Evolving Legal Frameworks for Private Sector Development in Central and Eastern Europe

Cheryl W. Gray
### Recent World Bank Discussion Papers

<table>
<thead>
<tr>
<th>No.</th>
<th>Title</th>
<th>Author(s)</th>
</tr>
</thead>
<tbody>
<tr>
<td>150</td>
<td>Successful Rural Finance Institutions</td>
<td>Jacob Yaron</td>
</tr>
<tr>
<td>151</td>
<td>Transport Development in Southern China</td>
<td>Clell G. Harral, editor, and Peter Cook and Edward Holland, principal contributors</td>
</tr>
<tr>
<td>152</td>
<td>The Urban Environment and Population Relaxation</td>
<td>Michael M. Cernea</td>
</tr>
<tr>
<td>153</td>
<td>Funding Mechanisms for Higher Education: Financing for Stability, Efficiency, and Responsiveness</td>
<td>Douglas Albrecht and Adrian Ziderman</td>
</tr>
<tr>
<td>154</td>
<td>Earnings, Occupational Choice, and Mobility in Segmented Labor Markets of India</td>
<td>Shahidur R. Khandker</td>
</tr>
<tr>
<td>155</td>
<td>Managing External Debt in Developing Countries: Proceedings of a Joint Seminar, Jeddah, May 1990</td>
<td>Thomas M. Klein, editor</td>
</tr>
<tr>
<td>156</td>
<td>Developing Agricultural Extension for Women Farmers</td>
<td>Katrine A. Saito and Daphne Spurling</td>
</tr>
<tr>
<td>157</td>
<td>Awakening the Market: Viet Nam's Economic Transition</td>
<td>D. M. Leipziger</td>
</tr>
<tr>
<td>158</td>
<td>Wage Policy during the Transition to a Market Economy: Poland 1990–91</td>
<td>Fabrizio Coricelli and Ana Revenga, editors</td>
</tr>
<tr>
<td>159</td>
<td>International Trade and the Environment</td>
<td>Patrick Low, editor</td>
</tr>
<tr>
<td>160</td>
<td>International Migration and International Trade</td>
<td>Sharon Stanton Russell and Michael S. Teitelbaum</td>
</tr>
<tr>
<td>161</td>
<td>Civil Service Reform and the World Bank</td>
<td>Barbara Nunberg and John Nellis</td>
</tr>
<tr>
<td>162</td>
<td>Rural Enterprise Development in China, 1986–90</td>
<td>Anthony J. Ody</td>
</tr>
<tr>
<td>163</td>
<td>The Balance between Public and Private Sector Activities in the Delivery of Livestock Services</td>
<td>Dina L. Umali, Gershon Feder, and Cornelis de Haan</td>
</tr>
<tr>
<td>164</td>
<td>How Do National Policies Affect Long-run Growth?: A Research Agenda</td>
<td>William Easterly, Robert King, Ross Levine, and Sergio Rebelo</td>
</tr>
<tr>
<td>165</td>
<td>Fisheries Development, Fisheries Management, and Externalities</td>
<td>Richard S. Johnston</td>
</tr>
<tr>
<td>166</td>
<td>The Building Blocks of Participation: Testing Bottom-up Planning</td>
<td>Michael M. Cernea</td>
</tr>
<tr>
<td>167</td>
<td>Seed System Development: The Appropriate Roles of the Private and Public Sectors</td>
<td>Steven Jaffee and Jitendra Srivastava</td>
</tr>
<tr>
<td>168</td>
<td>Environmental Management and Urban Vulnerability</td>
<td>Alcira Kreimer and Mohan Munasinghe, editors</td>
</tr>
<tr>
<td>169</td>
<td>Common Property Resources: A Missing Dimension of Development Strategies</td>
<td>N. S. Jodha</td>
</tr>
<tr>
<td>170</td>
<td>A Chinese Province as a Reform Experiment: The Case of Hainan</td>
<td>Paul M. Cadario, Kazuko Ogawa, and Yin-Kann Wen</td>
</tr>
<tr>
<td>171</td>
<td>Issues for Infrastructure Management in the 1990s</td>
<td>Arturo Israel</td>
</tr>
<tr>
<td>172</td>
<td>Japanese National Railways Privatization Study</td>
<td>Koichiro Fukui</td>
</tr>
<tr>
<td>173</td>
<td>The Livestock Sector in Eastern Europe: Constraints and Opportunities</td>
<td>Cornelis de Haan, Tjaart Schillhorn Van Veen, and Karen Brooks</td>
</tr>
<tr>
<td>174</td>
<td>Assessing Development Finance Institutions: A Public Interest Analysis</td>
<td>Jacob Yaron</td>
</tr>
<tr>
<td>175</td>
<td>Resource Management and Pastoral Institution Building in the West African Sahel</td>
<td>Nadarajah Shanmugaratnam, Trond Vedeld, Arne Mossige, and Mette Bovin</td>
</tr>
<tr>
<td>176</td>
<td>Public and Private Sector Roles in Agricultural Research: Theory and Experience</td>
<td>Dina L. Umali</td>
</tr>
<tr>
<td>177</td>
<td>The Regulatory Impediments to the Private Industrial Sector Development in Asia: A Comparative Study</td>
<td>Deena Khatkhatc</td>
</tr>
<tr>
<td>178</td>
<td>China: Reforming Intergovernmental Fiscal Relations</td>
<td>Ramgopal Agarwala</td>
</tr>
</tbody>
</table>

*Continued on the inside back cover.*
Discussion Papers present results of country analysis or research that is circulated to encourage discussion and comment within the development community. To present these results with the least possible delay, the typescript of this paper has not been prepared in accordance with the procedures appropriate to formal printed texts, and the World Bank accepts no responsibility for errors.

The findings, interpretations, and conclusions expressed in this paper are entirely those of the author(s) and should not be attributed in any manner to the World Bank, to its affiliated organizations, or to members of its Board of Executive Directors or the countries they represent. The World Bank does not guarantee the accuracy of the data included in this publication and accepts no responsibility whatsoever for any consequence of their use. Any maps that accompany the text have been prepared solely for the convenience of readers; the designations and presentation of material in them do not imply the expression of any opinion whatsoever on the part of the World Bank, its affiliates, or its Board or member countries concerning the legal status of any country, territory, city, or area or of the authorities thereof or concerning the delimitation of its boundaries or its national affiliation.

The material in this publication is copyrighted. Requests for permission to reproduce portions of it should be sent to the Office of the Publisher at the address shown in the copyright notice above. The World Bank encourages dissemination of its work and will normally give permission promptly and, when the reproduction is for noncommercial purposes, without asking a fee. Permission to copy portions for classroom use is granted through the Copyright Clearance Center, 27 Congress Street, Salem, Massachusetts 01970, U.S.A.

The complete backlist of publications from the World Bank is shown in the annual Index of Publications, which contains an alphabetical title list (with full ordering information) and indexes of subjects, authors, and countries and regions. The latest edition is available free of charge from the Distribution Unit, Office of the Publisher, The World Bank, 1818 H Street, N.W., Washington, D.C. 20433, U.S.A., or from Publications, The World Bank, 66, avenue d'Iéna, 75116 Paris, France.

ISSN: 0259-210X

Cheryl W. Gray is senior economist in the Transition and Macro-Adjustment Division of the World Bank's Policy Research Department.

Library of Congress Cataloging-in-Publication Data

Evolving legal frameworks for private sector development in Central and Eastern Europe / Cheryl W. Gray ... [et al.].

p. cm. — (World Bank discussion papers ; 209)
ISBN 0-8213-2588-4
KJC2045.E96 1993
346.47'07—dc20
[344.7067] 93-26652
CIP
## CONTENTS

**Abstract** .......................................................... v

**Foreword** .......................................................... vii

**Acknowledgements** ................................................ ix

**Legal Frameworks in Emerging Market Economies** ...................... 1

**Bulgaria** .......................................................... 23
  with Peter G. Ianachkov

**The Czech Republic** ................................................ 47

**Hungary** ........................................................... 65
  with Rebecca J. Hanson and Michael A. Heller

**Poland** .............................................................. 95
  with Rebecca J. Hanson, Michael A. Heller, Peter G. Ianachkov,
  and Daniel T. Ostas

**Romania** .......................................................... 115
  with Rebecca J. Hanson and Peter G. Ianachkov

**Slovenia** .......................................................... 133
  with Franjo D. Stiblar
ABSTRACT

The legal framework in a market economy has at a minimum four basic economic functions:

- to define the universe of property rights in the system,
- to set a framework for exchanging those rights,
- to set the rules for the entry and exit of actors into and out of productive activities, and
- to oversee market structure and behavior to promote competition.

These four basic tasks of a legal system can be loosely related to specific and well-recognized areas of law. Property rights are defined in the constitution of a country and in more specific laws dealing with real, tangible, and intellectual property. Exchange is covered generally by contract law. Entry is governed by company and foreign investment law, while bankruptcy and liquidation laws govern exit. Finally, antimonopoly and unfair competition laws are intended to promote competition. These basic areas of law are joined by many other important ones—such as labor, taxation, and banking, to name just three—in the rich and intricately interconnected web of laws that comprise the complex legal frameworks for private sector activity in advanced market economies.

This discussion paper uses this general classification to analyze the evolving legal framework for private sector development in six transforming socialist economies of Central and Eastern Europe—Bulgaria, the Czech Republic, Hungary, Poland, Romania, and Slovenia. It suggests some fundamental questions such analysis should address and provides a summary of developments in these countries. The CEE countries have a rich legal tradition dating from pre-socialist times. This tradition was suppressed but not eliminated during its 40 years of socialism, and it is being revised and supplemented as the countries move toward a private market economy. Extensive progress has been made in putting private ownership and business activity on an equal footing with that of public enterprises and in freeing up the entry of new private firms through company and foreign investment law. Progress has also been made in strengthening protections for intellectual property and in defining clear exit mechanisms through bankruptcy law. The most difficult and contentious challenges involve allocating real property rights, designing rules for the exit of ailing firms, and creating the conditions for free and fair competition, largely because they tread so heavily on existing vested interests. Progress so far in CEE shows that setting impersonal legal rules—such as rules of property ownership, contract, or entry—is relatively easy. Actually choosing winners and losers through judicial or administrative action—whether it involves property allocation, bankruptcy adjudication, or enforcement of competition norms—is more difficult.

Furthermore, although the legal structure is evolving rapidly in most areas, practice is still very uncertain. The generality of many laws leaves wide discretion for administrators and courts, and there has not yet been time to build up a body of cases and practice to further define the rules of the game. The wide discretion and general lack of experience create legal uncertainty that hampers private sector development in the short-run. Legal drafting is only the beginning, and CEE countries have made great progress. Efficient enforcement is the harder challenge and will take longer to achieve.
FOREWORD

The economies of Central and Eastern Europe are in the midst of an historic transition from central planning and state ownership to market-driven private sector development. This transition requires comprehensive changes in the "rules of the game"—i.e., the legal framework for economic activity. This volume is the culmination of a year-long project on reform of the legal framework for private sector development in Central and Eastern Europe (CEE). The project was financed in part by a grant from the Japanese Grant Facility and was organized and carried out by the Transition and Macro-Adjustment Division, Policy Research Department (PRDTM), with input from the Europe and Central Asia Division, Legal Department (LEGEC). Its intended audience includes both policymakers in reforming socialist economies and economists and lawyers working on issues of private sector development in the CEE region.

The volume fulfills four purposes. First, it provides a precise definition of the term "the legal framework for private sector development" in this context and suggests how one might go about studying it. The term "legal framework" is often used in the Bank, although its exact meaning and scope are not always clear. Second, it describes in some detail the progress six CEE countries have made to date in reforming their legal frameworks for private sector development touching on the major legal and institutional issues in the areas studied. Third, it provides guidance to policy makers in these CEE countries on how outsiders (including potential investors) view their progress on legal reform and where the greatest problems remain. Finally, it provides information and guidance for policymakers in other reforming socialist countries (including the former Soviet Union), who may be just beginning to initiate reforms. They can learn from CEE experience in areas such as property rights (including restitution), corporate governance, bankruptcy, antimonopoly law, and the development of judicial institutions.

This volume is an initial attempt to document such experience. Through further work, we hope to delve deeper into specific areas touched in this volume, including property rights, corporate governance, bankruptcy, and competition law and policy.

Nancy Birdsall
Director
Policy Research Department
ACKNOWLEDGEMENTS

Much of the information in this volume was obtained from direct interviews with policy makers, lawyers, judges, and business persons in the countries studied. We sincerely thank all of the people who offered us their time, assistance, and valuable insights. In particular we would like to thank the extensive assistance offered by Lachezard Stefanov and Misho Valchev (Bulgaria); Gerhardt Bubnik, Vladimir Fiser, Pavel Florian, Daniel Futej, Milan Ganik, Milos Kolacek, Ludvik Kopa, Thomas Samii, Jaroslav Sodmonka, Richard Surrey, and Carol Welu (Czech Republic); Izak Atiyas, Ted Boone, Richard Hirschler, Peter Paczolay, and Ferenc Vissi (Hungary); Andrzej Burzynski, Stanislas Dwernicki, Wojciech Gerlaczyk, Mariusz Jakubowski, Michal Kulesza, Jerzy Modzelewski, Dariusz Olesczuk, Leon Paczyński, Eugeniusz Piontek, Roman Rewald, Pawel Rytel, and Peter Swiecicki (Poland); Doina Fülop, Donald de Keiffer, Grigore Florescu, Teodore Stolojan, Victor Tănăsescu, Cornel Tarhoaca, and Nicolae Zaharia (Romania); Aleksandra Janezic, Janez Kopa, Nina Plavsak, and Bojan Zabel (Slovenia). Variations in the depth of coverage of particular topics across countries reflect differences either in the priorities of those countries (and thus in the degree of legislative activity) or in the availability of information to the researchers.

All of the country chapters have been published in slightly different forms in law journals. Detailed citations to country-specific legislation can be found in these publications. We would like to thank the respective journals for permission to republish amended versions of these papers: Gray et al., "The Legal Framework for Private Sector Development in a Transitional Economy: The Case of Poland," Georgia Journal of International and Comparative Law 22:2 (Spring 1992); Gray, Hanson, and Ianachkov, "Romania's Evolving Legal Framework for Private Sector Development," The American University Journal of International Law and Policy 7:3 (Spring 1992); Gray and Stiblar, "The Evolving Legal Framework for Private Sector Activity in Slovenia," University of Pennsylvania Journal of International Business Law 14:2 (Spring 1993); Gray and Ianachkov, "Bulgaria's Evolving Legal Framework for Private Sector Development," The International Lawyer, forthcoming (Winter 1993); Gray, Hanson, and Heller, "Legal Reform for Hungary's Private Sector," The George Washington Journal of International Law and Economics 26:2 (Spring 1993); Gray, "The Legal Framework for Private Sector Activity in the Czech Republic," Vanderbilt Journal of Transnational Law, forthcoming (May 1993).

Finally, we would like to thank Alan Gelb for his support of this work and Maxine Berg for her patient assistance in preparing the manuscript for publication.
LEGAL FRAMEWORKS IN EMERGING MARKET ECONOMIES

The countries of Central and Eastern Europe (CEE) are moving rapidly to transform their economies from socialist systems based on centralized ownership and planning to market systems based on decentralized ownership and relatively unregulated economic activity. These changes are being accompanied by political reforms to disperse political power and introduce democracy. Both sets of changes—economic and political—need to be supported by a wide range of institutional reforms, including changes in the legal framework.

The legal framework in a market economy has at a minimum four basic economic functions:

- to define the universe of property rights in the system,
- to set a framework for exchanging those rights,
- to set the rules for the entry and exit of actors into and out of productive activities, and
- to oversee market structure and behavior to promote competition.

These four basic tasks of a legal system can be loosely related to specific and well-recognized areas of law. Property rights are defined in the constitution of a country and in more specific laws dealing with real, tangible, and intellectual property. Exchange is covered generally by contract law. Entry is governed by company and foreign investment law, while bankruptcy and liquidation laws govern exit. Finally, antimonopoly and unfair competition laws are intended to promote competition. These basic areas of law are joined by many other important ones—such as labor, taxation, and banking, to name just three—in the rich and intricately interconnected web of laws that comprise the complex legal frameworks for private sector activity in advanced market economies.

This book uses this general classification to analyze the evolving legal framework for private sector development in six transforming socialist economies of Central and Eastern Europe—Bulgaria, the Czech Republic, Hungary, Poland, Romania, and Slovenia. This first chapter suggests some fundamental questions such analysis should address and provides a short summary of developments in these countries. More in-depth country-specific analysis follows in later chapters.

The CEE countries have a rich legal tradition dating from pre-socialist times. This tradition was suppressed but not eliminated during its 40 years of socialism, and it is being revised and supplemented as the countries move toward a private market economy. Extensive progress has been made in putting private ownership and business activity on an equal footing with that of public enterprises and in freeing up the entry of new private firms through company and foreign investment law. Progress has also been made in strengthening protections for property, whether real, moveable, most difficult and contentious challenges involve allocating real property rights, defining and enforcing clear exit mechanisms through bankruptcy law, and creating the conditions for free and fair competition, largely because they tread so heavily on existing vested interests. Furthermore, although the legal structure is evolving rapidly in most areas, practice is still very uncertain. The generality of many laws leaves wide discretion for administrators and courts, and there has not yet been time to build up a body of cases and practice to further define the rules of the game. The wide discretion and general lack of experience create legal uncertainty that hampers private sector development in the short-run.
Constitutional Law

Although not necessarily dealing with the private sector per se, a country’s constitution is the bedrock of its legal and political system. It defines the philosophy, structure, and degree of interventionism of the public sector, and in turn profoundly influences the role and viability of the private sector in an economy. Three CEE countries—Bulgaria, Romania, and Slovenia—adopted new post-socialist constitutions in 1991. Hungary did not adopt a new constitution, but it passed extensive amendments in 1989 that abrogated approximately 80 percent of the 1949 version. Poland also made some basic amendments to its socialist constitution but has not yet adopted a new one. The Czech Republic adopted a new constitution in December 1992; the process was stalled by political disagreements over governmental structure and the distribution of powers among the republics and between levels of government, and it could not proceed further until basic questions on union or disunion were resolved.

What fundamental tenets and structures for the political and economic system are embedded in the constitution?

A private market economy depends on the acceptance of certain core values, the most important being the freedom of individuals to own and exchange property and to associate in private commercial ventures. The right to collective bargaining and certain social and environmental protections may also be enshrined in the constitution, as may basic principles concerning the role of the government vs. the role of the market.⁴

The new or amended constitutions of the CEE countries all enshrine the most basic values of a democracy and a market economy, including not only protection of basic human rights but also protection of private property rights, including compensation in the event of expropriation.⁵ Some also promise certain social benefits such as free education and medical care (Bulgaria and Romania), pre- and post-natal care for women (Hungary), and the right to housing (Slovenia). Most give special attention to land, sometimes including prohibition on foreign ownership (Bulgaria, Romania, Slovenia). None impose specific restrictions on government powers, other than the duty to abide by law.

Constitutions also lay out the structure of the public sector and specify voting rules for choosing leaders and passing laws. The new CEE constitutions—for Bulgaria, the Czech Republic, Hungary, Romania, and Slovenia—all adopt similar parliamentary systems, with a balance of power between an elected parliament (unicameral in Bulgaria and Hungary, bicameral in the Czech Republic, Romania and Slovenia) and a "government" headed by a prime minister. Each also has a president, but the power of this office tends to be relatively weak. Representation by political parties in the parliament is generally proportional to the popular vote received, thereby reinforcing the tendency in an emerging democracy toward a proliferation of parties.⁶

Does the constitution provide for the independence of the judiciary? for judicial review?

The judiciary needs independence from political interference if it is to gain the trust and respect of the private sector. Furthermore, the ability of the judiciary to review the actions of the legislature ("judicial review") provides a powerful check to assure that laws follow the letter and spirit of the constitution. To revive checks and balances on government that disappeared during the socialist period, all of the CEE countries have sought to guarantee renewed freedom for the judiciary, with judges generally appointed for life. Rather than granting powers of judicial review to regular courts, however, the CEE countries have opted for the model of a separate constitutional court, with power to overturn laws deemed unconstitutional. The exact powers of the various constitutional courts vary considerably. Hungary’s is the most
powerful, with extremely wide jurisdiction and absolute veto power over laws. The others have more limited jurisdiction in that only other courts or selected officials can bring cases. Furthermore, the decisions of Poland’s and Romania’s constitutional courts can be overruled by a two-third’s majority in Parliament. They still serve the new and important function, however, of providing a check on government power.

**Rights to Real Property**

Markets presuppose a set of property rights and a system of laws or customs that enable the exchange of those rights. Real property rights involve a vast legal terrain. Not only must the law define basic rights, but the transition from socialism to capitalism requires that property rights formerly owned by "the state" or "the people" be allocated to specific owners, whether in the public or private domain.

Reform of property rights has lagged behind legal reforms for general business activity in the last few years in the CEE countries. Compensation laws to reverse prior expropriations are creating tremendous uncertainty, land registration and court adjudication systems are underdeveloped, and transfer laws for state property are sparking conflict among levels of government. Many specific procedures for real estate development and transfer are either missing from the current legal framework or are cumbersome and in practice unenforceable. Developing economically and environmentally sensible real property regulations and removing current legal bottlenecks is critical for sustained private sector development.

**How are rights to property defined?**

Perhaps the most basic role of property law is to define the types of property tenure and the "bundle" of rights that attaches to each. Concepts of tenure vary among different systems of law; for example, common law systems appear to have a richer array of tenure possibilities than civil law systems (under which, for example, a leasehold is not a property right, as it is in common law, but a contract right). Furthermore, the "bundle" of rights that accrues to a particular property owner and the rules of priority among conflicting rights may vary from system to system.

**The socialist legacy.** A unique feature of socialist property law was its concept of a hierarchy of property rights based on ownership. Four categories of property were typically distinguished. "State" or "social" property, which included virtually all urban industrial and commercial property, was considered the "highest" form and was accorded the greatest level of legal protection. Yet actual rights to use this property and exclude others from using it were often unclear. Socialist property was typically considered to belong "indivisibly to the State." Under this theory, neither local governments nor state-owned enterprises owned the property they used; rather they had the ownership-like right of "operational administration." Because property was indivisible, ownership was indeterminate; those who "operationally administered" property could in some cases lease it but never sell it.

The other three forms of property were all subordinate in principle and practice. Following state property was "cooperative" property, most prevalent in the agricultural sector and typically governed by a special cooperative law. Cooperative property often remained nominally under private ownership, but all rights of use were given to the cooperative. Next came "personal" or "individual" property, which was typically limited to one residence of a particular size, one vacation house, and incidental personal belongings. Lowest on the ladder was "private" property, meaning private ownership of means of production, which was considered a negative remnant of capitalism and was accorded little legal protection. When allowed at all, private property in urban areas was generally limited to rental housing and property of small, individually-run shops and businesses.
Redefining property rights. All CEE countries have moved since 1989 to eliminate this hierarchy of property and replace it with the principle of equal legal protection for all property, both through amendments to existing Civil Codes or Property Laws and through abolition of socialist regulations that gave precedence to state property. The Civil Codes have essentially returned to their pre-war roots and now follow closely the civil law models of Western Europe in their basic definitions of property rights.

How are rights to property currently assigned to specific owners?

Once basic rights to private property have been defined, the next steps in moving towards a private market economy are to link those rights with specific owners and then to begin the process of transferring state-owned rights to the private sector through privatization. This is the most controversial aspect of reform as it raises the possibility of a redistribution of assets that could decidedly influence the pattern of wealth for the foreseeable future.

Who is the public owner? Assigning state property to specific government owners is proving to be one of the most complex challenges in the transition to a market economy. The approach being taken in most CEE countries is to divide socialist property among three owners. State enterprises are given ownership rights over the land and buildings they occupy. Ownership of the enterprises themselves (and thus ultimate control over their real property) is then assigned to a specific arm of the national government, such as the State Property Agency in Hungary. Finally, ownership of the bulk of remaining state-owned real property, including apartment buildings, commercial space, and other state-owned buildings, is assigned to municipal governments. While this concept may be clear in theory, problems arise in the actual implementation, as disputes arise among various public actors as to ownership of specific pieces of property, thereby stalling the process still further.

What are the rights of former owners and how are competing claims decided? The CEE countries have all taken steps to reverse the nationalizations of the socialist period by paying compensation or restituting property to former owners. Bulgaria, the former CSFR, and Slovenia adopted laws providing for extensive restitution of land, housing, and enterprises, either in-kind (if possible) or through substitute property, securities, or money. Romania has also moved aggressively for in-kind restitution of agricultural land. Hungary has opted against in-kind restitution in favor of coupons that can be used to purchase privatized property. Poland is the only CEE country that has not taken decisive steps in this area. Although Poland also favors some form of restitution, legislation has been delayed by political difficulties.

Restitution-in-kind is complex and leaves many problems in its wake. The legal precedence typically given restitution over privatization has created great uncertainty among potential investors and has complicated privatization, particularly in the case of small businesses and housing. It is also leading to many disputes that are beginning to clog the courts. In Romania, for example, restitution of agricultural land has led to more than 300,000 court cases. In the case of housing, tenants in restituted apartments are clashing with new owners over rights and responsibilities; some argue that they too should be eligible to participate in existing or anticipated programs of housing privatization even though their particular residence is no longer in state hands. In the case of small businesses, interested private parties are afraid to purchase businesses due to fear of restitution claims.

How are property rights registered?

Developing an adequate registry to determine legitimate title for privately-owned property is less controversial than allocating property, but it
is no less fundamental. All CEE countries inherited real property registries from pre-war days. Those registries continued to be maintained during the socialist period for remaining privately-owned property (primarily housing), because buyers still had some incentive to register their purchases in the property registry to claim priority over other claimants. Some private buyers, however, avoided registration if their individual holdings exceeded permissible levels. Furthermore, nationalizations by the state and transfers among public owners were not typically recorded in the land registry, nor were individual flats registered in many large state housing developments. Agricultural land records are in the poorest condition in most CEE countries because of extensive nationalizations and regrouping of cooperatives. Missing records, inadequate staff, and lengthy delays in the land registration process add to uncertainty in real estate transactions.

Are there limits on who can own property?

While some restrictions on property rights may be justifiable on policy grounds, too many restrictions create costly distortions in property markets and may inhibit investment and growth of the private sector. The primary restriction imposed by all CEE countries is on foreign ownership of land. In no country can a foreigner freely own land without limitation. The constitutions of Romania and Slovenia and the foreign investment law of Bulgaria prohibit foreigners from owning land. Similarly, the foreign exchange law of the former CSFR has prohibited foreigners from purchasing real estate. Hungary prohibits foreigners from owning agricultural land, although they may own non-agricultural land and immovable property if they obtain permission from the Ministry of Finance. In all countries, foreign-owned domestic companies are permitted to buy land, albeit sometimes within certain limitations.

How is the freedom to use property limited by law?

There are a myriad of ways that laws can limit the use of property, generally for reasons of public policy. The regulatory framework in all of the CEE countries needs a thorough overhaul to bring it in line with the needs of a market economy. Major changes are needed, for example, in land use planning. During the socialist period, CEE's static land use planning and large-panel construction methods resulted in highly inefficient patterns of urban land use. Clusters of high-rise residential units tended to be separated from the urban core, resulting in high infrastructure and transport costs. In the absence of market signals, the government often converted good agricultural land to industrial use rather than utilize lower-quality land within a municipality. The development of a private market in land and buildings will slowly help to correct these inefficiencies in land use, if accompanied by more dynamic and generally less restrictive zoning rules. The large fines now applied on the conversion of agricultural land to other uses should be phased out as market mechanisms and complementary zoning regulations develop.

CEE governments also need to rethink rent and eviction restrictions. Rent controls often do not allow owners—whether public (generally local governments) or private (including owners of newly restituted property, as in the Czech Republic) even to cover maintenance costs, much less service debt on infrastructure. The lack of functioning foreclosure and eviction systems prevents the development of a mortgage finance system, stunts the growth of a private rental market, and constrains commercial real estate development. In Hungary, for example, foreclosure and eviction is a cumbersome and futile endeavor. Those seeking to carry out evictions must provide alternative living quarters, which can be very difficult given the shortage of available housing. Because evictions can take up to five years to clear all procedural hurdles, there are few, if any, cases of foreclosure resulting in eviction.
Not only is there a surfeit of potential regulatory authority in some areas, but there is a problematic lack of it in others—such as commercial subdivision of undeveloped land or the financing of infrastructure for private land development. It will take time and effort to develop a modern land use planning and regulation system that offers clear procedures, wide discretion to the market, and a dispute resolution mechanism that fairly balances interests of neighbors, developers, and local government.

**Rights to Intellectual Property**

Given their desire for western technology, their desire to integrate their economies into the western commercial community, and prodding they are receiving from the West,¹³ CEE countries are moving rapidly to extend their legal protection of patents, trademarks, and copyrights. It is worth noting at the outset that the protection of intellectual property in developing and transitional economies is a controversial subject. On the positive side, intellectual property protection not only helps spur domestic invention and creation,¹⁴ but it also helps to attract foreign investment, because an investor is more likely to invest in a country where property is protected. Foreign investment brings not only technology, but also employment, foreign exchange, and management talent—all urgently needed in Central and Eastern Europe. Some observers argue, however, that intellectual property protection is essentially a one-way street—that it protects industrialized countries (where most inventions and creations originate) at the expense of countries who must import most technology. Granting monopoly rights to proprietary knowledge tends to raise the price of that knowledge by giving "owners" the sole right to use or license it, and thus it can slow technological and economic development in lesser-industrialized countries.¹⁵ The most contentious areas tend to be patents for pharmaceuticals (where lives are often at stake) and copyrights for computer software and books.

All three products are relatively easily copied and are crucial for economic development. Although this debate is alive across the CEE region, policy makers are opting in practice in favor of strict protection of intellectual property rights.

**How are rights to intellectual property defined?**

*The socialist legacy.* Laws on intellectual property had little meaning in the domestic economies of the CEE countries during the socialist period. State control over the economy was pervasive, and inventors and creators tended to work within the state apparatus. Inventors were given credit for their inventions in the form of lump-sum cash awards, calculated generally as a percentage of the savings achieved by the design or a percentage of the net return on the investment. The socialist organization upon whose behalf or within whose contractual relation the invention was created obtained an "authorship certificate," which gave it the right to use the invention and apply for patent protection abroad. Because the rights to the invention remained essentially with the state, there was little experience with the enforcement of private patents, which will be the challenge of the new intellectual property regimes.

**Recent legislative changes.** Recent reforms in the intellectual property legislation of most CEE countries have generally brought the legal protection of intellectual property more or less up to international norms. For example, patent protection has typically been extended to previously-excluded products, such as drugs, chemical compounds, and plant or animal varieties, and copyright protection has been extended to computer software. The terms of patent and copyright protection have typically been lengthened to the international norms of 20 and 50 years, respectively. Some controversial provisions, such as compulsory licensing,¹⁶ have remained in certain cases.

Although protection for new inventions may be relatively clear, many issues loom in the transition from the old to the new system,
particularly with regard to rights previously conferred through authors' certificates. Do those certificates continue to confer rights? If so, who owns those rights, particularly in the case of newly privatized entities? Does prior usage by others confer any rights? What happens if an invention was made and recognized, but never actually used? These are the types of transition questions that are yet to be resolved in the move to a new intellectual property regime.

All of the CEE countries are signatories to the major international conventions on intellectual property, including the Paris Convention for the Protection of Industrial Property,\(^7\) the Madrid Agreement Concerning the International Registration of Marks,\(^8\) and the Berne Convention.\(^9\) These conventions provide little protection, however, in the absence of well-designed and enforced domestic laws.

**How are rights to intellectual property enforced?**

Enforcement capacity is an issue in all areas of intellectual property law. Although a registration procedure exists, can a holder of intellectual property rights actually protect those rights if another person infringes them? In the socialist state this was not much of an issue, because most rights—particularly in the case of patents and trademarks—were held by the state. Enforcement of intellectual property legislation will emerge as a critical issue as the private sector and foreign investment grow. Giving true meaning to these rights will require institutional strengthening in the registration agencies and the courts to ensure that infringements can be identified, halted, and punished as appropriate.

**Company and Foreign Investment Law**

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

Every CEE country now provides a modern and open legal framework for the establishment of companies, whether domestic or foreign. New company laws have been recently adopted in Bulgaria, the former CSFR, Hungary, and Romania, and the old pre-war company law has been revived in Poland. Slovenia inherited Yugoslavia's recently-enacted Enterprise Law and is about to enact a new, more comprehensive version.

**What forms of private companies are recognized by law?**

The CEE countries follow continental European models of company law. They generally provide for four types of companies. The most formal is the joint stock company, which resembles the French "societe anonyme" (SA), the German "Aktiengesellschaft" (AG), and the American publicly held corporation. This form allows for various classes of shares, with different rights and powers, and imposes relatively strict oversight, audit, and disclosure rules. It is most appropriate for companies seeking a large number of shareholders and/or anticipating public offerings. In most countries the minimum capital required of a joint stock company is high—the local currency equivalent of some $18,000 in Poland, $35,000 in Czechoslovakia, $40,000 in Bulgaria, and $130,000 in Hungary.\(^10\) While substantial minimum capital requirements reassure potential creditors, they could act as barriers to entry to new entrepreneurs.\(^21\)

The limited liability company is the other company form in CEE company law that offers limited liability to all owners. It resembles the French "societe a responsibilite limitee" (SARL) and the German "Gesellschaft mit beschrankter
Haftung" (GmbH) and has fewer formal requirements than the joint stock company. This form is popular because of its simpler structure and lower capital requirements, ranging from the local currency equivalent of under $1,000 in Poland, Romania and Slovenia to $13,000 in Hungary. It is primarily intended as an investment vehicle for a relatively small group of investors who know and deal with each other on a regular basis. In general an investor must obtain approval from the other investors to sell his or her stake to an outside party.

In addition to these two forms, CEE company laws typically recognize general and limited partnerships. In the general partnership, all partners are jointly and severally liable for the partnership's liabilities. The limited partnership consists of limited partners, whose liability is limited to their contribution to the partnership, and one or more general partners, who are responsible for actively managing the company and whose liability is unlimited. Both forms are quite flexible, as partners are able to negotiate their own arrangements concerning capital contributions, distribution of profits and losses, and allocation of voting and managerial rights. In most CEE countries (with the exception of Poland and the former CSFR), neither type of partnership is a pass-through entity and thus both are subject to tax at the entity level.

Do special rules apply to foreign firms?

The CEE countries have all opened their doors to foreign investment in recent years. All have adopted liberal foreign investment regimes, allowing up to 100 percent foreign ownership, removing restrictions on profit repatriation, guaranteeing full compensation in the event of expropriation, and generally abolishing pre-approval requirements (except in the case of certain specifically-designated sectors). Forms of investment are governed by domestic company law.

Foreign investors are in most cases eligible for special tax incentives. Hungary's 1988 law was the first to grant such incentives, and other CEE foreign investment laws have followed suit. These tax incentives have been widely criticized by outside observers, both because they discriminate against domestic investment and because they can lead to substantial revenue loss and severely complicate tax administration. Furthermore, it is not clear that tax holidays do much on the margin to attract foreign investment. Firms look most for stability and potential markets. Above all, they want to avoid major losses, and holidays do nothing to further that goal; firms that succeed in making profits are often not so adverse to paying moderate taxes (particularly if they are from countries with foreign tax credit systems that would otherwise tax them at home, albeit perhaps with some deferral). Of course, firms will take anything that is offered. With their precarious budgetary situations, CEE countries can hardly afford significant revenue loss, nor can they afford to complicate the already daunting task of developing a competent and modern tax administration. They should open their doors to foreign investors but provide no better or no worse than national treatment—including a moderate level of taxation. Hungary—the first CEE country to offer serious tax incentives—was also among the first country to attempt to eliminate those incentives; they are to be available only to companies that are substantially in production before the end of 1993.

What type of corporate governance is envisioned in the company law and related legislation?

Corporate governance is a critical issue in all CEE countries as they move to privatize large segments of their economies. Many variables in an economy—including the dispersion of share ownership, the type of owner, and the tightness of other market-based constraints on managers—have an effect on corporate governance. Company laws are also important, because they provide the framework in which owners actually exert their influence in monitoring managerial behavior.
What oversight bodies are required? CEE company laws generally follow the German model of oversight for joint stock companies, providing for hands-on management by an administrative board (sometimes called a Board of Directors or Management Board) and oversight functions by an independent supervisory board. Persons may not serve on both boards simultaneously. For larger companies independent auditors may also be required. In both law and practice, the division of responsibility among these various bodies can vary greatly by company (within general guidelines set out in the laws). Management and oversight structures are generally simpler for limited liability companies, reflecting their smaller number of owners and the underlying assumption that the owners know each other and have regular contacts.

How are voting rights distributed? The voting rules contained in company laws translate a firm's ownership structure into shareholder influence. The company laws of CEE countries provide extensive flexibility to each company to adjust voting rights to suit its own needs. First, shares can be assigned different voting rights. In Poland, for example, one share can have up to 5 votes. In the Czech Republic, Hungary, and Romania, the total votes of certain shareholders can be limited in the company statute. In this way ownership can be widely dispersed yet more active and/or experienced shareholders can have greater weight in corporate decision-making.

Second, quorum and/or majority voting rules can be adjusted to shift the powers of corporate voting blocks. Low quorum or majority vote requirements (say 30 percent) give minority blockholders more power to push through their own initiatives if other shareholders are passive; high requirements (say 70 percent) give minority blockholders more power to veto the majority will by not "showing up" or by voting against a proposal. The Czech company law, for example, provides a quorum rule of 30 percent and requires a simple majority for most decisions, although either requirement can be changed by company statute. The company laws of other CEE countries generally have quorum and minority voting rules of 50 percent, unless the company's articles provide otherwise. Most of the CEE laws require supramajority (two-thirds or three-quarters) votes at the general meeting for some important decisions, such as changes in the company's articles, changes in the rights of certain classes of shareholders, or sale, merger, or dissolution of the company.

Third, proxy rules can enhance the ability of active and informed shareholders to vote the shares of passive shareholders. Most company laws in the CEE countries provide for proxy voting if a shareholder cannot attend a general meeting. It is unclear whether or not an intermediary—such as a mutual fund or a custodial bank—can vote proxies for affiliated shareholders on a regular rather than case-by-case basis or can easily obtain access to shareholder lists to try to influence proxy voting.

What other laws limit the activities of directors and managers? The activities of directors should in principle be limited not only by shareholder oversight, but also by laws on fiduciary responsibility, conflicts of interest, insider trading, and fraud. Yet legal principles such as these are underdeveloped in the CEE countries. Furthermore, the legal provisions that do exist are difficult to enforce in practice given the shortage of well-trained lawyers and judges and the difficulties of obtaining evidence (due in part to underdeveloped "discovery" rules). The weakness of the legal sanctions for misconduct makes corporate governance even more difficult in this setting than in mature market economies.

Contract Law

The ability to contract freely with others and the assurance that contracts will be enforced are among the most basic requirements of a legal framework for a market economy. Freedom of contract allows resources to gravitate to their most valuable uses. On the other hand, freedom
of contract often conflicts with other social concerns, such as protection of the labor force from harsh employer policies, protection of consumers from warranty disclaimers, and, more generally, protection of weaker parties from one-sided contracts. Striking a proper balance among these various competing interests and imposing constraints to that end on pure freedom of contract is a primary function of contract law in market economies.

*Are there clear rules and standards governing exchanges of property through the market?*

*Features of socialist contract law.* Three major characteristics distinguished CEE contract law during the socialist period from that of Western market economies. First, socialist ideology dominated contract law. Contracts that were consistent with the law but considered inconsistent with the "rules of socialist co-existence" could be nullified. Second, contracts among private parties were treated differently than contracts among state enterprises. Civil Codes generally governed contracts in the limited (generally non-commercial) sphere open to private sector transactions, while contracts among socialized enterprises tended to be governed by separate legislation or by administrative orders and decrees of the government. Third, the idea of contractual freedom (though proclaimed in theory) was in practice subordinated to the needs of the central plan. The plan was adopted annually and had the force of law. Every other related law was drafted in such way that the priority of the plan over individual contracts was assured. There was even a specific category of "pre-contractual" disputes in which the subject matter was not the fulfillment or breach of contract but the very willingness of one of the parties to conclude the contract. Virtually the only way for a party not to conclude such a contract was to prove that the production capacity to fulfill it was not available. Contractual disputes between state enterprises were resolved pursuant to a system of state arbitration, not in the courts.

*Post-socialist reforms.* Since 1989, CEE contract law has developed primarily by widening the scope for transactions governed by the relevant Civil Code. Although the socialist Civil Codes often contained extensive socialist phraseology and certain uniquely socialist principles, they also contained many legal principles common to continental European legal systems. These Codes have been amended to create a level playing field for all types of property (as noted earlier) and to delete many of the specifically socialist sections. Contracts among all types of entities have been brought within their jurisdiction, and both the special regulations and the special arbitration institutions associated with central planning have been abolished. Although all of the CEE countries are making plans to replace their old Civil Codes entirely, none has yet done so.

The most interesting changes in contract law may come in the form of re-interpretation of existing doctrine. For example, contracting under central planning officially embraced the principle of "freedom of contract," yet in practice there was very little freedom. Contracts were set by the plan and were subject to the political needs of the state and the principle of social co-existence. Practice under a market system will bring new meaning to this principle. Similarly, reinterpretations are likely in most areas of private interaction.

The task of redrafting formal contract laws is highly complicated and technical. Yet the problems associated with such a task pale in comparison to the difficulties of teaching an entire society to think in market terms. It will take time to change attitudes and build knowledge, experience, and a body of legal interpretation and thus create adequate certainty in the decentralized contracting process for a market to function effectively.

*Bankruptcy*

Bankruptcy as practiced in market economies was unknown and unneeded in centrally planned ones. In Central and Eastern Europe, debtors
and creditors were generally arms of the state or ultimately supported by the state, and thus the inherent conflicts of interest that drive bankruptcy proceedings did not exist. For example, state-owned banks had little incentive to collect on bad debts because state guarantees explicitly or implicitly supported such debts. And workers were guaranteed jobs, steady income, and related support systems whether or not their particular firms thrived. Measures in lieu of bankruptcy, including financial "rehabilitation" and "compulsory settlement" (i.e. pro-rate debt reduction) were relied upon to keep ailing firms alive and preserve employment.

This situation must change as the CEE countries adopt market-based reforms. As the private sector grows, true conflicts of interests will emerge among debtors and various categories of claimants, including banks, suppliers, the government (as tax collector), and shareholders. Orderly rules of priority are needed to reassure creditors and thus spur the flow of credit from new private banks to new private firms. Working systems of bankruptcy are needed to allow the orderly liquidation of insolvent firms, to impose discipline on enterprise managers, and to facilitate the development of the financial system.

Who is bankruptcy designed to serve?

Bankruptcy is one of the most contentious areas of legal reform in the CEE countries. This is in large part because of the conflict and confusion between two different sets of potential "users" of bankruptcy procedures. The first is the large group of state-owned enterprises in need of restructuring or liquidation. For these state-owned firms, bankruptcy procedures and the threat of liquidation are thought to provide either the means to close hopelessly inefficient firms that drain the public budget or the motivation to restructure those with some potential as a going concern. However, the social costs of widespread liquidation of these firms are often considered to be too high to let bankruptcy proceed unabated. The second group is the newly emerging private sector, whether enterprises or banks. For this group, bankruptcy law is part of a wider set of legal rules—which also includes provisions defining legally-enforceable security interests and methods of foreclosure—that increases the potential for debt collection and thus facilitates the flow of private credit in an economy. Such credit is essential for the success of new private business.

Thus serving two "masters", bankruptcy law is seriously overburdened in reforming socialist countries. Expecting it to play a major role in the solution of the systemic problems of enterprises and banks carried over from socialism may be more than can be asked of a judicial procedure; these systemic problems may instead require systemic solutions outside of bankruptcy proper.29 In most market economies, in contrast, the bankruptcy process works at the margin for the relatively few firms that cannot make it in an otherwise healthy economy. Such a role is important to the second "audience" in the CEE countries—the newly emerging private sector.

How broad is the bankruptcy law? Does it allow for reorganization as well as liquidation?

The trend in the last 20 years in mature market economies has been toward reorganization in lieu of liquidation. The most extreme example is perhaps the United States, where Chapter 11 of the Federal Bankruptcy Code gives debtors extensive powers vis-a-vis creditors to design and implement reorganization plans and thus remain as going concerns. Germany, in contrast, uses its judicial bankruptcy proceedings almost exclusively for liquidations, leaving reorganization to pre-bankruptcy workout procedures. Although reorganization is clearly preferable to liquidation in some cases of insolvency (and may play a central role in the case of many CEE enterprises), the Chapter 11 approach has been criticized in the U.S. as slow, cumbersome, expensive, and heavily biased toward existing management.30 Not only does debtor
Legal Frameworks In Emerging Market Economies

management remain in day-to-day control and formulate the reorganization proposal, but creditors are often fragmented and poorly represented by the representatives of the creditors’ committee. In practice, the great bulk (about 90 percent) of reorganization cases in the U.S.—especially for small and medium-sized firms—end eventually in liquidation anyway. Numerous reforms have been proposed to Chapter 11, and other innovative ideas have been put forward as alternatives to the traditional judicial approach. At a minimum, to the extent reorganization is included as an option in the CEE countries, steps should be taken to reduce the power of company managers and strengthen the voice of creditors, perhaps by imposing strict time limits and/or allowing the submission of competing restructuring plans.

The CEE countries are moving at different speeds to reform bankruptcy law and practice. Hungary has taken the strongest steps toward reform, adopting a far-reaching law with comprehensive coverage, extensive provisions for reorganization as well as liquidation, and strict time limits. Its courts were flooded with over 14,000 cases in the first 12 months after the law’s adoption in January 1992. Slovenia inherited a fairly traditional 1989 Yugoslav law that provides for liquidation and compulsory creditor settlement but not active reorganization. The application of this law was in effect suspended, however, in mid-1992 due to the fear of economic disruption that would result from the growing number of cases. The former CSFR also adopted a similar law in 1992 but then suspended its application until April 1993. Even after the suspensions were lifted, neither Slovenia nor the Czech Republic had a flood of cases as in Hungary, because their laws have fewer mandatory trigger mechanisms. Poland and Romania still depend on old, pre-war bankruptcy legislation that emphasizes liquidation, with the possibility of pro-rata debt reduction through compulsory settlement. Bulgaria’s first major post-socialist legislation, Decree 56, provided a rudimentary bankruptcy procedure, and a more extensive bankruptcy draft law—again providing for liquidation and compulsory settlement but not reorganization—is expected to be adopted in mid-1993.

Are the rules of priority reasonable?

The typical order of priority in bankruptcy laws in advanced market economies gives secured creditors first priority with regard to the secured property, and then gives priority to salaries, tax and other public liens, suppliers’ credits, and general unsecured creditors, with shareholders being the residual claimant. The supremacy of secured creditors is important to the flow of credit in the economy. In the new Hungarian law, these rules of priority are shifted to place the claims of workers for salaries and severance pay (considered here as liquidation costs) above that of secured creditors. This is likely to dampen the incentives of secured creditors to initiate bankruptcy, reduce the role of banks in enterprise restructuring, and ultimately constrain the development of secured credit as a financial instrument.

How onerous are the procedural barriers to bringing bankruptcy cases?

Under current law, the procedural barriers to creditor filing of bankruptcy cases are often enormous in CEE countries. First, the creditor must often bring a case and get a court judgment that a claim exists. This can take up to several years. Then, the creditor must often prove that it cannot recover in any other way, which takes still more time. If this is proved, the creditor must deposit money to cover the costs of the bankruptcy case itself—sometimes reaching into the local currency equivalent of thousands of dollars (which is theoretically later reimbursable from any bankruptcy proceeds). It is little wonder under these conditions that relatively few cases are brought. Lowering the procedural barriers to the filing of cases should be an important focus of reform.
Are there alternatives to bankruptcy for debt collection and exit?

There are alternative "exit" mechanisms to bankruptcy for existing firms in mature market economies, including voluntary dissolution, friendly sales, and hostile takeovers. Many aspects of the legal framework—including collateral, banking, foreclosure, and securities laws, as well as modes of corporate governance envisioned by company laws more generally—affect the mode and timing of exit of ailing firms. As of yet, these areas of law are as underdeveloped as that of bankruptcy in the CEE context.

First, the state of collateral law determines whether clear mechanisms exist for establishing the priority of claims on assets, and the state of foreclosure law determines whether creditors can readily foreclose on bad debts by means other than bankruptcy. Furthermore, if secured credit and foreclosure laws provide more favorable priority than bankruptcy law, they may be a preferred route of creditors. In all CEE countries these areas of law are undeveloped in practice, and there is very little experience with secured lending and debt collection through foreclosure. While Civil Codes generally provide that both real and movable property can be used as collateral, only security interests in real property can be publicly registered. Even then, land records are often out-of-date and unreliable, and the difficulty of eviction makes foreclosure on residential property practically impossible.

Second, banking law determines whether banks can own equity interests in the firms they lend to; if their interest is solely as creditor, they are perhaps more likely to seek foreclosure and liquidation than if they also hold an equity interest (and can thus profit from preserving the firm as a going concern). The role of banks in equity ownership is still very much an open question in practice, deeply entwined in the debate over bank and enterprise restructuring and privatization.

Third, the state of the capital market and related securities laws helps determine whether the capital market is well enough developed to permit takeovers of poorly run but potentially viable firms, and whether conditions (including the disclosure of necessary information) are conducive to such takeovers. Securities markets are still extremely undeveloped in all CEE countries, and it will be some time before takeovers are a disciplinary force or an alternative "exit" mechanism.

Antimonopoly Law

The CEE countries have inherited a highly concentrated industrial structure with many monopolistic or oligopolistic firms. In fact, one of the biggest impediments to the growth of the new private sector is the dominant role of the public sector. Small private firms often deal only with public enterprises, who exert market power and may impose unfair or onerous conditions.

Markets require competition to function efficiently, and monopolistic distortions need to be corrected through the pressures of international trade, through domestic laws that limit monopoly behavior, through laws that force the production of information needed for market players to make informed decisions, and through public ownership or regulation of natural monopolies. Low tariffs can themselves go a long way in promoting competition by importing world prices (adjusted for transport costs) as an effective ceiling on domestic prices, but they should be complemented by domestic laws against monopoly behavior. However, these newly emerging market economies should move very carefully in applying competition law in order to avoid overzealous enforcement and resulting bureaucratic dampening of healthy competition.

All of the reforming socialist economies in Central and Eastern Europe have adopted or are considering adopting antimonopoly laws. Hungary and Poland passed laws in 1990, followed by the former CSFR and Bulgaria in early 1991 and Slovenia in early 1993. Romania has yet to adopt antimonopoly laws, although drafts are being considered.
What behavior is forbidden by antimonopoly legislation?

Monopoly can be defined either with reference to market structure or with reference to specific types of conduct. In the former case, the law typically imposes ceilings on market share, imposes break-ups on overly dominant firms, and regulates merger activity. In the latter case, the law tries to prevent such conduct as collusive agreements, predatory pricing, price discrimination, and vertical restraints on trade.

The CEE laws generally follow U.S. and Western European models in addressing both behavior and structure. They all prohibit horizontal and vertical restraints to trade (some differentiating among these better than others) and the abuse of a "dominant" position (typically defined as 30-40 percent of the relevant market), and they all give central authorities the power to block anticompetitive mergers. The Polish and Czech laws also authorize intervention to break up monopolistic firms, particularly in conjunction with the privatization process. In most cases the approach appears to be "rule of reason" (meaning the illegality of the activity is judged on a case-by-case basis) rather than "per se" (meaning the activity is illegal under any circumstances), giving the authorities almost unlimited discretion to choose which cases to prosecute or to whom to grant exemptions in particular cases.

What institution is charged with enforcing antimonopoly legislation?

Given the technical expertise needed for good administration of antimonopoly laws, specialized agencies are likely to be the preferred choice, if their powers can be strictly limited and their activities kept visible to the public. All of the CEE laws provide for special competition offices, with power of appeal of the offices' decisions to the regular judiciary. The offices in Hungary, Poland, and the former CSFR have been in existence for over two years. While this is a good start, the offices will continue for some time to need extensive training and continued efforts to expand dissemination of their activities and decisions in order to increase visibility and facilitate public oversight.

Might a narrower definition of forbidden behavior be appropriate given scarce administrative resources?

Perhaps the biggest problem with these laws and their administration is inherent to the subject itself; even industrial countries have found it notoriously difficult to differentiate a restraint of trade that reduces efficiency from a legitimate business deal that raises efficiency in the short- or long-run. Sophisticated economic analysis in the U.S. and Europe shows that many vertical restraints (such as tying of sales, resale price maintenance, refusals to deal, discriminatory pricing) may enhance efficiency under certain circumstances—typically when market structure is competitive and the firms imposing the restraints are not in a dominant position. As a result of this economic analysis, enforcement of U.S. antitrust law has softened in the 1980s, and the Department of Justice refuses to prosecute many cases it would have brought in earlier times. The OECD is also recommending that European jurisdictions relax certain competition laws to look at each case on a "rule of reason" rather than a "per se" basis.

Given the difficulty of administering antimonopoly legislation, some observers argue that CEE countries should keep their interventions at a minimum, depending heavily on international trade to promote competition. For example, perhaps the competition offices should focus primarily on a few tasks: breaking up the most egregious monopolists (particularly as they are privatized), overseeing merger activity to prevent the formation of new monopolies, prohibiting clearly collusive horizontal agreements, and intervening aggressively if large public firms refuse to deal with new private entrepreneurs. These offices also have a very important role to play as an advocate for competition in the economy at
large. In this regard they should publish all decisions and the reasoning behind them and should lobby actively with policymakers to promote the lowering of barriers to international trade and domestic competition.

Judicial Institutions

Laws by themselves are only paper; the legal framework will "come to life" only when the legal and administrative institutions can enforce the laws and readily resolve the disputes that they inevitably spur, and when the public accepts that the laws are indeed binding. Furthermore, the laws are by necessity general frameworks only. Their content needs to be filled in by more detailed regulations and practice in individual cases. Among the biggest challenges now facing Central and Eastern Europe is that of building up the capacity of their judicial institutions to set legal standards, enforce the myriad of new laws now being adopted, and resolve economic disputes.

What is the role and competency of formal legal institutions?

Formal legal institutions (whether general courts or specialized legal entities) need expertise, resources, integrity, and independence to play an objective and professional role in interpreting and enforcing laws and resolving disputes. If legal institutions are unreliable, businesses may restrict activities to certain types (such as current cash transactions) with certain people (depending on personal knowledge or reputation) to ensure that agreements are enforceable and property rights protected. Such restrictions on the scale of activities could well dampen private sector growth. Furthermore, weak institutions will be incapable of correctly interpreting and enforcing laws—such as constitutional, antimonopoly, or bankruptcy laws—designed to protect the public interest.

Formal legal institutions are quickly being drawn into the center of economic activity in Central and Eastern Europe. For example, the numbers of claims in such economic areas as real property rights (particularly related to restitution), intellectual property rights, and bankruptcy are increasing dramatically. Although courts were not generally involved in economic matters during the socialist period, they do have certain strengths on which they can now draw. First, the European tradition of rule by law survives in large part, and the public takes the written law seriously. Second, judges are generally considered honest, and corruption does not appear to be a major problem. Third, many judges from the socialist period have been replaced by new judges with a fresh perspective and a firm commitment to market principles.

On the other hand, existing judicial institutions face many challenges in adjusting to the task at hand. Few judges have had extensive training or experience with the legal issues common in private market economies. Judges tend to have little prestige and relatively low pay, and many of the best ones are finding more lucrative opportunities in the private sector. Modern principles and techniques of litigation are virtually nonexistent. Resources to expand and upgrade support services are scarce. As a result, the wait can be long—often several years—for a civil case to be decided, and in there is scant written documentation to which the private sector can turn to when seeking to discern legal norms of conduct. Legal uncertainty is still pervasive and will be reduced only with time and experience. "Borrowing" concepts from industrialized market economies (assisted by legal exchange programs and legal technical assistance from abroad) could help to speed up the process.

What alternative avenues exist for enforcement and dispute resolution?

In light of the problems of the courts, arbitration may be an attractive and efficient alternative form of resolving domestic commercial disputes. Moving toward arbitration away from litigation in effect "privatizes" dispute resolution itself, which can be highly desirable when government capacity is severely stretched. Arbitration is already the
preferred form of international dispute resolution, because it provides participants with a neutral forum. Domestic arbitration is increasing in popularity in more advanced market economies, primarily because it circumvents problems common to national court systems. Arbitration is usually speedier than litigation, not only because tribunals are set up ad hoc (thus avoiding court back-log), but also because arbitral decisions are final and not subject to appeal. Arbitrators are usually well-versed in commercial matters, as opposed to judges sitting in courts of general jurisdiction. Although the court systems of CEE countries typically include an economic branch, the judges’ lack of experience in private sector disputes makes arbitration more attractive, because parties can choose arbitrators with specific experience with private sector disputes of various types. Yet arbitration does not substitute completely for a well-functioning judicial system, because local judicial institutions must still be willing and able to recognize and enforce arbitral awards if needed.

On the international front, arbitration has long been relied upon in CEE joint venture contracts, and most CEE countries are party to at least some of the important international conventions.37 On the domestic front, however, CEE countries are just beginning to encourage the development of arbitration as an alternative to litigation. Their Chambers of Commerce, who were often involved in international arbitration during socialist economies, are leading this effort. While still very new, these efforts deserve the active support and encouragement of the international community.

Summary

All of the CEE countries are moving rapidly to create legal frameworks conducive to private sector development and the growth of a market economy. New or amended constitutions proclaim the new market orientation of these economies, provide a level playing field for all forms of property ownership, and establish a system of judicial oversight to limit government interference. Real property rights are being redefined, and large amounts of property are being returned to former owners or privatized to new owners. Laws on intellectual property are being amended to bring their levels of protection in line with that of the most advanced market economies. New company laws lay out modern and flexible structures for companies (whether domestic or foreign), although they are sometimes compromised by continuing bureaucratic interference through other laws and regulations. The sphere for freedom of contract is being enlarged by an expansion in the applicability of existing Civil Codes (as amended to delete socialist rhetoric and principles). New competition laws are beginning to provide frameworks for antimonopoly protection, while new bankruptcy laws are attempting to provide at least the beginnings of a legal framework for the restructuring or liquidation of nonviable enterprises. Judicial institutions are beginning to develop the capacity to adjudicate economic cases, and arbitration, though still in its infancy, is beginning to develop as a private substitute for litigation.

Yet there are major challenges ahead to implement the new laws that are now on the books. The interests of former owners of property are clashing with those of current tenants, leading to a surge in new disputes now entering the courts. The surge in cases is likely to be exacerbated as claims under the new bankruptcy and intellectual property laws and commercial codes come on stream. The courts, suffering from understaffing as well as generally low pay and prestige, are unlikely to be able to handle this surge. The specialized offices handling intellectual property and antimonopoly concerns are also facing daunting challenges adjusting to the radical changes in policy and thinking now sweeping the CEE countries. Their areas of concern are complex, and they will need continuing resources to train their staff to understand the issues and keep up with the growing workload. All in all, it is a time of great progress, great confusion, and great challenge.
Endnotes

1. Essentially the same legal framework exists in Slovakia as in the Czech Republic, although the two could diverge significantly in the years ahead.

2. This book focuses on the main areas of law noted above. It does not discuss certain other areas of law that are also important to the private sector, including privatization, banking, taxation, and labor law. Privatization is considered a transitional issue, whereas the paper seeks to address the longer-term legal structure. The other areas of law are omitted due both to space limitations and to likely coverage in other World Bank or external studies.

3. Although the structure of the various country chapters is similar, the emphasis placed on any particular topic may vary due to information constraints or different policy agendas in the countries concerned.

4. Government's economic role in neoclassical theory is in principle limited to the provision of "public" or "merit" goods (such as law and order, military, basic infrastructure, basic health and education) and correction for market failures (such as monopoly behavior) or externalities (through, for example, pollution control or public immunization programs). For a discussion of government's role, see World Bank, World Development Report 1988. There is also a case for more specific limits on the powers of government, such as constitutional limits on taxation, public spending, or public deficits. D. Mueller, "Choosing a Constitution in East Europe: Lessons from Public Choice," Journal of Comparative Economics 15:2, June 1991.

5. Such compensation was also guaranteed in socialist constitutions, but was subject to the higher "interests of socialism."

6. The most common alternative is a district-based "winner-take-all" system, which tends to concentrate parliamentary power in 2 or 3 major parties. See D. Mueller, supra note 4.

7. While agricultural land was always considered a means of production under socialist law, its categorization varied in different socialist systems. For example, the Soviet Union took the position that land must be exclusively under state socialist ownership. In Bulgaria and Romania, agricultural land was not owned by the state but was "contributed" to cooperatives, with private owners retaining only nominal property rights. In Poland and Yugoslavia, in contrast, private ownership of land remained the rule, not the exception.

8. There were typically four main forms of housing ownership under socialist law: (1) State rental apartments were typically allocated to families, who then had near-ownership rights of tenancy and inheritance but circumscribed rights to sublease and no right to sell (although they could "trade" for units occupied by other families); (2) Employee housing was allocated according to the employment relationship; (3) Cooperative housing units in multi-family units took one of two forms determined at the time of allocation: (a) tenancy, which was non-alienable, non-transferable to successors (other then those registered as living on the property), and not subject to execution or (b) ownership, which was alienable, transferable and subject to execution; (4) Private housing (individual houses or apartments) was limited to a single unit for family use, i.e. personal property. Additional private units were "private property" and were heavily regulated, with the state allocating
tenants, setting rents, and determining the landlord/tenant relationship.


10. Housing tenants in Slovenia are entitled to receive 30 percent of the value of the apartment plus a housing credit of the same amount if they vacate within 2 years. Purchasers of small businesses in the Czech Republic acquire the right to rent the premises for 3-5 years at fixed rent regardless of who might become owner, after which the rental contract is subject to renegotiation.

11. There is a minor exception for land acquired through inheritance, if there is reciprocity in the home country of the heir.

12. For example, in Bulgaria no domestic company with more than 50 percent foreign participation may own arable land, and in Poland purchases of land by majority foreign-owned firms require the approval of the Interior Ministry.

13. Specific conditionality on intellectual property is included, for example, in U.S. trade agreements with the former CSFR and Poland and in EC association agreements with the former CSFR, Hungary, and Poland.

14. In addition to spurring invention by eliminating the "free rider" problem and thus increasing the economic returns to basic research, another economic rationale for patent law is to prevent socially-wasteful over-investment in research. R. Posner, The Economic Analysis of Law, Little, Brown and Co., Boston, 1986, pp. 36-37.

15. Only one percent of existing patents are held by nationals of developing countries. OECD, Economic Arguments for Protecting Intellectual Property Rights Effectively, Paris, 1989.

16. A compulsory license allows the state to issue rights of use to third parties (with compensation) if a patent has been unjustifiably unutilized or underutilized for a period of time. Compulsory licenses are well-known throughout the world and are allowed by the Paris Convention. The policy behind compulsory licensing is that countries granting monopoly rights in intellectual property deserve something in return, namely, use of those inventions. Practically speaking, however, compulsory licenses are often ineffective without the cooperation of the patentee, due to the necessary technological know-how in the possession of the patentee. Furthermore, in many cases there may be no third party interested in obtaining a license to the patent. Thus, the compulsory license provision may not significantly reduce the patent protection. Rather, it provides the government with a tool to prod the holder of an unused patent when a potential licensee meets resistance to any efforts to negotiate a licensing arrangement.

17. The Paris Convention is the major international treaty protecting patents and trademarks. The two most important rights granted by the treaty are national treatment of foreigners and right of priority in registration. The right to national treatment obligates countries to treat foreigners as they would their own nationals under their own laws. The right of priority gives the holder of a patent or trademark one year or six months, respectively, to file in other member countries without losing priority rights over other potential claimants to the invention. However, the criteria for patentability is still a question of domestic law. Thus, the Paris Convention would do little to protect patents without a domestic law that provided reliable substantive patent rights. The Paris Convention does, however, provide a bit more substantive protection for trademarks than for patents by automatically protecting well-known marks, apparently without requiring that the mark be registered in other member countries.
18. The Madrid Agreement protects both trademarks and service marks by allowing members of signatory countries to register their trademarks with the International Bureau of the World Intellectual Property Organization (WIPO) in Geneva. The mark must first be registered in the country of origin, whose administration applies for registration with WIPO. The effect of WIPO is that the trademark is protected in all signatory countries. Upon notification of the registration of a trademark, national administrations may still be authorized by national law to declare that certain trademark protection cannot be granted in that territory. Thus, like the Paris Convention, the Madrid Agreement depends ultimately on domestic law in protecting substantive rights.

19. The Berne Convention protects literary, scientific, and artistic works. The most recent revision of the Berne Convention is the Paris text of 1971, which extends the period of protection from 25 to 50 years. The convention traditionally includes computer software, which is the most controversial subject of international copyright protection. Under Berne, no formalities are required to protect a work in other member countries. Whereas in the country of origin protection may depend on registration, no central registration exists for international protection; upon creation, works are protected. As with the other treaties, however, Berne allows countries to deny protection of certain works through domestic legislation, even if they are covered by Berne.

20. All figures are based on exchange rates in late 1992. Minimum capital requirements are lower in Romania and Slovenia, although in the latter case they will be raised under the new company law soon to be enacted.

21. Minimum capital requirements tend to be quite high in Western Europe but low to nonexistent in the U.S. An alternative means to protect creditors is to increase the availability and credibility of collateral through changes in laws, institutions, and attitudes. In such a way more extensive property or contract rights (i.e. contingent or "collateral" rights on moveable property) can replace distortionary direct controls (i.e., high minimum capital requirements).

22. C. Gray and W. Jarosz, "Foreign Investment Law in Central and Eastern Europe," World Bank, PRE Working Paper 1111, March 1993. Only Romania continues to require prior approval, and if no ruling is issued in 30 days, approval is deemed granted.

23. Foreign firms know many ways to shift income into and expenses out of the tax holiday period, thereby effectively stretching out the tax holiday period and the corresponding revenue loss, often for many years. Because tax authorities tend to ignore firms in holiday periods, they do not build up the records and firm history needed to tax these firms effectively when the holidays expire.


25. Bulgaria has a hybrid system, in that a joint stock company can have either a "two-tier" system (management and supervisory boards) or a more simple "one-tier" system (a board of directors only). Romania differs from the others in that its company law does not provide for a supervisory board, although its "board of administration" may delegate some of its powers to a managing committee, thus in effect creating something like a U.S.-type system.

26. An example of the importance of this flexibility can be seen in negotiations in 1991 between the Polish Post Telegraph and Telephone ("PPTT") and two foreign investors to create a joint venture to build and operate a cellular telephone system in Poland. Polish telecommunications regulations required that PPTT maintain majority ownership of the
venture, yet the foreign partners—providers of both the capital and the technology for the venture—wanted to have de facto control over the decisions of the company. The parties negotiated an arrangement that (a) gave PPTT 51 percent ownership of the shares in the company but (b) gave the foreign investors the right to choose a majority of the members of the supervisory and management boards and (c) increased the threshold for the quorum and majority vote needed to validate the shareholder’s general meeting from 51 to 60 percent.

27. A comparison of the U.S. and German systems shows the importance of proxy rules. In the U.S., incumbent managers prepare ballots and make formal recommendations on the items submitted for shareholder vote. The shareholder then has the opportunity to vote in person or through a proxy (to which the shareholder may give specific voting instructions or may delegate the voting decision). If the shareholder does nothing, that vote is never counted. Access to shareholder lists in the U.S. tends to be controlled by incumbent managers and directors (who are required to disclose them only to shareholders with a "legitimate business purpose"), making it hard for dissident shareholders to lobby others to vote against incumbent’s recommendations. In addition, dissident candidates and proposers of resolutions must pay for the reproduction and mailings of their proxy ballots, whereas management’s are paid for by the corporation. In contrast, German rules on both proxies and custodial rights give banks, in their status as custodians to shareholders, great power to recommend positions independent from those of management. Banks submit their own recommendations to the shareholders for whom they serve as custodians. Unless those shareholders specify voting instructions, the banks are entitled to vote those shares according to their recommendations. Thus, in Germany the vote of a passive shareholder is voted by an active shareholder, whereas in the U.S. the passive shareholder’s vote is lost. Not only are more votes cast in the German model, but the votes of passive shareholders are more likely to be cast in their best interests. Most passive shareholders who vote in the U.S. vote along with management, even though management’s proposal may not be compatible with the shareholder’s interest. In the German model, passive shareholders’ votes will support the custodial bank’s recommendation and are more likely to be in line with shareholders’ interest.

28. The former CSFR, however, augmented the general provisions of its Civil Code with extensive provisions governing commercial contracts in its new Commercial Code.

29. Poland and Slovenia are two CEE countries that are designing extra-judicial work-out procedures between creditors and problem debtors (i.e., the existing stock of loss-making state-owned firms).


31. An interesting and more far-reaching alternative to traditional liquidation and reorganization has been suggested in recent literature. The alternative essentially involves the following steps:

(1) Upon bankruptcy filing (by the debtor or creditor), the debt of the company is immediately converted to equity and all of the company’s equity is given to the senior creditors.

(2) Simultaneously, a court-appointed expert solicits bids from any party (outsiders or insiders) to buy the firm as a going concern. These outside bids provide important information about the going-concern value of the company. The burden on the judicial system is kept to a minimum, because much of the valuation and decision-making is in effect privatized.
(3) Once the bids are received, the next junior class of creditors can elect to buy the equity held by the senior creditors and pay off their debts. Then the next junior class has the same right (to take the equity and pay off the two more senior classes), and on down the line through all classes. Finally, the company's original shareholders (before step 1) have the option of taking the equity and paying off all creditors. This step #3 is essentially a way for each class of creditors to evaluate, given the bids received from inside and outside, how much they think the company is actually worth as a going concern. If the company does not have enough worth even to pay off senior creditors, no junior creditors will get anything in any case. Whoever ends up owning the equity (whether the senior creditors or claimants of lower priority who pay off those above) can decide what to do with its equity—sell it to one of the bidders, liquidate the company, or keep and try to restructure it. Through this scheme, creditors and debtor management are put on a more equal footing that in a Chapter 11-type system, and each creditor is free to evaluate the situation as it sees fit. See P. Aghion, O. Hart and J. Moore, "The Economics of Bankruptcy Reform," paper presented at NBER conference, February 1992.

32. Legal frameworks in most CEE countries follow the German model of universal banking, allowing banks to own equity interests in firms. This model is essentially untested in practice, however, in these settings.


34. Opponents of the rule of reason approach argue that businesses need certainty above all, and that the rule of reason approach leaves too much uncertainty as to what is permitted and what is not, and therefore inhibits business activity.

35. In the CEE countries these typically include the court system (with three levels of courts—local courts, regional courts, and a Supreme Court) and specialized agencies set up to enforce certain laws, such as antimonopoly laws or laws on intellectual property.

36. When discussing arbitration in CEE countries, it is important not to confuse ad hoc arbitration with state economic arbitration, the administrative mechanism by which disputes between state-owned enterprises were resolved during socialist times. This form of arbitration was centralized in state arbitration committees that served both judicial and administrative functions. In their judicial capacity, they settled individual disputes. In their administrative capacity, they worked on the source of the dispute in an effort to ensure fulfillment of the state economic plan.

37. The following are among the important international conventions on arbitration:

(1) 1923 Geneva Protocol on Arbitration allows parties to submit claims against foreign parties to arbitration in other signatory countries.

(2) 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards ensures the cooperation of all signatory countries in recognizing and enforcing arbitral awards granted in other signatory countries.


(4) The Convention on the Settlement of Investment Disputes between States and Nationals of Other States (1965) guarantees a forum to resolve disputes between one Contracting State (or one of its subdivisions or agencies) and a national of another Contracting State. Parties must have
consented to ICSID's jurisdiction before the dispute in order to be heard there.

(5) A number of bilateral investment protection treaties also provide for arbitration.
BULGARIA

Bulgaria has made impressive strides since 1990 to enact laws designed to support a market economy. There is, however, still a long way to go in formulating a comprehensive legal framework and in creating and reorienting the legal institutions needed to implement it. As in the other countries of Central and Eastern Europe, defining real property rights and creating the conditions for free and fair competition are perhaps the most contentious and confused legal areas. Furthermore, privatization, although not discussed in detail in this book, is proceeding slower in Bulgaria than in most other CEE countries. Other areas of law, including intellectual property, company, foreign investment, and contract law, are less problematic.

Constitutional Law

The Historical Setting

The first Bulgarian constitution (known as the Turnovo Constitution) was adopted by the Constituent Assembly of Bulgaria in the old capital Turnovo in 1879. Although it established a constitutional monarchy, it contained many democratic principles and contributed to the creation of parliamentary institutions in the country. Private property, universal male suffrage, and separation of powers were elaborated as basic principles. The constitution failed, however, to provide strong checks against authoritarian tendencies and was suspended twice (in 1881-1883 and in 1934-1938) and finally replaced by the first socialist constitution in 1947.

The socialist constitution of 1947 created the legal base for the transformation of Bulgaria into a one-party state with a centrally planned economy. It granted public property extensive protection and imposed limitations on private property. Several laws adopted pursuant to the constitution reclassified remaining private property as "individual property," a category reserved primarily for residential real estate. Extensive nationalization began in 1948. The collectivization of agricultural land into cooperatives, completed in the early 1950s, concluded the process of transformation of the Bulgarian economy into a centrally planned and bureaucratically regulated system.

In 1966, the 9th Congress of the Bulgarian Communist Party decided to draft a new constitution to transform the state from "a State of proletarian dictatorship" into an "all-people's State." This resulted in the constitution of 1971—the constitution of "mature socialism." According to Article 5, "national sovereignty, unity of power, democratic centralism, socialist democracy, legality and socialist internationalism" were the main principles of Bulgaria's political system. The constitution consolidated the role of the Communist Party as the guiding force in society. Although adopting some seemingly democratic provisions, the document further centralized state power. It established a new body, the State Council, designed to be a permanent collective head of state. Although not mandated by law, the State Council was in fact presided over by the Secretary General of the Communist Party. The forty members were elected by the National Assembly and were members of the Assembly as well. The Council had broad legislative powers and could issue decrees when the Assembly was not in session—some 350 days a year! Such decrees, when endorsed by the Parliament, held the power of law. In this way the legislative process was "streamlined"; in fact, the legislative power of the National Assembly was reduced to rubber-stamping and virtually transferred to the State Council. The economic system continued to be based on the public ownership of the means of production, with the aim of preventing the "exploitation of one human being by another" and of developing the economy in a planned manner (Article 13).
The New Constitution

The constitution of 1971 was amended several times in 1990 and finally replaced in July 1991 after the ouster of the communist regime. The present Bulgarian constitution represents a radical departure from its socialist predecessors. Most socialist phraseology is gone, replaced by democratically-oriented legal principles and values. In general the new constitution provides reasonable protection for the property and economic rights of individuals and creates a favorable legal basis for the development of the private sector for the first time since the end of the World War II.

The constitution contains 169 Articles organized in ten chapters:

I. General Principles;
II. Fundamental Rights and Obligations of the Citizens;
III. National Assembly;
IV. President of the Republic;
V. Council of Ministers;
VI. Judicial Power;
VII. Local Autonomy (Self-government) and Local Administration;
VIII. Constitutional Court;
IX. Changes and Amendments of the Constitution. Adoption of New Constitution; and
X. Coat of Arms, Seal, Flag, Anthem and Capital.

Chapters 1 and 2 define the rights and obligations of citizens. The enumerated human rights are those accepted by most democratic societies—including equality before the law, guaranty against arbitrary arrest and imprisonment, and freedom of expression, religion, association, and movement. Private property rights are guaranteed, and private property is declared inviolable (Article 17). It may be nationalized only for state and municipal needs, only if those needs cannot be met in any other way, and only with prior and equivalent compensation. Article 19 states that the economy of Bulgaria is based on free enterprise and that domestic and foreign investment are to receive equivalent treatment. The law is obliged to prevent unfair competition and the abuse of monopoly power.

Article 21(1) declares land to be a basic part of national wealth that will receive special protection from the state and society. Arable land can be used only for agricultural purposes, with conversion to nonagricultural uses only on an exceptional basis and as strictly regulated by law. Foreigners may not own land except through inheritance (in which case the property must be subsequently transferred to Bulgarian nationals) (Article 22). As noted in Chapter 1, this provision could deter foreign involvement in the economy if it limits the ability of foreign lenders to take security interests in real property.

The power to tax is more strictly limited in the new constitution than in the old one. Article 60 obliges all citizens to pay taxes and other fees as established by law (and only by law). Article 84(3) then states that "the National Assembly establishes the taxes and tax rates." This is an important guarantee against the liberal interpretation of similar provisions of the former constitution, under which the Council of Ministers was authorized to grant tax exemptions and in some cases to set tax rates.

Although reduced in scope from those in the socialist constitution, the new constitution continues to provide certain social guarantees, including free elementary and secondary education (only in public schools) and free medical care (Articles 52 and 53). Under certain conditions (to be elaborated in a later law) university education may also be free. Although desirable from society's standpoint, these guarantees may prove expensive. On economic grounds, a good case can be made for some user charges, particularly for curative health care and higher education, with targeted subsidies for low-income families.

With regard to the structure of the public sector, the old idea of unitary and indivisible power has been abandoned. Returning to the pre-war tradition, a balance of power among the unicameral Parliament (or "National Assembly"), the executive branch (or
"Government"), and the judiciary is re-established as a basic principle of the constitution. Nevertheless, the structure of the public sector is similar to that under the last version of the former constitution, with the exception of the judicial sector, which will be radically restructured.

The National Assembly has one chamber with 240 representatives elected on a proportional basis. Although this structure is similar on paper to that of the previous socialist Assembly, the role of the new parliament is very different. During socialist times, the Assembly met only twice a year for several days, essentially to rubber-stamp the numerous decrees of the former State Council or laws prepared under the supervision of high-ranking officials of the Communist Party. In contrast, the new Assembly is a full-time institution designed to have final authority over lawmaking. Bills can be introduced by the Government or by any of the 240 members of the National Assembly. To become law, a bill must be approved by a simple majority of those present in the National Assembly (with a required quorum of a least 120) and signed by the President. The National Assembly must also authorize all contracts for public borrowings (Article 84) and ratify all international agreements that include financial obligations for the State (Article 85).

The functions of the President (an office introduced in March 1990) are primarily representative in nature. The President is Head of State. After consulting with parliamentary groups, he proposes as candidate for prime-minister the person designated by the biggest parliamentary group (Article 99). The National Assembly elects the Prime Minister and, upon his proposal, the ministers, the President of the National Bank, and the heads of other public institutions. The President also calls general elections for the National Assembly and local authorities and sets up the dates for referenda called by the Assembly.

The Council of Ministers has executive power in Bulgaria. It is responsible for public order and national security, public administration, and foreign policy (Article 105). It is also responsible for the implementation of the budget and for the management of State property. It has the right to issue decrees (Ordinances-постановления), executive orders (разпорядки) and decisions (решения), based on authority delegated by law. In the past the Council of Ministers used this delegated legislative power extensively due to the generality of many laws. A constant stream of decrees, often at odds with law and sometimes unpublished, created a very uncertain legal environment. The Government still issues many decrees and regulations, but the underlying laws tend to have more substance (thus better confining the scope of decree making authority), and regular publication is the norm.

As in other reforming socialist economies, the role of local authorities in designing and implementing local policy is expanding rapidly in Bulgaria. Formerly the municipalities were subordinated to the government and under the strong influence of local committees of the Communist Party. Their property rights were unclear. Although sometimes charged with administering state property, they rarely owned property in their own name. Under the constitution, municipalities are for the first time supposed to have clearly defined property rights and their own budgets.

The new constitution radically restructures the judiciary. While repeating previous provisions regarding judicial independence, it adds some important new guarantees, including life tenure (after 3 years in office) and the same immunities accorded a member of the Parliament. Judges are by the Supreme Judicial Council (Article 130), which will consist of 25 members, of which 22 will be elected (11 by the National Assembly and 11 by the judicial authorities) and 3—the Chairman of the Supreme Cassation Court, the Chairman of the Supreme Administrative Court and the Attorney General—will be members by law.

The role of judicial institutions is further strengthened by the formation of a new Constitutional Court, whose roles are to rule (upon request) on the constitutionality of new laws, to provide binding interpretations of the
constitution, and to rule on the constitutionality of international agreements and their consistency with previous agreements. The Court has 12 members, one-third elected by the National Assembly, one third appointed by the President, and one-third elected by the general meeting of the judges of the Supreme Court. Members have single 9-year terms, with one-third replaced every three years. Cases can be brought upon request of 1/5 of the members of the Parliament, the President, the Council of Ministers, the Supreme Cassation Court, the Supreme Administrative Court,\textsuperscript{13} or the Attorney General. The powers of the Court may be changed only with an amendment of the constitution. Although this is a very new institution for Bulgaria, it could grow—as it has, for example, in Hungary—to be a decisive check on the power of the executive and legislative branches of government.

**Rights to Real Property**

The reform of property rights is the most complicated legal challenge in Bulgaria. The country faces problems similar to those in other CEE countries emerging from socialism. Marxist attitudes towards property, which shaped the entire economic system of every socialist state, were profoundly different from those of market economies. Reversing these attitudes and the laws and institutions that embody them is a *sine qua non* for private sector development.

**Defining Basic Ownership Rights**

Unlike other CEE countries, Bulgaria did not have a comprehensive unified Civil Code governing both property and contract relations among private individuals in the decades prior to the socialist period. Rather, individual property rights were governed by the Property Act, and contracts were governed by the Law on Obligations. Both were based loosely on German civil law, and thus both embodied the basic civil law concepts common to European capitalist systems of the period.

After World War II, Bulgaria moved quickly to strict central planning and control, and—unlike Yugoslavia, Poland, or Hungary—it remained tightly centralized throughout the socialist period. In addition to adopting a new socialist constitution (with extensive provisions on property), the pre-war laws on property and obligations were explicitly abrogated in 1951 and replaced by socialist legislation in line with Marxist doctrine. The 1951 Property Act replaced the pre-war version in defining property rights and relations of individuals. Although maintaining many civil law concepts, it also added certain new principles and provisions to fit the needs of a socialist state.

As noted in Chapter 1, one of the unique features of socialist property law was its concept of hierarchy of property based on ownership. The two socialist constitutions of 1949 and 1971 defined the three main categories of ownership. "Social" ownership—ownership by all the people in theory, by the state in practice—was the highest category of ownership and received special protection. Such property included virtually all urban industrial and commercial property,\textsuperscript{14} mineral resources, and public utilities. Although in theory regulated by law, it tended to be managed in practice through decisions of the Council of Ministers. Because this kind of property was excluded from individual transactions under the constitution, it was not covered by the provisions of the 1951 Property Act.

The other two forms of property were "cooperative" and "individual" property. Cooperative property included most agricultural land and was governed by the law on cooperatives. "Individual" real property was limited to one residence and one vacation house per household (but not a separate rental house, which was considered a means of production). Individual property rights and transfers were governed during the socialist period by the 1951 Law on Property.\textsuperscript{15}

Because of the superiority of social property, the two socialist constitutions provided
practically unrestricted rights to the State to expropriate individual property. In urban areas these right was widely used. All industrial property and much residential property was nationalized pursuant to the nationalization laws of 1947 and 1948, and small private plots of land were gradually expropriated to secure the land needed for large-scale residential and public construction (and very often also for the needs of the Communist Party and other public organizations). Although the state kept firm control of commercial property, almost all residential property nationalized or later built by the state was sold to tenants at low prices in the 1950s and 1960s.

The Bulgarians moved quickly in 1990 and 1991 to change the basic legal concepts underlying property ownership. The hierarchy of property was eliminated with the amendment of the old constitution in 1990 and the adoption of the new constitution in 1991. As noted earlier, the new constitution grants full and equal protection to all property regardless of ownership, and it forbids expropriation except for carefully-defined public purposes and with full and adequate compensation. The Property Act was also amended in 1990 to eliminate some of the socialist overlay added in 1951. It now refers to private property and state property, rather than individual and social property. The law reflects the basic civil law framework of its pre-war predecessor and is thus generally adequate to govern property rights and relations in the private sector. It does not adequately address, however, the entire panoply of difficult problems relating to state-owned property.

**Eliminating the Monopoly of State Ownership**

A major challenge in developing a market economy in Bulgaria is to eliminate the virtual monopoly of the state over commercial property that existed during the socialist period. This entails both privatizing commercial property (or "reprivatizing" it to previous owners) and developing an active rental market in property still held by the state.

As noted in Chapter 1, ownership of social property was indeterminate during the socialist period. Neither local governments nor state-owned enterprises ("SOEs") owned the property they used, managed, or transferred; rather they had the ownership-like right of "operational management." State-owned enterprises that "operationally managed" property could in some cases lease it but could never sell it. The relevant overseeing ministries had ultimate decision-making authority with regard to such property. Municipalities had somewhat more independent authority than SOEs. Under the Property Act, the chairman of the local municipal council could transfer state-owned residential property within municipal boundaries to individuals (at prices fixed by the Council of Ministers).

Ownership of SOE property became a major issue in 1990 as Bulgaria began its economic transition in earnest. The 1990 amendments to the old Constitution removed the prohibition against individual ownership of commercial property, and Decree 56 (discussed in greater detail below) for the first time permitted SOE's to enter into joint ventures with private partners. For a brief period in 1990 and early 1991, some Bulgarian's thought that SOE's would be able on their own initiative to transfer real property to the private sector, in particular to contribute real property to a joint venture. However, the Law on the Formation of State Property Sole Proprietorship Companies of June 27, 1991 essentially barred such transfers of property by SOEs. The law gave the Council of Ministers all rights as sole owner of the SOE (as defined under the Commercial Law), including control over all real property. Although this clarification of ownership rights was an important first step in managed privatization, it clearly slowed down the development of a private real estate market (just as it slowed the privatization process more generally).

At present all parties accept the basic principle that the Council of Ministers controls real property attached to SOEs, while municipal governments have the power to transfer other property within municipal boundaries. This
means, for example, that private entrepreneurs seeking leases of commercial space generally know with whom they must negotiate. However, there is still considerable uncertainty about the exact powers of municipalities with respect to the property they control—including what property they actually own (rather than just administer) and who sets sale prices and is entitled to sale proceeds. These issues are now being debated and negotiated in the political arena.

Restitution. The issue of restitution of previously-nationalized property is the subject of intense debate in Bulgaria, as in all other CEE countries. In December, 1991, Parliament took a first, limited move by passing a law providing for the restitution of certain small shops and other business premises. Specifically, under this law former owners can reclaim all business premises bought by the State at artificially low prices pursuant to Ordinance #60 (1975) of the Council of Ministers. Because the number of such properties is relatively small, this law has not caused extensive uncertainty and disruption in property markets.

Restitution of residential property nationalized after the war is more difficult, because most such property was subsequently sold to new tenants in the 1950s and 1960s. Former owners of residential property that remained unchanged and in state hands can claim restitution under the Restitution of Nationalized Real Property Law, passed by the Parliament on February 5, 1992. Former owners whose property was subsequently sold to private parties or changed in other ways are entitled to alternative compensation, supposedly to be specified in a later law.

Another restitution law was also passed on February 5th, 1992—the law for "Restitution of Property Rights over Property Alienated Pursuant to the Urban Regulation Law, the Planned Urban Construction Law, the Urban Development Law, the State-Owned Real Estate Law, and the Property Law." Its purpose is to return to former owners real property that was expropriated for development purposes by the state, provided that the property (if a building) still exists or (if a plot of land) is suitable for single home construction.

Restitution of large, industrial properties is not as big an issue in Bulgaria as it is in East Germany or the former CSFR, for example, because Bulgaria's economy was primarily agrarian before World War II. Although no law has yet been passed, the intention of the Bulgarians is to treat those industrial properties that were nationalized the same as urban property, in essence returning them to former owners (either legal persons, if they still exist, or their former partners or shareholders). Such solution, however, may make little sense given the enormous changes that are likely to have occurred in the business over the past 40 years. Some kind of monetary compensation would perhaps be more reasonable.

Because of its traditionally heavy reliance on agriculture, land was always considered the most important means of production in Bulgaria. Land was never extensively nationalized as it was in the Soviet Union, although large farms were confiscated in 1946-47, broken up into smaller plots, and returned to the peasants. Rather than set up state farms, the state pressured farmers to contribute their land to cooperative farms, and they gradually lost contact with the property. Massive migration to the cities resulted in further loss of attachment to the land. Though many former owners preserved their titles to land, the registration system lost its importance and fell into disuse.

Former land owners in every CEE country have been pressing the state for restitution of agricultural land, and Bulgaria is no exception. On March 4, 1991, the General Assembly passed the Ownership and Use of Farm Land Act. The law seeks to return land to those farmers (or their heirs) who owned it just after the post-war agrarian reform. Farmers who never owned land before are also eligible to receive it. Each household is limited to 20 hectares (approximately 50 acres), or 30 hectares (approximately 75 acres) in certain areas of
"intensive land use." In an attempt to prevent land speculation, the law originally prohibited recipients from transferring their plots again for three years, although this prohibition was recently lifted. The restitution is to be carried out by the National Land Board and 269 local land boards. The period for submission of claims was one year from the passage of the law, later extended to 15 months. By the end of January 1992, some 512,000 claims had been submitted.

The land boards have faced many problems to date in implementing the law. Proving former ownership can often be difficult, particularly for former owners who have lost old titles. Because of the mergers of cooperatives (especially after 1971) and the neglected registration system, borders of rural property are often unclear. The process of issuing legal titles has also been very slow. By April 1, 1993, some 1.07 million hectares (23 percent of total arable land) had been restituted, but legal titles had been issued for only one-half of that land.

There is also concern for agricultural efficiency, especially in the case of crops that cannot be grown efficiently on small plots. Rather than try to preserve large farming units, however, Bulgarian policy makers are depending on the voluntary re-creation of cooperatives in the old Bulgarian tradition but in a form that is acceptable to the new private farmers now emerging. It appears that the overwhelming majority of new owners (some 90 percent) in some form intend to participate in agricultural cooperatives.

Revising the Regulatory Framework

Land registration. The system for registering individual real property was never interrupted during the socialist period and continues to work quite well. There was, and still is, a strong personal interest in recording all transactions dealing with private property (mainly residential buildings), and the system—computerized in the mid-1980s—is relatively efficient and accurate in this private sphere. However, due to lack of serious incentive, transfers of state-owned property were not always recorded. As noted earlier, registration is in particular disarray in rural areas, where state-controlled cooperatives were often merged and reorganized during the socialist period. As land and buildings are privatized, incentives should reemerge for careful registration of ownership in both urban and rural areas.

Mortgage Lending. Mortgage lending has long been common in Bulgaria. Lending conditions under socialism were not, however, those likely to prevail under capitalism, and the transition to a new system will be difficult. During the socialist period, housing was relatively inexpensive due to controlled prices and subsidized interest rates, and the debt burden of mortgages was therefore relatively easy for families to bear. Furthermore, because both banks and employers were state-owned companies, banks could readily garnish wages to satisfy overdue mortgage payments or, as a last resort, could expect to be subsidized by central authorities if nonpayments cut into bank profits. Eviction was possible but rare, both because of these alternative avenues for bank collection and because of the paternalistic attitude of the state. To evict an owner, a bank would had to follow long drawn-out procedures, and the state generally had to find alternative housing. Homelessness was not a socially-acceptable outcome.

A private market economy has very different features from that described above. Market-determined housing costs are likely to be much higher, creating more of a burden on households and thus greater likelihood of default. Private banks will not be readily able to garnish wages (particularly wages paid by private employers) to satisfy debts, and they will not be able to count on state bail-outs on bad debts. Foreclosure on the property—and thus the possibility of eviction—will become a necessity if truly private mortgage lending is to emerge. This will clearly take a major change in attitude as well as a
rethinking of the legal framework for eviction and foreclosure.

Land use. As described in Chapter 1, Bulgaria followed the general socialist pattern of static land use planning and large-panel construction methods that resulted in a highly inefficient pattern of urban land use. Clusters of high-rise residential units were built outside the urban core, resulting in high infrastructure and transport costs. In the absence of market signals, good agricultural land was often put to industrial use rather than utilize lower-quality land within a municipality. The development of a private market in land and buildings will slowly help to correct these inefficiencies in land use, if accompanied by more dynamic and generally less restrictive zoning rules. The large fines now applied on the conversion of agricultural land to other uses (adopted in lieu of market forces) should be phased out as market mechanisms and complementary zoning regulations develop.

Rights to Intellectual Property

Bulgaria is moving steadily to adopt western-style intellectual property laws. An important recent development in Bulgaria is the signing of the Trade Agreement with the United States, which obliges Bulgaria to enact the modern legislation with full protection of intellectual property.

Patents

During the socialist period, patent law had little meaning in Bulgaria's domestic economy. State control over the economy was pervasive, and inventors worked within the state apparatus. The basic framework for patent rights was provided by the Law on Inventions and Innovations of October 18, 1968. This law was firmly based on socialist principles and was thus strongly oriented towards the protection of the rights of the state. For a large category of products, inventions—generally employees within state-owned enterprises—were given credit for their inventions in the form of "authorship certificates," which were one-time cash awards calculated generally as a percentage of the "economic effect," or savings achieved by the design or a percentage of the net return on the invention. These awards were typically quite small, providing little incentive for inventive behavior. Patents could in principle be obtained by the socialist organization with whom the inventor worked, but in practice domestic patents were rare. Patents could also be obtained to protect Bulgarian inventions abroad, even if only an "authorship certificate" had been issued in the country. Foreigners have always been able to register patents in Bulgaria, which signed the Paris Convention in 1923.

This 1968 patent law was still in force until early 1993, although many of its provisions were no longer used. The existing framework clearly needs adjustment to fit the needs of a private market economy. A new Patent Law that provides patent protection similar to that in industrialized countries was passed by the National Assembly in March, 1993. Enforcement and dispute resolution procedures must also be developed for any new law to have a meaningful effect in practice. There is virtually no experience with the enforcement of private patents, which will be the major challenge of Bulgaria's intellectual property regime as it moves to a market economy.

Trademarks

Bulgarian trademarks and industrial designs are protected by the Law on Trade Marks and Industrial Designs of 1967. The law is also one of the first in Central and Eastern Europe to protect appellations of origin, which is important for many Bulgarian agricultural products, especially the quality wines. Under the law, trademark protection lasts for 10 years and is renewable (Article 19). The right of exclusive use of an industrial design lasts for five years (Article 29). Trademarks are protected upon registration at the Institute of Inventions and
Innovations. Limited protection is also available for non-registered trade marks with common and long standing usage. If someone else tries to register the same or essentially similar mark, the prior user may apply for registration of the mark within three months. The trademark law does not appear to need major overhaul. On the international front, Bulgaria is signatory to the most current text of the Madrid Agreement Concerning the International Registration of Marks (Stockholm, 1967).

Copyright

The Copyright Law is one of the oldest Bulgarian laws in force. It covers works of literature, science and art that are the product of creative activity and are published or expressed in any form. Protection does not depend on "aesthetic content" or originality. This wide definition makes the law potentially applicable to certain commercial products, including computer software. Protection grants the owner the right of public recognition (Article 3), the right to publish the work and to authorize the translation and publication in other languages (Article 4). Protection lasts for the life of the author and for fifty years after his or her death. The copyright passes to the heirs by law, or to heirs designated by the will of the author. If there are no heirs left, the copyright passes to the State (Article 18). On the international front, Bulgaria is a signatory to the Berne Convention (Paris text of 1971), which protects literary, scientific, and artistic works for 50 years.

Enforcement capacity is an issue in all of the areas of intellectual property law discussed above. Although a registration procedure exists, can a holder of intellectual property rights actually protect these rights if another person infringes them? The enforcement capacity of the existing Bulgarian agencies varies for the different areas of intellectual property. While copyright has been successfully protected for some time, the lack of experience in dealing with patent or trademark protection over the last 40 years makes those areas more problematic. Trademark infringements are growing daily, but little action is being taken despite the existence of the appropriate provisions in the Criminal Code. Very few lawyers specialize in protection of intellectual property outside of the few state institutions active predominately in the protection of copyrights. Enforcement will emerge as a critical issue as the private sector and foreign investment grow.

Company Law

Historical Background

The first Bulgarian company law was the Commercial Law of May 29, 1897. It was based on German Commercial Law but also borrowed from other continental legal systems. It was amended several times before 1946, and related laws were passed—including the Law on Limited Liability Companies (1929), the Law on the Cooperatives (1907), and the Law on the Stock Exchange (1912 and 1928).

In 1951 all commercial laws in Bulgaria were abolished and replaced by a legal system designed to meet the needs of a centrally planned economy. For the next four decades, the activity of Bulgarian enterprises was regulated through constantly changing (and sometimes contradictory) decrees of the Council of Ministers. Market-oriented company law ceased to be taught at the only law school in Bulgaria—the University of Sofia. Only a few Bulgarian lawyers maintained exposure to market-oriented company principles while working for foreign trade companies or the few companies with Bulgarian participation registered abroad. A few joint-stock companies continued to be formed by decree of the Council of Ministers, but in practice they operated like other state-owned enterprises. Several companies with foreign participation were formed under State Council decree 535/1980, but their activity was limited.

The State Council’s issuance of Decree 56 in January 1989 was a watershed event in Bulgaria’s transition to a market economy, even though at the time it was issued the move to a market economy was not a clearly-defined goal.
Decree 56 represented Bulgaria's first attempt to restructure and decentralize the management of state enterprises, as well as its first move to allow private investment in commercial activities. Decree 56 re-established most forms of companies that existed in the prewar Commercial Law, including the joint stock company, the limited liability company, and the "unlimited liability firm" (similar to a limited partnership). State-owned firms were supposed to reorganize into joint stock or limited liability companies. Private and foreign investment could be structured as of these more formal entities or more informally as "individual", "collective", or "partnership" "firms of citizens". Of these only the partnership firm of citizens was a registered and taxable legal entity. The individual firm was essentially a sole proprietorship and the collective firm was essentially a "pass-through" general partnership. The first version of the Decree restricted the rights of private companies to participate in foreign trade or to hire workers, but these restrictions were subsequently removed.

Decree 56 succeeded in decentralizing some decision making within state enterprises and in stimulating the beginnings of private entrepreneurship in the economy. It was accompanied by other reforms to the same end, including a reduction in central price controls and revisions in tax and accounting rules. However, it had many shortcomings. First, its philosophy was somewhat schizophrenic, in that it attempted to combine continuing state control with economic liberalization and private entrepreneurship. Second, it was too broad and thus too general, designed as a comprehensive business code and thus covering not only company formation and liquidation but also taxation, bankruptcy, foreign investment, and even currency regulation and social security. A document of 126 Articles and about 30 pages was clearly too short and too general to cover these complex areas adequately. Subsequent implementing regulations issued by the Council of Ministers also failed to clarify outstanding issues.

The new Bulgarian Commercial Law was the first post-war law drafted by a team of Bulgarian lawyers in line with prewar legal tradition, and in general it is fully satisfactory for the needs of a market economy. While following in general the pre-war law, an attempt was made to introduce post-war company law concepts from western Europe. These concepts aim primarily for flexibility—for example, flexibility in establishing managing bodies, in assigning voting rights, and in converting bonds into shares in joint-stock companies. Most provisions concerning Articles of Association are optional and may be changed by the partners. At the same time, care is taken to protect various interests, especially small investors and creditors.

The law recognizes the five types of companies that are common in European civil law jurisdictions. The joint-stock company (JSC) resembles the French SA, the German AG, and the Anglo-American public corporation. The limited liability company (LLC) is similar to the French SARL and the German GmBH, and to some extent to the private (closed) corporation under Anglo-American law. These two are the investment vehicles most likely to be used by the majority of medium and large investors. In addition, limited partnerships (equivalent to the German "Kommanditgesellschaft" or the French "societe commandite") or partnerships limited by shares ("societe commandite par action" or "KG mit Actionen") may be formed for specific purposes as described below. Small businesses may operate through general partnerships. Another law, the Law on Obligations and Contracts, provides the traditional form of the civil partnership, which has no legal personality.

**Characteristics of a Joint-Stock Company**

**Capital and share requirements.** At least two founders are necessary to set up a JSC (or one if the State is a founder) (Articles 61, 63, 159). Capital requirements are high relative to those in other CEE countries. Minimal capital of BGL
(Bulgarian Lev) 1 million (about $40,000) is required, or 5 million (approximately $200,000) if raised by public offering. This may include the value of in-kind contributions, as evaluated by three experts appointed by the Court upon request of the founders and contributors (Article 72). The entire capital of the company must be subscribed, but only 25% must be contributed prior to the registration (Article 174). Capital can be increased by issuing new shares, by appreciation of the nominal value of shares already issued, by conversion of convertible bonds into shares (Article 192), or by partial capitalization of profits upon a decision of the general meeting of shareholders (Article 197). Bonds (including convertible bonds if so provided by the Articles of Association) may be issued, but their value may not exceed 50 percent of deposited capital.

Reporting requirements are designed to promote transparency and the flow of information to shareholders and creditors. Financial data on the company must be included in the Articles of Association and made available to the court prior to registration. They must also be entered in the Commercial Register and published (Article 174). Raising capital through public subscription requires a detailed prospectus.

The law provides great flexibility in assigning shareholders’ rights. Both registered and bearer shares are allowed and may be exchanged for one another. Shares are transferable, but the articles of association may impose conditions on the transfer of registered shares besides the entry into the share register (Article 185). Shareholders are entitled to dividends and liquidation proceeds in proportion to their capital contributions. Interest bearing shares are not allowed. A share entitles the shareholder to one vote in the appropriate meetings (Article 181), although shares with special voting rights can be issued if so provided by the Articles of Association. Preferred shares entitled to guaranteed or additional dividends or liquidation proceeds are also allowed (Article 182). The Articles of Association may provide that such shares will be non-voting. Shares with equal rights form a separate class, and restrictions of the rights of such class may only be taken with the consent of the meeting of this class of shareholders (with at least 50 percent of the shares represented and at least three-fourths consent of those represented).

**Corporate governance.** The system of corporate governance is similarly very flexible, allowing either one-tier (Board of Directors only) or two-tier (Board of Directors and Supervisory Board) systems. The former is likely to be more appropriate for companies with fewer shareholders who can readily oversee management, while the latter may be preferable for companies with a larger number of shareholders. In the latter case the supervisory board in supposed to provide an additional check on management without being involved directly in management decisions.

**Characteristics of a Limited Liability Company**

The limited liability company is an intermediate form, designed to avoid the cumbersome procedures and public disclosure requirements of a joint-stock company and the unlimited joint and several liability of the partners in a general partnership. It was introduced for the first time in Bulgaria in 1924 and was popular among small and medium-sized companies during the prewar period because it provided flexibility while reinforcing strong personal contacts between the partners. The number of limited liability companies already formed under the new Commercial Law suggests that it will again be a very popular company form.

The limited liability company can be formed by one or more persons (Article 113). There is no maximum number of partners as in some other countries. Minimum capital of BGL 50,000 (about US$2,000) is required. Rules are very flexible. The partners are free to negotiate the distribution of voting rights and profits, the quorum needed for the general meeting, and the majority vote required for particular decisions.
The share of the partner in the company is proportional to his contribution, but this provision can also be changed (Article 127). At the moment of registration only 70 percent of the capital must be effectively contributed, with some partners contributing as little as one-third (Article 119). While not reducing the liability of partners in the longer-run, this flexibility can relieve financial pressure in the short term. The articles of association can then establish under what conditions the capital of the company will be called up (Article 115 para 4).

Shares are freely transferable among partners. However, transfers to third persons are conditional on approval at the general meeting. Such limitation on outside transfer, designed to preserve strong personal links among the partners, is one of the basic features of the European LLC. The number of the partners in the company is not limited.

Characteristics of the Four Partnership Forms

Four partnership forms currently exist under Bulgarian law—the general partnership, the limited partnership, the limited partnership divided by shares, and the "civil" partnership. The first three are governed by the Commercial Law and the last by the Law on Obligations and Contracts. Two major differences among the four forms concern taxation and liability. The three forms governed by the Commercial Law are considered taxable legal entities, while the civil partnership is not. With respect to liability, all partners in the general and civil partnerships—but only the general partners in the limited liability forms—have unlimited joint and several liability. The liability of the rest of the partners in the limited forms is limited to the amount of their agreed contribution (Article 99). The limited partnership divided by shares, like the joint-stock company, can raise capital through public offerings and is subject to the same requirements in so doing.

Setting up a Company

Establishing a company in relatively easy in Bulgaria from a legal and administrative perspective. Prior to registration, the founders of a company must draft the Articles of Association, the first general meeting of shareholders must approve the Articles, the management must be appointed, and the minimal capital contribution must be made. The Articles of a JSC or LLC need not be approved by a notary as in many other European countries, although partnership deeds require notarial approval. The founders then apply to the relevant district court for approval of the Articles and for registration in the Commercial Register. This generally takes less than a week if all documents are drafted properly. The company is deemed incorporated as of the day it is entered in the Register. Upon approval by the court, the decision must be published in the Official Gazette and the company must register with the tax authorities.

Foreign Investment

On January 16, 1992, the National Assembly passed a new foreign investment law—the Law on the Business Activity of Foreign Persons and the Protection of Foreign Investment. The new Government, formed after the elections in October, had declared that removing obstacles to foreign investment would be a top legislative priority. The new law is extremely liberal, imposing almost no constraints and offering generous incentives for foreign investment.

Forms of Investment

Unlike its predecessor, the applicability of the new law is reasonably clear. Non-residents, excluding Bulgarian nationals, are considered foreigners for purposes of the law. Resident foreign nationals are not considered foreigners and have unconditional national treatment. Bulgarian nationals with a second dual nationality who are resident abroad may choose how to be treated for purposes of the law.
(Article 2, para 2). Foreign-owned companies set up and registered in Bulgaria are Bulgarian legal persons and are not considered foreigners. Forms of investment are governed by domestic law. Foreign investment can be organized in any of the forms recognized in the Commercial Law (as discussed above) or as a civil partnership under the Law on Obligations and Contracts. In addition, foreign persons and partnerships without legal personality can be recognized in Bulgaria for purposes of the Commercial Law if registered in their country of residence (Article 3, para 6). The share of foreign ownership is not limited. Foreigners can participate in joint ventures with Bulgarian entities or can operate through wholly-owned entities. Foreign companies can also set up branches in Bulgaria.

No investment approval is needed except in a few areas (as specified in a negative list). The abolition of the complicated and unclear approval procedures of the former law is one of the most important features of the new one.

**Profit Repatriation and Other Rights and Guarantees**

Foreigners receive national treatment in all areas except land ownership. No foreigner may own land (Article 5, para 2), and no domestic company with more than 50% foreign participation may own arable land. Foreigners may, however, own buildings and acquire rights (including long-term leases) over land if needed for business activity. Foreigners may own residential property with a "construction right" on the underlying land.

In line with constitutional guarantees, the law allows expropriation only for important public needs that cannot otherwise be met (Article 10). Any expropriation of foreign property must be authorized by the Minister of Finance, and prior compensation is required, either in-kind or (upon the consent of the foreigner) in money (Article 10, para 7). Expropriation decisions can be contested in court.

The law guarantees full repatriation of profits (in domestic or foreign currency), foreign debt service payments, and other proceeds (including liquidation or sale proceeds) from the investment (Article 13).

**Tax Incentives**

Tax incentives are covered not by the foreign investment law but by Decree 56. This decree provides, among other things, five-year tax holidays for companies with foreign participation that operate in high-technology industries, agriculture, food-processing and tourism, as well as companies with foreign participation operating in free-trade zones. Because the government has not provided a specific list of "high-tech" sectors, the incentives are in practice available to most if not all investors. The same tax incentives are not, however, available to domestic investors, even if they operated in the same kind of business. Thus, the system discriminates against domestic investors. Custom regulations provide for exemption from custom duties of imports to be used for export-targeted production as well as relatively low duties on imports to be used for investment. In general these customs regulations apply equally to foreign and domestic investors.

**Contracts**

**Features of Socialist Contract Law**

Bulgarian contract law during the socialist period varied in several important ways from its pre-war predecessor. First, the idea of contractual freedom (though proclaimed in theory) was in practice subordinated to the needs of the central plan, as discussed in Chapter 1. The annual plan had the force of law, and every related law was drafted to assure the priority of the plan over individual contracts. Second, contracts among private parties were treated differently than contracts among state enterprises. The Bulgarian contract law applicable to the limited (generally non-commercial) sphere open to private sector transactions was the Law on Obligations and Contracts of 1950. The law in theory applied to
socialized enterprises, but in practice contracts among such enterprises tended to be governed by separate legislation or by administrative orders and decrees of the Council of Ministers. Although the law contained extensive socialist phraseology and certain uniquely socialist principles (especially with regard to the priority of the plan), it reflected many legal principles common to continental European legal systems.

The Current Situation

The law on Obligations and Contracts remains the contract law of the country. Although the central planning agency was closed and central planning abolished in 1990, no changes were made in the law until 1993. Until then the law still formally distinguished between contracts among individuals and contracts among socialized enterprises, but all transactions after 1990 were regulated by the general provisions applicable for individuals. These distinctions were finally eliminated in the 1993 amendments.

As noted earlier, this law reflects generally-accepted civil law concepts of contract and thus has provided an acceptable legal framework for private sector activity. It covers quite a wide breadth of topics, including security interests (Section VII-Guarantees) and negotiable instruments (Section XVIII-Promissory Notes, Bills of Exchange and Checks). However, some important commercial concerns—such as securities and bankruptcy—that were covered in the pre-war Commercial Law were omitted during the 1951 drafting of the Law on Obligations and Contracts, because they were no longer considered relevant in a socialist economy.

Rather than updating the Law on Obligations and Contracts, the aim of Bulgarian lawmakers since 1990 has been to restore the pre-war Commercial Law in full, adding a second book to the new Commercial Law to accompany the first book on companies and thus create a comprehensive legal framework regulating commercial activity. Only private non-business transactions are to be covered by the existing Law on Obligations and Contracts. This second book has recently been completed as is currently awaiting Parliamentary approval. It includes, most commercially-oriented sections of the Law on Obligations and Contracts, as well as some types of transactions that were introduced in Continental law after World War II, such as leasing and franchising. The task of redrafting and restructuring the law has been accomplished quickly. It will take more time to build experience with the law, enforcement capability and a body of judicial interpretation in the courts, and the strict discipline for contract fulfillment in the population.

Bankruptcy

Bulgaria had a well-developed legal framework for bankruptcy before World War II. It was incorporated in the Commercial Law and was modeled after the French, Italian and Romanian Commercial Codes, but with some original provisions. After being adopted in 1897, the bankruptcy section of the Commercial Law was amended several times, the last time in 1934. Considerable practice and a body of court decisions were built before the bankruptcy provisions were abolished with the rest of the Commercial Law in 1951.

These prewar bankruptcy regulations, though comprehensive, suffered from the same problems of other European systems—long and expensive court procedures, low recovery rate, and the availability of loopholes through which the debtor could transfer property before initiation of the proceedings. Bankruptcy was harsh and meant certain closure of the debtor firm; reorganization was not an option in these prewar systems. A Law on Mutual Agreement Procedure ("Concordat") was, however, passed in 1932 to provide an alternative path for insolvent debtors—a framework to negotiate proportional debt reduction with all creditors and thus continue in operation. Similar laws were passed in most CEE countries during the prewar period.
Current Situation

Along with its many other tasks in connection with the transition to a market economy, Decree 56 of 1989 attempted to reintroduce the concept of bankruptcy. Although still the relevant law in this field, the bankruptcy framework provided by Decree 56 is ill-equipped for the needs of a market economy. It reflects the extensive involvement of the state in enterprise decision making that existed in 1989 when the Decree was adopted. It also reflects a desire to keep insolvent enterprises afloat if possible. Not only does it anticipate state assistance to rescue insolvent enterprises (without setting precise guidelines for such assistance), but it erects barriers to creditor initiation of bankruptcy procedures. First, 60 days of nonpayment is required before a firm is eligible for bankruptcy. Second, before bankruptcy can be initiated, creditors must negotiate with the debtor to try to reach conciliation. Although supposedly limited to one month, such negotiations can be extended. Third, even if such negotiations fail and bankruptcy begins, the court cannot appoint a liquidator and take actions to stop the firm's transactions until the debtor produces a detailed list of its assets and liabilities. These preliminary steps can in practice delay bankruptcy indefinitely, thereby risking even further loss of assets and unnecessarily burdening creditors (particularly in such a highly inflationary environment).

Once bankruptcy begins, a liquidator is appointed to collect the list of claims and liquidate assets to satisfy such claims to the extent possible. Claims are to be satisfied in the following order: wages, tort liabilities, claims of the state, claims secured by lien or mortgage, and unsecured claims. As noted in Chapter 1, this order to priority is problematic, in that it places secured claimants below worker or state claims and thus lowers the value of security interests. Furthermore, the extensive limits placed on the sale of certain categories of assets—most notably real estate—used by state enterprises but owned by the state places a further barrier to the satisfaction of claims.

The bankruptcy procedures under Decree 56 have only rarely been applied. Not only are they slow and cumbersome, but there is still little incentive to use them. A well-functioning bankruptcy system requires a true conflict of interest between debtors and creditors, and this still does not exist in the state-owned sector. Indeed, it is unlikely ever to exist as long as the bulk of creditors and debtors are owned by the state. For that reason, it can be argued that bankruptcy as known in advanced market economies will only take firm root in transforming socialist economies when the private sector has grown sufficiently to develop an extensive network of links between private debtors and private creditors (whether banks or suppliers).

The New Draft Bankruptcy Law

Recognizing the shortcomings of Decree 56, the Bulgarians have prepared a new bankruptcy law that is expected to be approved by the parliament in mid-1993. It does not allow for "Chapter II-style" reorganization but only for liquidation of a bankrupt firm. Liquidation can be avoided only if the debtor and creditors can negotiate a work-out agreement through which debts are reduced. Pre-bankruptcy work-out agreements are governed by a companion law similar to the prewar model, while work-out agreements in the course of bankruptcy are governed by Chapter XI of the bankruptcy law. The requirements for a post-bankruptcy work-out agreement are quite strict. In particular, all creditors must agree if the debtor is to satisfy less than 40 percent of outstanding claims. In practice, unsecured creditors rarely recover close to 40 percent in bankruptcy cases around the world. The new draft law closely follows the bankruptcy provisions in the original 1897 Commercial Law.

In addition, the draft law reinforces the negative stigma traditionally attached to bankrupt firms. Not only does bankruptcy (even if caused through negligence) appear to be considered a crime, but conclusion of a bankruptcy case does not appear to rid the debtor of potential claims.
Creditors can continue to pursue debt collection even after the debtor's assets have been liquidated, unless creditors and debtors have agreed to a work-out under the mutual agreement procedure. This harsh treatment again contrasts with more recent thinking in many industrialized countries, where bankruptcy laws try to remove the stigma of bankruptcy (assuming no criminal intent). Modern laws implicitly recognize that the very essence of capitalism is risk-taking. Some ventures are certain to fail, and the economy gains if those who lose through risk taking are allowed a "fresh start" free from past burdens and stigma.

Finally, the draft gives a central role in administering a bankruptcy proceeding to the judge. For example, the judge is in charge of attaching the property of the estate, investigating questions concerning the bankrupt or its property, and overseeing the sale of the debtor's property. Given the shortage of capacity in the Bulgarian court system and the burgeoning number of cases likely to arise in the future, the Bulgarians should be careful to conserve scarce judicial resources. In this regard more of the burden of administration could fall to the trustee, and more decisions could be made without requiring meetings and approvals.

The major dilemma faced by policy makers in Bulgaria, as in other CEE countries, is what to do with the large stock of illiquid or insolvent state enterprises carried over from socialism. As noted in Chapter 1, a separate extra-judicial procedure, linked to privatization and bank restructuring, is likely to be needed, to avoid flooding the courts with an impossibly large number of cases.

**Antimonopoly Law**

Because it was one of the most centrally-controlled economies during the socialist period, Bulgaria started its reform process with a highly concentrated industrial structure. To lower the transaction costs involved in implementing a central plan, the socialist government explicitly created large state-owned monopolies that dominated both production and distribution of virtually all goods. During the socialist period the Bulgarian private sector was very small and operated primarily in retail trade and some services.

On May 2, 1991, the National Assembly passed the Law for the Protection of Competition. The law regulates both monopolies and unfair competition. It establishes broad principles concerning illegal behavior and sets up a specialized office—the Commission for the Protection of Competition—to prosecute cases, with the possibility of appeal to the Sofia City Court. In addition, the law allows individuals, companies, the Competition Commission, or the District Attorney to bring claims under the law directly to district courts. Although the law is quite imprecise and unclear in its wording, it is a useful start in this very difficult area of law.

The antimonopoly section of the law applies exclusively to entities deemed to hold a monopoly position either they have the exclusive legal right to carry on a particular business (for example, the existing tobacco monopoly) or because they account for market share of over 35 percent (Article 3). The creation of monopoly by government (Article 4) or through merger (Article 5) is not forbidden per se but only if it "restricts free competition and/or pricing." On the other hand (and perhaps in contradiction to Article 5), Article 8 bans cartel agreements that would establish explicitly or implicitly a domestic monopoly.

Once a monopoly exists, it is forbidden from misusing its position, and the definition of misuse is extremely broad. Article 7 defines as misuse: (a) restricting the growth of a market or access thereto; (b) applying inequitable standards or contract terms on others, or selling goods and services that are below common quality standards; (d) conditioning a contract on the acceptance by the other party of unrelated terms ("tie-ins"); (e) "resorting to economic constraint to cause other firms to dissolve, split up, merge or transform"; and (f) monopoly pricing above cost for a considerable period of time. Article 8 bans market-sharing agreements among competitors if they restrict competition or harm
consumers, and Article 10 prohibits contracts granting exclusive downstream distribution rights. Article 9 allows competitors to adopt unified forms for commercial contracts only if approved by the Competition Commission. These various categories of wrongdoing, though stated in rather unusual terms, presumably could be interpreted to encompass most of the major horizontal and vertical restraints of trade commonly addressed by antimonopoly regulation in industrialized countries. While the law is all-encompassing, it adopts explicitly or implicitly a "rule of reason" approach in most cases, giving virtually unlimited discretion to the antimonopoly office to decide which cases to prosecute. Yet the wording implies that the named practices are prima facie illegal, i.e. that, if charged, the burden of proof lies with the company. Given the imprecise and somewhat confused wording of the law, it is likely to be very difficult to know in practice what is permitted and what is not. Thus there is tremendous scope for misapplication, which would do particular harm if it were to stifle legitimate business practices in the emerging private sector.

If any of these practices are ruled anticompetitive, the Competition Commission has broad powers to nullify relevant government enactments or impose sanctions on offenders. On its recommendation, the Council of Ministers can enforce maximum and/or minimum prices on the monopoly firm. The law does not give the Office the authority to break up a firm in a monopoly position, nor does the office have the authority to review all proposed mergers and acquisitions except those carried out by firms that are already in a monopoly position (Article 6).

Chapter 4 of the Law bans unfair competition, defined at length in Article 12. Although the definition is very broad, specific examples focus primarily on misinformation—whether misleading advertising, concealment of deficiencies in products, circulation of false facts about competitors, or misuse of trademarks or brand names. Also banned more generally is "non-compliance with ... a contract...aimed at concluding a similar contract with a third party", if it hurts the competitive position of the original counterpart.

Interpreting and applying the new Bulgarian law effectively is an enormous challenge, particularly given the lack of clarity in the law itself and the broader set of problems with antimonopoly legislation in general. The competition office will need to tread lightly at first. As well as handling individual complaints, it should concentrate on its other important missions: educating the public about the distortions caused by monopoly behavior and lobbying the government and Parliament to minimize barriers to international trade—the most powerful antimonopoly force of all. Given the importance of industrial structure in determining monopoly behavior, and the office should also be given a mandate to review privatization proposals (as is done in Poland and the former CSFR) to try to stop public monopolies from becoming private ones.

Judicial Institutions

The implementation of the new set of business-related laws discussed above will be the greatest challenge facing the judicial system in Bulgaria in the next few years. The lack of judicial experience, if not dealt with adequately through technical assistance and training, could prove to be a serious obstacle to market reforms.

The Court System

Under socialism the judicial system was not independent but was supposed to serve the goals of the state. Although central control over the judicial system relaxed somewhat in the mid- and late 1980s, local communist party committees continued to have decisive influence over the appointment and promotion of judges. Judges in courts of first instance had greater independence than those in higher positions.

Courts in Bulgaria were not involved in commercial cases during socialist times. The private sector was almost non-existent, and disputes between state enterprises were dealt
with in specialized state arbitration boards under the Council of Ministers. These boards have been dissolved, and most arbitrators have joined newly-created commercial sections of regular courts. Unfortunately, the experience gained by these arbitrators—primarily oriented to implementing the central plan—has little relevance today. Not only is the subject matter of future commercial litigation likely to differ markedly, but legal procedures are likely to differ as well. In the past, enterprises had little incentive to win a case, and little outside evidence was ever used to resolve disputes. Modern principles and techniques of litigation were virtually nonexistent.

The Bulgarian court system is still organized according to the provisions of the Constitution of 1971, although it will soon be reorganized to comply with the new Constitution. The highest judicial body is the Supreme Court, which used to be elected by the National Assembly. It has three chambers—Civilian, Criminal and Military. Its important decisions are published and widely used by practicing lawyers as references. Below the Supreme Court are the District courts, and below them are the Regional (general) courts. District courts have appellate jurisdiction in matters covered by the regional courts, and original jurisdiction in certain cases. Time and training is needed at all levels of the court system to develop the capacity and experience to handle the plethora of new commercial issues emerging as the economy moves toward a market system.

Arbitration could be a useful alternative to court procedures as a means to resolve commercial disputes among private parties. As in other CEE countries, the Bulgarian Chamber of Commerce and Industry has an arbitration commission that specialized during the socialist period in the settlement of international trade disputes. A broader mandate and proper technical support could help this body develop into a viable alternative means for dispute resolution. The legal basis for private arbitration between domestic parties is unclear. Although the Code of Civil Procedure (Article 9) restricts private arbitration to disputes between Bulgarian and foreign persons, Decree 56 (Article 98) explicitly allows private arbitration between domestic parties if both parties agree in writing. How a decision reached pursuant to Decree 56 would be executed is, however, unclear.

Lawyers

As in other CEE countries, the Bulgarian legal profession was divided into two branches during the socialist period—lawyers belonging to a bar association (advocates) and legal advisers within state enterprises (jurisconsults). The jurisconsults handled virtually all commercially-related legal work, while lawyers were not generally involved in commercial areas. There is now somewhat of a tug-of-war between these two groups as to who is the more qualified to emerge as the private commercial lawyer of tomorrow.

Setting up private commercial law practice has been allowed in Bulgaria since 1989, and it has grown considerably since then. Until recently it was subject to certain regulations carried over from the previous regime. For example, persons with legal training could not appear in court if they are not employed by particular enterprises as "jurisconsults" or were not members of a particular bar association. Passage of the bar examination, required of all legal practitioners, was not synonymous with membership in the bar, which until recently was regulated by the state. Recently the requirements for private legal practice have been clarified and simplified. The profession is fully privatized, and the Bar is no longer controlled by the state. On the other hand, many legal and ethical issues surrounding the practice of law in industrial economies—such as liability for advice given, confidentiality, and conflicts of interest—have not yet been addressed.

Conclusion

The Bulgarian government is working steadily to create a legal framework in which the private sector can develop. Many new laws—including
a new Constitution and new laws on companies, foreign investment, and competition—have been adopted over the past 2 years, and more are now being drafted and debated. Bulgaria's pre-war legal framework was quite modern for its time, and most of these new laws draw on pre-war Bulgarian tradition.

However, the administrative and judicial machinery for implementing those laws is slower to develop. Laws by themselves are only paper; the legal framework will "come to life" only when the legal and administrative institutions can enforce the laws and readily resolve the disputes that they inevitably spur, and when the public accepts that the laws are indeed binding. Furthermore, the laws are by necessity general frameworks only. Their content needs to be filled in by more detailed regulations and practice in individual cases, a process which by necessity takes time. The challenge of legal development in Bulgaria and the other CEE countries is as immense as that of economic reform, and the two are inexorably intertwined.
Endnotes

1. For detailed references to Bulgarian legislation mentioned in this Chapter, see Gray and Ianachkov, "Bulgaria's Evolving Legal Framework for Private Sector Development, "The International Lawyer, forthcoming (Winter 1993).

2. The Bulgarian Communist Party was declared the leading force in society. All other traditional parties were dissolved, and the once powerful Bulgarian Agrarian People's Union was reduced to an "ally" of the party in the construction of socialism. The BAPU, however, participated in all post-war Bulgarian governments.

3. As in most socialist constitutions, many of the constitutional provisions lacked an exact legal meaning but were rather general political statements repeating basic Marxist theoretical concepts.

4. All mineral deposits, beaches, public roads, bodies of water, and forests and parks (including archeological sites) of national importance remain the exclusive property of the State (Article 18). Although not required, the state may establish a monopoly (with the possibility of concessions to private operators) over the railroads, the national post and telecommunication networks, nuclear energy, and the production of radioactive materials, arms and explosives, and biologically active substances.

5. Foreigners may acquire rights to use or build on land, and foreign nationals resident in Bulgaria may acquire residential property. Furthermore, foreign nationals who are not permanent residents in Bulgaria are able to acquire residential property if they obtain permission from the Ministry of Finance. If the residence is a house rather than an apartment, the land on which the house sits can also be acquired. Although even this limited ownership of land by foreigners would appear to contravene the constitution, it has apparently not been contested. Foreign-owned companies registered in Bulgaria are Bulgarian legal persons and thus do not fall under the constitutional prohibition on land ownership.

6. Private alternatives in education and health care are to be regulated by the state.

7. This is yet another unclear provision calling for further clarification in a separate law. Though the law on education has not yet been passed, fees are already being collected in some state and emerging private universities.

8. The only exception is the annual budget bill, which must be prepared and presented by the Government.

9. The President cannot veto a bill but can return it for reconsideration within 15 days after passage. A majority vote of all representatives (at least 121 votes) is then required for the bill to become law.

10. If successive candidates are unsuccessful in forming a government, the Parliament must be dissolved and new elections called within 2 months.

11. Although judges were nominally independent and subordinated only to law under the previous constitution, local party committees had decisive influence over appointment, recall, and promotion.

12. No institution had such power of judicial review before or during the socialist period.
13. Other courts may not rule on the constitutionality of laws but should instead refer such questions to the Constitutional Court.

14. Until 1990, the socialist constitution did not permit individuals to own commercial property. The 1990 amendments removed this restriction.

15. During the socialist period other laws suspended temporarily the application of the Property Act to particular transactions, types of property, or regions of the country. One example was the residential property law—The Property of the Citizens Act (1971)—which attempted to limit individual ownership and provide affordable housing to all through administrative means, and in effect displaced the Property Act (except in small and relatively unpopulated rural areas) for some 20 years. Widespread application of the Property Act was restored only with the 1990 partial repeal of the Property of the Citizens Act.

16. Although the Property Act did not apply to property (including virtually all commercial property) used or transferred exclusively within the public sphere (on the theory that this was no transfer, because the owner was still the state), it did apply to property transfers between the state and private individuals, as referred to here.

17. Because of relatively low prices, the right to buy state-owned land was a highly sought-after privilege. A heavy bureaucracy existed to check whether the applicant was qualified to buy the land, and buyers often waited for years for the transaction to be concluded. This also led to corruption related to assignment of the right to obtain the property.

18. The law was in fact intended to curb the process of "spontaneous privatization"—pursuant to which SOE managers could sell SOE assets to private firms they controlled at artificially low prices—and replace it with more managed "top-down" privatization.

19. Former legal entities are unlikely to still exist except in the case of some religious and political organizations.

20. The Bulgarian cooperative movement had a strong and well-developed tradition even before the war. After the war, however, collectivization was very often forced, and cooperatives became increasingly inefficient, overburdened by bureaucracy and centralization.

21. These limits reflect the limits applied in the 1947 agrarian reform. "Intensive land use" is not defined, but specific areas are likely to be designated as was done in the agrarian reform law (The Earned Land Property Act of March 9, 1946). It is unclear whether a household can subsequently acquire and own more land than the limits set in this law.

22. Unlike some other socialist economies, Bulgaria has long had the concept of individually-owned units in multi-family buildings—i.e. the concept of condominium (although not with that specific name). Defining the unit for mortgage purposes was therefore not a problem as it could be, for example, in the case of cooperative housing.

Cooperatives were more common in building construction than in ownership. In the 1950s Bulgaria developed a specific form of housing construction—the Residential Construction Cooperatives (КCK). The idea of the cooperatives was to engage the efforts of future owners in the construction of multi-family housing and to make them responsible for the final works, the landscaping, and the maintenance. This form was widely used, but construction was hindered by the lack of materials, restrictions on the use of hired labor, underdeveloped systems of contracting, and costs well above official calculations (the latter based on fixed state prices). The cooperatives were usually built on land expropriated by the State and allotted to the cooperative. The former owners were compensated with apartments in the new building. The members
of the cooperative acquired rights to the building, but the land remained state-owned. When construction was completed, the cooperative was dissolved and the participants became owners of individual apartments.

23. This obligation to find alternative housing also applied to evicted renters pursuant to the Law on Rent.

24. This category included all chemical substances, all substances used for pharmaceutical purposes, for food and in cosmetics (obtained by chemical or non-chemical methods), all methods used for medical purposes, the new varieties of crops or new breeds of animals, technical solutions to problems related to nuclear technologies, and all inventions made as part of the work assignment by a "socialist organization" or related to the defence or the security of the country (Article 14).

25. The enterprise was obliged to implement the invention and pay 50 percent of the remuneration not later than two months after the beginning of the implementation. The balance of the remuneration was due after one year and was supposed to correspond to the actual "economic effect". Litigation between the enterprise and the inventor concerning the amount of such effect was common.

26. Although hardly ever done in practice, the 1968 law allowed the state's patent office to issue a compulsory license to third parties with compensation if a patent registered in Bulgaria had been unjustifiably unutilized or under-utilized for three years following the publication date of the patent or four years from the day of filing the patent application (Article 37).

27. Bulgarian nationals were able to obtain patents abroad only through the Institute for Inventions and Innovations. The use of the foreign exchange acquired from foreign licensing of the patent was subjected to further bureaucratic regulation (Article 46).


29. An earlier, unsuccessful attempt was made in 1987-88 to transfer state enterprise property to employees.

30. General partnerships could be formed under the Law on Obligations and Contracts.

31. Unlike in some other CEE countries, economic reform to some degree preceded political reform in Bulgaria. The desire to maintain central power reflects the fact that the communist government was still in firm control when Decree 56 was passed.

32. For banking and insurance companies the minimal capital is BGL 10 million.

33. A subscriber who does not accept the evaluation is free to contribute in cash or withdraw from the company. Although this procedure is designed to protect outside creditors from overvaluation of in-kind contributions, it is somewhat cumbersome and does restrict the negotiating freedom of the investing parties.

34. If a dividend is not paid to them for two consecutive years, non-voting shares acquire the right to vote until the dividend is paid (Article 182 para 3).

35. In the former the general meeting of shareholders elects the directors, while in the latter the general meeting elects the supervisors, who in turn elect the directors. One person cannot be both a director and a supervisor.

36. Although widely used in Bulgaria, the term "civil partnership" is imprecise, because these entities can also engage in commercial activity.

37. While not very flexible, the civil partnership is sometimes used by foreign
investors because of its favorable tax consequences.

38. The new law replaced the previous foreign investment law, which had only been in force for 6 months. The old law was quite restrictive in comparison to similar laws in other CEE countries.

39. Article 5 (Restrictions). Most of the areas on the negative list are "sensitive" industries for which licenses are also required of domestic investors. These include the manufacture and trade of arms, ammunition and military equipment; banking and insurance, including the acquisition of shares in banking or insurance companies; and exploration and exploitation of natural resources in the territorial sea, the continental shelf, or the exclusive economic zone.

40. Foreign persons or foreign-controlled companies may not acquire real property in some regions of the country, as designated by the Council of Ministers (Article 5, para 3).

41. Such "construction right" is typically granted to owners of apartments in buildings built on state-owned land. It provides that such land cannot be expropriated without regard to the building on it.

42. Decree 56 will continue to govern taxation until new tax laws are introduced, perhaps later in 1993.

43. The companies operating in free trade zones were to be subject to a 20 percent rate of tax after the expiry of the holiday period.

44. These comments refer to the original draft law. It may be modified substantially by the government or by Parliament before being finally adopted.

45. The Commission for Protection of Competition is independent from the Government. Its 10 members (including the Chairman and Vice-Chairman) are elected by the National Assembly (Article 2).

46. This joint jurisdiction of both the Commission and the regular courts in competition cases is unusual. Although the same model is followed in the U.S., in many countries a specialized agency has exclusive primary jurisdiction, with courts handling only appeals. Although providing two avenues of redress may promote more vigorous enforcement of the law, it also opens up greater possibility of conflicting interpretations or misapplication of the law—a particular problem given the complexity of the topic.

47. Setting a minimum size level (as a share of the entire domestic market) that will trigger action under the law helps to save on administrative resources by targeting administrative action on those firms most likely to restrain competition. However, the threshold of 35 percent, like any figure, is arbitrary, and may or may not reflect a dominant position in any particular market. Much depends on the definition of the product (and to what extent close substitutes exist) and the reach of the actual market (including its openness to international competition).
After its "velvet" revolution in late 1989, the Czech and Slovak Federal Republic (CSFR) moved steadily to create the conditions for the development of a private market economy. Not only did it free up the conditions for entry of new private firms, but it also took innovative steps to return nationalized property to former owners and privatize large parts of its state-owned industry. This chapter surveys legal developments in the Czech Republic. Essentially the same legal framework exists in Slovakia, although the legal frameworks of the two could diverge considerably in the coming months and years.

CSFR was somewhat different from its Central and Eastern European (CEE) neighbors, particularly Poland and Hungary, in that its pre-war legal system was more thoroughly abrogated during the socialist period. There are thus fewer people (in or out of government) who are familiar with market-oriented legal principles and practices. On the other hand, in 1989 the CSFR had the advantage of starting with a relatively "clean slate" on which to craft modern laws. In some areas of law, such as company, contract, and antimonopoly law, legal reform in the Czech Republic is relatively well-advanced and could serve to some degree as a model for other reforming socialist economies. In others, including constitutional and real property law, legal reform has lagged behind developments in some neighboring countries. Institutional capacity in the judicial system appears to be relatively weak—ill-prepared to cope with the skyrocketing demands now emerging in the newly reformed system.

Constitutional Law

CSFR's first constitution was adopted in 1920. A new constitution, based firmly on socialist principles, was adopted in 1948, and a second socialist constitution was adopted in 1960 and amended in 1968. The CSFR did not adopt a new constitution after the 1989 revolution, although the Federal Assembly elected in June 1990 was supposed to draft a new constitution within its two-year term. The process was stalled by political disagreements over governmental structure and the distribution of powers among the republics and between levels of government, and it could not proceed further until basic questions on union or disunion were resolved. However, numerous amendments were made to the 1960 Constitution to bring its provisions in line with the needs of a private market economy. The Constitutional Law on Fundamental Rights, adopted in January 1991, granted all persons the right to own and inherit property, and provided equal protection for all types of ownership rights. It provided for expropriation only "in the public interest" and only according to law and with compensation. It further provided that "everyone has the right to freely choose their profession...[and] to undertake other economic activities." Thus, although governmental structure was still an open question, the constitutional barriers to private ownership and private entrepreneurship were quickly removed through amendments to the old socialist constitution.

The Czech National Council adopted a new Czech constitution on December 16, 1992, which took effect on January 1, 1993. The new Constitution is relatively short and concise, consisting of 113 Articles in 8 Chapters:

I. Basic Provisions
II. Legislative Power
III. Executive Power
IV. Judicial Power
V. The Supreme Inspection Office
VI. The Czech National Bank
VII. Territorial Self-Administration
VIII. Temporary and Final Provisions
It deals primarily with governmental structure and powers; rather than restate basic protections of private property rights, it explicitly incorporates the Constitutional Law on Fundamental Rights referred to above. It provides for a bicameral Parliament, with a Chamber of Deputies and a Senate. The former has 200 members elected for four-year terms, while the latter has 81 members elected for staggered six-year terms (Article 16). Parliament elects the president, who in turn appoints the prime minister and other ministers. As in other CEE countries, the Czech constitution provides for an independent judiciary and a separate Constitutional Court. The latter has fifteen judges appointed by the president for ten-year terms (Article 84). It has the power to annul laws or their individual provisions if it finds them unconstitutional or at variance with international agreements, an to annul regulations or other public decisions or acts that run counter to the constitution or to individual laws or international agreements (Article 87). The decision as to who is eligible to bring complaints to the Court is left to a separate law (Article 88).

**Rights to Real Property**

Rights to real property are in a tremendous state of flux in the Czech Republic. As the basic legal framework of real property rights is being redefined, the clash of competing claims of current tenants, former owners, and new would-be purchasers is creating widespread uncertainty. Meanwhile, the land registry and regulatory institutions left over from the socialist period are in need of major overhaul. A real estate market is just beginning to emerge and is still in disequilibrium.¹

**Defining Basic Ownership Rights**

Apart from the general constitutional principles discussed above, the primary legislation defining property rights in detail in the Czech Republic is the Civil Code.² The existing Civil Code dates from 1964. As in the Civil Codes of other CEE countries during the socialist period, this Code originally established a hierarchy of property rights among state, cooperative, personal, and private property. State property, the "highest" form, encompassed major means of production and was accorded special legal status. Personal property included the family house (up to a size of 120 square meters) and small items for personal use. Private property, the lowest of the hierarchy, referred to private ownership of means of production (in practice mostly real estate).

Although the 1964 Code continues in force, major amendments made at the beginning of 1992 abolished the socialist hierarchy of property and equalized the legal status of state and private property. A thorough overhaul of the Civil Code is being planned but will take several years.

**Eliminating the Monopoly of State Ownership**

Unlike in Poland and Yugoslavia, where a significant amount of real property remained in private hands, the state owned or controlled almost all real property in Czechoslovakia during the socialist period. Industrial enterprises and the real property they occupied was all under state ownership, as were most apartment buildings. Although agricultural land was never officially expropriated during the socialist period, rights of use and transfer were allocated to state farms and cooperatives. The only real property that remained in private hands was single-family housing, a few apartment buildings, and the land on which these were built (including small adjacent yards).

Changing the basic definition of property rights to expand the scope for private property is the first, and in some sense the easiest, step in reforming real property rights. Actually implementing these changes in rights, primarily by eliminating this virtual monopoly of state ownership, is much more problematic because of the tremendous distributional implications. The process entails privatizing commercial property through restitution to previous owners or transfers to new purchasers, and developing an
active rental market in property still held by the state.

Restitution. CSFR moved quickly after its 1989 revolution to reverse the nationalizations of the socialist era by returning both real property and businesses to former owners. Four laws govern the restitution process. The first, the "small" restitution, applies to property (mostly apartment houses and small businesses) nationalized between 1955 and 1961 by two sets of government decrees that contravened existing law even at that time. The deadline for claims under this first law was April 1, 1991, and an estimated 70,000 properties were involved. Because the original takings were illegal, restitution under this law has primarily been in-kind.

The second, the "large" restitution law, covers property (mostly companies, including any real property owned by them) nationalized from individuals under prevailing law after the Communists came to power on February 25, 1948. It involves 5-10 percent of all state property, significantly more than the first law. However, it does not cover most of the major nationalizations of large industrial enterprises, which were undertaken by the interim government between 1945 and 1948. The deadline for claims under the second law was October 1, 1991. Restitution under this law has primarily been financial (mostly in vouchers that can be invested in newly-privatized companies or shares in the companies themselves) rather than in-kind, reflecting the promise of compensation in the 1948 nationalization law that was in fact never paid. Emigres were eligible to claim restitution under the first law, but claims under the second were limited to resident citizens. Although many claims under these two laws have been settled, many disputes (often between restituted owners and existing tenants) are now entering the courts.

The third restitution law concerns agricultural and forestry land. The land law gives use and transfer rights to such land back to the legal owners, provided they are resident citizens. It could apply to as many as 3.5 million title-holders, despite the fact that less than 500,000 are still engaged in agriculture. There is widespread concern that this restitution not disrupt agricultural production. The deadline for claims was December 31, 1992.

Finally, a fourth law, adopted by the Parliament in April 1992, returns land confiscated from ethnic Germans and Hungarians after World War II, as long as the former owners remained in the country and regained their citizenship.

This patchy and complex legal framework has left many problems in its wake. First, the heavy reliance on restitution-in-kind (particularly in the first law) has led to many disputes—often between competing claimants or between former owners and current tenants—that are now beginning to clog the court system. Second, the legal precedence given restitution over privatization has created great uncertainty among potential investors and has complicated privatization, particularly in the case of small businesses and housing. Finally, restitution is poorly coordinated with other laws that restrict the ownership rights of new owners. The most important of these involve housing. New private owners of apartment buildings are still subject to rent control and limitations on eviction, yet they must assume the costs of maintenance and repairs.

Privatization. Business or residential real property that is not returned in-kind to former owners is potentially available for sale to new owners. In the case of land and buildings used by state-owned enterprises, privatization of real property is one part of the larger task of privatizing the firms themselves. Privatization of state-owned firms is proceeding rapidly in the Czech Republic, perhaps more rapidly than in any other CEE country. Two laws cover the privatization process. The first is the "small privatization" law, pursuant to which some 100,000 small enterprises in the former CSFR (such as retail shops and restaurants) have been sold by local authorities through public auction.
Most sales under this law have involved only machinery, furniture, or inventories. Rights to real property have been included in only a small minority of these cases because of the existence or fear of competing restitution claims. However, a purchaser does acquire the right to rent the premises for 3-5 years at fixed rent, after which the rental contract is subject to renegotiation.

Privatization of larger firms, and the real property on which they sit, is also affected by restitution claims, but to a somewhat lesser extent than in the case of small firms. Over 3000 large companies (over 2000 in the Czech Republic) are being privatized through the "first wave" of the "large privatization" effort in the two republics, and a second wave of similar magnitude will be privatized in 1993. Privatization of the large firms is being accomplished through direct sale to individual purchasers, auction to the public in exchange for vouchers, restitution to former owners, or in many cases some combination of these 3 routes. Unlike in the case of small privatizations, the real estate owned by the firm is generally transferred along with other assets.

Privatization of state-owned housing has been stalled. The last Parliament failed in May, 1992 to pass a draft law pursuant to which houses not already returned to former owners and apartments would be sold by local governments to tenants. The main stumbling point was price—how it would be determined, how much subsidy it would reflect, who would provide credit, and at what rate of interest. The newly-elected legislators are expected to take up the issue again in 1993.

Revising the Regulatory Framework

Rent and tenancy restrictions. The Czech Republic faces an array of regulations on real property that have been carried over from the socialist period but need rethinking as the economy is transformed to a market-based one. Rent and tenancy regulations are among the most distortionary. Rent control has long kept housing rents extremely low, far out of line with rents that would prevail in a free market and even too low to support basic upkeep and maintenance. Although permissible rents were raised in 1992 they are still very low. Combined with this rent control are tight restrictions on eviction. A tenant cannot be evicted unless alternative equivalent housing is found. Given the acute shortage of commercial space in Prague (caused in part by these rent and tenancy regulations that prevent housing from being converted to commercial space), speculation in Prague is leading some private enterprises to buy up available space at very high prices, sometimes paying tenants large sums to leave voluntarily or actually building alternative housing in other areas of the city to meet the legal requirements for eviction. The shortage of space and resulting high prices make it difficult for small entrepreneurs to find affordable space in which to open new businesses.

Land registration. Another critical challenge is updating and modernizing the land registry. Although some transfers and encumbrances continued to be registered in the land registry during the socialist period, not all were registered, and thus the land records for that period are not fully reliable. In particular, many transfers to and among state entities were not recorded.

The land register in the Czech Republic was originally designed on the Austrian model, while that in Slovakia followed the Hungarian one. All transfers made until 1951 were duly entered in the old register, because such entry was the decisive step in gaining firm title under the old Civil Code. From 1951 (when a new Civil Code was adopted) until 1964, the old cadastre continued to exist, but entry in the register was no longer decisive in proving title. Rather, a contract of real estate transfer was decisive if registered with the state notary. The period from 1951 to 1964 is the most unreliable with regard to the accuracy of land transfer and ownership records. In 1964, when the most
recent Civil Code was adopted, the old cadastre books were closed and a new land register was opened. Registration of real estate contracts with the state notary continued to be the decisive step in obtaining firm title. However, because the state notary had a duty to send all contracts for entry in the new register, this register is thought to be quite an accurate record of real estate transfers and encumbrances after 1964.

Mortgage Lending. Real estate mortgages were rarely used after 1949. As in other CEE countries, there was little need for mortgage financing during the socialist period. Housing costs were low, and foreclosure was not a viable option due to the near impossibility of eviction. Because both banks and employers were state-owned, banks could readily garnish wages if needed to satisfy any overdue payments. The concept of a mortgage (or pledge) was omitted altogether from the Civil Code in 1964.

These conditions are changing rapidly, and mortgage lending will need to develop as an independent and viable instrument of finance as the real estate market grows through restitution, privatization, and increased rental of state-owned space. This will require the growth of market-oriented financial institutions, a reintroduction of concepts of collateral security into law and everyday practice, the eventual phase-out of heavily subsidized interest rates, and an easing of foreclosure (and thus presumably eviction) procedures to transform real estate collateral into a true instrument of security. The concept of collateral was reintroduced by a 1988 amendment of the Civil Code in the form of a pledge on immovable property, and it was further expanded to moveable property in the new Commercial Code. In the case of immovable property, the land record is supposed to serve as a central registry to inform third parties and determine priority. It will take time and practice, however, to transform this concept into a practical and widely-used form of security.

Rights to Intellectual Property

The CSFR moved in the late 1980s and early 1990s to update its intellectual property legislation to adapt it to the needs of a market economy. A new trademark law was passed in 1988, and the existing patent and copyright laws underwent major amendments in 1990. The 1990 amendments came on the heels of the U.S.-Czechoslovakia Trade Agreement, which included specific conditionality in this area in return for "most-favored nation" status. These changes have brought Czech legislation generally in line with international norms. In the patent area, for example, the amendments establish a 20-year term for patents (extended from 15 years under the previous version), extend protection to products and processes in all areas of technology, limit the use of compulsory licenses, and make decisions of the patent office subject to judicial review. In the area of copyright, the amendments extend protection to computer programs and data bases, audiovisual works, and sound recordings.

On the international front, the former CSFR has long cooperated in international conventions, although (as noted in Chapter 1) the protection these conventions provide in the country has generally been a matter of domestic law. In the patent and trademark area, the former CSFR (and now the Czech Republic) is signatory to (among others) the Paris Convention for the Protection of Industrial Property (1883) and the most current text of the Madrid Agreement Concerning the International Registration of Marks (Stockholm, 1967). In the copyright area, the former CSFR is a signatory to the Universal Copyright Convention and the Berne Convention (Paris texts of 1971).

As noted in Chapter 1, many uncertainties remain in the transition from the old to the new system (particularly with regard to rights previously conferred through authors' certificates), and enforcement capacity is an issue in all areas of intellectual property law. Although a registration procedure exists, it is often slow, and how a holder of intellectual property rights can in practice protect these
rights if another person infringes them is still uncertain and untested.

Company Law

Historical Background

Czechoslovakia's pre-war company law was contained in its Commercial Code, which followed European norms of the time and was fully in line with the needs of a market economy. The pre-war Commercial Code was abolished in 1950 with the adoption of a new Civil Code. Both were then replaced in 1963 by 3 new Codes—Civil, Economic, and International Trade—which were supposed to represent the full achievement of socialism. Of these, only the International Trade Code followed generally accepted western ideas of contract, as found, for example, in the Hague Convention of 1964, the New York Convention on Prescription of 1973, and the Vienna Convention on sales contracts of 1980.

The CSFR adopted a new company law—the Commercial Code—on January 1, 1992. It is the most comprehensive and arguably the best such law to emerge in Central and Eastern Europe. This Code covers both company law and commercial contracts, replacing the Economic and International Trade Codes passed in 1963, the Law on Joint Stock Companies of 1990,\textsuperscript{15} and former laws on cooperatives. It applies equally to domestic and foreign entrepreneurs and thus also replaces former legislation specifically tailored to foreign investment. It also has a section on unfair competition.

The company section of the Code (Part II) generally follows the German model and sets out four types of companies—the joint stock company, the limited liability company, the "comandite" company, and the unlimited liability company. A separate chapter then covers cooperatives.

Characteristics of a Joint Stock Company

The most formal type of company provided for in the Commercial Code is the joint stock company, or "akciová společnost" (abbreviated as "akc. spol." or "a.s."). It resembles the German AG, the French SA, and the American public corporation. This form is intended to be used by large firms, in which ownership is widespread and thus necessarily separated from management. Tighter regulations and more extensive reporting requirements apply to this form, primarily to protect the public in public offerings and to give shareholders tools to oversee management. About 3000 joint stock companies had been registered by the end of 1991, most being either state-owned enterprises or foreign joint ventures.

Capital and share requirements. Minimum capital of 1,000,000 Kcs. (approximately $35,000) is required to set up a joint stock company. This level of minimum capital is in the middle range for European countries but very high by U.S. standards. It represents a ten-fold increase from the 100,000 Kcs. under the previous joint stock company law. Existing firms were given one year under the law to increase their capital to the 1 million Kcs. minimum or change their form.

Capital contributions can be either in money or in kind. The value of in-kind contributions must be supported by an expert assessment (Para. 165 (2)). At least 30 percent of monetary contributions must be paid in before the first general meeting of shareholders, with the remainder due within one year (or shorter period if so provided in the company's statutes)(Para. 177). In addition to minimum capital, each company must maintain a reserve fund in readily realizable assets, initially 10 percent of capital, to be supplemented each year by at least 5 percent of net profits up to 20 percent of capital.\textsuperscript{16}

The law provides great flexibility in structuring ownership interests in a firm, although it is likely to be some time before
widespread use of elaborate share structures emerges in the Czech setting. Registered or bearer shares are allowed (Para. 156), and the company may, with some limitation, also issue employee shares with certain advantages. Up to one-half a firm’s equity may be in the form of preferred shares (i.e. with a dividend preference and with or without voting rights) (Para. 159). Interest-bearing shares were permitted in the 1990 joint stock company law but are not permitted in the Commercial Code (Para. 159 (2)). The law also allows companies to issue debentures that are convertible into shares within a certain time period (Para. 160).

Shares entitle the holder to dividends and a percentage of assets upon liquidation. Although a one share-one vote rule generally applies, the company statutes may set a maximum number of votes per shareholder. Unlike in Poland, however, it is not possible to assign more than one vote per share.

Corporate governance. In line with the German model, the Code provides that each joint stock company must have both a Board of Directors and a Supervisory Board. The Board of Directors must have at least three members, and they are elected by the general meeting of shareholders (or by the supervisory board if so stipulated in the company statutes) (Para. 194). The Supervisory Board, which oversees the Board of Directors, must also have at least 3 members. In companies with more than 50 employees, one-third of the supervisory board’s members (or up to one-half, if the company statutes so provide) are elected by the employees (following the German model of "codetermination"), with the remainder elected by the general meeting of shareholders (Para. 200). Quorum and voting rules determine the power of individual shareholders to influence outcomes at the general meeting. Pursuant to the law, the presence of shareholders owning at least 30 percent of company equity constitutes a quorum (Para. 185 (1)). and most decisions require majority vote, although either the quorum or the voting rule can be changed by company statute. The flexibility to change these rules, plus the ability to limit the maximum number of votes per shareholder, gives the company wide latitude to separate the power of corporate governance from shareholding status. This might be useful, for example, in negotiations between a foreign investor and local investors or the government, if the domestic partner wants to maintain majority ownership but the foreigner requires veto power over major corporate decisions. In such case, high quorum and/or supramajority voting rules can be used to give the minority shareholder effective veto power, or the voting power of the majority shareholder can be limited to equalize voting power per shareholder.

Characteristics of a Limited Liability Company

The limited liability form of company, or "spolecnost s rucemin omezenym" ("spol. s r.o." or "s.r.o."), is less formal than the joint stock form. It resembles the German GmbH and the French SARL. Because it offers the benefits of limited liability to all investors yet minimizes regulatory and reporting requirements, it is preferred by most small and medium-sized entrepreneurs. The maximum number of participants is 50 (Para. 105 (3). Minimum capital is 100,000 Kcs. (approximately $3500), with at least 20,000 Kcs. from each participant (Para. 109 (1)) (at least 30 percent of which is paid in upon registration (Para. 111)). Because it is intended to be a vehicle for investment by a small group of investors who are acquainted with one another, one participant cannot transfer his share except with the approval of the others (Para. 115).

Rules on corporate governance and reporting requirements are much simpler than in the case of the joint stock company. Rather than a Board of Directors, the limited liability company is managed by one or more "statutory representatives" appointed by the general meeting from among the participants or other persons (Para. 133). As with the joint stock company, rules on required quorum (generally one-half of all voting rights represented) and
voting majority at the general meeting (generally simple majority) are set in the law but can be altered by company statute. A supervisory board is not required but can be set up if the company agreement so stipulates (Para. 137).

**Characteristics of the Two Partnership Forms**

The two partnership forms, the "unlimited liability company" and the "comandite" company, are analogous to general and limited partnerships in the U.S. In the former—"verejna obchodni spolecnost" ("ver.obch.spol." or "v.o.s." or surname plus "a spol." [& co.]), all partners have unlimited joint and several liability with regard to the partnership’s obligations, and they share equally in company profits unless the company agreement stipulates otherwise. Participants choose a commercial director from among themselves, and all have full access to the books and records of the company. In the "comandite" company—"komanditini spolecnost" ("kom. spol." or "k.s."), one or more participants (the general partners) have unlimited liability and responsibility for management, while the liability of the others (the "sleeping" partners) is limited to their capital contribution. In other respects it is similar to the unlimited liability company. Both forms of partnership have an important advantage over the joint stock and limited liability company forms: they are not subject to tax at the entity level under the new tax law in force as of January 1, 1993.

**Setting up a Company**

Although the new Commercial Code establishes a modern and well-designed legal framework for the establishment of companies, the process of actually setting up a company in the Czech Republic can be very complicated indeed. The firm must prepare the company’s founding contract and statutes in the form of a notarized deed, and apply for registration with the commercial registry. The main bureaucratic complaint at the present time is not with notaries or the Commercial Registry, although the latter in particular can be a bit cumbersome. Rather, businessmen and lawyers are now concerned with another law that came into force January 1, 1992—the "Law on the Pursuit of Trade Activities". This law requires most companies to obtain a business license before they can register with the Commercial Registry. Although in theory designed to insure professional competency in technical areas of work, the law appears far more encompassing and restrictive than such a purpose would justify. For example, in many cases the law requires 3 years of apprenticeship before a license can be obtained. The annexes specify certain activities covered by the law, but even unspecified activities require general licenses. A separate application is reportedly needed for each business activity, and a fee of 1000 Kcs. is charged for each application. The applicability of the law and procedures for obtaining licenses are still being worked out, but local lawyers report that the law is causing confusion and delay.

Furthermore, companies must fulfill other bureaucratic requirements before a business license will be issued. For example, a permit from the local council is needed to open a business office. To get this permit the business must show that it has a lease and that the property has been zoned as "commercial" space. If the space is zoned as residential, the owner will have to apply for a "change of use" permit under the Construction Act before the lease will be approved by the local council. If the company is foreign, it must also have a notarized deed of incorporation from its home government with a certified translation into Czech, and it must show a notarized power of attorney for local proxy. If it wants to appoint a foreign manager, it must obtain a residence permit from the Ministry of Interior, which in turn requires a police statement showing a clear criminal record, a medical certificate showing an absence of infectious diseases, and a signed and notarized lease agreement (and, in the case of a sub-lease, a certificate from the owner that the tenant has the right to sublease). In sum,
there are still many bureaucratic hurdles to the opening of a business. They must be satisfied in succession and together are cumbersome and time-consuming. Czech authorities would be well-advised to review the applicability of this law and related requirements and limit them to the extent possible, in order to reduce the barriers to entry for new private entrepreneurs.

Foreign Investment

As noted above, the new Commercial Code applies to both foreign and domestic investors, thus supplanting the previous foreign investment law. The Czech Republic and Slovakia are the only CEE countries so far to have thus eliminated specialized foreign investment legislation from their legal frameworks altogether. Thus, foreigners can generally freely invest in the countries without limitation on size of holdings, sphere of activity, or repatriation of profits, and without prior approval from any government agency. Until 1993 foreign investors received special tax incentives not available to domestic entrepreneurs, including lower income tax rates and discretionary tax holidays. Beginning January 1, 1993, both domestic and foreign entities are subject to the same tax rate of 45 percent.

Most foreign investment is entering the Czech Republic as part of the privatization process, as foreign companies bid to purchase all or part of firms being privatized. The country attracted foreign investment commitments of more than $5 billion from about 180 foreign firms through its first "wave" of privatization (covering more than 900 large companies and 100,000 small ones). Of this, American companies had committed some $1.4 billion as of mid-1992, and German companies some $2.5 billion. Although the basic legal framework for such investment is clear, one unclear area of major concern to these companies is the question of responsibility for environmental liabilities incurred in the past. The Czech authorities are trying to resolve this question by promising indemnification for existing environmental liabilities (within limits) that are unknowable at the time the venture is negotiated, but whether this will suffice in practice is still unclear.

As in most other CEE countries, foreigners cannot own real property in the Czech Republic. This prohibition is contained in the foreign exchange law, which states that a foreign expatriate may acquire ownership rights in real property "by inheritance, marriage, swap, or only when stipulated by a special act." A 100-percent foreign-owned Czech company, in contrast, can purchase immovable property.

Contracts

Features of Socialist Contract Law

Czechoslovakia's prewar legal system was abrogated more completely and systematically during the socialist period than that of many of its socialist neighbors. While the pre-war contract regime survived to some extent in most other CEE countries, Czechoslovakia fully replaced its prewar regime with laws reflecting socialist principles. The first change came with the adoption of a new Civil Code in 1950. Although this code contained extensive socialist phraseology and gave directives of state organs the force of law, it still retained many traditional contract principles and types. This Civil Code was then replaced in the early 1960s by three laws—the Civil Code, the Economic Code, and the Code of International Business Transactions—that were supposed to represent the full achievement of socialism. The Civil Code governed the limited (generally non-commercial) sphere open to private sector transactions, the Economic Code of 1964 governed contracts among legal entities, and the Code of International Business Transactions governed contractual relations between domestic and foreign parties (individuals or firms). Of the three, only the last followed principles of contract common in Western market economies.
The Current Situation

The old legal basis for contracts has been radically transformed since 1990. Czech law on commercial contracts is now contained in two sources, the Civil Code and the new Commercial Code. The Civil Code was extensively amended in 1991 to put private property and private contracts on an equal footing with public ones and to reinstate traditional principles of contract law found in market economies. This law provides underlying general principles of contract, such as offer and acceptance, fraud, duress, mistake, and impossibility, and is considered a broadly acceptable framework within which the practice of private contracting can grow. Although there are plans underway to adopt a new Civil Code altogether, the process is likely to take several years.

The new Commercial Code goes into more detail by providing specific legal rules governing various types of commercial contracts. It addresses not only general contractual concerns, such as what constitutes fulfillment of a contract and remedies for breach, but also provides detailed regulations on many types of contracts—including agreements on the purchase of goods, credit, license of industrial property, storage, contractual work, proxy, commission, inspection, transport, and commercial representation. It also covers agreements in the financial area such as letters of credit, safety deposit, bank accounts, traveler's checks, and security interests. The law thus provides a detailed legal framework that fits into the mainstream of market-oriented commercial practice.

Bankruptcy

The CSFR adopted a new law on Bankruptcy and Settlement in 1992. The law has not yet been widely used due to a moratorium on claims against state-owned enterprises in effect until April, 1993. The law is based on prewar German and Austrian law and focuses on liquidation. Reorganization is not an alternative under the law as in the U.S. ("Chapter 11") or in the new Hungarian law, although a pro-rata reduction in outstanding claims of creditors—requiring approval of those creditors—is envisioned as a way to keep the firm operating as a going concern in lieu of liquidation.

While a more active reorganization option may be advisable, by far the biggest challenge in the area of bankruptcy will be equipping the judicial system to deal with the surge in cases that is likely to emerge as real restructuring of the enterprise sector occurs over the coming months and years. As noted in Chapter 1, a different—perhaps extrajudicial—mechanism may be needed to handle the stock of bad debt of enterprises and banks carried over from socialism, thus freeing the judicial bankruptcy procedure to deal with ailing firms in the newly emerging private sector.

Linked to the legal framework for bankruptcy is that of pre-bankruptcy debt collection, including the possibility for registering and foreclosing on collateral. The system of collateral in the Czech Republic is underdeveloped both in law and in practice. Although lenders are in theory able to take mortgages on real property and register them in the land registry, this has not been a common means of securing loans, primarily because of the impossibility of evicting tenants or residents from housing combined with the availability in practice of other forms of security (such as garnishment of wages). With regard to moveable property, the Civil (Para. 151a) and Commercial (Paras. 297-302) Codes provide a legal basis for using such property as collateral, but because there is no central registry, it is difficult—short of transfer of possession or title—to inform third parties about the claim and thus ensure priority. Providing viable means to mark property serving as collateral, or setting up a central registry for collateral interests in moveable property (as in the U.S.), would help increase the security of loans and improve debt collection.
Antimonopoly Law

Until recently the private sector has been very small in the former CSFR, even by CEE standards. In 1991 it accounted for an estimated 8 percent of GDP and 16 percent of employment. The economy still continues to be dominated by the public sector, primarily large public enterprises. Promoting competition in this environment will require strong and concerted action to break up public monopolies, privatize public firms, open any remaining barriers to foreign competition (both trade and investment), and prevent anticompetitive behavior or mergers among competing firms. Programs of privatization and trade liberalization are both progressing steadily. Breaking up public monopolies and preventing anticompetitive behavior lie within the mandate of antimonopoly law.

The CSFR antimonopoly law, the Law on the Protection of Economic Competition, was passed January 30th and took effect March 31, 1991. It follows closely German and EC law and is quite similar to the Polish antimonopoly law. It is concerned primarily with cartel agreements, mergers, and "dominant" behavior. With regard to cartel agreements, Section 3 prohibits agreements among entrepreneurs to set prices, limit production or sales, divide markets, "tie" purchases of certain products to purchases of other unrelated ones, discriminate against certain purchasers, or restrict others' access to markets. These prohibitions do not apply if the market share of the participants is less than 30 percent of the "relevant market." Section 4 then deals with licensing of intellectual property rights and prohibits licensing agreements that impose unrelated conditions on the transferee. However, Section 5 allows the Competition Office to exempt certain agreements from the prohibitions in Sections 3 and 4 for a set time upon request of the parties "as long as the restriction of competition ... is necessary for reasons of public interest, especially in the production of goods or in support for technological or economic development."

With regard to mergers, Section 8 requires prior approval from the Competition Office of merger agreements that would give the new firm a market share of over 30 percent. The office is to approve the merger if "the loss, which may occur due to the restriction of competition, will be outweighed by the economic benefits provided by the merger."

In line with European emphasis on "dominance," Section 9 requires any firm with at least a 30 percent market share to inform the Competition Office. It prohibits that firm from "abusing" that dominant status through unfair contract terms, "tied" sales, discrimination among purchasers, or monopolistic restriction in production, sales, or technological development.

In delineating the various types of anticompetitive behavior, the law does not distinguish between "horizontal" and "vertical" restraints, although antimonopoly theory in the U.S. and to some extent Europe tends to see horizontal restraints as the most egregious inhibitors of competition. Nor is there a clear distinction between behavior that is always illegal (the "per se" approach) and behavior that is illegal only under certain conditions (the "rule of reason" approach). In almost all cases (except perhaps Section 9) the approach appears to be "rule of reason," because the Office has almost unlimited discretion to grant exemptions from the prohibitions in the law.

Because of the former CSFR's federalist structure, the law set up not one but 3 Competition Offices—one in each republic and a federal one to deal with cases that affect at least 40 percent of the market in both republics (Section 10 (1)). The existence of 3 offices complicated the administration of the law, both because of the diminution in expertise among them and because of unavoidable confusion concerning their respective jurisdictions. The federal office was abolished in late 1992 in preparation for the country's split. All cases in the Czech Republic are now handled by the Czech Competition Office. The powers of this office are broad. It can bring cases on its own initiative or on the request of an outside party, investigate and decide those cases, and impose
fines or demand specific action to undo an identified wrongdoing (Section 11). Its decisions can be appealed to the court by any party within 30 days (Section 13 (2)).

One positive aspect of the law is its linkage with the privatization program. Section 19 requires that the government analyze the market conditions likely to result from a privatization proposal and "to stipulate specific conditions which, when they are met, will terminate the monopolistic status of the former enterprise or will prevent the creation of the monopolistic status of newly created enterprises" (Section 19 (1)). The analysis must be submitted to the relevant Competition Office for comment before a final decision is made on the privatization. This link is intended to help prevent public monopolies from becoming private ones.

As in Hungary and Poland, the impact of the antimonopoly law will depend on how it is applied in practice. As noted in the introductory chapter, it is notoriously difficult—even in the advanced market economies—to distinguish a restraint of trade that harms efficiency from a legitimate business initiative that enhances it. Overzealous enforcement, particularly enforcement that specifically attempts to regulate prices, could do great harm by overruling reasonable business decisions and more generally inhibiting entrepreneurship throughout the economy. On the other hand, it is clear that certain types of highly restrictive monopolistic behavior—such as price fixing among competitors or aggressively freezing new competitors out of the market by refusing to deal with them—need to be stopped. Furthermore, the Competition Offices can fulfill a very valuable public service by being the "advocate" for competition, both by publicizing their own initiatives and decisions and by lobbying more generally for freer international trade. Helping to change public attitudes and educate the public about the benefits of competition may be their most important mission at this time.

Judicial Institutions

As in other CEE countries, judicial institutions in the Czech Republic are ill-prepared to cope with the rapidly emerging challenges of a market economy. The plethora of new legislation in the past 2 years has bred many new types of disputes never before seen by this generation of judges and lawyers. In 1991, some 121,000 commercial cases were filed in the Czech Republic (48,000 in Prague alone). That number is rising rapidly as new restitution cases enter the courts and as the moratorium on bankruptcy claims is lifted.

A new law passed in late July, 1991—the Law on Judges and Courts—restructured the court system to help prepare it for its new role. Courts are divided into 3 levels—the Supreme Court, 12 regional courts, and about 120 local courts. The Supreme Court hears appeals from the district courts, while the district courts hear appeals from the local courts and are the courts of first instance for cases with over 50,000 Kcs. at issue. Pursuant to recent legislation, the Supreme Court and the district courts each have 4 departments—for criminal, civil, administrative, and commercial cases. Property and restitution cases are handled by the civil departments (which, together with criminal departments, were carried over from the previous system), while company and contract cases under the new Commercial Code are handled by the newly-established commercial departments. As of January 1, 1992, the newly-established administration departments can handle citizen's complaints against civil servants once internal avenues of redress have been exhausted, thus potentially providing an important new avenue of protection against arbitrary government acts.

In addition to restructuring the court system, efforts have been made both to give existing and new judges greater independence and to remove judges clearly compromised by the socialist regime. As a result of the purge, combined with the generally low pay and prestige of the profession and the growth of opportunities in private legal practice, there is
now a serious shortage of judges. While demand skyrocketed, the number of judges actually fell in the first two years after the 1989 revolution. It will continue to be very difficult to staff the courts with competent and experienced judges. Incapacity in the court system is likely to be a constraint for some time to come.

Conclusion

Like its CEE neighbors, the Czech Republic is moving rapidly to create a legal framework conducive to private sector development and the growth of a market economy. It has moved extremely quickly on restitution of real property rights, and its new Commercial Code is in many respects a model law for companies and commercial contracts, although its simplicity appears somewhat compromised by continuing bureaucratic interference through other laws and regulations. It has amended its laws on intellectual property, in large part due to prodding from the U.S. and the EC, to bring their levels of protection in line with that of the most advanced market economies. A new competition law provides a reasonable framework for antimonopoly protection, while a new bankruptcy law provides a beginning framework for the liquidation of nonviable enterprises.

As in the rest of the region, there are major challenges ahead to implement the new laws that are now on the books. The interests of former owners of property are clashing with those of current tenants, leading to a surge in new disputes now entering the courts. The surge in cases is likely to be exacerbated as the current moratorium on bankruptcy claims against state enterprises expires in 1993, and as cases under other new laws come on stream. The courts are suffering from recent purges of judges compromised by the former regime as well as low pay and prestige, and they will have difficulty handling the demands of the newly emerging system.
Endnotes

1. For detailed references to Czech legislation mentioned in this chapter, see Gray, "The Legal Framework for Private Sector Activity in the Czech Republic," Vanderbilt Journal of Transnational Law, forthcoming (May 1993).

2. A similar provision existed in the previous constitution but was virtually irrelevant due to the prohibition on private ownership of property.

3. Extreme price variation is one indicator of this disequilibrium. For example, the rental price of refurbished commercial space in a top location in Prague in mid-1992 could reportedly vary from under $100 to $450 per square foot.

4. When Czechoslovakia became an independent state after World War I, the Czech Republic continued to apply the Austrian Civil Code ("Buergurliches Gesetzbuch") of 1811, which had previously been in force in the Czech Kingdom. Slovakia, in contrast, continued to rely on Hungarian law, which at the time had a Commercial Code (dating from 1876) but no unified civil code. In 1950 the existing law in both republics was replaced with a new Civil Code, which included certain socialist principles and included directives of state organs (including the plan) as part of the law. A new Civil Code and an Economic Code were adopted in 1964. George E. Glow, "The Legal System of Czechoslovakia," Modern Legal Systems Cyclopedia, pp. 85-115.

5. Property taken from political parties and churches was thus excluded from restitution.

6. Before the end-February 1992 deadline, every CSFR citizen aged 18 or older was eligible to buy a book of coupons worth 1000 investment points for Kcs 1000. Some 8.5 million citizens—about three-fourths of all adult citizens—purchased coupons. These coupons could be used to purchase shares in individual companies or could be invested in one of several competing investment funds.

7. In most cases the property has been significantly altered since nationalization, so that financial compensation will be provided to former owners rather than restitution-in-kind. Three percent of all privatization receipts are earmarked for a compensation fund for that purpose.

8. The ratio of assets being sold through direct sale to assets being sold via voucher auction is approximately 50:50. The Privatization Ministry in each Republic selects the method among competing proposals put forward by the enterprise itself or outside parties. Several criteria are used to evaluate proposals, including not only price to be paid but also future plans for restructuring, labor use, and additional investment. Each proposal must include a plan for dealing with any restitution claims filed under the large restitution law.

9. An estimated one-fifth of state-owned housing has been returned to former owners under the first and second restitution laws, leaving four-fifths to be covered by a program of housing privatization. Tenants who happen to live in formerly-nationalized apartments are unfortunate in that they will be unable to purchase their apartments at subsidized prices like other tenants.

10. The 1990 Law on Municipalities made local governments the clear owners of publicly-owned apartment buildings.

11. Rent of a 2-room flat doubled in mid-1992 from 100 to 200 Kcs (about $7) per month.
12. The trademark law provides for registration with the Office of Inventions and Discoveries and grants an initial 10-year term of protection that can be extended indefinitely by 10-year periods.

13. The Agreement confirms the commitments made in the Universal Copyright and Berne Conventions and specifically requires 50 year protection for computer programs and databases, audiovisual works, and sound recordings.

14. For example, it reportedly can take one year to register a trademark and 18 months to have it published.

15. The law on Joint Stock Companies of 1990 replaced the extremely outdated 1949 Joint Stock Companies Act and introduced modern company forms (generally along German models) into the country's legal framework.

16. This reserve requirement appears to be quite high and should be reviewed to weigh its supposed benefits against the burden it imposes on the newly emerging private sector.

17. The company may not give more than 5 percent of equity free of charge to employees, and employee shares may be transferred only among current or retired employees (Para. 158).

18. The Board of Directors in this model has somewhat more hands-on responsibility than the outside Board typical of U.S. corporations. It usually meets twice a month. The day-to-day running of the company is the responsibility of the General Manager appointed by the Board. In practice the Supervisory Board is less important (as is also typical in Germany).

19. This is a rather low quorum requirement by international standards. Fifty percent is a more common rule.

20. Certain decisions, such as a change in company statutes, a change in rights attached to particular types of shares, an increase or reduction in equity, and dissolution of the company, require two-thirds majorities in all cases.

21. Although lower than the minimum capital required for a joint stock company, this is still a relatively high level.

22. Although it has long been the rule in the U.S., this pass-through tax treatment, whereby partners are taxed but not the partnership itself, is an innovation in the CEE countries. During the socialist period, all partnerships were taxed as legal entities. Poland, which recently introduced a limited partnership form of company with pass-through tax treatment, is the only other CEE country to adopt this approach so far.

23. The latter is mandatory only in the case of the joint stock company.

24. Although the process of preparing the founding documents can take several weeks, lawyers report that most notaries do not interfere unnecessarily in the substance of the documents as they have been sometimes reported to do, for example, in Poland. The Polish situation may change, however, due to the recent privatization of the profession.

25. There is a 3000 Kcs. (about $110) filing fee for registration.

26. It generally takes a few days for the Commercial Register to review and register company documents, provided they are in proper form. This is very different from the situation in Hungary, for example, where it can take six months to register a company.

27. The law does not apply to certain enumerated professions, such as doctors, lawyers, or accountants, or to firms engaged in certain specialized areas such as banking, mining, energy, agriculture, railroads, telecommunications, pharmaceuticals, or
broadcasting. Separate licenses are required, however, for many of these activities.

28. There is also legal uncertainty with regard to the definitions of "resident" under various laws—the foreign exchange act, the tax law, and the residence permit regulations—and how they interact. Under the former two, being a resident has serious potential consequences for a foreign manager; under the foreign exchange act, a resident is supposed to bring all foreign assets to the Czech Republic, while the tax law imposes worldwide income taxation on residents. Yet, pursuant to the third, the foreigner must get a residence permit to work in country. As these laws are new, lawyers are now grappling with how to deal with them.

29. The 1990 amendments to the 1988 foreign investment law had already significantly liberalized the environment for foreign investment, allowing up to 100 percent foreign ownership, providing guarantees against expropriation, and permitting repatriation of profits in hard currencies (but only subject to availability from the company’s export earnings and after mandatory sale of 30 percent of foreign exchange earnings to the State Bank). All foreign investments under that law required the approval of the Minister of Finance. The law was also an interim step in that disputes with other domestic firms were to be handled by a special judicial body called the State Arbitration rather than by the regular court system.

30. The new Code does have a short section—Chapter II—dealing specifically with "business activities of foreign persons." It applies only to businesses not incorporated under domestic law; foreign-owned Czech firms do not fit within this classification. This section is very liberal, giving foreigners equal rights with domestic entrepreneurs to carry out business, allowing expropriation of property only "by law and in public interest which cannot be satisfied otherwise," and guaranteeing full and immediate compensation in such cases of expropriation. Para. 25.

31. A few sectors of strategic importance may be closed to foreign participation under separate legislation.

32. For 1992, the domestic tax rate was 55 percent. Joint ventures with over 30 percent foreign ownership were subject to a 40 percent rate if net income exceeded 200,000 Kcs., or 20 percent if net income was lower than that amount.

33. Tax holidays of at least one year and (more often two to four years) were available to companies registered before the end of 1992 with a tax liability of less than 1 million Kcs. in the particular calendar year. If the tax liability was greater, the grant of the holiday was discretionary. The amounts saved by the tax holiday were supposed to be reinvested within 2 years in the business. "Legal and Taxation Consequences of Investing in Czechoslovakia", in Czechoslovak Financial Review 2:8, April 15-30, 1992.


35. The moratorium was originally scheduled to end on October 1, 1992, but was reextended by Parliament for another 6 months soon after the original deadline expired.

36. This "compulsory settlement" procedure existed in many CEE countries during the socialist period but was not part of the Czechoslovak socialist legal framework.


38. Prior to the breakup of CSFR, each republic had its own Supreme Court, and there
was a federal Supreme Court to act as final arbiter.

39. In three districts new commercial courts were set up in lieu of specialized departments within the regular district courts.

40. The latter are staffed primarily by former arbitrators from the recently-abolished state arbitration system, which used to decide disputes among state enterprises.

41. Judges generally have life tenure, but it is still possible to remove judges associated with the previous regime.

42. Before November 1989, there were some 1600 judges working in the Czech Republic. This number had fallen to 1300 by April 1991. J. Pehe, "Reforming the Judiciary," Report on Eastern Europe 2:34, August 23, 1991.
HUNGARY

Hungary is on the forefront of legal and economic reform in the CEE region. Although Hungary has long been in the forefront of efforts to reform socialism itself, after 1989 the goals of reform changed from market socialism toward capitalism, as the old Communist regime lost power and the idea of widespread private ownership gained acceptance. The legal framework—the "rules of the game"—is now being geared towards encouraging, protecting, and rewarding entrepreneurs in the private sector.

Constitutional Law

The Historical Setting

No written constitution existed in Hungary before 1949. Rather, constitutional principles were derived from various pieces of legislation, similar to the tradition of England. In Act XX of 1949, the People's Republic of Hungary adopted a constitution based on the Soviet model. Under this constitution the economy was based on the concept of "social ownership of the means of production" (Section 6(1)), a vague notion akin but not identical to state ownership. This constitution also established the primacy of the national economic plan in guiding the economy (Section 7). Not only did state planning control the economy in this and other socialist countries, but, by virtue of appearing in the fundamental law, it governed the entire legal culture in the country as well.

In 1972, this constitution underwent extensive amendment in order to accommodate the New Economic Mechanism of 1968. For example, for the first time it recognized and protected personal property and the economic activities of small-scale private producers of commodities (Sections 11 and 12). Such protection, however, was balanced against the needs of the "public interest," which in practice left great discretion to the state in regulating both state-owned and private business.

The "New" Constitution

On October 18, 1989, Parliament passed the most significant constitutional revisions to date. This amendment is often referred to as the "new" Hungarian Constitution, as approximately 80% of the 1949 version was abrogated. Drafted on the threshold of Hungary's democratic and economic reforms, the amendment was a political compromise between the old school communists and the new generation of politicians gradually replacing them. The new version was subsequently amended several more times in 1990. It is unclear how long this version of the constitution will remain in force. Its preamble envisions it as a transition document, but no further fundamental revision is expected in the near future.

The current Hungarian Constitution is composed of 78 sections falling within 15 chapters:

I. General Provisions
II. Parliament
III. The President
IV. The Constitutional Court
V. Parliamentary Commissioner of Citizens' Rights
VI. State Audit Office
VII. Council of Ministers
VIII. The Armed forces and the Police
IX. The Councils
X. The Judiciary
XI. The Prosecution
XII. Fundamental Rights and Duties
XIII. Fundamental Principles of Elections
XIV. Capital and National Symbols of the Republic of Hungary
XV. Closing Provisions
Much of the amended constitution deals with rights and duties of citizens. Chapter I deems Hungary a democratic constitutional state and asserts its commitment to a market economy and its encouragement of entrepreneurship and competition. It establishes protection of private property, including compensation in the event of expropriation, and general rights to freedom of association. Most of the fundamental rights and duties of citizens are contained in Chapter XII. These include rights to liberty, personal safety, and freedom from torture. Democratic rights, such as freedom of thought, speech, the press, and religion, are also guaranteed. These latter rights, as well as the right to compensation in the event of expropriation, were also guaranteed by Hungary's socialist constitution, but were always subject to the higher "interests of socialism."

Other sections of the constitution promise certain economic rights. Labor is guaranteed "the right to work, to freely choose [a] job and occupation" and "to have an income [commensurate] with the quantity and quality of the work performed by him/her" (Section 70/B). Every woman is guaranteed pre- and post-natal care (Section 66), and children are guaranteed "all the protection and care required for proper physical, mental and moral development" (Section 67). Although laudable in intent, the broad language of these rights may create expectations that Hungary is unable to fulfill.

With regard to the structure of government, section 2 declares Hungary a democratic constitutional state based on the separation of powers among Parliament, the Council of Ministers, and the Judiciary. This is a radical change from the previous system, in which absolute and undivided power was vested in the Communist party. The unicameral Parliament has 386 members elected for four year terms. Its primary legislative duty is to pass laws and constitutional amendments. Any legislation affecting the fundamental rights of citizens must take the form of a Constitutional Act. In light of past practice under socialism, in which Parliament was relatively inactive and the Council of Ministers governed by passing decrees, this requirement that Parliament make the laws is meant to ensure that the democratically elected body governs the citizenry.

Parliament elects Hungary's highest ranking officials, including the President, the Council of Ministers, the Parliamentary Commissioners of Citizens' Rights, the President and Vice-Presidents of the State Audit Office, the President of the Supreme Court, and the Chief Public Prosecutor (Section 19). A member of Parliament, the President, or the Council of Ministers may introduce legislation. After proposals are passed by Parliament, they must be signed by the President to become law. The President may refuse to sign an Act of Parliament by passing questions about the Act to the Constitutional Court. The precise boundaries of presidential power to veto executive decisions of the government remain unclear, but in general the President has much less power than the Presidents of either Poland or the former CSFR.

The Constitution also introduces Hungary's first Constitutional Court. This court is composed of 15 judges elected by Parliament. Each sits for a nine year term, which may be renewed once. These judges are prohibited from political activity and party membership, a restriction that applies to local and county judges as well. The Court's purpose is to interpret the constitutionality of legal rules, including international agreements, and to annul parliamentary acts and other regulations it finds unconstitutional. The power automatically to annul laws and regulations is strong relative to the powers of other constitutional courts in the region. It may also review draft laws before they are voted upon in Parliament, although in reviewing draft laws, the court has sometimes been accused by members of Parliament of impinging on legislative authority. The court has sometimes declined to rule on draft laws in order to avoid violating the principle of separation of powers.

The Hungarian Constitutional Court has extremely broad jurisdiction, perhaps the broadest of any constitutional court in the world.
Valid complaints are not limited to contesting the constitutionality of existing laws and administrative regulations, but they extend even to allegations of "negligence" against the legislature for not having passed a law, if such law's absence creates an unconstitutional situation. If the court agrees that lawmakers should have passed such a law, Parliament is given a limited period of time in which to pass the missing legislation, although the procedure for enforcing this time limit is unclear. One example of this proactive role is the Court's request in January 1990 that Parliament set up an administrative court system by April 30, 1991. In fact, the need for such court system arose in part because of the Constitutional Court's ruling that raising interest rates on housing loans was unconstitutional, because it needed to be passed by a two-thirds Parliamentary majority rather than a simple majority. This ruling stimulated petitions on a wide variety of economic problems not remotely related to the court's role as guardian of the Constitution. The Court believed that an administrative court system was needed to handle these economic cases. Parliament failed to set up such a system, but a crisis was averted because the regular courts decided to take on such administrative cases.

Not only does the Court have broad jurisdiction, but it also allows extremely broad access. Under the court's rules, any citizen is entitled to present a complaint to the court. The rules of open access and permissible claims have led to a virtual flood of cases. About 1500 cases were filed and 235 cases decided in 1990. In 1991, 2200 cases were filed, of which about 400 were accepted for review (the balance being dismissed as moot, repetitive, or otherwise technically flawed) and about 250 were decided. Of these decisions, about 50 resulted in annulment of laws or regulations.

In sum, the Constitutional Court is an important and powerful institution in Hungary, and its activity can have a major impact on private sector development. One landmark decision, for example, declared the original Compensation Act unconstitutional because it unfairly discriminated in favor of former landowners and against owners of other types of assets. Another important decision declared the prohibition of foreign ownership of land to be unconstitutional.

Rights to Real Property

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

Defining Basic Ownership Rights

Apart from the constitution, which gives very general conceptions of property, the most important law in defining fundamental property relations in Hungary over the past 30 years has been the Civil Code of 1959, as amended. Before 1959, property rights were governed by a mixture of numerous laws, collected "customs of judgement," and some decisions of higher courts. The drafting of the Code in 1959 consolidated these various sources. Although modeled after the German Civil Code (Das Bürgerliches Gesetzbuch), the Code was drafted during the socialist period and thus also reflected socialist ideology. The sections on property ownership in particular were perforated with government usurpations of property rights.

As noted in Chapter 1, a common element of socialist law throughout Central and Eastern Europe was the recognition of several categories of property, including social and cooperative ownership, personal property, and private property. In Hungary, these categories and their accompanying rights were set out in Part III of the Civil Code. Assets under "social" ownership included property specifically owned by the state, capital equipment (i.e. major "means of production"), and other property of "crucial importance for the national economy,"
Socialist ownership dominated industry, applying to over 99 percent of Hungary's industrial production. This property was deemed owned "by the entire people" and enjoyed greater legal protection than other forms of property. For example, all Hungarian citizens were obliged to protect state assets, and the Civil Code promised compensation for losses, injury, and death resulting from this duty (Civil Code, Para. 179).

Similar to socialist property was "cooperative" property. When over 90% of Hungary's land was nationalized, it became cooperative property. This differed from socialist property in that it was the "indivisible property of a group of citizens spontaneously associated for common production, distribution, or meeting demands." (Civil Code, Para. 90). While in this form ownership appeared to remain vested in individuals, ownership rights were still limited. Upon the winding-up of the cooperative, the property did not revert to the cooperative's members but continued to be part of the cooperative property, managed by countrywide organs representing the interests of the cooperatives.

"Personal" property was that which served personal needs, including family houses and apartments, vacation homes, furniture, and personal items such as clothes (Civil Code, Para. 91). These items were by law and in practice freely transferable. However, entrepreneurship was stifled by the prohibition of commercial trading; all transfers were supposed to meet only personal or familial needs. Also, separate pieces of legislation restricted the size and number of properties that individuals could own. Families were restricted to owning a maximum of one home (either a house or an apartment), one vacation home, and one agricultural plot. Families acquiring additional property, for example through marriage or inheritance, were by law required to sell the excess.

"Private" property was defined as the individual ownership of means of production. While the Civil Code did recognize "the private property of small producers which serves useful business activity" (Section 93), it also granted the state wide power to restrict its use through taxation or simply by decree.

Hungary has gone far over the past three years in redefining property rights and removing the stigma and legal impediments attached to private ownership. The Constitution and Civil Code have been amended, and many other laws affecting rights in real property have been adopted. Section 9(1) of the newly amended Constitution abolishes the preferential treatment of socialist property by granting private property equal rights and protection. In support of this right, Sections 13 and 14 of the Constitution guarantee compensation in the event of expropriation of property. The Civil Code (Para. 177) also guarantees "adequate compensation" for property expropriated for the public interest. Although under socialism such compensation was rarely paid, Hungary seems to express a greater commitment to abiding by this fundamental principle by elevating this guarantee from the Civil Code to the constitutional level.

As with the Constitution, the most important provisions on property in the Civil Code have been amended. Private ownership is now fully accepted in Hungary, and the privatization program is attempting to transfer the bulk of state assets into private hands. Law XIV of 1991 abolished all forms of socialist ownership, abrogated privileges of state and cooperative ownership as related to private ownership, reviewed the range of exclusive state property and inalienable assets, and empowered the state to cede certain property, such as forests and land, to private owners. Remnants of the prior system in related Code sections are no longer enforced and should be interpreted in the spirit of the recent amendments, a necessary process pending a thorough overhaul of the Civil Code. Although these prejudicial provisions of the Civil Code could perhaps be eliminated with a quick amendment as was done in Poland, the Hungarians have opted to undertake a more systematic revision to the Code over the next several years under the auspices of a special codification committee appointed by the Ministry of Justice.
In the area of real estate, Act I of 1987 on Land\(^*\) (as amended) has been instrumental in freeing up the private market for real estate. This Act, which covers not only land but also buildings and other constructions, defines the rights of owners and users and clarifies conditions for the purchase and sale of real estate. Although somewhat unstable in its specifics due to continual amendment, this Act has served the important function of removing the administrative barriers to private acquisition of real estate. For example, it eliminated the "trustee-management" form of land-holding common during socialist times, and it lifted the former 50 hectare maximum on private land ownership. Now a private Hungarian person (either natural or legal) may acquire real estate without any legal limitation. However, other practical impediments discussed below, such as ambiguity to title and access to credit, continue to retard the development of a real estate market.

Under the Land Law, foreigners are prohibited from owning agricultural land (unless allowed by another law). Foreigners may, however, own non-agricultural land and immovable real property after receiving permission from the Ministry of Finance.\(^*\) This permission is guided by the discretionary standard that the purchase may not "harm the Hungarian State or its autonomy, does not harm local governments,\(^*\) nor cultural and touristic interests." Apparently, Hungarian expatriates whose property was expropriated can secure this permission easily; similarly, foreigners who buy out their partners in a joint venture also tend to obtain permission.

In contrast, Hungarian corporate entities that are either partly or even wholly foreign owned are entitled to own real property under the Foreign Investment Act of 1988, discussed below. The only limitation on this ownership is that, under Section 19, the property must be related to the company's objectives. The original purpose of this limitation was to prevent speculative buying by foreigners; however, real estate development appears to qualify as a proper business purpose.

**Eliminating the Monopoly of State Ownership**

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

On the public side, assigning specific ownership rights to state-owned property (including property of state enterprises, public office buildings, and public housing) to various levels of government is proving problematic in Hungary, as in several other CEE countries. Two recent laws address this thorny question. First, Act LXV of 1990 on Local Government transferred control over all state enterprise property to the State Property Agency responsible for privatizations. Under this law, disputes still persist among the municipalities, the districts, and the State Property Agency as to ownership of enterprise specific property. Second, Act XXXIII of 1991 on the Transfer of State Property to Local Authorities transferred to local governments ownership rights in most other state-owned real property—including apartments, non-residential units such as small shops, and numerous other state-owned buildings.\(^*\) The Ministry of the Interior is charged with implementing this Act by setting up district and county level committees to review each land parcel transfer. With ownership rights comes the clear legal authority to sell this property. Such authority is critical to the development of the real estate market, because it identifies competent sellers to potential buyers, enables enforceable contracts of sale to be concluded, and thus reduces the longstanding dilemma of unclear or clouded title.

**Restitution.** Title to both publicly and privately held real estate is not likely to be complicated by restitution (or "reprivatization") in Hungary as it is in Poland, Romania, East
Germany, the former CSFR, or Slovenia. Hungary’s solution to the perceived injustices caused by socialist expropriations is Law XXC, the Compensation Act of 1991. This law partially compensates both Hungarians and foreigners whose property was expropriated through regulations enacted after 1939. Compensation takes the form of lump sum payments in the form of coupons, the amount of which is determined by the value of the nationalized property. Damages measuring up to HUF 200,000 will be compensated 100%; from HUF 200,001-300,000, 50%; from HUF 300,001-500,000, 30%; and over HUF 500,001, 10%. The maximum payment will be HUF 5 million (Compensation Act, Para. 4).

The coupons function as transferable bearer securities and pay interest (75% of the basic interest rate of the central bank) until the summer of 1994. Compensation coupons may be used as full or partial payment for property sold by the state, including apartments, shares in privatized state-owned industries, and farmland (id., Para. 7-8). A separate law is planned to enable the coupons to be transformed into life annuities to provide social insurance for their holders. It also seems possible to pledge the coupons as collateral for loans (id., Para. 7).

Only former land owners may use their coupons to purchase farmland. Such land will be auctioned and sold to the highest bidder. In theory, former land owners may repurchase their original land, if they prove to be the highest bidder and if their particular parcel is auctioned off. However, the land that will be auctioned is not likely to be the most fertile; the best land is currently held by cooperatives, which are expected to retain possession of their land under the new law on cooperatives (Law I of 1992 on Cooperatives; see also Law II of 1992 on Rules of Transition). Cooperatives are setting aside 2.4 million hectares and state farms about .4 million hectares for compensation auctions.

During the window for submitting claims (August-October 1991), 805,000 individuals submitted 3.3 million claims worth about HUF 60 billion. About 3 million claims refer to confiscated land. Another HUF 20-30 billion in claims are expected from the extension of the Act to cover claims during the 1939-49 period by Jews and Germans; and a final HUF 20 billion from a proposed extension to cover those politically persecuted. In total, it is estimated that the government will pay out a total of about HUF 100 billion (approximately $1.3 billion).

It is expected that about half the vouchers will be used to purchase land and the other half split among apartments, shares in privatized enterprises, rental rights to small shops, and annuities. The distribution of vouchers began March 31, 1992 and is expected to take up to 2 years.

Although Hungary’s solution to the restitution problem avoids much of the inequity and inefficiency created by other countries’ schemes, some doubt its plan will achieve its restitutionary goals. For example, in light of the shortage of attractive privatized assets, vouchers (and shares bought with them) may in fact be worth only 30% of their face value. Furthermore, alternative investment options (e.g. life annuities) will probably yield insignificant regular payments.

Revising the Regulatory Framework

Rent and tenancy restrictions. A large and healthy rental sector is one of the best indicators of a well-functioning real estate market, allowing wide household choice and facilitating labor mobility. Labor mobility is particularly critical during this transition period, as many old enterprises are forced into major restructuring or liquidation and newly emerging private firms expand employment opportunities. Hungary’s restrictive eviction procedures are the key bottleneck to a fluid rental market. As in the case of mortgage foreclosure, landlords seeking to evict tenants who have defaulted on their rent are obliged first to find an alternative unit for the tenants before evicting them. Unlike the case of mortgage default, renters who default on their rent payments are not subject to
garnishment of wages. However, an expedited lease termination procedure is available for certain types of public landlords. The Court Enforcement Office sits at the center of the debt collection and eviction process in Hungary. In 1991, the Budapest Office received about 3,000-4,000 new claims each month for debt collection and had only 16 enforcement officers for the whole city. The Office has not been active in mortgage foreclosures and has rarely pursued evictions in the case of non-payment of rent by renters of privately-owned apartments (of which around 100 private cases were submitted monthly to the Budapest office.) Although courts have rendered thousands of verdicts for eviction, the Office carries out only about 10-30 evictions per year from private rental units, after an average eviction process of 4-5 years.

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

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

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

**Land registration.** As noted earlier, most housing remained in private hands throughout the socialist period. Buyers have always had an incentive to register their purchases in the property registry, because under the Civil Code title passes only when it is recorded in the registry (Para. 117), and registered owners have priority over other claimants (i.e. unrecorded transaction are not enforceable against third parties). Thus, the existing property registry, which is based on the German model, provides adequate proof of private title in many cases, including private houses and apartments.

This is not to say, however, that the land registry is an accurate portrayal of current ownership in the economy. As noted in Chapter 1, some private buyers avoided registration during the socialist period if their individual holdings exceeded permissible levels, and state nationalizations and transfers—particularly transfers of trustee rights sold by state enterprises since the late 1970s—were not usually recorded in the land registry. Furthermore, individual apartments in large state housing developments often went unrecorded. As in many CEE countries, agricultural land records are in the poorest condition because of extensive nationalizations and regrouping of cooperatives. Lengthy delays in the land registration process—six months being the current norm—further heighten uncertainty in real estate transactions.

**Mortgage lending.** On the commercial side, mortgages of real property have long been legally possible in Hungary. The Civil Code provides for the use of real estate (usually the piece of property being financed) as collateral (Paras. 265-269). However, such mortgages have been rare, primarily is because commercial ventures have been rare. However, the availability of local financing of commercial property is now increasing, at least for property
being privatized by the government. The National Bank of Hungary refines credits extended by commercial banks to private Hungarian citizens for purchasing state assets (including real estate) sold by the State Property Agency ("SPA"). Despite this availability of financing, as well as the growing need for commercial mortgages, real estate lenders may be discouraged by the new Bankruptcy Law (discussed below), which grants priority to wages (including severance payments) and tax claims over registered mortgage liens. Direct foreign financing of commercial property development is not possible in practice, as foreign banks are prohibited from registering mortgage liens on Hungarian real estate. Private real estate developers argue that the main constraints to land development are not regulatory—compared with western regulatory hurdles—but are the unrealistically high prices asked by local governments. In addition, local government and SPA requirements for public tenders have tended to stifle deals.

As with commercial property, mortgages on residential real estate have long been legally permissible yet little used in practice. Lenders have been discouraged from making substantial mortgages because of the lack of effective legal mechanisms to repossess the collateral in case of default. Tenant protection laws, grounded in the still-applicable 1971 Housing Act, make foreclosure and eviction a cumbersome if not futile endeavor. Under this law, as noted earlier, those seeking to carry out evictions must provide alternative living quarters—a difficult process giving the shortage of available housing. Because evictions can take up to five years to clear all procedural hurdles, there are few, if any, cases of foreclosure resulting in eviction. Wage garnishment and third party wage guarantees have typically been used as alternatives to secure mortgages, but these alternatives are limited by priorities given to tax, alimony, and other possible claims.

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

By 1989 interest rate subsidies were eliminated so that current loans, when they are issued, carry market interest rates—now about 35% for 15 year fixed rate loans. While interest rate subsidies were eliminated, numerous other up-front subsidies remain, for example, based on the number of children or the purpose of the loan. Because Hungarian banks are inexperienced in underwriting techniques and because fixed rate mortgages are risky in the presence of significant inflation, few mortgages are being written. In practice, banks will make small loans only up to the amount of subsidies covered by the government. Most transactions are conducted in cash.

A final area of concern in financing real property is the legal status of multi-family dwellings, because the availability of clear title to individual units is important if such units are to serve as mortgage collateral. Law Decree 11 of 1977 on Condominiums updates the 1920s condominium law and places Hungary well ahead of many CEE countries. However, inadequacies in the law, particularly in the procedures to secure voting majorities for major decisions, threaten to paralyze the process of renovation and rehabilitation of the Hungarian housing stock.

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

While some existing regulations may no longer be needed, other regulations needed by private real estate developers—such as regulations governing commercial scale residential, commercial, or industrial subdivision of undeveloped land—still do not exist. Nor is there an appropriate regulatory framework governing infrastructure needs and financing for private land development—for example, a framework that would permit exactions, special assessments or land readjustment. A 1991 modification of the Building Law does permit conversion to industrial uses of agricultural land at the urban fringe (usually the most dynamic area for commercial land development) upon payment of a transfer fine to a land protection fund, but the actual impact of such regulation needs to be tested. Rules for real estate brokers and for resolving property valuation disputes are not in place. Finally, building standards are governed by the 1990 National Building Code and the old 1986 Budapest city planning rules. A new Construction Law has yet to be written with affordable building standards for the types of buildings market systems are likely to demand.

Rights to Intellectual Property

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

**Patents and Trademarks**

As in other CEE countries, Hungarian patent law had little meaning within the domestic economy during the socialist period. Just as the state owned most of the physical means of production, so it owned the rights to most inventions used in production. Almost all workers were employees of the state, and there was little competition or reward for entrepreneurship in ideas. The main demand for intellectual property protection arose from foreign firms doing business in Hungary.

Hungary's current domestic legislation on patents stems from the socialist period and includes Patents Act No. II of 1969, Decree-Law No. 5 of 1983 on Patents, and Decree No. 28 of 1978 on the Protection of Industrial Designs. As with many western laws, these laws give an inventor exclusive rights over an invention for 20 years from the date of application. Like other socialist patent legislation and unlike most western law, however, until 1992 Hungarian patent law prohibited certain inventions from being patented, including medicines and chemically fabricated products, food products, and "immoral" or illegal items. A recent amendment to the Patent Act deleted article 6(3) (excluding pharmaceuticals and chemicals from patentability) in order to harmonize the Act with the European norm and allow Hungary to apply for associate membership in the European Patent System. A complete revision of the Patent Act is expected to be presented by 1994.

The law also provides for "compulsory licenses," by which the state can grant use rights
to third parties if an invention has not been sufficiently utilized within three years of its being patented. In this situation, parties may negotiate the proper licensing fee, but if a fee cannot be agreed upon by the patentee and the licensee, it will be fixed by the court. It remains to be seen whether or not this provision will be removed or will remain in place, as a similar provision has remained in Romania’s new patent law of 1991. Practically speaking, however, the compulsory licensing power is unlikely to be used much in practice, as compulsory licenses are often ineffective due to the user’s likely need for the patent holder’s technological expertise and cooperation.

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

All patent applications are submitted to the National Patent Office, which conducts a formal examination of the application. The process takes approximately 18 months, normal by western standards. The application fee itself is nominal (HUF 1000-2000), as is the annual fee (HUF 6000) for the first five years. Thereafter, the fee grows incrementally, reaching HUF 24,000 (approximately $US 300) in the 20th year. Decisions of the Patent Office may be appealed to the Metropolitan or Regional Court, and from there to the Supreme Court.

Trademarks in Hungary are protected by Act No. IX of 1969. This law grants exclusive rights of use and transfer of registered trademarks for an initial period of 10 years, renewable for 10 year periods thereafter. Like patents, trademarks are to be registered at the Patent Office. Fees are HUF 3000 for the first ten years plus and additional HUF 1000 for international registration.

On the international front, Hungary has been a signatory to the Paris Convention for the Protection of Industrial Property (1883) since 1967. As noted in Chapter 1, this convention grants national treatment and right of priority to foreign holders of patents and trademarks. Right of priority lasts six months for trademarks, as opposed to one year for patents. The Paris Convention does, however, provide a bit more substantive protection for trademarks than for patents by automatically protecting well-known marks without requiring that the mark be registered in other member countries. Hungary is also signatory to the most current text of the Madrid Agreement Concerning the International Registration of Marks (Stockholm, 1967).

**Copyright**

The current Hungarian law providing copyright protection is the Hungarian Copyright Act No. III of 1969 (as amended in 1978, implemented by Decree No. 9 of July 12, 1983). This law is considered to be the most advanced of all CEE copyright laws, mainly because it contains some protection for computer programs (since 1983) and is generally consistent with European norms. In keeping with the commonly accepted language of copyright protection, this law protects "literary, scientific and artistic creations." While such language in other countries is often interpreted not to include computer software, the implementing decree of July 12, 1983 explicitly includes "computer programs and the related documentation."

Sound recordings are protected under Decree No. 19 of 1975 on the Protection of Producers of Phonograms. This protection grants producers the exclusive right to reproduce, distribute, or publicly perform the work in question but neglects the more important economic rights to commercial renting and lending. Furthermore, no criminal sanctions protect the rights that are granted in the decree.

Registration of copyrighted work is not required under Hungarian law. Upon creation works are protected. Generally, works are protected for 50 years after the death of the author. Sound recordings, however, are protected for only 20 years.
Chapter V of the Copyright Act lays out certain restrictions on contracting with Hungarian authors or users. Such contracts must be made through intermediary agencies listed in Section 20 of the Implementation Decree. One such agency is ARTISJUS, a governmental agency functioning as a performing rights society, a copyright licensing agency, and a copyright spokesman for the government. In addition, most copyright disputes are mediated by ARTISJUS, although they may be brought before the Metropolitan Court.

Hungary has been a signatory to the Berne Convention, which protects literary, scientific, and artistic works, since 1922. It adheres to the most recent revision of the Berne Convention, the Paris text of 1971, which extends the period of protection from 25 to 50 years. Hungary has also been a signatory to the Universal Copyright Convention since January 1971 (including the Paris Act, July 1974) and the Geneva Phonograms Convention since 1975.

Company Law

Historical Background

The idea of firm-level independence and autonomy is not an entirely new concept in Hungary. From 1875-1948, Hungary’s company law had been developing in tandem with those of its western neighbors. The law was abandoned after the introduction of socialism and, although it was never formally abrogated, it did cease to develop. For two decades after 1948 Hungary followed the classical model of centrally planned socialism. Then, in an attempt to move away from classical socialism toward a socialist market economy, Hungary adopted the New Economic Mechanism in 1968. As noted earlier, the NEM delegated more decision-making to the enterprise level. Enterprises were still expected to meet their production targets under the state economic plan, but they were freer to make their own decisions regarding the means (including labor and investment needs) to meet those ends.

Enterprise autonomy was first legally recognized in Act No. VI of 1977 on State-Owned Enterprises. The true landmark of enterprise management reform, however, appeared with the 1984 amendment to this act, Decree No. 22. The amended act introduced the concept of the self-managed enterprise, whose management could take one of two forms: the enterprise council (a representative body of employees) or the general assembly of employees. As a result of this law, approximately 80% of Hungary’s enterprises became self-managed, while the remainder stayed under central state administrative control.

In the late 1980s Hungary made a series of reforms designed to further its transformation to a market economy. Unlike Poland, it did not revive its prewar company law. Rather, Hungary used the opportunity to draft an entirely new code, the Act on Economic Associations, based upon German and Austrian models. As in other CEE countries, Hungarian company law serves companies being newly established as well as the "corporatization" of formerly state-owned enterprises. The law recognizes a number of business forms of organization, including the joint stock company, the limited liability company, and both general and limited partnerships.

Characteristics of a Joint Stock Company

In Hungary the joint stock company is often referred to as the "company limited by shares" or "share company." It resembles the French (SA), the German (AG), and the American publicly held corporation. It is designated by the letters "Rt." in its name. This form is most appropriate for companies seeking a large number of shareholders and is the most conducive to public offerings.

Capital and share requirements. A joint stock company may be founded by one or more individuals. Minimum capital is very high: HUF 10 million (approximately $130,000), of which at least 30% must be paid in upon
registration. The par value of each share must be at least HUF 10,000 ($130), or a value divisible by 10,000. The total amount of the par value of all shares constitutes the company’s registered capital. The value of non-cash contributions may be included in capital, if checked by an auditor and disclosed by the founders in a written declaration.

This form of company provides the most freely transferable vehicle for investment. Bearer shares are freely transferable, as are registered shares (Sec. 240). The form also offers the greatest flexibility in obtaining capital, although many of the financial instruments envisioned in the Company Act (as discussed below) are not yet used in practice, due in large part to a lack of familiarity by Hungarian investors.

A wide variety of stock classes is authorized by the Company Act, although shares within the same class must have identical face value. Voting rights of different classes of shares may differ without limit, if so specified in the company’s charter. While voting rights are generally proportional to share value, the articles may limit those rights. Preferred shares may be issued that entitle the owner to priority in the distribution of dividends, although the total value of preferred shares may not exceed 50% of the company’s registered capital (Sec. 242). Such preferred shares may carry limited or zero voting rights if so detailed in the company statute. Companies may also issue interest-bearing shares (Sec. 245). This share is a modern hybrid, possessing characteristics of both debt and equity financing. Like debt, interest-bearing shares earn a rate of interest, as determined by the company statute, regardless of whether the company has shown a profit that year. Like equity, such shares may also be entitled to receive dividends. In light of the demands such financing may put on a company, these shares may total only 10% of the company’s share capital. While this share type has not been used much yet in practice, owners of interest-bearing shares are entitled to "the other rights attaching to the share" (Sec. 245), including voting rights. It would also be possible to structure preferred shares without voting rights to resemble interest-bearing shares.

Varied instruments of debt financing, including convertible and preference bonds, are also possible under the Company Act (Sec. 246), although the value of convertible bonds may not exceed 50% of the company’s registered capital. A convertible bond entitles its holder to convert the bond into equity shares on terms detailed in the bond itself, which is favorable to the holder when dividends exceed the bond’s interest payments. A preference bond entitles its holder to the option of buying a proportional number of new shares, should the company decide to issue them. Apparently such a bond may be exchanged for the new shares, but the rate of conversion is an open question. While there is no practice yet, Hungarian lawyers read the statute to allow conversion only at par value, not at market value.

Finally, workers’ shares are envisioned by the Company Act (Sec. 244). These may be distributed to current employees free of charge or at a rate lower than the issuing or market price. Their total may not exceed 10% of the company’s registered capital. The shares may be transferred to other workers and pensioners.

The original version of the Company Act allowed the state to acquire a golden share, which enabled the state to exercise 51% voting power if it owned at least 33.3% of the shares (Sec. 269). Generally, such a golden share is meant to give veto power to its holder over certain company decisions (as indicated in the company statute) that could be harmful to national welfare. This privilege is usually reserved for government and is most often used by governments privatizing industries that they consider strategic for the national economy. It enables them to prevent "undesirable" parties from taking control, without forcing the government to own a full 51%. Use of the golden share by former socialist governments has been looked upon with suspicion, mainly because it locks in government control at the expense of a developing market for corporate control. Although the Hungarian government did seek a golden share in some of its privatized
industries (for example, in the tourism company Ibusz, one of Hungary's most profitable industries) overall golden shares have not been common in Hungary.

Shareholders are entitled to dividends in proportion to their share value, and, in the event of liquidation, to a proportional share of the company assets. The distribution of dividends is at the discretion of the directors, but dividends may not debit the registered capital. All shareholders may attend the general meetings, and those holding voting shares may vote in person or by proxy. A simple majority is needed to elect and recall members of the Board of Directors and the Supervisory Board, to approve the balance sheet and profit distribution, to issue convertible or preference bonds. A three-fourths majority is needed to amend the Articles of Association, modify rights attached to a particular type of share, and merge, dissolve, or convert the company to another form. Because this three-fourths majority is required to make many key business decisions, in practice investors have generally sought this level of control when buying companies privatized through the State Property Agency.

The company law protects the rights of minority shareholders, defined as representing 10% of the shares (or a smaller percentage if included in the company's charter). Such a minority can call a general meeting, place a specific item on the meeting's agenda, and request that the supervisory board examine management's activity (Sections 273-275). Any shareholder or member of the supervisory board may appeal to the Court any decision of the general assembly thought to infringe the Company Law, the articles of association, or any other law (Section 276).

Characteristics of a Limited Liability Company

The limited liability company form resembles the German GmbH and the French SARL. It is identified by the letters "Kft." or "Ltd." appearing after its name. A limited liability company may be founded by one or more individuals, apparently with no maximum limit. Its minimum capital must be HUF one million (approximately $13,000), lower than that for the joint stock company but still a high barrier for new private entrepreneurs. This capital is divided into stakes of a predetermined amount. Each stake must be at least HUF 100,000 and exactly divisible by 10,000 (Section 159). Parties holding a stake in the company are referred to as members. One stake may be held by several individuals, who together are deemed to be one member, who exercise their rights through a common representative, and who are jointly liable for the obligations of the members. Each member may hold no more than
one stake, but the value of that stake may increase (or decrease) in proportion to his or her contribution (Section 169). Contributions may be either cash or in-kind. Upon foundation of the company, at least 30% of the initial capital (but not be less than HUF 500,000) and at least 50% of each stake must be paid in (Section 160), the rest payable within two years. Members' stakes are freely transferable to any other member of the LLC, but before being sold to outsiders they must first be offered to other members, the company, or someone chosen by the membership. These requirements are absolute, and the deed of association may not stipulate more favorable terms. Unlike the joint stock company, the limited liability company may not recruit contributors through public appeal (Section 156).

Members are entitled to dividends and, in the event of liquidation, assets in proportion to the size of their stakes. Voting rights are determined by the size of each stake; each HUF 10,000 unit entitles its holder to one vote. Thus, each member has at least 10 votes, but variations above this minimum may be determined by the deed of association. Apart from the obligation to pay in one's primary stake, members bear no liability for the LLC's debts.

Members must hold meetings at least once a year. Decisions are passed by simple majority unless otherwise stipulated in the articles. However, members may pass decisions by mail without holding a meeting, subject to the normal requirements for voting majorities, unless any member requests a meeting be convened to discuss the decision. Minority shareholders (i.e. members representing at least 10% of the current registered capital) may call a meeting of all members (Section 190). As with the joint stock company, any amendment to the company's deed of association requires a three-fourths vote.

The LLC may be managed by one or more directors or managers, elected by members representing a majority of the company’s assigned votes to serve for terms of 5 years. A Supervisory Board with at least 3 members is mandatory for the LLC only if its capital exceeds HUF 20 million, the members exceed 25, or the annual average number of employees exceeds 200. In the latter case, one-third of the members of the supervisory board must be elected by the employees as with the joint stock company (Section 13(1-2)). An independent auditor is required if the company's initial capital is greater than HUF 50 million, or if the company is held by one person.

**Characteristics of the Two Partnership Forms**

Two common forms of partnership are included in the Company Act, the general partnership and the limited partnership. In the general partnership, all partners are jointly and severally liable for the partnership's liabilities (Section 55). The limited partnership consists of limited partners, whose liability is limited to their contribution to the partnership, and one or more general partners, who are responsible for actively managing the company and whose liability is unlimited. Both forms are quite flexible, as partners are able to negotiate their own arrangements concerning capital contributions, distribution of profits and losses, and allocation of voting and managerial rights. As is common in CEE countries (with the exception of Poland and the former CSFR), Hungarian partnerships are not pass-through entities and are thus subject to tax at the entity level.

**Setting Up a Company**

The first step in setting up either a joint stock company or a limited liability company is drafting the Articles of Association, which must then be signed by all the founding members and the company attorney (Section 19). Although the Articles must be notarized, this procedure is not so expensive or time-consuming as in some other CEE countries, because the job of notaries is not to approve the form of the documents, but merely to certify that the signatures are authentic.
Within 30 days of the Articles being adopted, the company must apply to the Court of Registration to register the company (Section 23). Included in its application must be a registration fee equalling 2% of the company’s initial capital and a certification from the bank that the initial capital is on deposit. This step is known to be slow—taking on average about 6 months—and cumbersome, although the Court of Registration is now fully computerized. The delay is caused by the enormous backlog of applications, mistakes generated by the relative inexperience of lawyers filing registrations, and careful court scrutiny of each application for conformity to Company Act requirements. If some provisions do not comply with the Act’s formal requirements, the Court may return the Articles for changes. As local lawyers gain more experience with the Company Act, they are using simpler articles of association (which closely track the Act’s language) and are having fewer returned for corrections.

The company attains legal personality upon its registration in the Trade Register (Section 24). It may then access its bank deposit and formally begin its activities. In addition, it may then ratify any actions taken by the founders after adoption of the articles but before company registration.

Foreign Investment

Since Hungary opened its doors to foreign investment in 1988, the country has enjoyed a level of foreign investment unmatched by any other CEE country. This was initially due to Hungary’s original foreign investment law, Act XXIV of 1988, which was the most liberal investment law in the region at that time. The law has been modified periodically since then, but it still retains the basic features that are attractive to foreign investors.

Forms of Investment

The law allows foreign individuals and entities to own up to 100% of a Hungarian investment, including the real property associated with it. The forms for such investment are governed by the Law on Economic Association discussed above and include both incorporated firms and branches. No special permission is needed. In the event of expropriation, the law guarantees foreign investors full compensation in the currency of the original investment.

Profit Repatriation

While the Hungarian forint is not yet formally convertible, the foreign investment law does allow foreign investors to repatriate their forint profits in the currency of the original investment (at the official exchange rate), "provided the company has the equivalent amount in forint on reserve." This language has been a source of confusion for many investors but has been understood to mean that profits must be actually received and deposited in the investor’s account before repatriation is possible. In practice, this means companies must obtain bank certification that the forints have been deposited. And while the law is unclear on the point, some lawyers understand that companies may apply for such certificates only at the year’s end, when the company declares its annual dividend. Other lawyers, however, argue that profits may be repatriated at any point during the year, based on an approved temporary balance sheet and subject to the requirement that the profits be returned to Hungary if there is a negative profit balance at year end.

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

Tax Incentives

Hungary's corporate tax rate is currently 40%, but the foreign investment law offers generous tax incentives to foreign investors (Para. 15 (4)). These incentives are industry
specific and depend upon the amount of foreign investment.\textsuperscript{52} An annex to the Foreign Investment Law identifies areas of particular importance to the Hungarian economy.\textsuperscript{53} If more than 50\% of a company's sales revenue is derived from these activities, the founding capital exceeds 50 million forints, and the foreign contribution is at least 30\%, the company receives a 100\% tax holiday for the first five years, followed by a 60\% holiday for the second five years. Other sectors receive smaller tax benefits. For example, companies receiving a foreign contribution are at least 30\% receive a 60\% tax holiday for the first five years and a 40\% holiday for the second five years. In addition, taxes are rebated on profits reinvested by the foreign partner in Hungary.

On the customs side, foreign investors importing capital equipment will not be charged customs duties if 1) the equipment is part of the foreign investor's contribution, or 2) it is paid for out of the company's hard currency account. If, however, during the subsequent three years the company sells or leases that equipment, then the company must pay the customs duty applicable at the time of importation. Customs free zones for foreign investors are also envisioned by the act. Companies incorporated in these zones will be exempt from Hungarian customs, excise, and exchange control regulations, as well as price controls and state supervisory regulations. They may maintain accounting systems in fully convertible currencies. Companies seeking to incorporate in such zones must obtain approval of the Ministry of Finance. Customs free companies have already been established in certain industries, with special rules on how the plant is built and operated—requiring security fences, guards, and documents—to segregate customs-free goods.

The generous tax incentives offered to foreign investors in Hungary have been widely criticized by economists and tax policy experts. Not only do they discriminate against domestic investment, but tax incentives—holidays, in particular—can cause large revenue loss and severely complicate tax administration. Recognizing these problems, Hungary has moved recently to eliminate these special tax incentives for foreign investments. They are to last for a maximum of 10 years and be available only to companies that are substantially in production before the end of 1993.

\textit{Dispute Resolution}

The Hungarian foreign investment regime gives substantial freedom to private investors to choose the mode and venue for purposes of dispute resolution. Given the relative lack of commercial experience and precedent in the Hungarian legal system, joint venture agreements often provide for arbitration to resolve disputes that may arise. At present approximately half of all disputes are arbitrated through the Hungarian Chamber of Commerce, and about half in other international fora. Apart from the Articles of Association, which must be governed by Hungarian law, any other agreement related to the setting up or operation of a joint venture may be governed by foreign law if the parties so choose.\textsuperscript{54}

Hungary has been a signatory to the International Convention for Settlement of Investment Disputes since October 1986. This Convention guarantees a forum in which private citizens of signatory states may arbitrate against governments of other signatory states.

\textit{Contracts}

\textit{Features of Socialist Contract Law}

Contract law in Hungary, as in all of its European neighbors, has been broadly governed since 1959 by the Civil Code and more specifically by companion laws and implementing regulations and decrees. Two distinct spheres of contractual relations existed during the socialist period: the private and the commercial, or "economic." The private sphere consisted mainly of personal agreements among individuals, usually for small monetary amounts or equivalents. For these contracts, the Civil
Code was and still is adequate to set a framework for bargaining and to resolve any disputes that may arise. Contracts between citizens, or between citizens and economic organizations, did not differ essentially from similar contracts in western market economies, although their scope was influenced by the economic policies of the state—most importantly the restrictions on ownership of private property and the means of production.

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

Like Poland, and the former CSFR, Hungary specifically incorporated socialist principles into its Civil Code. Thus, the civil code allowed for mandatory conclusions of contracts by statute or ministerial decree (Para. 198); nullification of contracts injurious to socialist norms (Para. 200); modification and conclusion of contracts by the courts to further national economic interests (Para. 206); and definition of the contents of contracts (such as prices) by legal rule (as determined by state arbitration), regardless of the wishes of the parties (Para. 226).

Until the 1970s, disputes resulting from socialist contracts were usually withdrawn from the jurisdiction of the courts and relegated to so-called Decisional Committees, which functioned more as administrators of the state plan than impartial jurists.56 Because contracts were designed to implement the central plan and because of the scarcity and monopolization of most resources, the preferred form of remedy in case of breach was specific performance. In contrast, monetary damages tend to be the preferred remedy in a market economy, where the damaged party can typically reenter the market and negotiate another contract for those goods or services.57 In socialist economies there was often no other supplier or purchaser to which the injured party could turn. Furthermore, determining the proper level of damages would not be as straightforward given the absence of market signals.

Compared to other CEE countries, Hungary’s industrial sector is generally thought to have enjoyed relatively greater freedom of contract during the socialist period. Much of this was due to management reform under the New Economic Mechanism of 1968, which shifted more decision-making power from the ministries to the enterprises. Act IV of 1977 significantly modified Hungary’s contract law by reintroducing the concept of freedom of contract into the commercial sphere. While management did enjoy greater independence after the reforms of the late 1960s and 1970s, enterprise output was still expected to meet the goals set by the national economic plan. Moreover, freedom of contract continued to be limited by the scarcity of both economic resources and credits. Thus, freedom of contract was substantially increased but still did not approach that found in western market economies. To this day, many transactions remain governed by the Contract for Delivery of Merchandise (Paras. 379-386) and the Contract for Delivery of Agricultural Produce (Paras. 417-426), which include many obsolete administrative requirements and restrictions.

The Current Situation

Commercial transactions in the economy are increasingly being conducted according to the sections of the Civil Code originally designed for small, noncommercial private transactions. These sections embody standard western contract concepts. They incorporate basic principles of offer, acceptance, and performance. They provide standard terms for about 25 types of transactions, such as sales contracts and real
They also provide legal doctrine to govern usurious interest rates, bad faith dealing, illegal contracts, mistake, deception, duress, capacity, and impossibility of performance.

Because courts have little experience with commercial contract cases, how such provisions will be applied in commercial disputes remains to be seen. Court interpretations and decisions over the coming years will determine the true substance of contract law in Hungary and just how far "freedom of contract" extends, particularly when it collides with other social concerns.

Bankruptcy

The New Bankruptcy Law

The Law on Bankruptcy Procedures, Liquidation Procedures and Final Settlement was passed by Parliament in September, 1991. It provides two alternative avenues for defaulting debtors—reorganization and liquidation. The first avenue, reorganization (or "bankruptcy" in the official Hungarian translation), did not exist under previous law and is similar in purpose to Chapter 11 of the U.S. Bankruptcy Code. It is a workout procedure designed to allow the debtor to achieve a settlement with creditors and continue in operation. The debtor may file for reorganization if it expects that it will otherwise be forced to default on its debts within a year, or if it is already insolvent but its creditors have not yet initiated liquidation. The debtor is indeed obligated under the new law to file for bankruptcy (i.e., reorganization or liquidation) if it is more than 90 days in default.

During reorganization, the current management remains in control of the debtor's assets. After the announcement of the bankruptcy procedure, the debtor is entitled to a 90-day moratorium on monetary claims (other than wages) that have become due. Within 60 days it must prepare a proposal for reorganization to restore solvency, which must then be approved by all creditors present at the hearing called for such purpose. If the proposal is approved, the court declares the bankruptcy procedure concluded within 15 days.

The second procedure, liquidation, can be initiated by the debtor itself or by a creditor. In addition, a reorganization procedure automatically becomes a liquidation one if the debtor and the creditors fail to reach agreement within 90 days. During liquidation, the debtor's assets are managed by a trustee, who is charged with liquidating the debtor's assets and repaying creditors. However, the debtor may still try to reach a settlement with its creditors during liquidation. If such a settlement is reached, the liquidation procedure is suspended. A settlement is approved only if accepted by half of the creditors entitled to vote in each class of creditors, and by creditors representing at least two-thirds of the total claims. The law also contains a "simplified" liquidation procedure for cases where the value of the debtor's assets are insufficient to cover even the costs of liquidation proceedings. In such case assets themselves may be distributed to the creditors.

The new law is different from the previous one in several important respects. First, it establishes time limits on the different stages of the bankruptcy and liquidation process in order to speed up the process. For example, following a petition, the court is required to determine whether to initiate a bankruptcy procedure within 15 days (Section 12), an action that under the old system took up to several months. In the case of petitions for liquidation, the court has to establish the presence or absence of a default within 90 days (Section 27). As noted earlier, there are strict time limits on the preparation and negotiation of a reorganization agreement. The draft law also imposes a maximum of two years for the completion of liquidation.

Second, the law tries carefully to balance the distribution of control over assets and of bargaining power between debtor and creditors. As indicated above, the management of the debtor enterprise effectively retains control and therefore has significant bargaining power during negotiations for a settlement. However, two provisions are introduced to protect creditors. First, creditors may request the court
to appoint a "property supervisor", who has no management powers but nevertheless oversees the financial situation and asset management of the company to protect creditors' rights. Second, the automatic transformation of reorganization into liquidation (Art. 21) in case a settlement is not reached inhibits the debtor's managers from delaying the process or adopting an unduly tough position during negotiations.

Third, the new law encourages reorganization in lieu of liquidation when feasible, and it tries to encourage real as well as financial restructuring to make surviving firms more competitive in the longer-run. The restructuring agreement is required to contain "measures likely to result in the increase of incomes" (Art. 18,1.a). Moreover, the law explicitly mentions that "within the framework of the agreement...creditors or third parties may secure ownership rights in the property of the debtor" (Art. 17). Both provisions increase the likelihood that agreements address not only financial but also real restructuring. The creditors are also allowed to designate persons to monitor the debtor's compliance with the agreement. The ability to monitor increases creditors' confidence in agreements and therefore encourages reorganization.

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

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

Finally, the mandatory filing requirement after 90 days of nonpayment and the unanimous consent requirement for reorganization agreements, both noted earlier, are perhaps overly strict and could reasonably be relaxed.

The Law in Practice

The number of bankruptcy filings has skyrocketed under the new law, the number of filings increasing from 528 in 1991 to 14,300 (4400 as reorganizations and 9900 as liquidations) in 1992. Because the law came into effect January 1, 1992 and requires reporting after 90 days in default, there was a particular surge of 3500 filings in April alone—including 2200 reorganization filings and 1300 liquidation filings.

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

This surge in cases demonstrates the difficulty of applying the traditional solution—judicial bankruptcy proceedings—to the systemic problems of enterprise insolvency in CEE countries. It is highly improbable that any judicial system—much less one with relatively little exposure to economic matters—could handle such a surge in caseload efficiently and effectively. As noted earlier, the judicial route works best at the margin, but other
means may be needed to handle the large systemic problems, which could affect 30-50 percent of the economy. Not only are experienced judges in short supply, but so are qualified trustees. Especially in cases that involve large enterprises, liquidators have to act as corporate managers and financial managers in order to preserve the assets of the enterprise and, whenever viable, to encourage settlements between creditors and debtors. They also need to have legal expertise. The Ministry of Finance has recently increased the pool of liquidators by establishing objective criteria for eligibility and selecting 90 additional liquidators from among numerous applicants. That is, however, still a small number for the thousands of cases now being filed.

Antimonopoly Law

Hungary’s new competition law is Act LXXXVI of 1990 on the Prohibition of Unfair Market Practices, which took effect on January 1, 1991. The law deals with the traditional areas of antimonopoly enforcement, including horizontal and vertical agreements among firms, abuse by a single firm of a dominant position, and merger control, and it sets up a specialized antimonopoly office, the Office of Economic Competition, to enforce these provisions (subject to review upon appeal by the Budapest district court). The law also covers unfair competition and prohibits such activities as misleading advertising or "unfair" acquisition and use of business secrets.

On the topic of horizontal agreements, the law explicitly forbids agreements among competitors concerning such things as price, market division, technological development, or exclusion of certain consumers or input suppliers (Para. 14). However, the approach is a "rule of reason" one rather than the "per se" ban on horizontal cartel arrangements, as there are numerous exceptions to the prohibition, both specific (such as agreements between parties with less than 10 percent of the market) and general (for example, if such agreements are "aimed at stopping abuses of economic superiority" or if "the advantages exceed the disadvantages") (Paras. 15-17). Thus the law provides a relatively weak restriction and gives the antimonopoly office and the courts wide discretion in reviewing cases. While this discretion might help the authorities concentrate scarce administrative resources on certain cases, it weakens the general deterrence power of the law and could lead to long drawn-out arguments on what is or is not a limitation of competition. Hungary might want to consider strengthening the prohibition of horizontal cartel agreements by adopting a "per se" approach.

In the area of vertical agreements, a separate section of the law forbids abuse of a "dominant" position (Para. 20) and includes certain restrictions on vertical agreements. Para. 9 prohibits vertical tying arrangements regardless of the size of the firms involved. Hungary is wise to limit its scrutiny of vertical restrictions to those involving dominant firms, and the same rule should probably apply to tying arrangements.

Also included in the section on dominant firms is any behavior that limits access to the market to new entrants (Article 20). This is extremely important in the Hungarian context if new private firms are to gain access to inputs and distribution networks. However, the Hungarians must be careful not to interpret reasonable market behavior—such as buying in bulk, requiring up-front deposits from purchasers, or raising or lowering prices to consumers—as anticompetitive. In general enforcers should refrain from imposing direct price conditions, concentrating more on conditions of access to the market.

With regard to market structure, the Hungarian law empowers the antimonopoly office to review proposed mergers of large firms (Article 23) and block any that are deemed anticompetitive (Article 24). As with horizontal agreements, there are exceptions to the rule; mergers need not be blocked, for example, if the advantages to competition exceed the disadvantages, or if the merger promotes penetration into foreign markets. Again, the agency is given almost unlimited discretion.
One important element missing from the law is authority of the antimonopoly office to order the break-up of large monopolistic firms. Such authority should exist, particularly in the case of state-owned enterprises being privatized. Such a link between antimonopoly policy and privatization exists in both Poland and the former CSFR and is a useful tool to inhibit the privatization of public monopolies into private ones (which are much harder to control or break-up once in private hands).

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

Judicial Institutions

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

The Court System

There are four types of courts in the Hungarian judicial system: the Supreme Court, county courts, local courts, and special courts. Nationwide there are about 2000 judges, with about 200 unfilled positions. Most cases are brought initially in the local courts, of which there are 102. They are courts of general jurisdiction and hear criminal, civil, and commercial cases. Although the local courts are not divided into chambers, judges do tend to specialize, meaning that in practice cases are heard by judges with some experience in the area. Hungary has a fairly unified court system with few separate specialized courts, except for the Labor Court, the Court of Registration, the Court of Arbitration attached to the Hungarian Chamber of Commerce, and the Military Court.

Appeals from the local courts are to the county courts. There are nineteen county courts in Hungary, as well as the municipal court, which serves the Budapest metropolitan area. This level is divided into three branches: civil, commercial, and criminal. The Budapest municipal court has a separate labor chamber. A county court may act as the court of first instance when the amount in controversy exceeds HUF 3 million—typically disputes between state-owned enterprises—or in claims related to intellectual property, libel, slander, damages caused by state officials, and certain other matters. In such cases, appeal may be made to the Supreme Court. The Supreme Court also guides lower courts by issuing advisory opinions. This judicial guidance role is stipulated in the constitution (Ch. I, sec. 47).

Changes in court organization began in 1989. In 1990 a new law on the promotion and compensation of judges came into effect. Self-governing Judicial Councils were established to appoint court officials and to handle internal disciplinary cases. The latest amendment, Act LXVII of 1991, increases the role of Judicial Councils in court financial decisions and in selection and appointment of judges. The amendment also separates budget and administration of the Supreme Court from the Ministry of Justice, unlike local and county courts which remain subordinated to the Ministry.

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

An area needing particular attention is debt collection. Of the total number of 700,000 law suits filed nationwide in 1991 (a 60 percent increase from the previous year), two-thirds of those cases involved uncollectable debts. Streamlining debt collection, perhaps by allowing private debt collection in uncontested cases or reducing procedural requirements in judicial cases, could relieve much of the current strain on the courts.

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

The Legal Profession

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

Conclusion

Hungary has been on the forefront of CEE countries in reforming its legal framework to promote private sector development. It was among the first to make major changes in its constitution and Civil Code to promote free enterprise and put private property on the same legal footing as state-owned property. It moved quickly to establish a Constitutional Court to protect these legal rights; its Court has extremely broad jurisdiction, and has proven very active in reviewing economic as well as social legislation. With regard to formerly nationalized property, it is the only CEE country to eschew widespread restitution in-kind, opting instead for a coupon scheme that is likely to cause significantly less uncertainty and disruption in property markets. It has basic legislation in place to protect intellectual property and to provide a clear and flexible framework for the setting up of domestic or foreign-owned firms. Finally, new and relatively modern antimonopoly and bankruptcy laws went into effect at the beginning of 1991 and 1992, respectively.

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

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

1. For detailed references to Hungarian legislation mentioned in this Chapter, see Gray, Hanson, and Heller, "Legal Reform for Hungary's Private Sector," The George Washington Journal of International Law and Economics 26:2 (Spring 1993).

2. The New Economic Mechanism was Hungary's first major attempt at economic reform. It maintained national planning but ended the practice of imposing production targets on state-owned enterprises. Rather, a system of economic regulations and incentives (e.g. taxes, prices, and credit policy) was designed to induce firms to meet national planning targets. This experiment was popularly known as "goulash communism." Most of the lessons of that period were, however, negative, as decentralization led to over-investment and lack of fiscal discipline exacerbated macroeconomic imbalances without significantly increasing efficiency. See J. Kornai, "The Hungarian Reform Process: Visions, Hopes, and Reality," Journal of Economic Literature, Vol. XXIV, December, 1986; A. Gelb and C. Gray, The Transformation of Economies in Central and Eastern Europe: Issues, Progress, and Prospects, The World Bank, 1991; and Sajo, Andras, "Diffuse Rights in Search of an Agent: A Property Rights Analysis of the Firm in the Socialist Market Economy," 10 Int. Rev. of Law and Economics 42 (1990).

3. The current Parliament was elected in 1990 based on the negotiations embodied in Act XXXIV of 1989 on the Election of MPs. Rules governing MP status, including immunities, are governed by Act IV of 1990 on the Legal Status of MPs.

4. In enforcing this Parliamentary primacy, the Constitutional Court has several times overruled decrees by the Council of Ministers on the grounds that the decree either conflicts with a law or that the subject of the decree falls within an area that can only be addressed by Parliament through passage of a law. Interview with A. Nemeth, June 5, 1992.

5. See, e.g., "Court Vague on Goncz-Antall Media Debate," Budapest Week, June 11-17, 1992, at 3 (Constitutional Court decision on "the country's hottest political debate since the elections, pitting the [President and Prime Minister] against each other, [concerning] their respective rights to hire and fire people in key positions.").


7. For example, the decisions of Romania's and Poland's Constitutional Courts can be overturned by a two-thirds' vote of their respective Parliaments. In Hungary, the Parliament may not overrule a Constitutional Court decision except by changing the Constitution. For example, in a case concerning the voting rights of expatriate Hungarians, the Parliament passed an Act, the Court struck it down, and the Parliament then implemented the Act by amending the Constitution.

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

2:25, June 21, p. 7. The Court has interpreted its jurisdiction to hear such omission cases to be limited to those situations where the missing regulation is affirmatively required by a higher Act or Decree, or where the omission violates basic rights.


10. A. Nemeth, personal interview, June 5, 1992; see also Pataki, supra note 8, p. 7.

11. Plans to limit this access by requiring the litigant to have a direct interest are under active consideration. Other countries often restrict access to constitutional courts. For example, in the United States one can present a constitutional issue to the Supreme Court only if one has been directly affected by the issue, and the Supreme Court has discretion whether to consider the case.


14. This refers to property set out in both the Civil Code and the Constitution, namely oil and minerals, lakes, rivers and riverbeds, railways, banks, the Post Office, and the telephone, radio, and television networks (Civil Code, Para. 172).


19. Foreigners are defined as natural persons who are not Hungarian citizens, Hungarian citizens domiciled abroad, and business organizations not created under Hungarian law. An exception for Hungarians domiciled abroad allows them to own property through inheritance.

20. Local governments have the power to veto a sale. See Invest in Hungary, 1991/6 at 29.

21. This act also transfers historical architecture (para. 3), undeveloped land not covered by the Transformation Act XIII of 1989 (para. 9), public utilities exclusively serving that community (para. 11), public transportation (para. 14), and certain parks (para. 25). Conflicting claims now exist between the two levels of local government, the municipalities and the districts, although it is generally anticipated that the districts will assume ownership rights. Buildings on plots of land larger than 1000 square meters are transferred to the State Property Agency, and former Party property is transferred to the Hungarian Treasury Trust under the Ministry of Finance.

22. The original draft Compensation Act of April, 1990, allowed former farmland owners to exchange their compensation coupons for their original land. The Constitutional Court declared this unconstitutional, as it discriminated against former owners of urban and industrial property, who were given coupons but not the possibility of in-kind restitution.
23. The draft Rental Housing Bill currently being discussed would begin the process of removing some of the worst constraints on eviction, particularly by eliminating the requirement that an alternative unit be provided.

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


26. Sagari and Chiquier, id.

27. After being rejected on procedural grounds in 1990 by the Constitutional Court, the law was correctly passed in mid-1991. The law gave borrowers three options: (1) to have the loan converted to a 15% fixed rate loan with the possibility of having the rate adjusted from year to year; or to have half the loan forgiven -- that is, bought out by the government -- and the other half (2) repaid in full by the borrower or (3) converted to a market rate loan. To the government's surprise, over 40% paid back the loan, an indication of the monetary overhang in the economy; about 40% converted to market rate loan and the balance took the 15% loan. Hegedus and Tosics, "East European Housing in Transition: The Case of Hungary," unpublished mimeo, at p. 29 (1991).

28. The primary mortgage lenders are the National Savings Bank and the Cooperative Savings Bank. Under their policy, loan maximums are set such that households pay no more than one third of verified household net income.

29. Patentable inventions must be novel, meaning that the public must not have access to the design through the print media or common knowledge or practice.

30. A non-exhaustive list of protected works, similar to Art. 2(1) of the Berne Convention, appears in the Decree of the Minister of Culture of December 29, 1969 (as amended through August 24, 1988).

31. A related advance in this field is the recent Act on the Protection of the Topography of the Microelectronic Semiconductor Products.


33. The international norm for such protection is 50 years.

34. Self-management was a concept that had been followed in neighboring Yugoslavia since the early 1950s. For one view of its economic impact, see M. Hinds, "Issues in the Introduction of Market Forces in Eastern European Socialist Economies," World Bank, 1990.


36. Corporatization refers to the legal transformation of state owned enterprises into corporate forms set out in the Act on Economic Associations. The process by which this is accomplished is dictated by the Transformation Act (Act XIII of 1989 on the Conversion of Economic Organizations and Business Associations).

37. The limited liability form had been available for use since 1972, but this was restricted to joint ventures with foreign participation.
38. Such a high minimum capital requirement discourages the formation of companies and would seem inadvisable for Hungary at this time.

39. While not explicitly stated in the law, it is presumed that the Court of Registration, in reviewing the Articles of Association, may challenge this valuation.

40. Foreigners may acquire bearer shares, but these must be converted into registered shares within three months of acquisition.

41. If dividends due on preferred non-voting shares are not paid for two consecutive years, those shareholders are entitled to voting rights until those dividends are distributed.

42. For example, the articles of association of Rolls Royce in Great Britain allow the government to control voting concerning its "nuclear business," and the articles of the British Airport Authority subject the disposal of airports to the government's consent. Graham, "All that Glitters: Golden Shares and Privatised Enterprises," 9 The Company Lawyer 23.

43. See the Ibusz prospectus found in the First Privatization Program, State Property Agency, Budapest, 1990. In April 1992 a golden share was used in the privatization of the Hungarian State Insurance Co. Dutch Aegon bought 75% of the shares, but for five years major decisions such as capital increase or decrease would have to be approved by the Hungarian partner.

44. These shareholders must hold voting shares. Also, if these two requests are not honored, the Court of Registration has the authority to enforce the requests.

45. Some other European countries impose a maximum limit (such as 50) on the number of partners in this form of company in order to differentiate it more clearly from the joint stock form and force conversion to the latter form (with its stricter capital and information requirements) as the company grows in size.

46. This is different from the stricter rule found in some other European countries that a stake cannot be sold to outsiders without the express and unanimous permission of insiders. What constitutes a valid offer in the LLC case is somewhat unclear under the Hungarian formulation. The ability to formulate a tighter preemption rule under a separate shareholders' agreement is another reason that some foreign investors prefer the joint stock form.

47. In an apparent effort to protect creditors, the Company Act limits natural individuals to membership in one business organization in which he or she carries unlimited liability.

48. As of the end of 1992, some $3.5 billion of foreign capital (half the total foreign capital in all CEE) had been invested in about 12,000 joint ventures and 2,000 representative offices. Many of the joint ventures, however, were set up to take advantage of favorable tax and customs benefits and involve minimal foreign participation.

49. A previous requirement that the Minister of Finance and the Minister of Commerce approve foreign ownership exceeding 50% was repealed in 1990.

50. The foreign investor is also entitled to this repatriation right if the company is liquidated or the foreign investor sells his interest. Additionally, 50% of the taxed personal income of foreign managerial employees may be fully repatriated.

52. Earlier versions of this law granted an automatic 20% tax cut for companies with foreign equity of at least 20% or HUF 5 million.

53. These include electronics, car parts, machinery, engineering units, pharmaceuticals, packaging technology, agricultural and food technology, energy conservation, telecommunications, tourism, and public transportation.

54. The hotels covered by this section include not only those constructed by the company in question (Para. 15 (2)(a)), but also renovations that classify a building as a hotel or that upgrade a preexisting hotel to a higher classification (Para. 15 (3)(b)).

55. For example, Swiss law is commonly chosen to govern shareholders' agreements.

56. This mechanism was abolished in the early 1970s, after which inter-enterprise disputes were heard by the county courts.

57. In the interests of efficiency, western contract law allows parties to breach contracts if such breach is in their economic interest.


59. Although strict time limits are advisable, almost all observers agree that 90 days is too short.

60. Bankruptcy laws in most countries do not seek unanimous agreement for the approval of an agreement. In that respect, the Hungarian law is stricter.

61. This includes banks, suppliers, and the social security fund. Until 1991, suppliers were the most active in bringing cases against debtors; of 528 petitions in that year, only 8 were from banks and 5 from the social security fund.

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

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

64. These are filings for liquidations under the old law. K. Mizsei, "The Hungarian Transformation: A Middle of the Road Assessment," unpublished manuscript, April 1992, p. 52.

65. World Bank data.

66. As mentioned in Chapters 1, 5, and 7, integrated programs of bank restructuring, enterprise restructuring, privatization, and liquidation of insolvent state-owned firms—primarily using non-judicial means—are now under discussion in Poland and Slovenia.

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

68. Hungary’s concern with rules of competition actually began in the late 1960s, with its moves toward decentralized market socialism. As part of the reforms instituted under the New Economic Mechanism (1968), Hungary revitalized its original Act on Unfair Economic Competition (Act No. V on the Prohibition of Unfair Competition of 1923) through numerous governmental decrees. These rules were updated in 1984 with the adoption of Act No. IV on the Prohibition of Unfair Business Activities.

69. Claims concerning unfair competition can be brought only to the court, while those concerning freedom and fairness of competition or consumer fraud can be brought to either the court or the Office of Competition.


71. A dominant firm is defined as one having over 30 percent market share.

72. Firms must prenotify the office if they jointly have a 30 percent market share or if their joint turnover in the previous year exceeded HF 10 billion.

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

74. One area under active discussion involves overhaul of the court structure: whether a four level court system should be introduced or a modification of the current system is adequate, and whether the Ministry of Justice or the self-governing Judicial Councils should be the guarantor of the lawfulness of court procedures.

75. See Ostas, supra note 58, at p. 9.
Poland has a rich legal tradition dating from pre-socialist times. Unlike the former Czech, which largely began anew in 1990, Poland has revived its pre-war legal traditions where feasible. While many of the current laws are old (for example, the company law—the Commercial Code—and the Bankruptcy Law date from the 1930s), most are flexible enough to permit a wide range of modern market-oriented activity. Underlying property and contract rights are laid out in the 1964 Civil Code, modelled closely after the French Napoleonic Code. Although adopted under the socialist regime, the Civil Code was drafted by law professors and—after being recently purged of socialist rhetoric—is suitable for a market economy. Recent legislation—including the 1990 Antimonopoly Law and the recently adopted Securities and Foreign Investment Laws—appears to be quite well-designed for private sector development. As in other CEE countries, the most problematic area (apart from privatization, which is not discussed here) is property law, which is still—in the words of one Polish legal practitioner—a "jungle".

Constitutional Law

Poland has a long a sophisticated tradition of constitutional rule. It was in fact the second nation in history to adopt a written constitution—in 1791 (soon after the U.S.). The current constitution dates from the socialist period. The 1952 constitution still in force today was originally modeled on the 1936 Soviet constitution, and extensive amendments were made in 1976 in an attempt to solidify the rule of the Communist Party. These amendments were vigorously opposed by the intelligentsia and the Catholic Church. Political and economic reforms in the early 1980s led to further constitutional amendments that introduced more democratic principles, such as judicial review and a multi-party political system. More recent amendments in the early 1990s removed fundamental socialist conceptions, such as the dominant role of the Communist party and the hierarchy of property, and it laid the basis for the full introduction of democratic rule and a market economy.

Although a Constitutional Commission was established in 1989 to prepare a new constitution for the country, progress has been slow. The process has been stalled in part by debates over the proper structure of government—most notably the balance of power between parliament and the President. Furthermore, the Sejm elected in 1989 set aside two-thirds of the seats for the communist party, and was thus not universally considered a legitimate body to make fundamental constitutional decisions. Only in October 1992 was a fully democratic Sejm elected, and it has adopted guidelines for drafting a new constitution. Although both political groups and the public see a strong need for such a document, progress may continue to be slow for political reasons. In the meantime, the current amended version lays a satisfactory basis for market reforms.

Rights to Real Property

Property rights reform has lagged behind legal reforms for general business activity in last few years in Poland. The country is now facing legal dilemmas similar to those encountered in its Central and East European neighbors. In Poland, in contrast to many of its CEE neighbors, private ownership of land remained the rule, not the exception. Only certain land was placed under state ownership, including all of Warsaw, much other urban land, land occupied by state-enterprises, and about 20 percent of agricultural land (primarily in the northwest area recovered from Germany after World War II). Sale of public land was rare in Poland because of the constitutional protections
of state property. Private or cooperative acquisition of state property for construction was instead governed by the principle of perpetual usufruct, a legal form that gave the land user rights similar to ownership, typically for 99 years on payment of a yearly fee. Either private individuals or tenants’ housing cooperatives could hold rights of perpetual usufruct.

Defining Basic Ownership Rights

The 1952 Polish Constitution (Articles 7-8 and 11-13) defined the main categories of ownership, while the details were governed by the 1964 Civil Code. Under Polish socialist law, "social ownership"—including ownership by the state, cooperatives, and social organizations—was the highest category of ownership and was protected by the constitution and the Civil and Criminal Codes. Typically, such property included means of production, including, for example, land, mineral resources, and public utilities. In contrast, property used for personal consumption was individually owned and considered "personal property." Personal property could include, for example, one’s dwelling house but not a separate rental house, which was considered a means of production. Finally, "individual—or private—property" was defined as the individual ownership of means of production, a residue of presocialist economic relationships founded on exploitation and expected to "wither away" over time. Individual property received less constitutional protection than social or personal property and was subject to heavy taxation and numerous limitations on use and transfer.4

On December 29, 1989, the Polish Constitution was amended to eliminate the socialist property classifications and instead treat all types of property equally in civil, administrative, and criminal matters. In particular, Article 7 was amended to read that the Polish state "protects and fully guarantees private property." In 1990, the Civil Code was amended to abolish the distinction between personal and private property.5 In addition to protecting private property, the constitutional amendment also states that "expropriation is permitted only for a public purpose and for just compensation." This amendment narrowed state powers contained in the Land Use and Expropriation of Real Property Act of 1985, and the limits to state power were spelled out further in 1990 amendments to that Act.

Eliminating the Monopoly of State Ownership

The first step in eliminating the monopoly of state ownership is assigning state property to specific government owners. This has so far been a three-step legal process in Poland. First, a 1989 amendment to the Civil Code named the Treasury or other state legal personae as the legal owner of state property, the first step to making such property alienable. Most state enterprises could then become owners of the land and buildings they previously administered. Second, forty years after abolishing local governments, Poland reestablished them in 1990. The Act on Local Autonomy established a framework to assign local governments revenue rights (including taxation) and spending responsibilities (including land use planning, infrastructure provision, and housing management). The implementing regulations transfer without payment certain state property to the local governments, particularly property previously under their "operational administration"—including most urban land, the housing stock, public utilities, and certain state-owned enterprises. Once divided among state actors, state property can then be legally alienated to private investors. Third, 1990 changes to the Land Use and Expropriation Act gave the state and local governments the right to sell land outright, rather than being limited to granting only rights of usufruct.

The process of transferring state property to local governments—"communalization"—began simultaneously in all 2500 communes but is going slowly. Until the process is completed, with the land inventoried, disputes resolved, and land properly registered, local governments cannot make legal transactions to sell communal property.6 Currently local governments are
concluding some short-term leases, typically for high rents and only one-year terms. Generally local governments cannot make available land with clear title for sale or long-term lease, an essential element for sustained private sector investment. Communalization is a key area where technical assistance may be appropriate, particularly to help streamline the process of registration and the adjudication of plots.

**Restitution.** Poland is now struggling with issues of compensation for expropriated former owners: how far back in time to go, whether to offer monetary or in-kind compensation, and what form compensation procedures should take. Plans within the government for resolution of outstanding expropriation claims—"reprivatization"—range from no compensation at all to in-kind return of land, with voucher compensation the most likely. The severity of the problem varies in importance in different parts of the country. All the land in Warsaw was nationalized after World War II, while land in other cities remained in private hands. On the agricultural side, only about 20% of the land is currently in state hands, as noted earlier. Until the reprivatization issue is settled, very little land with clear and indisputable title will be available. Unsettled claims on land make land sales difficult and stalls investment. Reprivatization is an area where technical assistance may be particularly appropriate. Poland is in a position to learn from the other CEE countries, which have already moved ahead with compensation acts. In particular, Poland must carefully weigh the effect of in-kind compensation on the security of title; firms and individuals will be reluctant to invest in property improvements if there is a chance that former owners can successfully reclaim the property at some later date. Other important concerns include the length of claims periods and the effects of alternative reprivatization schemes on fragile registration and court adjudication systems.

**Revising the Regulatory Framework**

**Rent and tenancy restrictions.** Use of state-owned rental housing is strictly controlled. The many restrictions on subleasing and conversion of rental units encourage massive and inefficient evasion, an experience common to socialist economies. Furthermore, rent levels are still controlled by the central government and do not allow local governments even to recover operating costs for housing stock, much less to service debt on infrastructure. Finally, the lack of a functioning foreclosure and eviction system is a key legal obstacle in Poland requiring priority attention: it prevents emergence of a private rental sector, constrains commercial real estate development, and stunts development of a housing finance system, a system which can be an engine for economic development. While a foreclosure and eviction system is in place legally, it has apparently never been used, despite over forty years of mortgage lending. Even as written, the procedure appears cumbersome and ill-suited to the needs of modern mortgage lending. For example, the foreclosure procedure requires the court auction to reflect an ex ante "market" price. New foreclosure procedures that allow property to be securitized but that also fit in with local cultural norms might include forms of pledge, third-party guarantees, and liens on bank accounts and other movable property.

In addition to revising rent and tenancy restrictions, the legal forms for multi-family dwellings need to be reviewed and revised to promote the emergence of a viable real estate industry and eventual housing privatization. Reform of the law on cooperatives has been stalled, and cooperatives still have an unclear status—somewhere between public and private—under the Civil Code's revised property classifications. Numerous restrictions remain on the sale and transfer of cooperative property. At present there is no condominium law, an important legal tool for management of multi-family housing, although a draft has been prepared. Poland also has not yet developed
clear rules for building management in partially privatized buildings.

**Land Registration.** Poland's land registry system is in a state of disarray. Prior to the socialist takeover, three separate registration systems—Russian, German, and Austrian—existed in different parts of the country. Many of these registers are now missing or incomplete. Under socialism, the registration system was largely neglected for land under state ownership. As in other socialist countries, there were significant incentives for both individuals and the state not to comply with registration requirements. Therefore many transfers were not recorded. In Warsaw, for example, the pre-socialist owner is often still listed as the owner of record despite subsequent transfers.

The notarial system is considered by many to be a key constraint to emerging markets in land and housing. All land transactions must by law be notarized to have legal effect. Yet until recently notaries have been state employees; numbers have been inadequate and transactions slow. A recent positive step has been the privatization of state notaries. The property registers have been moved from the neglected state notary bureau into the court system, which however, is not yet well-equipped to administer them. A review and streamlining of the notary process is needed.

**Land Use.** Like other CEE countries, Poland has emerged from socialism with a highly inefficient pattern of urban land use. The Poles made a start towards a modern land use planning system with the passage in late 1991 of the Act on Special Conditions for Realization of Housing Construction in Years 1991-1995 (otherwise known as the "Anti-Crisis Act"). This Act attempts to provide an interim solution by granting municipal councils the authority to amend the official Master Plan of a city and to issue bonds for land purchase or infrastructure development.

In addition to zoning regulations, Poland needs new building standards for the types of office and residential buildings that market systems are likely to produce. Discussions with legal practitioners suggest that, in the current unsettled environment, side payments are often required to secure location and building permits. A new Building Code is currently being considered by Parliament.

There are numerous restrictions on land use and transfer that need to be reviewed and streamlined. These include, for example, the use and transfer restrictions for agricultural land, including prohibitions on conversion of such land to urban and industrial uses. Another restriction that should be reviewed is the requirement that majority foreign-owned corporations get approval from the Ministry of Internal Affairs to purchase land or enter into long-term leases. Although it is understandable that Poland wants to monitor land purchases by foreigners in the short run, given the currently volatile state of land markets, foreign investors should have ready access to business premises. The current approval process can reportedly be a lengthy procedure and can force some foreign investors to rely on the limited available forms of short-term lease.

**Rights to Intellectual Property**

A broad framework for protecting intellectual property has long existed under Polish law. Relevant Polish statues carried over from the socialist period included the Civil and Commercial Codes, the Unfair Competition Law (1926), the Copyright Law (1952), the Law on Inventive Activity (1972), and the Trademark Law (1985). Poland has also long been a signatory to several major international treaties on intellectual property, including, among others, the Paris Convention for the Protection of Industrial Property of 1883 (1967 Stockholm text) (patents and trademarks) and the Universal Copyright Convention. In August, 1990, it ratified the 1971 Paris text of the Berne Convention but limited its adherence to only the administrative provisions.
Although a broad framework has existed for some time, certain types of intellectual property were not well protected by the laws passed during the socialist era. In particular, the 1972 Law on Inventions did not allow patents on certain categories of inventions, including pharmaceuticals and chemicals, and the 1952 Copyright Law did not adequately protect computer software or sound recordings. These omissions were the subject of intense international debate, particularly during negotiations of the recently concluded United States-Poland Treaty Concerning Business and Economic Relations. In the copyright area, this treaty obligated Poland to adhere to the Paris text of the Berne Convention and to extend copyright protection to computer programs. In the patent area, it obligated Poland to extend the length of its patent protection to 20 years and to limit compulsory licenses of patented technology, and to extend the coverage of its patent law to cover pharmaceuticals, foodstuffs, and chemical products. The required changes in patent protection were incorporated in the new patent law adopted in early 1993. The changes in copyright protection are incorporated in a draft copyright law now being debated in the Sejm.

Administrative and institutional problems within this area of law are similar to those encountered in other areas. The administrative body (the patent office) is not prepared for new and more sophisticated problems. Qualified regulators are scarce, and investigation procedures are weak. As in other areas of law, enforcement proceedings tend to be seen as state intervention, which is still politically unpopular.

Company Law

Historical Background

The current applicable company law in Poland is the Commercial Code of 1934. Although the law fell into disuse during the Communist period, it was never formally abrogated. However, a variety of governmental restrictions (e.g. lack of necessary permits and prohibitive taxation) made this law virtually unusable. During this period, the Commercial Code was not taught in the universities; neither was it a subject for litigation, offering lawyers and judges no experience with its application. Thus, the Commercial Code faded from Poland's legal memory until the 1980s, when it was revitalized in order to accommodate Poland's economic liberalization. The comeback started with the Law on State Enterprises of 1982, which opened up the possibility of creating joint ventures with foreign or domestic partners. The first Foreign Investment Law (passed in 1986) and the later Foreign Investment Laws of 1988 and 1991 called for foreign investment to be organized in the company forms provided in the Commercial Code.

While specific provisions in the Commercial Code could be slightly modernized, the consensus of lawyers in Warsaw is that these forms are adequate for the formation of private companies. The two corporate forms allowed by the Commercial Code are the joint stock company (JSC) and the limited liability company (LLC). As noted in more detail below, there is relatively little difference between the two (less than between the two analogous forms in other market economies); the LLC is the preferred form for most investors, because it is more flexible and less cumbersome bureaucratically. In addition to these two corporate forms, businesses can operate through one of three partnership forms, the Registered Partnership, the Limited Partnership (both governed by the Commercial Code), or the Civil Partnership (governed by the Civil Code).

Characteristics of a Joint Stock Company

Capital and share requirements. As mentioned above, the Polish joint stock company resembles most closely the French SA. At least three founders are necessary, unless the State is a founder (in which case no co-founders are necessary). Minimum capital of 1 billion zlotys (about US$72,000) is required. This may
include the value of in-kind contributions, which are evaluated by private auditors and confirmed by court-appointed experts. Valuation of assets in all the CEE countries has been a great problem in privatization, and the same problems could prevail in valuation for the purposes of determining a company's initial capital.¹⁵

The Commercial Code's provisions on the joint stock company incorporate the principles of transparency common to western corporations statutes. Disclosure requirements make financial data on companies available at both the court of registration and the Ministry of Industry and Trade, and announcements of public subscriptions, including investor information, are mandatory.

Both registered and bearer shares are allowed, and these are exchangeable for one another unless otherwise stipulated in the articles of association.¹⁶ Shares are transferable, but the articles of incorporation may stipulate that registered shares may be transferred only with permission of the company (i.e. the Board of Directors) or they may otherwise restrict transfer of shares. However, if the articles of association do not provide a mechanism for identifying another purchaser, the seller may sell his shares freely.¹⁷

Shareholders are entitled to dividends and to a return of the company's assets in the event of liquidation. Interest bearing shares are not allowed.¹⁸ This distinguishes Poland's law from that of Hungary, which does allow for the issuance of interest-bearing shares. A share entitles its holder to at least one vote at the appropriate meetings; there are no non-voting shares, although "a company's articles may restrict the voting power of shareholders holding a larger number of shares" (Article 404). Certain shares may be assigned preferences with regard to voting rights (with a maximum of five votes per share), dividends, or claims on assets in the event of dissolution, with terms to be defined by the company's articles of association. Also, certain registered shares (which may be transferred only with the company's consent) may be linked to the obligation of repeated non-pecuniary performance for the benefit of the company. These provisions that differentiate the rights and obligations of various shareholders enable control to be concentrated more than ownership, which may be helpful in addressing the Polish desire for widespread ownership of privatized companies while maintaining strong corporate governance.

**Characteristics of a Limited Liability Company**

Although not fundamentally different in concept, the Polish limited liability company is a more flexible form than the joint stock company and is therefore preferred by most domestic and foreign investors. Only one founder is necessary, and there is no maximum limit on the number of owners. The minimum capital requirement is only 40 million zlotys (about US$3,000). Shareholders are free to negotiate how profits will be distributed, how voting rights will be assigned and exercised, how large the majority vote and quorum must be to validate the shareholders' general meetings, and how rights to choose representatives on the supervisory and management boards will be allocated. A partner's share is transferable by statute, although the law permits the company's articles of association to make transferability contingent upon the consent of the company's board or shareholders. (If consent is refused, the requesting party may appeal in court.) The Polish Commercial Code is even more flexible than most Western company laws, where, for instance, majority and quorum rules cannot generally be changed. As noted in Chapter 1, this flexibility allows partners to a joint venture to arrange a balance of power that reflects their perceived real contribution to the company rather than merely the distribution of shares/ownership.

**Characteristics of the Three Partnership Forms**

The three partnership forms currently in use are the registered partnership, the limited partnership, and the civil partnership. The former two are more flexible than the last and are better suited to larger initiatives where
partners' contributions, rights, and responsibilities are not necessarily equal.

The registered partnership is governed by Section IX of the Commercial Code. It is a general partnership form imposing unlimited ("joint and several") liability on all partners. Partners are free to assign management responsibilities and to define their respective shares in profits and losses through a deed of partnership, but this deed cannot assign management responsibilities to outside third parties to the exclusion of partners, and it cannot limit any partner's access to information about the partnership.

The limited partnership form was added to the Commercial Code in 1991. This partnership form imposes unlimited liability only on the general partners, who are responsible for management and form the Board of Directors. The other partners are passive and their liability is limited to their capital contribution. This is the only company form in Poland to have "pass through" tax treatment, meaning the profits are not taxed at the entity level.

The civil partnership is governed by title XXXI of the Civil Code of 1964 and is a less flexible form intended to cover simple initiatives among a few equally-involved individuals. It is defined as a contract (as evidenced by a "deed of partnership") between two or more persons who bind themselves to attain a common economic objective. Each partner may contribute property, rights, or services to the partnership; the partners' contributions are presumed to be of equal value, and the partners are entitled to share equally in both the company's profits and its losses. The main benefit of this form over no company form at all is that it protects the common property of the group from outside encroachment by third parties. Jointly-held property is not divisible among the partners for the life of the partnership, and a partner may not sell his share. Furthermore, jointly-held property may not be used to satisfy a creditor's claims against an individual partner, although a creditor may seek the dissolution of the partnership in order to gain access to a partner's share. A partner may withdraw from the partnership and recover his original contribution in kind (or its cash value) plus an appropriate portion of the partnership's accrued profits. As with the registered partnership, partners are jointly and severally liable for the obligations of the partnership. Partners are expected to be active, each being "entitled and bound to manage the partnership's affairs."

Setting up a Company

Although the basic framework for company law appears reasonable and admirably flexible, the process of establishing a private company in Poland—while simplified greatly in recent years—continues to require time and expense. Once the articles of association are drafted, they must be approved by a notary. Unlike those of common law systems, civil law notaries take a much more active role in approving official documents. A limited number of notaries have enjoyed a de facto monopoly in the market; they are difficult to find and there is little room for choice among them. Until recently all notaries were state employees. The profession is now privatized and opened to entry. Because Polish notaries have little experience in contemporary corporate forms, they may not understand complex or innovative arrangements, and Polish lawyers report that articles of association must sometimes be simplified in order for the notary to understand them. Notaries often offer advice on the articles' content or have difficulty understanding innovative arrangements. Getting notary approval is reported to be at times a time-consuming and frustrating process. It is also quite expensive, as significant notarial fees must be paid for every notarial act involved in the founding of a company, including approving a company's articles of association and subsequent amendments to them, including increases in capital.

Stamp duties are another cost in starting up a company. These are equivalent to the French "droits d'enregistrement" (registration fees). Stamp duties equal 2% of the company's equity up to 50 million zlotys, plus 1% of the amount from 50-100 million, plus .5% of the amount
Foreign Investment

The currently applicable Law on Foreign Investment was promulgated on June 14, 1991. This law establishes the procedures and conditions for setting up a company with foreign participation. It abolishes some of the administrative barriers to foreign investment contained in the former law (dated December 23, 1988). This is not the only law affecting foreign investment, and some important related provisions are included in other laws—including Foreign Exchange Regulations, the Land Use and Expropriation of Real Property Act, sector-specific laws (such as the Banking, Insurance, and Telecommunications Laws), and the Law on Acquisition of Real Property by Foreigners.

Forms of Ownership

The foreign investment law applies to investment by non-resident legal or natural persons, including Polish nationals. Foreign persons (non-residents) may participate only in companies established in Poland, although they may own up to 100 percent of the shares of such a company. Branches of foreign companies are not permitted under this law, although a separate law regulating foreign branches is expected to be passed in the future. Independent personal services are not explicitly forbidden, but they are not covered by the law and do not enjoy the related protections and benefits.

One of the most important changes introduced in the 1991 law was the abolition of a separate Foreign Investment Agency and the resulting downsizing and streamlining of the approval process. A smaller unit in the Ministry of Ownership Changes is engaged mainly in promotional activities. The authority of government to screen and approve foreign investment is restricted to a small predefined list of "strategic" areas.

Joint ventures with public enterprises continue to require government approval. The required permission may contain conditions for the establishment of the enterprise (such as the ratio of foreign to Polish participation or the
ratio of voting rights), depending on the "subject of activity" of the company. As formulated, Article 19 requires the prior consent of the Ministry of Ownership Changes for a company to diversify its activities. Furthermore, joint ventures with newly-privatizing enterprises situated on public land will need to deal with the government to acquire land rights, and purchases of land by majority foreign-owned firms require the approval of the Interior Ministry. Even if land is not purchased, leasing business premises from the state is itself a cumbersome process. In effect this means that many joint ventures (i.e. all those with state-owned enterprises or on state-owned land) will continue to require government screening and approval. It is unclear to what extent managers of small public enterprises are allowed to negotiate and carry out joint ventures with foreign partners independently.

In sum, formally unrestricted foreign investment is in reality only possible for 100 percent foreign-owned companies or ventures with private Polish partners that do not lease or own real property. While the Polish private sector is a growing part of the economy in trade and services, its role in industrial manufacturing is still very small. Furthermore, access to real property is a problem for both domestic and foreign private firms, and in-depth negotiations with government over real property rights will still be required of all investors for some time to come.

**Profit Repatriation**

The previous law limited profit repatriation to 15 percent of profits except where the firm generated sufficient net foreign exchange earnings to cover the desired repatriation. The new law allows unrestricted repatriation of all profits, a very important change in the eyes of most foreign investors. Another uncertain area under the old law was the transfer abroad of capital gains. The wording of Article 26 suggests that no restrictions are imposed on the transfer of shares inside Poland and the subsequent repatriation of the proceeds as long as the company is not liquidated during the period of tax incentives or within two years afterwards.

**Tax Incentives**

The 1988 Foreign Investment law provided for three-year tax holidays, which could be extended up to three more years by the Minister of Finance upon request. The 1991 law also provides tax incentives for foreign investors, but with greater limitations. A tax credit may be granted by the Minister of Finance to a company that (a) has a foreign capital contribution of at least ECU 2,000,000 (about $US 2.5 million) and (b) operates in regions with high unemployment, is engaged in high-technology activities, or exports at least 20 percent of its production (Article 23). The total amount of the company's tax credit may not exceed the initial capital contributed by the foreign partner.

**Dispute Resolution**

Although disputes arising under this law can be brought in Polish courts under Polish law, this avenue is unlikely to give confidence to most foreign investors. Poland does not accede to the Convention for the International Settlement of Investment Disputes ("ICSID"); however, mechanisms for the settlement of disputes between foreign investors and the government are established in a number of bilateral treaties, including treaties with virtually all major capital-exporting countries.

In sum, the 1991 foreign investment law is an important step forward in removing some of the legal and administrative barriers for foreign direct investment. This step needs to be supported by similar progress in privatization, real property, and tax law and in institutional strengthening throughout the legal system.
Contracts

Features of Socialist Contract Law

Divided and annexed by Prussia, Austria, and Russia in the eighteenth century, an independent Poland re-emerged following the First World War. Civil law at the time of re-emergence reflected a complex mix of foreign laws. The Poles responded with a codification movement designed to unify Polish law. Of relevance to contract law were the 1933 Code of Obligations and two 1936 Acts on negotiable instruments—one governing bills of exchange and the other regulating checks. This codification movement resulted in a contract regime patterned after German and French models. The law was western, complete with doctrines of offer and acceptance, rules of fraud, duress, and undue influence, and a statute of frauds. Under the new political structure after World War II, existing contract law remained in force except where it was inconsistent with socialist principles. Initially, most of Poland's contract law and law of negotiable instruments remained intact. Socialist conceptions of property and the practice of central planning, however, soon required changes in the civil law. From 1945 to 1964 adaptations to the 1933 Code of Obligations came through the promulgation of individual acts and decrees. The aim of 1964 Civil Code was to collect and unify these adaptations.

Polish contract law is still embedded in the Polish Civil Code of 1964, as amended significantly in July, 1990. The 1964 Civil Code reflected a mature system of contract law under socialism. This Code maintained many of the provisions found in the 1933 Code but tacked on a variety of socialist adaptations. The amendments of July 1990 reversed this evolution to recreate a civil law attuned to the market rules of the early 1930s.

A principal feature of the socialist Code, as noted in Chapter 1, was the distinction between contracts between private persons and contracts between state enterprises. With regard to the former (and to contracts between state enterprises and private parties), the law of the 1930s remained intact. Within the realm of activity afforded private persons, parties engaged in contractual conduct in ways similar to that found in western market economies. By contrast, contracting between state enterprises reflected the needs of central planning. The "General Conditions of Sale or Delivery" governed state enterprise contracts in detail, and the state (through the plan) had extensive control over whether commercial entities entered into contracts, with whom they contracted, and what conditions would be contained in their contracts. The Civil Code (Articles 397-404) established the possibility of "pre-contractual liability" for state enterprises, that is, a legal duty for enterprises to enter into contracts in accordance with state plans. Failure to accept a contract offer in harmony with a state target could result in liability (Article 397). Similarly, failure to create an offer in a timely fashion could also lead to damages (Article 384). In addition, once a contract was executed between state enterprises, each party became a fiduciary for the interests of the other (Article 355). Article 2 provided administrative organs with the authority to suspend the operation of the Code, and hence authorized administrative adjustment of contractual terms. Article 386 imposed a duty on all parties to cooperate with such adjustments. Contractual disputes between state enterprises were to be resolved pursuant to a system of state arbitration, not in the courts (Article 398).

Recent reforms have largely removed the legal distinction between contracts between individuals and contracts between state enterprises. First, Article 2, which grants administrative authority to suspend the operation of the Code, has been repealed. All contracts, whether between state enterprises or between private parties, are now governed by the same set of laws. In addition, in 1989 the system of state arbitration was dismantled, and all contractual disputes are now heard by the judiciary. And finally, the system of pre-contractual liability is obsolete given the abolition of central planning.
Another feature of socialist contract law in Poland was the explicit introduction of socialist principles. Socialist practice and ideology in the 1950s seemed to call for a new set of equitable or moral principles to guide business conduct. The Poles responded to these practical and ideological needs by introducing the principle of "social co-existence" into the Civil Code. Article 5 provided: "A right cannot be used in a way which would be in contradiction with the socio-economic purpose of that right or with the principles of social co-existence in the Polish People's Republic." This section was used as a check on excessive use of individual rights and created the opportunity to introduce moral standards into contractual conduct. Article 4 operated in a similar fashion. It stated: "Civil law regulations should be interpreted and applied in accordance with the principles of the political system and the objectives of the Polish People's Republic." Here the Code specifically provided for a political check on the substance of private civil agreements.

These articles have been widely used in judicial practice. For example, Article 4 has been used to protect long-term tenants from the harshness of eviction and to shield debtors from demands to pay interest accumulated over long periods of time. Article 4 was repealed in 1990. Article 5, a variant of which appears in many civil codes around the world, remains in the Code.

*The Current Situation*

The Poles are in the process of crafting a set of contract laws appropriate to a market economy. They started with the existing Civil Code of 1964. Most sections were retained, several sections were deleted, other sections are to be added, while still other sections must be reinterpreted in the light of current necessity. Thus far, the amendment process has emphasized deletions. The first goal of the 1990 amendments was to provide a system of contract law which could be uniformly applied to any type of transaction. The second goal was to provide a uniform contract system for all types of property. These goals have been largely achieved.

Most of the Civil Code does not need to change. Many of the core rules of contracting—such as rules of offer and acceptance or rules relating to performance—were fashioned in the 1933 Law of Obligations and remained in force throughout the decades of central planning. These sections, for the most part, reflect current western practice. Their exact meaning will be filled in over time through practice and judicial interpretation.

The major deletions taken to date—regarding central planning, property concepts, and socialist ideology—are highlighted above. Other deletions will follow. Since the majority of Polish property is still in state hands, some administrative rules regulating exchange of state property are still necessary. These should be phased out in time.

Additions to the Code are currently being considered by a group of scholars empaneled by the Ministry of Justice. This group has three areas of concern. First, the present Code does not provide standard terms for certain types of transactions found in industrialized countries. Rules regulating commercial leases, franchises, and factor leasing are conspicuously absent. The commission is considering such additions. Second, the state of commercial law may be in need of reorganization. The Civil Code regulates sales (Book 3, Title XI) and pledges of personal property (Book 2, Title III). Another body of law regulates mortgages. Still another regulates negotiable instruments (note 54). There is some concern that these various sources of commercial law need to be unified or updated. Third, and perhaps most importantly, the Poles wish to harmonize their Civil Code with the laws and customs of the European Community and with the rules of various international conventions.

*Bankruptcy*

As a concept, bankruptcy is gradually being reintroduced in Poland. The relevant law, the
Bankruptcy Act of 1934, was never formally abolished but was dormant until 1989 and has been used recently only for closures of state-owned enterprises (which is still not a true adversary situation). Western-style bankruptcy procedures will only truly be needed as the private sector grows, with private suppliers and banks who face truly hard budget constraints and thus have a strong incentive to collect on bad debts. Conversely, an absence of efficient bankruptcy procedures and other debt-collection mechanisms will inhibit the growth of the private sector.

The Current Situation

The Polish law (as amended several times, most recently in 1990) appears reasonable in broad terms, providing general procedures for both liquidation and reorganization (under the control of a receiver appointed by the court). Bankruptcy is overseen by a tribunal of the local court. Under the law, either the tribunal, the debtor, or a company's creditors may initiate an investigation. The initiator must prove that the company cannot pay its debts; there are no precise criteria for this standard of proof, although two-weeks of nonpayment is a minimum requirement. The tribunal accepts the case only if the assets of the enterprise are sufficient to cover the procedural costs. This establishes some barrier to legal action and helps to keep trivial cases from clogging the courts. If accepted, the tribunal appoints a judge-commissioner, who then appoints a trustee (receiver). The new trustee manages the company with the mandatory cooperation of the original managers, who lose their management rights (Article 20) but may continue to be involved if deemed appropriate by the trustee and approved by the bankruptcy judge (Article 98). The value of the company's assets and creditors' claims is determined by the tribunal, after which the tribunal either 1) decides how the company will pay its outstanding debts, or 2) liquidates the company. The bankrupt company has the opportunity to present proposals on the future of the company, and outsiders can submit proposals concerning the management takeover and reorganization of the company.

Despite its general reasonableness, it remains to be seen how it will be applied, as very few bankruptcies have actually been carried out pursuant to it. Practice is necessary to fill in more precise rules. Some observers fear the procedure is too complicated to handle the large number of liquidations anticipated in the coming years. As with antimonopoly law, it is important that decisions be publicized to provide guidance to potential creditors, to educate the public and the courts, and to provide an opportunity for debate over the emerging framework.

A Law on the Procedure for Mutual Agreement was also passed in 1934 and is still on the books. This law, modeled after a 1927 German statute and similar to numerous other European precedents of the late 1800s and early 1900s, was meant to provide an alternative to bankruptcy and liquidation by promoting the amicable settlement of debts between an ongoing company and its creditors. The procedure, which can be initiated only by the debtor, is very similar to that of bankruptcy, with (a) the appointment by the court of a judge, (b) the appointment by that judge of a trustee (under a different name), (c) the overseeing by that trustee of the operations of the company while the company prepares a plan to pay off its debts, and (d) the implementation of such plan if agreed to by two-thirds of the creditors (with some protection of the remaining minority from overly onerous terms). The main differences between this procedure and bankruptcy are that only the debtor can bring a mutual agreement case, and the trustee does not have the power to remove the management of the debtor company and take over the enterprise (but can terminate the case and in essence throw it into bankruptcy if the company does not comply with his wishes). It appears that this law (used often before the war) has remained dormant until now because of lack of knowledge of the public, although debtors may choose to use it in the future if it remains on the books because it is more favorable to them than bankruptcy.
Court capacity and training is certain to be a bottleneck to the development of sound bankruptcy precedents and principles. The legal institutions are not prepared for the plethora of bankruptcy cases that may be coming their way. Courts and judges are not adequately trained for bankruptcy cases. The law demands a special judge-commissary to be appointed for every case, which further reduces the already limited operational capabilities of the courts. While special economic courts have been established in Warsaw and some other big cities, the complicated bankruptcy procedures may overwhelm smaller generalized courts.

The availability of receivers (or trustees) is another serious problem. Specialized firms existed in the pre-war period, but the number of present experts is very limited. The law requires that trustees not be associated with the creditors in any way; nor may creditors propose to the court a specific trustee. This is often done, however, in practice.

It has been noted in previous chapters that the judicial bankruptcy process works best on the margin and is not well-designed to deal with the large stock of ailing firms carried over from socialism. Poland is perhaps the most advanced CEE country in designing alternative extra-judicial means to restructure or liquidate such firms. Under a recently approved scheme, banks, as the major enterprise creditors, have the right to conduct and conclude "conciliation procedures" with defaulting debtors (generally loss-making state enterprises) under a special law in effect only for two years. Such procedures are streamlined versions of Chapter 11-style reorganizations, whereby minority creditors can be forced into debt restructuring agreements with enterprises willing to implement credible restructuring plans. Courts will be involved only if appeals are brought by unsatisfied parties to a procedure. This conciliation procedure can help to address the problems of loss-making state enterprises while leaving judicial bankruptcy procedures primarily to the newly emerging private sector.

**Antimonopoly Law**

The Polish Antimonopoly Act of 1990 provides a comprehensive framework for competition law and practice to develop. It establishes broad principles concerning illegal behavior and it sets up a specialized office to prosecute cases (based on complaints filed by individual firms or companies, or on the office's own initiative), with the possibility of appeal to a special antimonopoly branch of the Warsaw district court (and then to the Supreme Court).

The law regulates both market structure and business conduct, and its definition of anticompetitive behavior is all-encompassing. Article 4.1 defines four types of "monopolistic practices": (a) onerous contract terms that yield unjustified benefits; (b) conditioning a contract on the performance by the other party of unrelated services it would not otherwise perform ("tie-ins"); (c) acquisition of shares or property of other companies, if it results in "major weakening of competition"; and (d) interlocking directorates or supervisory councils of more than one competing company if one controls more than 10 percent of the market. Article 4.2 adds to this list (a) direct or indirect price-fixing among competitors; (b) geographical or product-specific market-division agreements among competitors; (c) restriction of output, sales, or procurement; (d) limiting market access of third parties ("group boycotts"); and (e) fixing the terms of contracts with third parties (such as "resale price maintenance"). Article 5 defines as monopolistic the abuse of a "dominant" position and names several examples of such abuse—including market division, price discrimination, refusal to deal, resale price maintenance, and predatory pricing. Article 7 forbids monopolies or firms with monopoly-like dominant positions from cutting output or suspending sales to increase prices, or from imposing "exorbitant prices".

While the law is all-encompassing, it adopts a "rule of reason" approach in most cases, giving virtually unlimited discretion to the antimonopoly office to decide which cases to prosecute. Yet the wording implies that the
named practices are prima facie illegal, i.e. that, if charged, the burden of proof lies with the company; under Article 6, the practices defined in Articles 4 and 5 (i.e. "monopolistic practices" and "abuse of a dominant position") are prohibited "unless they are indispensable to the conduct of economic activity and do not cause a significant curtailment of competition." The practices of actual monopolies listed in Article 7 are per se prohibited.

If any of these practices are ruled anticompetitive, the Antimonopoly Office has broad powers to order the abandonment of such practices, impose a monetary fine of up to 15 percent of the offender’s annual income in the previous year, roll back prices, or even order the break-up or dissolution of violators with a dominant position. It also has the authority to review all proposed mergers and acquisitions (with no minimum size limit). The law gives it broad powers of investigation in line with this broad mandate.

The Polish Antimonopoly Office is made up of over 100 economists/lawyers in the headquarters and 8 regional offices. Because of the newness of this office, the enormous degree of change required in Polish industrial structure, and the complexity of antitrust analysis in general, the office is likely to make many questionable rulings in the early years. The office should be required to publicize its studies and rulings. Given the generality of the law, the rulings are going to define what the law actually is, and it is important that business can have access to this developing body of practice so that they can adapt their behavior accordingly (or challenge it if they believe it is inappropriate). In this way the office can play an important role in educating the public and reducing uncertainty.

**Judicial Institutions**

**The Court System**

The structure of the Polish judiciary is similar to that in other continental European systems. The Supreme Court, the highest court in the system, is composed of about one-hundred judges appointed by the President for five-year terms. It is divided into several chambers: civil, administrative, social (labor and social insurance), criminal, and military. Each chamber is divided into specialized sections. The civil chamber deals with all private matters (commercial and noncommercial), including property law, company law, bankruptcy, and family law. The Supreme Court’s role is to review questions of law in final decisions of general appellate courts and the High Administrative Court. Only certain high public officials (including the President of the Supreme Court, the Ombudsman, the Minister of Justice, and the General Prosecutor) can bring cases before the Supreme Court for review ("extraordinary revision"); parties to the dispute cannot bring cases directly but can petition these officials to bring the cases. Most cases are decided by panels composed of 3 judges.

Two types of courts are under the Supreme Court: courts of general jurisdiction and courts of special jurisdiction. The latter include the courts for military and social insurance matters and the High Administrative Court. All civil, commercial, social, and criminal cases are tried in general courts (either local or district—"voivodship"—courts, depending on the amount at issue or the nature of the charge), with right of appeal of both factual and legal issues to the relevant court of appeal.

In addition to these courts, a separate Constitutional Tribunal was established in 1985 to advise Parliament on the constitutionality of laws and to review government regulations to ensure they comply with parliamentary acts. Only certain high public officials can bring cases to this tribunal. Parliament has the final say over how to treat a decision of the tribunal regarding the constitutionality of a parliamentary act; the judiciary is subordinate to the Parliament (as is also the case in France) and does not have the power to declare statutes null and void as is possible in Hungary and the Czech Republic. The Tribunal’s decisions with regard to the legality of sub-statutory regulations are, in contrast, final and binding.
Although the court system has jurisdiction over the whole panoply of commercial matters likely to arise as Poland moves toward a private market system, it has limited competence in these areas. Until 1989, commercial disputes were resolved through state enterprise arbitration rather than in the courts. Over the past two years the role of the courts has expanded dramatically to include a whole range of commercial matters not considered before. Furthermore, most high-level judges are relatively new. About eighty percent of the appellate level judges were replaced between 1989 and 1992 in order to replace old ways with new thinking. Many of the newly appointed judges had been associated with the Solidarity movement for some time. Nonetheless, they lack experience with the various accounting, engineering, and economic problems associated with complex market transactions. Developing such expertise will take time.

Lack of experience and expertise creates uncertainty in the business population; other problems with the court system include cost (in both money and time). In the case of commercial disputes, courts require the party bringing the claim to deposit with the court a sum equal to 12% of the disputed amount. This sum is supposed to be returned upon the decision of the case. This deposit does not earn interest, nor is the return of the sum (if it occurs at all) adjusted for inflation. As many cases take around two years, this deposit imposes a significant financial liability for plaintiffs.

Arbitration

The Polish Code of Civil Procedure provides for formal arbitration similar to that in other western systems. Parties may design their own procedure; alternatively, the arbitrators may determine the procedure or the parties may submit to arbitration run by an organized forum with its own procedural rules (such as the Court of Arbitration at the Polish Chamber of Commerce, discussed in detail below). In ad hoc arbitration, the arbitrators' fees may be agreed upon in the arbitration agreement or will be fixed by an ordinary court upon request of the parties. The winner may request that the loser pay his costs. Unlike in the courts, no earnest money must be deposited with the arbitration tribunal.

Arbitrators usually have broad powers; the only thing they cannot do is take evidence or testimony under oath (a common aspect of arbitration). Arbitrators must give reasons for their decisions unless otherwise agreed upon by the parties. The award is then signed by the arbitrators and the parties and filed with an ordinary court. The award becomes enforceable, however, only when the successful party procures an enforcement order from a court of law. Arbitral awards may not be appealed; they may, however, be set aside if the award falls out of the scope set down in the agreement, the rules of procedure have been breached, or the award is redundant with a court award.

The Court of Arbitration at the Polish Chamber of Commerce provides one interesting forum for private arbitration. This originated as the Court of Arbitration at the Polish Chamber of Foreign Trade, which was established in 1950 to resolve international trade disputes. Although it was an office of the Polish Chamber of Foreign Trade, the Court of Arbitration was (and still is) an independent body. Until 1990, disputes with CMEA countries averaged around 200 per year, while the number of cases involving non-CMEA countries (including Yugoslavia) averaged 10-15 per year, or less than 10 percent of all disputes brought to the tribunal. This later figure is disproportionately low, considering that trade with non-CMEA countries amounted to approximately 30 percent of all of Poland's foreign trade volume. Western parties were particularly hesitant to submit to any socialist legal body. Most disputing parties chose instead to present their cases in a neutral forum (such as Switzerland or Austria). Despite this prejudice, however, the Polish Court of Arbitration of the Polish Chamber of Foreign Trade was considered fair and objective in adjudicating trade disputes brought before it.
In 1991 this tribunal was renamed the Court of Arbitration at the Polish Chamber of Commerce. The court remains available for the resolution of international commercial disputes, but through its transfer to the Chamber of Commerce its jurisdiction has been expanded to include disputes between Polish economic subjects.

Parties may submit to the Court of Arbitration only if they have agreed to do so in their commercial contract or by subsequent agreement; the clause must specify this court as the locus of arbitration. The Court keeps a list of qualified and available arbitrators, both Polish and foreign. These candidates include professors, practicing lawyers, economists, and others with expertise in commercial matters. State judges are prohibited from arbitrating disputes. This list is offered to assist parties in choosing arbitrators; it is not compulsory, and parties are free to choose anyone whom they wish. In keeping with standard arbitration rules worldwide, each party chooses one arbitrator. The opposing party may object to a party's choice if that arbitrator is related to one of the parties or is otherwise interested in the dispute. Arbitrators may also be refused for the same reasons a judge may be excluded for a court proceeding, which reasons are set out in the Code of Civil Procedure. Together the two chosen arbitrators chose a third, who acts as the presiding arbitrator. Parties may agree to a panel of five or seven as well.

Arbitration fees must be paid before proceedings begin. An arbitration is not considered commenced until all arbitration fees are paid. Fees are based on a sliding scale measured by the amount in controversy. Fees may be partially returned depending upon the length of the arbitration.

The arbitrators have the power to admit and exclude both evidence and testimony, regardless of whether it has been admitted by the parties. The rules of the Court of Arbitration also allow for the parties to apply the rules for "ad hoc" arbitration, which allows them to determine their own procedure. In the event the parties cannot agree on the procedural rules, UNCITRAL rules are applied.

Arbitral decisions from both the Court at the Polish Chamber of Commerce and ad hoc panels are published annually without the parties' consent. Confidentiality is maintained, however, by not identifying the parties involved.

Conclusion

Pre-war Poland had a reasonable legal framework that is being revived, amended, and supplemented by committed and intelligent law professors, legislators and administrators. The result is a set of laws that, although still needing careful study and revision in some key areas (most notably property rights), provides a cohesive legal framework to support the growth of the private sector. Practice and experience are needed to add detailed content to this framework and establish the precedents that reduce uncertainty in everyday transactions.

In addition to a developing legal framework, Poland has a legal history and legal institutions firmly embedded in the European tradition despite a forty year detour along the socialist path. Courts and judges are used and respected; they have not lost their reputation for honesty and integrity, although they may have trouble attracting the best talent given the burgeoning opportunities in the private sector. With time there is every reason to believe that they can develop the competence and expertise needed to give them a central role in interpreting and shaping the law and in providing the private sector with a reliable means for the resolution of disputes. It would be wise, however, for the Poles also to promote alternative means for dispute resolution—most notably, private or quasi-public arbitration—that place fewer demands on the scarce legal talent in the public sector.
Endnotes


4. Another form of property, "cooperative" property, was considered transitional, to be transformed to social ownership in the future.

5. While this equality of property has been incorporated into the constitution and the Civil Code, distinctions between public and private property have not yet been eliminated in other areas of law.

6. In particular, conflicts have arisen between local governments and state-owned enterprises due to the awarding to the latter of their own grounds. Because of undefined land title, capital shortages, and inappropriate taxation incentives, state enterprises have typically built large, low buildings, and claimed and held substantial amounts of vacant land.

7. A "Rental Housing and Tenant Protection Act" has been submitted to Parliament. Among other things, it proposes a controversial two-year scheme to decontrol rents in public housing.

8. It is also a bottleneck to the formation of companies, as discussed later in the paper.

9. It routinely takes six months to register a transfer.


11. The treaty was signed on March 21, 1990. It was ratified by the U.S. Senate in late 1990 and by the Polish Parliament in mid-1991. There was great resistance to these treaty provisions on the part of the Polish software and pharmaceutical lobbies, which fear incurring liabilities due to their use of foreign intellectual property over the past forty years. There was also widespread debate within the Polish community—and more generally within reforming socialist countries and developing countries alike—on whether the benefits of such rigorous patent protection outweighed the costs.

12. Apparently some types of state-owned companies, including Foreign Trade Organizations and some banks, continued to be organized as companies under the commercial code. The Civil Code of 1964 abrogated all but sections 9, 11, and 12, which deal with company forms.

13. A Law on Creating Joint Ventures was passed in 1979 but never used.

14. Although all shares must be issued, not all capital must be paid-in up-front. Only 25 percent of the value of registered shares must be paid-in. This is considered an advantage over
the limited liability form, for which all capital must be paid-in up-front.

15. If the court-appointed regulators determine a value that is at least 20% lower than that declared by the founder, then subscribers are free to renounce their part in the company.

16. Bearer shares may only be issued upon full payment. Partial payment may purchase certificates entitling the holder to the shares upon paying the balance. Registered shares may be purchased for partial payment. They may also be issued in exchange for the duty of repeated non-monetary contributions, but only with consent of the company.

17. This provision allowing the company to restrict the transfer of registered shares removes one characteristic distinction between the joint stock company and the limited liability company. Usually such restriction is possible only in the latter form.

18. Interest-bearing shares require the company to pay interest on the shares, regardless of how much company profit is earned. Such shares are prohibited in most western countries, because they confuse the basic distinction between bondholders (i.e. creditors) and shareholders (i.e. owners). With ownership comes risk, and interest-bearing shares are an attempt to create ownership without its attendant risk. On the other hand, interest-bearing shares might prove useful in countries trying to encourage private ownership of companies by an inexperienced and risk-averse population.

19. Shareholders agreements are a normal feature of business organization in common-law jurisdictions, but have not been typical in civil-law jurisdictions. They are becoming more common in Poland with increasing foreign investment. They create greater clarity and certainty for shareholders than is possible under articles of association alone.

20. This may cause some problems, as according to the constitution all Polish nationals are to be equally treated. On the other hand, some Polish nationals may claim they reside abroad in order to qualify for some of the incentives provided.

21. Several administrative requirements were also abolished, such as the evaluation of feasibility studies.

22. The law does not specifically define "state enterprise" though it uses the term, and most assume that this is an enterprise with more than 50 percent state participation. Even the Law on State Enterprises does not define the term.

23. The translation of Article 23(6) is approximately as follows: "The portion of the amount deducted from profit tax [i.e. the tax credit] may not exceed the value of stock and shares acquired by foreign persons."

24. As noted earlier in the discussion of real property law, the Civil Code provided for various types of property—social, individual (or private), and personal. Administrative regulations strictly limited the subject matter of private market activities and thus profoundly affected the content and reach of contract law.

25. This was achieved by amending the Code of Civil Procedure.

26. The existing Code is flexible enough, however, to permit these types of arrangements on a case-by-case basis. In fact, standard rules for these and other special types of contracts have been added to the French Civil Code over the years, but many appear to have fallen into relative disuse as lawyers find it preferable to craft individually-tailored arrangements under the more general provisions of the Code.

27. Judges in lower courts have life tenure.
28. The District Courts play the appellate role for the local courts, while several Courts of Appeal review decisions of the District Courts.

Like the other countries of Central and Eastern Europe, Romania has worked intensively since 1990 to create a legal framework for a market economy. While problems exist with the current laws, and numerous remaining gaps remain, on the whole the effort has been impressive given the short time-span and the tightly-controlled centralization of the former regime. Unlike some other CEE countries (such as Poland and Hungary), where private property and private markets were suppressed but not entirely extinguished during 40 years of socialism, Romania started virtually from scratch in 1990 to construct a market economy and corresponding legal framework.

Challenges remain in both law and practice. The broad principles of private ownership, free market exchange, and equal treatment of public and private firms are well recognized and have been largely achieved, at least on paper. Yet there continues to be a trend toward centralized, bureaucratic control—as evidenced, for example, in excessive requirements for approvals to do many things, as well as uneconomic limitations on certain activities. Furthermore, implementation will clearly take a long time (probably considerably longer even than in the other reforming countries), because the institutional framework for enforcement and dispute resolution is very weak. Developing expertise in the legal community through training and practice is crucial if the evolving legal framework is to become a guiding and binding force in everyday transactions.

Constitutional Law

The New Constitution

A draft constitution was introduced in Parliament on July 9 and was approved on November 21, 1991 after approximately 2 months of debate. It had been prepared by a constitutional commission composed of members of the two chambers of the Parliament and outside constitutional experts.

The document is long, containing 152 articles organized into seven main sections (or "Titles")—(1) General Principles; (2) Fundamental Rights, Liberties, and Duties; (3) Public Authorities; (4) Economy and Public Finance; (5) The Constitutional Court; (6) Revising the Constitution; and (7) Final and Temporary Provisions. Title 1 is generally noncontroversial from an economic viewpoint, but it has aroused strong debate from minority groups and monarchists because of Article 1, which declares Romania a "national state, sovereign and independent, unitary and indivisible. The form of government of the Romanian state is the republic."

Title 2 contains many sections defining rights and duties of citizens. The list of rights contains those that are common and expected in democratic societies, including freedom of expression, assembly, religion, and movement, and freedom from arbitrary arrest and imprisonment. On the economic front, the draft guarantees private property rights and equal protection of all private property regardless of owner, and it forbids uncompensated expropriations (Article 41). However, an accompanying provision that "the contents and limitations of [this right] are established by law" leaves wide room for government to restrict private property rights. Foreigners are explicitly forbidden from owning land in Article 41(2), a provision which—though apparently deeply rooted in history and culture—may nevertheless hinder foreign lending and investment in the economy.

Some rights guaranteed in the Constitution could prove expensive for the government to fulfill. One is the right to free education granted in Article 32: "State education [including by implication higher education] is free by law." Another potentially expensive guarantee is in Article 43: "The state is obligated to ensure a
decent living standard for the citizenry through measures of economic development and social protection; Citizens are entitled to a pension, paid maternity leave, health care in state medical facilities, unemployment relief, and other forms of social assistance envisaged by law."

All of these rights are granted subject to Article 49, which provides that "the exercise of certain rights or freedoms may be restricted only by law and only if the restriction is required ... in order to defend national security, public order, health, or morals, and civic rights and freedoms ...." This rather open-ended provision could create some uncertainty by leaving a window open for arbitrary government interference in the free exercise of economic rights.

Title 3 lays out the structure of the public sector, with chapters on the Parliament, the President, the Government, the Public Administration, and the Judiciary. Although not strictly economic in character, these provisions lay the ground rules for economic policy making. The structure is designed to create a balance of power among the various branches. The executive branch ("government") designs and introduces most legislation, and both chambers of parliament must approve it and the President sign it for it to become law. The President appoints the Prime Minister and cabinet with the approval of Parliament and can be impeached for wrongdoing by a majority vote of Parliament. Parliament is composed of two chambers, the Chamber of Deputies and the Senate. Parliament supervises the government through its approval of initial ministerial appointments, its power to express no confidence or censure, and its right to request information and explanations of governmental activity.

With regard to the judiciary, there was intensive debate regarding its powers in overseeing the constitutionality of Parliamentary acts. The Ministry of Justice favored ex-post judicial review by the Supreme Court, as existed prior to World War II. The constitutional drafting committee, in contrast, favored broad powers of judicial review (both before and after a law is passed) by a separate Constitutional Court, and the Constitution provides for such a Court in Title 5. Under Article 144, the Court is empowered to review the constitutionality of laws before they are promulgated. However, a ruling of unconstitutionality can be overridden if the law is again adopted in the same form by at least two-thirds of the members of each chamber, a provision that seriously weakens the power of judicial review over Parliamentary acts (Article 145). The Court is also empowered to adjudicate appeals brought before courts about the constitutionality of laws and ordinances, thus presumably eliminating the Supreme Court's jurisdiction over constitutional questions.

Title 4 deals with the economy and public finances. Article 134 defines Romania's economy as a market economy and orders the state to ensure free trade and protect competition. Under Article 135 the state protects property, whether public or private. Certain assets are reserved exclusively for public ownership and are "legally inalienable", including "underground resources of any kind, the means of communications, the air space, water resources that can produce power or can be used for public purposes, beaches, the territorial sea, the natural resources of the economic zone and the continental shelf, as well as other assets envisaged by the law." While this article prohibits private ownership, the state can grant concessions for private sector involvement in the wide range of activities on such property, including mining and telecommunications.

Despite the provisions indicated above that may compromise individual rights or impose difficult financial burdens on the state, the Constitution is a major step forward for Romania. Overall it provides strong support for the fundamental principles of private property and free market exchange as well as explicit limitation of the powers of the state.
Rights to Real Property

Rights to real property have been in a state of extreme flux in Romania. Extensive amounts of land are being returned to former owners or given to the owners of the buildings that occupy such land. Other land and buildings are being kept in municipal hands, with the possibility of lease and the future possibility of restitution or sale. The disposition of apartment buildings and other housing now in state hands is being intensely debated. And apart from basic questions of ownership of real property, land registration systems need to be revitalized, and numerous regulatory issues remain unresolved, including land use zoning and building standards.

Restitution

The major emphasis of restitution efforts in Romania has been agricultural land. The Land Law (No. 18), passed in February 1991, defines various categories of land and gives the broad outlines for their disposition. It is extremely bold and far-reaching; whether or not one agrees with the principle of restitution, it is clear that this is one area where Romania has moved decisively, ahead of land reforms in other Central and Eastern European countries and ahead of reforms in other areas of the Romanian economy.

The bulk of the law deals with agricultural land in producer cooperatives. Prior to the 1990 revolution, about 60 percent of agricultural land was controlled by cooperatives, about 30 percent by state farms, and the rest by private farmers working small individual plots. The land law provides that land of agricultural cooperatives is to be returned to the original owners or their heirs, with a maximum amount returned per household of 10 hectares. A period of 30 days (later extended to 45) was set in the law for the filing of claims, and some 3000 local commissions were established to determine the distribution of property rights, resolve disputes, and issue property deeds. Over six million claimants filed claims for some nine million hectares.

The restitution process has been plagued with problems. By September 30, 1992, almost eight million hectares had been distributed to about five million new land owners. Yet in many cases original plots could not be returned, because they had been converted to nonagricultural use. The resulting "allocation" of alternative plots has resulted in over 300,000 court actions to date. The commissions have been slow to issue titles to new holdings, which are needed to secure the new property rights and stimulate a land market. As of September 1992, only 124,000 titles had been issued.

Land formerly controlled by state farms is treated differently under the law (Article 36). Rather than provide restitution-in-kind to former owners, the state farms are to be converted into joint stock companies, and former owners or their heirs are eligible to receive shares of these companies in proportion to their former holdings (not to exceed 10 hectares).

In addition to providing for restitution, the law puts strict (and seemingly inconsistent) controls on the conversion of agricultural land to other uses. Any construction on some types of land—including land of "class I" and "class II" quality, land with "improvement facilities", and vineyards and orchards—is prohibited under Article 71. Yet the article also provides for the removal of land from agricultural or forestry use with the payment of steep taxes into a "Land Improvement Fund". Article 79 then appears to require that investors physically remove the topsoil to poor land (as indicated by agricultural authorities) before doing any construction.

Finally, the law places two further important limitations on land ownership. First, Article 47 repeats the constitutional prohibition on the ownership of land by foreigners (but seems to be limited in this case to nonresident foreigners). Second, Article 46 appears to provide that a family's total purchases (through "living deed") of land cannot exceed 100 hectares (approximately 250 acres) of arable land. Such a limit on land holdings is understandably intended to prevent the emergence of large
landholdings and inequitable land distribution, but in the longer run it could also compromise efficiency and entrepreneurship in rural areas.

Disposition of urban land is also addressed in the law (primarily Article 35), but in much less detail. Land on which buildings sit is to be given to the owner of the building, whether private or municipal. Pursuant to another law presently being drafted, state-owned enterprises will be given full ownership rights to the land on which they are situated. Until now they have had only use rights, which allowed a full range of uses but did not allow lease or sale. Empty land is to be returned to its original owner if possible. A municipal commission is being set up in each town to oversee this process. As in the case of agricultural land, there are likely to be many disputes.

Privatization

Ownership of buildings is not covered by the land law and is not subject to restitution. State-owned enterprises (and a few private enterprises) generally own the buildings they operate in. Municipalities own the rest of the commercial property within their borders (which makes up, by rough estimation, some 2/3 of the buildings in Bucharest, for example). The municipality is thus a major landlord for emerging private sector businesses and has strong market power over the rental of business premises, for which rents are considered to be high. When possible, businesses rent homes or apartments from private owners and turn them into offices in lieu of renting office space from the government. Privatization (probably through auction) of urban office buildings needs to be put on the government’s agenda to support private sector development.

Housing, unlike office buildings, is being privatized by the state. Many individuals own their own homes or apartments; this was possible even in the communist period, and it has been expanded through extensive sales at very low prices (one-fifth to one-tenth of "market value") under Decree-Law No. 61 of 1990. The sale of state-built housing to tenants at low cost is a generally accepted principle and is moving ahead rapidly. However, the disposition of urban housing formerly expropriated without compensation by the state is a contentious issue because of the conflict between former owners and current tenants. One proposal gives preference to current tenants (if resident since 1974), allowing them to buy the property and then giving the proceeds (probably far below would-be market value) to the former owners. This proposal has many critics, however, and a task force is currently looking for a solution.

Rights to Intellectual Property

Patents

Until late October, 1991, the Romanian Law on Inventions and Innovations (No. 62) of 1974 provided the basic framework for patent rights. In keeping with standard western patent law, Law 62 stated that holders of patents enjoy the exclusive right to exploit their inventions, unless they expressly permit others to do so. During the socialist period, however, patent law had little meaning in the domestic economy, as noted in Chapter 1. The exclusive right to utilize an invention remained with the Romanian state. As a result, there is no experience with the enforcement of private patents, which will be the challenge of Romania’s new intellectual property regime.

Parliament passed a new patent law in late October, 1991. The law provides patent protection similar to that in industrialized countries. The above-mentioned restrictions have been removed, and the basic protections remain. The law retains two controversial provisions: 1) a compulsory license provision and 2) a provision that the state has the right to appropriate patents if deemed to be in the "national interest." The compulsory license allows the state to issue rights of use to third parties (with compensation) if a patent registered in Romania has been unjustifiably unutilized or underutilized for four years. The compulsory license provision is unlikely to significantly
reduce the protection of patents registered in Romania. Rather, it provides the government with a tool to prod the holder of an unused patent when a potential license meets resistance to any efforts to negotiate a licensing arrangement.

More controversial (and less common elsewhere) is the appropriation provision, as this compromises the basic security of property rights. Compensation for expropriated patents is guaranteed by the patent law. Despite this, however, such a provision creates uncertainty as to the value of patents (present and future), making sale and leasing arrangement risky. Furthermore, "national interest" is not defined. In light of Romania's far reaching need for western technology, "national interest" could indeed include all technical innovations in the country. Thus, this far-reaching power of the state could seriously encroach upon the integrity of the patent law's protections.

All patents must be registered in the Romanian State Office for Inventions and Marks (OSIM) and are valid for 20 years. OSIM's main responsibility in approving patent applications is to determine the novelty of the claimed invention. Decisions of OSIM may be reviewed by the OSIM Appeals Commission, and the Commission's decisions may be appealed to the Civil Division of the Municipal Court of Bucharest. Such appeals may only address whether the OSIM Appeals Commission's decision complied with Law No. 62, and not whether the commission properly assessed the novelty of the patent.

Romania is signatory to the Paris Convention for the Protection of Industrial Property (1883). Foreign patents must be registered by the Bureau for Foreign Patents and Inventions (Rominvent) of the Romanian Chamber of Commerce to enjoy the protections set out in Romania's new law. In registering with Rominvent, the foreign patent holder also grants power-of-attorney to his or her Rominvent representative. This is an area that could usefully be opened up to broader participation of Romanian lawyers.

**Trademarks**

Romanian trademarks are adequately protected (at least on paper) by Law No. 28 of 1967 on Brands, Trade & Service Marks (as amended in 1977). The law grants exclusive right of use and transfer. Trademarks are defined as distinctive signs used by enterprises for distinguishing their products, works or services from those of other enterprises. Trademark protection lasts initially for 10 years and is renewable. Like patents, trademarks are protected upon registration at the State Office of Inventions and Marks (OSIM). The Paris Convention grants national treatment and right of priority to trademark owners. Romania is also signatory to the most current text of the Madrid Agreement Concerning the International Registration of Marks (Stockholm, 1967).

**Copyright**

Until recently, the primary source of Romania's domestic copyright law was Decree No. 321 of June 21, 1956 (as amended in 1957 and 1968). This decree dealt primarily with literary works, but it had wide potential application to the commercial sphere, particularly computer software. It granted the holder rights of public recognition as the author of a work, exclusive exploitation of the work, and alienation of exploitation rights. The protection of these rights existed for the life of the author and the spouse, plus 50 years for direct descendants and 15 years for other heirs. On the international front, Romania has long been a signatory to the Berne Convention (Rome text of 1928).

A new copyright law was recently passed by Parliament. Although more in line with international norms, there is still uncertainty with regard to protection of computer software, which has been an issue of particular sensitivity in the country. Under the Berne convention, retroactive protection of copyrights (e.g. for software) is possible, meaning infringers of protected works may incur liability for past illegal use. However, it is also worth noting
that Berne has no enforcement mechanism. Claimants may bring infringement cases before the International Court of Justice, but instances of this are rare. As noted in Chapter 1, enforcement capacity is an issue in all of the areas of intellectual property law discussed above.

Company Law

Historical Background

Romania made much early progress in the area of company law, moving from zero recognition of private business to a market-oriented company law in the first year after the 1989 revolution. The first law that allowed individual private initiative was Decree-Law No. 54 of 1990. This law provided for 4 types of organizations—small enterprises, business partnerships, family associations, and sole proprietorships. While a very important development in the transition, the law was outside the normal western framework and quite restrictive, and it gave the government broad powers of control over private activities.

Law 54 was largely supplanted in November, 1990 by Law 31, the Companies Act, which provides for all the types of company organization typical of continental legal systems. These include the general partnership, the limited partnership, the limited liability company, and the joint stock company. However, the law is quite disorganized and ambiguous, and it has numerous problematic provisions, as discussed below.

Characteristics of a Joint Stock Company

The Romanian joint stock company resembles the French SA, the German AG, and the Anglo-American public corporation. Extensive information and procedural requirements are imposed on this form of company in order to protect large numbers of anonymous investors. The joint stock company is an important company form in all mature market economies and is likely to become important in Romania in the future, as state-owned enterprises are privatized and as small private firms grow. At present, however, the form is hardly used, and most companies to date have been established as partnerships or limited liability companies.

Capital and share requirements. Under Romanian law, at least 5 founders are necessary to establish a joint stock company. They can be residents or non-residents, and legal or natural persons. Minimum capital of one million lei (approximately US$2300) is required. This may include the value of in-kind contributions, which are to be evaluated by experts appointed by the founding meeting. Both registered and bearer shares are allowed, with bearer shares to be paid in full. Registered capital cannot be increased before all shares issued previously are paid in full. Not all capital must be paid up front, but at least 30 percent of subscribed capital must be deposited upon founding of the company. A prospectus is required if stock is to be offered for public sale.

The law requires that the subject of activity of every company, as well as every shareholder, be listed in the founding Contract. The requirement that subjects of activity be listed could be problematic if the categorization of possible subjects were narrow, because it would restrict firms' ability to diversify in response to market signals. The Romanian system is not severely restrictive. It provides 5 broad subject areas to choose from; firms can choose one or more (with each entailing an extra registration fee, as discussed below). Listing every shareholder may not be difficult now, given that most private companies are still very small, but it will become difficult if shares become widely held and traded through the process of privatization or private sector growth. Some Romanian lawyers interpret this requirement to mean that only founding members need be listed.

The Contract and the Statutes (the bylaws) for establishing the company must be approved at the first general meeting of shareholders.
Voting rules in this meeting depart from the normal pattern in which voting rights are proportionate to share ownership. At the first general meeting every listed shareholder has one vote no matter how many shares held, with a quorum of 50 percent of the subscribers (rather than the shares) and a simple majority voting rule. Because that meeting appoints experts to evaluate in-kind contributions, investors making in-kind contributions are not allowed to vote at that meeting on issues concerning such contributions. These voting rules appear to give minority shareholders disproportionate (and highly unusual) influence in setting the general rules for operation of the company. Many important policies are set at the first meeting, and such a system of one person-one vote dilutes the incentive of shareholders to invest enough to acquire a majority stake in a company.

The law (Article 67) establishes a general one share-one vote rule (except at the first general meeting, as discussed above). However, the company’s contract or statute can limit the number of votes of shareholders owning more than one share, and thus voting rights can be weighted in specific cases in favor of certain shareholders. Furthermore, a supramajority can be required for decisionmaking at the general meeting (Article 74). The possibility for weighted voting rights and supramajority voting rules is likely to be particularly important for foreign investors in the medium- to longer-term, because it allows majority Romanian ownership to be combined with foreign control (or at least veto-power) over key corporate policies.

Corporate governance. With regard to corporate governance, the law provides for a sole administrator or a board of administration to be chosen by the general meeting of shareholders. The board may delegate some of its powers to a managing committee. The president of the board of administration is required also to be director of the managing committee. This requirement is problematic in that it focuses so much power (essentially the roles of Board Chairman and CEO) in one person. While this focus of power may be reasonable in some cases, it is not necessarily the best solution in all.

Regular oversight over company operations is to be provided by three or more auditors elected at the general meeting. One must be an accountant, and the majority must be Romanian citizens.

Characteristics of a Limited Liability Company

The Romanian limited liability company follows the form used throughout continental Europe, for example, that of the French SARL or the German GmbH. It combines some of the benefits of the joint stock company with the relatively simpler procedural requirements of the general partnership, and is particularly well-suited to small and medium-sized firms with only a few owners. This form has been the most used to date and will probably continue to be the favored form for most domestic and foreign investment.

The limited liability company differs from the joint stock company in several ways. A limited liability company can be owned by only one person (or "associate") and can have at most 50 associates. Minimum required capital is only 100,000 lei (about US$230). Because of the more personal nature of the expected interrelationships among owners, no prospectus is required to set up the company (as it is for joint stock companies that offer shares to the public), and a limited liability company cannot issue bonds (which are generally offered to the public and, in the case of the joint stock company, also require a prospectus). All associates must have access to the books of the company at any time, and they may perform the duties of auditors if no auditors are appointed by the General Meeting. Shares of individual associates cannot be transferred to persons outside the company unless approved by associates representing at least three-quarters of the registered capital. Although most decisions at the general meeting require only an absolute majority of the associates and of the registered
shares, unanimity is required to alter the company contract or statute. A one share-one vote rule is mandated (Article 141), in contrast to the more flexible voting rules of the joint stock company.

With regard to corporate governance, a limited liability company is to be managed by one or more administrators appointed by the company contract (in the case of the first administrator) or by the general meeting of associates. A board of directors is not required.

**Characteristics of the Three Partnership Forms**

The law provides for three partnership forms—the general partnership, the "sleeping" (or "limited") partnership, and the sleeping partnership limited by shares. In the general partnership all partners have unlimited joint and several liability with regard to the partnership's obligations, and all are entitled to participate in the management of the business, unless provided otherwise in the partnership's contract. This form is most suitable for small enterprises with a few active participants. In the sleeping partnerships, in contrast, only the active partners (who serve as the administrators) have unlimited liability, while the liability of the sleeping partners is limited to their capital contribution. These forms are more suitable for larger undertakings where a few active participants are seeking capital from passive investors. The sleeping partnership limited by shares most closely resembles the joint stock company in its formal requirements, including minimum capital, prospectus requirements for public subscription of shares or bonds, founding and general meeting requirements, procedures for valuation of in-kind capital, auditing requirements, and recordkeeping. Because of this formality, the form appears unlikely to be used much in practice.

**Setting up a Company**

The procedures required to set up a company, whether in a joint stock or a limited liability form, appear somewhat cumbersome to the outside observer. Seven basic steps are required:

- Foreign joint ventures must first get approval from the Romanian Agency for Development (see discussion under "Foreign Investment" below). Romanian companies skip this step.
- The public notary must approve the contract and statute. Although the official cost is low (1000 lei), this takes time, because the number of notaries is limited and they are not prepared for this work.
- The company must apply to the district court for a judicial decision granting authorization to set up the company. This appears to be a formality—of some 15,000 applicants, all have been approved. Yet it can take up to 3 weeks to get the decision from the court.
- Meanwhile, the court requires consultative advice from the Chamber of Commerce, which checks for any criminal record and passes judgment on the "moral character" of the applicant. This is at best another formality that requires several days (and another small outlay of money—200 lei for Romanians, $20 for foreigners); at worst it could become an outlet for unjustified discretionary refusals of applications.
- After receiving court approval, the judicial decision must be published in the Official Gazette, which takes yet more time.
- The new company must then be officially registered with the registry of companies. While this costs only 1000-2000 lei for Romanian companies, foreign investors are charged $500 plus $100 for each extra activity (up to $900 total). This step confers legal personality.
- The new company must register with fiscal authorities.

This procedure may not put much burden on large investors, Romanian or foreign, who can hire Romanians at low wages to stand in line and run back and forth from office to office filling out forms and seeking signatures of approval. Furthermore, large firms are not bothered by the "gifts" that (although perhaps
not necessary) reportedly speed up the process. They may not mind the 1-2 month wait that these procedures entail. Small entrepreneurs, however, may find these procedures daunting and expensive. To promote local private sector development, Romania would do well to streamline the process.33

Foreign Investment

Law 35 on Foreign Investments was adopted in April 1991. It replaced Decree-Law No. 96, which was issued in March 1990 as a first effort to provide a framework for foreign participation in the economy.34 Unlike Decree No. 96, which provided for individual negotiation of the terms of each joint venture, the 1991 law establishes clear procedures, requirements, and incentives that apply across-the-board to all foreign investors. Although still problematic in certain areas, as discussed below, the law does appear to be perceived favorably by foreigners, and thus it generally sends the right signal—that private investment with foreign participation is desired and welcome.

Forms of Investment

The law applies very broadly to virtually any participation by a foreigner in the Romanian economy. Foreigners are allowed to set up branches or wholly-owned subsidiaries, as well as joint ventures with Romanian partners. These types of foreign investments are subject to the general rules and corporate forms set out in the Company Law, as discussed above. Article 1 extends the law to cover licensing, management contracts, and even acquisition of property by a foreigner in Romania. Portfolio investment appears also to be included, even if it is merely the purchase of one share of stock by a foreigner.

Foreign investment in Romania requires approval from the Romanian Development Agency. If not notified within 30 days, the request for investment is deemed to be granted. It is not clear what purpose the "screening" process serves, aside from facilitating data collection on foreign involvement in the economy. Article 20 provides that RDA screens "the investor's character, the field and way in which the investment is to be made, and the amount of capital to be invested." Yet the law does not specify any closed sectors, minimum capital requirements, or other criteria—other that what is provided in the Company Law—to bring objectivity to the screening process. Furthermore, given the broad coverage of the law as described above, by the strict letter of the law approval would be required for even a very small purchase of property or shares by a foreigner. The experience of foreign investors to date suggests that the approval process is rapid and that this step does not now impose a major burden on investors. After some time the government may want to review again the role of the RDA and the efficacy of mandatory screening as opposed to more targeted intervention.

Profit Repatriation

Romania was the last CEE country to remove limits on profit repatriation. Although profits in convertible currency could always be repatriated without limit, until mid-1992 the law limited the repatriation of lei profits in any one year to at most 15 percent of registered capital (in convertible currency or in kind) contributed by the foreign partner. And to be repatriated, lei profits had to be exchanged for foreign currency at the auction rate of exchange, although initial capital was valued at the official rate (which was much lower). These two rates varied because of the official dual exchange rate system. In late 1991 the government unified the exchange rate, making the conversion of lei profits less costly to the investor.

Unfortunately, at the same time the government unified the exchange rate it also tightened access of the private sector to foreign exchange by requiring that all foreign exchange (other than a firm's equity participation) be surrendered to the government at the official exchange rate.35 Foreign currency bank accounts were no longer permitted, except in
specially-approved cases or as needed to hold equity contributions. Thus, not only did foreign investors face limits on the repatriation of lei profits, but they could also face some difficulty holding on to their foreign currency earnings under these regulations.

The Romanian government finally lifted these limits on profit remittance and on foreign currency accounts in June 1992, bringing the country's foreign investment regime closely in line with those of the other CEE governments.

**Tax Incentives**

Law 35 grants very generous customs and tax incentives to foreign investment. In the customs area, foreign investors are exempt from payment of customs duties on all imported capital equipment, and are exempt from duties on raw materials for two years. Not only do these exemptions open room for abuse (through the importation of non-essential goods for resale), but they are unfairly discriminatory against domestic entrepreneurs if not matched by similar exemptions for domestic firms. As an alternative, Romania could lower its tariffs on certain capital goods and raw materials for all investors, or it could adopt a duty-drawback system specifically for exports.

In addition to customs exemptions, the law offers tax holidays of 2-5 years, depending on the sector of activity. After the holiday period expires, taxes are reduced by 50 percent if the profits are reinvested in Romania, or by 25 percent if the firm meets certain criteria as to import, export, research and development, domestic procurement, or job creation. Although the current domestic tax situation is clearly in need of reform, granting tax holidays for foreign investment only makes it more difficult to develop a reasonable and productive revenue system. A preferable approach, increasingly followed around the world, would be to adopt a broad-based tax system that applies reasonable rates equally to foreign and domestic investors. If incentives are to be given, investment credits are generally considered to be more targeted and less subject to abuse than tax holidays.

**Contracts**

The legal framework for private contracts is contained primarily in the Romanian Civil Code, which dates from 1864 and was amended in 1913 and 1920. The Civil Code is modeled closely on the French Napoleonic Code. As such, it provides a reasonable basic framework for property rights and private contracts. Unlike most of its neighbors (including, for example, Poland and Hungary), Romania never amended its Civil Code after World War II to incorporate socialist conceptions of property and give primacy to state contracts; thus it was not necessary to re-amend the Code after the 1990 revolution to remove those conceptions and once again give full recognition to private property.

The Civil Code is supplemented by the provisions of the Commercial Code still in force, including some specific provisions on commercial obligations. Two other laws in the commercial area include the Law on Promissory Notes (which follows the model of the Geneva Convention in this area) and the Law on Bills of Exchange, both adopted in 1935. These laws were never abolished and thus can still be used. However, Romanians have little practical experience working with decentralized private business transactions, and there is not a body of judicial interpretation to answer the many questions that arise in everyday commerce. These will require time to develop.

**Bankruptcy**

**Current Situation**

The only bankruptcy procedure existing in Romania to date is that contained in the Commercial Code of 1887. The Code follows the pattern of other commercial codes of that period, especially that of France and Italy. When adopted, it was considered to be state-of-the-art, and it was subsequently used as a model for bankruptcy legislation in several neighboring
countries. The Code's bankruptcy procedure was widely used before World War II. Although not applied during the socialist period from 1945 to 1989, it was never formally abrogated.

The Code provides for liquidation proceedings under the direct administration of a judge. Romania's scheme is unique in appointing judges directly to administer the bankruptcy (Article 730) rather than private receivers. This solution seems problematic, because it ties up judges in long cases and prevents the emergence of a specialized profession of receivers. Because judges' remuneration is not related to the size of the company's assets (as is typical in the case of receivers), the rule also tends to lessen the administrator's incentive to preserve the company's assets and speedily resolve the bankruptcy case.40

Under the law, bankruptcy cases can be brought by debtors, creditors, or the court. As an alternative to bankruptcy, the law also provides a "mutual agreement" procedure (typical in European laws of this period) through which debtors and creditors can agree to restructure the debt obligations and thus keep the debtor in business. The procedure can be initiated only by the debtor, and any agreement must be accepted by creditors representing at least three-quarters of outstanding debt and approved by the court.

**Antimonopoly Law**

The Romanian Parliament has not yet adopted an antimonopoly law, although the government recognizes the importance of such a law and plans to introduce a draft law in the near future. General principles of competition are contained in Law No. 15 on the Restructuring of State Economic Units (1990),44 and in Law No. 13 on Unfair Competition (1991). These laws do not, however, provide an in-depth definition of anticompetitive monopoly behavior, nor do they specify the sanctions to be applied or establish specialized administrative machinery for enforcement. In the Eastern European environment, where few people are familiar with markets and where the general court system has little experience with commercial matters, it is unlikely that antimonopoly legislation will have much impact unless specialized enforcement machinery is established (as has been done in most other Central and Eastern European countries).

The government's rather slow approach to antimonopoly legislation (compared to other areas of legal reform) appears to be due in part to a fear of overcontrol—a fear that administrative officials would use any such law to impede private sector development rather than facilitate it. This is an understandable fear in this environment; even industrial countries continually debate the proper scope for administrative intervention, and many western economists believe that traditional antitrust enforcement has been detrimental to competition. Technical assistance from industrialized market economies could be useful in training Romanian officials in methods of antitrust analysis and enforcement.

**Judicial Institutions**

As can be expected, no judicial institutions in Romania—whether courts, arbitration panels, lawyers, or law schools—are fully prepared to take on the challenges inherent in their roles in a market economy. Large-scale efforts at institutional development are needed.
The Court System

Under the socialist system, courts were not involved in commercial areas. All commercial legal work was done under the old regime by lawyers within state-owned enterprises, and disputes were worked out in specialized arbitration institutions established for that purpose. As Romania continues to move towards a market economy, courts will soon be expected to handle a multitude of new responsibilities in commercial areas—including contract disputes, bankruptcies, real property disputes, intellectual property issues, and so forth.

A law introduced in Parliament in 1991 sets up a new court system composed of four types of courts—local, district, appeals, and the Supreme Court. Each (except for local courts) has four sections—civil, criminal, administrative, and commercial. The law attempts to increase the independence of the judiciary by granting life tenure for all judges (after a transition period), and it subordinates public prosecutors to the Ministry of Justice rather than maintaining their separate and independent status (subordinate only to the Communist Party) in the previous regime. Massive training and assistance will be needed to equip the courts to handle the expanded responsibilities in a professional and reasonably predictable manner. Without competence and experience in the court system, private commerce is unlikely to thrive.

Arbitration is a useful alternative to court litigation and is sanctioned by the Code of Civil Procedure. The Romanian Chamber of Commerce has long sponsored a service to arbitrate questions arising from foreign trade. Recently this arbitration service has expanded its area of responsibility to include domestic commerce. With support, assistance, and publicity, this and other arbitration panels have the potential to develop into viable and important alternative to the more cumbersome court system. Arbitration in foreign locations under foreign law is also allowed (French law being favored because of its similar tradition).

The Legal Profession

Although there are several thousand lawyers in Romania, very few are trained in commercial matters, and their profession was until recently still centrally controlled. The profession is divided into two branches—"private" lawyers ("advocats") and legal advisors within state enterprises ("jurisconsults"). All private lawyers, though nominally independent professionals under a new law passed in 1990, were until recently still required to belong to the Lawyers Union. Their clients paid the bar the legal fees (pursuant to a preset schedule), and the union withheld its own fees and taxes and then paid the remainder to the lawyer concerned. These requirements are steadily being lifted, and the legal profession is being opened up to independent practitioners.

Legal Education

The basic principles of contract law (as found in the Civil Code) have always been taught in Romanian law schools, and market-oriented commercial transactions have generally been taught in the context of international trade. Thus, a base exists on which to reorient the legal curriculum to a market economy. Although traditionally lasting 4 years, an extra year was recently added to the legal curriculum on a temporary basis to allow for the teaching of Romania's new commercial legislation, including the company, foreign investment, and tax laws.

The law school at the University of Bucharest has exchange programs with a number of universities in western Europe, including the Universities of London, Hamburg, and Florence. These programs should help to supplement the education of both students and professors during this period of transition. However, in order to launch this new educational program successfully at home, supplies such as documentation, books, and perhaps computers are needed.

A number of private law schools are now appearing in Romania. They cost much more than state education and are not officially "recognized" by the government. However,
they expand educational opportunities and may improve the overall quality of education by increasing competition.

Conclusion

The Romanian government has worked hard since 1990 to develop a legal framework in which the private sector can develop. Many new laws have been passed by the Parliament, and many more are being drafted and debated. However, both the administrative and judicial machinery for implementing those laws and the publicity apparatus for educating the public about them is lagging behind, as is true in other transforming socialist economies (and in many developing countries as well).
Endnotes

1. For detailed references to Romanian legislation mentioned in this chapter, see Gray, Hanson, and Ianachkov, "Romania's Evolving Legal Framework for Private Sector Development," The American University Journal of International Law and Policy 7:3 (Spring 1992).

2. The President may ask the parliament to reconsider the law but may not veto it.

3. Romania had a bicameral parliament under its 1923 constitution, which was replaced by a unicameral system under Ceaucescu. Thus the current proposal is a return to pre-socialist traditions. Under the 1923 system the two chambers of parliament had different powers and different means of selecting members. While deputies were chosen by direct election, the senate had appointed as well as elected members in an effort to protect under-represented interests. In contrast, under the current draft the two chambers have similar and equal powers; a law can be promulgated only after similarly-worded versions have been approved by both chambers. Given the similarities between the two chambers, some observers question the justification for the current bicameral system. M. Shafir, "Romania's New Institutions: The Draft Constitution," Report on Eastern Europe 2:22, September 10, 1991.

4. The right of judicial review over the constitutionality of laws was established in 1912 and included in the 1923 constitution.

5. The Court is to review the constitutionality of laws if requested by the President, one of the presidents of the two chambers of government, the Supreme Court, or at least 50 deputies or 25 senators. This is preferable to the mandatory review (at least of "organic" laws) contained in an earlier draft of the constitution.

6. This ability of the Parliament to override the decisions of the Constitutional Court is a major change from the initial draft, which made the Court’s decisions mandatory in all cases.

7. Under Government Decree 1228 of December, 1990, anything owned by the state can be leased, pursuant to the general framework for leasing in the Civil Code.

8. Prior to World War II, different parts of Romania had different systems of land registration. Transylvania followed the Austrian system of land registers classified by parcel of land, and these registers reportedly still exist. In other parts of Romania land was registered by owner, a less desirable system because of the difficulty of tracking the disposition of individual plots. A new land register is reportedly provided for in the new Law on Cadastre.

9. Land restitution in Romania and throughout Central and Eastern Europe is being driven far more by political forces than by economic ones. From an economic perspective, there is ongoing debate about the optimum size of land holdings and the wisdom of breaking up large farms into small private plots. Indeed, the restitution process in Romania has led to a sharp decline in agricultural output in the short-run. T. Stolojan, "Private Sector Development: Romania's Case," World Bank, unpublished manuscript, January 1993, p. 15.

10. Peasant households were allowed to maintain private plots no larger than 0.15 hectares. In addition to these private holdings, about six percent of cooperative land was individually cultivated. T. Gabriel, "The

11. Landless families (Article 20), families with inferior mountain land (Article 39), and cooperative employees who contributed no land (Article 18) also have the right to claim up to 10 hectares of arable land, although they cannot sell it for ten years thereafter (Article 31). Unclaimed land becomes the property of the municipality and can be leased to private parties who want to farm it (Article 30).

12. Stolojan, supra note 9, p. 17.

13. The rights of foreigners who are resident in Romania are not clear under this law.

14. Law No. 4 of 1973 provided for the sale of state-owned housing to tenants, with the right of use of the underlying land (up to 100 square meters of land per household in towns or 200 square meters in villages). All land was the property of the state.

15. In 1990 about one-third of the housing in Romania was state-owned, and two-thirds was privately owned. Of approximately two million state-owned units owned at that time, about three-quarters had been sold by the end of September, 1992. T. Stolojan, supra note 9, p. 11.

16. Under the 1974 law, patents for Romanian inventions in certain industries—including nuclear materials, chemicals, pharmaceuticals, medical products, disinfectants, food, animal/plant breeding, and silk worms—could be issued only to state organizations, although the manufacturing processes for these products could be the subject of private patents.

17. The Constitution also provides for compensation in the event of state expropriation.

18. Under the 1974 law, this period was only 15 years, which could be extended. No such extension is possible under the new law.

19. Granting power-of-attorney to local counsel is normal when registering patents in other countries, as local counsel are usually the only ones authorized to register patents. The extent of the power-of-attorney is usually spelled out in the contract of services between the patent holder and local counsel.

20. Examples include words, letters, graphics and numbers, in combination with certain colors, as well as wrappings and sound recordings. Signs must have a distinctive character to become trademarks.

21. As in the case of patents, foreign trademarks must be registered through Rominvent.

22. This discrepancy in duration depending on the nature of the relation is peculiar to Romanian law.

23. For example, a small enterprise could employ no more than 20 wage-earners, and a business partnership could have no more than 10 partners. Sole proprietorships were intended primarily to cover individuals conducting trade or services. Each firm had to obtain a license from the mayor’s office, and was obligated to submit its budget to "local financial bodies" and to publish its balance sheet twice a year in the Official Gazette "after being checked by the financial authorities." In order to obtain inputs of raw materials and energy, firms had to work with state authorities to gain access to central allocation mechanisms.

24. The new law required that small enterprises and "lucrative associations" previously set up under Decree-Law 54 reorganize themselves into one of the new company forms within six months. Decree-Law 54 is still in force with respect to the other two
types of firms, family associations and sole proprietorships.

25. The prewar Romanian company law closely followed the Italian law of 1881 and other continental models.

26. Although not clearly stated, it appears from Article 212 that the State may be a single shareholder.

27. This presumably does not include the holders of bearer shares unless they are specifically listed. It also does not include shareholders who fail to deposit their shares 5 days before the meeting in the place specified by the statutes—a very cumbersome procedure indeed.

28. This is a rather inefficient means of giving more voting power to certain shareholders, because it ties voting rights to the specific shareholder rather than to the share. In this way a share's voting rights can change merely through transfer to another shareholder. A preferable way, possible in the company laws of many other jurisdictions, is to allow some shares to have more than one vote.

29. The sole administrator or the president and at least half the members of the board of administrators must be Romanian citizens, unless the company contract or statutes provide otherwise. The Foreign Investment law provides that foreigners can be employed by a company only in such positions or as experts.

30. An auditor is required only if there are more than 15 associates.

31. There is also a civil partnership form, governed by the Civil Code, which is intended to cover simple initiatives among a few equally-involved individuals.

32. Until recently, notaries were all state employees. Pursuant to a new law private notaries are now allowed.

33. Step 2, approval by the public notary, is potentially useful as a check to insure that the law has been followed in setting up the company. However, in practice notaries are not always well-trained, and the approval requirement can become one more time-consuming bureaucratic bottleneck. Notaries can even have a negative impact if they insist that companies follow certain narrow rules they happen to be familiar with.

34. The first recognition of foreign joint ventures was in Decree 424 of 1972, although this decree was virtually unused in practice.

35. The official rate is still managed and remains somewhat lower than the parallel ("black market") rate. Although the lei was supposedly made convertible with the exchange rate unification, foreign exchange continues to be rationed in the official exchange market through enforced waiting periods.

36. The latter option, however, may be too difficult to administer for some time.

37. Five year tax holidays are available for investments in industry, agriculture, and construction. Tax holidays are three year for investments in exploration and exploitation of natural resources, communications, and transportation, and two years for investments in trade, tourism, banking, and insurance.

38. The entire Romanian tax regime is in flux. A tax on profits passed in 1991 imposed steeply progressive tax rates on business profits (up to a top marginal rate of 77% on profits over 1 billion lei). However, domestic firms received tax holidays under this law that were only slightly less generous than the holidays given foreign investors under the foreign investment law. Therefore, it is unlikely that many domestic private firms paid any tax at all. A new company income tax with a far lower general rate of 45 percent (or 30 percent on profits up to 1 million lei) was approved in 1991, and further tax reforms were made in
1992, lowering the general rate to 35 percent. In any case, it is unlikely that the government’s administrative machinery has the capacity to enforce and collect taxes on the newly-emerging private sector. Extensive technical assistance, time, and experience will be needed.

39. Most of the commercial code—the provisions dealing with company forms—has been replaced by Law No. 31, the Company Law.

40. This may be one reason why the percentage of assets actually recovered in pre-war bankruptcies in Romania was typically lower than that in neighboring countries.

41. As with the old Commercial Code, the new draft applies only to commercial companies, essentially those covered by the new company law.

42. Bankruptcy cases can be initiated by the debtor, the creditor, or the court. (Only creditors can initiate bankruptcy in the case of state-owned enterprises.) Upon initiation of a case, the management of the company is turned over to an administrator appointed by the court. The judge-receiver and administrator then work together to decide whether reorganization or closure is preferable.

43. Only the debtor can initiate a mutual agreement procedure, and any proposed agreement to reduce indebtedness must be approved by the court and must satisfy at least 50 percent of the creditors’ claims.

44. Law No. 15 provides some basic protections against monopoly behavior. Specifically, Article 36 forbids agreements among companies to set prices or unfair contract terms; to limit production, sales, technological development, or investment; to allocate input or sales markets; to discriminate among purchasers, or to impose unrelated conditions on contracting partners. It also generally forbids monopoly behavior of firms with a dominant position.

45. Small cases begin at the local courts and larger matters at the district courts, with two levels of appeal for each. The first level of appeal can reconsider issues of both fact and law, while the second level of appeal can consider only matters of law.

46. Lay judges—common in socialist legal systems—were eliminated from the panels of judges in July 1991.

47. The Romanian Ministry of Justice has already begun to organize a program of judicial training. Romanian experts—those formerly involved in international commercial law or inter-enterprise disputes—have been called upon to teach commercial law to judges and lawyers, as well as staff of the Ministry of Justice. The Ministry has sponsored regional conferences and training seminars that incorporate both economic theory and case studies of foreign and Romanian commercial disputes. Finally, foreign professors are being invited to lecture at law faculties and participate in workshops with Romanian lawyers and judges.
Since independence in 1991, Slovenia has been intent on creating the conditions for an efficient market economy and an expanding private sector. The Slovene case is rather unique in Central and Eastern Europe for three reasons. First, Yugoslavia took an independent course and began experimenting with the introduction of market forces soon after World War II. As a result, Slovenia—which was the richest of the Yugoslav Republics—is ahead of other CEE countries in standard of living, experience with markets, and openness to influences from abroad (particularly from Western Europe). Second, unlike other CEE countries, the federal structure of Yugoslavia until 1991 gave large lawmaking powers to the individual Republics, and the issue of Federal-Republic legal relations and "conflicts of laws" was always central. Third, Slovenia has since 1991 been trying to resolve the issue of which Yugoslav laws to adopt and which to replace with wholly new Slovene legislation. Legal "succession" has been a major issue.

Constitutional Law

On December 23, 1991, Slovenia adopted a new constitution, one year after the public referendum overwhelmingly voted in favor of an independent sovereign Slovenia. This is the culmination of a series of constitutional developments promoting ever-greater dissolution from Yugoslavia.

The Historical Setting

In contrast to the United States, with its one constitution in 200 years, constitutions in Eastern Europe change regularly. Post-war Yugoslavia had 4 constitutions—1946, 1953, 1963, and 1974. The 1946 constitution introduced central planning, while the 1953, 1963, and 1974 constitutions introduced and later revised the concept of worker self-management. Yugoslav constitutions also tend to be long, with extensive sections on desired goals for the country. The 1974 Yugoslav constitution, for example, has over 400 articles on over 160 pages.

The federalist structure of Yugoslavia gave the Republics extensive powers over the legal frameworks within their jurisdictions, especially under the federal constitution of 1974. In addition to the federal constitution, each republic had its own constitution. Slovenia's most recent socialist constitution dates from 1974, with amendments in 1981, 1989, 1990, and 1991. Federal law was supposed to set the basic legal foundation in any particular area, with specifics regulated by republican law; for example, federal law set the foundations of the tax system, with specific rates and regulations set by the republics. In case of conflict the federal law had priority, but the Republics began to question this priority as tensions developed in the late 1980s.

The 1990 and 1991 amendments to the Slovene constitution were designed to further reforms toward a market economy and set the stage for the ultimate independence of Slovenia. For example, amendment 91 in March 1990 deleted the word "Socialist" from the Republic's title. Amendment 96 in September 1990 reversed the priority of laws in cases of conflict, stating that articles of the Federal constitution would not apply if not in accord with the Slovene constitution, and that new federal laws, regulations, and acts of federal authorities would be valid in Slovenia only after approval by the Slovene Parliament. Old Yugoslav laws were implicitly still valid unless specifically rejected by Parliament. More than 200 Yugoslav laws implicitly remained in force.

The public referendum was held on December 23, 1990, followed in February 1991 by Parliamentary resolutions that granted Slovenia control over turnover and import taxes, with only a small payment authorized to the center to support the minimal functioning of
The resolutions also directed the Slovene government to prepare an anti-inflation program, a proposal for the separation of financial assets and liabilities (including external debt) among federal units, and several policies and laws in the areas of pricing, fiscal and monetary policy, and international economic relations. Amendment 99 in February 1991 then revoked Slovenia’s authorization for the Federal government to manage Slovenia’s international relations with foreign countries (including all international treaty authority). And on February 20, 1991, the Parliament adopted a resolution proposing the consensual dissolution of Yugoslavia. The resolution called for the independence supported by the December referendum to be realized within 6 months of the plebiscite.

During this same period, the Slovene Parliament and government studied which federal laws should apply and which should not apply in Slovenia. Constitutional laws of October 1990 and January 1991 declared null and void in Slovenia federal legislation in many areas, including (in the economic area) all or parts of laws on cooperatives, the tax system, economic planning, associated labor (with regard to worker self-management), internal trade, nationalization (the 1946 law), pension and social security, social capital transformation, ownership relations, labor relations, and financial management. On the other hand, changes in numerous federal laws made after October 1990 were accepted by decrees of the Slovene Parliament as binding in Slovenia (at least temporarily), including changes in the enterprise, accounting, bankruptcy, banking, and insurance laws.

Finally, on June 25, 1991, Slovenia proclaimed its independence with three documents—the Basic Constitutional Document on Sovereignty and Independence of the Republic of Slovenia, the Constitutional Law for its realization, and the Declaration on Independence. These documents were designed as the final step toward independence, transferring all remaining powers and duties from federal to Slovene institutions and asserting full control over borders and diplomatic relations and over domestic economic policies. Numerous new (or renamed) institutions opened on that day, including the Bank of Slovenia; the Customs, Air Traffic, and Telecommunications Administrations; the Office for Standardization and Measurement; and the Patent Office. A package of new "laws of independence" was also adopted, including laws on citizenship, foreign affairs, customs, foreign exchange, the central bank, banking, bank restructuring, and prices. And amendment 100 to the existing Slovene constitution established the coat of arms and the flag of the Republic of Slovenia.

The federal government reacted negatively and forcefully to these acts of independence, and a 7-day war erupted that led to about 70 casualties. In early July the European Community brokered a 3-month moratorium on further acts of both dissolution and armed aggression. When the 3-month moratorium ended in early October, Slovenia introduced its own currency, the tolar. And on December 23, it adopted a new constitution.

The New Constitution

Slovenia’s new Constitution consists of 174 articles organized in a preamble and 10 chapters:

I. General Provisions (13 articles)
II. Human Rights and Basic Liberties (52)
III. Economic and Social Relations (14)
IV. State System (58)
V. Local Government (8)
VI. Public Finance (7)
VII. Constitutionality and Legality (7)
VIII. Constitutional Court (8)
IX. Procedures for Changing Constitution (4)
X. Provisional and Final Provisions (3)

Although most of the constitution’s provisions are non-economic in nature, certain provisions are designed to create and protect individual economic rights in a private market economy. For example, chapter II contains explicit protection of private property (Article 33), freedom of occupation ((Article 49), free
primary education (Article 57), and protection of copyrights (Article 60). Chapter III stresses the economic importance of ownership rights (Article 67), but forbids foreign ownership of land, except if inherited on principle of reciprocity (Article 68). This chapter also promises freedom of entrepreneurship (Article 74) and forbids restrictions to competition and unfair competition (Article 74). It requires the state to create conditions for employment (Article 66) and guarantees the right to strike (Article 77) and the right of citizens to appropriate housing (Article 78). The chapter calls for special protection of land, including the protection of agricultural land (Article 71).

It is interesting to note that the draft article giving workers the right to participate in economic decision making was omitted from the final proposal. After having the most extensive worker participation of any country in the world, the pendulum has swung back in the opposite direction, and the idea is now virtually abandoned in Slovenia. Worker management is, however, still widespread in state enterprises as a vestige of the past, and the recently adopted privatization law envisions extensive future ownership of firms by their employees.3

Effective yet limited government is essential for the private sector to grow and prosper. Chapter IV, on state structure, tries to insure a responsible state apparatus by setting up a system of checks and balances similar to that in other parliamentary systems in Europe, including those provided in the new constitutions of other CEE countries. It establishes a bicameral parliament, with a main chamber—the State Assembly—and a second, less important chamber—the State Council. This was a compromise solution between the opposition parties, which wanted a Parliament with two equal chambers (one weighted in favor of regional interests), and the ruling coalition, which favored a one-chamber Parliament. The State Assembly has 90 members (Articles 80-95) elected for 4 years.4 It has the sole power to adopt laws. The State Council, included as a compromise to protect regional interests and occupational groupings, has 40 members elected to 5-year terms by various interest groups (Articles 96-101). It has the power to propose legislation, to advise the State Assembly on proposed legislation, and to block the adoption of a proposed law and return it to for renewed discussion (Article 97). If the proposed law is then reconsidered and readopted by a majority of all delegates in the State Assembly, it becomes law and cannot again be blocked (Article 91). This chapter also gives lawmakers authority to the public referendum, which may be called by either chamber of parliament or by petition from at least 40,000 voters (Article 90).

The power of parliament is counterbalanced by the other branches of the state—the president, the prime minister, and the judiciary. The president is elected directly by the public for a 5-year terms (with a maximum of two consecutive terms) (Article 103). The president is commander-in-chief of the army (Article 102) and proposes a candidate for prime minister to the State Assembly (Article 111). If approved by Parliament, the prime minister then proposes ministers, who are scrutinized by parliamentary commissions (Article 112). The judiciary is composed of three levels of courts—the basic courts, the higher courts, and the Supreme Court (Articles 126, 127). Military and other extraordinary courts are prohibited in peacetime (Article 126), although the Court of Associated Labor, formed under the socialist regime to handle labor disputes, still exists. Judges are proposed by the Court Council and appointed for life terms by the State Assembly (Articles 128, 130). Unlike some other formerly-socialist countries, Slovenia has maintained the institution of lay judges (Article 128), who join professional judges on panels to decide cases and impose appropriate sanctions.5

Chapter 8 provides for a constitutional court, another source of checks and balances in the system.6 Its primary role is to review the constitutionality of laws, regulations, and individual acts of the state or political parties (Article 160). It is also empowered to review whether laws conform to international treaties and to decide disputes regarding the competency of the various branches of the state or local
communities (Article 160). Any person with a "legal interest" (presumably a case in controversy) may request review of a constitutional complaint (Article 162). If the court finds a law to be unconstitutional, it is automatically annulled (Article 161).

The remaining chapters of the Constitution deal generally with local government (Articles 138-145), public finance (Articles 146-152), constitutionality and legality (Articles 153-159), and amendment (Articles 168-171) and transition procedures (Articles 172-174). A constitutional law, adopted on the same day as the constitution, provides that existing laws remain valid but should be harmonized with the constitution by the end of 1993 (Article 1). Numerous issues that remain undecided in the constitution are to be addressed in later legislation.*

Rights to Real Property

As in most of Central and Eastern Europe, real property rights are in a state of flux in Slovenia as it moves to reverse decades of socialist and labor-management influence. Private ownership of land and housing and privately-owned small businesses have long existed in Slovenia, albeit on a limited basis, and thus the concept is not as radical as in some of the more traditional former socialist states. Furthermore, basic principles of property law and property rights and the system of land registration (with accompanying records) inherited from the Austro-Hungarian empire remain in place. However, the massive efforts now beginning to return previously nationalized real property to former owners is likely to create great upheaval in property markets and uncertainty in real property rights for some time to come.

Defining Basic Ownership Rights

A large part of Yugoslavia—including Slovenia, Croatia, Bosnia and Herzegovina—was part of the Austro-Hungarian empire before the creation of Yugoslavia in 1918. After 1918 Austrian law continued to heavily influence lawmaking in the new country, and the Austrian General Citizens Code ("Allgemeines Buergeliches Gesetzbuch") of 1811 (as later amended) became the basis for property and contract relations among private natural persons and legal entities, whether in private or business activity.10 It was translated and essentially adopted as general law except in a few fields (such as bankruptcy) where specific Yugoslav statutes held precedence.

During the socialist period after World War II until 1990, three forms of property were legally recognized in Yugoslavia. The first, "social" property, was owned in principle by all the people11 and was managed under the uniquely-Yugoslav variant of socialism, the system of worker self-management. Most of the economy, including 90 percent of all fixed capital, fell in this category. The second, cooperative property, was recognized but not well-developed or widely used in Yugoslavia as in some of its socialist neighbors. The third, private property, was restricted to personal ownership of real property (with a general maximum of one medium-sized house or 2-3 apartments per person, not including vacation homes), small businesses (primarily individual service providers such as lawyers or craftsmen), and small private farms (with a maximum size of 10 hectares, increased to 30 hectares in 1988). Unlike other socialist economies (except Poland), most farming in Slovenia was done on a small scale, and 85 percent of all land remained privately owned.

After World War II, a special 1946 decree prolonged the validity of any prewar legislation not clearly in opposition to socialist principles until it could be replaced by new legislation. The private civil law adapted from the Austrian civil code remained essentially unchanged, although much of it fell into disuse. It continued to apply only in the small area carved out for private property and private transactions. It took over 30 years for the country to adopt new legislation in the two main areas of private civil law—property and obligations. In the property area, the Law on Foundations of Property
Relations was adopted in 1980. Even this law, however, retained many of the principles of the Austrian predecessor, and incorporated relatively few principles unique to socialism and worker self-management. Amendments in 1990 removed these few socialist principles from the law, returning it more or less to its original foundations from the Austrian empire.

The Law on the Foundations of Property Relations remains valid in Slovenia, as do numerous special laws in the area of property rights that were adopted in Yugoslavia in recent years and not explicitly abrogated by Slovene laws. At some point the general law will be replaced by specific Slovene legislation. Already specific Slovene laws have been adopted in the areas of denationalization, housing and cooperatives, and proposed laws on land and forestry are being considered by Parliament. And, as noted earlier, the newly-adopted constitution guarantees private property rights and abolishes any limits on property ownership (Article 33). Thus, rights of Slovene citizens to own and use real property in private business appear to have a solid legal basis.

These rights do not extend to foreigners, however. The new Slovene constitution specifically restricts foreigners from owning land in Slovenia, either for business purposes or as a residence, except in the special case of inheritance when reciprocity is provided by the home country of the heir (Article 68). Although foreign ownership of buildings is not strictly illegal, the right of foreigners to own or obtain mortgages in any real property was temporarily suspended in October 1991 until specific Slovene legislation covering the property rights of foreigners is adopted.

Eliminating the Monopoly of "Social" Ownership

Restitution. The Slovenian reprivatization initiative, called "denationalization," is among the most radical to date of all similar initiatives in reforming socialist countries. Although the Slovene law on privatization of social enterprises was entwined in political dispute within Parliament until late 1992, a Law on Denationalization was adopted in November 1991. This law intends to "reprivatize" not only the land previously nationalized under the agrarian reform statutes of 1946, 1948 and 1953, but also the property and shares of businesses nationalized in 1946 and 1948, buildings nationalized in 1958, and property confiscated in 1944 and 1946 from citizens accused of collaborating with the Germans. It was estimated during preparation of the law that some 4 billion Deutsche Mark (or US$2.5 billion) worth of social property would be subject to denationalization—about 10 percent of all social property or 7 percent of all property in Slovenia. Natural persons who were Yugoslav citizens at the time of nationalization (or their close relatives or heirs) are eligible, as are religious organizations (Articles 5, 9-13). Legal entities other than religious organizations are not eligible (Article 14). If possible, the property is to be returned in-kind (Article 2). Otherwise, compensation is to be provided in substitute property, securities, or money (Article 2). Eligible individuals have until June 1993 to submit a request (Article 64).

Although it represents a clear statement of radical intent by the Parliament, the reprivatization law will not necessarily result in an efficient allocation of property rights. Furthermore, it is creating tremendous uncertainty due to the law's long period for claims. The process could take several years, especially given the limited capacity of the judicial system for processing claims and resolving disputes. Insecurity of property rights during that period threatens to seriously impede the investment that is so badly needed for economic recovery and growth. Finally, the law is likely to exacerbate political tensions and uncertainty if it leads to large redistributions of wealth away from workers toward pre-war owners of property and their heirs (whether resident in Slovenia or abroad).

Housing privatization. In the same month that the denationalization law was passed, the
Slovene parliament adopted a housing law that provides, among other things, for extensive privatization of socially-owned apartments. About 50 percent of these 229,000 apartments in Slovenia are being sold within 2 years to current tenants under this law. Because of administratively-determined prices and official discounts offered to purchasers, sales prices are low. For example, when the law was passed a one-bedroom apartment (55 square meters) in the capital city, Ljubljana, could cost less than $8,000 at current exchange rates.

While privatization of state-built housing is relatively easy because existing tenants have clear priority rights (Article 18), privatization of previously nationalized housing is much more difficult because of the competing interests of current tenants and former owners. Because of strong support for tenants’ rights, the strong push for reprivatization (or denationalization) throughout Central and Eastern Europe is most difficult to apply in the area of housing. In Slovenia the denationalization law takes precedence over the housing law. Previous owners can choose between compensation from a restitution fund or return of the property in kind. If they receive the apartment in kind, holders of the housing right are entitled to receive 30 percent of the value of the apartment plus a housing credit of the same amount (Article 125) if they vacate within 2 years.

Revising the Regulatory Framework

Slovenia, like the other formerly-socialist economies of Central and Eastern Europe, needs to rethink the many controls on the use of real property that it has inherited from the socialist period. For example, like its neighbors, Slovenia has long protected agricultural land from “misuse” through strict zoning regulations. A permit is still required to convert agricultural land to nonagricultural uses; not only is permission difficult to obtain, but such conversion, if administratively approved, is further discouraged through high taxation. As the market in urban and rural land develops, relative prices should become more of a gauge of the most productive use of scarce land and should over time replace many administrative controls.

Controls on the use of urban land also need rethinking. Although Slovenia suffered less from rigid land use planning and large-panel construction methods than more highly-centralized socialist systems, its construction and zoning rules had some of the same shortcomings. Furthermore, existing Slovene construction regulations contain a long list of required permits that are likely to be overly-restrictive, ill-designed, or redundant in a private market economy. If the past is an indicator, they are also likely to impose an expensive and time-consuming burden that will further hamper the emergence of a private construction sector.

Rights to Intellectual Property

Patents and Trademarks

After declaring independence, Slovenia recognized all federal Yugoslav laws in the field of intellectual property as applicable in the new republic. These include the law on the protection of industrial property of 1981 (covering patents and trademarks), the copyright law of 1978 (as amended), and the statute setting up the patent office. Slovenia is now moving to update and replace these laws with legislation that is more in line with market-based international norms. On the institutional side, in June 1991 it established the Agency for the Protection of Industrial Property, which is supposed to assume the functions previously carried out by the analogous Yugoslav federal agency. Registrations previously made in the federal agency remain valid in Slovenia.

The applicable law for patents and trademarks in Slovenia until March 1992 was the Yugoslav industrial property law of 1981—the Law on the Protection of Inventions, Technical Improvements and Distinctive Signs. When adopted, this law was a step backward from its predecessor in terms of the legal protections it provided. For example, patents and trademarks
were protected for only 7 years, with the possibility of extension for 7 more (Article 51), and many items (such as pharmaceuticals) were excluded from protection altogether (Articles 20, 23). Internal and external pressure led to amendments in 1990 that improved patent and trademark protection, and Yugoslavia simultaneously moved to expand its participation in relevant international conventions.

Slovenia passed a new patent law in March 1992. The new law is similar in structure to the amended federal law of 1990 but broader in coverage.\textsuperscript{25} It provides patent and trademark protection closely in line with modern international standards and existing international conventions. The period of patent protection is extended to 20 years (Article 37), the first 10 upon request without examination as to novelty or applicability\textsuperscript{26} and the second 10 upon submission of written proof of testing (the so-called "Document of Evidence") by an approved foreign testing institution (as specified in the Patent Cooperation Treaty) (Article 71).\textsuperscript{27} Compulsory licenses—pursuant to which the government can force the issuance of a license to a third party to produce a patented product if the patent holder does not produce it—continue to be a feature of the law (Articles 112-117).\textsuperscript{28}

Copyright

The Yugoslav Copyright Law of 1978, as amended in 1986 and 1990, remains valid in Slovenia. The original law was heavily influenced by the self-management philosophy of the time and was a step backward in legal protection from the previous law of 1968. The 1990 amendments were more extensive. Among other things, they eliminated the self-management rhetoric in the original law and introduced copyright protection for computer programs. Copyright protection under the current law lasts during the author's life and for 50 years after his or her death (Article 82 of the Copyright Law); in this and most other ways it fully meets international norms for protection. Although the Slovenian government has announced its intention to adopt a new copyright law in the future, the need is not urgent and preparation has not yet begun.

Needs are greater on the institutional side. The previous Yugoslav copyright agency consisted of a main office in Belgrade and regional offices in the capital of each republic. In mid-1991, the Ljubljana office became the Slovenian Copyright Agency, without change to its general functions or staffing. As in the case of patents and trademarks, institutional development is critical to the development of a reliable legal framework for copyright protection.

Yugoslavia has ratified the major conventions in the field of intellectual property, including the 1883 Paris Convention for the Protection of Industrial Property (1967 Stockholm text), the 1891 Madrid Agreement for the International Registration of Trademarks (1967 Stockholm text), and the Berne Copyright Convention (Paris text of 1971). Slovenia has indicated its intention to be a signatory to these conventions in its own right.

Company Law

Historical Background

For some 30 years prior to 1989, Yugoslav companies operated under the unique Yugoslav concepts of social ownership of the means of production and worker self-management. These principles, enshrined in successive constitutions and laid out in greatest detail in the Law on Associated Labor of 1976, gave no one true ownership rights over enterprise assets but gave ultimate managerial power (at least formally) to workers' councils elected by the workers' assembly (Articles 490-495). Separate enterprises with legal personality—called "basic organizations of associated labor" or "BOALs"—could be formed by any group of workers, whether or not these enterprises constituted logically separate economic entities. The only three conditions required for a BOAL to be formed were (1) that it be a working unit, (2) that the value of its product could be separately calculated, and (3) that self-
management rights could be exercised (Article 320). Thus the industrial economy was carved up into a multitude of small self-managed units, often themselves departments of larger operating entities. The government used fairly ad hoc taxes and subsidies to redistribute income among these units, thus keeping the weaker ones afloat and preserving employment. Incentives in this extreme version of worker democracy under "soft budget constraints" ran counter to efficiency and growth, as workers tended to be more concerned with increasing wages and benefits—and the government with preserving employment—than with preserving and enhancing the productive capital stock of the firm.

The Yugoslav Enterprise Law adopted in 1988, which took effect January 1, 1989, represented a radical departure from the past. It introduced modern company forms into Yugoslavia and provided equal treatment for privately-owned and socially-owned firms. Together with the new Foreign Investment Law that took effect the same day, it also provided greatly expanded avenues for foreign investment and similar treatment with domestic investment. It repealed most of the Law on Associated Labor (except Article 196 dealing with labor relations) and called for the BOALs to be consolidated in larger units and reorganized into stock companies (Article 192). It also downgraded the powers of workers’ councils (Article 131), and 1990 amendments to the law did away with the requirement of obligatory establishment of workers’ councils in joint stock and limited liability companies.

The Yugoslav Enterprise Law is still the currently applicable law in Slovenia, although lawmakers have prepared a draft of a new law that is expected to be adopted in mid-1993. The new law, The Law on Economic Companies, closely follows the German model. Although it contains company forms similar to those in the current law (as discussed below), it is a longer law and its provisions are far more detailed. As described below, both the current and proposed laws and the procedures for setting up a company are relatively well-adapted to the needs of a private market economy.

The 1988 law distinguishes 4 types of ownership—social, cooperative, mixed, and private—and 4 forms of companies—the joint stock company, the limited liability company, the limited partnership, and the general partnership (Article 2). Social ownership is a remnant of the previous regime. Enterprises with social ownership continue under this law to be worker self-managed, although they may for the first time be set up as joint stock or limited liability companies (Articles 36-41). Cooperative ownership continues to be recognized, although it has never been widely used in practice (Article 143). Cooperatives can in principle be organized in any of the 4 forms as well as a more traditional cooperative enterprise. Mixed ownership refers to any combination of social, private, and/or cooperative ownership, whether or not there is participation by foreigners (Articles 81-131). Wholly private ownership—involving neither social nor cooperative ownership in any way—can similarly be either domestic or foreign (Articles 138-142). Firms with mixed and private ownership—those most relevant to the topic of this paper—can be set up in any of the 4 company forms provided by this law. In addition, small private activities such as shops, farms, or services (such as lawyers or craftsmen) can be carried on less formally with simple registration (Articles 141-142). In principle all forms of enterprise under all types of ownership have the same status, rights and responsibilities in the economy.

**Characteristics of a Joint Stock Company**

*Capital and share requirements.* The joint stock company is similar to the French SA, the German AG, and the Anglo-American public corporation. Until recently minimum required capital was quite low at 150 million old dinar (Article 86), or 15,000 tolar—worth approximately $29,000 in December 1988 but less than $1,500 just one year later and less than
The minimum was raised to $200 today.29 The minimum was raised to 450,000 tolar (about $4,000) in 1992, and under the new proposed law it will again be raised to three million tolar (about $27,000). Capital contributions can be in money or in-kind (Article 95), and contributions must be paid-in before the first shareholder meeting (Article 98).

Shareholders' rights and duties are quite flexible in this law, and the company's articles of association has wide latitude to tailor them to the needs of the company. Both bearer and registered shares are allowed (Article 175), and both may be freely transferred (the former by delivery and the latter by endorsement and entry in the share register). Shares can be divided into common and preferred, with the latter having priority with regard to dividends or return of capital upon liquidation (Article 177). Although the general voting rule is one share-one vote, some shares may be accorded more than one vote or the total votes of any one investor can be limited by the articles (Article 122). Non-voting shares are also allowed (Article 89). Thus investors have wide latitude to separate control from ownership and to tailor shareholders' rights to the specific concerns of individual investors. For example, some foreign investors—such as those with highly sophisticated technology—may want management control despite having only a minority ownership interest. Or they may be more risk averse than the Slovene partner and prefer priority in the event of liquidation to anything else. These flexible rules allow joint investors to accommodate each others concerns.

Corporate governance. The 1988 law provided for two levels of corporate governance for both joint stock and limited liability firms—a managing board and a supervisory board. The managing board (Articles 124-127), analogous to a board of directors in the U.S., was responsible for appointing the company's senior managers and setting general guidelines for their performance. The supervisory board (Articles 128-130) was supposed to oversee the managing board by reviewing annual reports, accounts, and proposals regarding profit distribution. Members of both boards (minimum of three each) were to be appointed for four-year terms by the general meeting of shareholders or partners (Article 123). Amendments to the law in 1990 eliminated the requirement of a supervisory board, although one may still be provided for in the company's articles of association. The new proposed law reinstates the requirements of a supervisory board for large firms. Aside from setting this basic structure for corporate governance, the law is flexible. The company can determine the number of members of each board and special conditions for selection in its articles of association or bylaws (Article 123).

As noted earlier, workers no longer have an explicit role in management.30 Even the requirement that joint stock companies have workers' councils, which was contained in the 1988 law, remained only as option in the 1990 amendments (Article 45). Workers' councils are still required in socially-owned companies (Article 47), but the law envisions that such companies will soon be transformed into share-issuing joint stock companies in which workers' managerial rights will derive solely from any share ownership they may have. Workers' rights in joint stock companies will henceforth be protected by collective bargaining agreements governed by republic-wide standards combined with enterprise-specific agreements.

Characteristics of a Limited Liability Company

The limited liability company resembles the French SARL and the German GmbH. It is intended as an alternative, less formal corporate form to be used by small groups of investors who know each other. Minimum capital was originally set at 20 million old dinar (Article 104, about $4,000 in 1988 but only $200 one year later) and is now 100,000 tolar (about $900). As with the joint stock company, it will be raised under the proposed new company law—to one million tolar (about $9,000) in the LLC case. Although there is no minimum or maximum number of partners prescribed by law,
a partner cannot sell shares to outside parties without the consent of the other partners (Article 107). This restriction reflects the nature of the company, where all investors are expected to play an active role and where close control over the activities and ownership of the company is thus desired.

**Characteristics of the Two Partnership Forms**

The two types of partnership are the limited partnership and the "company with unlimited joint and several liability" (or general partnership) (Articles 109-119). Both forms are similar to analogous forms typical of market economies. In the limited partnership, the limited partners are passive investors and their liability is limited to their investment (Article 109). The general partners manage the company and have unlimited liability (Article 109). Share capital can be transferred to third parties only with the agreement of the founders, unless otherwise specified in the articles of association (Article 112). In the general partnership, all partners are assumed to be active in management and are fully liable for the obligations of the company (Articles 115-117). As with the limited partnership, share capital can be transferred to third parties only with the agreement of all partners (Article 119).

**Setting up a Company**

Setting up a company has typically been relatively easy and inexpensive in Slovenia. The founders must first prepare the articles of association and deposit the initial capital in a temporary account with the Service of Social Accounting (Company Law, Articles 81-84). The signatures of the firm's directors must be approved by the court (Article 184). Approval of the firm's articles by a notary is not required under the current law but is expected under the new proposed law. A new Notaries Act, which would introduce this institution into Slovenia for the first time, is now under debate. Companies with foreign participation must then submit the joint venture agreement (or similar document) to the Ministry of Foreign Affairs, whose approval is deemed granted if no response is received within 30 days. All companies must then send all relevant documents to the regular court at the seat of registration, which is supposed to issue its decision within 30 days (Company Law, Articles 183-187). The company is a legal entity upon approval by this court. In practice, approvals by both the Ministry of Foreign Affairs and the courts have been relatively quick. The final step is entry in the court register (at which time it is binding against third parties) and publication in the Official Gazette (Article 186).

**Foreign Investment**

Foreign investment was first allowed in Yugoslavia in 1978, with the passage of the Law on Investment of Foreign Persons into Domestic Organizations of Associated Labor. This law was, however, relatively restrictive, with high requirements for invested capital and strict limits on profit repatriation. Furthermore, foreign investment had to accommodate the Yugoslav self-management rights of workers, which in practice meant an often intolerable sacrifice of managerial control for the foreign partner. Amendments in 1984 and 1986 did little to change this restrictive regime. As a result, the flow of foreign investment was small, amounting to less than 1 percent of domestic investment over this period (but still more significant than that in any other CEE country in that period).

**Forms of Investment**

The Foreign Investment Law of 1988, introduced simultaneously with the Enterprises Law, represented a radical departure from the previous regime. Pursuant to this law, which is still the law in force in Slovenia today, foreigners (whether legal entities or natural persons) may freely invest in Yugoslav firms and may own up to 100 percent of the assets (Article 10). The form of foreign investment is governed by the enterprises law (with its 4
forms as outlined above), and foreigners are free to invest in firms with social, cooperative, mixed, or private ownership.  

Profit Repatriation and other Rights and Guarantees

No matter the form or ownership, firms are guaranteed management rights and the right to share in profits or return of capital, both in proportion to the amount invested (Article 5). No limits are placed on profit repatriation (Article 5 para 6). Broad national treatment is provided by Article 8:

Enterprises with foreign investments shall have the same status, rights and responsibilities on the unified Yugoslav market as socially-owned enterprises.

The law does not specify a particular tax regime or special tax incentives for foreign investment. Rather it provides that the individual republics shall decide on the tax regime and on tax reliefs on start-up profits or amounts reinvested (Article 8). Slovenia recently reformed its tax structure, and its company income tax rate—30 percent—is now among the lowest in Europe. New firms, whether domestic or foreign, get special treatment. As noted in Chapter 1, special tax incentives for foreign investment alone are not advisable; not only do they complicate tax administration and unfairly discriminate against domestic firms, but they are unlikely to have a major impact on the volume of investment as long as the underlying tax structure is reasonable.

Despite the far-reaching changes in attitude and treatment toward foreign investment embodied in the 1988 law, the most important change introduced that year for foreign investors was the repudiation of worker self-management and the introduction of modern corporate forms contained in the Enterprise Law. The concept of worker self-management was in constant tension with the desire of foreigners to control and manage their investments. Even if foreigners obtained day-to-day management rights by agreement, they could not remove the workers’ ultimate power to repudiate such agreement. The new laws for the first time give managerial authority clearly to the owners of a firm, and provide flexible rules within which the investors can work out their own optimal balances between ownership and authority.

Even with these important changes in 1988, there has been relatively little foreign investment to date. The main reasons are clear—extreme economic instability followed by political instability. Yugoslavia’s inflation soared to an estimated 2800 percent in 1989 due to a lapse of fiscal and monetary control in the face of growing enterprise deficits. Dramatic attempts at stabilization at the beginning of 1990 succeeded in bringing down inflation and resurrecting some positive economic signs, but they were quickly followed by the growing political crisis and eventually civil war. The returning relative political calm and economic stability in Slovenia as its independence begins to be recognized around the world gives renewed hope that the political and economic climate for foreign investment will support the favorable legal framework introduced earlier to stimulate a renewed inflow of foreign capital.

Contracts

In 1991 Slovenia implicitly adopted the Yugoslav law on contracts, the 1978 Law on Obligations. This law, along with the Law on the Foundations of Property Relations discussed earlier, had replaced the Austrian Civil Code which had previously governed both property and contract relations. The 1978 Law on Obligations did not depart radically from its Austrian predecessor, and its principles fit squarely within the civil law tradition. For example, the generally-applicable sections in Part I of the law provide for freedom of contract and equality of rights among the parties and set out modern rules of offer and acceptance, concepts of capacity and invalidity (on grounds of error, deceit, or duress), notions of consideration (or equivalence of things
exchanged), standards for completion, and remedies for breach of contract. The law then provides in Part II special rules for particular types of contracts, including (among other) sale, gift, rent, employment, storage, business representation, insurance, warranty, assignment, and secured and unsecured credit.

Although drafted during the socialist period, the 1978 law included few references to socialist or self-management principles. This was because it was always meant to govern relations between private parties, while relations involving public entities were to be covered by other laws. Thus, major revisions are not needed (as, for example, were needed in Poland) for the law to provide an adequate framework for private contracts in the post-socialist era.

Bankruptcy

The Current Situation

Yugoslavia passed a new bankruptcy law in December 1989. The same month it adopted a new package of economic policies designed to bring down the hyper-inflation of 1989 and open the economy to foreign competition. The government vowed to stop bailing out loss-making firms, forcing them instead into bankruptcy. The Social Accounting Service was instructed to file a bankruptcy case any time a social enterprise was in arrears for more than 60 days. As a consequence, the number of bankruptcies increased rapidly. While only 62 bankruptcy petitions were filed in Slovenia between 1983 and 1989 (with 41 ending in closure), 134 petitions were filed in 1990 and 234 in the first half of 1991. Among them were numerous large firms, and the rate of unemployment more than doubled in Slovenia from 1990 to 1992. Fearing the social disruption that would result from the ever-increasing number of bankruptcies, the Yugoslav authorities suspended the right of the Social Accounting Service to bring cases in early 1992. The suspension was formally lifted in October, 1992, but relatively few cases are being brought, and there appears to be an informal moratorium on most cases until privatization and other modes of restructuring are given a chance to proceed.

Under the 1989 Yugoslav law, now still valid in Slovenia, bankruptcy proceedings may be initiated by creditors, the debtor himself, the Social Accounting Service, or other persons as determined by law (Article 3). A bankruptcy board composed of three judges oversees the proceedings, with day-to-day management of the proceedings by a bankruptcy judge (who is not a member of the board) (Article 13). Through public notice creditors are asked to post their claims. The board may form a board of creditors to represent creditors’ interests if requested by creditors with more than half of all claims (Article 53). The management of the insolvent company is turned over to a trustee, who takes active steps to wind down the activities of the company (Articles 61-64). Workers are let go (Article 93), an estate in bankruptcy is formed (Article 95), the accounts of the debtor are suspended (Article 97), and all activities are terminated except for the completion of transactions already begun (Article 119). Assets are sold, and the proceeds are used to pay the costs of the proceeding itself and then to satisfy creditors’ claims, generally on a proportional basis (Article 121).

Although the law does not allow specifically for reorganization, an insolvent debtor is entitled to propose a compulsory settlement to creditors prior to or concurrent with bankruptcy proceedings (Article 18). Under compulsory settlement, the company is allowed to continue its normal activities under existing management but not to sell or mortgage property (Article 47). If creditors with over 50 percent of all claims agree, the three judge settlement board can approve a settlement whereby a percentage—not less than 50 or 60 percent—of each claim will be repaid over three years and the remainder forgiven (Article 21). In contrast to reorganization, compulsory settlement is not aimed at changing the structure or activities of the debtor and thus insuring that the indebtedness problem is alleviated in the longer run.
Although some bankruptcy cases have been filed by the Social Accounting service, as noted above, no cases of bankruptcy have been brought by creditors. In fact, under current procedural law, the procedural barriers to creditor filing are enormous. First, the creditor must bring a case and get a court judgment that a claim exists. This can take 2-3 years. Then, the creditor must prove that it cannot recover in any other way, which takes still more time (perhaps 1/2 year). If this is proved, the creditor must deposit money to cover the costs of the bankruptcy case itself—typically DM 2000-3000 (which is theoretically later reimbursable from any bankruptcy proceeds).

The New Draft Bankruptcy Law

Although Slovenia continued to use the Yugoslav law after declaring its independence, the Slovene government is now debating a new bankruptcy law. The new law, which is still in draft, is intended to remedy some of the deficiencies of the old one. Most importantly, it introduces the possibility of financial reorganization in lieu of either compulsory settlement or closure of insolvent firms. Such reorganization could include, for example, sale of part of the assets of the firm, streamlining the activities of the firm or laying off workers to reduce costs, merger of the firm with another, or sale of the entire firm as a going concern. The debtor can introduce a plan for financial reorganization concurrently with a plan for compulsory settlement, and both are voted on by creditors. Because of the possibility of financial reorganization, compulsory settlement is no longer the only alternative to bankruptcy, and thus it takes on less importance. The bankruptcy board is no longer obligated, for example, to test the compulsory settlement route by trying to assess either the willingness of the majority of creditors to settle or the adequacy of the bankrupt’s assets to meet the claims under such settlement. Rather, the board and the creditors can consider the alternative of reorganization simultaneously or in lieu of either of the other options.

The Slovene draft also contains other changes, including the downgrading of the Social Accounting Service (which is no longer competent to introduce bankruptcy proceedings), the introduction of the concept of shareholders’ claims (which are subordinate to those of creditors), and the replacement of the bankruptcy judge by the president of the bankruptcy board. Liquidation is not covered by the new draft, but is to be regulated instead by a new company law now under discussion.

Some marginal changes could be made to improve the current draft law. First, the procedural barriers to creditor filing of cases should definitely be lowered. Second, steps could be taken to reduce the power of company managers and strengthen the voice of creditors in the restructuring process. One means might be to allow not only current management to submit a restructuring plan, but to solicit other competing plans (including plans from creditors and/or outsiders) at the same time. This could be highly beneficial in pushing incumbent management for true restructuring and giving creditors a better view of the true going-concern value of the company. In addition, strict time limits could be imposed on the submission of plans, and managers could be allowed only one chance to submit a plan before the procedure converts to liquidation.

The main problem with regard to bankruptcy in Slovenia, however, is not the law but rather the incentives still inherent in the system. Creditors are very hesitant to bring cases to court for several reasons, including the high costs of the proceedings, the inexperience of most judges and trustees, the questionable value of the remaining assets of the debtor (especially in today’s recessionary environment), and the lingering hope that the public treasury will bail them out from bad debts. More generally, many Slovene enterprises are illiquid or insolvent, and the government and Parliament both fear the social disruption that strict enforcement of bankruptcy laws might create. Meanwhile, other means to collect on bad debts, including creation and foreclosure of security interests in real or moveable property, are themselves
underdeveloped in both law and practice.\textsuperscript{41} Bankruptcy is only one part of this larger legal arena of debtor and creditor rights that will take some time to develop.

As noted in Chapter 1, a two-track approach may be optimal in the CEE countries, with one track—traditional bankruptcy—applying to new private sector firms and a second—an extra judicial workout procedure—applying to the stock of illiquid or insolvent firms carried over from socialism. Like Poland, Slovenia is working actively to design an integrated program of bank restructuring, enterprise restructuring, and privatization for socially-owned firms. Such a program would involve both financial and real reorganization and/or liquidation of a substantial number of loss-making public enterprises outside of the traditional bankruptcy route. Thus, it could help relieve judicial institutions from the extra burdens now being faced in Hungary, where such loss-making firms are being forced into judicial bankruptcy procedures.

**Antimonopoly Law**

As in other CEE countries, Yugoslav firms were quite large and industry and trade was quite concentrated during the socialist period when compared with industry in market economies at a similar level of development. Collusion was actually encouraged in Yugoslavia, as all producers of a certain product were obligated to form associations with each other, and traders of that product were required to conclude self-management agreements with producers. Traders were also encouraged to form sector-specific trade monopolies. Although they were not formally supposed to collude in price-setting or market sharing behavior, once brought together they were able to collude and also to exert a powerful force in lobbying for protection from international competition. The resulting hierarchy of power in the economy put producers first, traders second, and consumers—who remained unorganized and unrepresented—last.

Clearly these old ideas and practices must change as Slovenia moves to a private market economy. Competition policies are needed to control monopolies and end collusive behavior among producers and/or traders, and unfair competition legislation is needed to prevent deceptive trading practices. The existing legal framework is inadequate in both areas. Until recently the only relevant law in force in Slovenia was the Yugoslav federal Law on Trade (1990), which remained applicable in Slovenia after independence. It replaced the federal Law on Unfair Competition of 1974. Although it provides a beginning framework for limiting anticompetitive behavior, this law applies only to trading activities, whether retail or wholesale. Similar behavior in production or services is not covered by the law. Furthermore, the law has hardly been applied in practice and thus has little relevance in practice, although the previous 1974 law is generally thought to have had some positive effect on business practices.

The trade law prohibits certain monopolistic practices (Articles 21-29, unfair competition (Articles 30-32), speculation (Article 33), and "limitation of the market" (Articles 33-34). Prohibited as monopolistic agreements or behavior are such practices as division of market share, price collusion, refusals to deal, and "misuse" of a dominant position (defined as controlling over 40 percent of the Yugoslav market\textsuperscript{42}) (Article 23). Prohibited as unfair competition are, among other things, advertising with an inability to deliver, misuse of trademarks, and hiding of defects in merchandise (Article 31). "Speculation" includes provoking disruptions in the market or "unjustified" price increases (Article 32); this category is somewhat of a holdover from the socialist period and could include many strategic moves of competitive companies that are entirely legal in industrial market economies. Finally, "limitation of the market" is a broad category that includes acts that block free entry or exit or the free exchange of goods (Article 33). In addition to prohibiting supposedly anticompetitive activities, the law establishes a federal commission of consumer protection (Article 16) and charges inspection officers with the ministry of trade with enforcement responsibilities (Articles 35-39).
Both civil suits (Articles 40-41) and criminal penalties (fines) (Articles 42-47) are envisioned for breach of the law.

In March 1993, Slovenia adopted a new law on the protection of competition. The law is broad, combining not only monopoly regulation and unfair competition, but also antidumping and limits on "speculation". For purposes of enforcement, the law envisions the creation of a new specialized agency, the Agency for the Protection of Competition (Articles 19-21), along the general model of the Bundeskartellamt in Germany or the Federal Trade Commission in the United States. The Agency would render rulings in administrative procedures, with right of appeal to the Slovene Supreme Court (Article 22).

In the areas of unfair competition and antimonopoly policy, the law appears generally to follow international norms. With regard to the former, it prohibits such activity as deceptive advertising and misuse of a competitor's trade secrets. With regard to the latter, it addresses both horizontal and vertical restraints on competition. With regard to horizontal restraints, the law prohibits cartels in restraint of trade, prohibits the "abuse" of a "dominant position" (defined as 40 percent or more of the Slovene market), and requires that the competition office approve mergers that would lead to a market share of over 60 percent. Certain cartel agreements (such as joint R&D) are not prohibited, but such agreements must be submitted to the competition office for information. In the area of vertical restraints, Article 8 closely follows EC law and prohibits such behavior as resale price maintenance, tied sales, and refusals to deal, but it recognizes that certain restraints may be appropriate in particular contractual arrangements (such as franchises). In all cases the approach is "per se" rather than "rule of reason".

Another issue is whether the Antimonopoly Office should be given the authority to break up existing firms. The Slovene industrial structure, like that of other CEE countries, tends to be more concentrated than that of typical market economies. As the economy transforms to a market economy based on private ownership, this industrial structure will need to change if the economy is to achieve its desired degree of domestic efficiency and international competitiveness. Some large firms may need to be broken up into smaller competitive pieces. Yet few monopolies break up willingly, and unless the competition office has the authority to mandate such break up, today's socially-owned monopolies could become tomorrow's privately-owned monopolies. One convenient way to promote changes in industrial structure is to explicitly link antimonopoly policy with the process of privatization. Both Poland and the former CSFR have made this explicit link by requiring that the monopoly office review all privatization proposals to see whether a break-up of the firm should be required prior to privatization on efficiency grounds.

Of course the first line of defense against monopoly behavior, particularly in a small open economy like Slovenia, is international competition. If trade barriers (tariffs and quotas) are kept low, large Slovene firms will be forced by international competition to remain competitive. However, trade cannot necessarily provide sufficient competitive pressures in the short run, nor for firms producing nontradeable goods or services (such as construction). Furthermore, domestic producers will often lobby for increased protection, and one of the main roles of a competition office should be to provide a counterweight, that is, to aggressively and publicly advocate free and fair competition.

Two other rather controversial provisions were included in the law. One concerns "speculation", i.e. "the exploitation of irregular market conditions for the purpose of gaining undue wealth, if such acts result or may result in interference in the market or in supply or in undue price increases." Somewhat similar provisions are found in section VI—"Market Restrictions through Official Acts and Measures," which allows the Executive Council to impose market restrictions not only during natural disasters but also "if appreciable disturbance is or may be caused on the market due to the lack of goods essential for production
... if necessary to ensure [inputs] for production of strategically important products ..., or if imports and exports of goods create appreciable disturbance on the domestic market or they threaten the supply of the domestic market or cause or may cause appreciable damage to production or trade within the Republic of Slovenia. Both of these sections provide wide discretion for the competition office to intervene in markets and could be seriously misapplied in practice.

Another issue regards the "dumping" of foreign goods on the Slovene market and whether the competition office should be authorized to impose additional levies (countervailing duties) in cases of dumping. Antidumping policy is essentially protectionist in nature, and thus it goes against the spirit of competition and the mission of a competition agency. If Slovenia is to adopt antidumping legislation, it should arguably be in a separate law and administered by a separate agency. Furthermore, Slovenia should seriously consider whether it wants to implement antidumping legislation at this time. Such legislation is often a backdoor way of protecting inefficient local production, thus forcing consumers to pay higher prices and damaging the international competitiveness of local firms. If it does introduce such legislation, cost of production or international price should be the applicable standard, not domestic price.

Judicial Institutions

The many parts of the legal framework discussed above will take on true meaning only as they are interpreted and enforced through judicial institutions, including courts and arbitration panels that resolve disputes and attorneys who advise and educate clients about legal norms in their day-to-day work. Although far more exposed to market-oriented norms and principles than some of their socialist neighbors, Slovene legal institutions still have far to go in gaining the experience and expertise to fulfill the promise of the evolving legal framework.

The Court System

The Slovene court system is divided into three levels, with 8 basic courts, 4 appellate courts, and one supreme court, in addition to the constitutional court discussed earlier. Twelve specialized "courts of associated labor", which deal mainly with labor disputes in socially-owned enterprises, also still continue in operation. As described earlier, cases in basic courts are handled by panels of professional and lay judges, while those in higher courts are handled exclusively by professional judges. Slovenia's 14 courts are currently staffed by about 500 judges and almost 7000 lay judges.

The courts are used extensively in resolving disputes. Some 150,000 civil cases were handled by first-level courts and some 94,000 by appeals courts in 1990 alone. Although courts are used extensively, the wait is long—on average 3-5 years and sometimes as long as 10 years—for a civil case to be decided. The court system, while not particularly inefficient when compared to systems in neighboring countries, could benefit from enhanced training and technical assistance, particularly in relatively new and unfamiliar commercial areas such as company, bankruptcy, and competition law.

As in other post-socialist economies, arbitration is not well-developed in Slovenia. It has not been seen as a viable alternative to regular court procedures in handling domestic commercial disputes, despite the lengthy procedures and long delays typical in the courts. Arbitration in the area of international trade has been an accepted tradition, and has been handled in Yugoslavia by the Chamber of Commerce since 1981. But only in 1990 did Slovenia authorize its Chamber of Commerce to set up a general commercial arbitration facility applicable to domestic as well as international disputes. Although still in its infancy, this is a promising new avenue—a way to "privatize" dispute resolution and thus save on scarce legal and administrative resources—that could usefully be supported and expanded in the future.
The Legal Profession

There are many trained legal professionals in Slovenia, but few who are well-trained for the needs of a newly-emerging private market economy. Yugoslavia has traditionally had a very high number of law students relative to other countries, in part because it was one of the very few countries offering a short (two-year) first degree program. However, its number of lawyers is proportionately much lower because a high percentage of law students do not graduate. Although still high by international standards, Slovenia has traditionally had fewer law students and a higher graduation ratio than other Yugoslav republics. Now around 300 new second degree law students graduate from the two Slovene law schools per year.

Despite the sizeable number of law students and graduates, there have traditionally been relatively few practicing professional lawyers in Yugoslavia and Slovenia. Most law graduates have been employed in general business or government administration, with only between 5 and 10 percent of law graduates going into law practice or the judiciary. Attorneys have tended also to work for the social sector, and private lawyers, although allowed to practice by law, have been rare indeed (with around 600 in Slovenia). The number of private attorneys is expected to increase rapidly with the increasing role of private market forces. New laws prepared at the beginning of 1992 are designed to regulate the profession and set higher standards for entrance through a bar examination.

Furthermore, those lawyers that do work in legal professions tend to be inadequately prepared for the legal demands of a market economy. Until the mid-1980s the law schools’ curricula and law practice provided little exposure to market-oriented commercial law principles. Social property and all relations and obligations stemming from it were the principle topics of study and work. This began to change, however, in the late 1980s, when the principles and institutions of industrial market economies began to creep into law curricula. Many law professors had been formally educated in the West, and they could draw on their earlier learning to introduce these new areas of study.

But while current law students are getting increasing exposure to market-oriented commercial law, the job of retooling existing judges and lawyers is a major challenge. Although judges in particular remain respected for their honesty and integrity, they understandably lack experience and expertise in many of the more complex areas of law applicable to market economies. Technical assistance, training, and time can all help to remedy this situation, as can increased publication of legal articles and court decisions.

Conclusion

Slovenia is making steady progress in creating a basic legal framework in which the private sector can grow and develop. It benefits from the efforts of Yugoslav economic and legal reformers since mid-1988, and from the fact that it was willing to adopt many of the Yugoslav solutions upon independence rather than try to start again from scratch. Few changes appear to be needed in some areas of law—including company, foreign investment, and intellectual property. In others, however, such as bankruptcy and antimonopoly law, both the legal framework and the legal institutions to interpret and implement it are still lacking an adequate structure and sufficient credibility to support a private market economy. As in other post-socialist economies, real property rights is an area of uncertainty, both because of Slovenia’s determination to reverse the past through reprivatization and because of the limits it places on foreign ownership. All in all, Slovenia is one of the most advanced CEE countries in economic, legal, and institutional reform. Continued political stability and economic reform should provide an attractive setting for new private sector investment from both domestic and foreign sources.
Endnotes


2. The U.S. Constitution, in comparison, has 7 articles with 20 sections on 16 pages.

3. The privatization law, adopted by the Slovene Parliament in November, 1992, provides that 20 percent of the shares of each enterprise will be sold at a discount to employees, and 40 percent more can be offered to employees at book value if certain conditions are met.

4. As in most CEE countries, the method of election is not governed by the constitution but by a separate law. The Slovene election law was passed by the Parliament (after extensive debate) prior to the December 1992 elections.

5. Lay judges bear some resemblance to common-law jurors in that they are intended to bring a layperson’s perspectives and judgments into the legal arena. However, their role is not distinguished from that of the professional judge as in common law systems, where jurors decide facts (including guilt or innocence) and judges assure that the proceedings are in accordance with the law. In the continental tradition, lay judges and professional judges together decide on the law, the facts, and the appropriate penalties. The new Code of Civil Procedure allows their exclusion in certain civil cases (particularly commercial cases) if both sides agree.

6. Although not officially part of the judiciary, the Court is composed of 9 recognized legal experts (Article 163) selected for one-time 9-year terms (Article 165) by the State Assembly on proposal by the President. All cases are decided by majority vote of at least 5 members (Article 162).

7. As an additional check upon the state, Chapter 6 provides for a "court of accounts" to inspect public finances (Articles 150-151) and for a central bank responsible to the State Chamber and thus independent from the executive branch (Article 152).

8. Two reasons help to explain why numerous issues remained undecided when the constitution was adopted. First, Parliament had promised and was under time pressure to adopt it one year after the national referendum on independence. Second, the ruling coalition of parties in Parliament only held 53 percent of the votes, while a two-thirds majority was needed to adopt the constitution. Therefore, numerous controversial issues had to be omitted for the document to be acceptable to opposing factions.

9. The Austro-Hungarian landbook law from 1871 and the land register (cadastre) law from the 1920s form the basis of the land registration system that exists today. The system of social property of the last 40 years, however, did significant damage to land records. Many transfers of social property and most transfers of private apartments were not registered. Prewar private owners of land and buildings often remain on the books, thus providing a basis for implementing the denationalization law discussed below.

10. The Austrian Code was very broad, covering not only property and contract principles, but also family law, inheritance, and (through later amendment) bankruptcy, taxation, and collateral.
11. Social property was in theory everyone's property but was in fact no one's property, in that no private individual could transfer rights to the property. In practice "usufruct" (or use) rights were allocated to firms at low cost. This administrative allocation resulted in arbitrary and unequal distribution in access to social capital among workers.

12. The draft laws on lands and forestry deal with the 15 percent of agricultural land and two-thirds of forests now under social ownership. Under these laws, these lands would first become the property of the state and then either be returned to previous private owners (pursuant to the denationalization law) or kept within special state funds under state ownership and management (with the possibility of lease to private parties). An earlier draft was rejected in Parliament because of a disagreement over which level of government—central or local—should own the funds.

13. In its original 1980 version, Chapter 6 of the Yugoslav Law on the Foundations of Property Relations prohibited foreigners from owning any real property in Yugoslavia, except in the case of inheritance if reciprocal rights were granted by the home country of the heir. Renting was permitted under 5-30 year leases. Under 1990 amendments to this law, foreigners could become owners of commercial building space if allowed by specific federal and republican laws (Yugoslav Official Gazette, No 36, 1990, Article 82a). Some federal laws did then grant broader property rights to foreigners. For example, amendments to the Law on Exchange and Disposition of the Social Capital (Yugoslav Official Gazette, No 84 (1990), Article 4) granted the right of 99-year use, or "usufruct." Slovenia has not specifically abrogated this Yugoslav legislation.

14. This temporary moratorium on the acquisition of property rights by foreigners not only hampers foreign companies wishing to invest in Slovenia, but also makes it impossible for foreign banks to take security interests in real property. New legislation on property rights for foreigners is now under preparation. Although the constitution prohibits foreigners from owning land, the new legislation is expected to permit foreigners engaged in business to own buildings and hold mortgages on real estate.

15. The housing law also contains numerous other provisions dealing with landlord-tenant relations, lease contracts, and the management of multi-unit buildings.

16. Yugoslav citizens have always been allowed to own private housing, and thus about 70 percent of all apartments and houses in Slovenia were already in private hands before the housing law was adopted.

17. A 60 percent discount is given from the administratively determined price if the purchaser pays in full within 60 days (Article 119). Alternatively, the purchaser can pay 10 percent at the time of sale and the rest (with at least a 30 percent discount) over a period up to 20 years (with reasonable interest rates and values defined in domestic currency but indexed to foreign currency) (Article 117). A portion of the sale proceeds is earmarked for state and local housing funds, to be used to finance housing loans in the future (Article 130).

18. For comparison, average annual salaries at that time were approximately $2500, and average annual per capita income was in the range of $4000-$4500.

19. The word tenant may be a bit misleading, because "housing rights" to state- or enterprise-owned housing under the socialist system were more extensive than renters' rights in capitalist systems. For example, those with housing rights had life-time rights of occupation, could transfer those rights easily to relatives, and paid rent far below comparable market value (as measured by the "gray" rental market in some cities).
20. Tenants cannot be forced to vacate, although new owners will have the right to renegotiate rents within certain limits.

21. For example, the tax charged to convert agricultural land to "building" land can be up to $8000 for a one-house plot.

22. Administrative intervention may be justified on economic grounds if private market prices do not fully reflect social costs. For example, governments sometimes set strict zoning limits to protect fragile yet socially-valuable ecosystems from individual encroachment, or to preserve quaint rural settings—and thus the widespread benefits of tourism—from incompatible private development.

23. Obtaining a permit for building construction typically takes at least 1 year.


25. For example, the law covers plant and animal varieties and all drugs and chemical compounds (Article 28). However, in the case of drugs, applications can be filed only after December 31, 1992 (Article 121).

26. The application is examined only to be sure that it meets formal requirements and that exclusion of other users is feasible (Article 54). Although the patent office does not go further, any person may oppose the patent by filing a suit in court. A patentee may sue a third party for patent infringement only if he submits a Document of Evidence (as referred to below) to the patent office (Article 86).

27. Relying on officially-approved foreign testing institutions is not unusual for a small country that cannot afford to carry out its own examination to prove the applicant is the inventor and to assess the novelty and applicability of the invention.

28. Although not allowed under U.S. law, compulsory licenses are common throughout the world and are permitted under the Paris Convention.

29. Yugoslavia suffered severe inflation in 1989, and nominal amounts in the law were not adjusted accordingly.

30. Only workers in socially-owned enterprises continue to have an explicit role in management (Articles 63-75). If such enterprises invest jointly with private investors in mixed enterprises, their workers will have a management role in such mixed enterprises, but it will be strictly proportional to the amount of resources invested (Article 122).

31. The partners have the option of raising capital through the issuance of individual shares, in which case the rules on share purchase provided for joint stock companies are applicable (Article 114). This is similar to the "limited partnership divided by shares" found in some other European countries.

32. Article 9 also specifies that foreigners may invest in banks and other financial institutions, insurance organizations, and "other forms of cooperation and joint business as specified by statutes." Investments in the extractive industries require legislative approval (Article 19), and wholly-owned foreign investments are prohibited in armaments, rail and air transport, communications and telecommunications, insurance, publishing, and the mass media (Article 21).


34. For more information on recent economic developments, see F. Coricelli and R. Rocha, "Stabilization Programs in Eastern Europe: A Comparative Analysis of the Polish and Yugoslav Programs of 1990," in Corbo,

35. Some private contracts in particular areas, such as securities, are also governed by specific legislation.

36. The law does include some provisions regarding the relationship of private obligations to the plan and to self-management agreements. These provisions, to be removed in future amendments, do not interfere with the sections governing purely private obligations.

37. This was part of an expanded effort during this time to adopt a legal framework (such as the enterprise and foreign investment laws described above) suitable to a market economy. In addition to bankruptcy and compulsory settlement, the 1989 law has a chapter devoted to liquidation for reasons other than insolvency.

38. These included tight monetary and credit policies, a devalued and newly-pegged exchange rate, and a dramatic opening of the economy to international trade. See F. Coricelli and R. Rocha, supra note 34, and A. Gelb and C. Gray, supra note 33.

39. These numbers may somewhat overstate actual attempts to close companies, as the bankruptcy procedure was sometimes used to shed unwanted labor or rid the company of its debt burden, while the firm continued its activity under a new name. In fact, bankruptcy is currently one means for "spontaneous privatization" in Slovenia, as firms rid themselves of unwanted liabilities and are sold at low prices to new private owners.

40. These costs are exacerbated by the requirement that creditors prove that a valid claim exists and was not able to be satisfied in any other way.

41. Mortgages on real property are impeded by the poor state of land registration and the difficult of evicting tenants. Security interests in moveable property, although legal under the Law on Obligations, are rarely used in practice.

42. Presumably the 40 percent rule now applies to the Slovene market.


45. In fact, in the early 1980s Yugoslavia had the highest number of law students relative to its population of any country in the world. F. Stiblar, Zaposlovanje pravnikov v Jugoslaviji, Zbornik znanstvenih razprav, XLIII, Pravna fakulteta v Ljubljani, Ljubljana, 1984.

46. Stiblar, id.

47. Out of 80,000 lawyers in Yugoslavia in 1988, about 6000 were judges and roughly the same number were attorneys. Statistical Yearbook of Yugoslavia 1989.
Distributors of World Bank Publications

<table>
<thead>
<tr>
<th>Country</th>
<th>Address</th>
</tr>
</thead>
<tbody>
<tr>
<td>Argentina</td>
<td>Casa de Libros, S.A.</td>
</tr>
<tr>
<td>Australia</td>
<td>1600 Fifth Avenue, Suite 700, Suite 600, Suite 1000, Suite 1200</td>
</tr>
<tr>
<td>Austria</td>
<td>Gereon &amp; Co.</td>
</tr>
<tr>
<td>Bangladesh</td>
<td>P.O. Box 220</td>
</tr>
<tr>
<td>Canada</td>
<td>C.P. 85, 15018 1st Ave Yongei</td>
</tr>
<tr>
<td>Chile</td>
<td>Inverance, 340-500</td>
</tr>
<tr>
<td>China</td>
<td>China Financial &amp; Economic Publishing House</td>
</tr>
<tr>
<td>Colombia</td>
<td>Instituto de Periodismo</td>
</tr>
<tr>
<td>Denmark</td>
<td>Danska Litteratur</td>
</tr>
<tr>
<td>Dominican Republic</td>
<td>Editores Taller, C.</td>
</tr>
<tr>
<td>Egypt</td>
<td>Al Alam</td>
</tr>
<tr>
<td>Finland</td>
<td>Newspaper Literature Ltd.</td>
</tr>
<tr>
<td>France</td>
<td>VIA   4 rue de la Harpe</td>
</tr>
<tr>
<td>Germany</td>
<td>Verlagsgesellschaft Zs.</td>
</tr>
<tr>
<td>Guatemala</td>
<td>Servicio de Publicaciones Internacionales</td>
</tr>
<tr>
<td>Hong Kong</td>
<td>Comercial y Editorial</td>
</tr>
<tr>
<td>Indonesia</td>
<td>P.T. Indonesia</td>
</tr>
<tr>
<td>Ireland</td>
<td>Government Supplies Agency</td>
</tr>
<tr>
<td>Israel</td>
<td>Yeartime Literature Ltd.</td>
</tr>
<tr>
<td>Jamaica</td>
<td>Ministero della Pubblicita</td>
</tr>
<tr>
<td>Japan</td>
<td>Eastern Book Service</td>
</tr>
<tr>
<td>Kenya</td>
<td>Africa Book Service (E.A.) Ltd.</td>
</tr>
<tr>
<td>Korea</td>
<td>Korea Book Corporation</td>
</tr>
<tr>
<td>Malaysia</td>
<td>University of Malaya Cooperative Bookshop</td>
</tr>
<tr>
<td>Netherlands</td>
<td>Universiteit Leiden</td>
</tr>
<tr>
<td>New Zealand</td>
<td>Ed. Elricro, S.A.</td>
</tr>
<tr>
<td>Norway</td>
<td>Narvesen Information Center</td>
</tr>
<tr>
<td>Philippines</td>
<td>International Book Center</td>
</tr>
<tr>
<td>Poland</td>
<td>Government Publishing Service</td>
</tr>
<tr>
<td>South Africa</td>
<td>South African University</td>
</tr>
<tr>
<td>Sri Lanka</td>
<td>Language Academy</td>
</tr>
<tr>
<td>Trinidad &amp; Tobago</td>
<td>Libraria del Estado</td>
</tr>
<tr>
<td>Turkey</td>
<td>Libraria del Estado</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>Libraria del Estado</td>
</tr>
<tr>
<td>Venezuela</td>
<td>Libraria del Estado</td>
</tr>
</tbody>
</table>

For subscription orders:

<table>
<thead>
<tr>
<th>Country</th>
<th>Contact Information</th>
</tr>
</thead>
<tbody>
<tr>
<td>Argentina</td>
<td>Edelweiss</td>
</tr>
<tr>
<td>Australia</td>
<td>Oxford University Press</td>
</tr>
<tr>
<td>Austria</td>
<td>Vienna University Press</td>
</tr>
<tr>
<td>Bangladesh</td>
<td>University of Malaya Cooperative Bookshop</td>
</tr>
<tr>
<td>Canada</td>
<td>World Bank Publications</td>
</tr>
<tr>
<td>Chile</td>
<td>Libraria del Estado</td>
</tr>
<tr>
<td>China</td>
<td>Libraria del Estado</td>
</tr>
<tr>
<td>Colombia</td>
<td>Libraria del Estado</td>
</tr>
<tr>
<td>Denmark</td>
<td>Libraria del Estado</td>
</tr>
<tr>
<td>Dominican Republic</td>
<td>Libraria del Estado</td>
</tr>
<tr>
<td>Egypt</td>
<td>Libraria del Estado</td>
</tr>
<tr>
<td>Finland</td>
<td>Libraria del Estado</td>
</tr>
<tr>
<td>France</td>
<td>Libraria del Estado</td>
</tr>
<tr>
<td>Germany</td>
<td>Libraria del Estado</td>
</tr>
<tr>
<td>Guatemala</td>
<td>Libraria del Estado</td>
</tr>
<tr>
<td>Iceland</td>
<td>Libraria del Estado</td>
</tr>
<tr>
<td>Jamaica</td>
<td>Libraria del Estado</td>
</tr>
<tr>
<td>Japan</td>
<td>Libraria del Estado</td>
</tr>
<tr>
<td>Kenya</td>
<td>Libraria del Estado</td>
</tr>
<tr>
<td>Korea</td>
<td>Libraria del Estado</td>
</tr>
<tr>
<td>Malaysia</td>
<td>Libraria del Estado</td>
</tr>
<tr>
<td>Netherlands</td>
<td>Libraria del Estado</td>
</tr>
<tr>
<td>New Zealand</td>
<td>Libraria del Estado</td>
</tr>
<tr>
<td>Norway</td>
<td>Libraria del Estado</td>
</tr>
<tr>
<td>Philippines</td>
<td>Libraria del Estado</td>
</tr>
<tr>
<td>Poland</td>
<td>Libraria del Estado</td>
</tr>
<tr>
<td>South Africa</td>
<td>Libraria del Estado</td>
</tr>
<tr>
<td>Sri Lanka</td>
<td>Libraria del Estado</td>
</tr>
<tr>
<td>Trinidad &amp; Tobago</td>
<td>Libraria del Estado</td>
</tr>
<tr>
<td>Turkey</td>
<td>Libraria del Estado</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>Libraria del Estado</td>
</tr>
<tr>
<td>Venezuela</td>
<td>Libraria del Estado</td>
</tr>
</tbody>
</table>

For single titles:

<table>
<thead>
<tr>
<th>Country</th>
<th>Contact Information</th>
</tr>
</thead>
<tbody>
<tr>
<td>Argentina</td>
<td>Edelweiss</td>
</tr>
<tr>
<td>Australia</td>
<td>Oxford University Press</td>
</tr>
<tr>
<td>Austria</td>
<td>Vienna University Press</td>
</tr>
<tr>
<td>Bangladesh</td>
<td>University of Malaya Cooperative Bookshop</td>
</tr>
<tr>
<td>Canada</td>
<td>World Bank Publications</td>
</tr>
<tr>
<td>Chile</td>
<td>Libraria del Estado</td>
</tr>
<tr>
<td>China</td>
<td>Libraria del Estado</td>
</tr>
<tr>
<td>Colombia</td>
<td>Libraria del Estado</td>
</tr>
<tr>
<td>Denmark</td>
<td>Libraria del Estado</td>
</tr>
<tr>
<td>Dominican Republic</td>
<td>Libraria del Estado</td>
</tr>
<tr>
<td>Egypt</td>
<td>Libraria del Estado</td>
</tr>
<tr>
<td>Finland</td>
<td>Libraria del Estado</td>
</tr>
<tr>
<td>France</td>
<td>Libraria del Estado</td>
</tr>
<tr>
<td>Germany</td>
<td>Libraria del Estado</td>
</tr>
<tr>
<td>Guatemala</td>
<td>Libraria del Estado</td>
</tr>
<tr>
<td>Iceland</td>
<td>Libraria del Estado</td>
</tr>
<tr>
<td>Japan</td>
<td>Libraria del Estado</td>
</tr>
<tr>
<td>India</td>
<td>Libraria del Estado</td>
</tr>
<tr>
<td>Indonesia</td>
<td>Libraria del Estado</td>
</tr>
<tr>
<td>Ireland</td>
<td>Libraria del Estado</td>
</tr>
<tr>
<td>Israel</td>
<td>Library Services</td>
</tr>
<tr>
<td>Jamaica</td>
<td>Libraria del Estado</td>
</tr>
<tr>
<td>Japan</td>
<td>Libraria del Estado</td>
</tr>
<tr>
<td>Korea</td>
<td>Libraria del Estado</td>
</tr>
<tr>
<td>Malaysia</td>
<td>Libraria del Estado</td>
</tr>
<tr>
<td>Netherlands</td>
<td>Libraria del Estado</td>
</tr>
<tr>
<td>New Zealand</td>
<td>Libraria del Estado</td>
</tr>
<tr>
<td>Norway</td>
<td>Libraria del Estado</td>
</tr>
<tr>
<td>Philippines</td>
<td>Libraria del Estado</td>
</tr>
<tr>
<td>Poland</td>
<td>Libraria del Estado</td>
</tr>
<tr>
<td>South Africa</td>
<td>Libraria del Estado</td>
</tr>
<tr>
<td>Sri Lanka</td>
<td>Libraria del Estado</td>
</tr>
<tr>
<td>Trinidad &amp; Tobago</td>
<td>Libraria del Estado</td>
</tr>
<tr>
<td>Turkey</td>
<td>Libraria del Estado</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>Libraria del Estado</td>
</tr>
<tr>
<td>Venezuela</td>
<td>Libraria del Estado</td>
</tr>
</tbody>
</table>

For subscription orders:

<table>
<thead>
<tr>
<th>Country</th>
<th>Contact Information</th>
</tr>
</thead>
<tbody>
<tr>
<td>Argentina</td>
<td>Edelweiss</td>
</tr>
<tr>
<td>Australia</td>
<td>Oxford University Press</td>
</tr>
<tr>
<td>Austria</td>
<td>Vienna University Press</td>
</tr>
<tr>
<td>Bangladesh</td>
<td>University of Malaya Cooperative Bookshop</td>
</tr>
<tr>
<td>Canada</td>
<td>World Bank Publications</td>
</tr>
<tr>
<td>Chile</td>
<td>Libraria del Estado</td>
</tr>
<tr>
<td>China</td>
<td>Libraria del Estado</td>
</tr>
<tr>
<td>Colombia</td>
<td>Libraria del Estado</td>
</tr>
<tr>
<td>Denmark</td>
<td>Libraria del Estado</td>
</tr>
<tr>
<td>Dominican Republic</td>
<td>Libraria del Estado</td>
</tr>
<tr>
<td>Egypt</td>
<td>Libraria del Estado</td>
</tr>
<tr>
<td>Finland</td>
<td>Libraria del Estado</td>
</tr>
<tr>
<td>France</td>
<td>Libraria del Estado</td>
</tr>
<tr>
<td>Germany</td>
<td>Libraria del Estado</td>
</tr>
<tr>
<td>Guatemala</td>
<td>Libraria del Estado</td>
</tr>
<tr>
<td>Iceland</td>
<td>Libraria del Estado</td>
</tr>
<tr>
<td>Japan</td>
<td>Libraria del Estado</td>
</tr>
<tr>
<td>Korea</td>
<td>Libraria del Estado</td>
</tr>
<tr>
<td>Malaysia</td>
<td>Libraria del Estado</td>
</tr>
<tr>
<td>Netherlands</td>
<td>Libraria del Estado</td>
</tr>
<tr>
<td>New Zealand</td>
<td>Libraria del Estado</td>
</tr>
<tr>
<td>Norway</td>
<td>Libraria del Estado</td>
</tr>
<tr>
<td>Philippines</td>
<td>Libraria del Estado</td>
</tr>
<tr>
<td>Poland</td>
<td>Libraria del Estado</td>
</tr>
<tr>
<td>South Africa</td>
<td>Libraria del Estado</td>
</tr>
<tr>
<td>Sri Lanka</td>
<td>Libraria del Estado</td>
</tr>
<tr>
<td>Trinidad &amp; Tobago</td>
<td>Libraria del Estado</td>
</tr>
<tr>
<td>Turkey</td>
<td>Libraria del Estado</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>Libraria del Estado</td>
</tr>
<tr>
<td>Venezuela</td>
<td>Libraria del Estado</td>
</tr>
</tbody>
</table>

For single titles:

<table>
<thead>
<tr>
<th>Country</th>
<th>Contact Information</th>
</tr>
</thead>
<tbody>
<tr>
<td>Argentina</td>
<td>Edelweiss</td>
</tr>
<tr>
<td>Australia</td>
<td>Oxford University Press</td>
</tr>
<tr>
<td>Austria</td>
<td>Vienna University Press</td>
</tr>
<tr>
<td>Bangladesh</td>
<td>University of Malaya Cooperative Bookshop</td>
</tr>
<tr>
<td>Canada</td>
<td>World Bank Publications</td>
</tr>
<tr>
<td>Chile</td>
<td>Libraria del Estado</td>
</tr>
<tr>
<td>China</td>
<td>Libraria del Estado</td>
</tr>
<tr>
<td>Colombia</td>
<td>Libraria del Estado</td>
</tr>
<tr>
<td>Denmark</td>
<td>Libraria del Estado</td>
</tr>
<tr>
<td>Dominican Republic</td>
<td>Libraria del Estado</td>
</tr>
<tr>
<td>Egypt</td>
<td>Libraria del Estado</td>
</tr>
<tr>
<td>Finland</td>
<td>Libraria del Estado</td>
</tr>
<tr>
<td>France</td>
<td>Libraria del Estado</td>
</tr>
<tr>
<td>Germany</td>
<td>Libraria del Estado</td>
</tr>
<tr>
<td>Guatemala</td>
<td>Libraria del Estado</td>
</tr>
<tr>
<td>Iceland</td>
<td>Libraria del Estado</td>
</tr>
<tr>
<td>Japan</td>
<td>Libraria del Estado</td>
</tr>
<tr>
<td>India</td>
<td>Libraria del Estado</td>
</tr>
<tr>
<td>Indonesia</td>
<td>Libraria del Estado</td>
</tr>
<tr>
<td>Ireland</td>
<td>Libraria del Estado</td>
</tr>
<tr>
<td>Israel</td>
<td>Library Services</td>
</tr>
<tr>
<td>Jamaica</td>
<td>Libraria del Estado</td>
</tr>
<tr>
<td>Japan</td>
<td>Libraria del Estado</td>
</tr>
<tr>
<td>Korea</td>
<td>Libraria del Estado</td>
</tr>
<tr>
<td>Malaysia</td>
<td>Libraria del Estado</td>
</tr>
<tr>
<td>Netherlands</td>
<td>Libraria del Estado</td>
</tr>
<tr>
<td>New Zealand</td>
<td>Libraria del Estado</td>
</tr>
<tr>
<td>Norway</td>
<td>Libraria del Estado</td>
</tr>
<tr>
<td>Philippines</td>
<td>Libraria del Estado</td>
</tr>
<tr>
<td>Poland</td>
<td>Libraria del Estado</td>
</tr>
<tr>
<td>South Africa</td>
<td>Libraria del Estado</td>
</tr>
<tr>
<td>Sri Lanka</td>
<td>Libraria del Estado</td>
</tr>
<tr>
<td>Trinidad &amp; Tobago</td>
<td>Libraria del Estado</td>
</tr>
<tr>
<td>Turkey</td>
<td>Libraria del Estado</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>Libraria del Estado</td>
</tr>
<tr>
<td>Venezuela</td>
<td>Libraria del Estado</td>
</tr>
</tbody>
</table>
Recent World Bank Discussion Papers (continued)

<table>
<thead>
<tr>
<th>No.</th>
<th>Title</th>
<th>Authors/Editors</th>
</tr>
</thead>
<tbody>
<tr>
<td>179</td>
<td>Nippon Telegraph and Telephone Privatization Study: Experience of Japan and Lessons for Developing Countries.</td>
<td>Yoshiro Takano</td>
</tr>
<tr>
<td>180</td>
<td>China's Reform Experience to Date.</td>
<td>Peter Harrold</td>
</tr>
<tr>
<td>182</td>
<td>Privatization Problems at Industry Level: Road Haulage in Central Europe.</td>
<td>Esra Bennathan and Louis S. Thompson</td>
</tr>
<tr>
<td>183</td>
<td>Participatory Development and the World Bank: Potential Directions for Change.</td>
<td>Bhuvan Bhattachar and Aubrey C. Williams, editors</td>
</tr>
<tr>
<td>185</td>
<td>Military Expenditure and Economic Development: A Symposium on Research Issues.</td>
<td>Edited by Geoffrey Lamb with Valeriana Kallab</td>
</tr>
<tr>
<td>186</td>
<td>Efficiency and Substitution in Pollution Abatement: Three Case Studies.</td>
<td>Dennis Anderson and William Cavendish</td>
</tr>
<tr>
<td>187</td>
<td>The State Holding Company: Issues and Options.</td>
<td>Anjali Kumar</td>
</tr>
<tr>
<td>188</td>
<td>Indigenous Views of Land and the Environment.</td>
<td>Shelton H. Davis, editor</td>
</tr>
<tr>
<td>190</td>
<td>Natural Gas in Developing Countries: Evaluating the Benefits to the Environment.</td>
<td>John Horner</td>
</tr>
<tr>
<td>191</td>
<td>Appropriate Macroeconomic Management in Indonesia's Open Economy.</td>
<td>Sadiq Ahmed</td>
</tr>
<tr>
<td>192</td>
<td>Telecommunications: World Bank Experience and Strategy.</td>
<td>Bjorn Wellenius and others</td>
</tr>
<tr>
<td>194</td>
<td>Social Gains from Female Education: A Cross-National Study.</td>
<td>K. Subbarao and Laura Raney</td>
</tr>
<tr>
<td>195</td>
<td>Towards a Sustainable Development: The Rio de Janeiro Study.</td>
<td>Edited by Alcira Kreimer, Thereza Lobo, Braz Menezes, Mohan Munasinghe, and Ronald Parker</td>
</tr>
<tr>
<td>197</td>
<td>Korean Industrial Policy: Legacies of the Past and Directions for the Future.</td>
<td>Danny M. Leipziger and Peter A. Petri</td>
</tr>
<tr>
<td>198</td>
<td>Exporting High-Value Food Commodities: Success Stories from Developing Countries.</td>
<td>Steven M. Jaffee with the assistance of Peter Gordon</td>
</tr>
<tr>
<td>199</td>
<td>Borrower Ownership of Adjustment Programs and the Political Economy of Reform.</td>
<td>John H. Johnson and Sulaiman S. Wasty</td>
</tr>
<tr>
<td>201</td>
<td>Urbanization, Agricultural Development, and Land Allocation.</td>
<td>Dipasis Bhadra and Antônio Salazar P. Brandão</td>
</tr>
<tr>
<td>202</td>
<td>Korean Industrial Policy: Legacies of the Past and Directions for the Future.</td>
<td>Danny M. Leipziger and Peter A. Petri</td>
</tr>
<tr>
<td>203</td>
<td>Poverty Reduction in East Asia: The Silent Revolution.</td>
<td>Frida Johensen</td>
</tr>
<tr>
<td>204</td>
<td>Managing the Civil Service: The Lessons of Reform in Industrial Countries.</td>
<td>Barbara Nunberg</td>
</tr>
<tr>
<td>205</td>
<td>Designing a System of Labor Market Statistics and Information.</td>
<td>Robert S. Goldfarb and Arvil V. Adams</td>
</tr>
<tr>
<td>206</td>
<td>Information Technology in World Bank Lending: Increasing the Development Impact.</td>
<td>Nagy Hanna and Sandor Boyson</td>
</tr>
<tr>
<td>208</td>
<td>Developing Effective Employment Services.</td>
<td>David Fretwell and Susan Goldberg</td>
</tr>
</tbody>
</table>