

## Impermissible Profits from subleasing Business Apartments



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**In Switzerland, lessees (especially relocation companies) have discovered the business of subleasing business apartments. They rent an apartment, furnish it and make additional services available. Thereafter, the apartment is subleased for two to three times the original rent. This is legally problematic.**

### Definitions

This NewsLetter examines the emerging legal treatment of the subleasing of rental apartments as business apartments. This involves a lessee (e.g. a relocation company) who rents an apartment for a specified rent ("*Base Rent*") and usually furnishes it with furniture and technical infrastructure (internet, television, telephone) and who often makes additional services available (housekeeping and administrative services, etc.) with the intention of ultimately subleasing the apartment as a so-called business apartment for a rent ("*Sublease Rent*") which is greater than the Base Rent.

### Subleasing in general

Subject to limitations on the abusive assertion of legal rights, a lessee is able to sublease the property he has subleased, in full or in part, to a third party (Art. 262 sect. 1 Swiss Code of Obligations ["CO"]). The legal prerequisites for a sublease are (i) that the lessee seeks the approval of the lessor when the apartment leased to him is to be subleased or, if already subleased, the contractual terms are to be changed significantly and (ii) that the lessor does not assert one of the reasons recognised by Art. 262 sect. 2 CO for refusing to give his approval:

- lit. a: the refusal of the lessee to disclose the terms of the sublease;
- lit. b: abusive sublease terms (e.g., impermissible profits, the imposition of a special commission when the agreement is made or greater restrictions for the sublessee on the use of the property compared to those in the primary lease agreement); and
- lit. c: the creation of significant disadvantages for the lessor (e.g., a use inconsistent with the use permitted for the property under the primary lease agreement).

### Abusive sublease terms

The justification for withholding consent under lit. b is probably the most relevant to a sublease agreement for a business apartment because it should in particular prevent impermissible subleasing profits from an abusive Sublease Rent.

A Sublease Rent is considered abusive if it is in excess of the Base Rent and there is no justification for the difference. Additional services provided by the lessee may justify such a difference. For example, leaving fixtures in the apartment, cleaning the premises etc. fall into this category. If compensation for such items is deducted from the Sublease Rent, then what remains is the net Sublease Rent. The cost of additional services may not be so high that a reasonable counterparty would find them objectionable in relation to the actual service provided by the lessee. The Swiss Federal Court without specifically addressing the issue did not, for example, object to compensation for high quality furniture in the amount of 20% of the net Sublease Rent (decision of the Swiss Federal Court 119 III 353); and in this regard, the scholarly opinions hold that it should be possible to justify such compensation on the basis of the acquisition costs, the amortisation period, an interest rate of 5% and a risk surcharge.

It is disputed whether a lessee in a sublease transaction may earn a profit. Although for some authors, earning a profit should be completely prohibited, others hold that a net Sublease Rent, which is not significantly greater than the Base Rent, is permissible. According to these authors this is the case if the profit is 3% of the Base Rent, provided that it does not exceed the amount of CHF 100 per month. Other authors find abuse exists in the case of a profit of 50%. The Swiss Federal Court, in the above-mentioned decision, had noted that a sublease should

fundamentally not have a profit-making character and stated that a profit of 30-40% is *obviously* abusive. In certain cantonal court decisions even profits of 9.38% or 14% were considered to be abusive.

### Consequences of abusive sublease conditions for the lessor

If the terms of the sublease are abusive, the lessor may refuse to approve the sublease. Another option, according to a minority of the scholarly opinions, is that after the disclosure of the terms of the sublease, the lessor increases the Base Rent to the level of the net Sublease Rent.

If a sublease is made despite either the justified refusal of the lessor to approve the sublease or in the absence of the approval of the lessor when reasons to refuse approval exist, the lessee takes the risk of an exceptional termination under Art. 257f sect. 3 CO, as well as the appropriation of the resulting profits by the lessor (but not, however, by the sublessee) in accordance with Art. 423 CO.

### Consequences of abusive sublease conditions for the sublessee

It is not uncommon that a lessor, despite the existence of abusive sublease terms, will grant its approval, especially if, for example, it can lease the apartment on a long-term basis to a relocation company. With the lessor's approval, the sublease agreement becomes enforceable and the profits from the abusive Sublease Rent flow into the coffers of the lessee or, as described above, the lessor. This raises the question of what action a sublessee can take.

Generally, all the provisions of the landlord-tenant law under Art. 253 et seq. CO apply to the sublease agreement. This means that the initial Sublease Rent can be challenged under Art. 270 CO within 30 days after the sublessee takes possession of the apartment. Thereafter, the initial Sublease Rent cannot be challenged unless there was a form obligation (*Formularspflicht*) under Art. 270 sect. 2 CO, together with Art. 269d CO, and the Sublease Rent was established without the required form. In this case, the sublessee can, at any time, assert the partial or complete invalidity of the Sublease Rent and require the judicial determination of the Sublease Rent. At this time, there is a form obligation only in the cantons of Fribourg, Geneva, Neuchatel, Nidwalden, Vaud and Zug.

If a challenge to the initial Sublease Rent is no longer possible, then the sublessee may consider an approach based on the partial invalidity of the sublease agree-

ment (in respect of the Sublease Rent) on the basis of fundamental mistake (Art. 24 sect. 1 ciph. 4 CO). The sublessee must show, within one year of becoming aware of the mistake, that he would not have entered into the sublease if he had known the fundamental terms of the transaction, specifically the amount of the Base Rent.

It is theoretically possible, in exceptional cases, to sue on the basis of Art. 41 CO if the elements of usury (*Wucher*) are fulfilled or if the lessor either fraudulently or incorrectly and misleadingly provided information to the sublessee about the amount of the Base Rent.

### Summary

In a nutshell, the profit-making opportunities from subleasing business apartments are substantially restricted by Swiss law. The most effective instrument against impermissible profits from subleasing is the right of the lessor to withhold its consent and, depending on the circumstances, combined with the appropriation of profits under Art. 423 CO. If the sublessee wants to take action against an impermissible profit on the Sublease Rent he has paid, then he can challenge the initial rent under Art. 270 CO. If the time period for this challenge has lapsed, then, in the absence of a fundamental mistake or liability based on impermissible conduct, he must accept the Sublease Rent or terminate the contractual relationship in accordance with its terms.

The ww&p NewsLetter provides comments on new developments and significant issues of Swiss law. These comments are not intended to provide legal advice. Before taking action or relying on the comments and the information given, addressees of this NewsLetter should seek specific advice on the matters which concern them.

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