

Court Rules on Early Termination of Franchise Agreement

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February 10 2004

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Facts

The Swiss Federal Tribunal (4C.228/2000/rnd) recently had to make a determination with regards to a franchise contract in the context of an executive search. In the agreement in question, the parties had agreed on a fixed contract term of five years. After one year, the franchisee gave notice of early termination. The franchisor refused to accept this termination and sued the franchisee for the franchise fee due for the four years until the end of the agreed term.

The franchisee claimed that since franchise agreements are not explicitly dealt with under the Swiss Code of Obligations, they are subject to the rules governing the commercial mandate; the agreement in dispute could thus be terminated at any time. Moreover, the defendant claimed that he had reasonable cause to terminate the agreement before the expiration of the contract term.

Decision

The cantonal commercial court and the Swiss Federal Tribunal made the following statements with regard to termination of a franchise agreement and the consequences of early termination without reasonable cause.

Franchise agreement as continuous contract relationship

While the franchise agreement is not explicitly dealt with in Swiss legislation, it has developed into a clearly defined type of agreement both in practice and in legal commentary. The object of a franchising agreement is a long-term collaborative effort between the parties by means of a common organizational structure. It is in this way that the franchise agreement distinguishes itself from a regular mandate.

While a mandate can be terminated at any time under Swiss law, the franchise agreement is considered to establish a continuous contractual relationship. As a result, the parties may undertake to be bound for a fixed contract term of several years, and cannot avail themselves of the right to terminate at any time which would otherwise be applicable under mandate.

Early termination of contract with reasonable cause

Franchise agreements often specify a number of grounds which entitle one or both parties to terminate the agreement before the fixed term has expired.

In addition to these contractually agreed grounds for early termination, continuous contractual relationships such as the franchise agreement are always subject to the right of early termination in the event of reasonable cause. This right has been recognized in Swiss judicial practice and doctrine as a generally applicable principle of law.

Pursuant to this principle, a continuous contractual relationship may be terminated for reasonable cause where the facts justifying this move would destroy the underlying trust required in such a relationship, or at least undermine this trust to such extent that the parties could not reasonably be expected to continue in the relationship. Whether reasonable cause exists in a given case will depend on the individual circumstances, in particular the nature and gravity of the breach and the level of trust required between the parties.

Consequences of early termination without reasonable cause

Early termination of the franchise agreement without reasonable cause is to be considered as a refusal to perform and constitutes a flagrant breach of a contractual obligation (a so-called 'grave and anticipated breach of contract').

In Swiss legal commentary and judicial practice, anticipated breach of contract is considered to be a positive contractual violation. This entitles the other party to proceed in accordance with the rules governing debtor default.

Pursuant to these rules, the affected party has the following options:

- ② to sue for performance plus damages incurred due to the delay;
- ② to renounce the right to demand delayed performance and to sue for compensation of damages incurred due to non-performance, particularly on the grounds of lost profits; or
- ② to repudiate the contract while suing for reimbursement of its contribution, as well as compensation for any damages incurred as a result of entering into the agreement.

In this respect, it is important to ensure compliance with the relevant formal steps and to ensure that the requisite legal declarations are submitted on time.

In the case at hand the court found that the franchisee had unjustifiably terminated the franchise agreement four years before the expiration of the contract term. It ordered the franchisee to pay the franchisor the franchise fee, minus any savings the franchisor would make, for the outstanding contractual period.

Comment

The following conclusions may be drawn from this decision:

- ② The franchise agreement is a continuous contractual relationship;
- ② Before notice of early termination is given, it must be considered whether the necessary conditions have been fulfilled and the termination is therefore justified;
- ② Where the franchise agreement is unjustifiably terminated before the expiration of the contract term, different options will arise involving compensation claims for the affected contract party;

- ② The affected contract party should ensure it undertakes all the necessary formal steps in order to utilize the options afforded it by law; and
- ② Claims for damages due to unjustified early termination of the franchise agreement can be considerable.

For further information on this topic please contact Andreas M Dubler at Dubler Attorneys at Law by telephone (+41 1 396 86 86) or by fax (+41 1 396 86 96) or by email (dubler@dubler.ch).

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