

## Franchising - Switzerland

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### Franchise agreements – pre-contractual information requirements

Contributed by **BADERTSCHER Rechtsanwälte AG**

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#### Introduction

#### Pre-contractual information obligations

#### Comment

#### Introduction

The Swiss legal system generally imposes few statutory restrictions on parties to franchise agreements (for further details please see "[A guide to franchise standard form agreements](#)"). However, during negotiations before the conclusion of a new franchise agreement, franchisors usually have more extensive knowledge than franchisees about the strengths, weaknesses, opportunities and threats affecting their particular franchise. A franchisee thus risks entering into a permanent binding contract without an accurate prior assessment of related economic and legal consequences.

To counterbalance this information asymmetry, Swiss law imposes certain duties of care and consideration on a franchisor (and also a franchisee), of which the franchisor's pre-contractual information obligations are paramount.

#### Pre-contractual information obligations

One of the basic principles governing all areas of Swiss private and public law is the legal obligation to act in good faith (Article 2 of the Civil Code). In contract negotiation situations, both parties must negotiate with care and not lead a negotiating partner to act to its detriment before a binding agreement is concluded. As a result, each party must take into account all relevant circumstances of the particular business relationship at issue, with a view to discovering which pre-contractual disclosure obligations it has to its prospective contractual counterparty.

#### **Franchisor's pre-contractual information obligations**

In franchise negotiations, the franchisor must overcome the information asymmetry well ahead of the conclusion of the franchise agreement by informing prospective franchisees about all important economic and legal particularities affecting the franchise, to the extent that such particularities are relevant to franchisees' decision to enter into the franchise, but are not evident to the franchisees when consulting available public sources. All information revealed by the franchisor must be true, fair and complete. Negotiation efforts undertaken by the franchisor must be genuine and in good faith.

Unfortunately, published case law dealing with good faith and the information obligations of contracting parties does not specifically address franchise relationships. Soft law guidance can be found in the Ethics Code of the Swiss Franchise Association, with which all ordinary and associated members of the Swiss Franchise Association must comply.<sup>(1)</sup>

Pursuant to Section 3 of the Ethics Code, complete and specific information and documents for the franchisee must be disclosed in writing. The code is applicable between the franchisor and its franchisees and between master franchisees (as sub-franchisors) and sub-franchisees. However, it is not applicable between a (master) franchisor and a master franchisee.

As a result of the disclosure required under the code, the franchisee must be in a position to assess the financial, temporal and personal resources necessary to operate the franchise business in the franchise territory at issue. For the required extent of the pre-contractual disclosure, it also matters whether the franchisee has already undertaken a similar business independently before entering into the franchise negotiations or whether the franchisee otherwise acquired the relevant specific industry or business knowledge beforehand. At a minimum, the franchisor must always inform the franchisee in writing at least 20 days before signing the franchise agreement about the following topics:

- the relevant market in relation to the franchise business;
- the products and services covered by the franchise business;
- the franchisor's organisation and business activities, particularly in regard to the franchise system;
- the franchise offer (franchise package);

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Author

Jeannette Wibmer



- the potential franchisee obligations (especially an estimate of the necessary financial commitment);
- the franchise agreement and further agreements, guidelines and other terms relating to the franchising activity; and
- alternative distribution channels of the franchisor, if any, for contractual products or services.

This is not intended to be an exhaustive list. Rather, it is necessary to assess on a case-by-case basis, which information the franchisor must disclose in addition to the above before concluding a franchise agreement, taking into account all specific circumstances of the particular case.

#### **Franchisee's pre-contractual information obligations**

The franchisee is likewise subject to a pre-contractual information obligation covering all particularities relevant to the franchisor's decision to enter into the franchise agreement (eg, with regard to the franchisee's professional skills, experience and financial means).

#### **Consequences of breach**

If the franchisor or franchisee breaches the pre-contractual information obligations and the negotiating partner has been led to act to its detriment by concluding a franchise agreement which it would have avoided if fully and correctly informed by the contracting partner about all relevant issues beforehand, the damaged party is entitled to withdraw from and thereby terminate the franchise agreement.

The damaged party may also recover damages from the counterparty for all costs for contractual payments made under the franchise agreement, such as (in case of a damaged franchisee):

- investments made in the franchise business;
- lump-sum and milestone payments; and
- ongoing franchise fees forwarded to the franchisor.

All net profits made by the franchisee with the franchise business must be deducted from such amounts.

However, the franchisee may not argue that it has lost profits as a result of entering into a franchise agreement with one particular franchisor as opposed to another which would have been more profitable based on all circumstances of the particular case. In case of breach of the franchisee's pre-contractual information duty, a franchisor cannot argue that it has lost business by entering into a relationship with one franchisee as opposed to another.

#### **Comment**

A franchisor can avoid all liabilities for infringement of its pre-contractual information obligations in franchise negotiations by addressing all important information asymmetries between the franchisor and prospective franchisees well ahead of the conclusion of the franchise agreement, as well as by informing them about all important economic and legal particularities affecting the franchise. The Swiss Franchising Association's Ethics Code offers guidance on the minimum standard of the duty of care and consideration due under the principle of good faith, irrespective of whether the parties are members.

With a view to avoiding the situation where a potential franchisee later uses such disclosed information for its own business purposes outside the franchise system, it is paramount that a franchisor contractually binds a potential franchisee by a suitable confidentiality agreement before entering into franchise negotiations, ideally including further rights and obligations for these negotiations.

*For further information on this topic please contact [Jeannette Wibmer](mailto:wibmer@b-legal.ch) at BADERTSCHER Rechtsanwälte AG by telephone (+41 44 266 20 66) or email ([wibmer@b-legal.ch](mailto:wibmer@b-legal.ch)). The BADERTSCHER Rechtsanwälte AG website can be accessed at [www.b-legal.ch](http://www.b-legal.ch).*

#### **Endnotes**

(1) The Ethics Code is available at [www.franchiseverband.ch/Home/UBER-UNS/EHRENKODEX.aspx](http://www.franchiseverband.ch/Home/UBER-UNS/EHRENKODEX.aspx) (in German and French).

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