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ESSAYS

Privatization and Foreign Investment in Czechoslovakia: The Legal Dimension

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I. INTRODUCTION

Post-socialist Central Europe has become a laboratory for socio-economic restyling of unprecedented proportion. Within a short period of time, its political, economic, and legal landscapes have changed beyond recognition. The centrally planned economies of Poland, Hungary, and Czechoslovakia have crumbled, as have the political edifices based on the power monopoly of the Moscow-oriented Communist parties. The democratic regimes that emerged from the recent revolutions were required to choose a model of economic development, and all three countries have opted for a Western model of a market-oriented economy combined with elements of social welfare.

Despite the many difficulties that Czechoslovakia has encountered since the revolution, its steady progress toward a stable democracy and an economy based on free enterprise deserves recognition. Perhaps this progress stems largely from the legacy of the pre-war Czechoslovak Republic. The Republic, led by the Presidents Thomas G. Masaryr and Edward Beneš, managed to sustain a democratic form of government when fascism was ascending in Central Europe. With its liberal economic and legal environment, the Republic encouraged entrepreneurship and spurred the rise of large corporations that sought access to competitive foreign markets.[1]

This Essay is intended to outline the legal developments in Czechoslovakia since the November 1989 revolution, which ended forty-one years of Communist domination. The new era, inaugurated by the revolution, began with a painstaking search for a political and constitutional model and for a strategy of socio-economic development that would make the country's transition to democracy and prosperity as smooth and painless as possible.

The law has become one of the main instruments of the current transformation. There is a massive recourse to law to sustain the present thrust of development, and a radical law reform is underway in Czecho-

1. In the late 1920s and early 1930s, large Czechoslovak enterprises, such as the Bata Shoe Company in Zlin, Moravia, were formed with interests in Europe and overseas. By 1939, Bata's factories and sales outlets had spread over five continents. In India alone, Bata employed several thousand workers in its factory in Batanagar (a town named after the Czech manufacturer). Other corporations with extensive international business activities included the Skoda Works in Pilsen, the Vitkovicke Zelezarny in Ostrava-Vitkovice, the Ceskomoravska Kolben-Danek in Prague, and the Prvni Brnenska Strojirna in Brno. Domestic and international economic activities were unrestrained by government regulations, and tariff and taxation issues were settled satisfactorily through treaties with other countries.

slovakia. The most important objectives of this reform are legal protection of private ownership, the privatization of the assets of state enterprises, the dissolution of monopolies, the establishment of financial markets, the institution of a convertible currency and a sound banking system, and the creation of favorable conditions for foreign investment. In the eighteen months following the revolution, the Czechoslovak legislature passed over sixty major reform measures, and this flurry of legislative activity is likely to continue in the years to come. In the summer of 1990, as a prologue to Czechoslovak privatization, the national parliament approved a scenario providing for the adoption of a variety of political, economic, and financial measures, as well as for the overhaul of the existing codes of law. Western lawyers and businessmen have concentrated most on the legislative activities relating to the program of privatization, and it is this legislation on which this Essay will focus.

II. The Scenario for Privatization

A. *Models for Privatization*

Contemporary Czechoslovak economic thinking is influenced by both United States monetarism and the Keynesian system. The driving force behind monetarism in Czechoslovakia is Vaclav Klaus, the influential Federal Minister of Finance, who is orchestrating a brisk shift to a free-market economy. Insisting that the main influence on the economy be monetary action, he has the support of an increasingly influential group of business-oriented parliamentarians who endorse a speedy transformation of the Czechoslovak economy. On the other hand, the liberals in Civic Forum, the dominant political group in the national legislature, promote the Keynesian vision of equitable distribution of income through government intervention. Both viewpoints have valid claims, and reconciliation is not easy. Although their proponents agree that de-nationalization and privatization of state property[2] are the centerpieces of eco-

2. All European countries that practiced socialism in the past, including the Soviet Union, now seem to embrace the principle of privatization. Although the enthusiasm for a free-market economy is less perspicuous in the USSR than in Poland, Hungary, or Czechoslovakia, the goal of privatization is intertwined with the hope of a democratic transformation of the Soviet society. Unlike Poland, Hungary, or Czechoslovakia, there is no present Soviet statute that would provide legal encouragement to privatization. The issue is being debated, however, and the proponents of economic reform have circulated two interesting draft laws: *The Fundamentals of the Legislation of the USSR and the Union Republics on Denationalization of Assets and Privatization of Enterprises*, *reprinted in* EKONOMIKA I ZHIZN', No.7, Feb. 1991, at 18, and *Draft Law of the Russian Soviet Federative Socialist Republic on the Privatization of State Enterprises.* Both

nomic reform, they frequently disagree over methods, which has resulted in interminably delayed legislative action. In the closing months of 1990, disputes over the division of power between the federation and the republics also complicated economic steps necessary for reform.

In contrast to Polish and East German socialism, which tolerated, to a certain extent, small businesses in the manufacturing and service sectors, the Czechoslovak socialist "perfectionists" nationalized or "persuaded" private owners to transfer practically all businesses to the state or to a cooperative. The 1960 Czechoslovak Constitution celebrated this feat as an astounding victory for socialism.[3] Because even small Czechoslovak businesses were nationalized, the Czechoslovak privatization plan, unlike Poland's,[4] is being implemented in two stages, one providing for small-scale privatization and the other envisaging large-scale privatization. Both the small-scale and large-scale plans pursue the objectives of stripping the state of its present ownership, protecting productive assets from administrative encumbrance, and encouraging private ownership as the springboard for free enterprise. These plans differ, however, in both procedure and the categories of assets to be privatized. As their names suggest, small-scale privatization is concerned with the transfer of state-owned small businesses to private hands, and the large-scale variant seeks to denationalize large and medium-size industrial enterprises, hotels and other service establishments, construction firms, and transportation companies. Before either privatization plan can go into effect, however, the government must return properties that belonged to private individuals to those from whom they were taken during the process of socialization from 1948 to 1989. This will occur through the separate process of restitution.

B. *Restitution of Expropriated Property*

It is uncommon for a state to return expropriated properties to the original owner.[5] For reasons that can be understood only when analyzed in the context of the political and moral purification occurring in Czech-

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drafts reflect the processes of privatization used in the formerly socialist countries of Central and Eastern Europe.

3. The 1960 Constitution added the epithet "Socialist" to the name of the Czechoslovak Republic.

4. The Polish privatization program is legally defined in the Law on Privatization of July 13, 1990 (Dziennik Ustaw, No. 51 (1990), item 298). For a translation, see 1 CENTRAL & EASTERN EUROPEAN LEGAL MATERIALS (V. Pechota ed. 1990).

5. Even Louis XVIII did not completely restore the ownership rights confiscated during the French Revolution.

oslovakia today, the government of President Havel decided to return everything that was tainted by unfair gain. Undoubtedly, the regime that dominated Czechoslovakia from 1948 to 1989 acquired property unfairly. The same situation occurred throughout the former Soviet bloc, but no other country, with the notable exception of East Germany, has restored the property expropriated by the Communist regimes.[6]

The idea of restitution has not been accepted without hesitation in Czechoslovakia. Those who doubt its practicality argue that the bulk of the expropriated private property was taken four decades ago from owners who either have emigrated or have died and whose heirs have little, if any, personal attachment to the property. These heirs have no intention of running the reinstated businesses, and they are likely to sell or lease their newly acquired possessions. Further, in the pursuit of justice for some, restitution would inflict injury on others because the burden of financial compensation would be placed on a generation that bore no responsibility for the expropriations. Furthermore, equal justice would require compensation not only to former owners or their heirs, but also to those who were deprived by the Communist regime of opportunities to obtain property, a professional education, qualified jobs, or to those who suffered other economic loss. Therefore, restitution could lead to new inequities, for which there would be no remedy.

None of these arguments swayed the majority in the Federal Assembly, who supported the government's view that restitution was needed not only to do justice, but also to help create an entrepreneurial class that would strengthen the private sector during a critical period. Thus, restitution has been seen as an important means to accelerate the process of privatization.

1. The First Restitution Act

Restitution of property has been authorized by two laws adopted in October 1990 and February 1991. The Restitution Act of October 2, 1990 (First Restitution Act)[7] provides for the return to the original owners, or their successors, of any property expropriated by the socialist state in accordance with certain laws and decrees adopted in 1955 and 1959.

6. Hungary may become another exception; its parliament presently has before it a bill that demands partial compensation for the private property expropriated by the government from 1945 to 1988. Those entitled to compensation could receive up to $70,000 in coupons that would be valid to buy property privatized by the government.

7. The Act on the Alleviation of Certain Property Injustices, No. 403/1990 Coll. of L., *as amended by* Law of October 30, 1990, No. 458/1990 Coll. of L., *translated in* CENTRAL & EASTERN EUROPEAN LEGAL MATERIALS, *supra* note 4 (1991).

The First Restitution Act covers only a small part of the private property confiscated by the Czechoslovak Communist regime. The majority of the properties encompassed by the First Restitution Act were small businesses owned by individuals, and many were in the service sector. Now, the government either is returning these businesses or is offering compensation to the original owners or to their successors, who must claim the property within six months after the law has entered into force.[8] Both citizens and noncitizens can petition for the restoration of their property rights, although noncitizens can do so only if their claims have not been settled by a bilateral treaty between Czechoslovakia and their domiciliary country.[9] Further, enterprises or organizations that actually possess the property must enter into contracts with claimants who prove their title. Although the Czechoslovak Government will not return properties in which third parties, private companies, joint ventures, foreigners, or the state administration servicing the diplomatic corps have bona fide title, it will offer just and equitable compensation to the original owner.

2. The Second Restitution Act

The Restitution Act of February 21, 1991 (Second Restitution Act)[10] was passed after a long and acrimonious debate in the Federal Assembly. This Act provides for the transfer of wealth on an unprecedented scale; it provides for the return of or compensation for property with a value exceeding ten billion dollars. The Second Restitution Act authorizes the return of private property nationalized, confiscated, or otherwise expropriated[11] in the period from the Communist takeover on February 25,

8. The law came into force on November 1, 1990.

9. *See* Agreement on the Settlement of Certain Outstanding Claims and Financial Issues, Nov. 6, 1981, United States-Czechoslovakia, *reprinted in* 21 I.L.M. 371 (1982) [hereinafter Outstanding Claims Agreement]; *see also* Czechoslovak Claims Settlement Act of 1981, 95 Stat. 1675, Pub. L. No. 97-127 (1981); Pechota, *The 1981 U.S.-Czechoslovak Claims Settlement Agreement: An Epilogue to Postwar Nationalization and Expropriation Disputes*, 76 AM. J. INT'L L. 639 (1982).

10. Act on Extrajudicial Rehabilitation of February 21, 1991, *translated in* CENTRAL & EASTERN EUROPEAN LEGAL MATERIALS, *supra* note 4. In addition to restitution of expropriated properties, the Second Restitution Act addresses other property-related aspects of administrative and judicial decisions made during the socialist period now regarded as violative of the "principles of a democratic society protecting individual rights as enunciated in the Charter of the United Nations, the Universal Declaration of Human Rights, and the related International Covenants on Civil and Political and on Economic, Social and Cultural Rights." *Id.* § 1(1).

11. This includes gratuitous transfers of real property, mostly apartment houses, from private owners to the state, prompted by legislative and administrative measures

1948 to the end of 1989. Only individuals are entitled to restitution; companies and other legal entities are excluded. This Act requires that the current owners, usually a state enterprise or a municipality, relinquish the deed to the original owners. When a dispute arises, the case is submitted to a court. If property cannot be returned in kind, approximately 750 million dollars will be assigned for cash compensation to the original owners or their heirs, and the balance of compensation will be paid in government-issued bonds. Significantly, only resident citizens of Czechoslovakia are entitled to benefits under the Second Restitution Act. Consequently, neither foreign nationals nor Czechoslovaks permanently residing abroad qualify for restitution.[12]

The law does not apply to property nationalized or confiscated between May 1945 and February 1948; this property will not be returned.[13] Nor does it extend to either agricultural land in general[14] or to property taken from churches after February 1948[15] because claims to these categories of property are to be settled by future legislative action.

The property that will be reclaimed by its original owners or their

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that discriminated against private owners.

12. This provision may violate both the principle of equality and non-discrimination that is part of the same international human rights instruments referred to in section 1(1) of the Act on Extrajudicial Rehabilitation and Article 11(1) of the Czechoslovak Bill of Rights, The Charter of Fundamental Rights and Freedoms of January 9, 1991. The Czechoslovak Bill of Rights states that "[t]he ownership right of all owners has the same statutory content and enjoys the same protection." *Id.* Section 2 of the Constitutional Act Instituting the Charter states that "international treaties on human rights and fundamental freedoms, ratified and promulgated by the Czech and Slovak Federal Republic are universally binding on its territory and supersede its own laws."

13. If expropriation effected after February 1948 had its legal basis in nationalization decrees adopted during the period from May 1945 through February 1948 and compensation, as the decrees required, was not provided, a valid claim does arise. Such a claim, however, should not be settled through restitution pursuant to the Second Restitution Act, but by resorting to a special procedure provided for in section 47 of the Act on Large-Scale Privatization of February 26, 1991. *See infra* Part II.D.

14. A bill on the restitution of land is being debated by the Federal Assembly. At present, most agricultural land is held by cooperatives established under the Communist regime and enjoys large state subsidies. Privatization of agricultural land is a hotly contested issue because many cooperative farmers who are unsure of state support for individual farming do not favor transformation of cooperative enterprises into private farms. Claiming an equitable share, should the present cooperatives be dissolved or transformed, are also those members who never owned any land, but have worked for decades on cooperative land.

15. The Federal Assembly, which hopes to return property owned by churches, orders, congregations, and religious societies before February 25, 1948 in one form or another to the original owners, also has decided to exempt this property from the program of large-scale privatization of state-owned assets.

heirs under either the First or Second Restitution Act will be exempt from the processes of small-scale or large-scale privatization. Restitution claims take precedence over privatization procedures, and property returned under the restitution process will become part of the private sector from the moment of its restitution to the private party. Therefore, before initiating a privatization process, the management of a business must examine the records of the registry of deeds to determine whether there was a private owner prior to 1948. If a private owner did exist, the privatization action should be deferred until the period specified for the submission of claims (six months after the entry into force of the respective Restitution Act) expires. If no claim has been filed within this time limit, or when a filed claim is disallowed, the privatization action can proceed.

C. *Small-Scale Privatization*

The program of de-nationalization of state-owned property was launched on December 1, 1990, when the Act on Small-Scale Privatization (Small-Scale Privatization Act)[16] entered into force. This law introduces a market economy at the local level. It applies to unclaimed small industrial, business, or service establishments other than utilities or public services. The parliament's consideration of the Small-Scale Privatization Act aroused a public debate over whether to offer small properties to employees at discount prices or to sell it to the highest bidder in a public auction. The debate revealed considerable aversion to the notion that people who had made their money by engaging in illicit ventures or by serving the previous regime in well-paid positions should obtain lucrative and visible business establishments, such as restaurants or fancy stores. This view, however, failed, and unclaimed small enterprises are being sold in auctions to current and former Czechoslovak citizens[17] or to legal entities formed by Czechoslovak citizens. Small-size privatization covers over 120,000 small businesses, and it will be completed in about three years.[18]

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16. The Act Concerning the Transfer of Some State Property to the Ownership of Individuals or Juridical Persons of October 25, 1990, No. 427/1990 Coll. of L. *translated in* CENTRAL & EASTERN EUROPEAN LEGAL MATERIALS, *supra* note 4.

17. Only those persons who held Czechoslovak citizenship at any time and for any period of time after February 25, 1948 would be eligible for participation in the auctions. Thus, former Czechoslovaks naturalized as United States citizens before February 25, 1948 are excluded.

18. Selling off small shops and businesses has been a smashing success. In the first auctions held in January and February 1991, most businesses sold for much more than

Small-scale privatization is entirely controlled by the governments of the republics, which receive the proceeds from the auctions.[19] Therefore, the modalities of the privatization process are regulated by laws enacted by the legislatures of the two republics.[20]

D. *Large-Scale Privatization*

Although Parliament passed the Small-Scale Privatization Act relatively easily, the government-sponsored bill on the transfer of large and medium-size state enterprises to private ownership (Large-Scale Privatization Act)[21] occasioned endless debates and controversies. In the process, many constitutional, political, and legal issues had to be resolved, with the principal constitutional issue concerning the devolution of state ownership and federalism. The new federalism in Czechoslovakia, which strongly favors the republics and limits the powers of the federation, required that the present state assets be redistributed between the federation and the two constituent republics, the Czech Republic and the Slovak Republic. According to a constitutional amendment adopted in December 1990, most state enterprises have become the property of the republics, and the process of privatization will be influenced substantially by the laws and policies adopted by each. Other issues raised in the debates included whether to monitor the sources of investment capital and how to cope with social consequences of privatization, such as unemployment.

The Large-Scale Privatization Act's central ideas were relatively untroublesome. All parties agreed to privatize most businesses except for certain industries, such as railroads, nuclear power stations, and telecommunications, which should remain under government ownership and

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the asking price.

19. The republic will have to allot 30% of the receipts to the local government.

20. The Law of the Czech National Council of November 15, 1990 on the Competence of the Organs of the Czech Republic Concerning the Transfer of Some State Property to the Ownership of Juridical Persons or Individuals, No. 500/1990 Coll. of L. and the Law of the Slovak National Council of November 21, 1990, No. 474/1990 Coll. of L. are similar. The two laws create district commissions for privatization that conduct the auctions and authorize the republican ministries for administration of state property and privatization to monitor the process.

21. The Law on Conditions of Transferring State Property to Other Persons (Large-Scale Privatization Act) was adopted by the Federal Assembly on February 26, 1991 and took effect on April 1, 1991. Vaclav Klaus, the chief architect of the economic reform, hailed this Act as a "historic document" and an "all-out attempt to get rid of . . . state ownership of industry." *See* CENTRAL & EASTERN EUROPEAN LEGAL MATERIALS, *supra* note 4.

control. Likewise, all parties agreed that the goal was to obtain maximum profits and, consequently, that privatization should be achieved through a variety of methods, such as creation of joint stock companies with the subsequent offering of shares to specified groups of individual and institutional investors, direct sales of enterprises to domestic and foreign investors, transfer of properties to municipalities, and endowment of social security and health care funds.

1. The Federal Fund of National Property

The Large-Scale Privatization Act creates a new agency, the Federal Fund of National Property (Federal Fund), and entrusts the task of carrying out the privatization program to the Federal Fund and to the Czech Fund of National Property and the Slovak Fund of National Property. The latter two funds will be established by the legislatures of the respective republics. The Federal Fund will assume the ownership of any federal property to be privatized, whereas the funds of the republics will become the owners of all republican assets chosen for privatization.

The Federal Fund is a legal entity separate from the state. The property of the Federal Fund cannot be used by the state to generate revenues or to meet its budgetary needs; the property can be utilized only for privatization and for satisfying restitution claims. The duties of the Federal Fund include entering into contracts with the buyers of privatized property, selling the shares of joint stock companies it has founded, and exercising shareholder's rights in the companies it owns. In addition, the Federal Fund is liable for non-fulfillment of its obligations and can be sued in courts of justice.

The statutory bodies of the Federal Fund comprise a nine-member policy-making Presidium elected for a five-year term by the Federal Assembly, a nine-member Executive Committee appointed by the Presidium, and a Supervisory Council elected by the Federal Assembly. The Executive Committee exercises management functions, negotiates the sales of enterprises, and enters into contracts on behalf of the Federal Fund.

2. Plans of Privatization for State Properties

The first step toward privatization will be the compilation of lists of state properties to be encompassed by the program. These lists will be approved by the government. Then, each of the state enterprises on the list must formulate its own plan of privatization, which must include a timetable.

At this stage, the state enterprises will face the problem of valuation.

The government has recommended that these enterprises retain, when advisable, experienced foreign consulting firms, banks, and lawyers to ensure that their assets are properly valuated.[22]

The enterprise's proposed plan must provide for the method of privatization. The two basic methods of privatization are direct sale to an investor and transformation of the enterprise into a joint stock or limited liability company. In the case of a direct sale, the plan should include information about potential buyers. When a joint stock company is contemplated, the plan must indicate how the shares are to be distributed, whether employees will be entitled to buy the company's shares at discount prices, and what portion of the stock may be sold to investment voucher holders. Incidentally, the Large-Scale Privatization Act imposes no limits on foreign holdings in any given company.

After formulation, the plan will be reviewed by the founder of the state enterprise, the federal or republican government department to which the enterprise is subordinated. The plan then will be submitted for final approval to the Federal Ministry of Finance, when the founder is a federal agency, or to the competent authority of the republic. In most instances, the governmental agencies of the republic in which the enterprise is located will review and approve the privatization projects. Privatization plans that envisage direct sale to a specific domestic or foreign investor must be approved by the competent government.[23]

3. Capital Scarcity and Investment Vouchers

It is estimated that the Large-Scale Privatization Act will affect about 4500 industrial and other enterprises tentatively valued at some 130 billion dollars. The nagging question remains how to privatize businesses in a country that has over one hundred billion dollars worth of property, but only a few billion dollars in individual savings with which to buy the property. The problem of inadequate domestic capital persists across Central and Eastern Europe. An unknown factor is the demand for corporate shares, given the severe shortage of capital in the country and the

22. The Skoda Automobile Works retained Price Waterhouse to determine the value of its company before it accepted a merger offer by Volkswagen A.G. Under the agreement signed in April 1991, Volkswagen acquired a 30% share in Skoda that is to rise to 70% by 1995. The remaining 30% will be sold to the public as non-voting shares, which should enable Volkswagen to maintain tight control over Skoda and should preclude any hostile moves by the new shareholders.

23. At the moment when it is sold to an investor or when it is transformed into a joint stock company, the enterprise ceases to exist as a state enterprise and begins a life of its own as a privatized company.

general lack of experience with stock ownership. To encourage participation, the privatization scenario implicitly entitles workers to obtain shares of their enterprise at a discount.[24]

To compensate for the scarcity of readily available capital, the Large-Scale Privatization Act introduced the concept of investment vouchers as a means of assuring popular participation in the privatization process. Under a complex plan yet to be finalized, each citizen over eighteen years old will be entitled to purchase at a discount a non-transferable voucher, with which the citizen can buy stock in designated companies or shares in mutual funds, which have investments in numerous companies.[25] The types of the vouchers and their value will be determined by the federal government in consultation with the Czech and Slovak governments.

The voucher system may prove ineffective in increasing capitalization for several reasons. First, it is uncertain whether every citizen will be prepared to pay even a nominal amount for the vouchers. Second, the plan perhaps credulously assumes that citizens will behave like experienced shareholders. In European societies with long-standing traditions of stock markets barely ten percent of the population ordinarily invests in stocks. Czechoslovak citizens, most of whom have never been exposed to any stock market, probably will not embrace in large numbers and with confidence a form of ownership that entails considerable risks. It is more likely that, rather than maintaining the investment, the voucher holder will seek to turn his stock into cash quickly, even if the holder has to sell the stock for less than its nominal value. This may result in a sudden decline of the stock market.

Third, it is a philosophical proposition that vouchers incarnate the public's right to a fair share in state-owned enterprises. The program, however, in addition to becoming a bureaucratic nightmare, might miss

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24. In general, the law does not permit privileges in acquiring shares. The only exception is envisaged by section 9 of the Joint Stock Companies Act of April 18, 1990, No. 104/1990 Coll. of L., *translated in* CENTRAL AND EASTERN EUROPEAN LEGAL MATERIALS, *supra* note 4, which states that "[t]he statutes can provide for the issue of employee shares, sold at an advantageous price." Expectations of the feasibility of the employee stock option plan (ESOP) are inflated because of somewhat inaccurate reports that the ESOP plays a major role in capitalizing United States corporations.

25. The Polish privatization program makes citizens' vouchers usable only for purchasing shares in private intermediary institutions (mutual funds), which will buy companies to be privatized. Each citizen will have a choice among the intermediary institutions in which he or she wants to invest. *See* Rapaczynski & R. Frydman, *The Polish Government's Large-Scale Privatization Plan: A Preliminary Analysis*, 2 PARKER SCHOOL BULLETIN ON SOVIETS EAST EUROPEAN LAW (S.E.E.L) 1 (Feb. 1991).

the point. Vouchers are not only difficult to distribute, but they do not answer the critical question of who appoints management. Vouchers beget general ownership, which is conducive to the entrenchment of managers who have survived from the socialist past. The other extreme, in which mutual funds become the majority owners, is no less foreboding because mutual funds may install management that will yield too easily to the pressure of those who view profit as the sole measure of success.

The Large-Scale Privatization Act does not resolve all aspects of the privatization scenario. The Act's details are far from clarified. Therefore, privatization will remain the center of legislative attention for some time, requiring the adoption of additional laws and regulations.[26] The magnitude of the task and the many complicating factors, such as restitution of expropriated property, make an early realization of large-scale privatization unlikely. Realistically, it may require up to five years before the process is completed.

III. LEGISLATIVE FRAMEWORK

A. *A New Company Law*

Since 1990, a business in Czechoslovakia has been allowed to operate in any of several different organizational forms provided for by law. These forms can be divided into three broad categories based on ownership: (1) state enterprises;[27] (2) agricultural cooperatives;[28] and (3) pri-

26. One such law to be enacted is the bill on land property now before the Federal Assembly.

27. State enterprises are governed by the Act on State Enterprise of April 19, 1990, No. 111/1990 Coll. of L., *translated in Central & Eastern European Legal Materials*, *supra* note 4. The founder of a state enterprise can be the central ministry of state administration or a municipality. Therefore, municipal enterprises are considered to be state enterprises. A state enterprise is a legal entity that acts in its own name and is liable for its own debts. Unless otherwise provided by law, the state does not assume responsibility for a state enterprise's debts. Although the property of a state enterprise is part of the state's assets, it cannot be taken from the enterprise, except when authorized by law. The organs of the state enterprise are the managing director and the supervisory council. The managing director is appointed by the founder after consultation with the council. The council supervises the management and operations of the enterprise. One half of the membership of the council is appointed by the founder, the other half by the employees. Each council member's term of office is five years. Mergers and takeovers of state enterprises, as well as their liquidation, are within the powers of the founder.

28. Act on Agricultural Cooperatives of May 15, 1990, No. 162/1990 Coll. of L., *translated in* CENTRAL & EASTERN EUROPEAN LEGAL MATERIALS, *supra* note 4. A cooperative is defined as "the voluntary association of citizens, who together manufacture agricultural products and foodstuffs, farm and perform other activities, to satisfy and support their interests." *Id.* art. 2.

vate business organizations, which include sole proprietorships,[29] partnerships,[30] silent partnerships,[31] consortia,[32] limited liability companies,[33] joint enterprises,[34] and joint-stock companies.[35] Foreigners can form business organizations of any type.

The joint-stock company, which broadly corresponds to the United States corporation, apparently will become the dominant form of business organization in industry and trade. The state, legal entities under private law, or individuals can found these companies. The company can own property, enter into contracts, sue and be sued in courts, and generally perform the same legal functions as a legal person. The law permits a single shareholder to form a joint-stock company. Ordinarily, a joint-stock company consists of its shareholders, a board of directors, the supervisory board, and auditors. The directors may employ managers to oversee the daily operation of the company. Because the joint stock company is recognized as a legal entity separate from its owners, the shareholders are not personally liable for company obligations beyond the amount of their respective investments. Common and preferred stock represent ownership interests in a company. The capital of a company must be a minimum of one hundred thousand Czechoslovak crowns, and at least one third of this amount must be paid in at the time of incorporation.

B. *Securities Legislation*

Current legal regulations encompass areas that, in the past, were relevant only to international transactions. Regulations in these areas are

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29. Act on Private Enterprise of April 18, 1990, No. 105/1990 Coll. of L., *translated in* CENTRAL & EASTERN EUROPEAN LEGAL MATERIALS, *supra* note 4. A firm owned by a private entrepreneur is established by registration with the municipal registration office. There are no limits on the number of employees or on property ownership. Entrepreneurs who employ more than 25 employees or whose revenues exceed 540,000 Czechoslovak crowns, however, also must register in the court-maintained corporate registry. A foreign applicant must obtain permission of the ministry of finance of the republic in which he intends to establish his firm.

30. Act of April 18, 1990, Amending the Economic Code, No. 103/1990 Coll. of L., arts. 106a-106m, *translated in* CENTRAL & EASTERN EUROPEAN LEGAL MATERIALS, *supra* note 4.

31. *Id.* arts. 106u-106z.

32. *Id.* arts. 106za-106zc.

33. *Id.* arts. 106n-106t.

34. *Id.* arts. 106zd-106zg.

35. The Joint-Stock Companies Act of April 18, 1990, No. 104/1990 Coll. of L. [hereinafter Joint-Stock Companies Act], *translated in* CENTRAL & EASTERN EUROPEAN LEGAL MATERIALS, *supra* note 4.

now becoming important legal accessories to the domestic economic reform. As a first step toward creating a financial market, the Federal Assembly enacted a securities law that regulates the issuance of bonds and other debentures.[36] A bill on a stock exchange is pending in the legislature, and the creation of stock exchanges in Prague and Bratislava are in the planning stages.[37]

C. *Anti-Monopoly Legislation*

In a country whose economy had been dominated for decades by state production and distribution monopolies, which were free from competition at home and were protected from foreign competition by a system of import barriers and taxes, antitrust regulation is a new and untested area of the law. The Act on Protection of the Economic Competition of January 30, 1991 (Competition Act)[38] is the first Czechoslovak statute specifically intended to serve as an antitrust measure. The Competition Act declares certain agreements between enterprises to be unlawful. These agreements include: (1) direct or indirect pricing or setting of other commercial terms; (2) obligations to restrict or control production, sales, technical development, or investment; (3) divisions of markets or purchases of resources; (4) commitments to purchase services or other performances that are unrelated to the main contract; (5) discriminatory terms; (6) obligations to restrict the access of non-parties to the agree-

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36. The Act on Securities and Debentures of November 26, 1990, No. 530/1990 Coll. of L., *translated in* CENTRAL & EASTERN EUROPEAN LEGAL MATERIALS, *supra* note 4.

37. The stock exchanges will be organized in the form of joint-stock companies whose founders must obtain permission from the Federal Ministry of Finance in agreement with the Czech Ministry of Finance or the Slovak Ministry of Finance, as appropriate. The general meeting of the shareholders, the chamber of the stock exchange, the supervisory council, and the inspectors of the accounts will be the main statutory bodies. The stock exchanges will be authorized to deal in securities, in bonds and debentures, and in foreign currency and gold. Except for state bonds, no securities will be admitted for trading at the stock exchange without a prospectus and disclosure of essential information. The chamber will issue the rules of the stock exchange and will have disciplinary jurisdiction over participants in the dealings, their agents, and issuers of the securities who violate these rules. Disputes arising from transactions completed at the stock exchange will be adjudicated by the civil court having territorial jurisdiction, unless the parties agree to refer the dispute to the chamber for settlement. The commissioner appointed by the Federal Minister of Finance will exercise overall supervision of the stock exchange's activities. The Federal Minister of Finance can order the stock exchange to suspend trading temporarily if it is the only way to prevent extensive economic damage.

38. 1991 Coll. of L., CENTRAL & EASTERN EUROPEAN LEGAL MATERIALS, *supra* note 4.

ment to the market; and (7) exclusions of or unfounded limitations on rights to revoke the agreements.

The Competition Act establishes the Office for Competition, a federal agency that supervises the implementation of the Competition Act in agreements that affect at least forty percent of the market in both the Czech and the Slovak Republics. The Competition Act envisages the creation of Competition Offices in both the Czech and Slovak Republics to address cases that predominantly affect the respective republic. The Competition Offices also will monitor mergers and acquisitions that might adversely affect competition. Either the Competition Office or the party whose economic interests are affected can initiate proceedings, and the Office may impose penalties on those found guilty of antitrust violations.

D. *Other Foreign Economic Legislation*

An amended statute regulating foreign economic activity (Amended Foreign Economic Relations Act)[39] redefines the scope of state supervision of foreign trade. The Amended Foreign Economic Relations Act also governs the status of foreign trade representation offices in Czechoslovakia, defines rules for the import and export of economic services, and controls the activities of the chambers of commerce and industry. This Act also provides a legal basis for the Court of Arbitration at the Czechoslovak Chamber of Industry, an independent arbitration tribunal that adjudicates international commercial disputes.

E. *Second Generation Legislation*

Many laws enacted during 1990 that regulate economic relations are not intended to endure because of their obviously interim nature. These acts serve as bridges to more lasting regulation that will require some time to develop. As a civil law country, Czechoslovakia regulates private relations, including commerce, by codes of law. Presently, there are three such codes: the Civil Code, the Economic Code, and the Code for International Trade.

All three codes need substantial revision. The Civil Code is being thoroughly revised, and upon enactment, probably in 1992, it will serve as the principal source of private law. The Economic Code, which regu-

39. The Act on Economic Relations with Foreign Countries of April 19, 1990, Act No. 113/1990, Coll. of L., *amending* Act No. 42/1980, Coll. of L. and Act No. 102/1988, Coll. of L., *translated in* CENTRAL & EASTERN EUROPEAN LEGAL MATERIALS, *supra* note 4.

lates domestic business, and the Code for International Trade, which applies exclusively to foreign transactions, will be merged into a single commercial code. This commercial code will make superfluous many of the laws enacted at the early stage of the economic reform.

IV. Regulation of Foreign Investment

The policy favoring participation of foreign capital in Czechoslovak enterprises predates the 1989 revolution. In November 1988, the Federal Assembly adopted a law on joint ventures (1988 Foreign Participation Act or 1988 Act).[40] The 1988 Foreign Participation Act exempted foreign joint ventures from requirements imposed by the system of central planning and provided both tax and non-tax incentives to those wishing to invest in Czechoslovak state enterprises. This Act generally limited foreign participation to forty-nine percent of a joint venture's assets,[41] and it only guaranteed repatriation of profits to the extent that the joint venture generated foreign currency. Subsequent amendments offered a reduced income tax rate to joint ventures of forty percent of profits rather than fifty to sixty-five percent rates imposed on Czechoslovak companies.

The 1988 Foreign Participation Act was substantially amended after the revolution (1990 Foreign Participation Act or 1990 Act).[42] Most of the limitations in the 1988 Act were removed. In contrast to the 1988 Act, which allowed only state enterprises to enter into joint venture agreements with foreign parties, the 1990 Act has opened participation to private Czechoslovak companies and to individual citizens. For example, there is no limit on a foreign participant's share in the enterprise. Perhaps the most far-reaching innovation is the application of the 1990 Act to wholly-owned foreign enterprises.[43] This provision transforms the 1990 Act into a statute regulating all forms of foreign investment, not merely those involving partnership with a Czechoslovak participant. In this peculiar fashion, the law opens the door to direct foreign investment

40. The Enterprise with Foreign Property Participation Act of November 8, 1988, No. 173/1988, Coll. of L.

41. On a case by case basis, the foreign partner was permitted to own a majority interest.

42. The Enterprise with Foreign Property Participation Act of April 19, 1990, No. 112/1990, Coll. of L. [hereinafter 1990 Foreign Participation Act], *translated in* Central & Eastern European Legal Materials, *supra* note 4.

43. Article 2(4) states that "the present Act shall apply also to cases where the enterprise is established exclusively by a foreign participant or where such a foreign participant participates exclusively in its trading." *Id.* art. 2(4).

in the form of sole proprietorships of foreign parties, partnerships comprising only foreign parties, and Czechoslovak corporations wholly owned by foreign parties. The potential of this provision will be tested as the privatization process unfolds.

The Federal Ministry of Finance in Prague is responsible for authorizing and registering foreign investments, although this designation may change in light of the December 1990 constitutional amendment that transfers certain powers from the federation to the republics. Under this amendment, licensing of foreign investment is likely to be in the competence of the republics.[44] Until February 1991, if the enterprise engaged in foreign trade, a separate license from the Ministry of Foreign Trade was required, but this special licensing requirement has been abolished. The necessity for a license may arise, however, if the foreign trade activity is unrelated to the enterprise's authorized field of activity.

A joint venture, or a wholly foreign-owned business established under the 1990 Foreign Participation Act, acquires the status of a legal entity under Czechoslovak law. Legal entities are qualified, among other things, to acquire real property in Czechoslovakia, a privilege generally denied to foreign companies not incorporated in Czechoslovakia.[45]

The rule that profit can be repatriated only to the extent that the joint venture generated foreign currency has been abandoned both in law and in fact. On January 1, 1991, Czechoslovakia introduced internal convertibility of its currency under the Foreign Exchange Act of November 28, 1990 (Foreign Exchange Act).[46] The Foreign Exchange Act allows any business firm and, with some limitations, citizens to trade Czechoslovak currency for foreign currency at an authorized bank to make legitimate payments abroad.[47] Presumably, transfer of profits earned by a foreign investor qualifies as legitimate payment.[48] Similar guarantees seem to

44. Foreign banking investments require authorization by the Czechoslovak State Bank.

45. Foreigners are barred from acquiring real estate in Czechoslovakia, except by inheritance or pursuant to special laws. Companies owned by foreigners but incorporated in Czechoslovakia, however, are not considered foreign juridical persons and are not subject to this prohibition. Foreign Exchange Act of November 28, 1990 [hereinafter Foreign Exchange Act]. No. 528/1990 Coll. of L., *translated in* CENTRAL & EASTERN EUROPEAN LEGAL MATERIALS, *supra* note 4.

46. *Id.* § 13.

47. *Id.*

48. Transfer abroad of the investor's share of earnings is guaranteed to a foreign investor. 1990 Foreign Participation Act, *supra* note 42, art. 20(2). Another guarantee for repatriation of profits, as far as United States investors are concerned, will be provided by the Investment Protection Agreement between Czechoslovakia and the United States, which is expected to be signed during 1991.

extend to repatriation of foreign capital. The Ministry of Finance, however, has wide discretion to sanction transfers abroad exceeding the legal limits. Not surprisingly, the Foreign Exchange Act requires Czechoslovak companies, including joint ventures and wholly foreign-owned companies incorporated in Czechoslovakia, to offer to sell all their foreign currency earnings to a commercial bank.[49]

As large-scale privatization gathers momentum, typical foreign investments will be through purchases of shares in existing Czechoslovak companies, rather than through the establishment of joint ventures. In addition, however, state enterprises will offer to sell property previously invested in existing joint ventures. Presumably, foreign participants in the ventures with interests in the property will be given the option to buy.

It is likely that any form of investment that will be open to an investor domiciled in Czechoslovakia also will be available to foreigners. The foreign investor will become an equal participant in the Czechoslovak capital market and, as owner or co-owner of Czechoslovak companies, will operate under the general legal rules governing investment and business activities, rather than under a special regime applicable only to foreigners.[50] Such special regimes will be confined to areas in which public policy requires the exclusion or restriction of foreign investment activity, and some restrictions may result from the constitutional prescription that certain industries must be owned by the state. The debate is continuing whether foreign participation in certain Czechoslovak industries should be restricted by imposing limits on foreign shareholding and management. Under the present law,[51] there seems to be no legal objection to all directors being foreigners.

Foreign investments are amply protected against political risks. Under the Czechoslovak Constitution, the property rights of foreign owners are accorded the same protection as those of Czechoslovak citizens.[52] Expro-

49. Foreign Exchange Act, *supra* note 45, § 11.

50. This equality of opportunity, however, is still unrealized. It will take several years and require substantial legislative action before all the details of privatization are delineated. Therefore, a high-level bipartisan task force of the Atlantic Council of the United States, in its recent report on United States policy toward Czechoslovakia made the following recommendation: "Czechoslovakia should not wait for privatization to take place before adopting liberal legislation which is unequivocal in its welcome of legitimate foreign investment and which sets out with clarity that what is not specifically prohibited is permitted." *Report Urges U.S. to Step Up Efforts to Promote Trade with Czehoslovakia,* Int'l Trade Rep. (BNA) No. 10; at 360 (March 6, 1991).

51. *See* The Joint-Stock Companies Act, *supra* note 35, art. 50.

52. CZECHOSLOVAK CONSTITUTION art. 14.

priation or other taking of property is admissible only according to the law and with compensation. An expropriation decree can be appealed, and the appeal must be decided by the court of justice. In addition, a network of bilateral treaties on investment protection[53] safeguards the property interests of a foreign investor by providing them internationally protected rights. Also, Czechoslovakia recently has acceded to the Convention on the Creation of the Multilateral Investment Guarantee Agency (MIGA), an arm of the World Bank.

The Czechoslovak Government also has set up the Agency for Foreign Investment, the duty of which is to help foreign businessmen understand the legal environment and offer specific information on Czechoslovak companies that seek foreign capital. This agency also will provide details regarding the government's investment incentive programs. According to recent information, the government plans to set up a special consulting unit to advise foreign investors on banking, accounting, and technical matters. This unit later will be privatized.

53. Such treaties have been concluded with Austria, Belgium, Canada, Germany, Italy, Sweden, Switzerland, the United Kingdom, and the United States.