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**THE LAWS ON RESEARCH, DEVELOPMENT & INNOVATION IN HUNGARY  
IN LIGHT OF THE EUROPEAN FRAMEWORK**

**BY DR. SÁNDOR NÉMETH AND LIVIA KOLTER**

*The promotion of research, development and innovation (R&D&I) has been identified as a key obligation by both the European Union as well as its member states in recent years. Given the specific challenges in the realization of that endeavor, such as the limited ability of states to grant aid and the necessity to support R&D&I to ensure economic growth and competitiveness while minimizing market distortions, legislative efforts on the European and national levels can be problematic. Through a review of the recent European Framework for Research and Development and Innovation as well as the national regulatory scheme in place in Hungary, it becomes apparent that meaningful growth in R&D&I will only come about as the result of targeted measures based on sound macroeconomic policies and administered through a specialized infrastructure.*

**LEGISLATIVE BACKGROUND**

The issue of R&D&I support is somewhat anomalous within the regulation of Community policies as Article 87(1) of the EC Treaty specifically prohibits state aid due to its distorting effect on competition, indirectly also complying with a similar prohibition under several of the World Trade Organization Agreements.

The EC Treaty

Subsections 2 and 3 of Article 87 provide the exceptions to the general prohibition under the Article, and state aid in support of R&D&I is seen as compatible with the common market through qualification under subsection 3(b) and 3(c) of that Article. These two subsections allow, respectively, for compatibility if aid is given “to promote the execution of an important project of common European interest” or “to facilitate the development of certain economic activities where such aid does not adversely affect trading conditions to an extent contrary to the common interest”. State aid in favour of R&D&I also finds support in other areas of the EC Treaty, such as Article 163 that advocates the Community’s objective of supporting the scientific and technological bases of the EC and Articles 164-173 that enumerate the activities to be carried out to that end. These last provisions are also the source of authorization for the development of multi-annual framework programs in respect of the scope and implementation of acceptable aid programs.

## EU Policy Instruments

The specific origins of the new Framework for R&D&I, although the successor to the previous text of the same name, can be traced back to the March 2002 Barcelona meeting of the European Council. The meeting gave birth to the policies and goals to be realized in connection with R&D&I past 2006. Specifically, it was agreed that spending on R&D&I would be increased in order to approach 3% of GDP by 2010, with two-thirds of capital infusions to come from the private sector. This was considered to be in line with the goals of the Lisbon Strategy established two years earlier, according to which an increase in R&D&I support would translate into increased growth in the EU economy.

In furtherance of these objectives, the State Aid Action Plan of 2005 was set out to become the roadmap for state aid reform to be carried out between 2005 and 2009. Reform, it was hoped, would lead to a new system of state aid in Member States that was less and better targeted through a refined economic approach and more effective methods. The increased transparency and predictability of the new system would address relevant market failures while allowing only minimally distorting competition. EU spending on R&D&I had long been criticized as less than ideal and positively harmful in comparison to that of the US. The resulting enhanced economic climate would be conducive of entrepreneurial activities, including R&D&I. The fundamental features of the Framework were thus formulated.

## **THE FRAMEWORK FOR STATE AID FOR RESEARCH AND DEVELOPMENT AND INNOVATION**

As outlined above, the general aim of the Research, Development and Innovation (R&D&I) Framework adopted by the European Commission, in effect from January 1, 2007 is the enhancement of economic efficiency through state aid with the long-term objective of sustainable growth and job creation.

### Structural Overview

The premise of the Framework remains the view that state aid for R&D&I is acceptable provided it leads to additional R&D&I and the resulting distortion of competition is not considered contrary to the common interest. In order to be deemed as compatible to Community interests, state aid measures by Member States need to carefully target relevant market failures that are preventing efficiency. Given the general prohibition on state aid in the EC Treaty and the exceptional allowance for such subsidies, the Framework outlines the general criteria used by the Commission in evaluating state aids that must be notified to it pursuant to the thresholds established in Commission Regulation 346/2004.

Upon notification of state aid provided for R&D&I, the Commission will utilize a balancing test based on an economic approach, consisting of three questions assessing the positive and negative effects of the measure in question. Specifically, the aid must be aimed at a well-defined objective of common interest and must be delivered in a manner that outweighs any deleterious effects to win the Commission's approval. As additional guidance, the Framework enumerates the categories of aid that may be deemed acceptable, including aid for fundamental, industrial and experimental research undertaken to correct market failures and complementary technical feasibility studies; aid for process and organizational innovation in services and aid for small and medium enterprises as well as a category of businesses described as young and innovative enterprises.

## Targeted Measures

The category of legitimate state aid measures aimed at young and innovative enterprises (“YIE”) entails certain additional parameters. To be qualified as YIE, first, the beneficiary must be a small enterprise in existence for less than six years at the time the aid is granted. Second, a finding that a young enterprise is innovative must be established by the Member State granting the aid, establishing the following facts:

- The YIE will, in the foreseeable future, develop products, services or processes that are technologically new or substantially improved; or
- The R&D expenses of the beneficiary represent at least 15% of its total operating expenses in the last one out of three years preceding the grant; or
- The aid in question does not exceed EUR 1 million

Lastly, in addition to other restrictions, the beneficiary may only receive aid once in the period in which it may qualify for such aid.

## Policy Objectives and Administration

For all types of aid measures, only those will be approved by the Commission that do not exclude the possibility of exploitation of R&D&I in other Member States. The criteria and thresholds set forth in the Framework aim to render the provision of state aid in all Member States more consistent and the evaluation of such measures by the Commission more transparent. Not only does the new Framework qualify the approval process but it also expands the possible targets of state aid. New acceptable targets must be activities that support innovation, aiming to increase the economic exploitability of knowledge and technology involving an element of risk while addressing market failures in a manner that satisfies the requirements of the balancing test.

Administration of state aid, following the recommendations of the Economic Committee assessment, will be ameliorated by extending the block-exemption available for R&D (currently limited to SME’s) in respect of which individual notification to the Commission does not have to be made. In contrast to block exemptions, the following thresholds are established for projects that must be notified to the Commission individually: EUR 20 million for projects predominantly for fundamental research, EUR 10 million for projects predominantly for industrial research and EUR 7.5 million for experimental development projects. The bonus limits for SME’s has also been raised to 20% and to 10% for medium-sized companies to address the specific vulnerability of these enterprises to market failures.

The Framework recognizes the fact that favorable conditions must accompany state aid in order to address market failures and to ensure that competition is not hampered or distorted through aid measures. The overall aim is to streamline state aid so as to channel aid to those market participants that will undertake meaningful R&D&I. This will inevitably entail changing the status quo where it leads to economic inefficiency or predatory use of state aid.

## **THE HUNGARIAN REGULATORY SCHEME**

Predating the 2006 framework, the applicable legislation in Hungary in respect of R&D&I is Act no. CXXXIV of 2004 on Research Development and Technological Innovation (the “RDTI Act”). As its title suggests, the law seeks to facilitate the growth of

competitiveness of the Hungarian economy based on R&D&I in a manner ensuring sustainable development.

### Structural Overview

Under the definitions in the RDTI Act, the term R&D included fundamental and applied research as well as experimental development. In order to provide support to a broad range of activities, the term technological innovation is defined to encompass efficiency- and income-generating commercial activities, and scientific, technical, organizational, management and commercial acts carried out to achieve favorable community and environmental effects, resulting in new or substantially altered products, procedures or services, technologies.

### Policy Objectives and Administration

More specifically, the act aims to improve creation and exploitation of R&D&I results, facilitate growth in competitiveness of businesses based on R&D&I, promote the creation of jobs offering high added value and promote improvement of professional preparedness while increasing its recognition by society. In order to achieve these goals, the act obliges the State to undertake a number of steps. It must develop a mid-range science, technology and innovation policy strategy, in respect of which it must report to Parliament on a biannual basis. In addition, it must also support Hungarian participation in EU programs, international R&D&I co-operation involving Hungarian R&D&I results as well as facilitate the financial exploitation of such inventions in Hungary and abroad. In order to realize its R&D&I strategy, the State must create research facilities and fund them through a central budgetary framework, support fundamental research through transparent public tender projects and provide publicly funded support for the end-use objectives stipulated in its strategy.

To this end, the Science and Technology Council has been established, chaired by the Prime Minister, to oversee the infrastructural changes mandated by the RDTI Act. A new government office, the National Office for Research and Technology (NORT), has also been created to implement the government's science and technology policy. The NORT oversees the Research and Technology Innovation Fund, financed by contributions from all businesses but small- and medium-sized enterprises of 0.25% of their turnover and an equivalent amount from the government. The Fund, in turn, is used to finance programs aiming to bring about innovative services and products that are chosen based on a tender system.

### Intellectual Property Rights

To the extent required for state-assisted growth in R&D&I, intellectual property rights are also addressed in the RDTI Act. However, the Patent Act (*Act XXXIII of 1995 on the Protection of Inventions by Patents*) and the Hungarian Civil Code remain authoritative with respect to intellectual property law in general. Under the RDTI Act, research facilities established through public funds are required to have internal regulations concerning the use of intellectual property. These internal regulations must address aspects, such as policies regarding the evaluation and registry of intellectual creations developed in a research facility for consideration, conditions for the transfer or other mode of their exploitation and the rights of researchers involved in the development of intellectual creations during its exploitation, among others.

In an effort to marshal support for growth in all fields and industries, state support is made available for services that facilitate R&D&I. This includes, among others, support for

businesses that provide capital financing for companies involved in R&D&I, services that promote co-operation for the exploitation of in R&D&I between research facilities and businesses, services aiming to realize equality of chance concerning access to market information as well as those promoting infrastructures to support R&D&I and technology transfer and dissemination.

The RDTI Act does not address the issue of young and innovative companies in its provisions and therefore no special benefits are afforded to such enterprises.

## **RESEARCH AGREEMENTS IN HUNGARY<sup>1</sup>**

According to the Civil Code, under a research agreement, an entrepreneur is obligated to perform research activities and the mandator is obligated to pay remuneration. The parties to the agreement may agree that remuneration will be paid even upon the unsuccessful completion of the mandate and the research agreement may be made for an indefinite period of time.

The research agreement is an independent incarnation of the entrepreneurial agreement although it may contain certain contractual elements that may more closely resemble a mandate agreement. While the entrepreneurial agreement contains an obligation to produce results, the research agreement is not premised on the precondition that the parties agree to the realization of results. Research agreements vary from entrepreneurial agreements also in that they must be in written form and under the main rule, an entrepreneur may only use the services of subcontractors with the consent of the mandator unless the entrepreneur has undertaken to achieve a specified result.

### Right of Disposal of Research Results

The provision of the Civil Code in respect of intellectual creations is twofold. The mandator may stipulate the right of disposal in the research agreement and this will determine who may use the intellectual creation and in what scope, including which party will have the right of disposal. In either event, the publication of and/or notification regarding the intellectual creation to third persons is prohibited.

In respect of intellectual creations that may benefit from legal protection and that have been made available pursuant to an agreement, the mandator has two options. If he stipulates the right of disposal, the entrepreneur inventor may only use the intellectual creation in connection with his own internal activities. The entrepreneur may not publicize or disclose the intellectual creation to third parties. In this case, the mandator may freely dispose of the intellectual creation.

If the mandator does not stipulate the right of disposal, he may only use the intellectual creation in the scope of carrying out his operational activities. The publication and disclosure prohibitions in respect of the intellectual creation are applicable. In this case, the entrepreneur may freely dispose of the intellectual creation.

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This section covers research agreements generally and therefore does not address the specific rules in connection with intellectual creations created in the context of an employment relationship.

## CONCLUSIONS

Although the 2006 Community Framework outlined above is the continuation, with certain adjustments, of the Union's long-standing R&D&I policies, there are considerable differences within Member States in the attainment of the Framework's goals. In addition, the Community is lagging behind R&D&I investment as compared to the US and Canada. Therefore, effort on the part of the EU as well as individual Member States is required to effect change and increase R&D&I investment and output.

The relatively recent laws in Hungary for the promotion of R&D&I through state involvement and the regulation of research agreements signify recognition of the need to increase the country's knowledge-based competitiveness. Through the establishment of a public infrastructure to facilitate R&D&I and the regulation of research agreements, Hungary aims to bring its policies and output in line with those of other Member States, such as in France, where the Act on Young Innovative Enterprises and United Kingdom where business-friendly legislative and fiscal measures have rendered the pursuit of R&D&I a worthwhile endeavor by both the public and private sectors. While the establishment of public offices to oversee and administer public funds for the promotion of R&D&I has begun the process of normalization, further changes are necessary to render the Hungarian market optimal for R&D&I participants, such as young and innovative enterprises.

*The contents of this article are intended to provide only a general overview of the subject matter. Specialist advice should be sought for specific matters. Queries relating to this article should be addressed to the authors at:*

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