

NOTE

AVENUES FOR INVESTMENT IN THE FORMER CZECHOSLOVAKIA: PRIVATIZATION AND THE HISTORICAL DEVELOPMENT OF THE NEW COMMERCIAL CODE

I. INTRODUCTION

The peaceful revolutions that recently swept through Eastern Europe replaced old communist regimes with new governments seeking to rebuild their countries under the guise of democracy. Although the capitulation of Communism has been seen by many as the inevitable triumph of good over evil, it has left in its wake a series of devastated economies and political structures.¹

"Reform" has become the buzz word of the 1990s. As the reform process moves Eastern Europe further from centrally planned economies into free market economies, the prospects for Western investment opportunities increase dramatically. Not only does the possibility of gain exist for the Western investor in the form of a new, untapped market, but the former Eastern bloc country also gains in the form of new technology and hard currency.² At first glance, these mutual benefits appear to evidence a prime opportunity. However, with the rapid and constant changes taking place in Eastern European legal systems, the Western investor must stay abreast of the changing laws and how those changes will affect his investment.³

The focus of this note is foreign investment in the Czech and Slovak Federal Republic (the CSFR). It traces the historical evolution of the Czechoslovak joint venture law and examines the effect of its

1. Sharon L. Wolchik, *Czechoslovakia's "Velvet Revolution,"* in CURRENT HIST. 413, 414-15 (1990).

2. *Czechoslovakia Needs Foreign Capital and Know-How, Finance Official Says*, 8 Int'l Trade Rep. (BNA) No. 12, at 444 (Mar. 20, 1991).

3. Donald J. Hasfurther, *Prospects for Business with East Europe*, in LEGAL ASPECTS OF TRADE AND INVESTMENT IN THE SOVIET UNION AND EASTERN EUROPE 1990, at 189, 199 (PLI Commercial Law and Practice Course Handbook Series No. 549, 1990). Such considerations include monitoring developments in property ownership law, environmental regulations, labor laws, currency convertibility regulations and profit repatriation rules.

embodiment in the new CSFR Commercial Code on the possible United States investor. Specifically, it discusses the questions that will confront the United States investor regarding the new incentives and impediments to investment. One factor of particular importance is the scheduled 1993 split of the CSFR.⁴ At best, the effects of the break-up on the economic and investment climates are speculative.⁵ In addition, this note will examine emerging investment opportunities as the process of privatization moves forward. In conclusion, it will examine the sectors that are becoming prime investment areas.

A. The Czech and Slovak Federal Republic

Czechoslovakia, or the CSFR, has a pre-communist history of democratic traditions and economic success and, thus, holds interesting investment opportunities. Prior to World War II and its forty-year suffocation by Communism, the CSFR was one of the most developed countries in Eastern Europe;⁶ a democratic government was in place, and the country's industry enjoyed world-wide renown for its superior quality goods.⁷ This history demonstrates that the idea of a market economy is not entirely foreign to the CSFR.

The Czech and Slovak approach to reform has been gradual,⁸ despite the November 1989 "Velvet Revolution"⁹ that replaced the old communist guard with a liberally-oriented government led by Vaclav Havel.¹⁰ Two modes of economic thinking influenced the

4. The reader should be aware that this note was written prior to the January 1, 1993 split of the CSFR into the Czech Republic and the Slovak Republic.

5. See Tom Redburn, "National Divorce" is Working, *Czech Aide Says*, INT'L HERALD TRIB., Feb. 1, 1993, at 2.

6. Karel Dyba & Jan Svejnar, *Czechoslovakia: Recent Economic Development and Prospects*, 81 AM. ECON. REV. 185, 185 (1991).

7. *Id.*

8. Wolchik, *supra* note 1, at 416. A 1990 public opinion poll revealed that a majority of the Czechoslovak population favored conversion to a market economy, even with the inherent risks of declining living standards and increased unemployment. *Id.* at 435. However, one-third of the respondents were "somewhat or firmly opposed" to reform measures due to the fear of unemployment and rising costs. *Id.* at 435-36.

9. See generally William H. Luers, *Czechoslovakia: Road to Revolution*, 69 FOREIGN AFF. 77, 77-98 (1990) (discussing historical background and the former Soviet Union's role in the 1989 events that resulted in the demise of Communism).

10. Dyba & Svejnar, *supra* note 6, at 186. The new, liberal government had "created strong expectations of a radical economic transformation from a centrally planned to a market economy." *Id.* It was not until September 1, 1990 (almost a year after the Revolution), that a "scenario of economic reform" was finally

reform process: Keynesian theory and U.S. monetary theory.¹¹ Keynesian economic thought dominated Havel's policies, which were characterized by slower economic transformation and an equal distribution of income through government intervention.¹² This slow reform process has been seen both in the evolution of the CSFR's foreign investment laws, and the slow-paced privatization efforts. Although the reform process has recently accelerated with the January 1992 implementation of the new Commercial Code,¹³ privatization still remains a few steps behind.

Another consideration is how the break-up of the CSFR will affect the reform process. Vaclav Klaus,¹⁴ the Prime Minister of the Czech Republic, in contrast to Havel, is recognized as believing in fast-paced reform policies and rapid transition to a market economy.¹⁵ Therefore, after the scheduled 1993 split, it is likely that the Czech Republic will remain reform oriented.¹⁶

II. JOINT VENTURES AS A VEHICLE FOR INVESTMENT

Foreign investment is a recognized means to stimulate economic revitalization.¹⁷ Unfortunately, the CSFR has not moved as quickly

submitted to the parliament. *Id.* at 187. One aspect of the reform package was the goal of minimizing the "social costs of transition" to a market economy, much in contrast with other East European countries' policies of reform. *Id.* The plan stressed an anti-inflationary policy while setting forth various reforms including, but not limited to, tax reform, price liberalization, internal convertibility of the crown, and privatization of former state-owned properties. *Id.* See also Hasfurth, *supra* note 3, at 192-93 (explaining, in contrast to Czechoslovakia's approach, Poland's "economic shock" reforms).

11. Vratislav Pechota, *Privatization and Foreign Investment in Czechoslovakia: The Legal Dimension*, 24 VAND. J. TRANSNAT'L L. 305, 307 (1991).

12. *Id.*

13. Czechoslovak Commercial Code, translated by U.S. Dept. of Commerce (1992).

14. Vaclav Klaus, the Federal Minister of Finance (and now the Czech Republic's Prime Minister), embraced monetarism and supported a rapid move to a market economy. Pechota, *supra* note 11, at 307.

15. See Wolchik, *supra* note 1, at 416 (discussing Klaus' desire to "move more quickly" in adopting a reform program prior to the June 1990 election).

16. As of December 1992, the laws of the Federation (the CSFR) were adopted by the Czech Republic. This includes the 1992 Commercial Code. Telephone Interview with representative from the Czech Republic Embassy in Washington, D.C. (Feb. 18, 1993). The 1992 Commercial Code has also been adopted by the Slovak Republic. Telephone Interview with representative from the Slovak Republic Embassy in Washington, D.C. (Sept. 13, 1993).

17. Kristina Smith, *Investing in Democracy: Joint Venture Opportunities in the Czech*

as other East European countries have to attract such investment.¹⁸ However, the liberalizing 1990 amendments to the CSFR joint venture law, coupled with the 1992 implementation of the Commercial Code, evidence a growing interest in attracting foreign investment.¹⁹

For the United States investor seeking opportunities in the CSFR, the international joint venture is a practical and successful means of establishing a business presence.²⁰ There are two categories of joint ventures: equity joint ventures and contractual joint ventures.²¹ The equity joint venture is preferred by the CSFR as a means of foreign investment²² and is also advantageous to the United States investor. This type of joint venture entails the establishment of a new business or trade with contributions of capital from each partner.²³ One advantage for the Western investor is shared control; each participant

and Slovak Federal Republic, 18 SYRACUSE J. INT'L L. & COM. 199, 202 (1992). Czechoslovak Premier Marian Calfa stated that the successful move to a market economy via economic reform "depends to a considerable extent on the influx of foreign capital." *Economic Reform Depends on Foreign Investments*, CTK Nat'l News Wire, Oct. 25, 1990, available in LEXIS, Nexis Library, INTL File.

18. 1 DAVID E. BIRENBAUM & DIMITRI P. RACKLIN, BUSINESS VENTURES IN EASTERN EUROPE AND THE SOVIET UNION: THE EMERGING FRAMEWORK FOR FOREIGN INVESTMENTS (P-H) § 5.02, at 5-6 to 5-7 (1990). See also

Laurie M. Brank, *Perestroika in Eastern Europe: Four New Joint Venture Laws in 1989*, 21 LAW & POL'Y INT'L BUS. 1, 2 (1989) (discussing Eastern Europe's move to attract foreign investment). Yugoslavia was the first East bloc country to implement foreign investment laws over twenty years ago. *Id.* The laws' goals were to expand export markets, modernize existing industry, gain new technology, promote research and development, and gain new production and management techniques. *Id.*

19. See Smith, *supra* note 17, at 202. See also *Economic Reform Depends on Foreign Investments*, *supra* note 17 (Premier Calfa stating that the CSFR government would be "liberal to the greatest degree" towards foreign investors).

20. Smith, *supra* note 17, at 202. See also Richard Sumann, *Investing in Czechoslovakia*, 24 VAND. J. TRANSNAT'L L. 369, 375 (1991) (stating that "[f]or the time being, the most practical way to invest in Czechoslovakia is through joint ventures").

21. Jeswald W. Salacuse, *Host Country Regulation and Promotion of Joint Ventures and Foreign Investment*, in INTERNATIONAL JOINT VENTURES: A PRACTICAL APPROACH TO WORKING WITH FOREIGN INVESTORS IN THE U.S. AND ABROAD 107, 114 (David N. Goldsweig et al. eds., 2d ed. 1990).

22. Smith, *supra* note 17, at 202. In the contractual joint venture, the foreign partner has no ownership interest and only provides services or operations. Salacuse, *supra* note 21, at 114-15. Examples of contractual joint ventures include "licensing the transfer of technology or transferring the right to engage in the distribution of a company's goods or services through a franchise agreement." Smith, *supra* note 17, at 202.

23. Salacuse, *supra* note 21, at 114.

owns a portion of the venture and participates in its control.²⁴ A second advantage is shared risk; responsibility does not fall entirely on one partner's shoulders.²⁵ The third advantage is shared knowledge; the United States business that wishes to participate in the expanding Czechoslovak market through a joint venture can benefit from the enlistment of a Czechoslovak co-investor who will contribute information regarding the local market climate.²⁶ The equity joint venture allows a United States business to secure and control a lasting presence in the CSFR market.²⁷ Such an established position opens opportunities to the United States investor for expansion into surrounding East European markets.²⁸

A. Early Joint Venture Laws: Effective Dissuasion of Western Investment

It is debatable whether the early Czechoslovak attempt to implement a joint venture law was motivated by the desire to attract foreign investors or to effectively discourage their presence. The first CSFR law governing this area was essentially a set of "Principles" that allowed for limited foreign investment.²⁹ The 1985 Principles were narrowly drawn and barred foreign investors from having majority ownership.³⁰ Additionally, approval by five separate CSFR government agencies was required before the joint venture could go

24. *Id.*

25. *Id.* at 114-15. See also Smith, *supra* note 17, at 202 (stating that the "equity investment is the best means to establish a long-term business presence and distribute the risk among the participants"). See generally CAROL McCORMICK CROSSWELL, LEGAL AND FINANCIAL ASPECTS OF INTERNATIONAL BUSINESS 3 (1980) (discussing the advantages of joint venture investments). In addition to risk spreading, another possible advantage with the joint venture is tax deferrals. *Id.* If less than 50% of the voting stock of a joint venture is owned by a United States citizen, the income will not be taxed until it is returned to the United States as dividends. *Id.*

26. Monte E. Wetzler, *Foreign Joint Ventures Generally*, in JOINT VENTURES AND OTHER FINANCING TECHNIQUES IN POLAND, HUNGARY, CZECHOSLOVAKIA, AND ROMANIA 51, 55 (PLI Commercial Law and Practice Course Handbook Series No. 613, 1992).

27. Smith, *supra* note 17, at 203.

28. See, e.g., CROSSWELL, *supra* note 25, at 32-33 (discussing the benefits of joint ventures, as opposed to mergers or acquisitions, for corporations investing in international markets).

29. Smith, *supra* note 17, at 204.

30. Richard S. Gruner, *Of Czechoslovakia and Ourselves: Essential Legal Supports for a Free Market Economy*, 15 HASTINGS INT'L & COMP. L. REV. 33, 42 (1991).

forward.³¹ With the strict government oversight and the severely limited ability of the investor to negotiate the venture,³² it is no surprise that few joint ventures were formed under these Principles.³³

Other fears and concerns also contributed to Western hesitation. One concern grew out of basic "fear of the unknown," or uncertainty about how to conduct business in a central economy.³⁴ Also, Western investors saw better opportunities in a system that embraced financial incentives.³⁵ Additional concern existed over east-west tensions and the possible risks of doing business in a country with a system that rivaled democracy.³⁶

Some liberalization occurred with the 1988 amendments that created the Act on the Enterprise with Foreign Property Participation (the 1988 Act).³⁷ Foreign investors were now allowed up to ninety-nine percent ownership.³⁸ Also, foreigners could now participate in any sector of the economy, except those areas deemed crucial to national defense.³⁹ However, repatriation of profits⁴⁰ was only permitted to the extent that the investment resulted in a return of foreign currency.⁴¹

By late 1989, the number of joint ventures in the CSFR had grown to approximately fifty.⁴² Of this number, thirty-two involved non-Socialist countries, with the majority involving West German and Austrian investors.⁴³

31. *Id.*

32. Smith, *supra* note 17, at 204 n.31, 205.

33. Gruner, *supra* note 30, at 42.

34. Brank, *supra* note 18, at 5.

35. *Id.*

36. *Id.*

37. Smith, *supra* note 17, at 205 n.35. "Prior to [this] law, only ten joint ventures had been established in [the CSFR]." Brank, *supra* note 18, at 21.

38. Smith, *supra* note 17, at 206. The government of the CSFR also decreed that it would exempt the foreign investors from the goals of central planning. Brank, *supra* note 18, at 21. For example, the government would not impose compulsory target production numbers on foreign investors as it did on state enterprises. *Id.* But see Pechota, *supra* note 11, at 321, 321 n.41 (stating that foreign participation was limited to 49%, but majority ownership could be permitted on a case-by-case basis).

39. Smith, *supra* note 17, at 205.

40. Repatriation of profits is defined as "[t]he return of profits from foreign investments to the investor's country." BLACK'S LAW DICTIONARY 1299 (6th ed. 1990).

41. Pechota, *supra* note 11, at 321.

42. Gruner, *supra* note 30, at 43.

43. *Id.* Most of the joint ventures at that time involved construction or the operation of hotels. *Id.* No joint ventures with United States business partners were formed prior to the communist government's demise. *Id.*

B. *Liberalization of the Joint Venture*

With the fruition of the Velvet Revolution, and Czechoslovakia's first faltering steps toward reform, came the country's public commitment to democracy and a free market economy.⁴⁴ The ambition to truly attract foreign investment was evidenced by the 1990 Amendments to the 1988 Enterprise with Foreign Property Participation Act (the 1990 Act).⁴⁵ The 1990 Act has further evolved into, and has been encompassed by, the recently enacted Commercial Code of January 1, 1992.⁴⁶

One of the most significant and investor-friendly changes between the 1988 Act and the 1990 Act involved the extent to which a foreign investor could participate in a joint venture. Whereas the 1988 Act limited foreign ownership to ninety-nine per cent,⁴⁷ the 1990 Act allowed an enterprise to be "established *exclusively* by a foreign participant."⁴⁸ Although this was only a one percentage point

44. In one of its first Constitutional amendments after the Revolution, the CSFR "articulate[d] the nation's commitment to free market economics." Charles G. Meyer III, *1992 and the Constitutional Development of Eastern Europe: Integration Through Reformation*, 32 VA. J. INT'L L. 431, 455 (1992). See also BIRENBAUM & RACKLIN, *supra* note 18, § 5.01, 5-5 to 5-6 (noting that the commitment to a free market was clearly evidenced by three major reform measures initiated January 1, 1991: (1) price liberalization, (2) the beginning of privatization, and (3) internal currency convertibility).

45. The Enterprise with Foreign Property Participation Act of April 19, 1990, translated in 2 CENTRAL & EASTERN EUROPEAN LEGAL MATERIALS (Vratislav Pechota ed., 1992) [hereinafter 1990 Act]. Also to encourage foreign investment, the Czechoslovak Chamber of Commerce and Industry published a list of Czechoslovak enterprises actively seeking Western partners along with a description of their investment plan. BIRENBAUM & RACKLIN, *supra* note 18, §§ 5.02, 5.7 n.19. The range of businesses included "engineering, construction, chemistry, printing, environment[al], waste management, transportation, communications, metallurgy," and numerous consumer goods. *Id.*

46. Czechoslovak Commercial Code, translated by U.S. Dept. of Commerce (1992).

47. Smith, *supra* note 17, at 206.

48. 1990 Act, *supra* note 45, arts. 2(2), 2(4) (emphasis added). The text of the statute provides in pertinent part:

(2) For the purposes hereof, a "foreign participant" shall include both a juristic or a natural person with a seat or domicile outside the territory of the Czechoslovak Federative Republic, who participates with an investment in the enterprise.

....

(4) In addition, the present Act shall apply also to a case where the enterprise is established exclusively by a foreign participant or where such a foreign participant participates exclusively in its trading.

Id.

difference, it allowed the foreign investor to operate an enterprise "completely devoid" of participation by a CSFR national.⁴⁹ The 1990 Act also permitted participation by a private Czechoslovak citizen,⁵⁰ setting private Czechoslovak citizens on equal ground with the "bodies corporate" and enabling them to participate in joint ventures.⁵¹

The procedure by which a foreign business applied and received permission to establish a presence in the CSFR⁵² was "streamlined" in the 1990 Act.⁵³ Final authorization for the foreign project was to be granted primarily by the Federal Ministry of Finance.⁵⁴ When deciding whether or not to grant authorization, the Ministry had to examine

whether there [was] hope that the enterprise being established [would] contribute to the increase of fruitful participation of [the] Czechoslovak economy in the international division of labour and whether during its economic activity [it would] be able to create sufficient financial resources both in Czechoslovak as well as in foreign currencies.⁵⁵

49. Smith, *supra* note 17, at 206 n.43. A similar change made by Hungary in 1990 resulted in more United States' corporations choosing to invest in Hungary than in any other Eastern European country. *Id.*

50. 1990 Act, *supra* note 45, art. 2(3). "[A] Czechoslovak participant' shall include both a legal or a natural person with a seat or a domicile situated on the territory of the Czechoslovak Federative Republic" *See also* Smith, *supra* note 17, at 206 (noting that this contrasts the earlier provision that permitted only a "juridical" person or a "corporate body" to participate in joint ventures, for example, foreign trade organizations and state enterprises).

51. *Remarks on the Amended Enterprise with Foreign Property Participation Act*, in LEGAL ASPECTS OF TRADE AND INVESTMENT IN THE SOVIET UNION AND EASTERN EUROPE 1990, at 705, 706 (PLI Commercial Law and Practice Course Handbook Series No. 549, 1990). *See also* Gruner, *supra* note 30, at 43 (stating that the 1990 Act provides for the participation of "individual Czechoslovak citizens" in joint ventures with foreign investors "on the same footing as Czechoslovak corporations").

52. This procedure is phrased as "AUTHORIZATION TO ESTABLISH AN ENTERPRISE." 1990 Act, *supra* note 45, pt. 2.

53. Smith, *supra* note 17, at 207. *See also* Brank, *supra* note 18, at 21 (describing the benefits of the 1990 Act). The author notes that the 1988 Act's application process required "a technical and economic analysis of the activities of the prospective enterprise." *Id.* In contrast, the 1990 Act no longer required such analyses, but did require information on the parties involved and some detail regarding the proposed venture. 1990 Act, *supra* note 45, art. 6.

54. 1990 Act, *supra* note 45, art. 5.

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

If the joint venture involved the banking business, however, authorization was to be granted solely by the Czechoslovak State Bank.⁵⁶ Authorization was to occur within sixty days⁵⁷ and could be granted in any economic sector, with the exception of any sector "important for defence [sic] and security" of the CSFR.⁵⁸

Under the 1990 Act, there were liberalizing innovations of the joint venture law in terms of ownership rights, possible participants and the authorization process. However, there still remained some disincentives regarding financial management,⁵⁹ primarily the con-

56. *Id.* art. 5.

57. *Id.* art. 7(3). The 1988 Act, in contrast, guaranteed a decision within 90 days, while processing with earlier laws could take up to six months. Brank, *supra* note 18, at 21.

58. 1990 Act, *supra* note 45, art. 7(2).

59. Some restrictions on joint venture investments involve foreign exchange regulations and repatriation of profits. Both subjects are of great importance to an American investor seeking opportunities abroad. The complexity of foreign exchange laws and profit repatriation requires a much more in-depth analysis and is, therefore, outside the scope of this note. However, a limited discussion follows:

In general, repatriation was linked closely to the foreign exchange profits generated by the joint venture. See 1990 Act, *supra* note 45, art. 20(2) (providing that "the foreign participant may transfer abroad his part in the earning of the enterprise . . . the part *exceeding the capital formerly paid in*, provided the enterprise has sufficient foreign exchange funds" (emphasis added)). However, the Foreign Exchange Act of November 28, 1990, provided for internal convertibility of the CSFR's currency and eliminated the rule that profits could be repatriated only to the extent that foreign currency was a profit generated by the investment. Pechota, *supra* note 11, at 322. There remained, however, the indirect restriction that repatriation had to be in foreign currencies exchanged at the official state rate. See Gruner, *supra* note 30, at 45 (discussing investor concern over the State Bank possibly using their currency exchange control to "impede the repatriation of dividends"). See also 1990 Act, *supra* note 45, art. 17 (stating that "[t]he conversion of the Czechoslovak currency into foreign currency . . . shall take place at rates fixed by the Czechoslovak State Bank"); *id.* art. 20(1) (stating that the foreign participant may transfer proceeds abroad as long as the proceeds are "in the currency formerly paid in").

Concerns over these issues were scheduled to be alleviated by an October 1991 agreement between Vaclav Havel and President Bush guaranteeing repatriation of profits and the free exchange of currencies. Michael Wines, *Havel Appeals for U.S. Investment and Market Talks with Bush*, N.Y. TIMES, Oct. 23, 1991, at A8. This agreement was one of several Bilateral Investment Treaties (BIT's) that the United States has negotiated internationally. 138 CONG. REC. S12,291, S12,293 (daily ed. Aug. 11, 1992). On August 4, 1992, the Committee on Foreign Relations "voted to report favorably th[is] treat[y], and recommend that the Senate give its advice and consent to [its] ratification." *Id.* at S12,294. The "Treaty Between the Government of the United States of America and the Czech and Slovak Federal Republic Concerning the Encouragement and Reciprocal Protection of Investment" had Senate ratification by August 5, 1992. *Id.* at S12,292.

For further discussion on the role of the Foreign Exchange Act of 1990, see *infra* notes 116-121 and accompanying text.

tinued requirement that a joint venture create a reserve fund comprised of ten percent of its basic capital.⁶⁰ A degree of liberalization occurred with the 1990 Act, which only required *one* reserve fund,⁶¹ in contrast with the earlier legislation which required *three* different capital funds.⁶² The purpose behind the reserve requirement has been termed a "bureaucratic measure" to ensure that a certain amount of currency is given to the CSFR government in exchange for the privilege of conducting business in the country.⁶³ Whatever its purpose, it evidenced the government's refusal to "relinquish control over an enterprise's activities and finances."⁶⁴

Finally, the 1990 Act helped to relieve investors' fears regarding the possible expropriation of the joint venture by the Czechoslovak government. The Act provided that the government could take the foreign enterprise "only in accordance with the rules of the Act."⁶⁵ These rules guaranteed compensation for the foreign investor that equalled the actual value of the acquired property.⁶⁶ In addition, the compensation was to be "freely transferable abroad in the currency which the foreign participant paid"⁶⁷ when investing, or paid in the currency of the investor's "seat or domicile."⁶⁸ Generally, Czechoslovak law allowed such expropriations only for "serious reasons of general interest, . . . and important public needs."⁶⁹

60. Article 12 provided that:

[a]fter its establishment, the joint ventures [sic] corporation shall create a reserve fund up to the amount, and in a manner, set forth in its by-laws [sic] or statutes. This fund shall be yearly fed from the earning after taxes by amounts of not less than five (5) per cent the distributable profits, until the amount fixed in the bye-laws [sic] or statutes is reached. The minimum amount of a reserve fund shall be ten (10) per cent the basic capital. The enterprise shall feed a part of the reserve fund in foreign currencies.

1990 Act, *supra* note 45, art. 12.

61. Smith, *supra* note 17, at 210.

62. The 1988 Act required three separate funds: (1) the reserve fund, (2) the cultural and social needs fund, and (3) the remunerations fund. *Remarks on the Amended Enterprise with Foreign Property Participation Act*, *supra* note 51, at 707. These requirements were modeled after Soviet legislation. Smith, *supra* note 17, at 210 n.68. In particular, the purpose of the remunerations fund, although not specifically explained in the Act, was to function as a "bonus fund." *Id.*

63. Smith, *supra* note 17, at 210 n.68.

64. *Id.* at 210.

65. 1990 Act, *supra* note 45, art. 22(1).

66. *Id.* art. 22(2). This section states that "the foreign participant shall receive a compensation corresponding to the actual value of his property affected . . . at the time of [the expropriation]." *Id.*

67. *Id.*

68. *Id.*

69. BIRENBAUM & RACKLIN, *supra* note 18, § 5.03[b], at 5-26. Examples of

C. *The New Commercial Code*

The new Commercial Code of the CSFR became effective January 1, 1992.⁷⁰ The new Code parallels many United States laws and has been termed by the United States Department of Commerce as "a very broad and modern document"⁷¹

1. Scope

The Code is broken into four distinct parts; however, part one and part two will be of the most interest to foreign investors. Part one sets forth the general provisions of the Code in five separate chapters: "Chapter I. Basic Provisions . . . Chapter II. Commercial Transactions by Foreign Persons or Legal Entities . . . Chapter III. The Commercial Register . . . Chapter IV. Entrepreneur Accounting Practices . . . Chapter V. Economic Competition."⁷²

The first chapter of part one, "basic provisions," defines who can participate in a commercial transaction and who is to be listed on the Commercial Register.⁷³ The second chapter, "commercial

such reasons or needs include "housing construction or creation of safety zones . . . air transport, mining, road construction, construction of power stations, etc." *Id.*

70. Czechoslovak Commercial Code § 775, translated by U.S. Dept. of Commerce (1992) (stating that "[t]his law becomes effective on 1 January 1992").

71. C.S.F.R.'s *New Commercial Code Praised, Compared to U.S. Laws by Commerce Official*, 9 Int'l Trade Rep. (BNA) No. 20, at 854 (May 13, 1992). The Code closely resembles parts of the U.S. uniform commercial code, the model partnership code, the model corporate code, and the unfair trade practices code according to the director of the Commercial Law Development Program for Central and Eastern Europe, Linda Wells. *Id.*

72. Czechoslovak Commercial Code, chs. 1-5, translated by U.S. Dept. of Commerce (1992).

73. *See id.* §§ 2-3. The relevant provisions are set forth as follows:
Section 2. Commercial Transactions

(1) A commercial transaction is understood to be the consistent activity independently engaged in by an entrepreneur in his own name and on his own

responsibility, for purposes of achieving a gain.

(2) According to this law, the following are considered to be entrepreneurs:

- a) a person entered in the Commercial Register;
- b) a person who engages in entrepreneurial activities on the basis of a small business permit;
- c) a person who engages in entrepreneurial activities on the basis of special regulations which are not equivalent to a small business permit;

. . . .

(3) The seat of a legal entity and the location at which a private individual engages in entrepreneurial activities is the address which is recorded in the Commercial or Small Business Register or in another record as the

transactions by foreign persons or legal entities," will be most important to the United States investor. It sets forth provisions regarding the extent of foreign participation,⁷⁴ the rules of expropriation,⁷⁵ and the process of authorization.⁷⁶ The former sixty-day authorization process⁷⁷ has effectively been replaced by the new Commercial Register provided for in chapter three.⁷⁸ Chapters four and five address accounting practices⁷⁹ and regulation of economic competition, respectively.⁸⁰

Part two will also be of interest to United States investors as it provides the rules and provisions governing commercial corporations and commercial cooperatives.⁸¹ Part three contains provisions

seat or location of the operation.

Section 3.

(1) The following are entered in the Commercial Register:

- a) commercial corporations, cooperatives, and other legal entities required to do so by law;
- b) foreign persons according to Section 21, Paragraph 4.

(2) A private individual with a domicile on the territory of the CSFR who is an entrepreneur as defined by this law . . . is recorded in the Commercial Register at his own request or if a special law so requires.

Id.

74. *Id.* § 25.

75. *Id.* § 21.

76. *Id.* §§ 21, 25.

77. *See supra* notes 52-58 and accompanying text.

78. *See* Czechoslovak Commercial Code ch. 3, translated by U.S. Dept. of Commerce (1992). The Commercial Register is a "public listing of legally stipulated data pertaining to entrepreneurs or other individuals . . ." *Id.* § 27(1). Required information for the register includes, but is not limited to, the business' name, the activity of the business, and the names and domiciles of participating individuals. *Id.* §§ 28(1)(a), (c).

79. *See id.* ch. 4. This chapter governs the obligation of entrepreneurs to keep accounts and which accounting method to apply. *Id.* §§ 35-40.

80. *See id.* ch. 5. Unfair competition practices are the focus of this chapter. Such practices are prohibited because they are seen as being "in conflict with the good customs of competition." *Id.* § 44(1). Various deceptive practices, bribery, defamation, violation of trade secrets, as well as endangerment to the health of individuals and the environment are all prohibited actions. *See id.* §§ 45-52. *See also C.S.F.R.'s New Commercial Code Praised*, *supra* note 71 (discussing the Code's section dealing with unfair competition and that treatment of environmental harm as an unfair trading practice is "a novel concept" (quoting Linda Wells, director of Commercial Law Development Program for Central and Eastern Europe)).

81. Czechoslovak Commercial Code, pt. 2, translated by U.S. Dept. of Commerce (1992). A commercial corporation is defined as:

a legal entity which is established for purposes of engaging in commercial transactions. Corporations are identified as *public commercial corporations*, *limited partnerships*, *corporations with limited liability*, and *joint stock corporations*.

dealing with contract law and various contractual relationships,⁸² and part four contains the concluding provisions, including a six-page listing of the various acts, laws, decrees and provisions that are rescinded by the new Code.⁸³

2. Application to Foreign Investment

The Enterprise with Foreign Property Participation Act of 1990⁸⁴ no longer exists under the new Commercial Code.⁸⁵ However, many liberal aspects of the 1990 Act are not only preserved in the Commercial Code, but improved upon as well. One of the Code's most liberal provisions concerns the allowable extent of participation by a foreign investor.⁸⁶ The Code provides that "[f]oreign individuals may engage in commercial transactions on the territory of the Czech and Slovak Federal Republic under the same conditions and to the same extent as Czechoslovak individuals, as long as the law does not stipulate otherwise."⁸⁷ A foreign investor is considered an "entrepreneur" under the Code's law.⁸⁸ The significance of such rec-

Corporations with limited liability and stock corporations may be established even for other purposes, where this is not prohibited by a special law.

Id. § 56(1) (emphasis added).

A cooperative is defined as "an association of an open-ended number of individuals, established for purposes of engaging in commercial transactions or of supporting the economic, social, or other requirements of its members." *Id.* § 221(1).

82. *See id.* §§ 261-755. *See also C.S.F.R.'s New Commercial Code Praised*, *supra* note 71 (reporting that a major part of the new CSFR Code deals with contracts and is similar to article two of the U.S. Uniform Commercial Code). The director of the Commercial Law Development Program for Central and Eastern Europe also advised prospective investors to "have a strong understanding of the terms of a contract and when and how its performance is agreed to occur." *Id.*

83. *See Czechoslovak Commercial Code § 772*, translated by U.S. Dept. of Commerce (1992). According to this section, rescinded legislation includes the Enterprises with Foreign Property Participation Act No. 112/1990 [the 1990 Act], the International Commerce Code No. 101/1963, and the Economic Code No. 103/1990.

84. 1990 Act, *supra* note 45.

85. Czechoslovak Commercial Code § 772(4), translated by U.S. Dept. of Commerce (1992).

86. *Id.* §§ 21-24.

87. *Id.* § 21(1). *See also C.S.F.R.'s New Commercial Code Praised*, *supra* note 71 (stating that "foreigners who are registered are assumed to get national treatment unless there is a specific provision to the contrary").

88. Czechoslovak Commercial Code § 23, translated by U.S. Dept. of Commerce (1992). "Foreign individuals who have the right to engage in commercial transactions abroad are considered to be entrepreneurs in the eyes of this law." *Id.*

ognition is that the United States investor is now on the same footing as the CSFR national and will receive the same legal treatment.⁸⁹ The 1990 Act's provision allowing an enterprise to be "established exclusively by a foreign participant"⁹⁰ is largely unchanged under the new Code. A foreign investor can "share in establishing a Czechoslovak legal entity or . . . participate as a partner or member in [one that] is already established."⁹¹ Additionally, a foreign *individual on his or her own* can establish a legal entity.⁹²

Even after streamlining the authorization process in the 1990 Enterprise with Foreign Property Participation Act,⁹³ the CSFR government remained concerned over the small influx of foreign investment and, thus, sought to ease authorization procedures even further.⁹⁴ This liberalization has been achieved with the 1992 Code.⁹⁵

89. *See id.* § 1(1) (stating that the Code regulates "the standing of *entrepreneurs*, commercial contractual relationships, as well as some other relationships connected with commercial transactions") (emphasis added).

90. 1990 Act, *supra* note 45, art. 2(4).

91. Czechoslovak Commercial Code § 24(1), *translated by* U.S. Dept. of Commerce (1992). Chapter two, section 24 provides that:

(1) [A] foreign person can, for the purpose of engaging in commercial transactions, share in establishing a Czechoslovak legal entity or may participate as a partner or member in a Czechoslovak legal entity which is already established. Such an individual may also, on their own, establish a Czechoslovak legal entity or become a partner in a Czechoslovak legal entity, provided this law permits a single founder or a single partner.

Id.

92. *Id.* In addition to foreign investor's rights being augmented, the private Czechoslovak citizen has maintained the privilege of participating in a joint venture. *See also id.* § 3(2) (providing that "[a] private individual with a domicile on the territory of the C.S.F.R. who is an entrepreneur as defined by this law . . . is recorded in the [C]ommercial [R]egister at his own request or if a special law so requires").

93. *See supra* notes 52-58 and accompanying text (discussing the former authorization process).

94. *See Czechoslovakia Government Proposes Easing Regulations on Foreign Investment Licensing*, 8 Int'l Trade Rep. (BNA) No. 3, at 92 (Jan. 16, 1991). The Czechoslovak Finance Ministry proposed exempting foreign investors from "government licensing procedures in a bid to attract foreign capital." *Id.* at 92-93. The proposal mandated that Western investors would not need ministry approval as long as the venture did not involve a Czechoslovak company. *Id.* at 93. *See also Official Says Foreign Investment Must Increase*, CTK Czechoslovak News Agency, July 25, 1991, available in LEXIS, Nexis Library, INTL File (Zdenek Drabek, director of the Czechoslovak Federal Agency for Foreign Investment, stating that foreign investment must be increased without curtailing obstacles).

95. Czechoslovak Commercial Code § 21(4), *translated by* U.S. Dept. of Commerce (1992). The relevant provision provides:

(4) The authorization for a foreign individual to engage in commercial activities on the territory of the Czech and Slovak Federal Republic arises

Ministry approval is no longer necessary; authorization for the commercial activity arises on the day that the enterprise is recorded on the Commercial Register.⁹⁶ The register is maintained by a special "register court"⁹⁷ and contains a compilation of data on the new enterprises, including the corporation name, an identification number assigned by the register court, the activity to be undertaken, what legal form the entity will be, the name and domicile of the participants, and whether there is a branch enterprise.⁹⁸ Foreign individuals have an additional requirement of registering the "location of the organizational component owned by a foreign individual,"⁹⁹ who the manager is, and where he or she can be found.¹⁰⁰

The somewhat restrictive reserve fund requirement¹⁰¹ remains in place under the Code.¹⁰² In general, the reserve fund is to be

as of the day this individual or the organizational component of his enterprise are registered in the Commercial Register, indicating the scope of the commercial transaction. The proposal for registration is submitted by the foreign person involved.

Id.

96. *Id.* In addition, the proposal for registration may be submitted by the foreign participant. *Id.*

97. *Id.* § 27(3).

98. *Id.* § 28(1). This provision sets forth the following information to be included:

- a) the trading name, the seat (in the event of legal entities), the domicile and place of operation (for private individuals) where the place of operation differs from the domicile;
- b) the identification number; [this number is assigned by the register court as provided by section 28(6)]
- c) the object of the undertaking (activity);
- d) the legal form of a legal entity;
- e) the name and domicile of the individual or individuals who are the statutory organs or its members, accompanied by a listing of the methods by which they will act in the name of the legal entity;
- f) the designation, location, and object of the undertaking (activities) of a branch enterprise; the name of its manager and his domicile;
- g) the name of the proxy and his domicile;
- h) other factors, if the law so stipulates.

Id.

Additional data is recorded depending on which legal form the enterprise has taken (i.e., public commercial corporation or a limited partnership, for example). *Id.* § 28(2).

99. Czechoslovak Commercial Code § 28(3), translated by U.S. Dept. of Commerce (1992).

100. *Id.* Also, a foreign individual wishing to register as an agent "authorized to act for the entrepreneur" must have documentation allowing them to reside in the CSFR. *Id.* § 30(3).

101. See *supra* notes 60-64 and accompanying text for a discussion of the reserve fund requirement.

102. Czechoslovak Commercial Code § 67, translated by U.S. Dept. of Commerce (1992).

either cash in a local bank account or secured property which can be quickly converted to cash.¹⁰³ The reserve requirement will vary slightly, depending on which corporate form the investor chooses.¹⁰⁴ The two most frequently used corporate entities in the CSFR are the limited liability corporation (společnost s ručením omezeným¹⁰⁵) and the joint stock company (akciová společnost¹⁰⁶).¹⁰⁷ The reserve fund for the limited liability corporation is established at the same time as the corporation and must equal "at least five percent of [the] basic capitalization."¹⁰⁸ The original amount is increased yearly by at least five percent of the corporation's net profits, until it reaches the minimum of ten percent of the basic capitalization.¹⁰⁹ However, the stock corporation must create a reserve fund that is at least ten percent of the basic capitalization.¹¹⁰ Similar to the limited liability corporation, the original amount is increased annually by five percent of the net profits, until the fund reaches at least twenty percent of its basic capitalization.¹¹¹

The regulations concerning expropriation by the state, which were set forth initially in the 1990 Act, are preserved.¹¹² The Code provides that a foreign investor's property involved in commercial transactions may be expropriated by the CSFR only "on the basis of law and in the public interest, which cannot be otherwise satisfied."¹¹³ As with the 1990 Act, the Code requires that if such expropriation occurs, the foreign investor must be compensated "*without delay . . . the full value of the property impacted . . .*"¹¹⁴ In addition, the compensation "must be freely transferable abroad in foreign currency."¹¹⁵

103. *Id.*

104. *See id.* §§ 124, 217.

105. *Id.* § 107.

106. *Id.* § 154(2).

107. Robert L. Drake, *Legal Aspects of Financing in Czechoslovakia, Hungary, and Poland*, 26 INT'L LAW. 505, 505 (1992).

108. Czechoslovak Commercial Code § 124(1), translated by U.S. Dept. of Commerce (1992).

109. *Id.*

110. *Id.* § 217(1).

111. *Id.*

112. *See supra* notes 65-69 and accompanying text for a discussion of the 1990 Act's rules on expropriation.

113. Czechoslovak Commercial Code § 25(1), translated by U.S. Dept. of Commerce (1992). In addition, the expropriation can be appealed to the courts. *Id.*

114. *Id.* § 25(2) (emphasis added). The 1990 Act did not indicate such an immediate time frame for compensation. *See* 1990 Act, *supra* note 45, art. 22.

115. Czechoslovak Commercial Code § 25(2), translated by U.S. Dept. of Commerce (1992).

The Foreign Exchange Act of 1990 (the Exchange Act) controls currency convertibility which affects repatriation and the availability of "hard currency."¹¹⁶ The Exchange Act allows financial obligations that are incurred in hard currency to be settled through the purchase of the currency at the official state rate.¹¹⁷ Under these rules, Czechoslovak persons who are accounted for in the Commercial Register may exchange Czechoslovak crowns up to any amount for "hard currency" in order to finance import activities.¹¹⁸ In order to support such a system, however, all Czechoslovak residents must convert their hard currency holdings to the Czechoslovak crown.¹¹⁹ Consequently, because a joint venture foreign investor is now treated as a Czechoslovak legal person, he or she is subject to the Foreign Exchange Act.¹²⁰ However, the foreign participant in a CSFR joint venture is exempt from the mandatory conversion requirement up to the extent of his initial hard currency investment.¹²¹

III. BALANCING THE QUESTION OF INVESTMENT IN THE CSFR

The United States Embassy in Prague reported that, as of March 1992, over 230 United States companies were active in the CSFR.¹²² Although this number has increased based upon earlier United States records,¹²³ it is still only approximately 4.9% of the total foreign investment in the CSFR.¹²⁴ Joint ventures registered in the Czechoslovak government as of May 1992 totaled approximately 2,900, with 70% in the Czech Republic and 30% in the Slovak Republic.¹²⁵

A. Incentives

For the United States business seeking to invest in Eastern Europe, Czechoslovakia provides a more secure opportunity than

116. Drake, *supra* note 107, at 508-09. *See also supra* note 59 (discussing the role of the Foreign Exchange Act of 1990).

117. BIRENBAUM & RACKLIN, *supra* note 18, § 5.05, at 5-42 (citing §§ 13(1)-(2) of the Foreign Exchange Act of 1990).

118. Drake, *supra* note 107, at 509.

119. BIRENBAUM & RACKLIN, *supra* note 18, § 5.05, at 5-42 (citing §§ 10, 11(1) of the Foreign Exchange Act of 1990).

120. Drake, *supra* note 107, at 509.

121. BIRENBAUM & RACKLIN, *supra* note 18, § 5.05, at 5-43 (citing § 11(3) of the Foreign Exchange Act of 1990).

122. *U.S. Firms Slow to Invest in C.S.F.R. Despite Stabilized Economy, Official Says*, 9 Int'l Trade Rep. (BNA) No. 19, at 816 (May 6, 1992).

123. A 1991 figure listed 132 U.S. joint ventures in the CSFR. *Foreign Companies Hesitant to Invest in Czechoslovakia*, CTK Czechoslovak News Agency, May 24, 1991, available in LEXIS, Nexis Library, INTL File.

124. *U.S. Firms Slow to Invest in C.S.F.R.*, *supra* note 122, at 816.

125. *Id.*

other Eastern European countries. First, a relatively low level of foreign debt, plus a well developed infrastructure, provide for a more stable economic environment than in other Eastern nations.¹²⁶ Other indicators of stability and economic revival are, first, controlled inflation and a stable exchange rate for the crown.¹²⁷ Second, Czechoslovakia has a "strong industrial tradition"¹²⁸ with a solid industrial base and communications infrastructure.¹²⁹ Low wages,¹³⁰ coupled with an abundant, educated labor force,¹³¹ should also attract Western investors.

The primary incentive for the United States investor is the adoption of the new Commercial Code. The Code increases investment stability by improving upon the liberalized joint venture laws already in place. First, there is a degree of familiarity for the United States investor in dealing with the new Code because it closely resembles parts of the U.S. Uniform Commercial Code, the Model Partnership Code, the Model Corporate Code, and the Unfair Trade Practices Code.¹³² Second, the United States investor is no longer limited to participation and ownership rights, but can decide to either cooperate with a Czech national in establishing a joint venture, or

126. Smith, *supra* note 17, at 200. See also *Coopers & Lybrand Eastern European Business & Investment Guides: Czechoslovakia*, Sept. 24, 1992, available in LEXIS, World Library, EEBIG File (providing that total external debt for the CSFR in 1991 was estimated at 9.7 billion U.S. dollars, and was forecast at \$10.8 billion in 1992).

127. See *Economy Revival Apparent in C.S.F.R. this Year*, CTK Nat'l News Wire, July 29, 1992, available in LEXIS, Nexis Library, INTL File. See also *U.S. Firms Slow to Invest in C.S.F.R.*, *supra* note 122 (noting that inflation in the CSFR "has been brought under control"). Deputy Secretary of State, Lawrence S. Eagleburger, reported that inflation has remained at or below one percent per month since May 1991, and was expected to reach no more than ten percent in 1992. *Id.*

128. Henry W. Lavine et al., *Czech and Slovak Privatization: Issues and Approaches for Western Investors*, in *JOINT VENTURES AND OTHER FINANCING TECHNIQUES IN POLAND, HUNGARY, CZECHOSLOVAKIA, AND ROMANIA* 61, 66 (PLI Commercial Law and Practice Course Handbook Series No. 613, 1992).

129. *Id.*

130. Dyba & Svejnar, *supra* note 6, at 189. The authors note that "Czechoslovakia is one of the few reforming economies that enjoys relative financial stability, a low level of foreign debt, a solid human capital base, and low wages." *Id.*

131. Smith, *supra* note 17, at 209. The literacy rate in Czechoslovak is at 99%, thus, nearly all individuals aged 15 and older can read and write (1970 estimate). UNITED STATES CENTRAL INTELLIGENCE AGENCY, *THE WORLD FACTBOOK* 79 (1991).

132. See *supra* note 70 and accompanying text. See also Pechota, *supra* note 11, at 324 (explaining the advantages of the CSFR's new commercial code). The author notes that the CSFR has also established the Agency for Foreign Investment to assist foreign businessmen in understanding the Czechoslovak legal environment. *Id.*

establish an enterprise on its own.¹³³ In any event, the United States business or individual will be subject to the same regulations and protections afforded the Czechoslovak citizen.¹³⁴ This "legally equivalent position"¹³⁵ will lend confidence to a United States investor examining prospective Czechoslovak opportunities.¹³⁶ Third, the United States investor no longer has to wait for ministry approval, as authorization to establish a joint venture is granted the same day that the investor provides the required information to the Commercial Register.¹³⁷ Finally, the United States investor does not have to fear seizure of his or her project by the CSFR government without full and prompt compensation, because the new Code provides regulations against such expropriation.¹³⁸

For the still wary investor, various sources of political risk and finance insurance are also available.¹³⁹ A prime provider of such insurance is the Overseas Private Investment Corporation (OPIC), which is a United States government agency that assists United States citizens, corporations and their subsidiaries with investments in various underdeveloped areas, including Eastern Europe.¹⁴⁰ OPIC provides three types of political risk insurance.¹⁴¹ First, there is expropriation coverage which insures against "nationalization, confiscation and creeping expropriation, including . . . material changes in . . . contracts unilaterally imposed by the host government."¹⁴²

133. See Czechoslovak Commercial Code § 24, translated by U.S. Dept. of Commerce (1992).

134. See *supra* notes 87-92 and accompanying text for a discussion of code regulation of foreign participation.

135. Gruner, *supra* note 30, at 46.

136. *Id.*

137. See *supra* notes 94-100, and accompanying text (discussing the authorization process and the Commercial Register under the new Code).

138. See *supra* notes 113-115 and accompanying text (discussing the expropriation provisions of the Code).

139. See B. Thomas Mansbach, *Political Risk Insurance*, in *INTERNATIONAL JOINT VENTURES: A PRACTICAL APPROACH TO WORKING WITH FOREIGN INVESTORS IN THE U.S. AND ABROAD* 201, 201 (David N. Goldsweig et al. eds., 2d ed. 1990). Overseas Private Investment Corporation (OPIC) has a great deal of experience in resolving investment disputes. *Id.* A United States investor can turn to OPIC as a United States government agency for assistance in settling investment issues with a host government. *Id.* There also are non-financial incentives for acquiring coverage and with the backing of the United States government, a dispute settled by OPIC will often be done in a "legal and financial framework rather than in a public political arena." *Id.*

140. *Id.*

141. *Id.* at 202.

142. *Id.* at 203. "Creeping expropriation" is defined as the host government

Such coverage gives the United States joint venturer added confidence if he or she is not fully satisfied with the expropriation provisions of the Code. Second, inconvertibility coverage is offered, which protects the insured against "deterioration of exchange control laws, regulation, practices and procedures."¹⁴³ This type of coverage may be attractive to the investor who has reservations regarding the planned January 1993 split of the CSFR, and the proposal to keep a common currency.¹⁴⁴ Finally, there is "political violence" coverage that applies in times of "war, revolution, insurrection and civil strife"¹⁴⁵ and insures against damage to assets caused by such violence.¹⁴⁶ Depending on how smoothly the planned 1993 split of the CSFR proceeds, this may also be an attractive preventive measure to the United States investor.¹⁴⁷

The World Bank also offers a political risk insurance package through its Multilateral Investment Guarantee Agency (MIGA).¹⁴⁸ MIGA offers coverage against political upheaval and other risks, both business and non-business, faced by investors.¹⁴⁹ For the concerned investor, coverage through MIGA has been in place since the CSFR rejoined the World Bank and subscribed to the Convention on the Creation of the Multilateral Investment Guarantee Agency.¹⁵⁰

A final incentive for United States investors is the evolution of trade agreements between the United States and the CSFR. The negotiations began in 1990 as President Bush granted the CSFR "Most Favored Nation" (MFN) status.¹⁵¹ The agreement that granted

neither nationalizing nor confiscating the foreign enterprise, but rendering "its operation economically and financially inviable through an act or series of acts of a lesser degree than nationalization or confiscation." *Id.*

143. *Id.* at 202.

144. Mary Battiata, *Czechs, Slovaks Set "Velvet Divorce"*, WASH. POST, Aug. 28, 1992, at A25. Czech Prime Minister Vaclav Klaus stated, "I would like to stress that there will be no immediate change in currency after January [1993], or in the foreseeable future." *Id.*

145. Mansbach, *supra* note 139, at 203.

146. *Id.*

147. It should be noted that OPIC acts as an "incentive agency," therefore, an investor can insure only new ventures, or new investment in an existing project. *Id.* at 204.

148. Smith, *supra* note 17, at 217. The OPIC insurance coverage can either work in conjunction with MIGA's program, or independently of it. Mansbach, *supra* note 139, at 201.

149. Smith, *supra* note 17, at 217. MIGA's coverage is modeled after OPIC, however, investors should be aware that MIGA will not insure investments exceeding \$30 million, nor will it insure loans by financial institutions for new projects in a developing country. Mansbach, *supra* note 139, at 205.

150. Pechota, *supra* note 11, at 324.

151. Agreement on Trade Relations Between the Government of the United

this status extended mutual nondiscriminatory tariff treatment with the goal of ensuring "overall reciprocity of economic benefits."¹⁵² This agreement also established the groundwork for later negotiations regarding repatriation of profits and the transfer of capital.¹⁵³ This groundwork reached its fruition with the October 1991 Bilateral Investment Treaty (BIT) between Havel and Bush that was to promote an unhindered flow of investment, as well as protect United States investments in the CSFR.¹⁵⁴

At the August 4, 1992 Committee on Foreign Relations hearing, Assistant Secretary of State for Economic and Business Affairs, Eugene J. McAllister, urged ratification of the BIT, even in the face of a possible split of the CSFR.¹⁵⁵ McAllister pointed out that the treaty was scheduled to be considered by the CSFR Assembly in September 1992.¹⁵⁶ If both the United States and the CSFR were able to ratify the BIT before a possible split, McAllister explained that "the treaty would be binding under international law on the

States of America and the Government of the Czechoslovak Federative Republic, H.R. Doc. No. 231, 101st Cong., 2d Sess. 7, 9 (1990) [hereinafter Agreement on Trade Relations]. Article I, § 2 states:

To this end, the Parties shall apply between themselves the provisions of the GATT [General Agreement on Tariffs and Trade], as those provisions apply to each Party, and shall accord each other's products most-favored-nation treatment as provided in the GATT, provided that, to the extent any provision of the GATT is inconsistent with any provision of this Agreement, the latter shall apply.

Id. MFN status was officially extended by President Bush in November 1990. *Czechoslovakia Set to Grant U.S. Businesses Broad Investment Incentives and Safeguards*, 8 Int'l Trade Rep. (BNA) No. 1, at 22 (Jan. 2, 1991).

152. Letter from President George Bush to Thomas S. Foley, Speaker of the House of Representatives, H.R. Doc. No. 231, 101st Cong., 2d Sess. 1 (1990).

153. Agreement on Trade Relations, *supra* note 151, at 25. Article XVI, § 1 provides that "both Parties shall strive to achieve mutually acceptable agreements on taxation and investment issues, including the repatriation of profits and transfer of capital." *Id.* (emphasis added). See also *Czechoslovakia to Lift Trade Barriers, Scale Down Government's Role in Trade*, 8 Int'l Trade Rep. (BNA) No. 1, at 25 (Jan. 2, 1991) (discussing that MFN status was "psychologically significant" to the CSFR, but was not expected to "produce immediate results in trade between the two countries").

154. 138 CONG. REC. S12,291, S12,293 (daily ed. Aug. 11, 1992). The United States began negotiating BITs in 1981 to "promote the free flow of investment internationally" and to "provide certain mutual guarantees and protections . . . to create a more stable and predictable legal framework for foreign investors with each of the treaty partners." *Id.* at S12,294.

155. *Id.* at S12,294. Other statements of support for the Treaty came from the National Association of Manufacturers and the United States Council for International Business. *Id.*

156. *Id.*

successor states.”¹⁵⁷ On August 5, 1992, two-thirds of the senators present resolved to “advise and consent to the ratification of the Treaty.”¹⁵⁸ This commitment by the United States to elevate the CSFR’s trading position, coupled with negotiations to ease restrictions on United States investors, has provided for a more secure investment atmosphere in the CSFR.¹⁵⁹

B. Disincentives

There has been a notable depletion of disincentives with the adoption of the new Commercial Code. However, despite its liberal qualities, there is the inevitable drawback that because the Code is new, there are no explanatory regulations or interpretations of how to apply it.¹⁶⁰

One remaining legal barrier is the state’s refusal to totally relinquish control over financial management, evidenced by the required maintenance of reserve funds by a corporation.¹⁶¹ Depending on the type of business, the initial amount required for the fund varies between five and ten percent of the basic capitalization and must eventually be maintained at ten to twenty percent.¹⁶² The discouraging aspect of this requirement is that a United States company must have investment funds available, in addition to its initial capitalization costs, in order to establish itself in the CSFR.

A more serious disincentive is the nationalistic clamoring that has resulted in the proposed 1993 “Velvet Divorce” of the CSFR into the Czech Republic and the Slovak Republic.¹⁶³ The “power

157. *Id.* This statement was made based on assurances given by the Bush Administration. *Id.*

158. *Id.* at S12,292.

159. Smith, *supra* note 17, at 214-15 (discussing the significance and incentive qualities of the granted MFN status).

160. Lavine et. al., *supra* note 128, at 68.

161. Czechoslovak Commercial Code § 67, translated by U.S. Dept. of Commerce (1992). See also *supra* notes 101-11 and accompanying text (discussing the provisions of the reserve fund requirement).

162. Czechoslovak Commercial Code §§ 124(1), 217(1), translated by U.S. Dept. of Commerce (1992).

163. Battiatia, *supra* note 144, at A25. Discord between the two republics has been brewing since the overthrow of Communism. *Czech-Slovak Discord Has Been Growing for Two Years*, CTK Nat’l News Wire, Nov. 19, 1991, available in LEXIS, Nexis Library, INTL File. The first indicator of discord was a 1990 dispute over the name of the new Communist-free state. *Id.* In mid-1991, the Slovak Premier, Jan Carnogursky, maintained that Slovakia “wants to play an independent role in a unified Europe.” *Id.*

sharing” between the two republics and the growth in nationalistic feelings have acted as non-legal obstacles to foreign investment.¹⁶⁴ The rise of nationalism could destabilize one republic, or the country as a whole,¹⁶⁵ thus discouraging potential investors. Although Klaus, the Czech Prime Minister, and Meciar, the Slovak Prime Minister, have emphasized that the dissolution of the CSFR will be a peaceful, advantageous process,¹⁶⁶ there is concern that the split will cost the republics their “lead among East European countries shifting to market economies.”¹⁶⁷ Concern over the division has slowed both foreign investment and the creation of international agreements with the CSFR.¹⁶⁸ Although the potential for ethnic violence does not appear to be great,¹⁶⁹ it does increase skepticism and raise concern among investors who might surmise that better opportunities exist elsewhere in Eastern Europe.¹⁷⁰

IV. PRIVATIZATION: A NEW AVENUE FOR INVESTMENT?

Under Communist rule, the Czechoslovak economy was the most centrally controlled of any economy in Eastern Europe.¹⁷¹ In order to transform itself into a free market economy, the formerly state-owned enterprises must be privatized.¹⁷² The privatization of

164. *Nationalism an Obstacle to Foreign Investment in Czechoslovakia*, CTK Nat'l News Wire, June 11, 1991, available in LEXIS, Nexis Library, INTL File.

165. *Id.* See also *Foreign Countries Hesitant to Invest in Czechoslovakia*, *supra* note 123 (stating that the political turmoil has discouraged foreign investment in the CSFR).

166. Battiata, *supra* note 144, at A29.

167. *Id.*

168. *Foreign Ministry Report Pessimistic About Division*, CTK Nat'l News Wire, Sept. 16, 1992, available in LEXIS, Nexis Library, INTL File. Great Britain, for example, seeing the area as one of “increased risks,” has raised interest rates on commercial credits for trade in the CSFR. *Id.*

169. See Battiata, *supra* note 144, at A29. There exist no “significant territorial disputes” between the Czech and Slovak Republics. *Id.*

170. One such possibility might exist in Hungary which recently established a \$25 million fund to “encourage large joint ventures with significant foreign equity to invest in infrastructure improvements and provide employee training.” *Hungary Establishes \$25 Million Fund to Encourage Large Foreign Investments*, 8 Int'l Trade Rep. (BNA) No. 1, at 25 (Jan. 2, 1991).

171. Wines, *supra* note 59, at A8. See also Catherine L. Mann, *Industry Restructuring in East-Central Europe: The Challenge and the Role for Foreign Investment*, 81 AM. ECON. REV. 181, 181 (1991) (stating that “as of 1989, 90% of industry was state-owned”).

172. Michael L. Neff, *Eastern Europe's Policy of Restitution of Property in the 1990's*, 10 DICK. J. INT'L L. 357, 357 (1992). Privatization is defined as “the transfer of ownership from the state to the private sector and is the hallmark of . . . market-oriented reform programs.” Mann, *supra* note 162, at 181.

property and protection of property rights will then act as an enticement to foreign investors.¹⁷³

The CSFR has implemented a privatization program that consists of three parts: (1) restitution, (2) small-scale enterprise privatization, and (3) large-scale enterprise privatization.¹⁷⁴ Previously, the joint venture was the only way for the foreign investor to enter the CSFR market. However, with the advent of privatization, the United States investor has another possible avenue for investment opportunities.¹⁷⁵ Although the joint venture still remains a more clearly defined and quicker means of investment, as large-scale privatization progresses, a United States investor will be able to purchase shares in Czechoslovak companies already in existence, rather than establishing new joint ventures.¹⁷⁶

The focus of the small-scale privatization is the transfer of small enterprises that were once state-owned into the hands of private citizens.¹⁷⁷ The large-scale privatization focuses on denationalizing the medium and large enterprises.¹⁷⁸ However, before either privatization program can be implemented, the government must return property expropriated during the Communist regime of 1948 to 1989.¹⁷⁹

A. Restitution

As of May 1992, approximately 100,000 property interests had been returned to their previous owners.¹⁸⁰ Two laws govern the restitution process: (1) the Restitution Act of October 2, 1990 (First Act),¹⁸¹ and (2) the Restitution Act of February 21, 1991 (Second Act).¹⁸²

173. Neff, *supra* note 172, at 357.

174. *Czechoslovakia Needs Foreign Capital and Know-How, Finance Official Says*, *supra* note 2, at 444. See generally Roman Frydman & Andrzej Rapaczynski, *Institutional Reform in Eastern Europe: Evolution or Design?* 1992 B.Y.U.L. REV. 1 (discussing the effects of privatization in relation to other obstacles in transforming to a market economy in Eastern Europe).

175. Mann, *supra* note 171, at 184.

176. Pechota, *supra* note 11, at 323.

177. *Id.* at 308.

178. *Id.* Included in this category are "hotels, other service establishments, construction firms and transportation companies." *Id.*

179. *Id.*

180. *Exchange of Vouchers for Shares Scheduled for May 18 in C.S.F.R.*, 9 Int'l Trade Rep. (BNA) No. 20, at 856, 857 (May 13, 1992). These interests included apartments, houses and land. *Id.*

181. Pechota, *supra* note 11, at 309 & n.7.

182. *Id.* at 310 & n.10.

The First Act provided for the return to original owners or their heirs, property expropriated between 1955 and 1959.¹⁸³ The property encompassed by the First Act was only a small percentage of the total amount confiscated, and to a great extent affected only small, individually owned businesses, often from the service sector.¹⁸⁴ If the property had been sold to a "bona fide purchaser,"¹⁸⁵ the CSFR offered equitable compensation to the original owner instead.¹⁸⁶

The Second Act is more encompassing. It provides for the return of "nationalized, confiscated, or otherwise expropriated" property between the years 1948 and 1989.¹⁸⁷ The property to be transferred must be valued at over \$10 billion,¹⁸⁸ and individuals making claims do not have the option of choosing financial compensation over receipt of the property.¹⁸⁹ Significantly, foreigners may not claim restitution; only "physical persons who are citizens and permanent residents" of the CSFR are eligible to participate in this process.¹⁹⁰

B. *Privatization: Small-Scale and Large-Scale*

The transfer of small businesses into private hands is controlled by the Act on the Transfer of State Ownership of Certain Property to Other Legal or Natural Persons (the Small-Scale Privatization Law),¹⁹¹

183. Neff, *supra* note 172, at 371; Pechota, *supra* note 11, at 309.

184. Neff, *supra* note 172, at 371. Previous owners had to claim the property at issue within six months of the November 1, 1990 enactment of the law. *Id.*

185. *Id.* Such bona fide purchasers include "private companies, joint ventures, foreigners or . . . the diplomatic corps." Pechota, *supra* note 11, at 310.

186. Neff, *supra* note 172, at 371.

187. *Id.* at 372.

188. Pechota, *supra* note 11, at 310.

189. BIRENBAUM & RACKLIN, *supra* note 18, § 5.02[a], at 5-9. The exception to this rule applies if the state has improved the property. *Id.* Then the claimant may choose financial compensation over receipt of the property. *Id.* If, under these circumstances, the claimant still chooses a transfer of the property, he or she would have to compensate the state for the property improvements. *Id.*

190. *Id.* Czechoslovaks permanently residing abroad and foreign nationals do not qualify for restitution. Pechota, *supra* note 11, at 311.

191. Act on the Transfer of State Ownership of Certain Property to Other Legal or Natural Persons of October 25, 1990, Act No. 427/1990, Coll. of Laws, translated in 2 CENTRAL & EASTERN EUROPEAN LEGAL MATERIALS (Vratislav Pechota ed., 1992) [hereinafter Small-Scale Privatization Law]. By May 1992, approximately 30,000 small businesses had been sold in the C.S.F.R. *Exchange of Vouchers for Shares Scheduled for May 18 in C.S.F.R.*, *supra* note 180, at 857. The first auctions held January 1991 were considered a "smashing success" as the businesses sold for much more than expected. Pechota, *supra* note 11, at 312-13 n.18.

which became effective December 1, 1990.¹⁹² This act applies to small industries, businesses, or services with the exception of utilities or public services.¹⁹³ Investors already established in the CSFR need not fear losing their businesses since the act prohibits the transfer of property controlled by a foreign individual.¹⁹⁴

The transfer of the property is done via public auctions carried out by an "authorized state agency."¹⁹⁵ A small business has two chances to be auctioned off to a purchaser. In the first "round," only citizens of the CSFR are eligible to purchase auctioned properties.¹⁹⁶ If the business is not sold in the first auction, a second round takes place, at the discretion of the two republics, in which foreign individuals can participate.¹⁹⁷ This provides another possible means by which a United States investor can enter the CSFR market. However, to participate in the auction process, an individual must first make an "auction security deposit" of a minimum ten percent of the opening bid price,¹⁹⁸ and pay a fee for the "right to participate" amounting to one thousand crowns.¹⁹⁹ The major disadvantage to this method of investment is the very slow speed at which privatization is occurring. The *first* round of small-scale privatization was still underway,²⁰⁰ as of May 1992, and no openings for possible foreign investors had yet occurred.

Large-scale privatization is controlled by the Act on the Conditions of Transfer of State Property to Other Persons (Large-Scale

192. BIRENBAUM & RACKLIN, *supra* note 18, § 5.02(c), at 5-19.

193. Pechota, *supra* note 11, at 312. This process involves over 120,000 small enterprises and is expected to be completed in about three years. *Id.* Examples of the small enterprises encompassed by the act are shops, restaurants, and roadside stands previously controlled by the state. Drake, *supra* note 107, at 507.

194. Small-Scale Privatization Law, *supra* note 191, art. 2(2). This section provides in pertinent part that "[t]he subject of the transfer of the property cannot be a business unit, to which the right of use is being upheld by persons whose residence or seat is on the territory of another state." *Id.*

195. *Id.* art. 4(1)-4(2).

196. BIRENBAUM & RACKLIN, *supra* note 18, § 5.02[c], at 5-19. *See also* Small-Scale Privatization Law, *supra* note 191, art. 3 (describing who is eligible for ownership).

197. Small-Scale Privatization Law, *supra* note 191, art. 13(1)-13(2). This article provides that "[w]hen the same business unit is again auctioned . . . other natural persons and juristic persons . . . can become its owners." *Id.* art. 13(2).

198. *Id.* art. 5(1). The 10% minimum must be at least 10,000 crowns. *Id.*

199. *Id.* art. 5(3). The auction security deposit is then deducted from the purchase price if the potential buyer is the highest bidder. *Id.* art. 5(2). Other participants are refunded their deposits at the conclusion of the auction. *Id.* As of November 3, 1992: 1 U.S. \$ = 27.62 crowns (koruna). *Currency Trading*, WALL ST. J., Nov. 4, 1992, at C17.

200. *Exchange of Vouchers for Shares Scheduled for May 18 in C.S.F.R.*, *supra* note 180, at 857.

Privatization Law)²⁰¹ which became effective on April 1, 1991.²⁰² Under the Large-Scale Privatization Law, each enterprise will initiate and develop its own plan for privatization.²⁰³ It is anticipated that large-scale privatization will transfer a substantial amount of the economy into private hands and will "sharply accelerate" foreign investment.²⁰⁴

There are four possible methods available for large-scale privatization, three of which involve direct sales of the former state-owned enterprises.²⁰⁵ The first method is the direct sale of the enterprise to either a "foreign or a domestic investor,"²⁰⁶ and there is no cap on the maximum "foreign holdings" for any enterprise.²⁰⁷ The second method is an auction of the property to the highest bidder, and the third method involves selling the enterprise to its management and employees.²⁰⁸ To compensate for the scarce availability of capital,²⁰⁹ the fourth method implements the use of "investment coupons" or vouchers.²¹⁰ Any Czechoslovak citizen over age eighteen has a right to these vouchers,²¹¹ which are sold to them at a "nominal fee," and can be exchanged for either shares in companies or investment funds.²¹²

Once the privatization plan is chosen by the enterprise, it is submitted to a "founder,"²¹³ who submits it for authorization to

201. Act on the Conditions of Transfer of State Property to Other Persons of February 26, 1991, Act No. 92/1991, Coll. of Laws, *translated in 2 CENTRAL & EASTERN EUROPEAN LEGAL MATERIALS* (Vratislav Pechota ed., 1992) [hereinafter Large-Scale Privatization Law].

202. BIRENBAUM & RACKLIN, *supra* note 18, § 5.02[b], at 5-12 to 5-13.

203. *Id.* § 5.02[b][1], at 5-15. *See* Large-Scale Privatization Law, *supra* note 201, art. 6. The privatization plan shall include, but is not limited to: (1) the name and definition of the property to be privatized; (2) an explanation on how the state acquired the property originally; (3) a description of unusable assets and uncollectible claims; (4) an evaluation of the property; (5) the legal form of any proposed commercial company and any relevant date; and (6) a timetable for the implementation of the privatization plan. *Id.* art. 6(1). For a complete list of information required for the plan, see *id.* art. 6(1)-6(2).

204. Drake, *supra* note 107, at 507.

205. Lavine et. al., *supra* note 128, at 89.

206. *Id.*

207. Pechota, *supra* note 11, at 315.

208. Lavine et al., *supra* note 128, at 89.

209. Pechota, *supra* note 11, at 316.

210. *See* Large-Scale Privatization Law, *supra* note 201, arts. 22-26 (dealing with the provisions of the investment coupon).

211. *Id.* art. 24.

212. *Exchange of Vouchers for Shares Scheduled for May 18 in C.S.F.R.*, *supra* note 180, at 856.

213. The founder is the ministry (either federal or republic) that has jurisdiction over the enterprise. BIRENBAUM & RACKLIN, *supra* note 18, § 5.02[b], at 5-13.

either the Federal Ministry of Finance (if the founder is a federal authority), or in all other cases, to the republic's state administrations.²¹⁴ However, if the plan involves directly selling an enterprise to a "specific" foreign or domestic investor, government approval is necessary.²¹⁵ Once authorized, the assets of the enterprise are transferred by the founder to the relevant fund,²¹⁶ and the enterprise is then dissolved.²¹⁷ The assets from these funds are either transferred to new enterprises, sold to investors, or transferred to municipalities.²¹⁸

The new avenue for investment through privatization is far from being a clear-cut, unobstructed path. The debates concerning the Large-Scale Privatization process are numerous,²¹⁹ primarily centering on the anticipated effectiveness of the voucher system.²²⁰ The system assumes that citizens will be eager to participate and able to purchase the available coupons,²²¹ as well as behave like "experienced shareholders."²²² However, this last assumption is an unfounded one in a society that has no stock-market tradition.²²³

The slow rate at which privatization is occurring may also prevent United States investors from rapidly switching to this means of investment. Since the first auction round of small-scale privatization is moving so slowly, opportunities for foreign participation in this realm do not yet exist.²²⁴ Another complicating and slowing factor in the process is restitution.²²⁵ An investor should be aware that restitution claims take precedence over privatization,²²⁶ and as

214. Large-Scale Privatization Law, *supra* note 201, art. 8(1).

215. Pechota, *supra* note 11, at 315.

216. Large-Scale Privatization Law, *supra* note 201, art. 11. When the founder of the enterprise is the federal central authority, the relevant fund is the Federal Fund of the National Property. *Id.* art. 11(2). If the founder is either "the authority of state administration of the Republic or a municipality," the relevant fund is either the fund of National Property of the Czech Republic, or of the Slovak Republic. *Id.* art. 11(3).

217. Drake, *supra* note 107, at 508. These funds are separate from the federal and republic budgets. *Id.*

218. *Id.*

219. Pechota, *supra* note 11, at 315-16.

220. *Id.* at 316.

221. *Id.*

222. *Id.*

223. *Id.* It is unlikely that individuals will invest in a manner that entails the risk factor that stock ownership holds. *Id.* It is more probable that the stock owner will seek a quick return on the investment by selling early. *Id.*

224. *See supra* notes 196-97 and accompanying text.

225. Pechota, *supra* note 11, at 317. It is possible that the entire process could take up to five years to complete. *Id.*

226. *Id.* at 312.

a consequence, an investment opportunity could be delayed, or even extinguished, while prior-owner possibilities are investigated.²²⁷

Finally, there is the ever-present question of how the 1993 split of the CSFR will affect this entire process. When the privatization process was being developed, there was a trend in the country favoring the republics' autonomy and seeking to limit the powers of the federation.²²⁸ This resulted in the state's assets being split equitably between the two republics.²²⁹ The question that arises, and remains unanswerable, is how the two republics will resolve future distributions of former CSFR assets through the privatization process, once they are no longer a common entity.

V. SECTORS FOR INVESTMENT

If, after weighing the incentives against the disincentives, the United States investor deems the CSFR to be a prime investment opportunity, the areas available for the establishment of a joint venture or purchase of a business are far from narrowly drawn. The possibilities range from producing common consumer goods to establishing a sophisticated consulting group. However, before embarking on a project, a United States investor would be well-advised to hire a Czechoslovak attorney to handle his transaction.²³⁰ This will ensure a complete understanding of the CSFR laws, and of European legal customs in general.²³¹

Eastern Europe is much more accessible now that it is no longer the "Eastern Bloc." The fear once associated with traveling into the Communist stronghold has been removed, and Westerners are now beginning to discover this new frontier for travel. The tourism industry has become a popular and growing area for joint ventures, and many have undertaken such projects as hotel construction.²³²

Another popular area for investment is the consumer goods sector. In particular, the CSFR has been termed a "gold mine" for United States cigarette companies seeking new markets;²³³ Phillip

227. *Id.*

228. Neff, *supra* note 172, at 373.

229. Pechota, *supra* note 11, at 313.

230. C.S.F.R.'s *New Commercial Code Praised*, *supra* note 71, at 854.

231. *Id.*

232. Sumann, *supra* note 20, at 376.

233. "Gold Mine for Cigarette Magnates" *Opening up in Czechoslovakia*, CTK Nat'l News Wire, Apr. 7, 1992, available in LEXIS, Nexis Library, INTL File. The combination of the former East Bloc states rank fourth in the world in cigarette consumption. *Id.*

Morris' winning 1992 bid for the Czech cigarette maker, A.S. Tabak, totalled \$329 million.²³⁴ Retail stores have also started to stake their claim in the CSFR market; K-Mart has recently purchased twelve stores in the CSFR and has also committed \$100 million to future investments over the next three years.²³⁵ Also moving into the CSFR market is the United States chemical industry. In November 1991, Dow Chemical negotiated a \$100 million deal with the CSFR state-owned Chemicke Zavody Sokolov.²³⁶ Other United States companies to join Phillip Morris, K-Mart and Dow include Sara Lee, General Motors, and Proctor & Gamble.²³⁷

Services are also a prime investment area. In November 1991, the United States and Foreign Commercial Service in Prague listed the following as the best service investment opportunities: computer services and equipment, telecommunication services, information services, education and manpower training services, management consulting services, and finally, financial and accounting services.²³⁸ In addition, the need for equipment associated with these services will be great.²³⁹

If a United States investor decides to join the ranks of Phillip Morris and Dow, he or she should not anticipate overwhelming first or second year profits.²⁴⁰ An investment in the CSFR should be approached with a focus on long-term returns.²⁴¹ One reason for this, and something the American investor must understand, is the effect that forty years of Communism has had on the CSFR's economic and social systems, particularly on management and decision-

234. *Id.* The bid was broken down into \$150 million for the Czech Republic's national property fund, \$126 million for stocks, and the remaining \$53 million to be set aside for future investments. *Id.*

235. *Exchange of Vouchers for Shares Scheduled for May 18 in C.S.F.R.*, *supra* note 180, at 857.

236. "Gold Mine for Cigarette Magnates", *supra* note 233.

237. *Exchange of Vouchers for Shares Scheduled for May 18 in C.S.F.R.*, *supra* note 180, at 857. See generally *U.S. Companies with Offices, Agents & Representatives in Czechoslovakia*, in *JOINT VENTURES AND PRIVATIZATION IN EASTERN EUROPE*, at 193-94 (PLI Commercial Law and Practice Course Handbook Series No. 575, 1991) (listing U.S. companies active in the CSFR as provided by the U.S. Dept. of Commerce).

238. *U.S. Firms Slow to Invest in C.S.F.R. Despite Stabilized Economy, Official Says*, *supra* note 122, at 817.

239. *Id.* Such equipment includes telecommunications, electrical power systems, hotel and restaurant equipment, and renewable energy equipment. *Id.*

240. Sumann, *supra* note 20, at 377.

241. *Id.*

making skills.²⁴² First, managers in the CSFR under the Communist regime learned a "yes/no" and "black/white" method of analysis instead of thinking of alternate approaches or modifications.²⁴³ Second, for an official or manager to be successful under a centrally-planned system, he had to learn to *take* orders, not give them.²⁴⁴ Third, decision making was something dictated from above—it was not reached through discussion or planning on a managerial level.²⁴⁵ Therefore, the lack of managerial experience is a problem that the Western investor will have to face and deal with effectively.

VI. CONCLUSION

Eastern Europe is a "new frontier" for Western capitalists. As it builds a market economy from the ground floor up, it is in prime position for a United States corporate invasion.

From a social, economic, and legal standpoint, the Czech and Slovak Federal Republic has become a leading choice for a Western corporation seeking an Eastern European market. The country's democratic traditions and past economic success, coupled with a strong industrial base, low wages, and a large, *educated* work force make it a much more attractive choice than other emerging world markets.

A practical and successful method of investing in the CSFR for a Western business or individual is through the equity joint venture. A slow but steady evolution of progressively more liberal joint venture laws has recently culminated with the January 1992 adoption of a new Commercial Code.²⁴⁶ The Code places a foreign investor on a level playing field with a Czechoslovak national, affording the investor the same responsibilities and protections offered a CSFR citizen. In addition, because the Code is similar to various United States codes, the United States investor will not be faced with as many unfamiliar concepts and guidelines as he or she might first expect. However, the United States investor should be aware that although the Code theoretically appears solid, it has yet to be put into practice to any great extent, and no interpretive regulations exist. Therefore, as with

242. Lavine et al., *supra* note 128, at 74.

243. *Id.*

244. *Id.*

245. *Id.*

246. Czechoslovak Commercial Code, *translated by* U.S. Dept. of Commerce (1992).

any new piece of legislation, there will likely be a "breaking-in" period when its application may not go as smoothly as anticipated.

Another possible avenue for investment is slowly emerging in the process of enterprise privatization. As former state-run entities are offered for sale, the United States investor has the opportunity to establish a presence in the CSFR. However, there are numerous hurdles and time delays to be overcome: restitution continues to conflict with possible privatization, the small-scale privatization process inches along, and the debate continues over the level of success to be anticipated with the voucher system. Presently, investment incentives or advantages via privatization are not as clearly defined or predictable as they are with joint ventures. If privatization follows the same evolutionary path as joint ventures, as the reform process moves forward, it is likely to become a more secure means of investment.

The one wild card with both means of investment is the scheduled 1993 "divorce" of the Republic. The type of instability, and the effects on both the economy and reform efforts that this will cause in the CSFR, are speculative at best. Nevertheless, if the United States investor decides to pursue an investment project, the opportunities are wide-ranging—from tourism to pharmaceuticals. However, the United States investor must realize that early profits will not be large, and he or she must always remain cognizant of and patient with the effects of forty years of Communism.

Heather V. Weibel

ADDENDUM

After completion of this note, the long debated separation of Czechoslovakia became a reality; and on January 1, 1993, the independent Czech and Slovak Republics were officially formed.²⁴⁷ The 1992 Commercial Code, one of the focuses of this note, was adopted by both Republics, thus reinforcing its validity.²⁴⁸ Although the split gave investors cause to stop and re-evaluate their choices, many of

247. Philippa Fletcher, *Czechs and Slovaks Wake to Cold Dawn of Division*, REUTERS LTD. (Jan. 1, 1993), available in LEXIS, Nexis Library, Wires File. The United States has recognized the two Republics' existence and has established diplomatic relations with both. Mark J. Mowrey, *Birth of New Nations Should Yield Opportunities; Czech Republic and the Slovak Republic 1993 World Trade Outlook*, BUS. AM., Apr. 19, 1993, at 32.

248. See *supra* note 16.

those companies already doing business in the former CSFR remained "optimistic" that the separation would not negatively effect their enterprises.²⁴⁹

Although privatization has progressed, its rate has been slow.²⁵⁰ On May 24, 1993, both Republics initiated the voucher exchange program in which previously purchased vouchers were traded by private citizens for shares in various companies.²⁵¹ By early June, the Slovak Republic had announced plans for its "next round of privatization" involving loans to enable "local people" to actually purchase enterprises.²⁵² The Slovak plan, however, did not abandon the voucher program: fifty billion crowns (\$1.7 billion U.S. dollars) has been slated for a "second 'wave' of voucher privatization" in 1994 that is to include energy, chemical, and engineering enterprises.²⁵³

The Czech Republic has actually seen an *increase* in foreign investment since the January 1 split,²⁵⁴ most likely attributable to

249. Tina Cassidy, *Local Firms Not Broken Up About Czechoslovakia*, B. BUS. J., Jan. 18, 1993, at 9. Massachusetts' companies doing business in the former CSFR were the focus of this article. *Id.* Companies that already have an enterprise established, or are in the process of establishing a joint-venture in the former CSFR, include Cabot Corporation, LoJack Corporation, Raytheon, and Sanborn. *Id.*

250. David Rocks, *Czech Privatization Moves at a Snail's Pace*, Inter Press Service, June 8, 1993, available in LEXIS, Nexis Library, INTL File. Soon after the January split, both Republics began arguing over bank debts owed to each other. *Id.* Great delay was caused by failed negotiations regarding \$850 million that the Czech Republic claimed Slovakia owed them. *Id.* Czech Premier Vaclav Klaus "froze" shares in various Czech enterprises that the Slovak Republic was to receive through the privatization voucher program. *Id.* However, since computer databases at that time were unable to distinguish between Czech and Slovak citizens, *no one* was able to get his or her shares. *Id.*

251. Bernd Debusmann, *Czechs, Slovaks Take Final Step Towards Capital Markets*, REUTER BUS. REP., May 24, 1993, available in LEXIS, Nexis Library, INTL File. The companies "open to voucher-to-share conversion" on May 24 numbered 987, all of which were located in the Czech Republic. *Id.* See also *supra* notes 210-12 and accompanying text (discussing the basics of the voucher program).

252. Jonathan Lynn, *Slovakia Readies for Second Round of Privatization*, REUTER EUR. BUS. REP., June 8, 1993, available in LEXIS, Nexis Library, Wires File. The plan involved loans from local commercial banks to individuals who wished to privatize a company. *Id.* The banks would have the autonomy to decide whether or not to grant the loan based on the viability of the investor's "business plan." *Id.* However, even if a loan was granted, the investor would have to be able to finance 15% of the loan with personal assets. *Id.*

253. *Id.*

254. *Investors Not Deterred by Split*, REUTERS LTD., Jan. 29, 1993, available in LEXIS, Nexis Library, Wires File (Czech Industry and Trade Minister, Vladimir Dlouhy, stating that foreign investment interest in the Czech Republic has increased

wide spread investor confidence in the Czech Republic.²⁵⁵ While the Czech Republic has profited from the "divorce," the Slovak Republic has not been as fortunate.²⁵⁶ It has not had the steady influx of foreign investment that the Czech Republic has experienced,²⁵⁷ despite the fact that by the middle of 1993, foreign capital was on a seemingly steady uprise.²⁵⁸ It still remains to be seen how all the recent developments will play out as foreign investors meet the challenges of this newest frontier.

since its split from Slovakia). According to the Czech Central Bank, direct foreign investment in the Czech Republic was 31% higher in the first quarter of 1993 as compared to the first quarter of 1992. *Foreign Investment in Czech Republic Rises*, REUTERS LTD., May 13, 1993, available in LEXIS, Nexis Library, Wires File.

255. A recent survey of Western Company directors conducted by two daily newspapers, *The Wall Street Journal* and *Handelsblatt*, revealed that most directors chose the Czech Republic as the East European country which would not only have the "most stable economy in 20 years' time" but would also be the "most attractive" country for future foreign investments. *Western Directors Say Czech Republic Most Attractive Country*, CTK Nat'l News Wire, July 9, 1993, available in LEXIS, World Library, TXTEE File.

256. Within the first six months of 1993, the Slovak economy "shrank by 6.2[%]" compared with 1992 figures. Chris Sularik, *Slovak Economy Shrinks After Split with Czechs*, REUTERS LTD., Sept. 1, 1993, available in LEXIS, Nexis Library, Wires File.

257. By the second half of 1992, the Slovak Republic saw a "marked slowdown" in direct foreign investments. *Austrian Study of Slovakia's Economic Woes*, CTK Nat'l News Wire, May 17, 1993, available in LEXIS, World Library, TXTEE File.

258. *Slovakia: 1993 Foreign Investment Rises by SK 1.1 Billion*, Hospodarske Noviny, June 21, 1993, available in LEXIS, World Library, TXTEE File.