

# Franchise 2022

Contributing editor  
Mark Kirsch



**Publisher**

Tom Barnes  
tom.barnes@lbresearch.com

**Subscriptions**

Claire Bagnall  
claire.bagnall@lbresearch.com

**Senior business development manager**

Adam Sargent  
adam.sargent@gettingthedealthrough.com

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# Franchise

## 2022

**Contributing editor**

**Mark Kirsch**  
Lathrop GPM

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Lexology Getting The Deal Through is delighted to publish the sixteenth edition of *Franchise*, which is available in print and online at [www.lexology.com/gtdt](http://www.lexology.com/gtdt).

Lexology Getting The Deal Through provides international expert analysis in key areas of law, practice and regulation for corporate counsel, cross-border legal practitioners, and company directors and officers.

Throughout this edition, and following the unique Lexology Getting The Deal Through format, the same key questions are answered by leading practitioners in each of the jurisdictions featured. Our coverage this year includes new chapters on Australia, India and United States.

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Every effort has been made to cover all matters of concern to readers. However, specific legal advice should always be sought from experienced local advisers.

Lexology Getting The Deal Through gratefully acknowledges the efforts of all the contributors to this volume, who were chosen for their recognised expertise. We also extend special thanks to the contributing editor, Mark Kirsch of Lathrop GPM, for his assistance with this volume.



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For further information please contact [editorial@gettingthedealthrough.com](mailto:editorial@gettingthedealthrough.com)

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# Switzerland

Vincent Jäggi, Maëva Mégane Jeanrenaud and Christophe Rapin

Kellerhals Carrard

## MARKET OVERVIEW

### Franchising in the market

- 1 How widespread is franchising in your jurisdiction? In which sectors is franchising common? Are there any economic or regulatory issues in the market that are more or less hospitable to franchising or make it economically viable in your jurisdiction?

No official statistics are available on the extent of franchising in Switzerland. According to the Syndicate Unia, there were estimated to be approximately 20 franchisors with 400 franchisees in the early 1970s and 150 franchisors, mainly foreign, in 2000. The market continued to increase significantly to reach 250 to 300 franchisors (with up to five franchisees each) in 2015, the vast majority of which expected to grow in the future according to a study conducted by the Swiss Franchise Association, which has recently rebranded to become Swiss Distribution.

However, the difficulty for franchisees to obtain a bank loan to finance their market entry does not facilitate market access.

According to Swiss Distribution, franchising is primarily present in retail, health and wellness, followed by gastronomy and fashion. The consulting and real estate sectors also count franchises, though to a lesser extent. Swiss Distribution itself has 23 member franchisors.

### Associations

- 2 Are there any national or local franchise associations? What is their role in franchising, including any impact on laws or regulations? Are there any rules of conduct or membership requirements?

Swiss Distribution is the leading association in the Swiss franchise industry. Franchise associations have a limited impact on the development of statutory laws and regulations. During the consultation procedure on preliminary drafts of new legislation affecting franchising activities, franchise associations and various stakeholders from civil society (political parties, interest groups, non-governmental organisations, etc) may express their opinions on the proposed bill.

Swiss Distribution has developed its Code of Conduct, which is binding to its members only (soft law). The Code of Conduct provides specific pre-contractual disclosure obligations and the specific duties of the parties to a franchise agreement. Indeed, a franchisor must demonstrate that it has successfully operated its franchising concept for a reasonable period of time (proof of concept) and must provide adequate initial training as well as commercial and technical support throughout the term of the franchise agreement.

## BUSINESS OVERVIEW

### Types of vehicle

- 3 What forms of business entities are relevant to the typical franchisor?

When it comes to setting up business in Switzerland, franchisors have a variety of legal forms from which to choose. However, the prevailing form of corporate vehicle established by a typical franchisor is the company limited by shares (AG), followed by the limited liability company (GmbH). Both AG and GmbH limit the personal liability of their holders for the debts of the company to their share of the corporate stock. However, only the AG may list on the Swiss stock exchange (the SIX Swiss Exchange or the BX Swiss).

### Regulation of business formation

- 4 What laws and agencies govern the formation of business entities?

In Switzerland, no regulations apply specifically to franchises and franchise relationships. The relevant legislation is, therefore, to be identified on a case-by-case basis.

In terms of the formation of business entities, the Swiss Civil Code (CC) and the Swiss Code of Obligations (CO) are relevant. The technical aspects of registration required for the formation of an AG or a GmbH are governed by the Commercial Register Ordinance.

### Requirements for forming a business

- 5 Provide an overview of the requirements for forming and maintaining a business entity.

The formation and maintenance of a business entity depend on the legal corporate form chosen. Nevertheless, the process follows the same steps for an AG and a GmbH. The business entity may be formed by one or more natural or legal persons (regardless of domicile or nationality) during an assembly, known as a constitutive assembly, in a notarial deed.

The articles of association must contain in particular the company name, seat and objects, the form of the company's external communications as well as the total amount of the capital, the extent to which it is paid up and the nominal value of shares. Irrespective of the size of the company, the minimum capital value of an AG is 100,000 Swiss francs, divided into shares with a nominal value of at least 1 Swiss cent, while that of a GmbH is 20,000 Swiss francs, divided into shares with a nominal value of at least 100 Swiss francs.

The franchisee is then registered in the public commercial register of the canton of its headquarters. The commercial register indicates, in particular, a list of the members authorised to act on behalf of the company. In the case of a GmbH, all listed individuals have management powers. The company is liable for the actions of publicly registered persons.

Function and residency requirements apply to the latter. At least one member of the board of directors of the AG, respectively a managing officer of the GmbH or a member of the top management entitled to represent the company with sole signature power, must reside in Switzerland. If the signature power is joint, two members must reside in Switzerland.

### Restrictions on foreign investors

#### 6 | What restrictions apply to foreign business entities and foreign investment?

The franchise company must be represented by a person (ie, a member of the board of directors or a director domiciled in Switzerland).

Foreign franchisors must also be aware that, according to the Federal Act on the Acquisition of Real Estate by Persons Abroad, natural and legal persons with their registered office or domicile abroad as well as persons acting on their behalf may only acquire real estate in Switzerland after an authorisation procedure. However, the purchase of real estate for commercial use (eg, hotels, shops, offices and production halls) does not require authorisation.

No other restrictions apply to foreign business entities or foreign investment.

### Taxation

#### 7 | What aspects of the tax system are relevant to franchisors? How are foreign businesses and individuals taxed?

In terms of taxation, the Swiss federal system means that tax powers and revenues are shared between the Swiss Confederation, the cantons and the municipalities. Businesses and individuals are therefore taxed on all three levels. While the Swiss Confederation is competent exclusively in areas that the Swiss constitution provides for, the cantons are sovereign in tax matters, which means in particular that they have a general competence to collect taxes, determine tax-exempt amounts, and set tax scales and rates. Thus, the level of taxation and the tax burden varies between cantons and each canton has the power to influence its tax competitiveness directly. This system has developed a domestic tax competition and led to relatively low tax rates in Switzerland in comparison with other jurisdictions.

Natural persons residing or staying for a certain period of time in Switzerland are subject to income and wealth tax. Foreign persons not benefiting from a permanent resident permit (the C permit) are, in principle, taxed on their income from Swiss sources by means of a withholding tax. However, admission fees and royalties paid to foreign franchisors are generally not taxed by withholding.

Legal entities, such as franchisees formed in AGs or GmbHs, residing in Switzerland are subject to tax as soon as they are entered in the commercial register or if they have their effective place of management in Switzerland. Profit tax is levied at the federal, cantonal and municipality levels (ie, by the Swiss Confederation, the cantons and the municipalities). Relative tax rates are, for the majority of the cantons, flat tax rates applying on the taxable profit of a legal entity (progressive tax rates are the exception).

Depending on the location, it is not unusual to expect a rate between 14 and 17 per cent for income tax. Taxable income is determined through the statutory accounts or, in the case of a foreign company, the branch accounts. The assessment for income tax is made on net profit after tax (tax expenses being deductible in Switzerland) as shown in the statutory financial statements that must follow the CO accounting standards. Companies that are not registered per se in Switzerland but are active in the country through a permanent establishment or a branch are only taxed on profits generated by the Swiss activity or on real estate assets located in Switzerland. According to a judgment of the Federal

Supreme Court (BGer 134 I 303), the activity of a franchisee does not, however, constitute a permanent establishment of the franchisor, even if the premises belonging to the franchisor are leased to the franchisee. Except for the taxation of an eventual rental income, no tax obligations arise for franchisors in the cantons where their franchisees are domiciled with regard to the franchise agreement as such.

After the rejection of earlier reform packages, the Swiss electorate agreed in May 2019 on a major tax reform, which had been debated at length. The reform aimed to align the Swiss tax system with international standards regarding corporate taxation. In general, the reform has increased the tax burden of large companies while reducing that of small and medium-sized enterprises. It implied the suppression, as of 1 January 2020, of special privileges granted to internationally active companies. To maintain a fiscally attractive business location, the fiscal reform introduced, among other things, the possibility to introduce a deduction of up to 50 per cent of research and development costs on the cantonal level and a 'patent box' system allowing profits from inventions to be taxed at a reduced rate on the cantonal level.

The Swiss value added tax (VAT) is only collected on the federal level.

Since January 2019, foreign persons with a turnover of at least 100,000 Swiss francs through deliveries in Switzerland are subject to domestic tax.

Taxable persons are required to register and responsible for declaring the tax due. The standard VAT rate is 7.7 per cent. Reduced rates are applied to some services and products, namely accommodation (at a rate of 3.7 per cent) and essential goods and services such as non-alcoholic beverages, food, medicines and books (at a rate of 2.5 per cent). In this framework, services related to franchise relations are subject to ordinary VAT.

### Labour and employment

#### 8 | Are there any relevant labour and employment considerations for typical franchisors?

In Switzerland, franchisees are considered independent entrepreneurs rather than employees of the franchisor. However, the franchise contract is not regulated as such by Swiss law but is a 'mixed' contract, which means that it consists of elements of several contracts regulated by the CO. It is, therefore, necessary for each matter in dispute to identify the predominant elements of the particular relationship to determine the regime applicable to the given case. On the basis of these principles, the Federal Supreme Court confirmed, in its judgment BGer 118 II 157, the application by analogy of labour law provisions providing for compensation of the employee in the case of wrongful termination in a case where the franchisor held a particularly dominant position in relation to the franchisee, who was limited in its entrepreneurial freedom. This risk can be limited by ensuring that the franchisee enjoys genuine and broad entrepreneurial freedom. However, the risk of equating the franchise relationship with subordination remains in two respects.

In the case BGer 134 III 497 concerning a distribution contract, the Federal Supreme Court concluded that the agent's protective provisions provided for in the provisions governing the commercial agency contract were applicable by retaining a relationship of subordination between the licensor and the distributor. This judgment may suggest that a franchisee might, in the same way, be protected as an agent even in the case of tenuous subordination to the franchisor. On the other hand, if a non-competition agreement has been concluded, part of Swiss legal literature states that the franchisee may be entitled to special remuneration when the franchise agreement is terminated. Unfortunately, the Federal Supreme Court has neither decided on nor outlined the answer to either of the latter two points.

## Intellectual property

### 9 | How are trademarks and other intellectual property and know-how protected?

The Swiss Trade Mark Protection Act (TmPA) provides that any sign (such as words, letters, numbers and graphics) distinguishing the goods or services of one company from those of another may be registered as a trademark. Registration grants the holder an exclusive right to use the mark on the registered goods and services and the protection of his or her right for a 10-year period, which may be renewed an unlimited number of times. However, well-known trademarks within the meaning of article 6-bis of the Paris Convention benefit from protection not only for registered goods and services, but also for any non-registered ones. The Swiss Federal Institute for Intellectual Property is in charge of processing applications for registration. The application may be filed by more than one person intended to be a holder of the right to use the trademark, without any requirement as to residence, headquarters or nationality being applicable. Since Switzerland is a party to the Madrid International Trademark System, the national registration can be supplemented by an international registration handled by the World Intellectual Property Organization in Geneva.

No proof of use of the trademark is required for registration. However, to avoid trademarks being registered as a reserve, the trademark must be used for its protection to take effect. If the owner does not use the trademark during the five years following registration, his or her right shall be forfeited if non-use is not justified and action may then be brought to cancel the registration.

Unauthorised use of a trademark identical or confusingly similar to a registered trademark shall be deemed to be an infringement. In such a case, Swiss law provides injunctive or prohibitive civil actions as well as other protective measures. The owner of the trademark may also demand financial compensation by means of a request for royalties, compensation of damages or the repayment of profits made by the infringer. Furthermore, the TmPA provides for criminal sanctions, upon complaint, of any unlawful use of another's trademark by a sentence of up to one year's imprisonment. In addition to civil and criminal remedies, the TmPA enables the owner of a trademark to oppose the entry in the register of an infringement of his or her trademark within three months following the publication of said infringement's registration.

Know-how is in Switzerland neither protected by specific legislation nor by Swiss regulations protecting intellectual property. In the case of unfair competition through the use of know-how, the Federal Act against Unfair Competition does, however, allow the franchisor to file a complaint. The case of unfair competition is then punishable by a pecuniary penalty or a sentence of up to three years' imprisonment. Know-how may also be protected by a clause in the franchise contract qualifying it as confidential information. The disclosure of the know-how could thus be pursued through the legal means available in the case of breach of contract. In addition, the Swiss Criminal Code punishes, upon complaint, the breach of manufacturing or trade secrecy with a pecuniary penalty or imprisonment of up to three years.

## Real estate

### 10 | What are the relevant aspects of the real estate market and real estate law? What is the practice of real estate ownership versus leasing?

Franchisees do not usually own their own premises and usually lease them in the main cities of Switzerland. The franchisor may sometimes be the owner of the premises where the franchising activities are to be operated by the franchisee. In this specific set-up, the franchise contract

also deals with the lease of the premises, and the franchisor – franchisee relationship may become a hybrid one combining franchising and commercial lease aspects.

Swiss law does not provide for specific legislation on commercial leases, but rather for one-off changes to the regime applicable to any lease contract. Local franchisors, as well as foreign franchisors, are free to enter into and arrange their lease relationships provided that mandatory tenants' protection provisions are complied with. As any lessee, franchisors are thus protected against abusive rent rates as well as by provisions requiring compliance with specific formalities upon the termination of the lease. Given the depreciation period of investments made and the inconveniences associated with moving a business, commercial leases are often longer than residential leases and must be terminated with at least six months' notice. If the landlord terminates the lease, the tenant may request an extension of the lease for a period of up to six years provided the circumstances justify it. It should also be noted that the installation and alteration of premises by lessees must be authorised by the owner and may give rise, at the end of the lease, to compensation for the lessee who financed them. It is, nevertheless, recommended that this matter be addressed more closely in the lease contract.

The CO requires the notarisation of the 'promise to sell' and the 'purchase of real estate'. When purchasing a building plot or changing the use to which the purchased property is to be put, land planning regulations and authorisation processes must also be taken into account.

In addition to these regulations, foreign franchisors must observe the restrictions imposed by the Federal Act on the Acquisition of Real Estate by Persons Abroad (BewG). According to the BewG, 'persons abroad', which are physical or legal persons domiciled or having their registered office abroad, as well as persons acting on their behalf, may acquire real estate in Switzerland under conditions verified in an authorisation procedure.

However, according to the BewG, the purchase of real estate for commercial use is not subject to authorisation. Hotels, retail premises, offices and manufacturing halls, for instance, are considered properties for commercial use.

## Competition law

### 11 | What aspects of competition law are relevant to the typical franchisor in your jurisdiction? How is competition law enforced in the franchising sector?

Franchising activities are governed by Swiss competition law, namely the Federal Cartel Act, the Federal Act on Price Supervision and the Federal Act against Unfair Competition. Indeed, a franchise agreement qualifies as a vertical restraint between two entities and is subject to the same legal assessment as a traditional distribution contract. Swiss competition law tends to be compatible with Commission Regulation (EU) No. 330/2010 of 20 April 2010 and general European practice. However, in the *Gaba* case (BGer 143 II 297), the Federal Supreme Court refused to apply an EU regulation on technology transfer agreements under Swiss law.

On 22 May 2017, the Swiss Competition Commission (ComCo) published a notice concerning the assessment of vertical agreements (CommVert) and related guidelines containing detailed rules that may also apply in franchise relationships (eg, cross-supplies, non-compete obligations, know-how and resale prices).

A franchise agreement is deemed to be illegal and invalid if it provides for a minimum or fixed price for a product, or for the allocation of territory between different franchisees by preventing passive sales by other franchisees into those territories. A general prohibition of online sales in franchise agreements qualifies as an illicit hardcore restriction, as internet sales are considered passive sales pursuant to

the CommVert (which may not be subject to an absolute prohibition) unless the website specifically targets customers in an individual territory (active sale).

Other restrictions may also qualify as hardcore restrictions, such as technical geoblocking measures, rerouting customers or restricting sales to customers located outside the contractual territory based on the information provided (eg, foreign credit cards) as those restrictions achieve the same goal of restricting passive sales to customers located outside a contractual territory.

In the latest development in the *Pfizer* case (BGer 2C\_149/2018, judgment dated 4 February 2021), the Federal Supreme Court held that recommended resale prices issued by Pfizer and made available to pharmacies through a third-party database that was directly connected to the cash registers of the pharmacies qualified as unlawful resale price maintenance. Notably, 89.3 per cent of the pharmacies supplied by Pfizer had fully or partly applied the recommended resale prices. The compliance of 50 per cent of the retailers appears to be sufficient for there to be a concerted practice. The fact that Pfizer has never exerted pressure on or offered special incentives to the pharmacies was not relevant. Pursuant to this judgment, non-binding price recommendations may be seen as problematic in Switzerland, especially when those recommendations are repeatedly and automatically communicated in the retailers' cash register systems. This ruling is stricter than the corresponding rules under European competition law.

The exposure of the parties to a franchise agreement that breaches Swiss competition law may be important. If a franchise agreement is found to contain illegal clauses, the parties may be fined up to 10 per cent of the turnover achieved in Switzerland in the preceding three years, without prejudice to potential civil claims.

## OFFER AND SALE OF FRANCHISES

### Legal definition

#### 12 | What is the legal definition of a franchise?

As Swiss legislation does not specifically define franchising, the concept has been developed by case law and legal literature. According to a leading decision of the Federal Supreme Court (BGer 118 II 157), in concert with the legal literature and the Swiss franchising association Swiss Distribution, a franchise agreement consists of the distribution of goods or services by independent entrepreneurs (the franchisees) according to a uniform concept of sale and advertising provided by the franchisor. For this purpose, the franchisee receives the right to use the franchisor's name, trademarks, equipment or other material or immaterial property rights as well as ongoing assistance, advice and training from the franchisor. Although the franchisee acts on its own behalf and at its own risk, the franchisor reserves, as a general rule, the right to give instructions and exercise control over the franchisee's business activity. The Federal Supreme Court stated, however, that the variety of forms in which franchise agreements are drawn up makes it impossible to define a franchise agreement 'with sufficient precision'. In any event, the relationship involves very close cooperation between the franchisor and the franchisee.

### Laws and agencies

#### 13 | What laws and government agencies regulate the offer and sale of franchises?

The offer and sale of franchises are not specifically governed by any law in Switzerland. In terms of law, the general provisions of the Swiss Civil Code (CC) and the Swiss Code of Obligations (CO) apply as well as the United Nations Convention on Contracts for the International Sale of Goods, if not waived. The General Data Protection Regulation of the

European Union, the Swiss Federal Act on Data Protection and the Swiss laws on intellectual property may also apply to the offer and sale of franchises. The important role of the principle of good faith in relation to the behaviour of the parties, which must be serious (serious intent to contract), as well as the disclosure of information during contractual negotiations should also be stressed.

Where general terms and conditions (GTC) are involved, although the general rules of the CC and the CO apply, case law of the Federal Supreme Court has developed specific rules regarding the adoption and interpretation of the GTC, which must also be taken into account. In particular, the GTC must be validly incorporated in the contract to be effective and, in any case, the agreement between the parties has priority over the GTC's content. Moreover, the Federal Act against Unfair Competition prohibits the use of GTC that provide for a significant and unjustified imbalance between the rights and obligations of a business and a consumer to the latter's detriment.

Accordingly, there is no government agency regulating franchises. However, Swiss Distribution, which is a private commercial organisation with no governmental function and self-regulated, provides a framework for its members.

### Principal requirements

#### 14 | What are the principal requirements governing the offer and sale of franchises under the relevant laws?

This is not relevant in Switzerland.

### Franchisor eligibility

#### 15 | Must franchisors satisfy any eligibility requirements in order to offer franchises? Are there any related practical issues or guidelines that franchisors should consider before offering franchises?

Swiss law does not provide for such requirements. However, Swiss Distribution does require franchisors and master franchisees aspiring to become members to meet certain requirements, such as a proof of concept, a minimum of two years of franchising and a franchise system comprising of at least two franchisees. It should, moreover, be noted that franchisees cannot join Swiss Distribution.

### Franchisee and supplier selection

#### 16 | Are there any legal restrictions or requirements relating to the manner in which a franchisor recruits franchisees or selects its or its franchisees' suppliers? What practical considerations are relevant when selecting franchisees and suppliers?

Swiss law does not provide for any special regulations in this area and gives free scope to contractual freedom. Franchisors and master franchisors may, with the consent of their co-contractor, apply possible restrictions.

In line with EU rules, if the franchisees' network qualifies as a selective distribution system based upon quantitative or qualitative criteria, or both, franchisors are required to apply those criteria in a uniform and non-discriminatory manner when selecting the candidates to a franchise agreement.

## Pre-contractual disclosure – procedures and formalities

### 17 | What procedures and formalities for pre-contractual disclosure are required or advised in your jurisdiction? How often must the disclosures be updated?

The procedure for making pre-contractual disclosure in connection with franchise contracts is not regulated by special statute under Swiss law. However, according to the principle of good faith, not only must all of the information disclosed during the pre-contractual phase be true, but the prospective franchisee must receive all the necessary information concerning the projected contractual relationship. In this context, Swiss Distribution has issued its Code of Conduct, supplemented by specific advice concerning the pre-contractual phase. Regulations issued by Swiss Distribution are binding only to its members and, in the case of its Code of Conduct, apply only to the relationship between franchisor and franchisee. However, as this information is available on Swiss Distribution's website, it can serve as an illustration for franchisor or master franchisee.

In general, for evidentiary reasons, it is recommended to keep a written record of any information transmitted.

## Pre-contractual disclosure – content

### 18 | What information is the disclosure document required or advised to contain?

There are no specific pre-contractual statutory disclosure regulations pursuant to Swiss law in a franchise context. According to the principle of good faith, the prospective franchisee must receive all the necessary information concerning the contemplated franchising activities prior to the execution of the franchise agreement. In addition, all of the information disclosed during the pre-contractual phase is to be true and not misleading. For evidentiary reasons, it is recommended to keep a written record of any information transmitted.

In its Code of Conduct, Swiss Distribution lays out specific pre-contractual disclosure obligations that are binding for its members only (soft law). The franchisor member of Swiss Distribution is thus required to provide the prospective franchisee with full written information concerning the terms of the franchise agreement within a reasonable period of time before the execution of the franchise agreement. Moreover, all information provided to the franchisor must be factually correct and void of ambiguity and misleading information.

## Pre-sale disclosure to sub-franchisees

### 19 | In the case of a sub-franchising structure, who must make pre-sale disclosures to sub-franchisees? If the sub-franchisor must provide disclosure, what must be disclosed concerning the franchisor and the contractual or other relationship between the franchisor and the sub-franchisor?

Under Swiss law, sub-franchise relationships are not governed by a special statute or monitored by a specific agency. Therefore, according to the principle of freedom of contract applicable under Swiss law, the parties to the sub-franchising structure decide by consensus which of them will make pre-sale disclosures to sub-franchisees.

## Due diligence

### 20 | What due diligence should both the franchisor and the franchisee undertake before entering a franchise relationship?

Under the Swiss Distribution's Code of Conduct, which is applicable to its members, the franchisor must conduct an investigation to determine whether a potential franchisee has the required qualities to operate the franchise in question (in other words, adequate training, financial capacity and personal qualities).

Since the reputation of the franchisor is directly linked to that of its franchisees, it is also necessary to ascertain the practices of the prospective franchisee in its business activity and in particular, if the prospective franchisee has employed staff, ensure compliance with labour law obligations.

However, the franchisee is advised to carefully examine the franchise of interest to the franchisee. In this regard, the Swiss Federal Department of Economic Affairs, Education and Research recommends that potential franchisees consider the following questions:

- How long has the franchisor been on the market?
- What skills and experience does management have?
- Are there any references?
- How is the financial situation presented?
- How is the company image presented?
- How many franchise managers are there and how long have they been franchise managers?
- Does the franchisor perform an aptitude test with applicants?
- Is the franchisor a member of a professional association?
- Is the franchisor trying to manipulate prices?
- Do you have to buy the merchandise and production resources from the franchisor?
- Is professional and commercial knowledge necessary?
- Is there comprehensive training and good preparation for the business?
- Is there a manual on how to manage the business?
- Are help and advice available if required?
- What services does the franchisor offer in terms of buying, advertising and PR?

Swiss Distribution further invites prospective franchisees to consult the selection criteria applicable to franchisees and to answer a series of questions to determine whether they are 'fit to buy'. Likewise, a 'fit to sell' test is available for franchisor self-assessment. In addition, Swiss Distribution's advice on the pre-contractual phase included in its Code of Conduct is relevant.

## Failure to disclose – enforcement and remedies

### 21 | What actions may franchisees or any relevant government agencies take in response to a franchisor's failure to make required disclosures? What legal remedies are available? What penalties may apply?

Swiss law recognises and applies the *culpa in contrahendo* and the 'error as to the basis of the contract' doctrines. If the franchisor hides information that had discouraged the franchisee from entering into the franchise contract with the franchisor or if a franchisee enters into a franchise agreement based on a material misrepresentation of the operation, the franchisee may rescind or cancel the franchise agreement.

The damage to be claimed by the franchisee arising out of a *culpa in contrahendo* is equivalent to the difference between the current wealth of the franchisee in its capacity as the injured party and the wealth he or she would hypothetically dispose of without the damaging event (ie, the conclusion of the franchise agreement). However, claims based on *culpa in contrahendo* are only admitted exceptionally by the Swiss courts.

If a franchisee rescinds a franchise agreement based on an error as to the basis of the contract resulting from its negligence (eg, by not requesting sufficient information before entering into the franchise agreement), the franchisee may be liable to pay damages to the franchisor amounting to the negative interest (ie, the amount of useless cost suffered by the franchisor that was caused by negotiating and entering into the cancelled franchise contract).



## Failure to disclose – apportionment of liability

22 In the case of sub-franchising, how is liability for disclosure violations shared between franchisor and sub-franchisor? Are individual officers, directors and employees of the franchisor or the sub-franchisor exposed to liability? If so, what liability?

Unless the parties have contractually provided otherwise, a sub-franchisor is liable to its sub-franchisee for disclosure violations in the same way that the franchisor is liable to the sub-franchisor. The franchisor is, in principle, not liable to the sub-franchisee. However, on the basis of the reasoning followed in judgment BGer 118 II 157, where the sub-franchisor is in a subordinate relationship to the franchisor then the franchisor could assume liability for violations by the sub-franchisor in the same way that an employer bears liability for the violations committed by its employee under the provisions governing employment law.

In Switzerland, the liability of individual officers or directors of a franchisor or sub-franchisor is limited if the business is formed as a company limited by shares or a limited liability company. Such executives would only be held directly or indirectly liable in the case of an intentional or negligent breach of duty of care. For damages caused by employees in the performance of their work, liability is generally borne by their employers. Furthermore, where disclosure violations infringe a criminal provision, for instance in matters of unfair competition, individual officers, directors and employees may incur direct liability.

## General legal principles and codes of conduct

23 In addition to any laws or government agencies that specifically regulate offering and selling franchises, what general principles of law affect the offer and sale of franchises? What industry codes of conduct may affect the offer and sale of franchises?

The offer and sale of franchises are not specifically governed by any law in Switzerland. General provisions of Swiss law remain applicable. However, the CC and the CO apply as well as the United Nations Convention on Contracts for the International Sale of Goods, if not waived by the parties. Those statutory provisions may impact the terms of the franchise contract; the General Data Protection Regulation of the European Union, the Swiss Federal Act on Data Protection and the Swiss laws on intellectual property may also apply to the offer and sale of franchises. Moreover, the Federal Act against Unfair Competition prohibits the use of general terms and conditions that provide for a significant and unjustified imbalance between the rights and obligations of a business and a consumer to the latter's detriment.

Pursuant to Swiss law, the principle of good faith plays an important role with respect to the conclusion and the performance of a franchise contract, in particular in relation to the behaviour of the parties, which must be serious (serious intent to contract), as well as the disclosure of information during contractual negotiations.

In contrast to common law jurisdictions, the interpretation of franchise contracts pursuant to Swiss law tends to focus on the real intention of the parties rather than on the terms of the contract. Indeed, should a provision of a franchise contract require interpretation, a judge will first seek to establish the real and common intention of the parties, adopting an empirical approach. When the actual intent of the parties cannot be ascertained on the basis of factual evidence, the provision is to be interpreted in accordance with the principle of trust and in accordance with the rules of good faith. The judge then gives the unclear provision the meaning that a person placed in similar circumstances, having a similar background as that of the parties, would reasonably do.

There is no government agency regulating franchises. However, Swiss Distribution provides a framework for its members, including

its Code of Conduct. Even though the rules and regulations of Swiss Distribution are not binding (at least for non-members of this association), they can serve as an illustration for a franchisor or franchisee.

## Fraudulent sale

24 What actions may franchisees take if a franchisor engages in fraudulent or deceptive practices in connection with the offer and sale of franchises?

In the case of fraud or deceptive practice, several possibilities are, depending on the circumstances, open to the franchisee. The franchisee may take civil action for breach of contract and claim damages, rescind or terminate the franchise contract as well as claim damages or challenge the franchisor on the basis of the unfair competition act.

The franchisee may also file a criminal complaint if the franchisor's conduct can be qualified as *escroquerie* within the meaning of the Swiss Criminal Code. The criminal complaint is, in principle, directed against a physical person. However, if the failing organisation of the incorporated franchisor does not make it possible to determine which person is responsible for the *escroquerie*, then the company may be sanctioned with a fine of up to 5 million Swiss francs.

## FRANCHISE CONTRACTS AND THE FRANCHISOR/ FRANCHISEE RELATIONSHIP

### Franchise relationship laws

25 What laws regulate the ongoing relationship between franchisor and franchisee after the franchise contract comes into effect?

The general rules of the Swiss Civil Code (CC) and the Swiss Code of Obligations (CO) regulate the ongoing relationship between franchisor and franchisee. Depending on the structure of the relationship between franchisor and franchisee, the topical regulation of various specific contracts provided for in the CO may additionally apply, in particular the provisions on the employment contract and the agency agreement.

### Operational compliance

26 What mechanisms are commonly incorporated in agreements to ensure operational consistency and adherence to brand standards?

A right to direct and control the franchisee is reserved to the franchisor in a typical franchise agreement. In this context, the concrete control mechanisms taken by the franchisor usually consist of an inspection of the franchisee's premises and control of the franchisee's accounts. Usually, the franchisee is also required to report periodically to the franchisor on the conduct and impact of their business. Such reports may cover all matters relating to quality, health, safety, security and environmental friendliness. This could include, for example, customer satisfaction and the labour conditions of employees, if any. In consideration of the long-term nature of the franchise relationship, additional reporting could be provided for, in the case of, for instance, an internal incident, an audit or new directives given by the franchisor. The scope of the mechanisms varies according to the standards applicable to the franchise branch. For example, in the gastronomy and food retail sector, a daily report of food freshness and quality management may be introduced and the inspection of the cleanliness of the premises must be particularly meticulous to protect the customers' health as well as the reputation of the company.

## Amendment of operational terms

### 27 | May the franchisor unilaterally change operational terms and standards during the franchise relationship?

Unilateral modifications of the operational terms and standards are admissible if they are contractually provided for by the parties and do not amount to a modification of the contract in itself. Indeed, the contractual freedom of the parties and the principle of *pacta sunt servanda* are limited by the fundamental principle in Swiss law according to which the conclusion and modification of a contract can only take place through the expression of the concordant will of the parties.

## Policy affecting franchise relations

### 28 | Do other government or trade association policies affect the franchise relationship?

Swiss Distribution's Code of Conduct applies to franchise relationships. These principles are, however, only compulsory for the members of the association. Although optional, the membership to Swiss Distribution represents a pledge of professionalism, and is noteworthy for its positive impact on the business practice and reputation of the franchisor.

## Termination by franchisor

### 29 | In what circumstances may a franchisor terminate a franchise relationship? What are the specific legal restrictions on a franchisor's ability to terminate a franchise relationship?

Franchise agreements may be concluded for a fixed or indefinite period. In the first case, the relationship expires at the agreed term without the intervention of the franchisor, unless the parties have agreed otherwise.

Franchise agreements are usually for a fixed period of time, at the end of which the contract is automatically or tacitly extended. In such a case, the contract is then considered to be of indefinite duration and comes to an end, if the parties have not provided otherwise, by termination with six months' notice (by analogous application of the rules on partnership contracts supported by the majority of the legal literature), by mutual agreement or, exceptionally, by the invocation of motive (good cause) justifying the immediate termination of the relationship (on the basis of the BGer 4A\_241/2017 judgment). According to case law of the Federal Supreme Court concerning an exclusive distribution contract (BGer 107 II 216), the contract must in any case extend over a sufficiently long period of time for the franchisee to make a return on his or her initial investment of capital and preparatory work. Should the franchisee not be exclusively related to the franchisor, a court might take into account the reduced scope of the relationship compared to an exclusivity.

Even in the absence of an express rule, the immediate termination of the relationship for good cause is presumed to be justified where the continuation of the contractual relationship would, according to the rules of good faith, be unacceptable to the terminating party. Notice of immediate termination must reach the other party within a relatively short period of time after the occurrence of the good cause. To provide guidance to the parties, the contract may define and illustrate the notion of good cause. However, in a case concerning a franchise agreement (BGer 4A\_148/2011), the Federal Supreme Court stated that such clauses do not bind the judicial authorities if they limit the possibility of immediate termination if a good cause not listed or not corresponding to the definition of the parties arises. While the Federal Supreme Court has recognised the principle of immediate termination of a franchise agreement for good cause, it has not yet had the opportunity to decide on the effects of such termination in the absence of any valid good cause.

The case law of the lower courts as well as the Swiss legal literature consider that the absence of good cause prevents the immediate termination of a franchise agreement. The parties, therefore, remained

bound to fulfil their contractual obligations, failing which a civil injunction could be issued against the recalcitrant party (BGer 125 III 451). If the concrete relationship between the parties justifies the application by analogy of the provisions of the CO on employment contracts, an unjustified immediate termination would still be effective and the franchisee would be entitled to compensation, the amount of which, determined according to all the circumstances of the case, would correspond at most to the amount that the franchisor would have earned if the contract had been terminated at the agreed expiry or after the applicable notice period. Likewise, any other type of abusive termination entitles the franchisee in a subordinate relationship to the franchisor to claim compensation (BGer 118 II 157).

In the event of non-renewal of the franchise agreement or termination with notice, the franchisee may also claim compensation for, depending on the situation, loss of customers and not amortised investments. However, there is some doubt on this issue because the legal authors are not unanimous and the Swiss Federal Supreme Court has not ruled on the matter. It can be, however, expected that the compensation of the franchisee in such a case will vary according to the applicable regime by analogy to the concrete situation.

## Termination by franchisee

### 30 | In what circumstances may a franchisee terminate a franchise relationship?

Regarding the termination of contractual relations, the franchisee disposes of the same means and is subject to the same rules as the franchisor. It should be pointed out, however, that in the event of non-renewal of the franchise agreement or termination with notice, it is unlikely that the franchisor would be eligible for compensation for customer loss since the clientele generally remains loyal to the brand rather than to the franchisee.

## Renewal

### 31 | How are renewals of franchise agreements usually effected? Do formal or substantive requirements apply?

Unless the parties have provided for a particular form or substantive requirement, the common will of the parties to renew a franchise agreement subject to a limited duration must be expressed in the same form as the initial agreement or by means of an amendment. Nevertheless, if the parties continue to perform their respective services after the expiry of the contract, the latter may be deemed to be tacitly renewed. If the franchise agreement is of unlimited duration or renews itself from year to year without the intervention of the parties, no formal renewal is necessary.

## Refusal to renew

### 32 | May a franchisor refuse to renew the franchise agreement with a franchisee? If yes, in what circumstances may a franchisor refuse to renew?

By virtue of the contractual freedom of the parties, the franchisor is in principle entitled to refuse to renew an agreement with a franchisee. However, the refusal to maintain business relations by a franchisor with a dominant market position could be unlawful according to the Federal Cartel Act (CartA). In such a case, the franchisor's refusal to renew the franchise agreement would not be legally justifiable. The current revision of the CartA introduces new obligations for entities with relative market power. Indeed, companies upon which other companies are dependent in terms of supply or demand, even though they do not reach a 40 to 50 per cent market share threshold on the relevant market, are subject to the existing provisions regarding the abuse of a dominant

position and therefore may be restricted in their capacity to refuse to deal with dependant companies. A company may be considered as a dependant of an entity with relative market power if it does not have sufficient or reasonable possibilities to switch to other companies.

Furthermore, franchisors should be aware that, regardless of their position in the market, if they refuse to renew the agreement they are liable to compensate any investments that the franchisee may have made in good faith (ie, on the basis of a promise or intention to renew the franchise agreement expressed by the franchisor). Along the same lines, one must also take into consideration the indemnification of the franchisee if the term of the contract was not sufficiently long to allow for the amortisation of the franchisee's investments.

### Transfer restrictions

#### 33 | May a franchisor restrict a franchisee's ability to transfer its franchise or restrict transfers of ownership interests in a franchisee entity?

Such restrictions are admissible to the extent provided for in the franchise agreement.

Depending on the will of the parties, the restrictions may consist of a prohibition, such as a right to terminate the entire franchise agreement in the event of a transfer of ownership (change of control clause), or a limitation on any transfer of ownership, including pledges, by requiring the franchisor's approval. The requirement for prior written approval from the franchisor for transfers is, however, the most common modality in practice.

### Fees

#### 34 | Are there laws or regulations affecting the nature, amount or payment of fees?

The nature, amount or payment of fees generally depends on the choice of the parties expressed in the franchise agreement. However, the provisions and general principles applicable to contracts subject to Swiss law allow the franchisee to terminate the contract within one year of its conclusion and claim for the reimbursement of the entry fees paid under two conditions:

- the fee to be paid by the franchisee is manifestly out of proportion with the franchisor's counter-performance to the detriment of the franchisee; and
- such disparity results from the exploitation of the franchisee's distress, inexperience or improvidence by the franchisor.

### Usury

#### 35 | Are there restrictions on the amount of interest that can be charged on overdue payments?

The general provisions of the CO provide for an interest rate of 5 per cent. However, the franchise agreement may provide for a lower or higher interest rate. In such a case, the rate must not be excessive, otherwise it is considered as usury punishable by a pecuniary penalty or imprisonment for up to 10 years. This limit is estimated to range between 10 and 15 per cent.

### Foreign exchange controls

#### 36 | Are there laws or regulations restricting a franchisee's ability to make payments to a foreign franchisor in the franchisor's domestic currency?

No, provided that the parties have agreed upon the chosen currency.

### Confidentiality covenant enforceability

#### 37 | Are confidentiality covenants in franchise agreements enforceable?

Confidentiality covenants in franchise agreements are enforceable. In the case of a breach of contract, the aggrieved party may initiate a civil action to order compliance with the clause and claim damages. It is recommended to add to the contract, in addition to the confidentiality clause, a penalty clause stipulating that any breach of contract will be punished through the payment of a fee or any other contractual penalty. Besides encouraging the parties to comply with the contract, such a clause helps to avoid the additional difficulty often encountered in proving the amount of damages in civil proceedings by fixing a lump-sum compensation in advance.

Depending on the information revealed to a third party, a breach of confidentiality may, furthermore, constitute a criminal act.

### Good-faith obligation

#### 38 | Is there a general legal obligation on parties to deal with each other in good faith during the term of the franchise agreement? If so, how does it affect franchise relationships?

Objectively, good faith is the foundation of loyalty in business and governs the whole area of contract law. The idea is that every person involved in a legal relationship is bound by general duties dictating one's conduct, which means that everyone must behave as an honest, loyal and respectful person would behave towards others. The principle is therefore based on social ethics and a sense of justice. The normative consequences of this principle are mostly developed by case law. Good faith thus has many applications. For example, BGer 125 III 257 developed the prohibition of contradictory behaviour of the parties to the franchise agreement on the basis of good faith.

Subjectively, good faith is the feeling of acting lawfully despite the existence of a legal irregularity. It may represent a legal requirement or influence the burden of proof.

### Franchisees as consumers

#### 39 | Does any law treat franchisees as consumers for the purposes of consumer protection or other legislation?

As a general rule, franchisees are treated as entrepreneurs and not as consumers under Swiss law and jurisdiction. Only franchisees who are considered a weak party with respect to their franchisor's position may benefit from the protection afforded to employees.

### Language of the agreement

#### 40 | Must disclosure documents and franchise agreements be in the language of your country?

Disclosure documents and franchise documents must be in one of the official Swiss languages. Franchisors and franchisees are free to choose which of these official languages they wish to use in their contracts. The parties must nevertheless be aware of the consequences of their choice on possible legal proceedings.

### Restrictions on franchisees

#### 41 | What types of restrictions are commonly placed on the franchisees in franchise contracts?

By virtue of freedom of contract, restrictions placed on the franchisees are subject to the parties' discretion. They may consist of a prohibition of performance by substitution, an obligation to obtain supplies principally or exclusively from the franchisor by applying, where appropriate, the

prices indicated or its recommendations. However, such restrictions are regulated by the CartA. Furthermore, the principle of good faith as well as the CC and the CO may protect the franchisee against excessive or overly restrictive commitments.

### Courts and dispute resolution

**42** Describe the court system. What types of dispute resolution procedures are available relevant to franchising?

The Swiss Court system distinguishes between civil, criminal and administrative courts.

Legal proceedings are conducted in one of the three official languages, namely German, French or Italian. The language is, in principle, that of the place where the proceedings were initiated. Evidence in a language other than the language of the proceedings must be translated. Exceptionally, some courts (the Federal Patent Court, if the parties to the proceedings agree, and some commercial courts) accept the filing of evidence in English.

Typically, proceedings may be conducted successively in three levels of courts. The cantons usually provide for two courts. In civil matters, the cantons may introduce commercial courts as the sole cantonal instance for commercial matters. Sole cantonal instances further exist in all cantons for disputes in connection with intellectual property rights, antitrust and unfair competition law. In addition, certain cases are directly and exclusively handled by a federal authority. For example, this is the case for patent disputes, for which the Federal Patent Court has exclusive jurisdiction.

The Federal Supreme Court, the highest court in Switzerland, acts as the last ordinary Swiss court of appeal.

The majority of Swiss judges are professionals. However, some of them are laymen (ie, they have not received any legal training). The commercial court judiciary is, furthermore, composed of specialised lay judges, chosen for their expertise in the relevant area of litigation. Technical cases can thus be handled with a combination of legal and technical expertise.

Although the Swiss Court system is exhaustively governed by the applicable law, franchisors and franchisees have the right to elect a forum and a law applicable to their dispute. When making such a choice, however, the Federal Act on Private International Law (PILA) and the Lugano Convention on Jurisdiction and the Enforcement of Judgments in Civil and Commercial Matters (applicable in Switzerland) must be taken into account. Thus, despite a choice of court, a breach of competition rules by one of the parties in the performance of the contract could, for example, be the subject to proceedings before the court of the place where the damage occurred, provided that the contractual aspect of the dispute is not preponderant (CCIV.2017.3 judgment of 25 September 2018 by the Cantonal Court of the Canton of Neuchâtel).

In lieu of Swiss courts, the parties may, furthermore, agree to arbitrate their disputes.

### Governing law

**43** Are there any restrictions on designating a foreign governing law in franchise contracts in your jurisdiction? How does the governing law affect the contract's enforceability?

The parties to a franchise agreement are generally free to agree on the governing law and to choose a foreign governing law. The choice of law may be made or amended at any time. If a choice of law is made after the execution of the contract, it has a retroactive effect as of the time of conclusion of the contract (article 116, paragraph 3 of the PILA).

Although it is not recommended, disputes arising from franchise agreements governed by a foreign law may be subject to the Swiss courts, provided they have jurisdiction. In such case, it is the

responsibility of the parties to prove the content of the chosen foreign law. However, Swiss courts will not apply foreign governing law if it breaches Swiss public policy or Swiss mandatory laws that, by reason of their special purpose, are applicable regardless of the chosen governing law (articles 17 and 18 of the PILA).

### Arbitration – advantages for franchisors

**44** What are the principal advantages and disadvantages of arbitration for foreign franchisors considering doing business in your jurisdiction? Are any other alternative dispute resolution (ADR) procedures particularly favoured or disfavoured in your jurisdiction?

Arbitration has the advantage of providing a tailor-made dispute resolution because the parties are free to determine the terms of the procedure. In cases where the award is not subject to appeal and the documents are not in one of the official Swiss languages, arbitration may save the parties time. Moreover, arbitration is particularly suitable for disputes that the parties wish to resolve with all available discretion.

Swiss law fully recognises the coexistence of state judgments and arbitral awards, whether they are rendered to parties based in Switzerland or abroad. Arbitral awards are also taken into account, recognised and even protected by the Federal Supreme Court. Indeed, according to consistent federal case law, only a gross violation of fundamental rights (such as the right to be heard and the right to a fair trial) constitutes grounds for appeal against an arbitral award before the Federal Supreme Court. The legal remedies available to challenge arbitrators' decisions are thus particularly limited. Furthermore, the Swiss Chambers' Arbitration Institution, a not-for-profit organisation, offers means of dispute resolution based on the Swiss Rules of International Arbitration. It is probably for these reasons that Switzerland is a particularly popular place for arbitration.

However, the Swiss courts have a good reputation and solutions that are particularly suitable for commercial disputes are available. Before opting for arbitration, foreign franchisors should evaluate whether arbitration would be advantageous in their particular situation. For example, the costs of arbitration remain high despite the absence of appeal if the dispute involves a small monetary amount. Moreover, arbitration requires the agreement of the parties as well as a supplementary prior investment by the parties in its organisation.

In short, even if Switzerland is particularly attractive for arbitration proceedings, it is recommended to reserve this mode of dispute resolution for disputes involving large sums of money or that must be kept secret.

### National treatment

**45** In what respects, if at all, are foreign franchisors treated differently (legally, or as a practical matter) from domestic franchisors?

In Switzerland, foreign franchisors are treated differently from domestic franchisors with respect to the acquisition of real estate and, only for natural persons, with respect to obtaining residence and work permits.

Owing to the particularly close relations between Switzerland and European countries, citizens of the European Union (excluding Croatian) and European Free Trade Association countries benefit from the free movement of persons and, therefore, have an advantage over other foreign nationals in obtaining residence and work permits.

**UPDATE AND TRENDS****Legal and other current developments**

46 | Are there any proposals for new legislation or regulation, or to revise existing legislation and regulation? Are there other current developments or trends to note?

Three ongoing reforms of existing legislations and proposals for new legislation are likely to change the regulations impacting franchises.

The Swiss parliament passed the total revision of the Swiss Data Protection Act (DPA) on 25 September 2020. The purpose of the DPA revision (which originally came into force in 1992) was to adapt the outdated law to today's social and technological conditions and to align the DPA with the General Data Protection Regulation. At the end of the 100-day referendum period, the Federal Council will decide when the federal act will enter into force. Accordingly, the revised DPA is unlikely to enter into force before 1 January 2023.

On 29 November 2020, the Swiss electorate rejected the Responsible Business Initiative, which aimed to legally oblige corporations based in Switzerland to incorporate respect for human rights and the environment into their business activities in Switzerland and abroad. A counter-proposal from the government, with similar objectives but less intrusive sanctions, has been adopted. Consequently, Swiss companies of public interest (ie, listed companies and companies in the financial sector supervised by the Swiss Financial Market Supervisory Authority), together with controlled companies in Switzerland and abroad have at least 500 FTEs on an annual average and exceed either total assets of 20 million Swiss francs or an annual turnover of 40 million Swiss francs, have increased their reporting and due diligence requirements to ensure that their business activities comply with human rights and international environmental standards.

These companies must report annually on certain non-financial matters including environmental concerns (eg, carbon dioxide emissions), social and employee concerns, human rights, and the fight against corruption. If no optional referendum is requested, these reporting and due diligence obligations must be observed for the first time with respect to the financial year commencing one year after the entry into effect of the new articles 964-bis et seq of the Swiss Code of Obligations. This will likely take place in the 2023 financial year.

In the 2021 spring session, the Swiss parliament adopted a revision of the Federal Cartel Act and the Federal Act against Unfair Competition as an indirect counter-proposal to the Stop the Isle of Expense initiative. This revision implements the so-called Fair Price Initiative, which aims to enable the purchase of products outside of Switzerland in potentially more favourable purchasing conditions. The revision establishes various new behavioural obligations for companies that are powerful relative to their market, prohibits discrimination while procuring goods and services abroad, and prohibits practices of geoblocking. Provided that no referendum is called, the revised provisions are expected to come into force in 2021 or at the beginning of 2022.

**Vincent Jäggi**

vincent.jaeggi@kellerhals-carrard.ch

**Maëva Mégane Jeanrenaud**

maeva.megane.jeanrenaud@kellerhals-carrard.ch

**Christophe Rapin**

christophe.rapin@kellerhals-carrard.ch

Effingerstrasse 1  
 P.O. Box  
 CH-3001 Berne  
 Tel: +41 58 200 35 00  
 Fax: +41 58 200 35 11  
 www.kellerhals-carrard.ch

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