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Legal Aspects of Doing Business with and in Hungary

Lajos Schmidt

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LEGAL ASPECTS OF DOING BUSINESS WITH AND IN HUNGARY

*Lajos Schmidt**

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I. INTRODUCTION

A recent New York Times article describes Hungary as "the Communist world's economic showcase, with plenty of goods in the shops and a fair measure of political liberty."¹ It points out that while Poland is struggling with idle factories and empty stores, Romania has introduced food rationing and Czechoslovakia may do the same, the Soviet Union is buying foreign grain to bridge the winter, and East Germany is feeling the impact of rising energy prices and a widening trade gap, Hungary is prospering. How can a small member of the Council for Mutual Economic Assistance² (COMECON) with little mineral or natural wealth other than fertile land and the skill and willingness of its population, uphold a standard and style of living more similar to that of the West than that of the Soviet Union or the highly industrialized and heretofore quite prosperous German Democratic Republic?

For more than a decade Hungary has secured a better and freer standard of living for its population by relaxing centralized State planning. Instead, Hungary has encouraged the profit motive and decentralized the management authority of plants, farms, and co-operatives. Hungary's recent applications for membership in the International Monetary Fund and the World Bank are a result of her steady, liberal economic evolution.³ Hungary also expects to have its currency, the forint, become partly convertible into dollars, marks and yen sometime in 1982.⁴ As a further step towards the Westernization of its economy, Hungary will allow the establishment of small, privately owned enterprises after January 1, 1982. The creation of private enterprise is Hungary's greatest departure from accepted economic activities in other Socialist countries.

1. N.Y. Times, Dec. 3, 1981, at A1, col. 2.

2. Hungary's total population is only 10.7 million.

3. International Monetary Fund Press Release No. 81/75 (Nov. 4, 1981), reprinted in IMF SURVEY (Nov. 9, 1981).

4. In order to further adjust the Hungarian monetary and economic system to comply with free market conditions, the National Bank of Hungary has published weekly uniform exchange rates (*i.e.*, purchase, sale, and median rates) since October 1, 1981, at which all foreign exchange conversions are to be made.

These uniform rates replace the prior so-called "parallel rates," which assured a better exchange rate for exports and a disincentive to imports and tourism in Hungary. The parallel exchange rates continue to be applied by the other member-states of COMECON.

The Hungarian legal system provided the structure for these dynamic changes in Hungary's economic life. This paper analyzes this system and its importance for foreigners doing business with and in Hungary. In particular, this paper will discuss the legal forms through which foreigners can participate in Hungarian economic life, including the background of the new law allowing the establishment of small, privately owned enterprises which may in time affect the Hungarian economy and the ability of foreigners to do business with Hungary.

II. THE GENESIS AND DEVELOPMENT OF HUNGARIAN LAW

Hungarian law and legislation historically have been equitable, progressive, and consonant with the requirements of the times.⁵ Hungarian law is based on Roman law, as are the other continental European legal systems. Until the middle of the nineteenth century, Hungarian laws were written in Latin, the prevailing legal language in many European countries, and Latin was used for the legal training of Hungarian and other European jurists.⁶ Until the end of World War I, Hungary was united with Austria under a "personal union" (*i.e.*, the Austrian Emperor was also the King of Hungary). Consequently, there are many similarities between Hungarian law and the laws of Austria and Germany. Unlike a large number of other countries, Hungary did not abolish its prior laws after World War II and the Socialist revolution. Many of these laws were modified or set aside, however, because certain laws were no longer applicable in a Socialist economic system.⁷

5. At the beginning of the 12th century, Hungarian King Coloman Beauclerc (1095-1116) declared as law for his subjects, at a time of heresies and superstitions, that "there shall be no questions about witches since there are none." In 1222, just seven years after the proclamation of the Magna Carta, Hungarian King Andrew II (1205-1235) issued the Golden Bull, a decree in which individual freedom and property rights were secured for the Hungarian nobility, and, to some extent, for the entire country through the nobility.

6. Law No. II of 1844 proclaimed that thereafter all legislation adopted by the Parliament would be enacted and confirmed by the King only in Hungarian.

7. The present establishment in Hungary of a joint venture company in the form of a corporation by a foreign firm with a Hungarian enterprise could be effected either under the Trade Act of 1875, Law No. XXXVIII, §§ VII-X (1875) (published by the Lower House of the Parliament May 18, 1875, and by the Upper House May 19, 1875) or under the Limited Liability Company Act of 1930, Law No. V (1930). Although much has changed since both laws were promulgated, they have been subject to minor amendments only.

A review of the many laws enacted by the Hungarian legislature or of the decrees and regulations issued by the Hungarian ministries since the Socialist revolution demonstrates that these provisions are based on prerevolutionary Hungarian legal principles of equity and fairness. To the extent feasible, these laws and regulations fit the general legal framework which Hungary established over the three centuries following the expulsion of the Turks from the country. This legal tradition has enabled Hungary to be a full-fledged trading partner with the West European nations.

Hungary is a country where laws prevail over people. Hungarian laws are well-designed and evenly administered by a judicial system rich in tradition. For several hundred years Hungarian legislation has reflected a desire to assure individual rights, as well as to define and defend the ownership of property. Today, individually-owned houses dot the countryside, and the condominium is the preferred means of apartment ownership in Budapest. The ultimate ownership of companies is vested in the state or in cooperatives, but the independence and managerial prerogatives of Hungarian companies are well defined and well preserved. While the ownership of Hungarian companies is centralized in the state, the decision-making and day-to-day control are legally delegated to the companies' managers.⁸

The legal principles which led to the establishment of the West European corporations and limited liability companies resulted from economic and legal developments over the last few centuries. These legal principles permeate Hungarian corporate and limited liability company legislation, as well as the current Hungarian commercial legislation, which is particularly geared to international trade and business. Approximately fifty percent of Hungary's gross national product is import or export-generated. A country depending so heavily on foreign trade must foster this vital element of its economy with modern legislation to accommodate the international flow of goods and ideas. Hungary has such legislation. The introduction of its New Economic Mechanism in 1968 evidences the presence of such legislation in Hungary.⁹ The

8. See Law on State Companies, Law No. II (1977) (published Dec. 27, 1977); Law on Cooperatives, Law No. III (1971) (published Oct. 2, 1971).

9. The laws, law-decrees, decrees, and regulations introducing the New Economic Mechanism were enacted in 1967 and became effective on January 1, 1968. The legislation was so lengthy that two volumes were required for its pub-

New Economic Mechanism has been further streamlined to make the Hungarian economy more closely resemble that of Western Europe. Hungary has long realized that the Hungarian legal system must accommodate generally accepted international legal principles.

III. HUNGARY'S BUSINESS SYSTEM

United States and other Western businessmen are generally apprehensive about doing business in and with Hungary. They are concerned that their Hungarian counterparts will have a different manner of doing business, and more importantly, that they will have different goals and purposes in conducting business. In fact, however, the individuals who manage Hungarian enterprises engaged in both domestic and international business transactions have similar business practices to their Western counterparts. Admittedly, the Hungarian businessman manages an enterprise owned by the Hungarian state or by a cooperative. He is not, however, a government official; his goals are not different from those of Western businessmen. He wants to make a profit; he wants his enterprise to manufacture modern, up-to-date products; he knows that he can establish a lasting business relationship only if his enterprise can punctually deliver the products that the other party wants to acquire with the desired quality at competitive prices.

In Hungary, foreign trade is a state monopoly.¹⁰ Only an enterprise authorized to deal in foreign trade (*i.e.*, the import or export of goods, services, or industrial property rights) may enter into a contract with a foreign company. Fortunately, Hungarian legislation has liberally interpreted the state monopoly on foreign trade. It has recognized that divorcing foreign trade activity from manufacturing activity is sometimes detrimental to a complex economy desiring to keep abreast of world trade and technology. Therefore, an increasing number of Hungarian manufacturing enterprises are being given foreign trade rights.¹¹ Even when the ultimate re-

lication. A third volume was required for additional laws, law-decrees, decrees, and regulations amending and updating the original legislation as a result of continuing developments and reforms.

10. Law for Foreign Trade, Law No. III, para. 3, art. 1 (1974) (published Oct. 17, 1974).

11. All of the larger manufacturing enterprises have been entrusted with foreign trade rights. According to statistics published by the Hungarian Chamber

recipient of foreign technology or products does not have foreign trade rights, the Western businessman probably will be in direct contact with the Hungarian enterprise. Legal differences between the various types of Hungarian enterprises are as negligible as those between a United States company whose stock is quoted on the New York Stock Exchange and one listed on the American Stock Exchange.

The management structure of Hungarian enterprises is quite similar to that of Western companies. The general manager of the Hungarian enterprise corresponds to a United States company's chief executive officer. Perhaps the only difference between officers of Hungarian enterprises and those of United States companies is that the Hungarian chief executive usually has broader powers and correspondingly greater responsibility than a chief executive in the United States. Under the general manager are directors (not to be confused with directors in the United States corporate sense) who correspond to a United States company's vice presidents in the various fields of manufacture-technology, sales, administration, and finance. The directors in the first two fields have the greatest responsibility and influence within the enterprise.

If a Hungarian enterprise does not achieve its goals, the remedy is the same as within United States companies (*i.e.*, the general manager and possibly other members of the management are replaced). If the restructuring of management or production does not render the enterprise profitable, then the enterprise is likely to be merged into another enterprise or liquidated.

International business in Hungary is conducted by an enterprise which is a separate legal entity that maintains its own assets and liabilities and is responsible for its corporate acts to the extent of its corporate assets. Although theoretically possible, it is highly unlikely that a Hungarian enterprise would fail to satisfy its liabilities to foreign creditors due to a lack of assets. While it is not uncommon for a Western company to be unable to satisfy its liabilities, no such precedent has developed in Hungary. Consequently, Hungarian ownership of enterprise should not be considered a hindrance to free and efficient business relationships be-

of Commerce 1980, there were 38 foreign trade companies and agencies and more than 80 manufacturing enterprises, cooperatives, and other economic organizations with foreign trade rights. The size of the latter group continues to increase.

tween Western and Hungarian companies. In fact, the state's practical role as guarantor of the solvency of Hungarian enterprises could be considered an advantage of doing business with and in Hungary.¹²

IV. LEGAL FORMS OF DOING BUSINESS WITH AND IN HUNGARY

A. *Export of Western-Made Products to Hungary*

The simplest method of trading with Hungary from a foreign base is the export of products to Hungary. Western companies can freely correspond with any interested Hungarian enterprise. If a foreign company does not know which enterprise is likely to be interested in acquiring its products, the Hungarian Chamber of Commerce¹³ puts the company in touch with a potential Hungarian importer or interested end-user of its products at no charge. The various Hungarian Commercial Attachés or Trade Representatives in the United States and many other countries also have knowledge about and communication with potential importers and end-users of particular Western-made products.

Western businessmen can travel freely in Hungary¹⁴ and engage in business discussions with any interested enterprise entrusted with foreign trade rights. If the potential importer is a Hungarian foreign trade company and a Western manufacturer of sophisticated machinery and equipment is involved, the foreign trade company will most likely bring together the end-user and the Western company. If the product is intended for general consumption, the foreign trade company will find the appropriate Hungarian sales channel without the Western exporter's direct involvement with the end-user. Even in such a case, however, the Western company is free to contact the Hungarian end-user or domestic sales enterprise and discuss its advantages over its competitors. The Western company may even propose, for the consid-

12: See *infra* notes 44-48 and accompanying text. The newly authorized privately owned small enterprises will not have such state backing. They will compete freely; consequently, in the event of failure they could suffer liquidation in bankruptcy.

13. The Hungarian Chamber of Commerce is a state-organized association of approximately 480 member-companies, most of which are foreign trade companies or enterprises entrusted with foreign trade rights. The member-companies account for approximately 85% of Hungary's exports.

14. Western businessmen normally can obtain a Hungarian entry visa at the border within an hour.

eration of the Hungarian enterprise, the most efficient advertising or sales promotional means for its products.

Like a Western purchaser, the Hungarian purchaser will be interested in the quality, price, and delivery terms of the product. If the parties reach an agreement, they will enter into either a standard form contract (often utilized for commodities or mass-produced items) or a special contract, utilized when the product is a complex or specially designed item. Although most Hungarian foreign trade companies use standard contract language, a Western company's contract language may be substituted if the Western company has justified objections to the provisions proposed by the purchaser. Similarly, the payment terms that Hungarian enterprises are prepared to offer for Western products or services are as varied as in the West. In most cases, Western companies insist on opening a letter of credit, with payment to be made at the time of receipt of documents or thirty, sixty, or ninety days thereafter. As more confidence is gained between the parties, Western companies often are prepared to sell on the basis of "cash against documents" or on open account with a thirty, sixty, or ninety day delayed payment, or a combination of these payment terms. All of these payment terms are legal and acceptable in Hungary. They are subject to negotiation in the same manner as any sales contract is negotiated in the West.

B. *Sales Efforts in Hungary Through an Agency Enterprise*

To provide a more continuous sales effort than it can exert from a foreign base, a Western company may seek representation from one of the state-owned Hungarian enterprises which specialize in the representation of foreign manufacturers and large foreign distribution organizations.¹⁵ These agency enterprises compete with each other for business in the same manner as their Western counterparts. Some of these enterprises are more specialized in a particular product line than others, but a Western company is free to choose the one with the greatest preparedness and offering the best terms. The agency enterprise merely solicits orders from Hungarian end-users; rather than entering into contracts on behalf of its foreign principal, the foreign principal contracts directly with Hungarian importers. The foreign principal pays the contracted compensation directly to the Hungarian

15. See Decree of the Minister for Foreign Trade No. 8 (1974 KKM) (X.17).

agency enterprise.

The Hungarian Government encourages competition among agency enterprises. A Western company is free to terminate the Hungarian agency agreement and to seek representation by another agency enterprise if it finds that the agency enterprise originally chosen does not render the services expected. Although the agency agreement must be terminated in accordance with its terms, there is far greater freedom in Hungary than in other countries with respect to the termination of an agreement.¹⁶ Unlike many other jurisdictions, no termination benefits are due to a Hungarian agency enterprise upon the termination or nonrenewal of the agency agreement in accordance with its terms.¹⁷

If a Western company wishes to increase the sales effectiveness of its products in Hungary, it may negotiate to establish a separate division within the agency enterprise. Specialists or technicians are then designated to work exclusively on the sale and, in some cases, the servicing of the products.¹⁸ These persons remain the employees of the agency enterprise, but their exclusive task is the sale and servicing of the foreign principal's products. They have an intimate contact with the foreign principal as a manufacturer because their *raison d'être* is to make a success of the sale and servicing of the Western company's products. In such a case, the Hungarian agency enterprise will require a fixed monthly payment to cover the direct and overhead costs of the foreign principal's sales division, plus a commission on the sales achieved in Hungary. Once again, the entire arrangement will be subject to free negotiation between the parties without the interference of Hungarian laws and regulations concerning the number of personnel to be employed by the agency enterprise on behalf of the foreign principal or the amount and manner by which the agency enterprise is to be compensated for its sales efforts.

Finally, Hungarian income tax will not be levied against the foreign principal using an agency enterprise, nor will the transfer in Hungary to the Hungarian customer of title to the goods be

16. In countries such as Yugoslavia, local law does not permit the foreign principal to terminate a local agency company and appoint a new agency company except on the same or more favorable terms and conditions.

17. The "dealers" legislation existing in many countries provides special compensation to local agency companies or distributors upon termination, for the good-will created for the foreign principal.

18. See Law for Foreign Trade, Law No. III, para. 2, art. 1 (1974).

subject to Hungarian tax consequences for the foreign principal.¹⁹

C. *Branch Sales Offices Located in Hungary*

Under Hungarian law,²⁰ as confirmed by specific provisions of the United States-Hungary Trade Agreement,²¹ a United States company may establish branch offices in Hungary to oversee sales and servicing of its product. Although the establishment of a branch office requires the approval of the Hungarian Ministry of Foreign Trade, such approval is granted as a matter of course when the foreign manufacturer has already achieved substantial market penetration in Hungary. The Japanese have established the greatest number of branch offices, but companies from numerous other foreign countries have opened branch offices in Hungary.²²

Hungarian law provides that between three and eight percent of the foreign principal's total sales in Hungary will constitute taxable income in Hungary. Hungarian law disregards the actual involvement of the foreign principal's branch office in sales transactions with Hungarian customers because there is a presumption that the branch office has assisted the foreign principal in generating its sales. Furthermore, Hungarian law allows a deduction for ten percent of the taxable income attributable to the branch office to cover overhead expenses. The balance is then subject to a forty percent flat tax rate.

Article 7 of the Income Tax Treaty between the People's Republic of Hungary and the United States contains a provision that only income attributable to a Hungarian "permanent establishment" (defined to include a branch sales office) may be taxed in Hungary.²³ The purpose of this provision is the avoidance of

19. See Decree of the Minister of Finance No. 62 (1970 PM), Tax Covering Foreign Trading, Annex (Agency enterprises).

20. Law for Foreign Trade, Law No. III, para. 25 (1974).

21. Trade Relations Agreement, March 17, 1978, United States-Hungarian People's Republic, 29 U.S.T. 2711, T.I.A.S. No. 8967 (embodied in Law Decree No. 12 (1978) published on July 29, 1978, as the United States-Hungary Trade Agreement).

22. For example, IBM and Dow Chemical Co. are two United States companies with branch sales offices in Hungary.

23. Convention Regarding Double Taxation, February 12, 1979, United States-Hungarian People's Republic, T.I.A.S. No. 9560 (embodied in Government Decree (MT) No. 49 of 1979 (XIII. 6.)). The treaty became effective upon ratification by both countries on September 18, 1979.

double taxation. The expenses sustained by the permanent establishment, as well as a reasonable allocation of executive and other administrative expenses incurred by the United States head office in connection with its Hungarian permanent establishment, may be deducted from the amount of income so attributed. Based on the Tax Treaty formula, it is possible that a substantially lower profit would become taxable in Hungary than that computed in accordance with the rules of Hungarian law outlined above.

D. *Licensing*

A Western company may enter a licensing or cooperation agreement with a Hungarian enterprise for the manufacture and sale of its products in Hungary. If the Hungarian manufacturer does not have foreign trade rights, a Hungarian foreign trade enterprise is required to intervene as a co-licensee to pass the licensed rights to a mutually agreed upon ultimate manufacturing licensee.

Hungarian enterprises have concluded several hundred licensing agreements with foreign companies (predominantly with West German companies). United States technology is highly respected and sought after in Hungary; there are several dozen license agreements between United States and Hungarian enterprises, particularly in the agricultural field.²⁴ Hungary's interest in and need for foreign licenses is a result of its desire to use the best available technology in order to manufacture the most progressive products. The Hungarian Government wants to decrease the heavy reliance by Hungarian companies on technology and products originating in the Federal Republic of Germany and other members of the European Economic Community. United States technology and products have a certain advantage with respect to this desire to diversify. United States licensors and cooperation partners of Hungarian enterprises appear pleased with the results derived to date from their association with Hungarian licensees.

Hungary has also developed advanced technology in a number of specialized fields including the manufacture of pharmaceuticals, electric light bulbs, and axles for agricultural tractors. Ac-

24. Hungary upgraded its corn production through an agreement entered into by Corn Production System, Inc. of Chicago and Babolna State Farm; International Harvester licensed a substantial number of its lines of products in the agricultural implement field to RABA, and there was a regular shuttle of DC-8s in the mid 1970s carrying outstanding cattle from the United States to Hungary.

cordingly, not only have United States manufacturers granted licenses to their Hungarian counterparts, but Hungarian enterprises have also engaged in licensing United States companies.

One crucial question for any Western manufacturer is whether it can entrust the confidential handling of its industrial property rights to a Hungarian state-owned company. No case has been reported in which a Hungarian licensee has failed to keep the licensed technology confidential or has disclosed the licensed technology to another company in breach of the license agreement.

Contrary to many restrictions imposed in Latin America and in other parts of the world on the terms of a license agreement, Hungarian law and practice do not interfere with the terms and conditions of the license agreement. It may be freely negotiated between the Western manufacturer and its Hungarian counterpart. If the communication of the technology is structured as a license, it will remain a license and not a sale (*i.e.*, the Western licensor may limit the use of the technology by the Hungarian licensee to a fixed period of time). Moreover, the more valuable and unique the technology is, the higher the royalty or other compensation the Western licensor will be able to derive.

If a Hungarian manufacturer does not produce up-to-date goods which appeal to Western purchasers, the Hungarian enterprise is often eager to obtain the Western company's technology and become a contract manufacturer, or a licensee. The Western licensor may become the principal purchaser of the licensed products manufactured in Hungary for its own use or resale, while the Hungarian licensee embodies part of the licensed products in its own (larger or more complex) end-products and may sell the balance of the licensed products in previously agreed markets.

Before engaging in detailed license negotiations, a United States company should obtain an informal reading from the Export Control Administration of the United States Department of Commerce to determine whether a validated export license is likely to be issued at the conclusion of the license agreement. This is advisable because the transfer of United States technology to a Hungarian licensee may be made only upon the issuance of a validated export license. United States government officials have given repeated assurances that validated export licenses for technology transfers to Hungary will be handled promptly and objectively, but it is still advisable to obtain advance informal advice as to the likely attitude to be taken by the Department of Com-

merce once the request for an export license is officially submitted.

E. Patents

Hungary has a long history of protecting patent rights. The first Hungarian patentee obtained patent rights from Maria Theresa in her dual capacity as the Empress of Austria and the Queen of Hungary in 1770.²⁵ Hungarian patent legislation originated in 1822 when the first Austrian patent law was extended to Hungary.²⁶ The Hungarian Patent Law of 1895 was Hungary's first patent law.²⁷ It closely followed the Austrian patent law, and it remained in effect until it was superseded by the New Hungarian Patent Law²⁸ on January 1, 1970. The 1970 law protects a patented invention for twenty years after filing.

In 1909 Hungary became a member of the Paris Convention for the Protection of Industrial Property Rights.²⁹ Hungary presently adheres to the Stockholm version of the Paris Convention.³⁰ The Patent Cooperation Treaty (PCT), adopted by Hungary on June 27, 1980,³¹ allows an applicant to file an "international patent application" at his national patent office with the same legal effect as if national applications had been made in each of the countries indicated in the international application. The applicant's national patent office is required to pass on the application to its counterparts in the countries indicated in the application for the purpose of "international research." Based on the resulting research report, each of the national patent offices in the indicated countries independently decides whether to provide legal protec-

25. The first Hungarian patentee, Baron Andras Madruczi, was granted the exclusive 10 year right to use egg shells instead of lead in the production of paint.

26. The first Austrian Patent Law was enacted in 1820. Its validity was extended to Hungary in 1822 by Royal Decree.

27. Law No. XXXVII (1895) (published in the Országos Törvénytár, July 14, 1895) [hereinafter cited as Official Gazette].

28. Patent Law No. 2 of 1969 (published April 26, 1969).

29. Law No. LII (1908) (published in the Official Gazette, Dec. 31, 1980).

30. Law-Decree No. 18 of 1970 (published July 8, 1970; the protocol of notification was deposited on Dec. 18, 1969).

31. Law-Decree No. 14 of 1980; Government Reg. (MT) No. 29 of 1980 (VII.27.) (published July 29, 1980, and put into force June 27, 1980). The PCT was signed in Washington on June 19, 1970, and it became effective on January 24, 1978.

tion to the patent in its own territory. Accordingly, a United States company may now protect its patent rights in Hungary by designating in its United States patent application that it seeks protection in Hungary.

F. Trademarks

The first Hungarian trademark law dates back to 1890.³² After modernizing its economic system in 1978, Hungary redefined its trademark law to better serve the international trade community. The Hungarian Trademark Law of 1969³³ is a modern statute conducive to the registration and protection of Western trademarks in Hungary. It grants protection for ten years following the date of application, and it may be renewed indefinitely. Although Hungary has only 10,500,000 inhabitants, more than 160,000 trademarks owned by nationals of some fifty-five jurisdictions are registered in Hungary. Hungary is a member of the Paris Convention for the Protection of Industrial Property Rights and the Madrid Convention on the International Registration of Trademarks.³⁴

Under Hungarian law and practice, Western companies may license their trademarks to Hungarian enterprises. These licenses need not be listed on the official Hungarian trademark Register or evidenced through a "registered user agreement."³⁵

G. Protection of Know-How

The new Hungarian Civil Code,³⁶ which became effective on March 1, 1978, specifically provides for the protection of intellectual property rights in addition to patents and trademarks. This is one of the first codifications to treat know-how and other proprietary, unpatented technology as property for legal purposes and to provide for the statutory protection of such rights. The new law protects intellectual property rights which are not protected by the specific laws covering patents, trademarks, copy-

32. Trademark Law No. II (1890) (published in the Official Gazette, Feb. 13, 1890).

33. Trademark Law No. IX (1969) (published Dec. 23, 1969).

34. Stockholm Revision of Paris Convention for the Protection of Industrial Property, July 14, 1967, 21 U.S.T. 1629, T.I.A.S. No. 6923.

35. This is also the case in the United Kingdom and the former Commonwealth countries.

36. Law No. 4, arts. 86-87 (1977) (published Oct. 25, 1977).

rights, indications of origin, and recording rights as well as those which have not yet come into the public domain.

Individuals and legal entities are entitled to have their economic, technical, and organizational knowledge and experience protected if it has an economic value. The Civil Code puts a time limit on the protection of each of these rights. Any person whose intellectual property rights have been infringed has the right to demand remedies under the general provisions of the new law, as well as the remedies provided in special laws like the patent or trademark laws. If intellectual property rights not protected by specific laws are infringed, the aggrieved person may request a share of the profits derived from such unauthorized exploitation.

H. *Cooperation Agreements*

Even though Hungarian law recognizes the rights of Hungarian enterprises with foreign trade rights to acquire foreign technology through licenses, most Hungarian enterprises prefer a closer and more lasting association with the foreign licensor than is generally feasible within a license agreement. There are two reasons for this objective: first, the Hungarian enterprise may fear that the Western company's technology either is obsolete at the time that the latter grants the license or will become obsolete during the course of the license; second, the Hungarian enterprise may wish to assure itself of the continuing technical support of its licensor, rather than to acquire merely a one-time transfer of the technology.

Accordingly, the Hungarian licensee may endeavor to have its foreign licensor purchase at least a part of the products manufactured pursuant to the license, either for use by the foreign licensor or for sale in designated (generally Western) countries. The Hungarian licensee may sell the licensed products embodied in its own products or as separate products, either exclusively within Hungary or also in certain other designated countries, including certain members of the COMECON. The Hungarian licensee may undertake the manufacture of either the entire licensed product or certain components thereof. In the latter case, the Hungarian licensee will supply such components to the foreign licensor in addition to utilizing them for its own needs. The foreign licensor will specialize in the manufacture of other components and supply them to the Hungarian licensee as well. Through such cooperative manufacture the entire licensed product will be produced. These infinitely varied cooperation agreements are greatly pre-

ferred by the Hungarians over a straight license contract.

The negotiation of a cooperation agreement is often a long and difficult task. The agreement must encompass the licensing of the technology, including the licensing of patents and trademarks, the purchase-back of parts and components, and possibly even the sale of additional Western-made parts and components. The Hungarians often engage in protracted discussions in order to reveal every necessary detail and to be sure that all levels of their management are in agreement at each stage of the international licensing or cooperation transaction. Once an agreement has been executed the Hungarians will adhere strictly to all of its terms and conditions. Consequently, any time seemingly "lost" by a Western company with a Hungarian enterprise in the exploration and negotiation stages of such a transaction is gained back through the smooth and harmonious implementation of the agreement.

A Hungarian enterprise generally will not insist on some sort of counterpurchase because the Hungarian enterprise generally is able to economically manufacture modern products which its Western partner is avidly interested in acquiring. Coercing a Western company to purchase products which are not competitive and are likely to be "dumped" on the market would create considerable expense to the Western company and would sacrifice the good name of the Hungarian manufacturer. There is little evidence that any Western companies engaging in trade with Hungary have been required to participate in contrived, unprofitable counterpurchase transactions.

I. *Joint Ventures*

The most intensive method of foreign trade and business with and in Hungary is the joint venture. The genesis of the joint venture can be found in the 1970 Law on Economic Associations.³⁷ A 1972 decree was Hungary's first deliberate attempt to attract ad-

37. See Law-Decree No. 19 of 1970 on Economic Associations, para. 31. Hungarian companies which may be used as corporate vehicles for joint ventures with foreigners are similar to the German *Aktiengesellschaft* (AG) (corporation) and *Gesellschaft mit beschränkter Haftung* (GmbH) (limited liability company). In fact, the Hungarian laws regulating the establishment and functioning of corporations and limited liability companies are based on German legal principles. See *supra* text accompanying notes 9 & 10 (concerning Law No. XXXVII (1875) and Law No. V (1930)).

vanced technology and a more substantial, lasting interest on the part of a foreign partner, while upgrading Hungarian production capacities.³⁸ Unfortunately, this was only a half-step forward. Under those early laws, the joint venture company could not own production facilities; it served merely as a conduit for the transfer of technology to a production facility wholly-owned by the Hungarian joint venture partner, while channelling the necessary funds to the manufacturing enterprise. Only three joint ventures were established under the 1972 decree: VOLCOM, between Volvo and Csepel, for the manufacture of the four-wheel drive Laplander by Csepel and for its sale in Western markets by Volvo; Sicontact, between Siemens AG (Munich) and Intercooperation, for the production of computer software; and Radelcor Instrument Sales Limited, between Corning Glass Works and RADELKIS, a Hungarian cooperative, for the manufacture of medical diagnostic instruments.

In 1977 the Hungarian Minister of Finance provided for increased foreign involvement in the Hungarian economy by allowing the establishment of joint ventures in the production sphere.³⁹ Joint venture companies must receive permission from the Minister of Finance, who consults with the relevant Hungarian government ministries, prior to their operation. The Minister of Finance issued implementing regulations in July 1979.⁴⁰ In September 1979⁴¹ the Hungarian Government consolidated all of the laws and regulations (including the implementing regulations) concerning joint ventures into one decree, thereby increasing their accessibility to interested foreign investors. Thus, a Hungarian joint venture can presently conduct manufacturing, trading, research and development, and service activities. Forty-nine percent foreign investment participation is allowed in manufacturing enterprises, while no such limit exists for the service and financial field.⁴² Even in the manufacturing field, authorities may

38. Implementing Decree of the Minister of Finance No. 28 of 1972 (X.3.) PM on Economic Associations with Foreign Participation.

39. Decree of the Minister of Finance No. 7 of 1977 (V.6.) PM.

40. Regulation of the Minister of Finance No. 5 of 1979 PM.

41. The restatement was published in *PÉNZÜGYI KÖZLÖNY*, No. 10 (July 25, 1979).

42. Under Hungarian law, the National Bank of Hungary or the Hungarian Foreign Trade Bank may guarantee the transferability of the capital invested by the foreign partner, as well as the transferability of dividends. In fact, statutes provide for the free repatriation of both capital and dividends.

permit a greater than forty-nine percent foreign investment participation.

The Hungarian Government specially regulates the taxation of the joint venture company and imposes a profit tax of forty percent on its net taxable profits. The Minister of Finance also may establish a more advantageous rate of taxation if a joint venture company offers special advantages to the Hungarian economy. No taxes are imposed on the joint venture company other than the aforementioned forty percent corporate income tax. The payment of this Hungarian corporate tax can be credited against local taxes in many countries, including the United States. If the joint venture company uses any of its taxed profits to increase its assets, then a percentage of the profits tax used for that purpose may be refunded upon the appropriate application. The profit is calculated after deducting contributions to a "risk fund" which must first accumulate to an amount in excess of ten percent of the company's capital. An even greater amount must be accumulated if the joint venture company anticipates potential losses. In addition, an "employee's participation fund" may be created which may not exceed fifteen percent of the total wages paid by the joint venture company in a particular year.

Although typically in a minority position, a foreign partner nonetheless may require that all policy decisions be subject to the unanimous approval of the joint venture company's board of directors or to some other mechanism which assures the foreign partner an effective veto right over defined policy decisions. Hungarians generally refer to the foreign joint venturer as a partner, because the enterprise is actually regarded as a "partnership" between the Hungarian enterprise and the foreign enterprise. Four substantial manufacturing joint ventures have been established under the new legislation. The first joint venture is between BIOGAL, a Hungarian pharmaceutical enterprise, and Syma, a subsidiary of CIBA Geigy, which joined for the manufacture of pharmaceuticals. The second is the recently signed joint venture agreement between BCR (a joint venture formed by Babolna State Farm, Chinoin Chemical and Pharmaceutical Works Ltd., and Chemical Works of Gedeon Richter Ltd.) and Eli Lilly Co. for the manufacture of animal feed supplements based on fermentation products. A substantial part of the output of BCR-Eli Lilly KFT (the name of the joint venture company) is destined for other COMECON and Middle Eastern countries where Babolna State Farm, participating through its interest in BCR,

sells large poultry installations including delivery of feed and feed supplements. The third most recently announced joint venture is between J.L.N. Laing (Switzerland), Standard Motoren and Magnetpumpentwicklung (both of West Germany), and EVIG for the manufacture of spherical water pumps for central heating and other industrial applications under license from Laing. Finally, the Central-European International Bank (CEIB) was established and sanctioned by the Hungarian Government at the beginning of 1980. Thirty-four percent of CEIB is owned by the National Bank of Hungary and eleven percent is owned by each of six stockholders from Western Europe and Japan.⁴³ CEIB is the only foreign majority-owned joint venture bank in Eastern Europe which may engage in all financing and financial transactions, except those involving *forints*. It also may acquire equity interests in Hungarian joint venture companies. With total assets of 165 million dollars and accrued profits of 2.6 million dollars, CEIB achieved remarkable success in its first year of operation. It is rumored that additional joint venture agreements have been negotiated and are merely awaiting official approval. Due to the great flexibility of the managers of the Hungarian economy and the excellent preparation of Hungarian business executives and technical experts, joint venture companies can be expected to flourish under this new legal regime within the advantageous economic atmosphere prevailing in Hungary.

J. *Privately Owned Small Enterprises*

In September 1981, a series of law-decrees and decrees were enacted⁴⁴ instituting several new types of privately owned and managed small enterprises as of January 1, 1982.⁴⁵ These new enter-

43. The following foreign banks are each 11% shareholders of CEIB: Banca Commerciale Italiana, Milan; Bayerische Vereinsbank, Munich; Creditanstalt-Bankverein, Vienna; The Long-Term Credit Bank of Japan, Ltd., Tokyo; Société Générale, Paris; and The Taiyo Kobe Bank, Limited, Kobe.

44. Law-Decrees Nos. 14, 15, and 16 of 1981; Government Decrees (MT) Nos. 25 of 1981 (IX.5.), 26 of 1981 (IX.5.), 27 of 1981 (IX.5.), and 28 of 1981 (IX.5.).

45. The "small cooperative," created by the enabling Law-Decree No. 14 of 1981, as provided by Government Decree (MT) No. 25 of 1981 (IX.5.), may engage as a separate juridical person in all business activities (except as an agricultural cooperative or in cultural-intellectual activities). Such a cooperative may be created with at least 15 but not more than 100 members, provided that the monetary contribution made by the members constitutes at least two months'

prises are designed to provide services and goods which are in short supply to the Hungarian economy, specifically services to the consumer population and spare parts and goods to larger industrial units. Some of these enterprises are independent juridical persons; others have no independent legal personality and merely constitute separate economic units created by groups of private citizens for the performance of particular business or agricultural tasks. In view of the establishment of these new small enterprises, the Hungarian Government has recognized that certain services, especially the retail trade, may be more effectively performed by small, individually owned units than by larger enterprises. The Government has also recognized that small, individually owned plants may produce parts and components which cannot be manufactured with the same flexibility or at the same cost by larger enterprises. In the same vein, the previously existing small (artisan) enterprises, which were given an expanded scope of operation by the recent law-decrees,⁴⁶ were further strengthened by a more recent decree of the Minister of Industry.⁴⁷ Additional de-

wages paid by the small cooperative.

"Specialized industrial or service division of a cooperative" was created by Government Decree (MT) No. 26 of 1981 (IX.5.), and may engage, for the benefit and at the risk of its members, in industrial, construction, and service activities as a separate division of an existing cooperative. While this new form of business has no separate juridical personality, it has its own separate profit and loss statement, and its relationship to the cooperative is provided for by contract.

The "specialized agricultural group" was created by Government Decree (MT) No. 27 of 1981 (IX.5.) to foster small agricultural and service activities in the field of agriculture. A specialized agricultural group may be created within the purview of an existing cooperative or an existing state farm. The relationship between the specialized agricultural group and either the cooperative or the state farm is governed by contract. The specialized agricultural group has no separate juridical personality, but it does have its own profit and loss statement.

The "business community," created by Government Decree (MT) No. 28 of 1981 (IX.9.), may be initiated by two or more persons in the form of a partnership. The members contribute not only assets, but must also lend their personal services to the "business community." Its activities may encompass joint purchasing, small industrial activities, auxiliary economic and service activities, engineering, planning, and organizational activities.

46. Law-Decree No. 16 of 1981.

47. Decree of the Minister of Industry No. 4 of 1981 (IX.9.) IpM, with the redefinition starting at page 713 of *TANÁCSOK KÖZLÖNYE*, Sept. 11, 1981. In particular, the functions of small enterprises were expanded and the legal provisions covering them were restated.

crees have maintained the same spirit of decentralization and the fostering of competition by permitting the creation of divisions within existing enterprises and the segregation of economic units of existing enterprises in the form of subsidiaries.⁴⁸ The recent willingness of the Hungarian Government to foster the creation of small, privately-owned, flexible and highly competitive enterprises is of great interest to foreigners doing business in Hungary, for such enterprises should assure a more competitive international posture for the Hungarian economy in the foreseeable future.

V. CONCLUSION

The continued practical and progressive modifications of the Hungarian legal system should enable Hungary to continue to "emerge from the greyness of socialism."⁴⁹ Hungary can be expected to attain its avowed goal of creating its own "market-oriented socialism,"⁵⁰ an achievement long desired by Western businessmen. The Hungarian business community has very recently been heralded by the news media as "a modified Communist system based on big competitive state concerns but with room for small, privately-owned ones as well."⁵¹

48. Government Decrees (MT) Nos. 20 of 1981 and 42 of 1981.

49. Manchester Guardian, Nov. 29, 1981, at 12, col. 1.

50. The N.Y. Times, Dec. 5, 1981, at 31, col. 3, and 34, col. 4.

51. *Id.*

