

SEMPACHERSTRASSE 15
CH-8032 ZÜRICH
TEL. +41-(0)1-387 19 00
FAX +41-(0)1-381 45 23
www.lgpartner.ch
mailbox@lgpartner.ch

URS LUSTENBERGER, Dr. iur.
HANNES GLAUS, Dr. iur., LL.M.*
NIKOLA BELLOFATTO, lic. iur., M.B.L.-HSG
PETER JÜSTEL, lic. iur., CFE
MICHAEL KIKINIS, Dr. iur., Dipl. Chem.-Ing. ETH
*auch zugelassen/also admitted in New York

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“HOW TO NEGOTIATE A CROSS-BORDER BUSINESS DEAL”
(protect your client’s rights and avoid the pitfalls of pre-contractual liability in negotiations with a foreign counterpart)

General Reporters:

Nicole Van Crombrughe (Lafili, Van Crombrughe & Partners, Brussels)

Carlo Mastellone (Studio Legale Mastellone and Nomostudi, Florence and Milan)

lic. iur. Nikola Bellofatto M.B.L.-HSG for Switzerland

Questionnaire

On the basis of the questions below, please outline the general principles, if any, applicable to negotiations and to pre-contractual liability in your jurisdiction. Please review such principles with special regard to negotiations know-how assignment and license agreements.

1. What are the rights and duties of the parties during the negotiations (from preliminary contacts to negotiations) in particular as regards:

- good faith

Swiss law requires that negotiations of a contract must be conducted in good faith. According to Art. 2 (1) Swiss Federal Civil Code (CC) the contracting parties are bound by the principle of *bona fides*, which includes the duty of serious negotiations. As a consequence, *culpa in contrahendo* (detrimental reliance) to recover the damage may be invoked against the party that culpably violates the principle of *bona fides*. Yet, the parties are free to break off negotiations at any time without being liable for damages, even if the other party already had expenditure or entered into contracts with third parties. Only if one party never had the intention to complete a contract -

i.e. did not negotiate in good faith - it may be held liable for damages. Practically, liability claims based on culpa in contrahendo are rather seldom, mainly because of difficulties to prove a damage. Of course, the parties are free to exclude the *culpa in contrahendo* and explicitly state a right to break off negotiations at any time in a LOI or a similar agreement (comp. Item 3. below) together with an appropriate cost sharing arrangement.

- disclosure of information

The parties do not have to disclose information. Consequently, the decision to disclose is subject to the parties' estimate. However, according to the ruling of the *Swiss Federal Supreme Court* the parties have the duty to negotiate according to their true intention and to inform the other party to a certain extent about facts that could affect its conditions or the decision to complete the contract (*BGE 105 II 80*). Since there is no general rule about the extent of this duty, it has to be determined case by case based on the circumstances.

- co-operation

There is no explicit duty in Switzerland to co-operate during negotiations. However, one can argue that the principle of good faith (*Art. 2 (1) CC*) may require a certain extent of co-operation such as the duty to disclose information to a certain degree (*BGE 105 II 80*) and the provision of information and advice to the best of one's knowledge with regard to the possible closing of an agreement (*BGE 68 II 302*).

- confidentiality

In General:

The members of the board of directors as well as third parties engaged with the management shall carry out their duties with due care and must duly safeguard the interest of the company according to *Art. 717 Code of Obligations (CO)* (for corporations) and *Art. 827 CO in analogy* (for limited liability companies), which inter alia includes the duty of confidentiality. The provision does not generally prohibit to disclose information but a board member or manager in Switzerland will hardly start negotiations unless a confidentiality agreement and a LOI are concluded. Otherwise, the directors run the risk of being held personally liable for any damages caused by an intentional or negligent violation of their duties (*Art. 754 CO*).

Art. 47 of the Swiss Federal Banking Statute (BankG) prohibits any officer, employee, mandatory, liquidator, commissioner of a bank, representative of the Federal Banking Commission, officer or employee of a recognized auditing firm from disclosing a secrecy which includes all business and contractual relations between the bank and its customers, all information relating to the

financial situation of the customer as well as the customer's relationship with other banks and third persons. *Art. 43 of the Swiss Federal Stock Exchange Statute* subjects stock exchanges and security dealers to the same confidentiality obligation as *Art. 47 BankG*.

Certain groups of professionals (lawyers, auditors and doctors) are subject to statutory secrecy obligations (*Art. 321 Federal Penal Code; Art. 13 Federal Lawyer Statute*).

Finally, the *Federal Data Protection Statute* contains various provisions regarding the protection of individuals against misuse of personal data by private persons.

With regard to know-how assignment and license agreements:

There is no specific statute governing the rights in trade secrets and know-how and their protection, although at least industrial and commercial secrecy is a well-established legal concept. Therefore protection of trade secrets and know-how depends mainly on the holder's own protective measures, whether factual (non-divulgence) or contractual (through confidentiality or obligations not to compete).

It is common in Switzerland to include confidentiality clauses into a license agreement. With regard to the licensed subject such confidentiality is the basic of a license agreement. Even without an explicit agreement, the licensee may have certain contractual and pre-contractual duties regarding the licensed subject, such as the duty to inform the licensor about any infringement by third parties or to support the licensor in a lawsuit. Such duties derive from the principle of good faith (*Art. 2 (1) CC*) and the contractual duty of faithful performance. With regard to licensed know-how a licensee will always have the duty of confidentiality. Disclosure of a secret would not only infringe the duty of faithful performance but may also be an act of unfair competition according to *Art. 5(a) Federal Unfair Competition Statute*, which may have consequences in criminal law based on *Art. 23 Federal Unfair Competition Statute* or *Art. 162 Penal Code* respectively (see below).

Inducing employees, agents or other assistants to divulge their employer's or principal's industrial or commercial secrets is considered an act of unfair competition according to *Art. 4 (c) of the Federal Unfair Competition Statute*. Moreover, *Art. 6 of the Federal Unfair Competition Statute* makes exploiting or communicating a trade secret, which has been discovered in an illegal way, an act of unfair competition. In connection with the protection of performance, trade secrets might further be protected from unauthorized use under *Art. 5(a) and (b) of the Federal Unfair Competition Statute*, which

makes the unauthorized exploitation of the results of someone else's work (like drafts, calculations or plans) an act of unfair competition. In such cases the holder of the trade secrets may use the remedies offered by the *Federal Unfair Competition Statute*.

Some contractual relationships, such as employer – employee or principal – agent, contain a fiduciary duty to keep secret and not personally exploit the employer's or principal's trade secrets, even in the absence of an express contractual provision to this effect (*Art. 321a (4) CO and Art. 418d CO*).

Trade secrets may also be protected under certain criminal law provisions. This is most directly the case for *Art. 162* of the *Penal Code* that threatens with imprisonment or a fine any person who discloses an industrial or commercial secret which, pursuant to a statutory or contractual obligation, he or she should preserve. Persons taking or granting advantage of the disclosure are subject to the same punishment. If the specific conditions are fulfilled in a given case, trade secrets and know-how might further enjoy the protection of other provisions such as *Art. 273* of the *Penal Code* (on economic espionage) *Art. 179 et seq.* (on violation of secrecy or privacy), and *Art. 161* (on use of insider information).

2. - Are there special rules granting protection to specific categories of parties (such as consumers)?

If a party has been induced to enter into a contract by the willful deception of the other party, this may not only cause culpa in contrahendo but the contract can also be voided (*Art. 28 CO*, willful deception). Similarly, the conclusion of a contract under duress or coercion entitles the aggrieved party to void the contract (*Art. 29 CO*, duress). The same applies to contracts that are unconscionable or were concluded through one party's exploitation of the stress, inexperience or improvidence of the other (*Art. 21 CO*, overreaching). Finally, a person acting under material error at the conclusion of a contract is not bound by it (*Art. 23 CO*, error). The party, influenced by error, deception, duress or overreaching can declare within one year, that he or she is not bound by the contract and can demand restitution. Otherwise the contract is deemed to be ratified. However, ratification of such a contract does not itself bar a claim for damages (*Art. 31 CO*).

With regard to consumers, *Art. 97* of the *Swiss Federal Constitution (Const.)* states that the Confederation will take measures for the protection of the consumer. There are several federal statutes in Switzerland, which deal with some aspects of consumer protection (based on European Community directives) such as the *Federal Consumer Credit Statute*, the *Federal Data Protection Statute*, the *Federal Unfair Competition Statute*, the *Federal Statute*

on Commerce in Foodstuffs and in Various Other Necessities, the Federal Price Supervision Statute, the Federal Consumer Information Statute, the Federal Package Travel Statute as well as the Federal Product Liability Statute.

- Are there special rules applicable to negotiations between distant parties (for example: by telephone, fax, or through on the internet)?

Unless otherwise agreed by the parties or required by law, offer and acceptance are not required to be in a particular form. When an offer is made to a person not present without setting a time limit, the offeror shall remain bound until such time as he should reasonably expect receipt of a reply dispatched properly and in due time. The offeror may thereby presume that his offer arrived in due time. If the declaration of acceptance was dispatched in due time, but arrived with the offeror only after expiration of that time, as he should reasonably expect receipt of a reply dispatched properly and in due time, the offeror is bound unless he gives notice, without delay, of his intention not to be bound (*Art. 5 CO*). The way the parties communicate (by fax, email etc.) may therefore influence the time an offeror is bound by his offer. An offer by telephone is considered an offer among persons present and without the setting of a time limit, the offeror shall be deemed no longer to be bound if the offer is not accepted forthwith (*Art. 4 CO*). However, the above mentioned rules are applicable for those cases, in which a contract is concluded by offer and acceptance. Contracts that are developed step by step through negotiations cannot become split anymore into offer and acceptance. Therefore, once the parties have agreed with regard to all essential points, it is presumed that a reservation of ancillary points is not meant to affect the binding nature of the contract (*Art. 2 (1) CO*) (comp. Item 8. below).

According to *Art. 6* of the *Federal Data Protection Statute*, data may not be disclosed abroad if the personality of the person concerned were put at a serious risk following the disclosure because the country of destination lacks comparable data protection. In addition, anyone who regularly transmits, or who transmitted a considerable amount of personal data abroad, has to notify the Federal Commissioner of Data Protection unless he or she were fulfilling a legal obligation or the persons concerned had knowledge of the transfer.

For professionals that are subject to statutory secrecy obligations it is highly recommendable obtaining permission from their clients prior to the transmission of messages through the internet.

- Are there special rules applicable under the local law for the protection of privacy?

The *Federal Data Protection Statute* contains various provisions regarding the protection of individuals against misuse of personal data by private persons. The data protection is aimed at all information of an intimate nature about a person. As between private parties, data protection was originally based on *Art. 28 et seq. Code Civil (CC)*: Where anyone is injured in his person by an illegal act, he or she can apply to the judge for his or her protection from any person who takes an active part in effecting the injury. According to *Art. 27 CC* no person can wholly or partially renounce his capacity to have rights and to effect legal transactions. No person can alienate his personal liberty nor impose any restrictions on his own enjoyment thereof which are contrary to law and morality.

3. Which documents, if any, are generally used during the course of the negotiations?
The only document governed by the Code of Obligations is the preliminary contract according to *Art. 22 CO*. The necessity of such documents depends on the parties' wills and the circumstances.

- | | |
|--|---|
| - confidentiality agreement | <input checked="" type="checkbox"/> <input checked="" type="checkbox"/> <input checked="" type="checkbox"/> |
| - escrow account | <input checked="" type="checkbox"/> |
| - letter of intent | <input checked="" type="checkbox"/> <input checked="" type="checkbox"/> <input checked="" type="checkbox"/> |
| - memorandum of understanding/agreement | <input checked="" type="checkbox"/> <input checked="" type="checkbox"/> |
| - heads of agreement | <input checked="" type="checkbox"/> <input checked="" type="checkbox"/> |
| - instructions or authority to proceed | <input checked="" type="checkbox"/> |
| - comfort letter/lettre de patronage | <input checked="" type="checkbox"/> |
| - other: | |
| - binding preliminary contract
according to <i>Art. 22 Federal Code of Obligations (CO)</i> | <input checked="" type="checkbox"/> |
| - good faith payment | <input checked="" type="checkbox"/> |
| - cost compensation arrangements | <input checked="" type="checkbox"/> |
| - exclusivity agreements | <input checked="" type="checkbox"/> |
| - lock-out agreement | <input checked="" type="checkbox"/> |

4. What is the legal effect of expressions such as 'subject to agreement' or 'without prejudice'?

The phrase "subject to agreement" means that the parties are still in the process of negotiations and the contract will only be formed when the final written version is produced and not only agreed during oral negotiations. It is an example of use of *Art. 16 (1) CO* according to which it is deemed that the parties intend not to be bound when the application of a certain form has been reserved in a contract which by law is not subject to any form.

The phrase "without prejudice" is used in Switzerland in documents or discussions that relate to endeavors to settle a dispute between parties. As a consequence such document or discussion cannot be used in the course of subsequent court proceedings. However, if the parties are represented by lawyers, it is anyway prohibited to the lawyers by their ethics of the profession to use such documents or discussions to either party's prejudice in court.

5. Are there specific linguistic requirements as regards the drafting of contractual or pre-contractual documents?

There are no form requirements in Switzerland for license or know-how contracts. Of course, such agreements should in practice be in writing.

Regarding linguistic requirements one can argue that the principle of good faith requires the (tentative) translation of a contractual or pre-contractual document if the parties speak two different languages and/or if one party is not fluent in English.

6. May the parties be liable, and if so, to what extent, in case of:

- breach of a pre-contractual document?

If a party is in breach of a pre-contractual document it very much depends whether it was a binding or non-binding document.

If a party is in breach of a pre-contractual non-binding document it may be held liable for damages according to *culpa in contrahendo* only if it never had the intention to complete a contract, i.e. did not negotiate in good faith. Practically, liability claims based on *culpa in contrahendo* are rather seldom, mainly because of difficulties to prove the missing intention.

However, if the parties entered into a binding preliminary agreement according to Art. 22 CO each party can not only claim damages but also completion of contract, provided that the preliminary contract is sufficiently definite.

- unilateral interruption of negotiations?

The parties are free to break off negotiations at any time without being liable for damages, even if the other party already had expenditure or entered into contracts with third parties. Only if a party unilaterally interrupted negotiations because it never had the intention to complete a contract - i.e. did not negotiate in good faith - it may be held liable for damages according to *culpa in contrahendo*. Practically, liability claims based on *culpa in contrahendo* are rather seldom, mainly because of difficulties to prove the missing

intention. Consequently, it is recommendable that the parties determine their negotiation rights and duties in a LOI or similar document.

- What are the consequences of misrepresentation? Damages?

Misrepresentation may cause *culpa in contrahendo*. Furthermore the party that has been induced to enter into a contract by the misrepresentation of the other party may use the remedy of Art. 28 CO (willful deception).

- If yes, how are damages calculated?

Whoever claims damages in Switzerland must prove damage (Art. 42 CO). Under Swiss law, damage is the involuntary diminution of one's net worth such as actual loss and lost profits. However, the amount of damages awarded may not exceed the amount of the loss that the victim has actually suffered. Swiss law does not allow punitive damages, courts adopt a conservative approach and are not willing to follow the trend of some other countries towards very high awards.

If the exact amount of damages cannot be estimated, the judge shall assess them in his discretion, having regard to the ordinary course of events and the measures taken by the damaged parties (Art. 42 CO).

Finally, the judge shall determine the nature and amount of compensation for the damage sustained, taking into account the circumstances as well as the degree of fault (Art. 43 CO).

- Is pre-contractual liability (“*culpa in contrahendo*”) a “contractual” liability or liability “in tort”?

There are different opinions in Switzerland about the nature of *culpa in contrahendo* such as contractual liability (Art. 97 et seq. CO), liability in analogy to contractual liability, liability in tort (Art. 41 et seq. CO) or a liability of its own kind. According to the most convincing opinion, *culpa in contrahendo* is a liability of its own kind between tort and contract. On the one side, there is no contractual liability because the parties are not in a contractual relationship. On the other side, liability in tort leads to results which are unsatisfactory, especially because many *culpa in contrahendo* cases are not unlawfully and therefore not covered by Art. 41 CO. The above mentioned opinion gives rise to the question how this liability of its own kind is justified by law since *culpa in contrahendo* is not mentioned in the *Federal Code of Obligation*. One has to confess to a gap in the *Code of Obligations* that can become closed according to the rule of Art. 1 (2) CC which allows the judge to escape from tort law and, if necessary and appropriate, apply rules of contract law for *culpa in contrahendo*. Otherwise, if *culpa in contrahendo* is

supposed to be a liability in tort, *culpa in contrahendo* actually becomes superfluous.

- Does this classification affect the rules of evidence of damages suffered?

The classification does not affect the rules of evidence of damages suffered. According to Art. 99 (3) CO the rules of evidence of damages in tort are applicable in contract law too and therefore also for *culpa in contrahendo*. However, the classification affects the rules of evidence of fault/negligence. In application of the rules of contract law the party, who is accused to have caused damage, must prove that no fault at all is attributable to him (Art. 97 CO).

- Does pre-contractual liability arise also when a contract is concluded?

Pre-contractual liability may arise also when a contract is concluded. In addition, the party who suffered damage may use the remedies of Art. 21, 23, 28 and 29 CO (see Item 2. above). In Switzerland this question rather arose the other way round and the Swiss Federal Supreme Court ruled in BGE 77 II 137 that *culpa in contrahendo* does not require the closing of a contract.

- Does pre-contractual liability give rise also to an offence under local criminal law?

The pre-contractual liability itself does not give rise to an offence under local criminal law. Of course, the action of one party that breaks off negotiations may at the same time be a criminal offence under Swiss law.

7. May third parties be liable when involved in the violation of a pre-contractual document or the interruption of negotiations?

No. In Swiss doctrine the majority argues convincingly that in case of *culpa in contrahendo* the parties are also liable for auxiliary persons (such as an employee) (Art. 101 CO). Third parties who are not involved in negotiations may be held liable in tort only, provided they acted lawfully.

8. At what stage of the negotiations, if any, may the parties be considered as having concluded a valid and enforceable agreement?

If the parties have not agreed a fixed date for closing, Swiss law has two presumptions:

1. When the parties have agreed with regard to all essential points, it is presumed that a reservation of ancillary points is not meant to affect the binding nature of the contract (Art. 2 (1) CO).
2. When the application of a certain form has been reserved in a contract which by law is not subject to any form, it is deemed that the parties thereto intend not to be bound before such form requirement is met (Art. 16 (1) CO).

9. Are the principles of pre-contractual liability applicable to negotiations and dealings with Government and other public entities?

It depends. If the government performs its public duties, liability is governed under public law. Private law and therefore culpa in contrahendo is applicable only for businesses in which the government acts like a private party, provided that the government is allowed to do so by law (*BGE 120 II 321 ff.*).

10. Under your private international law rules, when are negotiations and pre-contractual liability governed by the laws of your jurisdiction?

Unless otherwise agreed by the parties and unless otherwise ruled in a Treaty, culpa in contrahendo is subject to Swiss law if negotiations are most closely connected with Switzerland (in analogy to Art. 117 Federal Statute on International Private Law).

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