the third party.*

*1-bis. The acquisition, use or disclosure of trade secrets referred to in Article 98 shall be held unlawful even when, at the time of acquisition, use or disclosure, the individual knew or ought, under the circumstances, to have known that the trade secrets had been directly or indirectly obtained by a third party who unlawfully used or disclosed them pursuant to paragraph 1.*

*1-ter. The production, offering, or placing on the market of infringing goods, or the importation, export or storage of the same goods constitute an unlawful use of the trade secrets referred to in Article 98, where the person engaging in such conducts knew or ought, under the circumstances, to have known that the trade secrets was used unlawfully within the meaning of paragraph 1. 'Infringing goods' means goods, the design, characteristics, functioning, production process or marketing of which significantly benefits from the above-mentioned trade secrets unlawfully acquired, used or disclosed.*

*1-quater. Rights and actions arising from the unlawful conduct referred to in paragraphs 1, 1-bis and 1-ter are subject to a five years' limitation period."*

In addition, important procedural rules were introduced with Legislative Decree 63/2018 (confirming the main principles previously established by Italian case-law), under Articles **121-ter**, **124**, **126** and **132** of the Italian CIP.

Namely, **Article 121-ter** aims at guaranteeing confidentiality of trade secrets during judicial proceedings by stating that:

- the Court may forbid to persons nominated or delegated by the same, to the parties and their representatives and consultants, lawyers, administrative employees, witnesses, and other persons who have access to the measures, records and documents on file within the office, to use or reveal trade secrets which are the subject matter of the proceedings that it deems confidential. This measure, to be requested by the interested party, remains in force even after such proceedings ends;
- the Court can also restrict access to a limited number of people to hearings, records and documents on file, permitting the obscuration or omission of the parts containing trade secrets in the acts deciding the procedures;
- moreover, the Court can demand that, when the decision is issued, a note shall be made by the clerk stating the prohibition for the parties to disclose the integral version of the Court provision.

Moreover paragraphs *6-bis*, *6-ter* and *6-quater* have been added to **Art. 124 CIP** with the purpose of strengthening the protection of trade secrets. In particular, paragraph **6-bis** establishes circumstances and criteria to be considered by the Court when issuing the corrective measures and civil sanctions regulated by Article 124. These circumstances and criteria include: (1) the value and other specific features of trade secret; (2) the measures taken to protect the trade secret; (3) the conduct of the infringer in acquiring, using or disclosing the trade secret; (4) the impact of the unlawful use or disclosure of the trade secret; (5) the legitimate interest of the parties and the impact which the granting or rejection of the measures could have on the parties; (6) the legitimate interest of third parties; (7) the public interest; and (8) the safeguard of fundamental rights.

Paragraph **6-ter** provides for pecuniary compensation, which is payable as an alternative to the application of the aforementioned measures provided by **Article 124** of the Italian CIP. Under Paragraph **6-ter**, compensation may be granted by the Court upon request of the interested party, provided that:

- the requesting party, at the time of the use or disclosure, neither knew nor ought, under the circumstances, to have known that the trade secret was obtained from another person who was using or disclosing the trade secret unlawfully;
- execution of the measures would be unduly burdensome for the requesting party;
- pecuniary compensation appears proportionate with respect to the damages suffered by the party seeking the application of the measures;

In any case, pecuniary compensation shall not exceed the amount of royalties or fees which would have been due, had that person requested authorisation to use the trade secret in question, for the period of time for which use of the trade secret could have been prohibited.

Further, provisions concerning the publication of judgements and interim measures have been introduced under **Articles 126 and 132** of the Italian CIP.

Namely, paragraph *5-bis* of Art. 132 now provides that the Court may, in all proceedings aimed at seeking protective measures for trade secrets, as an alternative to the application of the precautionary measures listed herein, make the continuation of the alleged unlawful use of a trade secret subject to the lodging of guarantees intended to ensure the compensation of the trade secret holder.

The violation of trade secret is also a criminal offence under Italian law. **Art. 623 of the Criminal Code** provides:

***“Art. 623 - Disclosure of scientific or commercial secrets.***

*Anyone who has come to know, for reasons of his state or office, or of his profession or art, trade secrets or news aimed at remaining secret, over discoveries or scientific inventions, reveals them or uses them for his own or others' profit, is punished with imprisonment for up to two years.*

*The same sanction applies to anyone, having acquired commercial secrets in an abusive manner, reveals them or uses them for his own or others' profit.*

*If the fact relating to the trade secrets is committed through any IT tool, the penalty is increased.*

*The offender is punished subject to a complaint from the injured party.”*

Moreover, **Art. 388 of the Criminal Code**, which provides criminal sanctions for failure to enforce a

Court order, has been implemented to also include Court orders on violations of trade secrets.

### **3. The protection of know-how and trade secrets in franchising.**

As set forth above, under Italian law, a franchisor has several means to protect its know-how and trade secrets from possible disclosure or abusive use by its franchisee (or former franchisee) or by its competitors.

#### **3.1 The protection of know-how as IP right.**

Pursuant to the Italian CIP, the franchisor's protection is not limited to its know-how in the "strict sense" (e.g. the technical information; information provided for in the franchise manual), but is now extended to all trade secrets which under Italian case-law may also include the customers' data (not limited to the simple list of names and addresses, but with further indications), commercial experiences, marketing strategies, and market researches.

From the perspective of the franchisor, the scope of protection may include the use or disclosure of trade secrets by the franchisee in violation of a non-disclose provision, or also when the franchisee exceeds the limits of the rights granted to him.

It can also include the acquisition, use or disclosure by any third party, who has obtained the secret directly or indirectly through a third party, but knew or ought, under the circumstances, to have known that the trade secrets had been directly or indirectly obtained by a third party who unlawfully used or disclosed them.

Such protection also extends to the production, offering, or placing in the market of infringing goods, or the importation, export or storage of such goods, if they significantly benefit from the above-mentioned trade secrets unlawfully acquired, used or disclosed.

Finally, the protection is even granted against people who neither knew nor ought, under the circumstances, to have known that the trade secret was obtained from another person who was using or disclosing the trade secret unlawfully, although it may be limited to a fair pecuniary compensation.

The same protection is also granted to the franchisee for possible trade secrets transferred to the franchisor. For instance, an Italian Court required a franchisor to transfer back to the franchisee the customers' data that the franchisee had input into the franchisor's software after the franchisor terminated the contract, blocked franchisee's access to such data, and started competing with franchisee (Trib. Bologna, 18/1/2016).

On the other hand, due to the new provisions introduced under Article 99 CIP, the franchisee is exposed to the risk of being deemed responsible for possible violations of third parties' trade secrets made by the franchisor, based on the fact that "he knew or ought, under the circumstances, to have known" about the unlawful use or disclosure by the franchisor and such liability may be extended to the production, offering, or placing on the market of infringing goods, under the circumstances mentioned above.

In any case, in order to be granted such protection, the trade secret's holder must prove the existence of the conditions provided for under Article 98 CIP, i.e. that:

- the information is secret, i.e. not generally known among or readily accessible to experts and operators of the field;
- the information has an economic value: intended by Italian case-law as 'competitive advantage', and not as 'market value';
- the information is subject to measures adequate to keep it secret by its holder (according to Italian case-law, such conditions refer to contractual provisions on confidentiality, limited access to selected individuals, IT systems protected by passwords etc.).

In this respect, in one case (in our view quite disputable) the Court of Turin denied protection to a franchisor for lack of sufficient evidence of the above conditions, although the franchisee proceeded with an illicit termination of the contract, started working with a competitor and accessed the customers' data of the former franchisor through one of the competitor's computers (Trib. Torino, judgment No. 1148/2017 of 28/2/2017). In another case concerning a commercial agent, the protection was denied because, after the end of the contractual relationship, the principal forgot to deactivate the former agent's access codes to its IT system and the Court considered the post-termination access made by the agent as not abusive (Trib. Bologna, 4/7/2017). However, in most cases, if the trade secret's holder is able to prove the existence of the

abovementioned conditions, IP protection is normally granted (see. for cases of franchising, Trib. Torino 6/12/2007; Trib. Firenze, 16/1/2019).

Finally, of course, the IP protection includes all the typical IP remedies described above, including protective and corrective measures, specific provisions on compensation for damages and return of the infringer's profits, and criminal protection.

### **3.2 The protection provided by the rules on unfair competition.**

In addition to the IP rules mentioned above, the violation of trade secrets and know-how is also protected by the general rules of the Italian civil code on unfair competition.

Namely, **Article 2598** of the Italian Civil Code provides:

*“Without prejudice to the provisions concerning the protection of distinctive signs and patent rights, it is deemed as committing acts of unfair competition anyone who:*

*1), 2) (omissis)*

*3) uses directly or indirectly any other means that does not comply with the principles of professional correctness and is capable of damaging another company.”*

Such protection is only granted when the two parties are in competition between each other, i.e. when the former franchisee acts directly or indirectly in competition with his former franchisor (or vice versa).

However, in these cases, protection may also be granted when the conditions of Article 98 CIP (e.g. the confidential character of the information) are not sufficiently proven or met (see, for instance, Trib. Bologna, 27/7/2015, n. 2340). It is therefore very common to claim both protections in cases of violations of know-how or trade secrets.

## **4. The conflicting rules of the CIP and of the Italian Franchise Law concerning know-how.**

### **4.1 The definition of know-how under Law No. 129/2004.**

Under Article 1.3, a) of the Italian law No. 129/2004 (the Italian Franchise Law), know-how is defined as follows:

*“(.) an asset of non-patented practical knowledge deriving from experience and evidence which is:*

*i) secret, i.e. not generally known or easily accessible;*

*ii) substantial, i.e. which includes knowledge which is indispensable to the franchisee for the use, sale, resale, management, or organization of the contractual goods or services;*

*iii) identified or described in a sufficiently comprehensive manner so as to make it possible to verify whether it fulfils the secrecy and substantiality criteria.”*

This notion has been taken from Art. 1, f) of EU Reg. 2790/1999 (which referred to the provision of Regulation 4087/88, previously regulating antitrust rules applicable to franchise agreement); both Regulations are no longer in force.

The above definition is quite restrictive and may not include several situations in which the know-how is mostly characterised by for example ‘commercial experiences’, layout or display of the products. In fact, when implementing Law 129/2004 the Italian legislator did not consider that the aim of antitrust rules, in defining know-how, was to limit the benefit of the antitrust exemption to cases in which the franchise agreements were characterised by the transfer of qualified know-how. By way of contrast, the definition of know-how in the franchise law should have been wider, in order to be applicable to most franchise agreements, given that the purpose of such law should be to protect the franchisee, as weaker party.

Such restrictive definition of the Law 129/2004 is clearly in contrast with the definition provided by Directive (EU) 2016/943, and by Article 98 of the Italian CIP, as described above.

#### **4.2 The requirement of a know-how as ‘essential element’ of the contract.**

Article 3 of Law 129/2004, requires, for the validity of a franchise agreement, the written form *ab substantiam*. The same Article also provides - among the elements which have to be expressly indicated in the contract - “*d) a specific indication of the know-how the franchisor provides to the franchisee*”.

This Article, along with the restrictive notion of know-how provided by Art. 1 of the Franchise Law, has led several Italian Courts (and scholarship) to affirm that:

- know-how is an essential element of the franchise agreement; and
- in the absence of a specific description of the know-how in the contract, in compliance with its requirements of secrecy, substantiality and identification, the franchise contract is null and void.

Such approach has been followed, for instance, by Trib. Milano 29/1/2019, No. 871, which declared the contract null, because it did not provide for a sufficiently-specified know-how and instead only referred to manuals, which were not produced in the Court proceeding. Trib. Firenze, 16/1/2019, which evaluated the existence of the relevant elements, confirmed the validity of the contract. Trib. Torino, 19/12/2017, No. 6171, declared the contract null because the franchisor did not produce evidence that the manual was given to the franchisee. Trib. Bologna, 10/6/2015 determined that reference to the manual in the contract alone was not sufficient, although the franchisor established that the manual was effectively transmitted to the franchisee at a later stage.

#### **4.3 The decision of the Supreme Court of 10/5/2018.**

In this scenario, the Italian Supreme Court recently intervened with an opposite interpretation of the law, clearly in contrast with the previous approach, with its decision No. 11256 of 10/5/2018. The case concerned the franchise of a coffee shop, a concept that did not have a “heavy” know-how to be transferred from the franchisor to the franchisee.

First, the Supreme Court affirmed that know-how is not an essential element of the franchise contract, stating that, in the definition of the franchise agreement provided by Art. 1 of Law 129/2004, the know-how is mentioned among other IP rights, which all may (or may not) be present in the specific contract.

In fact, Art. 1 of Law 129/2004 provides:

*“(..) a contract, no matter how called, between two juridically and economically independent legal subjects, whereby one party grants the other, for consideration, the availability of a package of industrial or intellectual property rights regarding trademarks, trade names, shop signs, utility models, industrial designs, copyright, know-how, patents, technical and commercial assistance and advice, and inserts the franchisee in a system consisting of several franchisees spread in the territory, in order to market certain goods or services.”*

Moreover, the Supreme Court affirmed that, even where the know-how is provided in the specific franchise agreement, the elements listed in its definition, under Article 1.3, a) of Law 129/2004, considering the application to all sectors of economic activities, must be evaluated in a flexible manner, depending on the complexity of the franchise network concerned and, therefore, on the more or less regulated business activity. Therefore, in some cases the description of the know-how in the contract may be “light”, without being too generic and undetermined.

In that specific case, the notion of know-how described by the lower Court as “a heritage of practical knowledge indispensable to the franchisee for use, the sales, management and organization of the contractual services” was deemed by the Supreme Court as compatible with such elements. Namely, the Court of Cassation affirmed that: (i) as to the “confidentiality” requirement, the law does not require the know-how to be totally inaccessible, but ‘not generally know or easily accessible’; (ii) the ‘substantial’ character of the know-how should be regarded as ‘an effective economic utility for the franchisee, which he uses in the exercise of his activity in that specific franchising network’; and (iii) the know-how must be identified, *meaning “described in a sufficiently comprehensive manner, such as to enable it to verify whether it meets*

*the criteria of secrecy and substantiality", a requirement which, as held by scholarship, responds to a double interest, both of the franchisor and of the franchisee : of the first, because he can thus supervise the possible abuse of the affiliate, and of the latter, because it allows him to verify if the know-how is actually endowed with the secrecy and substantiality requirements.*

In conclusion, this recent decision of the Supreme Court provided for an interpretation of the know-how more in line with the recent international trends and with the new rules on trade secrets described above.

Also, in a more recent decision (Trib. Monza 26-06-2018, n. 1801), the Court affirmed that Art. 3 of Law 129/2004 should not be considered in the franchise context because this law established the obligation to specify and describe in a very detailed manner the know-how at the moment of contract execution. Since the concrete transfer of the know-how by the franchisor to the franchisee occurs at a later stage, through the provision of an operative manual and the possible training course to the franchisee, Art. 3 of Law 129/2004 should not be considered in the franchise context.

## **5. Conclusions**

Based on all the above, in order to protect their trade secrets and know-how in compliance with the applicable Italian rules, franchisors should carefully draft their contractual provisions, with a goal of clearly identifying the scope and limits of confidentiality obligations that their franchisees must comply with, both during and after the end of the franchise relationship. Franchisors should also include liquidated damages clauses applicable in case of violation.

Moreover, adequate measures to protect the franchisor's know-how should be put in place (e.g. limited access to software, password etc.).

In addition, as franchisors await additional confirmation of the new approach recently affirmed by the Supreme Court, in order to avoid the risk of a strict interpretation of the Franchise Law provisions concerning know-how (which may lead to a declaration that the franchise contract is void, allowing a franchisee to get back the franchise fee and royalties), franchisors should carefully describe the contents of the know-how to be transferred to the franchisee in the franchise agreement.

Finally, in case of dispute, franchisors should claim protection of trade secrets and know-how as an IP right and under the rules of unfair competition and should provide sufficient evidence of all the requirements provided by all the above-mentioned rules.

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## **Biography of the author**

Silvia Bortolotti is a partner at the law firm Buffa, Bortolotti & Mathis (Turin, Italy). She is specialized in international commercial transactions, cross border litigation and arbitration. Her extrajudicial practice covers domestic and international commercial contracts. Ms Bortolotti is a founding member and Secretary General of the International Distribution Institute (IDI), member of several international associations - the International Bar Association (IBA), the Commission on Commercial Law and Practice (CLP) of the International Chamber of Commerce (ICC) - and advisor to several Italian associations. Acknowledged by *Who's Who Legal* as one of the Italian leading experts in franchising, she often lectures in several conferences and training courses about international commercial contracts, commercial agency, distributorship, franchising and cross border trade. Moreover, she is a frequent contributor to publications on every aspect of Italian and international commercial law. She has also co-authored the book *Contratti di distribuzione* (Distribution contracts), Wolters Kluwer, 2016 (chapters on distribution and franchising), as well as some ICC publications, including *ICC Model International Franchising Contract* (2011), *Using franchising to take your business international* (2014) and the *ICC model contract on distributorship* (2016).