Franchising - Switzerland

Effect of cartel law on franchising

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Introduction

The revised Act on Cartels and Other Competition Restraints came into force in 2004. Due to the protracted nature of proceedings before the Competition Commission and the often equally time-consuming appellation proceedings at the Federal Supreme Court, there remains a steady flow of new decisions on Cartel Act infringements – some of which directly affect different parts of franchising agreements including the Swiss market.

To avoid the adverse effects of such infringements when drafting and implementing franchise agreements, it is paramount for both parties to respect the boundaries of the Cartel Act, which does not always follow the competition law applicable in the European Union.

In particularly serious cases financial penalties for Cartel Act infringements can amount to up to 10% of a company's annual revenue over the past three business years. The legal costs of defence are considerable and should be avoided by careful contract drafting. The involvement of a company in a commission investigation is made public from the outset, which can severely damage a company's business reputation in Switzerland, even in the absence of a final adverse decision in a particular case.

Franchising agreements

Overview of cartel law system

Article 5(3) of the Cartel Act lists certain types of agreement which are legally presumed to eliminate competition and thus to be unlawful *per se*. These include agreements along the value chain (known as vertical agreements, and including franchising agreements) for minimum price fixing, quantitative restrictions and geographical or personal market allocations, which eliminate passive (ie, non-solicited) sales.

Article 5(2) of the act concerns agreements (including vertical agreements) which significantly affect competition without actually eliminating it – for example:

- restrictions on a dealer's ability to freely determine its sales prices;
- restrictions on sales to certain territories or customers; and
- restrictions limiting a supplier to sell components or spare parts to third parties and non-compete obligations for more than one year after termination of a vertical agreement.

The legal presumption of unlawfulness can be rebutted by showing that there is enough competition in the relevant market which is not affected by the vertical agreement at issue.

Further details can be found in the commission's Notification for the Competition Law Treatment of Vertical Agreements, which took effect in August 2010. Finally, not only are contractual agreements in the proper sense covered, but so too are all sorts of other non-binding arrangements and concerted practices (ie, where participants knowingly impede competition through cooperation beyond mere parallel behaviour based on their autonomous independent assessment of what is dictated by the prevailing market conditions).

The rules of the act and the vertical agreements notification must be observed while drafting franchising agreements and taken into account for any other interaction affecting the Swiss market between the franchisor and the franchisees (or between several franchisees of the same franchise network).

Price fixing and information exchange

Unlawful price fixing includes any action by the franchisor that limits franchisees' ability to determine

sale prices independently. This can happen either directly through an agreement on sale prices for products or services or indirectly by the exchange of information between the franchisor and franchisees – or even between the franchisees –which leads to an alignment of sale prices through a concerted practice. Unlawful price fixing is not restricted to the mere setting of a fixed price or minimum price. Also, the alignment of single sale price parts, such as discounts or margins, is unlawful under the act. Only the setting of a maximum price is allowed, because such maximum prices are not considered to limit competition.

Thus, any price fixing within a franchise network is unlawful, irrespective of the fact that it may be beneficial for the franchising system as a whole. As such, price fixing is considered not to be justified on the grounds of economic efficiency. However, a franchisor may publish mere recommendations for sales prices as long as there is no incentive or pressure on franchisees to comply with the recommended prices. It is thus recommended to always state clearly that all price recommendations are not binding and not to deliver to franchisees any products to which a price tag is already attached. Finally, the advance exchange of franchisees' sale prices or further sales conditions (eg, margins or discounts) is problematic as long as these are not already public, as this may – even inadvertently – lead to concerted behaviour within a franchise network.

Market allocation

Market allocation is characterised by the exclusive assignment of specific regional or customer markets to a particular franchisee. Under Swiss law, vertical agreements concerning the allocation of markets are assumed to eliminate competition on the market as a whole if they limit both active and passive (ie, non-solicited) sales in these markets. This means that within a franchise network, only the active addressing of potential customers (also through advertising) by a franchisee in the territory of another franchisee (active sales) can be prohibited, and not, however, adhering to unprompted requests by a possible customer coming from a market assigned to a competing franchisee (passive sales).

This means that franchise agreements should not limit a franchisee's ability to sell to customers located in a regional market assigned to another franchisee, such customers should contact a franchisor on their own accord.

Non-compete obligations

A non-compete obligation prohibits the franchisee from taking part in any competing activity in the same market as that covered by the franchise agreement. It is possible to impose a non-compete obligation for the duration of a franchising agreement. However, after the termination of a franchise agreement, a non-compete obligation can be validly agreed on for an additional year only, and only to the extent that it is necessary to protect the franchisor's know-how and is limited to products or services formerly covered by the franchising agreement.

Comment

While the Cartel Act and the vertical agreements notification are only two of many factors to be taken into account when drafting and implementing franchise agreements, they and all related case law should be meticulously analysed and taken into account for franchise agreements which are already setting-up new franchise networks with a view to avoid serious financial and reputational damages from the outset. In particular, Swiss law does not always correspond to EU competition law in this respect. In all cases, franchisees must ensure that their prices are set independently. Franchisors must not restrict passive sales by a franchisee in any market assigned to another franchisee and must limit non-compete obligations to one year after contract termination.

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