International
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Outsourcing 2020

A practical cross-border insight into outsourcing law

Fifth Edition

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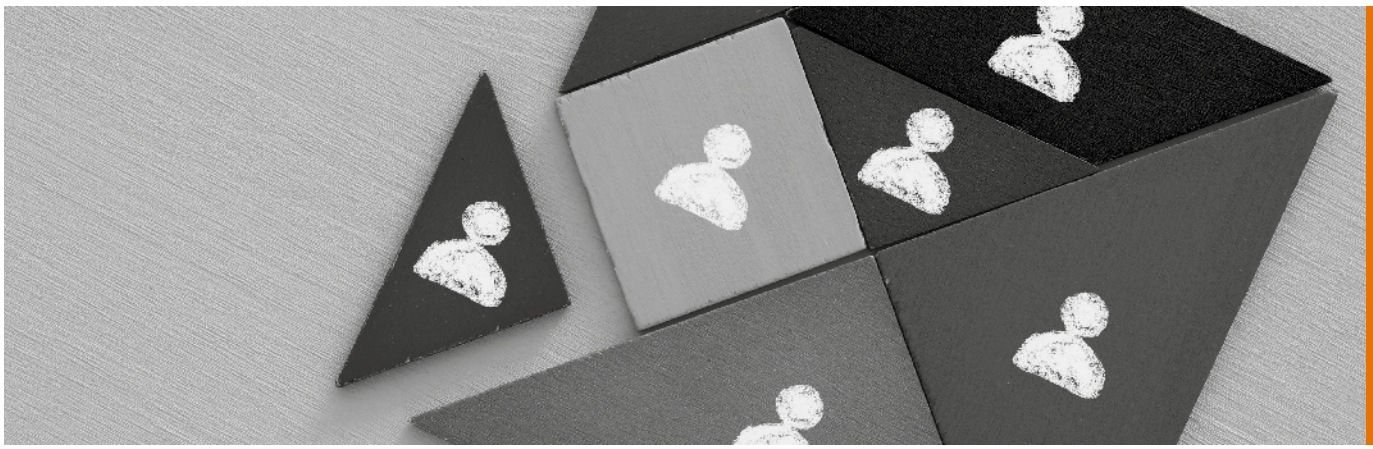

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1 Regulatory Framework

1.1 Are there any national laws or regulations that specifically regulate outsourcing transactions, either generally or in relation to particular types of outsourcing transactions (e.g. business process outsourcings, IT outsourcings, telecommunications outsourcings)?

No, Swiss law does not specifically regulate outsourcing transactions. Of course, mandatory statutory provisions must be adhered to that govern certain aspects of outsourcing transactions, such as employment law, data protection law and merger law.

Although business process outsourcing is not specifically regulated, the customer to an F&A BPO must comply with Swiss laws pertaining to annual reports, audit reports, storage of accounting records and supporting documents; such obligations need to be addressed in the outsourcing contract with the supplier.

There are no specific regulatory requirements applicable to the IT sector or the telecoms sector; however, telecoms providers are subject to telecoms regulations.

The healthcare sector is subject to extended secrecy obligations which render additional safeguards in outsourcing contracts necessary.

1.2 Are there any additional legal or regulatory requirements for outsourcing transactions undertaken by government or public sector bodies?

Outsourcing in the public sector is regulated on a federal and cantonal level by public procurement laws which provide for a mandatory competitive tender process if certain thresholds are met.

Switzerland is a signatory to the WTO Government Procurement Agreement and has entered into a bilateral agreement with the EU on certain aspects of government procurement.

1.3 Are there any additional legal or regulatory requirements for outsourcing transactions undertaken in particular industry sectors, such as for example the financial services sector?

The Swiss Financial Market Supervisory Authority FINMA has issued its revised Outsourcing Circular 2018/03, applicable as of 1 April 2018, which contains the regulatory requirements for outsourcing by banks, securities dealers as well as (new) insurance companies organised under Swiss law, including Swiss branches of foreign banks, securities dealers and insurers which are subject to FINMA supervision. The Outsourcing Circular 2018/03 contains provisions on the selection, instruction and control of suppliers, including a comprehensive audit right, as well as provisions to secure availability of data. The provisions on data protection contained in the previous FINMA outsourcing circular have been dropped to avoid inconsistencies with general data protection laws.

Article 47 of the Swiss Federal Banking Act protects customer-related data from disclosure to third parties and applies to all banking institutions in Switzerland (banking secrecy). An outsourcing agreement with a customer subject to banking secrecy must therefore contain the supplier's obligation to comply with the banking secrecy rules. Further, any disclosure of non-encrypted data to a supplier is only permitted with the express consent of each banking customer; such consent may be obtained based upon the bank's general terms of business applicable to the individual customer contract.

Notification requirements must be considered in connection with outsourcings by Swiss financial institutions.

1.4 Is there a requirement for an outsourcing transaction to be governed by local law? If it is not to be local law, is there any generally accepted norm relating to the choice of governing law?

No, there is no requirement for an outsourcing transaction to be governed by Swiss law; however, the norm is for the parties to choose the law applicable at the domicile of the customer. Irrespective of the choice of law, mandatory Swiss law overrides any contractual provision to the contrary (*lois d'application immediate*).

2 Legal Structure

2.1 What are the most common types of legal structure used for an outsourcing transaction?

Generally, the outsourcing relationship is based on a master services agreement between two independent companies. For global outsourcing transactions involving multiple group entities, the contractual structure is more complex: in a centralised contractual set up, the customer procures the supplier services on behalf of its group affiliates, whereas in a decentralised contractual set up, the customer affiliates procure services from the supplier directly as contractual parties.

Further, the customer and supplier may choose to set up a joint venture or enter into a contractual joint venture or partnership agreement. The customer may also establish an (offshore) captive entity.

3 Procurement Process

3.1 What is the most common type of procurement process that is used to select a supplier?

Most private companies issue a request for proposal (RFP) to selected suppliers. With an RFP, the customer is in the position to define key legal terms of the outsourcing agreement at an early stage and, upon assessing the submissions, select the supplier based upon the adherence to such legal terms in addition to the service quality and the commercial terms offered. Given a fully blown RFP process can be costly and time consuming, some companies choose to simply issue an invitation to tender or enter directly into negotiations with a preferred supplier based upon the customer's or supplier's standard contracts.

For public procurement, the processes set out in federal and cantonal public procurement laws need to be complied with. A direct award is only permitted in exceptional circumstances.

4 Term of an Outsourcing Agreement

4.1 Does national or local law impose any maximum or minimum term for an outsourcing contract?

No, there are no mandatory minimum or maximum terms for an outsourcing contract; the parties are free to determine the duration. Typically, outsourcing agreements have a fixed term of three to 10 years with automatic renewal unless terminated. In recent years we have seen a shift to shorter terms.

4.2 Does national or local law regulate the length of the notice period that is required to terminate an outsourcing contract?

No, there are no mandatory notice periods for outsourcing contracts. However, when negotiating a notice period, the customer should take into account the time it takes to insource or resource the services obtained by the supplier.

5 Charging

5.1 What are the most common charging methods used in outsourcing transactions?

The most common charging methods include cost-plus (the actual costs incurred by the supplier plus a pre-agreed profit margin), fixed pricing for regular and predictable volume and scope of services, or consumption/transaction-based charging.

5.2 What other key terms are used in relation to costs in outsourcing transactions?

The outsourcing agreement should provide for a mechanism for cost control and adequate adjustment of charges, including:

- charge variation mechanisms;
- change management procedures;
- service level credits or bonus/malus;
- measures to share cost savings between the parties and provide an incentive to the supplier to achieve these;
- auditing;
- benchmarking;
- disputed charges; and
- a pre-agreed inflation adjuster.

6 Transfer of Assets

6.1 What formalities are required to transfer, lease or license assets on an outsourcing transaction?

For the transfer, lease or license of assets, such as intellectual property, the written form is recommended. Further, it is strongly recommended to register transfers of trademarks and patents in the respective registries as soon as possible.

Only for the transfer of land does Swiss law prescribe a public deed (*cf.* question 6.2).

Third-party intellectual property must be taken into account as the relevant licence agreements may require the consent of such third party.

6.2 What are the formalities for the transfer of land?

Any transfer of land must be based on a written and notarised contract (public deed). In addition, the entry into the land register is generally constitutive for the transfer of land (exceptions apply for transfers according to the Swiss Merger Act). In addition, some transfers of land may be subject to further authorisations. Land acquisition in Switzerland by a non-Swiss resident may be subject to an authorisation by the competent cantonal authority unless certain exceptions apply, such as acquiring land for living or commercial real estate. Similarly, in order to transfer any contaminated site, an authorisation of the competent cantonal authority is required. The transfer of land within an outsourcing agreement is highly uncommon.

6.3 What post-completion matters must be attended to?

None, other than those under question 6.4.

6.4 How is the transfer registered?

Transfers of trademarks and patents can and should be entered into the respective registries administered by the Swiss Federal Institute of Intellectual Property.

The transfer of land must be entered into a cantonal land register, which is generally constitutive for the transfer (see also question 6.2 above).

7 Employment Law

7.1 When are employees transferred by operation of law?

Article 333 of the Swiss Code of Obligations (CO) stipulates that if the employer assigns its business or a business unit to an acquirer, the employment relationship of any employee affected automatically transfers to the acquirer unless the affected employee objects to such transfer. This also applies to mergers, splits or asset transfers in accordance with Article 27 of the Swiss Merger Act.

The previous employer is obliged to inform or consult with the employees' representatives or, if there is no representation, with the employees themselves in good time before the transfer takes place (Article 333a CO).

7.2 On what terms would a transfer by operation of law take place?

The employment agreements are automatically transferred to the acquirer on essentially all existing terms and conditions, including benefits granted under the employment agreement or based on a collective bargaining agreement, as well as accrued holiday entitlements. After the transfer, the acquirer can modify the employment terms (see question 7.5).

The former employer and the acquirer are jointly and severally liable for employee's claims which (i) are due prior to the transfer, or (ii) will become due up to the date the employment relationship can effectively be terminated or until its actual termination based on the employee's objection to the transfer.

7.3 What employee information should the parties provide to each other?

There is no statutory rule on what information must be exchanged by the parties to an outsourcing agreement. Prior to the transfer date, the data on employees disclosed to the acquirer must be limited to a "need to know" basis and should be anonymised to the extent possible. Information may include details on employment terms and conditions, function, seniority level, salary and notice period.

Upon transfer, the acquirer must be provided with all necessary information for the performance of the employment agreements in order for the acquirer to fulfil its obligations as employer.

7.4 Is a customer/supplier allowed to dismiss an employee for a reason connected to the outsourcing?

As a rule, such termination would contravene Article 333 CO. However, if the respective notice period is observed, the employment agreement may be terminated after or even prior to the transfer.

7.5 Is a supplier allowed to harmonise the employment terms of a transferring employee with those of its existing workforce?

Yes, after the transfer, the new employer may modify the employment terms of the transferring employee subject to the employee's consent and provided that the modification pertains to non-material aspects only.

The acquirer may also terminate the employment agreements and offer new agreements on changed terms of employment (constructive dismissal). The new terms can enter into force only once the contractual notice periods have expired.

7.6 Are there any pensions considerations?

When employees are transferred under Article 333 CO, the employees' vested benefits under the former employer's pension scheme are transferred to the acquirer's pension scheme. After the transfer, the employees' pension benefits are calculated according to the new scheme's regulations.

If the workforce that forms part of the former employer's pension scheme reduces substantially, the respective pension scheme must be partially liquidated. The employees then have individual or collective claims to a portion of the non-committed funds (free reserves) in addition to their ordinary claims to the vested benefit.

7.7 Are there any offshore outsourcing considerations?

If the outsourcing agreement entails the transfer of business offshore, the parties need to assess whether the employment contracts of the affected employees actually transfer by operation of law given Article 333 CO only applies if the business concerned preserves its identity post-transfer.

8 Data Protection Issues and Information Security

8.1 What are the most material legal or regulatory requirements and issues concerning data security and data protection that may arise on an outsourcing transaction?

Given Switzerland is not a member of the EU, the General Data Protection Regulation (GDPR) – as a rule – does not apply in Switzerland. However, the GDPR may apply to Swiss companies for the processing of personal data under Article 3 GDPR as well as in multijurisdictional outsourcings. Where the GDPR applies to the controller and the outsourced service involves data processing, a data processing agreement in compliance with Article 28 GDPR must be included in the outsourcing agreement. Such data processing agreement shall also include the technical and organisational data security measures implemented by the supplier.

The Federal Data Protection Act is currently being revised. The draft for the revised DPA was published in September 2017 and is, at the time of writing, still subject to parliamentary debate. In order to remain compliant with the Schengen *acquis*, the revision process was split and the transitional Schengen Data Protection Act (SDPA) entered into force on 1 March 2019. Provisions similar to the GDPR pertaining to data processing as well as the transfer of data to countries without an adequate level of data protection will be implemented in the second part of the revision process – in particular in view of maintaining the EU adequacy decision for Switzerland, which, at the time of writing, has yet to be taken. However, to date it remains unclear when the revision will be completed. It is expected to enter into force in 2021.

In addition, industry sector-specific regulatory requirements governing data security and data protection matters may apply.

Under the current Federal Data Protection Act, the following requirements for outsourcing transactions apply:

- the parties should conclude a written processing agreement, in particular as this will be mandatory under the revised Federal Data Protection Act;
- personal data may only be processed by the supplier in accordance with the purpose defined and within the limits of the processing permitted to the customer itself and pursuant to the instructions of the customer;
- the processing of personal data must not be prohibited by a statutory or contractual duty of confidentiality; and
- the customer shall ensure that the supplier provides for data security in accordance with the requirements of the Ordinance to the Federal Act on Data Protection by implementing adequate technical and organisational measures, taking into account the purpose as well as the nature and extent of the processing, an assessment of the possible risks to the data subjects and the current state of the art. The technical and organisational measures shall ensure confidentiality, availability and integrity of data by protecting data from unauthorised or accidental destruction, accidental loss, technical faults, forgery, theft or unlawful use, unauthorised alteration, copying, access or other unauthorised processing.

For cases of cross-border outsourcing, the Swiss Federal Data Protection and Information Commissioner provides a sample Swiss Transborder Data Flow Agreement, which allows data processors to comply with the requirements stipulated in the Federal Data Protection Act regarding cross-border data transfers.

As the customer remains liable towards the data subject for the compliant handling of personal data by the supplier, and reflecting the growing importance of data protection, there is a tendency to not apply a liability cap for breaches of data protection or other regulatory requirements in outsourcing agreements.

In May 2020, the Swiss Financial Market Supervisory Authority (FINMA) published a supervisory notice on the obligation to report cyber attacks for banks, insurance companies and other institutions under its supervision. FINMA stipulates that relevant cyber attacks must be reported within 72 hours of the incident being discovered. The revised Federal Data Protection Act will introduce such a reporting obligation applicable to all data controllers. For FINMA-supervised institutions, this entails that both the supervisory reporting obligation and the data protection reporting obligation will need to be adhered to.

8.2 Are there independent legal and/or regulatory requirements concerning information security?

The Swiss government issued the National Strategy for the Protection of Switzerland against Cyber Risks (NCS) 2018–2022 which contains measures to safeguard Switzerland's independence and security and to protect it from cyber threats. The strategy paper offers few specific instructions for action as, ultimately, the individual players are and remain responsible for their own protection. Further, no specific statutes have been enacted so far that go beyond the general obligations pursuant to the Swiss Federal Data Protection Act to implement appropriate technical and organisational measures to ensure data security when processing personal data. The draft Information Security Act that shall apply to the Swiss Federal government has yet to be enacted (at the time of writing, the discussions in the Swiss Parliament are ongoing). Information Security is left to the responsibility of the private sector within self-regulatory regimes and certifications such as ISO. Guidelines and checklists have been issued by various organisations, such as the "Information Security Checklist for SMEs" by the Reporting and Analysis Centre for Information Assurance MELANI (May 2018) or the Cloud Guidelines of the Swiss Bankers Association, a guide to secure cloud banking (March 2019). To boost activities in the area of cyber-risk awareness, on 30 January 2019 the Federal Council decided to set up a competence centre for cybersecurity, the National Cyber Security Centre, as a first point of contact for questions on cybersecurity.

9 Tax Issues

9.1 What are the tax issues on transferring the outsourced business – either on entering into or terminating the contract?

The transfer of assets may trigger corporate income taxes, real estate transfer tax, federal securities transfer tax, and VAT.

Intragroup outsourcing must be at arm's length and in line with general transfer pricing principles.

The termination of contracts without adequate compensation and/or a notice period may give rise to taxation of a constructive dividend/profit shift. According to prevailing doctrine, the mere shift of functions should not be taxed.

9.2 Is there any VAT leakage on the supply of services under the outsourcing contract?

Pursuant to Swiss law, every transfer of assets to the supplier constitutes a supply of goods or services and is, in principle, subject to VAT. If transferred assets are part of a transferred business entity, VAT must be notified.

Intragroup outsourcing may result in a VAT leakage, which can be neutralised by group taxation.

9.3 What other tax issues may arise?

For multijurisdictional outsourcings, it is recommended to consider holistic tax planning in order to avoid double taxation, to reduce source income taxes and, for intragroup outsourcings, identify tax optimising measures.

10 Service Levels

10.1 What is the usual approach with regard to service levels and service credits?

The definition of Service Levels and Service Credits depends entirely on the outsourcing transaction and differs considerably depending on whether the outsourcing pertains to IT services, business processes, facility management, etc.

In the Statement of Work, the parties define the services to be provided and the service levels, as well as the service criteria by which performance can be measured (key performance indicators). This entails detailed reporting and monitoring. In the event that the supplier does not achieve the agreed upon service levels, a (relatively small) amount is deducted from the service fees payable to the supplier as a service credit. Service credits for a specific time period are usually capped at an at-risk amount in the range of 5% and 15% of the fees due in that particular time period.

The service credits shall incentivise the supplier to consistently achieve the agreed service levels and to facilitate a partial compensation of the customer for poor service without the need to pursue a claim for damages or terminate the agreement.

Service credits are typically the sole remedy of the customer for the particular failure concerned, however, without prejudice to the customer's more extensive rights in relation to more serious contract breaches or persistent performance failures, *cf.* section 11.

11 Customer Remedies

11.1 What remedies are available to the customer under general law if the supplier breaches the contract?

Swiss law does not contain specific statutory provisions governing the outsourcing agreement and contract breach. Moreover, outsourcing agreements contain elements of the statutory provisions relating to contracts for work and services, to sales contracts and to corporations. Consequently, the applicable statutory provisions and corresponding remedies are highly dependent on what contractual obligations of the outsourcing agreement have been breached. Given the statutory provisions are not mandatory, the parties are free to determine remedies in the outsourcing agreement, such as:

- remediation of defects within determined time limits, including e.g. replacement of hardware;

- monetary compensation for damages, including liquidated damages;
- reduction of outsourcing fees;
- step-in rights; and
- termination or rescission of the outsourcing agreement.

11.2 What additional protections could be included in the contract documentation to protect the customer?

Additional protection measures may include:
- regular charge or a service provision review mechanism;
- contract change management; and
- audit and benchmarking.

11.3 What are the typical warranties and/or indemnities that are included in an outsourcing contract?

The parties are free to choose the warranties and/or indemnities best suited to their needs and the type of outsourcing transaction.

Typical warranties and/or indemnities in outsourcing agreements include:
- warranties for hardware and software;
- warranties for the diligent performance of the services with reasonable skill and care, in a timely and professional manner and in accordance with applicable laws and recognised industry standards;
- warranties regarding information provided during the tender phase and due diligence;
- indemnities for the infringement of third-party intellectual property rights;
- warranties to be entitled to enter into the outsourcing agreement; and
- indemnities with regards to claims put forward by affected employees transferred to the supplier.

12 Insurance

12.1 What types of insurance should be considered in order to cover the risks involved in an outsourcing transaction?

It is recommended that both parties to an outsourcing have sufficient personal liability and property insurance, professional liability insurance, corporate liability insurance, directors' and officers' liability insurance and legal protection insurance in place.

Further, contingent business interruption insurance and cybersecurity insurance have become more widely available in Switzerland.

In the past decade, there has been a shift from the mere assumption that an outsourcing supplier has the requisite insurance coverage in place to explicit contractual obligations to obtain adequate insurance policies and provide the customers with copies thereof.

13 Termination

13.1 How can a party to an outsourcing agreement terminate the agreement without giving rise to a claim for damages from the terminated party?

Given that Swiss law does not provide for specific termination provisions as regards outsourcing, the parties typically agree on termination for cause and termination for convenience, including the applicable notice periods. In particular, as regards termination for material breach, it is recommended that scenarios that constitute such material breach are specifically agreed on and respective contractual obligations are spelt out. If a party adheres to the contractually stipulated termination provisions, claims for damages from the terminated party should not arise. However, this does not necessarily preclude direct discussions on whether a breach may be deemed material or not.

13.2 Can the parties exclude or agree additional termination rights?

Yes, the parties are free to exclude or agree upon additional termination rights such as insolvency events, change of control, multiple/persistent minor breaches.

13.3 Are there any mandatory local laws that might override the termination rights that one might expect to see in an outsourcing contract?

Pursuant to Swiss law, any long-term agreement can be terminated with immediate effect for important reasons that render it unreasonable for the aggrieved party to uphold the agreement.

14 Intellectual Property

14.1 How are the intellectual property rights of each party protected in an outsourcing transaction?

Typically, the parties agree on the rights to use pre-existing IP and the allocation of rights in materials developed in the context of the outsourcing agreement ("work products"). Further, depending on the transaction, the transfer of ownership in IP or the assignment of licences may be agreed upon. It is advisable to specifically detail any and all IP rights in the outsourcing agreement in order to avoid difficult termination negotiations.

14.2 Are know-how, trade secrets and other business critical confidential information protected by local law?

The Federal Act Against Unfair Competition and the Criminal Code provide for penalties for the breach of trade secrets and the exploitation of such secrets.

It is recommended to protect know-how, trade secrets and other business critical confidential information by including extensive confidentiality clauses in the outsourcing agreement that provides for penalties to be paid in the event of breach. Note that the EU Directive 2016/943 of 8 June 2016 on the protection of undisclosed know-how and business information (trade secrets) against their unlawful acquisition, use and disclosure does not apply in Switzerland.

14.3 Are there any implied rights for the supplier to continue to use licensed IP rights post-termination and can these be excluded from the agreement?

No, there are no such implied rights. Accordingly, the outsourcing agreement should explicitly address the use of any IP rights post-termination.

14.4 To what extent can the customer gain access to the supplier's know-how post-termination and what use can it make of it?

It is highly recommended to agree on specific obligations of the incumbent supplier post-termination to ensure know-how transfer to the customer or new supplier and to oblige the incumbent supplier to assist in the smooth transfer of the services to the customer or new supplier. Of course, the incumbent supplier typically cannot be forced to share confidential business information with a competitor.

15 Liability

15.1 To what extent can a party limit or exclude liability under national law?

Pursuant to Swiss law, the parties cannot exclude or limit liability for damages caused by intent or gross negligence. Further, it is not possible to exclude or limit liability for death or personal injury resulting from a negligent breach of contract.

Typically, the supplier aims to extensively exclude liability for indirect and consequential loss or damages, for loss of business, profit or revenue. By contrast, the customer typically aims to have such damages contractually deemed as direct damages.

15.2 Are the parties free to agree a financial cap on liability?

Yes, the parties may agree on a financial limit on liability and indemnities, subject to the limitations set out in question 15.1. The cap can be a fixed amount or a percentage of the contract value.

16 Dispute Resolution

16.1 What are the main methods of dispute resolution used?

There are no main methods for dispute resolution used in Switzerland and there are no statutory rules on contract management, governance and escalation in Swiss contract law. Thus, it is recommended that detailed provisions are included in the outsourcing agreement governing a dispute resolution process before a party can resort to a court or arbitration. Any dispute resolution process must, however, be limited to a resolution time period to ensure expedited resolution.

Further, an outsourcing agreement may include provisions on alternative dispute resolution (ADR).

17 Good Faith

17.1 Is there any overriding requirement for a customer and supplier to act in good faith and to act fairly according to some objective test of fairness or reasonableness under general law?

Yes, Swiss law stipulates the general principle that parties must act in good faith (Article 2 of the Swiss Civil Code) and courts tend to remind disputing parties of their obligation to act in good faith in business transactions.

Martina Arioli has been listed by *Chambers Europe* for TMT in 2020 and 2019 and recognised as one of Switzerland's leading business lawyers since 2016 by *Who's Who Legal*. She has been selected as Thought Leader Data in Switzerland for 2020 and 2019 and won the Client Choice Award Data Switzerland 2020.
Martina is an experienced legal counsel, with almost 20 years of international practice, specialised in IT law and outsourcing. She has supported outsourcing engagements in all stages, from contract drafting, negotiating global and local agreements to implementation and transition, conflict mediation, termination and resourcing to new suppliers. Martina combines in-depth knowledge on complex contractual matters in outsourcing and information technology projects with the experience of implementing such global projects as in-house lawyer. Previous positions include senior roles at Zurich Insurance Company and UBS AG, as well as the law firm Walder Wyss Ltd.
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Arioli Law is a boutique law firm established 2013 in the heart of Zurich, one of the first to specialise in outsourcing, IT law, data protection law and entertainment law.
The renowned Swiss business magazine *BILANZ* has consistently ranked Arioli Law amongst Switzerland's 10 top law firms in TMT and IP law. Arioli Law is listed as "highly recommended" in the ranking of *Leaders League for Technologies, Internet & Telecommunications* – IT & Outsourcing 2019.

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