

Franchising - Switzerland

Distinction between subordination franchise and cooperative franchise

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Introduction

In Switzerland, the legal rules applicable to franchise agreements are not specified in the Code of Obligations. Instead, courts must determine for each particular franchise relationship whether it is based on all its economic characteristics, a partnership franchise (to which the rules on partnership contracts in Articles 530ss of the code may apply by analogy) or a subordination franchise (to which the rules for work or agency contracts in Articles 319ss or 418a ss of the code may apply by analogy in favour of the franchisee).

This basic distinction has numerous legal ramifications, including, in relation to:

- franchise parties' mutual rights and obligations;
- franchisee's social security contributions;
- franchise termination and termination consequences (eg, compensation by the franchisor for the franchisee's client base); and
- franchise disputes.

The competent jurisdiction for a recent Canton of Zurich High Court decision (ZR 112/2013, P 65ss) provides welcome and detailed guidance on how franchise systems may be structured from a business perspective in Switzerland, with a view to avoiding any uncertainty as to legal characterisation alternatives.

Facts

The dispute involved a franchisee who agreed to provide recruitment consultancy services within the franchise system of the franchisor. The franchisee was:

- granted exclusivity in a certain territory for specific business sectors (ie, facility management, conveyance and hoisting technology industries);
- entitled to profit fully from public relations, marketing and website promotion efforts by the franchisor; and
- bound to use the franchisor's branded printed materials for its recruitment services.

In consideration of this exclusive right, the franchisee was obliged to:

- pay €40,000 upfront in instalments as an entry fee and pay royalties to the franchisor;
- undergo compulsory introductory training;
- fulfil certain advertising requirements;
- have its employees trained by the franchisor; and
- support the franchisor's recruitment consultant network.

The fees charged to the franchisee's clients had to be invoiced by the franchisor by naming the franchisee. They were transferred to the franchisee after deducting the upfront entry fee instalments and net turnover percentage royalties. The franchisee agreed to strive for success and to a non-compete covenant. However, professional activities other than recruitment services under the franchisor's system were also allowed if they complied with the franchisor's company policy, subject to the franchisor's prior approval. Finally, further detailed provisions had to be complied with by the

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franchisee and its employees, including, in relation to:

- marketing;
- use of PR agencies;
- client handling;
- recruitment services provision;
- the fee structure to be agreed with clients under the franchise system; and
- cooperation and relationships between franchisee network members.

In a dispute, one franchisee argued that the contractual jurisdiction clause of the franchise agreement in favour of the Zurich courts was invalid under Swiss employment law rules (as possibly applicable to a subordination franchise). Thus, the court had to assess whether the franchise was to be characterised as a subordination franchise or a partnership franchise.

Decision

In line with Federal Supreme Court case law,⁽¹⁾ the Canton of Zurich High Court confirmed that under Swiss law, there is no legal preference for the characterisation of franchise systems (ie, all relevant economic circumstances must be assessed in each particular case). The High Court held that the franchise system in this case must be characterised as a partnership franchise, and that no mandatory employment or agency law provisions applied to it as a result. To reach this decision, the court assessed particular facts along the following detailed criteria:

- As the franchisee could also conduct professional activities other than recruitment services under the franchisor's system, and the franchisor could withhold its approval of such services only in cases where the franchise system's reputation was at risk, it was obvious that the franchisee was not contractually bound to dedicate all its efforts to the franchisor's system.
- Instead, unlike an employee, the franchisee could decide itself how much time it dedicated to the promotion and sale of services under the franchisor's system.
- All business risk was borne by the franchisee, which worked in its own name and on its own account under the franchisor's brand (eg, the risk of bad (client) debt was borne by the franchisee alone).
- The franchisee received a (large) share in only the invoices that the franchisor charged in its name to its franchisee's clients and the related profits; however, it did not share in the revenues of the franchisor.
- The fact that the fees charged to the franchisee's clients had to be invoiced by the franchisor was not decisive, as this was done only to secure payment of the upfront fee instalments and royalties in favour of the franchisor, which in this respect acted only as a fiduciary on behalf and for the account of the franchisee.
- The franchisor did not control the franchisee's day-to-day activities. The franchisee did not have to report on its client contacts or on the time spent on its everyday services under the franchise system, and received no instructions for them (other than general guidance manuals).
- The franchisee itself had to organise all its work under the franchise system, rent suitable premises, hire further employees and pay for introductory training (ie, the franchisee provided the whole franchise infrastructure and know-how at its own cost).
- The non-compete covenant in relation to recruitment services was a necessary means to guarantee exclusivity in favour of single members of the franchise network within a certain territory and for the specified business sectors.
- The introductory training, branded materials and further detailed general provisions in a franchisor manual on client handling, marketing, use of PR agencies, recruitment services provisions, the fee structure to be agreed with clients under the franchise system, as well as on the cooperation and relationship among the franchisee network set forth by the franchisor were necessary prerequisites for the protection of the franchisor's corporate identity, specialist know-how and the franchise system's brand image.
- Finally, the franchise network members could change the organisational rules applicable to them by majority decision among themselves, which was seen as highly unusual for a subordination franchise.

As a result of all these economic characteristics, the franchisee's position in the franchise system was characterised as an independent business with sole authority and responsibility for its business decisions, irrespective of the detailed general provisions on how to provide services under the franchise system. In particular, it was regarded decisive that the franchisee had full freedom to act as to when, where and through which internal organisation to provide the franchise system services. The franchisee's business results depended not on the economic success, referrals or solvency of the franchisor, but solely on its own efforts. The franchise was thus

characterised as a partnership franchise and the contractual jurisdiction prorogation clause was valid, irrespective of the fact that the franchisee was domiciled elsewhere.

Comment

The freedom of contract principle also governs franchise relationships in Switzerland. Swiss law offers franchise partners the opportunity to tailor the economic characteristics of their contractual franchise relationship so as to allow the franchisee to become an independent business responsible for its own business success. If this is done, the franchise relationship cannot be terminated by either party with immediate effect pursuant to the mandatory provisions in Articles 418r or 337(2) and (3) of the code. Instead, the franchise relationship will be liquidated under the rules for partnership contract and in case of a material breach, the non-breaching party will be entitled to damages.⁽²⁾ The franchisee will also be responsible for its social security contributions and the franchisee's income tax. Finally, the franchise partners can validly foresee jurisdiction clauses which prorogate the forum for litigation or even validly agree on arbitration in their franchise agreements.

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Endnotes

(1) See, for example, SFSCD 118 II 157 Yves Rocher and SFSCD 4A_148/2011 Y.

(2) SFSCD 4A_148/2011 Y.

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