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Hungarian Legal Reform for the Private Sector

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HUNGARIAN LEGAL REFORM FOR THE PRIVATE SECTOR*

CHERYL W. GRAY**
REBECCA J. HANSON***
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I. INTRODUCTION¹

Hungary is in the midst of a fundamental transformation toward a market economy. Although Hungary has long been in the forefront of efforts to reform socialism itself, after 1989 the goals of reform moved from market socialism toward capitalism,

1. While the authors of this Article have attempted to provide the most complete and current references to the legal provisions discussed herein, due to the nature of the subject much of the information was collected through personal interviews. Those interviews are noted wherever possible. The absence of extensive references in a particular section should thus be attributed to the unavailability of documentation.

as the old Communist regime lost power and the idea of widespread private ownership gained acceptance. The legal framework—the “rules of the game”—is now being geared toward encouraging, protecting, and rewarding entrepreneurs in the private sector.

This Article describes the evolving legal framework in Hungary in several areas: constitutional, real property, intellectual property, company, foreign investment, contract, bankruptcy, and antimonopoly law.² These areas of law serve to define: (1) property rights; (2) the means to exchange these rights; and (3) the rules for competitive market behavior. Together they form the bedrock of a legal system for a market economy.³ This Article then addresses the capacity of Hungary's current legal institutions to implement the new legal reforms. As in the other countries of Central and Eastern Europe (CEE), defining real property rights and creating the conditions for free and fair competition are perhaps the most contentious and confused areas in the current legal landscape, largely because they tread so heavily on existing vested interests. Other areas of law, including intellectual property, company, foreign investment, and contract law, are less problematic.

2. This Article is part of a larger research project sponsored by the Policy Research Department and the Legal Department of the World Bank to study evolving legal frameworks in Eastern Europe. Other studies include: CHERYL W. GRAY ET AL., *EVOLVING LEGAL FRAMEWORKS FOR PRIVATE SECTOR DEVELOPMENT IN CENTRAL AND EASTERN EUROPE* (World Bank Policy Research Working Paper Series No. WPS209, July 1993); Cheryl W. Gray, *The Legal Framework for Private Sector Activity in the Czech Republic*, 26 VAND. J. TRANSNAT'L L. (forthcoming Summer 1993) [hereinafter Gray, *Czech Republic*]; Cheryl W. Gray & Peter Ianachkov, *Bulgaria's Evolving Legal Framework for Private Sector Development*, 27 INT'L LAW. (forthcoming Winter 1993); Cheryl W. Gray & Franjo D. Stiblar, *The Evolving Legal Framework for Private Sector Activity in Slovenia*, 14 U. PA. J. INT'L BUS. L. (forthcoming Spring 1993); Cheryl W. Gray et al., *The Legal Framework for Private Sector Development in a Transitional Economy: The Case of Poland*, 22 GA. J. INT'L & COMP. L. 283 (1992) [hereinafter Gray et al., *Poland*]; Cheryl W. Gray et al., *Romania's Evolving Legal Framework for Private Sector Development*, 7 AM. U. J. INT'L L. & POL'Y 617 (1992) [hereinafter Gray et al., *Romania*].

3. This Article does not discuss certain other areas of law that are also important to the private sector, such as privatization, banking, taxation, and labor law. Although a critical area of reform, privatization is a transitional issue; this Article seeks to address the long-term legal structure. The other areas of law are omitted due to space limitations as well as likely coverage in future World Bank or external studies.

II. CONSTITUTIONAL LAW⁴

No written constitution existed in Hungary before 1949.⁵ Rather, similar to the tradition in England, constitutional principles were derived from various pieces of legislation.⁶ In Act XX of 1949,⁷ the People's Republic of Hungary adopted a constitution based in part on the Soviet model.⁸ Under this Constitution, the Hungarian economy was based on the concept of social ownership of the means of production, a vague notion akin to, but not identical to, state ownership.⁹ The 1949 Constitution also established the primacy of the national economic plan in guiding the economy.¹⁰ Not only did state planning control the economy in this and other socialist countries, but, by virtue of appearing in the fundamental law,¹¹ it governed the entire legal culture of the country as well.

In 1972, the Constitution underwent extensive amendment to accommodate the New Economic Mechanism of 1968.¹² For

4. The various versions of the Hungarian Constitution are interrelated and complex. For a brief and comprehensible overview of these amendments, see Gisbert H. Flanz, *Hungary*, in *CONSTITUTIONS OF THE COUNTRIES OF THE WORLD* v, v-viii (Albert P. Blaustein & Gisbert H. Flanz eds. & Marta Kiszely trans., 1990); Gabor Hamza, *The Republic of Hungary Commentary (1976-1990)*, in *CONSTITUTIONS OF THE COUNTRIES OF THE WORLD* ix, ix-x (Albert P. Blaustein & Gisbert H. Flanz eds. & Marta Kiszely trans., 1990).

5. See István Kovcs, *Hungary*, in *1 INTERNATIONAL ENCYCLOPEDIA OF COMPARATIVE LAW* H-13, H-18 to H-19 (Viktor Knapp ed., 1978).

6. See *id.* (collecting major acts from 1222 to 1949).

7. This Act is actually the Hungarian Constitution. See *A MAGYAR KÖZTARSASG ALKOTMNY* [1949 Constitution] (Hungary), translated in *CONSTITUTIONS OF THE COUNTRIES OF THE WORLD* (Albert P. Blaustein & Gisbert H. Flanz eds. & Marta Kiszely trans., 1990). The Constitution was subsequently amended several times for various reasons. However, instead of adopting an entirely new Constitution, Parliament chose to use legislative amendments instead. See Hamza, *supra* note 4, at ix. The substance of these amendments is not critical to the analysis in this Article.

8. See *A MAGYAR KÖZTARSASG ALKOTMNY* [1957 Constitution] pmbl. (Hungary), translated in *3 CONSTITUTIONS OF NATIONS* 432 (Amos J. Peaslee ed., 1968).

9. *Id.* § II, art. 6. The 1957 Constitution states that many public resources, such as forests and mines, as well as many services, such as telephones and banks, "are the property of the state and of public bodies as trustees for the whole people." *Id.* (emphasis added).

10. *Id.* § II, art. 5. "The economic life of the Hungarian People's Republic is determined by a state national-economic plan." *Id.*

11. *Id.* § XI, art. 71(1).

12. See Hamza, *supra* note 4, at ix. The New Economic Mechanism was Hungary's first major attempt at economic reform. It maintained national planning but ended the practice of imposing production targets on state-owned enterprises. Rather, a system of economic regulations and incentives—taxes, prices, and credit policy—was designed to induce firms to meet national planning targets. This experiment was popularly known as goulash communism. Most of the lessons of that period, however, were negative, as

example, the Constitution for the first time recognized and protected the economic activities of small-scale private producers of commodities,¹³ as well as private property.¹⁴ Protection of the latter, however, always had been balanced against the needs of the public interest,¹⁵ which in practice left great discretion to the state in regulating both state-owned and private business.

On October 18, 1989, the Hungarian Parliament passed the most significant constitutional revisions to date. This amendment is often referred to as the "new" Hungarian Constitution, since approximately eighty percent of the 1949 version was abrogated.¹⁶ Drafted on the threshold of Hungary's democratic and economic reforms, the amendment was a political compromise between the old-school communists and the new generation of politicians who were gradually replacing them. It is unclear how long this version of the Constitution will remain in force; while its preamble envisions it as a "transition" document,¹⁷ no further fundamental revision is anticipated in the near future.

The current Hungarian Constitution is composed of seventy-eight sections that fall within fifteen different chapters:

- I. General Provisions
- II. The Parliament
- III. The President of the Republic
- IV. The Constitutional Court
- V. The Parliamentary Commissioner of Citizens' Rights
- VI. The State Audit Office
- VII. The Council of Ministers
- VIII. The Armed Forces and the Police
- IX. The Councils

decentralization led to over-investment. In addition, the lack of fiscal discipline exacerbated macroeconomic imbalances without significantly increasing efficiency. See Jnos Kornai, *The Hungarian Reform Process: Visions, Hopes, and Reality*, 24 J. ECON. LITERATURE 1687 (1986); see also ALAN H. GELB & CHERYL W. GRAY, *THE TRANSFORMATION OF ECONOMIES IN CENTRAL AND EASTERN EUROPE: ISSUES, PROGRESS, AND PROSPECTS* (The World Bank Policy and Research Series No. 17, 1991); Andrs Sajó, *Diffuse Rights in Search of an Agent: A Property Rights Analysis of the Firm in the Socialist Market Economy*, 10 INT'L REV. L. & ECON. 41 (1990).

13. MAGYAR KÖZTRSASG ALKOTMNY [1972 Constitution] ch. I, § 12(1) (Hungary), translated in CONSTITUTIONS OF THE COUNTRIES OF THE WORLD (Albert P. Blaustein & Gisbert H. Flanz eds. & Marta Kiszely trans., 1990).

14. *Id.* ch. I, § 13 (protecting individual property owners against expropriation of their property, except in limited cases).

15. *Id.* ("Expropriation of property shall be permitted only in exceptional cases and in the benefit of the general public . . .") (emphasis added).

16. A MAGYAR KÖZTRSASG ALKOTMNY [1989 Constitution] (Hungary), translated in CONSTITUTIONS OF THE COUNTRIES OF THE WORLD (Albert P. Blaustein & Gisbert H. Flanz eds. & Marta Kiszely trans., 1990).

17. *Id.* pmbl.

- X. The Judiciary
- XI. The Office of the Public Prosecutor
- XII. Fundamental Rights and Duties of Citizens
- XIII. The Fundamental Principles of the Elections
- XIV. The Capital and the National Symbols of the Republic of Hungary
- XV. Closing Provisions¹⁸

A. *Rights and Duties of Citizens*

Much of the current Hungarian Constitution deals with the rights and duties of citizens. Chapter I deems Hungary a democratic constitutional state,¹⁹ and asserts its commitment to a market economy,²⁰ as well as its encouragement of entrepreneurship and competition.²¹ Chapter I also establishes protection of private property, including compensation in the event of expropriation²² and general rights to freedom of association.²³ Most of the fundamental rights and duties of citizens are contained in Chapter XII and include the right to liberty,²⁴ freedom from torture,²⁵ and personal safety.²⁶ Freedom of thought,²⁷ speech,²⁸ religion,²⁹ and the press³⁰ are also guaranteed. These latter rights, as well as the right to compensation in the event of expropriation, were also guaranteed by Hungary's socialist Constitution;³¹ however, they were always subject to the higher interests of socialism.

Other sections of the new Constitution promise and protect certain economic rights. Labor is guaranteed by ensuring "the right to work, to free choice of employment and profession"³² and to have "remuneration/wages adequate to the quality and

18. *Id.* chs. I-XV.

19. *Id.* ch. I, §§ 1-2.

20. *Id.* ch. I, § 9(1).

21. *Id.* ch. I, § 9(2).

22. *Id.* ch. I, § 13.

23. *See id.* ch. I, § 3(1) ("In the Republic of Hungary political parties may be formed freely and may function freely.").

24. *Id.* ch. XII, §§ 55(1), 58(1).

25. *Id.* ch. XII, § 54(2).

26. *Id.* ch. XII, §§ 54(1), 70/D.

27. *Id.* ch. XII, § 60(1).

28. *Id.* ch. XII, § 61(1) (protecting the "freedom of opinion").

29. *Id.* ch. XII, § 60(1)-(3)

30. *Id.* ch. XII, § 61(2).

31. *See* 1957 Constitution, *supra* note 8, § VIII, art. 55(1) (protecting the freedoms of speech, press, and assembly).

32. 1989 Constitution, *supra* note 16, ch. XII, § 70/B(1).

quantity of his or her work.”³³ Every woman is guaranteed pre- and post-natal care,³⁴ and children are guaranteed the right to have “special care and assistance on the part of his or her family, the State and the society, which is necessary to his or her appropriate physical, spiritual and moral development.”³⁵ No matter how laudable in intent these goals are, however, the broad language of these rights may create societal expectations that Hungary is unable to fulfill.

B. Structure of Government

The new Constitution declares that Hungary is a democratic constitutional state,³⁶ based on the separation of powers among Parliament, the Council of Ministers, and the judiciary.³⁷ This is a radical change from the previous system, in which absolute and undivided power was vested in the Communist Party.

The unicameral Parliament has 386 members, each elected to a four-year term.³⁸ Its primary legislative duty is to pass laws and constitutional amendments.³⁹ Any legislation affecting the fundamental rights of citizens must take the form of a constitutional act. In light of past practice in socialist Hungary, in which Parliament was relatively inactive and the Council of Ministers governed by passing decrees, Parliament’s renewed lawmaking responsibility is meant to ensure that this democratically elected body actually governs the citizenry.⁴⁰

Parliament is also responsible for electing Hungary’s highest ranking officials, including the President, the Council of Ministers, the members of the Constitutional Court, the Parliamentary Commissioners of Citizens’ Rights, the President and Vice-President of the State Audit Office, the President of the Supreme

33. *Id.* ch. XII, § 70/B(3).

34. *Id.* ch. XII, § 66(2).

35. *Id.* ch. XII, § 67(1).

36. *Id.* ch. I, § 2(1).

37. Although the Constitution does not expressly state this notion of a separation of powers, the structure of the document itself implies such a separation.

38. 1989 Constitution, *supra* note 16, § 20. The current Parliament was elected in 1990 based on the negotiations embodied in Act XXXIV of 1989 on the Election of Members of Parliament (MP). Rules governing MP status, including immunities, are governed by Act IV of 1990 on the Legal Status of Members of Parliament.

39. 1989 Constitution, *supra* note 16, ch. II, § 19(3)(a)-(b).

40. In enforcing this Parliamentary primacy, the Constitutional Court has several times overruled decrees by the Council of Ministers on the ground that either the decree conflicts with a law or that the subject of the decree falls within an area that can only be addressed by Parliament through the passage of legislation.

Court, and the Chief Public Prosecutor.⁴¹

A member of Parliament, the President, or the Council of Ministers may propose legislation.⁴² After any proposal is passed by Parliament, it must be signed by the President within fifteen days of receipt to become law.⁴³ In addition, if the President believes that a provision of an act of Parliament is unconstitutional, he may submit questions about the provision to the Constitutional Court.⁴⁴ While the precise boundaries of the presidential power to veto executive decisions of the government remain unclear, the president has, in general, much less power than the presidents of neighboring countries such as Poland or Czechoslovakia.

C. *The Constitutional Court*

The new Constitution also establishes Hungary's first Constitutional Court,⁴⁵ which is distinct from Hungary's Supreme Court.⁴⁶ The Constitutional Court is composed of fifteen judges who are elected by Parliament.⁴⁷ Each judge sits for a nine-year term, which may be renewed once. These judges are prohibited from political activity and party membership,⁴⁸ a restriction that applies to local and county judges as well.⁴⁹ The Court's purpose is to interpret the constitutionality of legal rules, including international agreements, and to annul parliamentary acts and other regulations that it finds unconstitutional.⁵⁰ The Court may also

41. See 1989 Constitution, *supra* note 16, ch. II, § 19(3)(k).

42. *Id.* ch. II, § 25(1).

43. *Id.* ch. II, § 26(1).

44. *Id.* ch. II, § 26(4).

45. Act I of 1989 establishes the Constitutional Court. See 1989 Constitution, *supra* note 16, ch. IV. Its purposes are detailed in Act XXXI of 1989, and detailed regulations on structures and procedures are set out in Act XXXII of 1989.

46. See *infra* notes 363-372 and accompanying text.

47. 1989 Constitution, *supra* note 16, ch. IV, § 32/A(4).

48. *Id.* ch. IV, § 32/A(5).

49. *Id.* ch. X, § 50(3).

50. *Id.* ch. IV, § 32/A(1)-(2). The Court's power to annul laws and regulations is very strong relative to the powers of other constitutional courts in the region. For example, the decisions of the Romanian and Polish constitutional courts can be overturned by a two-thirds vote of their respective parliaments. See Gray et al., *Poland*, *supra* note 2, at 322. In contrast, the Hungarian Parliament may not overturn a decision of the Constitutional Court except by amending the Constitution.

At present, regular courts, including the Supreme Court, are not allowed to declare an act or regulation unconstitutional, although they may stay a case and refer the matter to the Constitutional Court. There are discussions to amend this procedure so that regular courts can also rule on the constitutionality of laws and regulations, with appeal to the Constitutional Court.

review draft laws before they are put to a vote by Parliament.⁵¹ Members of Parliament, however, have on occasion accused the Court of using this power of review to impinge on Parliament's legislative authority.⁵² Consequently, the Court has declined to rule on some draft laws to avoid violating, at least in appearance, the principle of separation of powers.⁵³

The Hungarian Constitutional Court has extremely broad jurisdiction, perhaps the broadest of any constitutional court in the world. Valid complaints in the Court are not limited to those contesting the constitutionality of existing laws and administrative regulations, but extend to allegations of "negligence" against the legislature for failing to pass a law, if the absence of such a law creates an unconstitutional situation.⁵⁴ If the Court agrees that lawmakers should have passed such a law, Parliament is given a limited period of time in which to pass the missing legislation, although the procedure for enforcing this time limit is unclear.⁵⁵

One example of the Court's proactive role was its request, in January 1990, that Parliament set up an administrative court system by April 1, 1991.⁵⁶ In fact, the need for an administrative court system arose in part as a result of the Constitutional Court's ruling that statutorily raising interest rates on housing loans was unconstitutional because such statutes needed to be passed by a two-thirds Parliamentary majority rather than a simple majority.⁵⁷ This ruling stimulated petitions on a wide variety of economic problems not at all related to the Court's role as guardian of the Constitution.⁵⁸ The Court determined that an administrative court system was necessary to handle these economic cases.⁵⁹ Parliament failed to establish such a system, but a crisis was averted because the regular courts decided to take on such administrative cases.

51. 1989 Constitution, *supra* note 16, ch. IV, § 32/A(1) (stating that the Constitutional Court "supervises the constitutionality of the laws").

52. Edith Oltay, *The Postcommunist Judiciary*, REP. E. EUR., Oct. 11, 1991, at 15, 18.

53. *Id.*

54. Judith Pataki, *The Constitutional Court's Search for Identity*, REP. E. EUR., June 21, 1991, at 5, 7. However, the Court has interpreted its jurisdiction to hear such omission cases to be limited to those situations where the missing regulation is affirmatively required by a higher act or decree, or where the omission violates basic rights.

55. *Id.*

56. *Id.*

57. *Id.*

58. *Id.*

59. *Id.*

In addition to the Constitutional Court's broad jurisdiction, it is also extremely accessible. Under the Constitution, any citizen is entitled to present a complaint to the Court.⁶⁰ The liberal rules of open access and permissible claims have led to a virtual flood of cases.⁶¹ In 1990, the Court received over 1500 petitions for constitutional review of laws, regulations, and administrative decisions; it was only able to rule on 235 cases.⁶² In 1991, 1600 petitions were filed in the first seven months alone, of which only about 300 were to be decided for the entire year.⁶³

Finally, since the Constitutional Court began functioning, it has used its authority forty-seven times to annul laws and regulations.⁶⁴ One landmark decision, for example, declared the original Compensation Act unconstitutional because it unfairly discriminated in favor of former landowners and against owners of other types of assets.⁶⁵ In another significant decision, the Court declared the prohibition on foreign ownership of land unconstitutional. These decisions illustrate that the Constitutional Court is an important and powerful institution in Hungary, and its activities can have a major impact on private sector development.

III. RIGHTS TO REAL PROPERTY

In Hungary, as in other CEE countries, clarifying real property rights is perhaps the most difficult and slow-moving area of legal reform. It not only confronts the vested interests of former owners, existing users, and newly emerging business interests, but it also must be carried out in a setting plagued by poor records, struggling institutions, and a legacy of distorted public policies.

60. 1989 Constitution, *supra* note 16, ch. IV, § 32/A(3). Plans to limit this access by requiring the litigant to have a direct interest are under active consideration. Other countries often restrict access to constitutional courts. For example, the U.S. Supreme Court has held that in order for a litigant to invoke the power of a federal court, the case-or-controversy requirement of article III of the Constitution requires that they be directly affected by the challenged legislation. In other words, one must have standing to sue. *See, e.g., Allen v. Wright*, 468 U.S. 737, 750-51 (1984). Moreover, review by the U.S. Supreme Court is discretionary. *See* 28 U.S.C. §§ 1254, 1257 (1988).

61. *Oltay*, *supra* note 52, at 18.

62. *Id.*

63. *Id.*

64. *Id.*

65. *See Pataki*, *supra* note 54, at 8.

A. Defining Basic Ownership Rights

1. Socialist Ownership

Apart from the Hungarian Constitution, which provides general concepts of property, the most important law in defining fundamental property relations in Hungary over the past thirty years has been the Hungarian Civil Code of 1959, as amended.⁶⁶ Prior to 1959, a mixture of numerous laws, collected "customs of judgement," and some decisions of higher courts governed property rights.⁶⁷ The 1959 draft of the Code consolidated these various sources of law. Although modeled after the German Civil Code,⁶⁸ the Hungarian Code was drafted during the socialist period and thus reflected socialist ideology, particularly the sections on property ownership.

A common element of socialist law throughout Central and Eastern Europe was the recognition of several categories and concepts of property, including social and cooperative ownership, personal property, and private property. In Hungary, these categories and their accompanying rights were set out in Part III of the Civil Code.⁶⁹ Assets under "social" ownership included property specifically owned by the state,⁷⁰ capital equipment, and other property of "crucial importance for the national economy."⁷¹ Property under socialist ownership enjoyed greater legal protection than the other forms of property. For example, all Hungarian citizens were obliged to protect state assets,⁷² and the Civil Code promised compensation for losses, injury, and death resulting from this duty.⁷³

Similar to "social" property was "cooperative" property. When almost all of Hungary's land was nationalized during the

66. 1959. évi IV. Törvény a Magyar Köztrsasg Polgri Törvénykönyvéröl [Act IV of 1959 on the Civil Code of the Republic of Hungary], *Hatlyos magyar jogszablyok*, Nov. 15, 1990, translated in I./Nr. 21-24. HUNGARIAN RULES OF LAW IN FORCE 1227 (1990) [hereinafter Civil Code].

67. See Istvan Molnar, A Survey of Hungarian Property Law 6 (undated) (unpublished manuscript, on file with *The George Washington Journal of International Law and Economics*).

68. See *id.*

69. *Id.*; see also 1957 Constitution, *supra* note 8, § II, art. 6.

70. This refers to property set out in both the Civil Code and the 1957 Constitution, such as: oil and mineral resources, lakes, rivers and riverbeds, railways, banks, the postal service, and the telephone, radio, and television networks. See 1957 Constitution, *supra* note 8, § II, art. 6; Civil Code, *supra* note 66, ¶ 172.

71. See Civil Code, *supra* note 66, ¶ 89.

72. *Id.* ¶ 179.

73. *Id.* ¶ 181.

1950s and the 1960s, it became cooperative property.⁷⁴ Cooperative property differed from socialist property in that it was the indivisible property of a "group of citizens voluntarily associated for social production, distribution or the common meeting of demands."⁷⁵ While cooperative ownership appeared to remain vested in individuals, ownership rights were still limited. Upon the winding-up of the cooperative, the property did not revert to the cooperative's members but continued to be part of the cooperative property, managed by countrywide organs representing the interests of the cooperatives.⁷⁶

"Personal" property was that which served personal needs, including family houses and apartments,⁷⁷ vacation homes, furniture, and personal items such as clothes.⁷⁸ These items were by law and in practice freely transferable. However, entrepreneurship involving personal property was stifled by the prohibition on commercial trading; all transfers were required to meet only personal or familial needs. Additionally, separate pieces of legislation restricted the size and number of properties that individuals could own. Families were restricted to owning a maximum of one home—either a house or an apartment—one vacation home, and one agricultural plot. Families acquiring additional property, through, for example, marriage or inheritance, were required by law to sell the excess.

"Private" property consisted of individually-owned means of production. While the Civil Code recognized "the private property of small producers which serves useful business activity,"⁷⁹ it also granted the state power to restrict its use through taxation or by decree.⁸⁰

2. Redefining Ownership Rights

Hungary has taken important steps over the past three years to

74. Gabor Horvath, *Hungary: A Heated Row Over Land Reform*, Inter Press Service, Aug. 17, 1990, available in LEXIS, Nexis Library, INPRESS File.

75. Civil Code, *supra* note 66, ¶ 90.

76. See Molnar, *supra* note 67, at 8-9.

77. Civil Code, *supra* note 66, ¶ 92. Most housing remained in private hands. In the 1980s, the state only owned approximately 25% of the housing in Hungary. See HANNA MATRAS, STRUCTURE AND PERFORMANCE OF THE HOUSING SECTOR OF THE CENTRALLY PLANNED ECONOMIES: USSR, HUNGARY, POLAND, GDR AND YUGOSLAVIA 19 (The World Bank Policy, Planning and Research Staff, Infrastructure and Urban Development Department Discussion Paper No. INU 53, Oct. 1989).

78. Civil Code, *supra* note 66, ¶ 92.

79. *Id.* ¶ 93(1).

80. *Id.* ¶ 93(3).

redefine property rights and to remove the stigma and legal impediments that had attached to private⁸¹ ownership. The new Constitution and Civil Code have been amended, and many other laws affecting rights in real property have been adopted. For example, the newly amended Constitution abolishes the preferential treatment previously afforded to socialist property by granting private property equal rights and protection.⁸² Moreover, as noted above, the Constitution guarantees compensation in the event that private property is expropriated.⁸³ The Civil Code also guarantees adequate compensation for property expropriated for the public interest.⁸⁴ Under socialism such compensation was also guaranteed, but rarely paid. However, Hungary seems to have expressed a greater willingness to abide by this fundamental principle by elevating this guarantee from the Civil Code to the Constitution.

As with the Constitution, the most important property provisions in the Civil Code have been amended. Private ownership is now fully accepted in Hungary, and the privatization program is attempting to transfer the bulk of state assets into private hands.⁸⁵ Law XIV of 1991 abolished all forms of socialist ownership, abrogated privileges of state and cooperative ownership as against private ownership, reviewed the range of exclusive state property and inalienable assets, and empowered the state to cede certain property, such as forests and land, to private owners. Remnants of the prior system in related Code sections are no longer enforced and should be interpreted in the spirit of the recent amendments—a necessary process pending a thorough overhaul of the Civil Code. Although these outdated provisions of the Civil Code perhaps could be eliminated by a rapid amendment, as was done in Poland,⁸⁶ the Hungarians have opted to undertake a more systematic revision of the Code over the next several years under the auspices of a special codification commit-

81. Here, "private" property refers to any individually-owned property, as opposed to the narrower socialist definition of the term.

82. 1989 Constitution, *supra* note 16, ch. I, § 9(1).

83. *Id.* ch. I, § 13. This provision is discussed earlier. See *supra* note 22 and accompanying text.

84. Civil Code, *supra* note 66, ¶ 177.

85. See generally Rebecca J. Hanson, Note, *The Legal Framework for Privatization in Hungary*, 23 LAW & POL'Y INT'L BUS. 441 (1992) (examining Hungary's recent "legal revolution" by focusing on the Company and Foreign Investment Acts, which form the basis of privatization; the Transformation Act and its deficiencies; the State Property Agency; and the Compensation Act).

86. See Gray et al., *Poland*, *supra* note 2, at 287-88.

tee appointed by the Ministry of Justice.⁸⁷

Act I of 1987 on Land,⁸⁸ as amended through 1991, has been instrumental in freeing up the private market for real estate. This act, which covers not only land but also buildings and other constructions, defines the rights of owners and users and clarifies conditions for the purchase and sale of real estate.⁸⁹ Although somewhat unstable in its specifics because of continual amendment,⁹⁰ this act has served the important function of removing administrative barriers to private acquisition of real estate. For example, it has eliminated the "operational administration" form of land-holding, which was common during socialist times, and has lifted the former fifty hectare (123 acre) maximum on private land ownership.⁹¹ A private Hungarian person, either natural or legal, may now acquire real estate without any legal limitation. However, other impediments, such as ambiguity to title and access to credit, continue to retard the development of a private market for real estate.⁹²

3. Foreign Ownership

Under Act I on Land, foreigners are prohibited from owning agricultural land, unless ownership is permitted by another law. Foreigners may, however, own non-agricultural land and immovable real property after receiving permission from the Ministry of Finance.⁹³ This permission is guided by the discretionary standard that the purchase may not "harm the Hungarian State or its autonomy, does not harm local governments, nor cultural and

87. Tams Srközy, *Legal Framework for Reforms in Hungary I* (1990) (unpublished manuscript, on file with *The George Washington Journal of International Law and Economics*).

88. See 1987. évi. I törvény a földről a végrehajtsra kiadott 26/1987. (VII. 30.) MT és a 8/1987. (IX. 1.) MÉM rendelettel egységes szerkezetben (kiegészítve az azóta bekövetkezett változásokkal 1990. febr. 14.-vel beérőlag) [Act I of 1987 The Act of Land, in uniform pattern with Decree 26/1987 (VII.30) MT by the Council of Ministers and Decree 8/1987 (IX.1.) MEM by the Minister of Agriculture (complemented with all amendments from the said time up to February 14, 1990)], *Hatlyos magyar jogszabályok*, June 1, 1990, translated in I./Nr. 10. HUNGARIAN RULES OF LAW IN FORCE 547 (1990) [hereinafter Act I on Land].

89. *Id.* ¶ 2.

90. See Srközy, *supra* note 87, at 3.

91. See Viktor Knapp, *Socialist Countries*, in VI INTERNATIONAL ENCYCLOPEDIA OF COMPARATIVE LAW ch. 2, §§ 79-84 (Frederick H. Lawson ed., 1975) (explaining scope of the right of "operational administration" under socialist law).

92. See *infra* notes 98-122 and accompanying text.

93. Act I on Land, *supra* note 88, ¶ 38(1). Foreigners are defined as natural persons who are not Hungarian citizens, Hungarian citizens domiciled abroad, and business organizations not created under Hungarian law. An exception for Hungarians domiciled abroad allows them to own property through inheritance.

touristic interests."⁹⁴ Apparently, Hungarian expatriates whose property was expropriated can secure this permission easily; foreigners who buy out their partners in a joint venture may also obtain favorable judgment.⁹⁵

In contrast, Hungarian corporate entities that are partly, or even wholly, foreign-owned are entitled to own real property under the Foreign Investment Act of 1988.⁹⁶ The only limitation on this ownership is that, under section 19, the property must be related to the company's objectives.⁹⁷ The original purpose of this limitation was to prevent speculative buying by foreigners; however, real estate development appears to qualify as a proper business purpose.

B. *Assigning and Securing Title*

Once basic rights to private property have been defined, the next step is linking those rights with specific owners. This is the most controversial aspect of reform, since it raises the possibility of a redistribution of assets that could decidedly influence the pattern of wealth for the foreseeable future.

1. Clarification of State Property Ownership

The need to define owners applies to both the public and private sectors. On the public side, assigning specific ownership rights to state-owned property, including property of state enterprises, public office buildings, and public housing, to various levels of government is proving problematic in Hungary, as it was in several other CEE countries.⁹⁸

Two recent laws address this thorny question. First, Act LXV of 1990 on Local Government transferred control over all state enterprise property to the State Property Agency.⁹⁹ This law, however, has not eliminated disputes among municipalities, dis-

94. *New Government Regulations on the Acquisition of Real Estate by Foreigners*, INVEST IN HUNGARY, 1991, at 29. Local governments have the power to veto a sale. See Nelli Tas, *Real Estate Periscope*, INVEST IN HUNGARY, 1991, at 29-30 (discussing a recent government regulation).

95. *New Government Regulations on the Acquisition of Real Estate by Foreigners*, *supra* note 94, at 29.

96. See Unified Text of Act XXIV of 1988 Regarding Investments by Non-residents in Hungary With Subsequent Amendments and Supplements, ch. III, § 19(a), *reprinted in* U.S. DEPARTMENT OF COMMERCE DOC. NO. PB91-960627 (1991).

97. *Id.*

98. The problem is particularly acute in Poland, where the move to decentralize government has been very strong. See Gray et al, *Poland*, *supra* note 2, at 288.

99. Srközy, *supra* note 87, at 6.

tricts, and the State Property Agency as to ownership of enterprise-specific property. Second, Act XXXIII of 1991 on the Transfer of State Property to Local Authorities¹⁰⁰ transferred to local governments the ownership rights in most other state-owned real property, including apartments, non-residential units such as small shops, and numerous other state-owned buildings.¹⁰¹ The Ministry of the Interior is charged with implementing this act by setting up district and county level committees to review each land parcel transfer. With ownership rights comes the clear legal authority to sell the property. Such authority is critical to the development of the real estate market because it identifies competent sellers to potential buyers, and provides for enforceable contracts of sale, thereby reducing the longstanding dilemma of unclear or clouded title.

2. Claims of Former Owners

Title to both publicly and privately held real estate is not likely to be complicated by restitution, or "reprivatization" in Hungary as it was in Poland, Romania, East Germany, Czechoslovakia, and Slovenia.¹⁰² Hungary's solution to the perceived injustices caused by socialist expropriations is Law XXV, the Compensation Act of 1991.¹⁰³ This law partially compensates both Hungarians and foreigners whose property was expropriated through regulations enacted after 1939.¹⁰⁴ Compensation consists of

100. See 1991. évi XXXIII. törvény egyes állami tulajdonban lévő vagyontárgyak önkormányzatok tulajdonába adásáról [Act XXXIII of 1991 on Transferring Some State Owned Assets into the Ownership of Local Governments], *Hatlyos magyar jogszabályok*, July 12, 1991, translated in HUNGARIAN RULES OF LAW IN FORCE SPECIAL EDITION 54 (1991). In addition, the Act transfers to local governments, among other things: historical architecture; certain undeveloped land; public utilities exclusively serving that community; public transportation; and certain parks. *Id.* § 1, §§ 1-25.

101. Conflicting claims now exist between the two levels of local government, the municipalities, and the districts, although it is generally anticipated that the districts will assume ownership rights. Buildings on plots of land larger than 1000 square meters are transferred to the State Property Agency, and former Party property is transferred to the Hungarian Treasury Trust under the Ministry of Finance.

102. For a discussion of the problems in these countries see Gray et al., *Poland*, *supra* note 2; Gray et al., *Romania*, *supra* note 2. See also Gray, *Czech Republic*, *supra* note 2; Gray & Stiblar, *supra* note 2 (discussing Slovenia).

103. See 1991. évi XXV. törvény a tulajdonviszonyok rendezése érdekében, az államtól az állampolgárok tulajdonban igazságtalanul okozott károk részleges kárpótlásáról [Law XXV of 1991 on partial compensation for damages unlawfully caused by the state to properties owned by citizens in the interest of settling ownership relations], *Hatlyos magyar jogszabályok*, Aug. 15, 1991, translated in Nr. II./16. HUNGARIAN RULES OF LAW IN FORCE 1127 (1991) [hereinafter Compensation Act of 1991].

104. *Id.* § 1(1) (defining those who are eligible to receive compensation).

lump-sum payments in the form of coupons, the amount of which is determined by the value of the nationalized property.¹⁰⁵ The first HUF 200,000 (\$2300) of damages is to be compensated at 100%. The next HUF 100,000 (\$1150) is to be compensated at 50%. The next HUF 200,000 (\$2300) is to be compensated at 30%. Any remaining damages (those exceeding HUF 500,001 (\$5760)) are to be compensated at 10%.¹⁰⁶ By law, the maximum payment for a piece of property cannot exceed HUF 5 million (\$57,600).¹⁰⁷

The coupons function as transferable bearer securities and pay interest at seventy-five percent of the basic interest rate of the central bank until the summer of 1994.¹⁰⁸ Compensation coupons may be used as full or partial payment for property sold by the state, including apartments, shares in privatized state-owned industries, and farmland.¹⁰⁹ A separate law is planned to enable the coupons to be transformed into life annuities to provide social insurance for their holders. It also seems possible to pledge the coupons as collateral for loans.¹¹⁰

Only former land owners may use their coupons to purchase farmland. Such land will be sold to the highest bidder at an auction.¹¹¹ In theory, former land owners may repurchase their original land—if they prove to be the highest bidder and if their particular parcel is to be auctioned. However, the land that will be auctioned is not likely to be the most fertile; the best land is currently held by cooperatives, which are expected to retain possession of their land under the new laws. Cooperatives are setting aside approximately 2.4 million hectares, and state farms about 0.4 million hectares, for compensation auctions.

During the August through October 1991 time period for submitting claims, 805,000 individuals submitted 3.3 million claims worth about HUF 60 billion (\$692 million). About 3 million claims refer to confiscated land. Another HUF 20-30 billion

105. *Id.* ¶¶ 3, 5.

106. *Id.* ¶ 4. On April 1, 1993 one U.S. dollar was equal to 86.79 forints or "HUF" (the Hungarian unit of currency). *Exchange Rates*, WALL ST. J., Apr. 2, 1993, at C13.

107. Compensation Act of 1991, *supra* note 103, ¶ 4(3).

108. *Id.* ¶ 5(2)-(3).

109. *Id.* ¶ 7.

110. *Id.* ¶ 7(3).

111. The original draft Compensation Act of April 1990 allowed former farmland owners to exchange their compensation coupons for their original land. The Constitutional Court declared this law unconstitutional, as it discriminated against former owners of urban and industrial property, who were given coupons but not the possibility of in-kind restitution. *See Hungarian Confiscation Law*, WASH. POST, May 31, 1991, at A24.

(\$230 to \$346 million) in claims is expected from the extension of the act to include claims covering 1939-1949 by Jews and Germans; and a final HUF 20 billion (\$230 million) from a proposed extension to cover individuals who have been politically persecuted. It is estimated that the government will pay out a total of about HUF 100 billion (\$1.15 billion) pursuant to these claims. It is expected that about one-half of the distributed vouchers will be used to purchase land and the other half split between purchases of apartments, shares in privatized enterprises, rental rights to small shops, and annuities. The distribution of vouchers began March 31, 1992, and is expected to take up to two years.

There is some doubt whether Hungary's solution to the restitution problem will achieve its stated restitutionary goals. For example, in light of the shortage of attractive privatized assets, vouchers and the shares bought with them may well be traded at a substantial discount from their face value. Nevertheless, Hungary's compensation law is a significant achievement in the area of private sector development because it avoids the problem of clouded title to real property.

3. Land Registration

Developing an adequate registry to determine legitimate title for privately-owned property is less controversial than allocating property, but it is no less fundamental.¹¹² As noted earlier, most housing remained in private hands throughout the socialist period. Buyers have always had an incentive to register their purchases in the property registry because under the Civil Code, title passes only upon such recordation.¹¹³ Moreover, registered owners have priority over other claimants because unrecorded transactions are not enforceable against third parties. Thus, the existing property registry provides adequate proof of private title in many cases, including private houses and apartments.

This is not to say, however, that the land registry is an accurate portrayal of current property ownership. Some private buyers,

112. See generally *A Report on the Technical and Legal Aspects of the Creation of a Computerized Land Title Registration System in Hungary* (Hungarian-American Enterprise Fund, Budapest), Nov. 12, 1991 [hereinafter *Land Title Report*] (on file with *The George Washington Journal of International Law and Economics*). This report, prepared by the Stewart Information Services Group and Weil, Gotshal & Manges under the sponsorship of the Hungarian-American Enterprise Fund, was presented to officials of the Ministry of Agriculture in Budapest on November 13, 1991.

113. Civil Code, *supra* note 66, ¶ 117.

whose individual holdings exceeded permissible levels, avoided registration during the socialist period. Furthermore, nationalizations by the state and transfers among public owners—particularly of trustee rights sold by state enterprises since the late 1970s—were not typically recorded in the land registry; nor were individual flats registered in many large state housing developments. Agricultural land records are in the poorest condition because of extensive nationalizations and cooperative regroupings.¹¹⁴ Finally, missing records, inadequate staff, and lengthy delays in the land registration process—six months being the current norm—add to the uncertainty in real estate transactions.

C. *Financing the Acquisition of Property*

1. Commercial Property

Mortgages of real property have long been permissible under Hungarian law. The Civil Code provides for the use of real estate—usually the very piece of property being financed—as collateral.¹¹⁵ However, such mortgages have been rare, primarily because commercial ventures have been rare. Local financing of commercial property has recently become more readily available, at least for property being privatized by the government. The National Bank of Hungary refinances credit extended by commercial banks to private Hungarian citizens for purchasing state assets, including real estate, sold by the State Property Agency.¹¹⁶ Despite this availability of financing, as well as the growing need for commercial mortgages, real estate lenders may be discouraged by the new Bankruptcy Law, which grants priority over registered mortgage liens to tax claims and wages, including severance payments. Direct foreign financing of commercial property development is not possible in practice, as foreign banks are prohibited from registering mortgage liens on Hungarian real estate.

Private real estate developers argue that the main constraints are not the regulatory hurdles—compared with Western regulatory hurdles—but rather are the unrealistically high prices asked

114. Pursuant to Law Decree 31 of 1972, the entire land registry, including urban land, was placed under the direction of the Ministry of Agriculture.

115. Civil Code, *supra* note 66, §§ 265-269.

116. This credit may also be used for purchasing shares in companies being privatized at a preferential rate of 75% of the National Bank of Hungary refinancing rate. This scheme is limited to support of the privatization process and is not available to individuals purchasing previously privatized or privately-owned property.

by local governments. Moreover, local government and State Property Agency requirements for public tenders have also tended to stifle deals.

2. Residential Property

As with commercial property, mortgages on residential real estate have long been legally permissible, yet seldom used in practice. Lenders have been discouraged from making substantial mortgages because of the lack of any effective legal mechanisms to repossess the collateral in cases of default. Tenant protection laws, grounded in the still-applicable 1971 Housing Act, make foreclosure and eviction a cumbersome and futile endeavor. Under these laws, lenders seeking to carry out evictions must provide alternative living quarters, which is often a difficult process given the shortage of available housing. Moreover, since clearing all of the procedural hurdles to evictions can take up to five years, few, if any, cases of foreclosure result in eviction. Wage garnishment and third-party wage guarantees have typically been used as alternatives to secure mortgages, but these options are limited by the priorities given to tax, alimony, and other possible claims.

Housing reforms in 1983 allowed household savings account deposits to be used as mortgage collateral in lieu of the actual property and established a housing finance system of subsidized interest rates.¹¹⁷ This scheme resulted in a stock of housing loans with a market value significantly below book value—a stock later noted as the single most important factor leading to the technical insolvency of Hungary's portfolio-holding institutions.¹¹⁸ In mid-1991, this portfolio was cleaned up: the loans were taken away from the banks, borrowers were offered substantial loan forgiveness in exchange for accepting new terms, and the remaining portfolio was returned to the banks containing market rate loans with an explicit budget allocation to cover the loan forgiveness.¹¹⁹

117. See SILVIA B. SAGARI & LOIC CHIQUIER, COPING WITH THE LEGACIES OF SUBSIDIZED MORTGAGE CREDIT IN HUNGARY 2-3 (World Bank Policy Research Working Paper Series No. WPS847, Jan. 1992).

118. *Id.*

119. After the law was rejected on procedural grounds by the Constitutional Court in 1990, it was correctly passed in mid-1991. The law gives borrowers the following options: (1) have the loan converted to a 15% fixed rate loan with the possibility of having the rate adjusted from year to year; or (2) have half the loan forgiven—that is, bought out by the government—and the other half either (a) repaid in full by the bor-

By 1989, interest rate subsidies were eliminated so that when current loans were issued, they carried market interest rates, which are currently about forty-five percent for fifteen-year, fixed rate loans.¹²⁰ While interest rate subsidies were eliminated, numerous other up-front subsidies remain, such as subsidies based on the number of children or the purpose of the loan.¹²¹ Compounding the problem is the fact that Hungarian banks are inexperienced in underwriting techniques; since fixed-rate mortgages are risky in the presence of significant inflation, few mortgages are actually being written. In practice, banks will make small loans only up to the amount of subsidies covered by the government. Most real estate transactions are conducted in cash.

A final area of concern in financing real property is the legal status of multi-family dwellings; the availability of clear title to individual units is important if such units are to serve as mortgage collateral. Law Decree 11 of 1977 on Condominiums updates the 1920s condominium law and places Hungary well ahead of other CEE countries such as Czechoslovakia and Albania, which still do not have condominium laws. However, inadequacies in enforcing the law threaten to paralyze the process of renovation and rehabilitation of the Hungarian housing stock.¹²²

D. Regulatory Issues

1. The Rental Sector

A large and healthy rental sector is one of the best indicators of a well-functioning real estate market, allowing wide household choice and facilitating labor mobility.¹²³ Hungary's restrictive

rower or (b) converted to a market rate loan. To the government's surprise, over 40% paid back the loans, an indication of the monetary overhang in the economy; about 40% converted to market rate loans, and the balance took the 15% loan. The Polish Parliament similarly responded to their credit crisis by rewriting existing housing loans to eliminate unsustainable subsidies.

120. See *Land Title Report*, *supra* note 112, at 21 (quoting rates of 40-50% for terms between 2 and 15 years). The primary mortgage lenders are the National Savings Bank and the Cooperative Savings Bank. *Id.* Under their policies, loan maximums are set such that households pay no more than 33% of verified household net income. *Id.*

121. See FERENC RÉVÉSZ, HOW TO DO BUSINESS IN HUNGARY: MANAGEMENT OF HOUSING FINANCES 5-6 (PERFEKT Fin. Postgraduate Training Series No. 21, 1991) (on file with *The George Washington Journal of International Law and Economics*).

122. See generally CAROL S. RABENHORST, CONDOMINIUM OPERATIONS AND MANAGEMENT IN BUDAPEST: STATUS AND IMPLICATIONS FOR THE FUTURE OF THE PRIVATIZED HOUSING MARKET (The Urban Inst., Wash. D.C., Project No. 6251-03, Oct., 1992).

123. Labor mobility is particularly critical during the transition from a planned to market economy, as many old enterprises are forced into major restructuring or liquidation and newly emerging private firms expand employment opportunities.

eviction procedures are the key bottleneck to a fluid rental market. As in the case of mortgage foreclosure, landlords seeking to evict tenants who have defaulted on their rent are obliged to find an alternative housing unit for such tenants.¹²⁴ Unlike the case of mortgage default, renters who default on their rent payments are not subject to garnishment of wages. An expedited lease termination procedure is, however, available for certain types of public landlords.¹²⁵

Rent control for publicly-owned residential property is one of the most politically difficult issues on the current Hungarian policy agenda. Current rent levels do not allow local governments to recover even operating costs for housing stock, much less capital costs, a condition which has contributed to the chronic under-maintenance and the increasingly dilapidated condition of much of the housing stock. According to most observers, central government regulations still determine rent levels for the public housing stock, although some argue that this power has been devolved to local governments. Rents in these units probably will not be raised without clear action by the central government.

In a second group of quasi-public units, the central government eliminated rent control on "forced tenancies" in January 1992. These 100,000-odd private units were forcibly created during the 1940s and 1950s and allocated according to state rules. Tenants generally now view these units as public housing and have resisted owners' attempts to raise rents since January 1992, usually by successfully appealing to local district councils.

In the slowly emerging purely private stock, there are no rent controls. Rental agreements are set by lease and are usually for a fixed term. Disputes between landlords and tenants in private housing are typically handled directly through self-help measures; cumbersome enforcement procedures and the overburdened judicial system are generally avoided.

124. The draft Rental Housing Bill currently being discussed in Hungary would begin the process of removing some of the worst constraints on eviction, particularly by eliminating the requirement that an alternative unit be provided.

125. The Court Enforcement Office polices the debt collection and eviction process in Hungary. In 1991, the Budapest office received between 3000-4000 new claims each month for debt collection, but had only 16 enforcement officers for the whole city. The Office has not been active in mortgage foreclosures and has rarely pursued evictions in cases where renters of privately-owned apartments have failed to pay their rent. Although courts have rendered thousands of verdicts for eviction, the Office carries out at most only 30 evictions per year from private rental units, after an average eviction process of four to five years.

2. Zoning and Construction Standards

Zoning is another area in need of clarification. Hungary has emerged from socialism with a diffuse and inefficient pattern of land use. Currently, the zoning system is in limbo. Old regulations are not necessarily being followed, no general land-use framework has been established, and the authority to regulate has not been vested fully in local governments. Although questions of title are being addressed, authority over zoning and building regulations has yet to be distributed among local actors. Currently, this authority may be exercised by district or county governments, city planning departments, public utility authorities, county commissioners, or a number of central ministries. Because owners are unsure from whom to seek necessary permits, they often attempt to secure permission from everyone—those who currently appear to exercise authority as well as those who formerly did. This is clearly an inefficient and time consuming process.

Furthermore, not only is there a surfeit of potential regulatory authority in some areas, but there is a problematic lack of it in others. For example, some regulations needed by private real estate developers, such as regulations governing commercial scale residential, commercial, and industrial subdivisions of undeveloped land, still do not exist. Nor is there an appropriate regulatory framework governing infrastructure needs and financing for private land development—for example, a framework that would permit exactions, special assessments, or land readjustment. A 1991 modification of the Building Law permits conversion to industrial uses of agricultural land at the urban fringe, usually the most dynamic area for commercial land development, upon payment of a transfer fine to a land protection fund, but the actual impact of such regulation needs to be tested. Finally, building standards are governed by the 1990 National Building Code and the old 1986 Budapest city planning rules. A new construction law has yet to be written with affordable building standards for the types of buildings that market systems are likely to demand.

In summary, a modern land use planning system with clearly defined procedures is required—a planning system that offers wide discretion to the market, forces developers to internalize their environmental costs, and provides a dispute resolution mechanism that fairly balances the interests of neighbors, developers, and city government.

IV. RIGHTS TO INTELLECTUAL PROPERTY

The legal framework for intellectual property protection in Hungary has been considered better than those available in other CEE countries. However, investigation and enforcement remain a problem, resulting in widespread piracy of software, music, and pharmaceuticals, among other things. As Hungary begins to recognize and protect private property rights in general, intellectual property may also begin to receive better protection. This will require, however, stronger investigative and enforcement policies, without which infringements will be difficult to curb.

A. *Patents*

As in other CEE countries, Hungarian patent law had little meaning within the domestic economy during the socialist period. The state owned not only most of the physical means of production, but also the rights to most inventions used in production. Almost all workers were employees of the state, and there was little competition or reward for entrepreneurship in ideas. The main demand for intellectual property protection arose from foreign firms doing business in Hungary.

Hungary's current domestic legislation on patents stems from the socialist period and includes primarily Patent Act No. II of 1969.¹²⁶ As with many Western laws,¹²⁷ these laws give an inventor exclusive rights over an invention¹²⁸ for twenty years from the date of application.¹²⁹ Like other socialist patent legislation and unlike most Western law, however, Hungarian patent law prohib-

126. See 1969. évi II. Törvény a találmányok szabadalmi oltalmáról, a végrehajtásról szóló 4/1969. (XII. 28.) OMFB-IM együttes rendelet, valamint a 9/1969. (XII. 28.) IM rendelet a bírósági eljárásról szabadalmi ügyekben egységes szerkezetbe foglalt szövege [Act II of 1969 on the Patent Protection of Inventions; Joint Decree 4/1969 (Dec. 28.) Issued by the National Committee of Technical Development and the Minister of Justice on Its Implementation [sic]; and Decree No. 9/1969 (Dec. 28.) by the Minister of Justice on Court Proceedings in Patent Cases], *Hatlyos magyar jogszabályok*, Apr. 26, 1969, translated in Nr. II./11. HUNGARIAN RULES OF LAW IN FORCE 778 (1991) [hereinafter Patent Law]. Two other laws, Decree-Law No. 5 of 1983 on Patents, and Decree No. 28 of 1978 on the Protection of Industrial Designs, are also part of Hungary's domestic patent legislation.

127. For a comprehensive discussion of intellectual property laws on a global scale, see generally James P. Chandler, *Protection of U.S. Competitiveness in the International Software Markets: Reexamining the Question of Copyrighting Government-Created Software*, 25 GEO. WASH. J. INT'L L. & ECON. 387 (1991).

128. Patentable inventions must be novel, meaning that the public must not have access to the design through the print media or common knowledge or practice. See Patent Law, *supra* note 126, ch. I, §§ 1-2.

129. Patent Law, *supra* note 126, ch. II, § 12(1).

its certain inventions from being patented, including pharmaceuticals, chemically fabricated products, food products, and immoral items.¹³⁰ The Hungarian Patent Office is planning to remove these prohibitions to harmonize the act with the European "norm" and allow Hungary to apply for associate membership in the European Patent System. This amendment is close to being finalized, and a complete revision of the Patent Act is expected to be presented by 1994.

Hungary's patent law also provides for "compulsory licenses," by which the state can grant use rights to third parties if an invention has not been sufficiently utilized within three years of being patented.¹³¹ In this situation, parties may negotiate the proper licensing fee, but if a fee cannot be agreed upon by the patentee and the licensee, it will be fixed by a court.¹³² It remains to be seen whether this provision will be removed when the Patent Act is revised; it is interesting to note that a similar provision remained in Romania's new patent law of 1991.¹³³ Practically speaking, however, the compulsory licensing power is unlikely to be used often, as such licenses are usually ineffective due to the user's likely need for the patent holder's technological expertise and cooperation.

A related provision allows the government to license any patent at will for purposes of the national defense.¹³⁴ It is unclear what type of compensation is available in such circumstances, although the Constitution provides a general guarantee of compensation in cases of expropriation. As with the compulsory license provision, it remains to be seen whether this state power will remain in Hungary's patent law.

Hungary has been a signatory to the 1883 Paris Convention for the Protection of Industrial Property since 1967.¹³⁵ The two

130. *Id.* ch. I, § 6(3)(a)-(b).

131. *Id.* ch. II, § 11(3). Chapter IV, section 21 discusses and defines compulsory licensing. These provisions are known throughout the world and are permitted under the Paris Convention, discussed below.

132. *Id.* ch. IV, § 23(3).

133. See Gray et al., *Romania*, *supra* note 2, at 627-28.

134. Patent Law, *supra* note 126, ch. IV, § 24(1).

135. See Paris Convention for the Protection of Industrial Property, Mar. 20, 1883, 25 Stat. 1372, 161 Consol. T.S. 409 [hereinafter Paris Convention], *amended* Dec. 14, 1900, 32 Stat. 1936, 189 Consol. T.S. 134, *amended* June 2, 1911, 38 Stat. 1645, 213 Consol. T.S. 405, *amended* Nov. 6, 1925, 47 Stat. 1789, 74 L.N.T.S. 289, *amended* June 2, 1934, 53 Stat. 1748, 192 L.N.T.S. 17, *amended* Oct. 31, 1958, 13 U.S.T. 1, 828 U.N.T.S. 108, *amended* July 14, 1967, 21 U.S.T. 1583, 828 U.N.T.S. 306; UNITED STATES DEPARTMENT OF STATE, TREATIES IN FORCE: 1991 at 327-28 (1992) [hereinafter TREATIES IN FORCE].

most important rights granted by the treaty concern national treatment of foreigners¹³⁶ and the right of priority in registration.¹³⁷ The right to national treatment obligates countries to treat foreigners as they would treat their own nationals under their own laws.¹³⁸ The right of priority gives the holder of a patent one year to file in other member countries without losing priority rights over other potential claimants to the invention.¹³⁹ The criteria for patentability are, however, still questions of domestic law. Thus, without a Hungarian law that provides reliable substantive patent rights, the Paris Convention can do little to protect patents.

All patent applications in Hungary are submitted to the National Patent Office, which conducts a formal examination of the application.¹⁴⁰ The process takes approximately eighteen months, which is normal by Western standards. The application fee itself is nominal, HUF 1000-2000 (\$12-\$23), as is the annual fee of HUF 6000 (\$69) for the first five years.¹⁴¹ Thereafter, the fee grows incrementally, reaching HUF 24,000 (\$277) in the twentieth year.¹⁴² Finally, decisions of the Patent Office may be appealed to the Metropolitan Court, and from there to the Supreme Court.¹⁴³

B. Trademarks

Trademarks in Hungary are protected by Act No. IX of 1969.¹⁴⁴ This law grants exclusive rights of use and transfer of registered trademarks for an initial period of ten years, renewable for ten year periods thereafter.¹⁴⁵ Like patents, trademarks are to be registered at the Patent Office.¹⁴⁶ Fees are HUF 3000 (\$35) for the first ten years, and an additional HUF 1000 (\$12)

136. Paris Convention, *supra* note 135, art. 2(1).

137. *Id.* art. 4C(1).

138. *Id.* art. 2.

139. *Id.* art. 4C(1).

140. See Patent Law, *supra* note 126, ch. VIII, § 44(1).

141. See *Hungary*, in INVESTING, LICENSING & TRADING CONDITIONS ABROAD, July 1992, at 9 [hereinafter *ILT CONDITIONS ABROAD*].

142. *Id.*

143. See Patent Law, *supra* note 126, ch. X, § 58(1)-(2).

144. Law No. IX of 1969 on Trademarks completed with the rules according to Joint Decree No. 2/1970 (July 1) OMF-B-IM of the President of the National Committee for Technical Development and of the Minister of Justice on the Execution of the Law.

145. *Id.* ch. II, art. 6(1)-(2).

146. *Id.* ch. VII, art. 20(a).

for international registration.¹⁴⁷

As a signatory to the Paris Convention, Hungary grants national treatment, as well as the right of priority, to foreign trademark owners.¹⁴⁸ The right of priority lasts six months for trademarks, as opposed to one year for patents.¹⁴⁹ The Paris Convention does, however, provide a bit more substantive protection for trademarks than for patents by automatically protecting well-known marks, apparently without requiring that the mark be registered in other member countries.¹⁵⁰

Hungary is also a signatory to the most current text of the Madrid Agreement Concerning the International Registration of Marks.¹⁵¹ The Madrid Agreement protects both trademarks and service marks by allowing members of signatory countries to register their trademarks with the International Bureau of the World Intellectual Property Organization (WIPO) in Geneva.¹⁵² The mark must first be registered in the country of origin, whose administration applies for registration with WIPO. Registration with WIPO protects a mark in all signatory countries. Upon notification of WIPO registration, however, national administrations still may be authorized by national law to declare that certain trademark protection cannot be granted in that territory. Thus, like the Paris Convention, the Madrid Agreement ultimately depends upon domestic law to protect substantive rights.

C. Copyright

The current Hungarian law providing copyright protection is the Hungarian Copyright Act No. III of 1969.¹⁵³ This law is considered the most advanced of all CEE copyright laws because it has contained some protection for computer programs since 1983, and it is generally consistent with European norms.¹⁵⁴ In

147. See *ILT CONDITIONS ABROAD*, *supra* note 141, at 9.

148. See *supra* notes 135-139 and accompanying text.

149. See Paris Convention, *supra* note 135, art. 4C(1).

150. *Id.* art. 6bis.

151. See Madrid Arrangement Concerning the International Registration of Marks, Apr. 14, 1891, 828 U.N.T.S. 389. The Madrid Agreement has been revised a number of times, most recently in 1967.

152. See Convention Establishing the World Intellectual Property Organization, July 14, 1967, 21 U.S.T. 1749, 828 U.N.T.S. 3 [hereinafter WIPO Convention].

153. Hungarian Copyright Act No. III of 1969, as amended in 1978, implemented by Decree No. 9 of July 12, 1983. For a thorough discussion of this law, see Eric J. Schwartz, *Recent Developments in the Copyright Regimes of the Soviet Union and Eastern Europe*, 38 J. COPYRIGHT SOC'Y U.S.A. 123, 140-42 (1991).

154. Schwartz, *supra* note 153, at 140.

keeping with the commonly accepted language of copyright protection, this law protects "literary, scientific and artistic creations."¹⁵⁵ While such language in other countries is often interpreted not to include computer software, the decree implementing the Hungarian law expressly includes "computer programs and the related documentation."¹⁵⁶

Sound recordings are protected under Decree-Law No. 19 of 1975 on the Protection of Producers of Phonograms.¹⁵⁷ This protection grants producers the exclusive right to reproduce, distribute, or publicly perform the work in question, but it neglects to protect the more important economic rights to commercial renting and lending.¹⁵⁸ Furthermore, criminal sanctions are not available to protect the rights granted in the decree.¹⁵⁹

Registration of copyrighted work is not required under Hungarian law; works are protected upon creation. In general, works are protected for fifty years after the death of the author.¹⁶⁰ Sound recordings, however, are protected for only twenty years.¹⁶¹

Chapter V of the Copyright Act lays out certain restrictions on contracting with Hungarian authors or users.¹⁶² Such contracts must be made through the intermediary agencies listed in article 20 of the Implementation Decree.¹⁶³ One such agency is ARTISJUS, a governmental agency functioning as a performing rights society, a copyright licensing agency, and a copyright spokesman for the government. In addition, most copyright disputes are mediated by ARTISJUS, although they may be brought before the Metropolitan Court.

In cases of copyright infringement, civil remedies include injunctions, damages, fines, and possibly destruction of the

155. *Id.* at 141 (quoting Hungarian Copyright Statute of 1979, as amended up to 1978, ch. I, art. 1).

156. *Id.* (quoting Decree Concerning the Implementation of the Copyright Act No. III of 1969, Decree No. 9 of Dec. 29, 1969, as amended up to July 12, 1983, art. 1). A related advance in this field is the recent Act on the Protection of the Topography of the Microelectronic Semiconductor Products. See Memorandum prepared by Dr. Andrs Szecskay, Attorney at Law, S.B.G. & K. Patent and Law Office, Budapest (on file with *The George Washington Journal of International Law and Economics*).

157. Schwartz, *supra* note 153, at 141-42.

158. *Id.* at 142.

159. *Id.*

160. *Id.* at 141.

161. Although the international norm is 50 years, Hungarian law only protects sound recordings for 20 years. *Id.* at 142.

162. *Id.* at 141 (citing Copyright Statute of 1979, as amended up to 1978, ch. V).

163. *Id.*

offending material.¹⁶⁴ Under government decree, infringements of Hungarian copyright law qualify as misdemeanor offenses.¹⁶⁵ Some observers advocate additional criminal sanctions in cases of willful infringement, sanctions that exist in most European countries.¹⁶⁶ Such sanctions are expected to be included in an upcoming amendment to the Penal Code.¹⁶⁷

Since 1922, Hungary has been a signatory to the Berne Convention for the Protection of Literary and Artistic Works,¹⁶⁸ which protects literary, scientific, and artistic works. It adheres to the most recent revision of the Berne Convention: the Paris text of 1971, which extends the period of protection from twenty-five to fifty years.¹⁶⁹ Under the Berne Convention, no formalities are required to protect a work in other member countries.¹⁷⁰ While protection may depend upon registration in the country of origin, no central registration exists for international protection; works are protected upon creation.¹⁷¹ Also, Hungary has been a signatory to both the Universal Copyright Convention since January 1971 (including the Paris Act, July 1974)¹⁷² and the Geneva Phonograms Convention since 1975.¹⁷³

164. *Id.* at 142 (citing Copyright Statute of 1979, as amended up to 1978, ch. XIII, arts. 52-53).

165. *See Rules and Problems in Copyright Law*, HUNG. ECON. REV., Oct. 1991, at 24 (noting that government decree declares the unlawful use of an author's work to be a misdemeanor).

166. *See id.*; *see also* INTERNATIONAL INTELLECTUAL PROPERTY ALLIANCE, COPYRIGHT LAWS OF EASTERN EUROPE AND THE U.S.S.R. 28 (Nov. 1990) [hereinafter IIPA REPORT].

167. *Rules and Problems in Copyright Law*, *supra* note 165, at 24. The International Intellectual Property Association reports that as of November 1990, criminal incarceration of up to three years is available for plagiarism causing material loss to the author. *See IIPA REPORT*, *supra* note 166, at 28.

168. *See* Berne Convention for the Protection of Literary and Artistic Works, Sept. 9, 1886, *completed* May 4, 1896, *revised* Berlin, Nov. 13, 1908, 1 L.N.T.S. 217, *completed* Berne, Mar. 20, 1914, *revised* Rome, June 2, 1928, 123 L.N.T.S. 234, *revised* Brussels, June 26, 1948, 31 U.N.T.S. 217, *revised* Stockholm, July 14, 1967, 828 U.N.T.S. 221, *revised* July 24, 1971, S. TREATY DOC. NO. 27, 99th Cong., 2d Sess. (1986); TREATIES IN FORCE, *supra* note 135, at 295.

169. *Id.* art. 7(1).

170. *Id.* art. 5.

171. *Id.*

172. *See* Universal Copyright Convention, Sept. 6, 1952, 6 U.S.T. 2731, 216 U.N.T.S. 132, *revised* July 24, 1967, 25 U.S.T. 1341, 943 U.N.T.S. 178; TREATIES IN FORCE, *supra* note 135, at 403-16.

173. *See* Convention for the Protection of Producers of Phonograms Against Unauthorized Duplication of Their Phonograms, Oct. 29, 1971, 25 U.S.T. 309, 866 U.N.T.S. 67; TREATIES IN FORCE, *supra* note 135, at 362.

V. COMPANY LAW

Company law plays a central role in market economies. It sets guidelines for the internal organization of private companies and for systems of corporate governance. Together with securities legislation, company law protects outside investors and the public by specifying minimum requirements for capital and the dissemination of information about the company. It also encourages entrepreneurship by setting limits on the liability of investors. Because the notions of private capital, private investment, and private commercial liability are relatively new in Hungary and other reforming socialist economies, all of these functions of company law are also relatively new in the CEE context.

The idea of firm-level independence and autonomy is not an entirely new concept in Hungary. From 1875 to 1948, Hungary's company law had been developing in tandem with those of its Western neighbors. That line of company law was abandoned after the introduction of socialism, although it was never formally abrogated. For two decades after 1948, Hungary followed the classical model of centrally planned socialism.

Then, in an attempt to move away from strict socialism toward a socialist market economy, Hungary adopted the New Economic Mechanism (NEM) in 1968.¹⁷⁴ As discussed earlier, the NEM delegated more decision making to the enterprise level. Enterprises were still expected to meet their production targets under the state economic plan, but they retained freedom to make their own decisions regarding the means—including labor and investment needs—to meet those ends.¹⁷⁵

Enterprise autonomy was first legally recognized in Act No. VI of 1977 on State-Owned Enterprises.¹⁷⁶ The true landmark of enterprise management reform, however, appeared with the 1984 amendment to this act, Decree No. 33.¹⁷⁷ This amendment introduced the concept of the self-managed enterprise, whose

174. See, e.g., BELA BALASSA, *THE HUNGARIAN ECONOMIC REFORM, 1968-1981*, at 4-10 (World Bank Staff Working Paper No. 506, 1982).

175. See, e.g., Steven W. Popper, *Hungarian Management in Transition: Enterprise Guidance in an Era of Economic Reform* (1986) (unpublished manuscript, on file with *The George Washington Journal of International Law and Economics*) (describing the economic environment after the introduction of the New Economic Mechanism).

176. 1977. évi VI. törvény az állami vállalatokról [Act No. VI of 1977 on state-owned enterprises], *Hatlyos magyar jogszabályok*, Dec. 15, 1990, translated in I./Nr. 25. HUNGARIAN RULES OF LAW IN FORCE 1523 (1990).

177. *Id.*

management could take one of two forms: (1) the enterprise council, which is a representative body of employees; or (2) the general assembly of employees.¹⁷⁸ As a result of this law, approximately eighty percent of Hungary's enterprises became self-managed,¹⁷⁹ while the remainder stayed under central state administrative control.

In the late 1980s, Hungary made a series of reforms designed to further its transformation toward a market economy. Unlike Poland, which revived its pre-war company law,¹⁸⁰ Hungary used this opportunity to draft Act VI of 1988 on Business Organizations (Companies Act), an entirely new code based upon the German and Austrian codes.¹⁸¹ As in other CEE countries, Hungarian company law governs the establishment of new companies, as well as the "corporatization" of what were formerly state-owned enterprises.¹⁸² The law recognizes a number of different forms of business organization, including the joint stock company,¹⁸³ the limited liability company,¹⁸⁴ and both general and limited partnerships.¹⁸⁵

A. *The Joint Stock Company*

In Hungary, the joint stock company is often referred to as the

178. *Id.* at 1532, 1537.

179. Self-management was a concept that had been followed in neighboring Yugoslavia since the early 1950s. This concept is designed to give employees specific powers over management even though they may not have an ownership interest. For an incisive analysis of its economic impact, see MANUEL HINDS, ISSUES IN THE INTRODUCTION OF MARKET FORCES IN EASTERN EUROPEAN SOCIALIST ECONOMIES 20-54 (The World Bank Europe, Middle East and North Africa Region Internal Discussion Paper No. IDP-0057, Apr. 1990).

180. See Gray et. al., *Poland*, *supra* note 2, at 295-96.

181. See 1988. évi VI. törvény a gazdasági trsasgokról [Act VI of 1988 on Business Organizations (Companies Act)], *Hatlyos magyar jogszablyok*, Feb. 1, 1992, *translated in* Nr. III./3-4. HUNGARIAN RULES OF LAW IN FORCE 167 (1992) [hereinafter *Company Law*].

182. See 1989. évi XIII. törvény a gazdalkodó szervezetek és a gazdasági trsasgok talakulsról [Act No. XIII of 1989 on the conversion of economic organizations and business associations], *Hatlyos magyar jogszablyok*, Dec. 15, 1990, *translated in* I./Nr. 25. HUNGARIAN RULES OF LAW IN FORCE 1573 (1990) [hereinafter *Conversion Law*]. The term "corporatization" is used to refer to the legal transformation of state-owned enterprises into corporate forms set out in the Act on Economic Associations.

183. The joint stock company is discussed *infra* notes 186-227 and accompanying text.

184. The limited liability form had been available for use since 1972, but it was restricted to joint ventures with foreign participation. See *infra* notes 228-253 and accompanying text.

185. See *infra* notes 254-257 and accompanying text.

"company limited by shares"¹⁸⁶ or the share company. It resembles the French *societe anonyme* (S.A.), the German *Aktiengesellschaft* (A.G.), and the American publicly held corporation. The Hungarian joint stock company is designated by the letters "Rt" in its name.¹⁸⁷ This form, most appropriate for companies seeking a large number of shareholders, is the most conducive to public offerings.

1. Capitalization and Disclosure Requirements

A joint stock company may be founded by one or more individuals.¹⁸⁸ Minimum capital requirements are high: HUF 10 million (\$115,000), of which at least thirty percent must be paid in upon registration.¹⁸⁹ The value of non-cash contributions also may be included in capital, if checked by an auditor and disclosed by the founders in a written declaration.¹⁹⁰

A joint stock company provides the most freely transferable vehicle for investment. Both bearer shares and registered shares are freely transferable.¹⁹¹ Joint stock companies also offer the greatest flexibility in obtaining capital, although many of the financial instruments envisioned in the Company Act are not yet used in practice. As discussed below, the practical problems are due in large part to a lack of familiarity on the part of Hungarian investors.

A wide variety of stock classes are authorized by the Company Act; however, shares within the same class must have identical face value.¹⁹² Voting rights of different shares may differ without limit, as long as this is specified in the company's charter.¹⁹³ While voting rights are generally proportional to share value, the articles may limit those rights.¹⁹⁴

186. See Conversion Law, *supra* note 182, ch. VII.

187. See Company Law, *supra* note 181, art. 232(2).

188. *Id.* art. 250.

189. *Id.* art. 251. Such a high minimum capital requirement discourages the formation of companies and would seem inadvisable for Hungary at this time.

190. *Id.* art. 253(1)-(3). While not explicitly stated in the law, it is presumed that the Court of Registration, in reviewing the articles of association, may challenge this valuation.

191. *Id.* art. 240. Transfers of registered shares are governed by the rules regulating bills of exchange. See 1/1965. (I.24.) IM rendelet a váltójogi szabályok szövegének közzétételéről [Decree of the Minister of Justice No. 1/1965 (I.24.) on the Publication of the Regulations Concerning Bills of Exchange Law], *Hatlyos magyar jogszabályok*, Feb. 1, 1992, translated in Nr. 19-20. HUNGARIAN RULES OF LAW IN FORCE 1142 (1992).

192. Company Law, *supra* note 181, art. 234(3).

193. *Id.*

194. Compare *id.* art. 242(1) ("The voting rights attached . . . may be restricted or

Companies may issue preferred shares, which entitle the owner to priority in the distribution of dividends. The total value of all preferred shares, however, may not exceed fifty percent of the company's registered capital.¹⁹⁵ Such preferred shares may carry limited or zero voting rights, if so detailed in the company charter.¹⁹⁶

Companies may also issue interest-bearing shares.¹⁹⁷ This type of share is a modern hybrid, possessing characteristics of both debt and equity financing. Like debt, interest-bearing shares earn a rate of interest, as determined by the company statute, regardless of whether the company has shown a profit.¹⁹⁸ Like equity, such shares may also be entitled to receive dividends.¹⁹⁹ In light of the demands that such financing may put on a company, these shares may total only ten percent of the entire company's registered share capital.²⁰⁰ While this share type has been infrequently used in practice, owners of interest-bearing shares are entitled to other share-related rights, including the right to receive dividends and voting rights.²⁰¹ Preferred shares also could be structured without voting rights to resemble interest-bearing shares.

Varied instruments of debt financing, including convertible and preference bonds, also are permitted under the Company Act, although the value of convertible bonds may not exceed fifty percent of the company's registered capital.²⁰² A convertible bond entitles its holder to convert the bond into equity shares on terms detailed in the bond itself, an attractive option to the holder when dividends exceed the bond's interest payments.²⁰³ A bond ensuring the right of preemption, or preference bond, gives its holder the option of buying a proportional number of new shares, if and when issued by the company.²⁰⁴ Apparently,

precluded.") with Gray et al., *Poland*, *supra* note 2, at 299 ("A share entitles its holder to at least one vote at the appropriate meetings.").

195. See Company Law, *supra* note 181, art. 242(4).

196. *Id.* art. 242(1). If dividends due on preferred non-voting shares are not paid for two consecutive years, those shareholders are entitled to voting rights until those dividends are distributed.

197. *Id.* art. 245.

198. *Id.* art. 245(2).

199. *Id.* art. 245(3).

200. *Id.* art. 245(1).

201. *Id.* art. 245(3).

202. *Id.* art. 246.

203. *Id.* art. 246(1).

204. *Id.* art. 246(2).

this type of bond may be exchanged for the new shares, but the rate of conversion is an open question. While there is not yet an established practice, Hungarian lawyers read the statute to allow conversion only at par value, and not market value.

Finally, workers' shares are envisioned by the Company Act.²⁰⁵ These shares may be distributed to current employees free of charge or at a rate lower than the issuing or market price.²⁰⁶ Workers' total shares may not exceed ten percent of the company's registered capital,²⁰⁷ and these shares may be transferred to other workers and pensioners.²⁰⁸

Also worthy of mention are golden shares, which enable the state to exercise fifty-one percent voting power if it owns at least one-third of the shares. The original Hungarian Company Law did allow use of the golden share,²⁰⁹ but this provision was subsequently deleted.²¹⁰ Generally, the golden share is meant to provide its holder the power to veto certain company decisions, as indicated in the company statute, that are potentially harmful to the national welfare.²¹¹ This privilege is usually reserved for the government and is most often used by governments in the process of privatizing industries considered to be strategic to the national economy. It enables the government to prevent undesirable parties from taking control, without forcing the government to own a full fifty-one percent of the shares. Use of the golden share by former socialist governments had been looked upon with suspicion, mainly because it locks in government control at the expense of a developing market for corporate control.

2. Rights and Duties of Shareholders

Shareholders are entitled to dividends in proportion to their share value, and, in the event of liquidation, to a proportional

205. *Id.* art. 244(1).

206. *Id.*

207. *Id.*

208. *Id.* art. 244(2).

209. See Act VI of 1988 on Economic Associations (Company Act) § 269(3), reprinted in HUNGARIAN CHAMBER OF COMMERCE, HUNGAROPRESS SPECIAL EDITION [hereinafter Original Company Law].

210. Company Law, *supra* note 181, art. 269.

211. For example, the articles of association of Rolls Royce in Great Britain allow the government to control voting concerning its "nuclear business." In addition, the articles of the British Airport Authority subject the disposal of airports to the government's consent. See Cosmo Graham, "All that Glitters . . ." - Golden Shares and Privatised Enterprises, 9 COMPANY LAW. 23, 25 n.7 (1988).

share of the company's assets.²¹² The distribution of dividends is left to the discretion of the directors, but dividends may not debit the registered capital.²¹³ All shareholders may attend the general meetings, and those holding voting shares may vote either in person or by proxy.²¹⁴ A simple majority is needed to elect and recall members of the Board of Directors and the Supervisory Board, to approve the balance sheet and profit distribution, and to permit the issuance of convertible or preference bonds.²¹⁵ A three-fourths majority is required to amend the articles of association; modify rights attached to a particular type of share; and merge, dissolve, or convert the company to another form.²¹⁶ Because this three-fourths majority is required to make many key business decisions, investors have in practice sought this level of control when buying companies privatized through the State Property Agency.

Hungarian company law protects the rights of minority shareholders. Minority shareholders are defined as the holders of less than ten percent of the shares, or a smaller percentage if specified in the company's charter.²¹⁷ The minority rights protected by Hungarian law include the right to call a general meeting,²¹⁸ to place a specific item on the meeting's agenda,²¹⁹ and to request that the Supervisory Board examine management's activity.²²⁰ Any shareholder, member of management, or member of the Supervisory Board may appeal to the Court of Registration any decision of the general assembly thought to infringe upon company law, the articles of association or any other law.²²¹

3. Corporate Governance

All joint stock companies in Hungary must have two layers of governance—the Board of Directors and the Supervisory Board—in addition to an outside auditor.²²² Although directors are held to a general duty of care as defined by the Company

212. Company Law, *supra* note 181, art. 266(2).

213. *Id.* art. 266(4).

214. *Id.* arts. 270-271.

215. *Id.* art. 282.

216. *Id.*

217. *Id.* art. 273(1).

218. *Id.*

219. *Id.* art. 274(1).

220. *Id.* art. 275(1).

221. *Id.* arts. 273(2), 274(4).

222. *Id.* art. 30.

Law,²²³ principles of officer and director liability are not yet well-developed.

The Board of Directors must consist of between three and eleven members.²²⁴ Conflict-of-interest provisions attempt to prevent Board members from concluding transactions similar to that of the company in their own names; from being a partner with unlimited liability in any company similar to the company; and from being a leading official in similar companies.²²⁵

The Supervisory Board is charged with controlling the management of the company²²⁶ and overseeing the activity of the Board of Directors, although the respective competencies of the two Boards are determined largely by the specifics of the company's charter. The Supervisory Board must consist of at least three members, who may be shareholders or from outside the company. If the company annually employs an average of 200 employees, one-third of the Supervisory Board must be elected by the employees.²²⁷

B. *The Limited Liability Company*

Hungary's limited liability company (LLC) is identified by the letters "Kft" appearing after its name.²²⁸ As in other CEE countries, the LLC form is more popular than the joint stock company among local investors due to its simpler structure and lower capital requirements.²²⁹ In contrast, many larger foreign investors choose the joint stock form because it allows for greater ability to tailor share structure, voting, and other rules to the investors' particular needs. The LLC is primarily intended as an investment vehicle for a relatively small group of investors who deal with each other on a regular basis. During the first quarter of

223. Article 32(1) states that:

Senior officers, supervisory board members and auditors shall be obliged to act with the care generally expected from persons in such positions. In breaching their duties they shall be, in accordance with the general provisions of civilian law, liable for damage caused to the company even if they have a contract of employment with the company.

Id. art. 32(1).

224. *Id.* art. 285(2).

225. *Id.* art. 290(1).

226. *Id.* art. 36.

227. *Id.* art. 13(1)-(2).

228. *Id.* art. 155(2).

229. For example, a LLC may be formed by one person. *Id.* art. 156(1). The minimum capital requirement is HUF 1 million (\$11,500). *Id.* art. 158(2).

1992, over two thousand limited liability companies registered in the Budapest Court of Registration.

1. Capitalization

The LLC may be formed by one or more individuals, apparently with no maximum limit.²³⁰ Its minimum capital must be HUF 1 million (\$11,500), which is lower than that required for the joint stock company, but still a high barrier for new private entrepreneurs.²³¹ This capital is divided into stakes of a predetermined amount.²³² Each stake must be at least HUF 100,000 (\$1150) and exactly divisible by 10,000.²³³ Parties holding a stake in the company are referred to as members. One stake may be held by several individuals, who together are deemed one member, exercise their rights through a common representative, and are jointly liable for the obligations of the members.²³⁴ Each member may hold no more than one stake, but the value of that stake may increase or decrease in proportion to the member's contribution.²³⁵ Contributions may be either cash or in-kind.²³⁶ To register the company, at least fifty percent of the amount of each stake must be collected.²³⁷ The rest is payable as determined by the company's articles of association; cash contributions must be paid within one year.²³⁸ Members' stakes are freely transferable to any other member of the LLC, but before being sold to outsiders they must first be offered to other members, the company, or someone chosen by the membership.²³⁹ These requirements are absolute, and the article of association may not

230. *Id.* art. 156. Other European countries impose a maximum limit, such as 50, on the number of partners in limited liability companies in order to differentiate it more clearly from the joint stock form and to force conversion to the latter form, with its stricter capital and information requirements, as the company grows in size.

231. *Id.* art. 158(2).

232. *Id.* art. 159.

233. *Id.* art. 159(1).

234. *Id.* art. 169(3).

235. *Id.* art. 169(2).

236. *Id.* art. 161(3).

237. *Id.* art. 161(2).

238. *Id.* art. 161(4).

239. *Id.* art. 170. This differs from the strict rule found in other European countries that a stake cannot be sold to outsiders without the express and unanimous permission of insiders. See NORBERT HORN ET AL., GERMAN PRIVATE AND COMMERCIAL LAW: AN INTRODUCTION 254 (Tony Weir trans., 1982). What constitutes a valid offer in the LLC case is somewhat unclear under the Hungarian system. The ability to formulate a tighter preemption rule under a separate shareholders' agreement is another reason that some foreign investors prefer the joint stock form.

stipulate more favorable terms.²⁴⁰ Unlike the joint stock company, the LLC may not recruit contributors through public appeal.²⁴¹

2. Rights and Duties of Members

Members are entitled to dividends and, in the event of liquidation, assets in proportion to the size of their stakes.²⁴² Voting rights are determined by the size of each stake; each HUF 100,000 unit entitles its holder to one vote.²⁴³ Thus, each member has at least ten votes, but variations above this minimum may be determined by the articles of association.²⁴⁴ Apart from the obligation to pay in one's primary stake, members bear no liability for the LLC's debts.

LLC members must hold meetings at least once a year.²⁴⁵ Decisions are passed by a simple majority unless otherwise stipulated in the articles.²⁴⁶ Members may, however, pass decisions by mail without holding a meeting, subject to the normal requirements for voting majorities, unless any member requests that a meeting be convened to discuss the decision.²⁴⁷ Minority shareholders—members who in the aggregate represent at least ten percent of the current registered capital—may call a meeting of all members.²⁴⁸ As with the joint stock company, any amendment to the company's articles of association requires a three-fourths majority vote.²⁴⁹

3. Company Governance

The LLC may be managed by one or more directors or managers, elected to serve a set term of years by members representing a majority of the company's assigned votes.²⁵⁰ A Supervisory Board with at least three members is mandatory for the LLC if (1) its capital exceeds HUF 20 million (\$230,000); (2) its membership exceeds twenty-five people; or (3) its number of full-time

240. Company Law, *supra* note 181, art. 172.

241. *Id.* art. 156(2).

242. *Id.* art. 177(2).

243. *Id.* art. 187(1).

244. *Id.* art. 157(1)(c).

245. *Id.* art. 183(1).

246. *Id.* art. 186(1).

247. *Id.* art. 192(1)-(3).

248. *Id.* art. 190(1).

249. *Id.* art. 216(1).

250. *Id.* art. 197(1).

employees exceeds an annual average of 200.²⁵¹ In the last case, similar to the joint stock company, one-third of the Supervisory Board members must be elected by the employees.²⁵² An independent auditor is required if the company's initial capital is greater than HUF 55 million (\$634,000), or if the company is held by one person.²⁵³

C. Partnership Forms

Two common forms of partnership are included in the Company Act: the general partnership and the limited partnership.²⁵⁴ In the general partnership, all partners are jointly and severally liable for the partnership's liabilities.²⁵⁵ The limited partnership consists of limited partners, whose liability is limited to their contribution to the partnership, and one or more general partners whose liability is unlimited.²⁵⁶ General partners are responsible for the active management of the company. Both forms are quite flexible, as partners are able to negotiate their own arrangements regarding capital contributions, distribution of profits and losses, and allocation of voting and managerial rights.²⁵⁷ As is common in most CEE countries, Hungarian partnerships are not pass-through entities and are thus subject to tax at the entity level.

D. Procedures for Setting Up a Company

The first step in setting up either a joint stock company or a limited liability company is drafting the articles of association, which must then be signed by all founding members as well as the company attorney.²⁵⁸ Although the articles must be notarized, this procedure is not as expensive or time-consuming in Hungary as it is in other CEE countries.²⁵⁹ In Hungary, the job

251. *Id.* art. 34(1)-(2).

252. *Id.* art. 13(2).

253. *Id.* art. 39(2).

254. The Hungarian law uses slightly different terminology when referring to the two types of partnerships. The "general" partnership is called an "unlimited" partnership, while the "limited" partnership is known as a "deposit" partnership.

255. *Id.* art. 55(1).

256. *Id.* art. 94(1). In an apparent effort to protect creditors, the Company Act mandates that a natural individual can only be an unlimited liability member of one company at any given time. *Id.* art. 6(1).

257. *Id.* art. 97(1).

258. *Id.* art. 19.

259. See Gray et al., *Poland*, *supra* note 2, at 303-04 (discussing difficulty in finding notaries and their high fees in Poland).

of notaries is not to approve the form of the documents, but merely to certify that the signatures are authentic.

Within thirty days from the adoption of the articles, the company must apply to the Court of Registration to register the company.²⁶⁰ Its application must include a registration fee equal to two percent of the company's initial capital, and a certification from the bank that the initial capital is on deposit.²⁶¹ The registration process is known to be slow—six months is considered normal—and cumbersome, although the Court of Registration is now fully computerized. The delay is caused by the enormous backlog of applications, mistakes generated by the relative inexperience of lawyers filing registrations, and careful court scrutiny of each application to insure conformity with Company Act requirements. If provisions do not comply with the act's formal requirements, the Court of Registration may return the articles for changes. As local lawyers gain more experience with the Company Act, they are beginning to use simpler articles of association that closely track the act's language, the hope being that fewer applications will be returned for corrections.

The company attains the status of a legal personality upon its registration in the Trade Register.²⁶² It may then access its bank deposit and formally begin its activities. In addition, it may now begin to ratify any actions taken by the founders in the period between the adoption of the deed and the company's formal registration.²⁶³

VI. FOREIGN INVESTMENT LAW

Since Hungary first opened its doors to foreign investment in 1988, the country has enjoyed a level of foreign investment unmatched by any other CEE country.²⁶⁴ This was initially due to Hungary's original foreign investment law, Act XXIV of

260. Company Law, *supra* note 181, art. 23(1).

261. ILT CONDITIONS ABROAD, *supra* note 141, at 7.

262. Company Law, *supra* note 181, art. 24(1).

263. *Id.* art. 25(2).

264. As of late May 1991, Hungary had \$1.2 billion in foreign capital—over half the total foreign capital in all of Eastern Europe—invested in 5000 joint ventures. Germany and Austria are partners in approximately 2000 of these ventures, and approximately 40% of this \$1.2 billion comes from U.S. investments (fewer in number but typically larger in size). Most joint ventures are small service and trade operations, employing only one or two people. Around half of all joint ventures in Hungary have \$160,000 or less invested. Karoly Okolicsanyi, *Joint Ventures Begin to Have a Significant Impact on the Economy*, REP. E. EUR., May 24, 1991, at 23.

1988,²⁶⁵ which was the most liberal investment law in the region at that time. That law has, however, been modified periodically since then, but it still retains the basic features that are particularly attractive to foreign investors.²⁶⁶

A. *Ownership and Forms of Investment*

Hungarian foreign investment law allows foreign individuals and entities to own up to one hundred percent of a Hungarian investment, including the real property associated with it.²⁶⁷ The forms for such investment are governed by the Law on Economic Association and include both incorporated firms and branches. No special permission for foreign ownership is needed.²⁶⁸ In the event of expropriation, the law guarantees foreign investors full compensation in the currency of the original investment.²⁶⁹

B. *Profit Repatriation*

While Hungary's currency, the forint, is not yet formally convertible, the foreign investment law does allow foreign investors to repatriate their forint profits in the currency of the original investment at the official exchange rate,²⁷⁰ provided that the company has the equivalent amount in forint on reserve.²⁷¹ Although this language has been a source of confusion for many investors, it has generally been understood to mean that profits must be actually received and deposited in the investor's account before repatriation is possible. In practice, this means companies must obtain bank certification that the forints have been deposited. And while the law is unclear on this point, some lawyers' understanding of the law is that companies may apply for such certificates only at year's end when the company declares its

265. Act XXIV of 1988 on Foreign Investment in Hungary, *reprinted in HUNGARIAN CHAMBER OF COMMERCE, HUNGAROPRESS SPECIAL EDITION* (Apr. 1989) [hereinafter *Foreign Investment Act*].

266. Law No. XCVIII of 1990 amending Law No. XXIV of 1988 concerning foreign investments in Hungary [hereinafter *Amended Foreign Investment Act*] (unofficial translation, on file with *The George Washington Journal of International Law and Economics*).

267. See Hanson, *supra* note 85, at 442.

268. *Id.* A previous requirement that the Minister of Finance and the Minister of Commerce approve all foreign ownership that exceeded 50% was repealed in 1990.

269. *Foreign Investment Act, supra* note 265, ch. I, art. 1.

270. *Id.* ch. III, art. 32. The foreign investor is also entitled to this repatriation right if the company is liquidated or the foreign investor sells his interest. *Id.* Additionally, foreign officials, members with management duties, and employees have the right to transfer freely 50% of their taxed personal income. *Id.* art. 33.

271. *Amended Foreign Investment Act, supra* note 266, para. 10 (amending chapter III, article 32 of the *Foreign Investment Act*).

annual dividend. Other lawyers, however, argue that profits may be repatriated at any point during the year, based on an approved temporary balance sheet, subject to the requirement that the profits be returned to Hungary if there is a negative profit balance at year's end.²⁷²

Foreign individuals and companies with foreign participation are permitted to maintain hard currency accounts in any Hungarian commercial bank.²⁷³ Hungarian companies receiving capital contributions from foreigners in hard currency may also deposit them in such accounts.²⁷⁴

C. Tax and Customs Incentives

Hungary's corporate tax rate is currently forty percent,²⁷⁵ but the foreign investment law offers generous tax incentives to foreign investors.²⁷⁶ These incentives are industry specific and depend upon the amount of foreign investment.²⁷⁷ An annex to the Foreign Investment Law identifies areas of particular importance to the Hungarian economy.²⁷⁸ If a company's sales revenue derived from these activities exceeds fifty percent; the founding capital exceeds 50 million forints; and the foreign contribution is at least thirty percent, then the company is entitled to receive a one-hundred percent tax holiday for the first five years, followed by a sixty percent holiday for the second five years.²⁷⁹

Other sectors receive smaller tax benefits. For example, companies building or operating a new hotel,²⁸⁰ with founding capital

272. See George G. Lorinczi, *Overview of the Law Governing Foreign Investment in Hungary*, CORP. COUNS. INT'L ADVISOR, Sept. 1, 1990, at 64-02, 64-08 (on file with *The George Washington Journal of International Law and Economics*).

273. *Id.* at 64-08.

274. *Id.*

275. Foreign Investment Act, *supra* note 265, ch. III, art. 14(2).

276. *Id.* art. 15(1); Amended Foreign Investment Act, *supra* note 266, para. 4 (amending chapter III, article 15 of the Foreign Investment Act).

277. Foreign Investment Act, *supra* note 265, ch. III, art. 15; Amended Foreign Investment Act, *supra* note 266, para. 4. The early versions of this law granted an automatic 20% tax cut for companies with either foreign equity of at least 20% or HUF 5 million (U.S. \$65,100). See Foreign Investment Act, *supra* note 265, art. 15(2)(a).

278. Foreign Investment Act, *supra* note 265, ch. III, art. 15(2)(c). This subsection cross-references an appendix. The industries listed in the appendix include: electronics, car parts, machinery, engineering units, pharmaceuticals, packaging technology, agricultural and food technology, energy conservation, telecommunications, tourism, and public transportation. *Id.* app.

279. Amended Foreign Investment Act, *supra* note 266, para. 4 (amending chapter III, article 15(2)(b) of the Foreign Investment Act).

280. The hotels covered by this section include not only those constructed by the company in question, but also renovations that classify a building as a hotel or that

above 50 million forint and with foreign contributions of at least thirty percent, receive a sixty percent tax holiday for the first five years and a forty percent holiday for the second five years.²⁸¹ In addition, taxes are rebated on profits reinvested by the foreign investor in Hungary.²⁸²

On the customs side, foreign investors importing capital equipment will not be charged customs duties if either: (1) the equipment is part of the foreign investor's contribution; or (2) it is paid for out of the company's hard currency account.²⁸³ If, however, during the subsequent three years the company sells or leases that equipment, then the company must pay the customs duty applicable at the time of importation.²⁸⁴

Customs-free zones for foreign investors are also envisioned by the Foreign Investment Act.²⁸⁵ Companies incorporated in these zones will be exempt from Hungarian customs, excise, and exchange control regulations, as well as price controls and state supervisory regulations.²⁸⁶ They will be permitted to maintain accounting systems in fully convertible currencies.²⁸⁷ Companies seeking to incorporate in such zones must first obtain approval of the Ministry of Finance.²⁸⁸ Customs-free companies have already been established in certain industries, with special rules on how the plant is built and operated in order to segregate customs-free goods.

The generous tax incentives offered to foreign investors in Hungary have been widely criticized by economists and tax policy experts.²⁸⁹ In addition to discriminating against domestic investment, incentives such as tax holidays can cause tremendous revenue loss and severely complicate tax administration.²⁹⁰ Recognizing these problems, Hungary has recently moved to eliminate these special tax incentives for foreign investments.

upgrade a preexisting hotel to a higher classification. *See id.* para. 4 (amending chapter III, article 15(2)-(3) of the Foreign Investment Act).

281. *Id.*

282. *Id.* para. 5 (amending chapter III, article 16(1) of the Foreign Investment Act).

283. *Id.* paras. 7, 9 (amending chapter III, articles 18, 31(3) of the Foreign Investment Act).

284. *Id.*

285. Foreign Investment Act, *supra* note 265, ch. IV, art. 37.

286. *Id.* ch. IV, art. 38.

287. *Id.* ch. IV, art. 41(1).

288. *Id.* ch. IV, art. 40.

289. *See generally* Javad Khalilzadeh-Shirazi & Anwar Shah, *Introduction: Tax Policy Issues for the 1990s*, 5 *WORLD BANK ECON. REV.* 459 (1991); Anwar Shah & Joel Slemrod, *Do Taxes Matter for Foreign Direct Investment?*, 5 *WORLD BANK ECON. REV.* 473 (1991).

290. *See id.*

The incentives are to be restricted so that they only last a maximum of ten years and will be available only to companies that are substantially in production before the end of 1993.

D. *Dispute Resolution*

The Hungarian foreign investment regime gives substantial freedom to private investors to choose the mode and venue for purposes of dispute resolution. Given the relative lack of commercial experience and precedent in the Hungarian legal system, joint venture agreements often provide for arbitration to resolve disputes that may arise. At present, approximately half of all disputes are arbitrated through the Hungarian Chamber of Commerce, and the other half in various international forums. Apart from the company's articles of association, which must be governed by Hungarian law, any other agreement related to the establishment or operation of a joint venture may be governed by foreign law, if the parties choose.²⁹¹

Hungary is a signatory to the International Convention for Settlement of Investment Disputes.²⁹² Although rarely used in practice, this convention guarantees a forum in which private citizens of signatory states may arbitrate their claims against the governments of other signatory states.²⁹³ In so doing, it adds an additional degree of security not found in most other CEE countries.

VII. CONTRACT LAW

The ability to contract freely with others and the assurance that contracts will be enforced are among the most basic requirements of a legal framework for a market economy. The freedom to contract allows resources to gravitate to their most valuable use. On the other hand, this freedom often conflicts with other social concerns, such as protection of the labor force from oppressive employer policies, protection of consumers from warranty disclaimers, and, more generally, protection of weaker parties from one-sided contracts. Striking a proper balance between

291. For example, Swiss law is commonly chosen to govern shareholders' agreements. Theodore S. Boone, *Dispute Resolution and Related Issues in the Context of Investments in Central and Eastern Europe*, presented at the Country Risk Management Session, ABA Spring Meeting (Apr. 9, 1992) (on file with *The George Washington Journal of International Law and Economics*).

292. See *Convention on the Settlement of Investment Disputes Between States and Nationals of Other States*, opened for signature Mar. 18, 1965, 17 U.S.T. 1270, 575 U.N.T.S. 159.

293. *Id.* ch. I, art. 1(2).

these competing interests is a primary function of contract law in market economies.

A. *Contracts Under Socialist Law*

Contract law in Hungary has been broadly governed since 1959 by the Civil Code and, more specifically, by related companion laws and implementing regulations and decrees. Two distinct spheres of contractual relations existed during the socialist period: the private sphere and the commercial or "economic" sphere.²⁹⁴ The private sphere consisted mainly of personal agreements among individuals, usually for small monetary amounts or equivalents. For these contracts, the Civil Code was, and still is, adequate to set a framework for bargaining and resolving disputes that may arise.²⁹⁵ These private sphere contracts between citizens, or between citizens and economic organizations, do not differ in essential aspects from similar contracts in Western market economies, although their scope in the past was influenced by the economic policies of the state. Most importantly, the state's policies of restricting ownership of private property and the means of production were particularly influential.²⁹⁶

More significant for Hungary's economy were the commercial or "economic" contracts. These refer to contracts between state enterprises that were instruments of the state economic plan. Because state-owned enterprises were expected to fulfill their production quotas under the state plan, and because the socialist industrial base consisted primarily of monopolistic suppliers, state-owned enterprises had little choice regarding with whom and to what extent they contracted. Thus, inter-enterprise agreements were in essence translations of state economic plan targets into contractual form.²⁹⁷ If the term "contract" implies bargaining in pursuit of one's own interest, the term "socialist contract" seems oxymoronic.

The primacy of the plan led to certain aspects of contract law

294. See generally Civil Code, *supra* note 66.

295. For a thorough and comprehensive analysis of Hungarian contract law under the Civil Code, see FERENC PETRICK, MINISTRY OF JUSTICE OF THE HUNGARIAN PEOPLE'S REPUBLIC, *THE STATUTES OF THE HUNGARIAN PEOPLE'S REPUBLIC: CIVIL CODE OF THE HUNGARIAN PEOPLE'S REPUBLIC 19-51* (1982).

296. See Gyula Eörsi, *General Survey*, in VII INTERNATIONAL ENCYCLOPEDIA OF COMPARATIVE LAW 3-16 (Arthur von Mehren ed., 1978) (discussing contract law under socialism).

297. *Id.* at 9-10.

unique to socialist systems. For example, there arose a duty to contract. Although this duty originally applied to specific plan targets, it seemed to develop into a general duty to conclude economic contracts, even when the contract was not part of the plan.²⁹⁸ This duty was actionable, meaning that anyone who breached it could be formally challenged in a precontractual arbitration.²⁹⁹

Similar to Poland, but in contrast to Romania, Hungary specifically incorporated socialist principles into its Civil Code.³⁰⁰ Thus, the Civil Code allowed for mandatory conclusions of contracts by statute or ministerial decree;³⁰¹ nullification of contracts injurious to socialist norms;³⁰² modification and conclusion of contracts by the courts in order to further national economic interests;³⁰³ and definition of the contents of contracts, such as prices, by legal rule as determined by state arbitration, regardless of the wishes of the parties.³⁰⁴

Until the 1970s, disputes resulting from socialist contracts were usually withdrawn from the jurisdiction of the courts and relegated to so-called Decisional Committees, which functioned more as administrators of the state plan than impartial jurists. Because contracts were designed to implement the central plan, and because of the scarcity and monopolization of most resources, the preferred remedy for breach of contract in a socialist economy was specific performance.³⁰⁵ Furthermore, determining the proper level of damages was not as straightforward, given the absence of market signals. In contrast, monetary damages are usually the preferred remedy in a market economy, where the damaged party can typically re-enter the market and negotiate another contract for the goods or services desired.³⁰⁶

298. *Id.* at 11.

299. Civil Code, *supra* note 66, ¶ 208(2)-(4); see also PETRICK, *supra* note 295, at 35-36.

300. See PETRICK, *supra* note 295, at 19-23. Poland's Civil Code was drafted in 1964, during the socialist period, while Romania's Civil Code dates from prewar times and was never amended during the socialist period. The same socialist contract rules existed in Romania, however, but with an independent legal basis.

301. Civil Code, *supra* note 66, ¶ 198(2)-(3).

302. *Id.* ¶ 200(2).

303. *Id.* ¶ 206(2).

304. *Id.* ¶ 226(2)-(3).

305. See Eörsi, *supra* note 296, at 14.

306. Members of the law and economics movement, most notably Judge Richard Posner, believe that Western contract law should, in the interests of efficiency, allow a party to breach a contract when it will be in their economic interest to do so. In other words, if the promisor believes that his performance is worth more to someone else, then it is efficient to allow him to breach the contract, provided that he pays the prom-

Compared to other CEE countries, the Hungarian industrial sector is generally thought to have enjoyed relatively greater freedom of contract during the socialist period. Much of this was due to management reform under the New Economic Mechanism of 1968, which shifted more decision-making power from the ministerial level to the enterprise level.³⁰⁷ Act IV of 1977 significantly modified Hungary's contract law by reintroducing the concept of freedom of contract into the commercial sphere.³⁰⁸ While management enjoyed greater independence after the reforms of the late 1960s and 1970s, enterprise output was still expected to meet the goals set by the national economic plan.³⁰⁹ Moreover, freedom of contract continued to be limited by the scarcity of both investment resources and credit.³¹⁰ Thus, freedom of contract was substantially increased, but still did not approach the freedom found in Western market economies. To this day, many transactions remain governed by the Contract for Delivery of Merchandise³¹¹ and the Contract for Delivery of Agricultural Produce,³¹² which include many obsolete administrative requirements and restrictions.

B. Current Status

Commercial transactions in the Hungarian economy are increasingly being conducted according to the sections of the Civil Code originally designed for small, non-commercial private transactions. These sections embody standard, Western notions of contract theory. They incorporate basic principles of offer, acceptance, and performance. They provide standard terms for about twenty-five types of transactions, such as sales contracts and real estate leases.³¹³ They also provide legal doctrine to govern usurious interest rates, bad faith dealing, illegal contracts, mistake, deception, duress, capacity, and impossibility of performance.³¹⁴

isee the full extent of his damages. See, e.g., E. ALLAN FARNSWORTH, *CONTRACTS* § 12.3 (2d ed. 1990) (discussing the theory of the efficient breach); see also *Patton v. Mid-Continent Sys., Inc.*, 841 F.2d 742, 750 (7th Cir. 1988) (Posner, J.) (supporting same).

307. See generally Popper, *supra* note 175, at 7-19.

308. *Id.*

309. *Id.*

310. See Eörsi, *supra* note 296, at 3-7.

311. Civil Code, *supra* note 66, ¶¶ 379-388.

312. *Id.* ¶¶ 417-422.

313. *Id.* ¶¶ 365-378, 423-451. See generally Daniel T. Ostas, *Institutional Reform in East-Central Europe: Hungarian and Polish Contract Law*, 26 J. ECON. ISSUES 513 (1992).

314. See generally Civil Code, *supra* note 66, ¶¶ 198-218.

Because Hungarian courts have little experience with commercial contract cases, the application of these provisions in commercial disputes remains uncertain. Judicial interpretations and decisions over the coming years will determine the true substance of contract law in Hungary and just how far the doctrine of "freedom of contract" extends, particularly when it collides with other social concerns.

VIII. BANKRUPTCY³¹⁵

Bankruptcy law serves several related functions in a market economy. First, it provides a mechanism to liquidate inviable enterprises and repay creditor's claims according to some pre-established rule of priority. Second, in cases of default in which some or all of the operations of the debtor are potentially viable, it provides a legal framework through which creditors and debtors can negotiate binding agreements to undertake financial and real reorganization. In most cases, this reorganization includes partial liquidation, such as the sale of some of the debtors' assets. Third, the threat of bankruptcy imposes greater financial discipline on enterprise managers. Hence, bankruptcy laws are important promoters of industrial restructuring.

It is important to distinguish between two different sets of potential "users" of the bankruptcy procedures. The first is the large group of state-owned enterprises that are inefficient and in need of restructuring or liquidation. For these state-owned firms, bankruptcy procedures and the threat of liquidation³¹⁶ are thought to provide the motivation to restructure that might not otherwise exist, due in part to the pro-labor incentives caused by extensive worker self-management.³¹⁷ The second group is the

315. The authors are heavily indebted to Izak Atiyas for his generous and extensive input into this section.

316. Creditor passivity in initiating bankruptcy cases had been common in CEE countries, in part because state-owned banks themselves faced "soft budget constraints" and could in essence count on bail-outs from the government if enterprise debts were in arrears. To counter creditor passivity, the Hungarian government mobilized the tax and social security authorities to initiate liquidation proceedings against enterprises which were in arrears in their tax or social security payments. The effect of this initiative was limited, because enterprises started to pay their tax and social security obligations to avoid liquidation. With a similar purpose, the liquidation law was amended to require enterprise management to file for liquidation whenever a situation of default persisted for a certain period of time, a measure that has been dubbed "self-bankruptcy."

317. Many Hungarian state enterprises are "self-managed"—managed by enterprise councils where employment is over 500, or by enterprise assemblies where employment is less than 500. In these enterprises, restructuring or liquidation can take place only with the consent of enterprise councils or assemblies. Even though there are excep-

newly emerging private sector, both enterprises and banks. For this group, bankruptcy law is part of a wider set of legal rules that increase the potential for debt collection and thus facilitate the flow of private credit in an economy. Such credit is essential for the success of new private businesses. Private sector bankruptcy law also includes provisions defining legally enforceable security interests and methods of foreclosure.

Thus serving two "masters," bankruptcy law is as seriously overburdened in Hungary as it is in other CEE countries. Reorganization and liquidation procedures are expected to play a major role in solving the systemic problems of enterprises and banks that carried over from socialism. This may be more than can be expected; these problems may instead require systemic solutions outside of bankruptcy law. In contrast, the bankruptcy process in most market economies works at the margin for a relatively few firms. Such a role is important to the second "audience" in the CEE countries—the newly emerging private sector.

A. *The New Bankruptcy Law*

The Law on Bankruptcy Procedures, Liquidation Procedures and Final Settlement³¹⁸ was passed by the Hungarian Parliament in September 1991. It provides two alternative avenues for defaulting debtors—reorganization³¹⁹ and liquidation.³²⁰ A debtor is obligated under the new law to file for bankruptcy, either reorganization or liquidation, if it is more than ninety days in default on its debts.³²¹ Reorganization, or "bankruptcy" in the official Hungarian translation, did not exist under previous law and is similar in its purpose to Chapter 11 of the U.S. Bankruptcy Code.³²² It is a workout-oriented procedure designed to allow the debtor to achieve a settlement with creditors and continue operation. The debtor may file for reorganization if it expects that it will otherwise be forced to default on its debts within a year, or if it is already insolvent but its creditors have not yet

tions, the managements of these enterprises are widely believed to be unwilling to adopt restructuring policies that may result in unemployment or actual loss of control.

318. 1991. évi XL. törvény a csődeljárásról, a felszámolási eljárásról és a végelszámolásról [Law XL of 1991 on Bankruptcy Procedures, Liquidation Procedures and Final Settlement], *Hatlyos magyar jogszabályok*, Dec. 1, 1991, translated in Nr. II./23. HUNGARIAN RULES OF LAW IN FORCE 1719 (1991) [hereinafter Bankruptcy Law].

319. *Id.* ch. II, arts. 15-21.

320. *See id.* ch. III.

321. *Id.* ch. II, art. 9.

322. *See* 11 U.S.C. §§ 1101-1174 (1988) (pertaining to reorganization); 11 U.S.C. §§ 701-766 (1988) (pertaining to liquidation).

initiated liquidation.³²³

During reorganization, the current management remains in control of the debtor's assets. After the announcement of the bankruptcy procedure, the debtor is entitled to a ninety-day moratorium on monetary claims other than wages that have become due.³²⁴ Within sixty days, the debtor must prepare a proposal for reorganization to restore solvency, which must then be approved by all creditors present at a special hearing.³²⁵ If the proposal is approved, the court then declares the bankruptcy procedure concluded within fifteen days.³²⁶

The second procedure, liquidation, can be initiated by the debtor itself or by a creditor.³²⁷ In addition, a reorganization procedure automatically becomes a liquidation procedure if the debtor and the creditors fail to reach agreement within ninety days.³²⁸ During liquidation, the debtor's assets are managed by a trustee, who is charged with liquidating the debtor's assets and repaying creditors.³²⁹ However, the debtor may still try to reach a settlement with its creditors during liquidation. If such a settlement is reached, the liquidation procedure is suspended.³³⁰ A settlement is approved only if accepted by half of the creditors entitled to vote in each class of creditors, and by creditors representing at least two-thirds of the total claims.³³¹ The law also contains a "simplified" liquidation procedure for cases where the value of the debtor's assets is insufficient to cover even the costs of the liquidation proceedings.³³² In such cases, assets themselves may be distributed to the creditors.³³³

The new law is different from the previous one in several important respects. First, it establishes rigid time limits on the different stages of the bankruptcy and liquidation process. For

323. Bankruptcy Law, *supra* note 318, ch. I, art. 3.

324. *Id.* ch. II, art. 12.

325. *Id.* ch. II, arts. 15-17. Bankruptcy laws in most countries do not seek unanimous agreement for the approval of an agreement. In that respect, the Hungarian law is stricter than most.

326. *Id.* ch. II, art. 19.

327. *Id.* ch. III, art. 22(1)(b). Creditors include banks, suppliers, and the social security fund. Until 1991, suppliers were the most active in petitioning for relief against debtors; of 528 requests that year, only eight were from banks and five from the social security fund.

328. *See id.* ch. III, art. 22(1)(a).

329. *Id.* ch. III, art. 46.

330. *Id.* ch. III, arts. 41-45.

331. *Id.* ch. III, art. 44.

332. *Id.* ch. III, art. 55.

333. *Id.*

example, following a petition, the court is required to determine whether to initiate a bankruptcy procedure within fifteen days,³³⁴ an action that under the old system took up to several months. In the case of petitions for liquidation, the court has to establish the presence or absence of a default within sixty days.³³⁵ As noted earlier, there are strict time limits on the preparation and negotiation of a reorganization agreement. The new law also imposes a maximum of two years for the completion of liquidation.³³⁶

Second, the law carefully tries to balance the distribution of control over assets and of bargaining power between a debtor and its creditors. As indicated above, the management of the debtor enterprise effectively retains control and therefore has significant bargaining power during settlement negotiations. However, two provisions have been introduced to protect creditors. First, creditors may request the court to appoint a supervisor who, while having no management powers, oversees the financial situation and asset management of the company to protect the creditors' rights.³³⁷ Second, the automatic transformation of reorganization into liquidation in the event a settlement is not reached inhibits the debtor's managers from delaying the process or adopting an unduly adamant position during negotiations.

The third difference is that the new law encourages reorganization in lieu of liquidation when feasible, and it tries to encourage real as well as financial restructuring to make surviving firms more competitive in the long run. The restructuring agreement is required to contain "measures likely to result in an increase of incomes."³³⁸ Moreover, the law explicitly mentions that "[w]ithin the framework of the agreement creditors or third parties . . . may secure ownership rights in the property of the debtor."³³⁹ Both provisions increase the likelihood that agreements address not only financial, but also real restructuring. The creditors are also allowed to designate persons to monitor the debtor's compliance with the agreement.³⁴⁰ The ability to moni-

334. *Id.* ch. II, art. 11(1).

335. *Id.* ch. III, art. 27(2).

336. *Id.* ch. III, art. 52(2).

337. *Id.* ch. II, art. 14(2).

338. *Id.* ch. II, art. 18(1)(a).

339. *Id.* ch. II, art. 17.

340. *Id.* ch. II, art. 18(3).

tor compliance increases the creditors' confidence in agreements and thereby encourages reorganization.

Despite these positive aspects, however, there are a few areas where the current law might benefit from further improvements. An important drawback of the law involves the priority of claims upon liquidation. Specifically, the claims of creditors secured by liens on assets have lower priority than claims for wages and severance payments, which are considered to be liquidation costs. This provision, a political compromise and a deviation from the international norm, is likely to dampen the incentives of secured creditors to initiate bankruptcy, to reduce the role of banks in enterprise restructuring, and to constrain the development of secured credit as a financial instrument.

In addition, the rights of dissenting secured creditors in a settlement arranged between creditors and the debtor during the process of liquidation need to be further clarified.³⁴¹ In particular, it is not clear whether a dissenting secured creditor retains the right to exercise its security or whether an agreement can reduce its claims without its prior consent.³⁴²

B. *The Law in Practice*

The number of bankruptcy filings in the first few months after passage of the new law skyrocketed. Although the data is somewhat sketchy, the number of filings appears to have increased from 528 in 1991 to 14,300 in 1992.³⁴³ Of these 14,300, 4400 were reorganization ("bankruptcy") filings and 9900 were liquidation filings. Because the law came into effect on January 1,

341. This problem would not arise for settlements reached during reorganization because these agreements require the unanimous consent of all creditors. Therefore, any dissenting creditor would be able to block a proposed settlement.

342. For example, consider a secured creditor whose claim is reduced in a proposed agreement and who does not consent to the settlement. Does that creditor retain the right to execute the security? Can a settlement remove a security without the consent of the creditor? The draft law does not provide clear answers to these questions. Different countries have resolved this issue in different ways. In some countries, such as Germany, the claims of secured creditors cannot be reduced in a settlement. In the United States, a settlement can be approved despite dissenting creditors if the court decides that the dissenting creditors are treated fairly and equitably, which for secured creditors means that they retain their liens on assets and they obtain periodic cash payments equal to the value of their claims. In the United Kingdom, a settlement cannot be approved if it affects the rights of a secured creditor to enforce the security.

343. These are filings for liquidations under the old law. Although the number of filings is monitored, records are not systematically kept on the nature and size of companies that enter reorganization or liquidation, or on the duration or ultimate disposition of the proceedings.

1992, and requires reporting after ninety days in default, there was a particular surge of filings in April 1992, including 2259 for reorganization and 1281 for liquidation.

For several reasons, the strong pace of filings in Hungary is expected to continue. First, new banking and accounting laws are expected to put pressure on the banking system and make banks more vigilant on debt collection. Second, the new law is likely to make creditors more willing to initiate bankruptcy, both because liquidations should be faster and because the new law is more protective of creditors' rights. Third, enterprise managers are more likely to initiate bankruptcy under the new regime, as they are subject to penal sanctions if they willingly fail to do so when the enterprise is insolvent. Furthermore, they may be more willing to initiate bankruptcy because of the possibility of reorganization and retention of their jobs in lieu of liquidation.

This surge in cases demonstrates the difficulty of applying the traditional solution—judicial bankruptcy proceedings—to the systemic problems of enterprise insolvency in CEE countries. It is highly improbable that any judicial system, much less one with relatively little exposure to economic matters, could handle such a caseload surge both efficiently and effectively. As noted earlier, the judicial route works best at the margin, but other means may be needed to handle the large systemic problems, which could affect thirty to fifty percent of the economy.³⁴⁴ Not only are experienced judges in short supply, but so too qualified trustees. Especially in cases involving large enterprises, liquidators have to act as corporate managers and financial managers to preserve the assets of the enterprise and, whenever viable, to encourage settlements between creditors and debtors. They also need to have legal expertise.³⁴⁵ The Ministry of Finance has recently increased the pool of liquidators by establishing objective criteria for eligibility and selecting ninety additional liquidators from among

344. Integrated programs of bank restructuring; enterprise restructuring, privatization, and liquidation of insolvent state-owned firms—primarily using non-judicial means—are now under discussion, for example, in Poland and Slovenia.

345. The government is authorized to establish a list of liquidators. Until recently, the supply of liquidators was provided by six institutions, most of them consulting firms. However, under Government Decree No 165/1991, individuals can now also be included in the list of liquidators. Such individuals need to have a degree in economics, finance or law. Organizations that employ such individuals may also be enlisted. Applications are judged by a committee appointed by the Minister of Finance and Minister of Justice.

numerous applicants. In light of the thousands of cases now being filed, however, this pool of liquidators remains small.

IX. COMPETITION LAW

The structure and dominance of the public sector throughout Central and Eastern Europe is now proving to be an obstacle not only to the development of the private sector, but also to the improvement of the performance of the public sector itself. Large, state-owned monopolies are able to impose unfair conditions on private firms, smaller public firms, and consumers. In essence, private firms are free to thrive primarily in niches not dominated by the state sector. Because of their power over output and jobs, large state firms act as a powerful lobby to influence government decisionmaking in fiscal, monetary, trade, and other matters. For this reason, the breakup and privatization of state monopolies is essential not only to the growth of a private sector, but more generally to the development of a stable market economy. Competition law can be an important tool to encourage such breakup and to prevent abusive monopolistic behavior. Hungary should, however, move very carefully in applying its competition law in order to avoid overzealous enforcement and the resulting bureaucratic dampening of healthy competition.

Hungary's new competition law, Act LXXXVI of 1990 on the Prohibition of Unfair Market Practices,³⁴⁶ took effect on January 1, 1991. The law deals with the traditional areas of antimonopoly enforcement, including horizontal and vertical agreements among firms, abuse by a single firm of a dominant position, and merger control.³⁴⁷ Additionally, it established a specialized antimonopoly office, the Office of Economic Competition, to enforce these provisions, subject to review upon appeal by the Budapest district court.³⁴⁸ The law also covers unfair competition and prohibits such activities as misleading advertising and

346. Act LXXXVI of 1990 on the Prohibition of Unfair Market Practices, *reprinted in* HUNGARIAN MINISTRY OF FINANCE, PUBLIC FINANCE IN HUNGARY (PERFEKT Fin. Post-graduate Training Series No. 72, 1991). Hungary's concern with rules of competition actually began in the late 1960s, with its moves toward decentralized market socialism. As part of the reforms instituted under the New Economic Mechanism (1968), Hungary revitalized its original Act on Unfair Economic Competition (Act No. V on the Prohibition of Unfair Competition of 1923) through numerous governmental decrees. These rules were updated in 1984 with the adoption of Act No. IV on the Prohibition of Unfair Business Activities.

347. *See id.* chs. 3-5.

348. *See id.* ¶ 52.

“unfair” acquisition and use of business secrets.³⁴⁹

On the topic of horizontal agreements, the law explicitly forbids agreements among competitors concerning practices such as price fixing, market division, technological development or the exclusion of certain consumers or input suppliers.³⁵⁰ However, the standard for evaluating the legality of these arrangements is the “rule of reason,” rather than a *per se* ban on horizontal cartel arrangements.³⁵¹

There are, however, numerous exceptions to the prohibition. Some of these are specific exceptions, such as agreements between parties with less than ten percent of the market,³⁵² and some are more general, such as agreements that are “aimed at stopping abuse of economic superiority”³⁵³ or agreements where “the . . . advantages outweigh the . . . disadvantages.”³⁵⁴ Thus, the law provides a relatively weak restriction and gives the antimonopoly office and the courts wide discretion in their review of cases. While this discretion might help the authorities concentrate scarce administrative resources on certain cases, it weakens the general deterrence power of the law and could lead to long, drawn-out arguments on what is or is not a limit on competition. Hungary should consider strengthening the prohibition on horizontal cartel agreements by adopting a *per se* approach.³⁵⁵

In the area of vertical agreements, a separate section of the law

349. *Id.* ¶ 5.

350. *Id.* ¶ 14(2).

351. Under a rule of reason approach, which proceeds case-by-case, the pro-competitive benefits of a particular practice are weighed against the anti-competitive effects of that practice. In contrast, a *per se* approach forbids a particular practice under any and all circumstances. As the United States Supreme Court has stated:

There are, thus, two complementary categories of antitrust analysis. In the first category are agreements whose nature and necessary effect are so plainly anticompetitive that no elaborate study of the industry is needed to establish their illegality—they are “illegal *per se*.” In the second category are agreements whose competitive effect can only be evaluated by analyzing the facts peculiar to the business, the history of the restraint, and the reasons why it was imposed.

National Soc’y of Professional Eng’rs v. United States, 435 U.S. 679, 692 (1978). See also *Northern Pac. Ry. v. United States*, 356 U.S. 1, 5 (1958) (also discussing *per se* unreasonableness).

352. Act LXXXVI of 1990 on the Prohibition of Unfair Market Practices, *supra* note 346, ¶ 16(1).

353. *Id.* ¶ 15(a). Paragraph 15(b) also exempts agreements that are deemed to be “of minor significance” from scrutiny under this law. *Id.* ¶ 15(b).

354. *Id.* ¶ 17(1)(b).

355. The same argument is made in RUSSELL PITTMAN, SOME CRITICAL PROVISIONS IN THE ANTIMONOPOLY LAWS OF CENTRAL AND EASTERN EUROPE (U.S. Department of Justice, Antitrust Division, Economic Analysis Group Discussion Paper No. EAG 91-10, Sept. 20, 1991).

forbids abuse of any "position of economic superiority" and includes certain restrictions on vertical agreements.³⁵⁶ Also prohibited are vertical tying arrangements regardless of the size of the firms involved.³⁵⁷ It is wise of Hungary to limit its scrutiny of vertical restrictions to those involving dominant firms, and the same rule should apply to tying arrangements as well. Economic analysis in the United States and Europe shows that many vertical restraints, such as resale price maintenance, refusals to deal, discriminatory pricing, and tying of sales, may enhance efficiency under certain circumstances—typically when market structure is competitive and the firms imposing the restraints are not in a dominant position.³⁵⁸

Hungary's new competition law also prohibits dominant firms from limiting the access of new entrants to the market.³⁵⁹ This is extremely important in the Hungarian context if new private firms are to gain access to inputs and distribution networks. However, the Hungarians must be careful not to interpret reasonable market behavior, such as buying in bulk, requiring up-front deposits from purchasers, or raising/lowering prices to consumers, as anticompetitive conduct. In general, enforcers should refrain from imposing direct price conditions and concentrate more on conditions of access to the market.

With regard to market structure, the Hungarian law empowers the antimonopoly office to review proposed mergers of large firms³⁶⁰ and to block any that are deemed to be anticompetitive.³⁶¹ As with horizontal agreements, there are exceptions to

356. Any person or firm having over 30% market share is presumed to occupy a "position of economic superiority." Act LXXXVI of 1990 on the Prohibition of Unfair Market Practices, *supra* note 346, ¶ 21(1)(c).

357. *Id.* ¶ 9.

358. As a result of this economic analysis, enforcement of U.S. antitrust law has softened during the 1980s, and the Department of Justice has refused to prosecute many cases it would have brought in earlier times. See THE BASICS OF ANTITRUST POLICY: A REVIEW OF TEN NATIONS AND THE EEC 60 (World Bank Industry and Energy Department Working Paper, Industry Series Paper No. 43, Feb. 1991). The Organization for Economic Cooperation and Development (OECD) is also recommending that European jurisdictions relax their laws and look at each case of vertical restraint on a rule of reason rather than a *per se* basis. Opponents of the rule of reason approach argue that businesses need certainty above all, and that this approach leaves too many questions as to what is permitted and what is not, thereby inhibiting business activity.

359. Act LXXXVI of 1990 on the Prohibition of Unfair Market Practices, *supra* note 346, ¶ 20(d).

360. Firms must notify the office if they jointly have a 30% market share or if their joint turnover in the previous year exceeded HUF 10 billion (around \$115 million). *Id.* ¶ 23.

361. *Id.* ¶ 24(1).

the rule. Mergers need not be blocked, for example, if the advantages to competition exceed the disadvantages, or if the merger promotes penetration into foreign markets.³⁶² Once again, the agency is given almost unlimited discretion in making this decision.

One important element missing from the law, however, is the authority of the antimonopoly office to order the breakup of large monopolistic firms. This authority should exist, particularly where state-owned enterprises are undergoing privatization. This nexus between antimonopoly policy and privatization exists in both Poland and Czechoslovakia, and is a useful tool to inhibit the privatization of public monopolies into private ones, which are certainly much harder to control or split apart once in private hands.

Interpreting and applying the new Hungarian law in an effective manner is an enormous challenge, particularly given the discretion that is granted to the enforcement authorities in the law itself and the broader set of problems with antimonopoly legislation in general. The enforcement office will need to tread lightly at first. As well as handling individual complaints, it should concentrate on its other important missions: educating the public about the distortions caused by monopoly behavior and lobbying the government and Parliament to minimize the barriers to international trade—the most powerful antimonopoly force of all.

X. JUDICIAL INSTITUTIONS

As in other CEE countries, the judiciary did not play a very active role in the commercial sector during the socialist period, and it is currently not well-equipped to take on the sudden expansion in activity that has emerged from the rapid economic reforms of the past few years. To accommodate private sector activities, the judicial infrastructure will need to be upgraded through training, staffing, and equipment.

A. *Court Structure*

There are four types of courts in the Hungarian judicial system: the Supreme Court, district courts, county courts, and special courts.³⁶³ There are about 2000 judges nationwide, with

362. *Id.* ¶ 24(2).

363. The structure of the judiciary is defined by the following authorities: the new Constitution; Act IV of 1972 on the Judiciary; Act LXXX of 1990 on the Establishment of Local Courts; Act XXXII of 1989 on the Establishment of the Constitutional Court;

about 200 unfilled positions. Most cases initially are brought in the district courts, of which there are approximately 102.³⁶⁴ District courts have general jurisdiction and can hear criminal, civil, and commercial cases.³⁶⁵ Although the district courts are not divided into chambers, judges do tend to specialize, meaning that in practice, cases are heard by judges with some experience in the particular area. Hungary has a fairly unified court system with only a few separate specialized courts: the Labor Affairs Courts, the Military Courts, and the Courts of Original Jurisdiction.³⁶⁶

Appeals from the local courts are made to the county courts.³⁶⁷ There are nineteen county courts in Hungary, as well as the municipal court, which serves the Budapest metropolitan area. This level is divided into three branches: civil, commercial, and criminal. The Budapest municipal court has a separate labor chamber. A county court may act as the court of first instance when the amount in controversy exceeds HUF 3 million (\$35,000) (typically seen in disputes between state-owned enterprises)³⁶⁸ or in claims related to intellectual property, libel, slander, damages caused by state officials, and certain other matters. In such cases, appeals may be made to the Supreme Court.³⁶⁹ The Supreme Court also guides lower courts by issuing advisory opinions. This judicial guidance role is set forth in the Constitution.³⁷⁰

Changes in court organization began in 1989.³⁷¹ In 1990, a

Act III of 1952 on the Code of Civil Procedure; and Act I of 1973 on Criminal Procedure, as amended. Law Decree 23 of 1989 and Executive Decree of the Minister of Justice govern courts of registration and registration of companies. The 1989 amendment to the Constitution introduced into this system the Constitutional Court, but it is not formally part of the judicial structure. For a thorough discussion of the Hungarian judiciary, see Mikki Graves, *The Legal System of Hungary*, in 8 MODERN LEGAL SYSTEMS CYCLOPEDIA § 1.4 (Kenneth R. Redden ed., 1991).

364. Graves, *supra* note 363, § 1.4(C).

365. *Id.*

366. *Id.* § 1.4(E)(1)-(3).

367. *Id.* § 1.4(D).

368. Until 1972, all inter-enterprise disputes were heard by "economic arbitration tribunals," which settled supply and delivery agreements according to the state plan. These tribunals were abolished in the 1970s, and inter-enterprise disputes have since been heard by the commercial chambers of the county courts.

369. Graves, *supra* note 363, § 1.4(B)(1).

370. See 1989 Constitution, *supra* note 16, ch. X, § 47.

371. One area under active discussion involves the overhaul of the court structure: whether a four level court system should be introduced as opposed to a simple modification of the current system; and whether the Ministry of Justice or the self-governing Judicial Councils should be the guarantor of the lawfulness of court procedures.

new law on the promotion and compensation of judges came into effect. Self-governing Judicial Councils were established to appoint court officials and to handle internal disciplinary cases. The latest amendment, Act LXVII of 1991, increases the role of Judicial Councils in court financial decisions and in the selection and appointment of judges. The amendment also separates budget and administration of the Supreme Court from the Ministry of Justice; local and county courts remain subordinated to the Ministry.

The Hungarian judicial system suffers from a shortage of well-qualified judges, particularly in the newly emerging commercial areas. Judges are appointed for life by the Hungarian President and may be removed only for cause.³⁷² They do not enjoy particularly high status or pay, and over half work on a part-time basis. Over the past few years, their workload has more than doubled, due to the registration of new private companies, the rapid rise in the number of commercial disputes, the rash of new compensation claims, and growing criminal activity. To alleviate the judiciary of this increased workload, the Ministry of Justice sought unsuccessfully to re-establish the administrative courts, abolished under the socialist regime, to adjudicate alleged violations of citizens' rights by the state.

One area needing immediate judicial attention is debt collection. Of the 700,000 lawsuits filed nationwide in 1991, itself a sixty percent increase from the previous year, two-thirds involved uncollectible debts. Streamlining debt collection, perhaps by allowing private debt collection in uncontested cases or reducing procedural requirements in judicial cases, could relieve much of the current strain on the courts.

Arbitration could be a useful alternative to court procedures as a means of resolving commercial disputes among private parties. As in other CEE countries, the Hungarian Chamber of Commerce has an arbitration chamber that specialized during the socialist period in the settlement of international trade disputes. The 1988 Act on Business Organization gives this chamber jurisdiction for disputes arising out of a company's organizational documents, if the parties agree. A broader mandate and proper technical support could help this body develop into a viable alternative forum for dispute resolution. A new draft arbitration law now under consideration would give access to the Chamber of

372. See 1989 Constitution, *supra* note 16, ch. X, § 48.

Commerce's arbitration chamber to anyone doing business in Hungary.

B. *The Legal Profession*³⁷³

Law-Decree 4 of 1983 on the Legal Profession broke the close ranks of the "legal working groups" and allowed company attorneys to compete in dealing with economic organizations. Act XXIII of 1991 amended the 1983 law to give Hungarian attorneys the right to establish law offices with a minimum of two attorneys, or individual practices. Attorneys working in groups must transform themselves into law offices. Admission to the bar requires a law degree, professional exam, Hungarian citizenship, permanent domicile in Hungary, a clean record, and liability insurance. Practicing attorneys may not take up other employment, although they may join the boards of various companies. Currently, there are about 1200 practicing lawyers in Budapest. Foreign lawyers can open representative offices and provide legal assistance on foreign legal matters, but may not practice Hungarian law.

XI. CONCLUSION

Hungary has been on the forefront of CEE countries in reforming its legal framework to promote private sector development. It was among the first to make major changes in its Constitution and Civil Code to promote free enterprise and put private property on the same legal footing as state-owned property. It moved quickly to establish a Constitutional Court to protect these legal rights. This court has extremely broad jurisdiction and has proven very active in reviewing economic as well as social legislation.

With regard to formerly nationalized property, Hungary is the only CEE country to eschew widespread restitution in-kind, opting instead for a coupon scheme that is likely to cause significantly less uncertainty and disruption in property markets. It has basic legislation in place to protect intellectual property and to provide a clear and flexible framework for the establishment of domestic and foreign-owned firms. Finally, new and relatively modern antimonopoly and bankruptcy laws went into effect at the beginning of 1991 and 1992, respectively.

373. All of the information in this section was obtained through numerous interviews conducted with various members of the Hungarian legal profession.

Despite these achievements, however, numerous legal and institutional challenges remain. The most difficult area, apart from company privatization, which is not discussed here, remains real property. The development of efficient land markets continues to suffer from an inaccurate land registry, an underdeveloped legal and institutional framework for collateral, the near impossibility of eviction in cases of nonpayment of mortgage loans or rent, and an outdated and incomplete zoning and regulatory structure. Further substantive scrutiny is also called for in other areas of law, most notably bankruptcy and competition.

Finally, the challenge of implementing all of this new legislation is daunting, particularly given the country's limited experience with market principles and institutions. Both the specialized institutions, such as those charged with implementing intellectual property and antimonopoly laws and with registering companies, and the regular courts are in danger of being overwhelmed with a burgeoning caseload. A prime example is bankruptcy, where over 14,000 new cases were filed in 1992 alone. Another example is antimonopoly law, where the broad legislative mandate and the relative inexperience of the regulators could create the potential for counterproductive results. In addition to training and technical assistance, Hungary should work to provide widespread dissemination of the rulings of the Office of Competition and the courts more generally, both to educate the public and to promote public accountability and oversight.