



Hungary

János Tamás Varga and Zoltán Tarján
VJT & Partners

www.practicallaw.com/0-501-4983

REGULATION AND REQUIREMENTS

1. To what extent does national law specifically regulate outsourcing transactions?

Hungarian law does not specifically regulate outsourcing transactions, except in relation to (*see Question 2*):

- Various financial services.
- Services provided by electricity and gas suppliers.
- Certain specific services, such as the operation of Ferihegy International Airport of Budapest.

2. What additional regulations may be relevant on:

- **A financial services outsourcing?**
- **A business process outsourcing?**
- **An IT outsourcing?**
- **A telecommunications outsourcing?**
- **A public sector outsourcing?**
- **Other outsourcings?**

Financial services

Outsourcing by financial organisations is regulated by:

- **Act CXII of 1996 on credit institutions and financial enterprises (Credit Institutions Act).** This provides detailed rules on outsourcing by credit institutions and financial enterprises.
- **Act CXXXVIII of 2007 on investment enterprises and commodities brokers and on the rules of authorised activities (Investment Enterprises Act).** This regulates outsourcing by investment enterprises, commodities brokers and fund managers.
- **Act CXX of 2001 on capital markets (Capital Markets Act).** This provides rules on outsourcing by central depositories, clearing houses and central contracting parties.
- **Act LX of 2003 on insurance companies (Insurance Act).** This contains regulations on outsourcing by insurance companies.

- **Act LXXXII of 1997 on private pension and private pension funds (Private Pension Act), and Act XCVI of 1993 on voluntary mutual insurance funds (Voluntary Insurance Funds Act).** These regulate outsourcing by private pension funds and voluntary mutual insurance funds.

This legislation defines the scope of activities that can be outsourced and specifies the obligations of the financial organisations and suppliers. The most important obligations imposed on financial organisations include requirements to:

- Notify the Hungarian Financial Supervisory Authority (HFSA).
- Include certain mandatory provisions in the outsourcing contract.

Suppliers must satisfy certain personnel, material and security requirements required by law. The Acts vary in their requirements, so it is important to review the legislation relevant to the specific outsourcing transaction.

Business process

There are no regulations specific to business process outsourcings.

IT

There are no regulations specific to IT outsourcings.

Telecommunications

There are no regulations specific to telecommunications outsourcings.

Public sector

Certain purchases by public entities amount to public procurement and fall under Act CXXIX of 2003 on public procurement (*2003. évi CXXIX. törvény a közbeszerzésekről*) (Public Procurement Act) (PPA). Generally, if a contracting entity (for example, a Ministry, a budgetary organisation or a local government body) wishes to conclude a contract for a purchase, it must carry out a contract award procedure in accordance with the PPA's provisions. This obligation is only triggered if the contract value reaches or exceeds certain thresholds set out in the PPA. Different thresholds apply according to the type of contract, for example:

- Public supply contract.
- Public works contract.
- Public service contract.



The relevant regulations of the PPA vary according to the relevant threshold.

The basic types of contract award procedure if the value of the contract exceeds the community threshold (EUR125,000 (as at 1 February 2011, US\$1 was about EURO.7) or EUR193,000, depending on the nature of the contracting entity) are the:

- **Open contract award procedure.** This is a one-stage procedure, started by a request for proposal, which under the main rule must be published in the *Official Journal of the EU* and *Tenders Electronic Daily* (TED).

There are no restrictions on initiating open contract award procedures. The tender notice must contain all key information, such as the:

- contract subject;
- grounds for exclusion;
- qualification criteria;
- course of the contract award procedure;
- deadlines;
- requested documents;
- basic requirements of the proposals;
- evaluation criteria.

The tenderers must submit their proposals by the deadline set out in the tender notice. The contracting entity must examine the suitability of the tenderers and evaluate their proposals. The contracting entity must then announce whether a contract has been awarded and to whom.

- **Restricted contract award procedure.** This is a two-stage procedure, starting with the publication of a notice. There are no restrictions on initiating restricted contract award procedures. To begin with, there is a participation stage, during which the contracting entity decides which candidates are suitable to deliver under the contract. Then tenderers submit their proposals and the contracting entity evaluates them and announces the results.
- **Negotiated contract award procedure.** The basic rules are similar to those for the restricted contract award procedure (see above), but the negotiated contract award procedure can only take place if the PPA allows it.
- **Competitive dialogue procedure.** See above, *Negotiated contract award procedure*.
- **Framework agreement procedure.** The framework agreement procedure consists of two phases. During the first phase the contracting entity must apply an open or a restricted procedure (or a negotiated procedure, subject to certain conditions) to award a framework agreement to one or more tenderers. During the second phase the contracting entity asks for proposals for the subject matter specified in the framework agreement, and after written consultation with the tenderers, awards a contract for the implementation of the public procurement(s) in question.

The basic type of contract award procedure if the value of the contract exceeds the national threshold (as defined in the annual State Budget Act, which for 2011 is HUF8 million (as at 1 February 2011, US\$1 was about HUF199.6)) and if the types of contract award procedures referenced above do not apply is the “general simple contract award” procedure. This is a one-stage procedure, started by a request for proposal, which must be published in the *Gazette of Public Procurement*.

The tender notice must contain at least the information enumerated in the PPA, such as the:

- Contract subject.
- Grounds for exclusion.
- Term of the contract as well as the deadline and the place of performance.
- Qualification criteria.
- Deadlines.
- Whether it is a negotiated procedure or not.
- Evaluation criteria.

Otherwise, the basic rules are similar to those for the open contract award procedure (see above). However, negotiated contract award procedure without publication of tender notice can also be initiated subject to certain conditions (see above, *Negotiated contract award procedure*).

Public procurements of the contracting entities in central state administration are centralised in relation to certain products and services (for example, services relating to software). The Central Service Directorate General carries out public procurements, concluding framework agreements based on the demands of the organisations participating in the centralised public procurement system.

Other

The following laws can be relevant to specific outsourcing transactions:

- Act LXXXVI of 2007 on electricity (Electricity Act) and Government Decree 273/2007 (X.19.) on the implementation of the Electricity Act. Under these laws, the outsourcing of a significant proportion of licensed core activities is subject to prior approval by the Hungarian Energy Office. In relation to specific electricity suppliers (for example, universal services providers and distributors) the outsourcing of specified activities is prohibited and the outsourcing of non-core activities is subject to prior notification to the Hungarian Energy Office.
- Act XL of 2008 on natural gas supply (Natural Gas Act) and Government Decree 19/2009 (I.30.) on the implementation of the Natural Gas Act. Under these laws, the outsourcing of elements of licensed core activities is subject to prior approval by the Hungarian Energy Office. Also, the outsourcing of specified activities is prohibited and the outsourcing of non-core activities is subject to prior notification.



- Act XCVII of 1995 on air transport, which states that the asset manager of the Ferihegy International Airport of Budapest cannot outsource certain operational activities.

The following Acts can also be generally relevant to outsourcing transactions:

- Act LXIII of 1992 on the protection of personal data and public access to data of public interest (Data Protection Act), which regulates the processing and transfer of personal data.
- Act XXII of 1992 on the Labour Code (Labour Code), which regulates the transfer of employees.
- Act IV of 1959 on the Civil Code (Civil Code).
- Act LXXVIII of 1993 on the lease of flats and premises and on the rules of their transfer (Premises Lease Act), and Act LXXVI of 1999 on copyright (Copyright Act), which are relevant to the transfer of assets.

3. Please specify any further legal or regulatory requirements (formal or informal) concerning outsourcing in any industry sector.

See *Question 2, Other*.

4. Please specify any requirements (formal or informal) for regulatory notification or approval of outsourcing transactions in any industry sector.

Financial services

Credit institutions must notify the HFSA within two days of the conclusion of the outsourcing contract. The notification must contain the:

- Fact of the outsourcing.
- Supplier's name.
- Supplier's registered office.
- The term of the outsourcing.

Credit institutions must immediately report to the HFSA if the performance of the outsourced activity violates the law or the contract. The HFSA is entitled to prohibit the outsourcing on the basis of the report of the credit institution (*Credit Institutions Act*).

Investment enterprises must send the copy of the outsourcing contract to the HFSA within three days of the conclusion of the outsourcing contract (*Investment Enterprises Act*).

Central depositories, clearing houses and central contracting parties must, in the case of outsourcing of activities regulated in the Capital Markets Act, or of critical functions, continuously evaluate the fulfilment of certain requirements and must draw up an annual report about the fulfilment of the requirements and submit it to the HFSA (*Capital Markets Act*).

For insurance companies the notification of the outsourcing of the following activities to the HFSA is required in quarterly reports:

- Actuarial duties.
- Electronic technical data processing.
- Loss adjustment.
- Asset management.

The notification must contain (*Insurance Act*) the:

- Fact of the outsourcing.
- Supplier's name.
- Supplier's registered office.
- The term of the outsourcing.

Private pension funds and voluntary mutual insurance funds must notify the HFSA within three working days of the conclusion of the outsourcing contract (*Private Pension Act, Voluntary Insurance Funds Act*).

Electricity and gas suppliers

See *Question 2, Other*.

LEGAL STRUCTURES

5. In relation to the legal structures commonly used on an outsourcing, please briefly describe how each structure works, and its potential advantages and disadvantages.

Common structure

Direct outsourcing (that is, an outsourcing contract directly between the customer and the supplier) is the most widely used structure. This model includes:

- The main contract, commonly referred to as the master services agreement, specifying the general terms and conditions of the provision of the services being outsourced.
- A complex system of appendices and schedules setting out details including:
 - the specification of the services;
 - service levels and service credits;
 - the transfer of assets;
 - the transfer of employees;
 - payment issues;
 - the procedure for managing changes;
 - the plan for the return of the outsourced services, typically agreed by the parties as part of the outsourcing contract, to ensure the continuous and smooth pursuance of the outsourced activity following termination of the outsourcing contract.



The following factors can also be relevant:

- **The transfer of assets and employees.** In addition to the master services agreement, the parties often enter into separate agreements regarding the transfer of assets and employees.
- **Subcontractors.** Suppliers commonly use subcontractors to provide some of the services. Customers usually require notification of the subcontractor or a right of approval over key subcontractors.
- **Parent company guarantees.** Subject to the value of the outsourcing transaction, the customer can require a parent company guarantee from the supplier.

Other structures

Offshore outsourcing. This involves a customer contracting a supplier based abroad. The offshore model can offer significant cost savings and can also be tax efficient. However, enforceability of customer's rights and the degree of control over the services must be carefully addressed in the outsourcing contract.

Intra-group cross-border outsourcing. This involves certain services being provided on a "best shore" basis within a company group (that is, the customer transfers certain business activities to one of its subsidiaries and those activities are pursued by that subsidiary for the whole company group). The main advantage is that the customer has complete control over the outsourced services. Generally, Hungarian subsidiaries are preferred for setting up group-wide service centres.

Joint venture. This involves the customer and the supplier setting up a joint venture company in which the:

- Customer usually owns the majority shareholding.
- Supplier is responsible for the management of the operation.

One of the main advantages is that the joint venture allows the customer to have a sufficient degree of control over the services.

Built operate transfer (BOT). This involves a third-party supplier building and operating a facility and, after a specified period of time, transferring the operation to the customer. The BOT structure can be expensive, but it provides significant cost savings and relatively favourable risk allocation for the customer.

PROCUREMENT PROCESSES

6. Please briefly describe the procurement processes that are usually used to select a supplier of outsourced services (including request for proposal, invitation to tender, due diligence and negotiation).

The procurement process is typically as follows:

- The customer defines the functions or areas to be outsourced and, in certain cases:
 - conducts due diligence to define its requirements;
 - carries out a costs/savings analysis;
 - identifies potential suppliers on the market.

- The customer can send a request for information (RFI) to the potential suppliers, which:
 - briefly describes the function intended to be outsourced;
 - asks for information relating to the supplier's references and capabilities.
- The customer sends a request for proposal (RFP) to the suppliers shortlisted on the basis of their responses to the RFI. The RFP typically contains:
 - all the information necessary for suppliers to make a bid;
 - a detailed description of the customer's requirements;
 - a draft outsourcing contract;
 - the evaluation criteria.
- The customer assesses the bids received from potential suppliers, shortlists a small number of possible suppliers (or awards the contract to the preferred bidder) and enters into more detailed negotiations with them (or with the awarded bidder). At this stage potential suppliers (or the preferred bidder) usually conduct due diligence to obtain accurate information on:
 - transferring assets;
 - transferring employees;
 - the quality and costs of the services.
- Potential suppliers (or the preferred bidder) sometimes conduct only a limited due diligence process (or none at all), and rely on the representations and warranties of the customer instead.
- The customer concludes the outsourcing contract with the awarded bidder.

TRANSFERRING OR LEASING ASSETS

7. What formalities are required to transfer the following assets on an outsourcing:

- Immovable property?
- IP rights and licences?
- Movable property?
- Key contracts?

Immovable property

The transfer of title to immovable property must be:

- In writing.
- Registered with the Land Registry.

IP rights and licences

The outright assignment of the economic rights of copyright must be in accordance with the Copyright Act. The economic rights of copyright relating to software and databases, for example, can be assigned (*Copyright Act*).



The following formalities apply:

- **Economic rights of copyright.** Generally, assignments must be executed by written contract.
- **Copyright assets for which the customer has a non-exclusive and limited licence.** The customer can transfer the licence to the supplier subject to the copyright owner's explicit approval.
- **Rights deriving from patents and trade marks (except for the moral rights of the inventor).** These rights can be transferred. In relation to an outsourcing:
 - customers can transfer the licence to the supplier subject to the patentee's/trade mark owner's explicit approval;
 - new patentee or trade mark owners must be registered with the Patent Office, and documents evidencing the change in the ownership of the patent or trade mark must be attached to the registration application. It is therefore advisable that contracts for the transfer of patents, trade marks and licences are concluded in writing, but this is not required by law.

Movable property

Although not required under the Civil Code, it is advisable to specify in writing:

- The transfer of the ownership of movable assets.
- The exact extent of the right to use those assets.

Key contracts

Before a transfer of a service agreement concluded between the customer and a third-party supplier, the conditions of the service agreement should be closely examined. Typically, service agreements require prior written consent of the other party before assigning or assuming rights and obligations.

8. What formalities are required to lease or license the following assets on an outsourcing:

- **Immovable property?**
 - **IP rights and licences?**
 - **Movable property?**
 - **Key contracts?**
-

Immovable property

A lease of flats and premises must be in writing. The tenant can only sublease the premises if:

- The landlord consents.
- A written subleasing agreement is concluded.

IP rights and licences

A licence relating to copyright must be in writing. The copyright licensee can grant a sublicense to a third party, subject to the copyright owner's explicit approval.

Patentees and trade mark owners can grant licences. Customers can grant sublicences to suppliers, subject to the patentee's/trade mark owner's explicit approval. Licences and sublicences relating to patents and trade marks must be registered with the Patent Office, and documents evidencing the licence or sublicense must be attached to the registration application. It is therefore advisable that licences and sublicences relating to patents and trade marks are in writing, but this is not mandatory.

Movable property

It is advisable that leases of movable assets are in writing, for evidential purposes, but this is not prescribed by the Civil Code.

For subleases of movable assets, the contract concluded between the customer and the landlord or owner should be reviewed to establish whether there is a restriction on subleasing to third parties. The owner or landlord's prior written consent is usually required.

Key contracts

Key contracts are not usually the subject of leases or licences.

TRANSFERRING EMPLOYEES

9. In what circumstances (if any) are employees transferred by operation of law:

- **To an incoming supplier on an initial outsourcing?**
 - **To an incoming supplier on a change of supplier?**
 - **Back to the customer on termination of an outsourcing?**
-

Initial outsourcing

Where all of the following apply, employer succession (that is, the transfer from the transferor to the transferee of the rights and obligations of the employment relationship) takes place by operation of law (*Labour Code*):

- There is a transfer of a separate and organised unit of the employer's material and non-material assets (that is, a unit of assets necessary for the pursuance of a certain activity such as an economic unit, plant, shop, division, workplace or their parts) to an organisation or person falling within the scope of the *Labour Code*.
- The purpose of the transfer is to operate or restart the operation of the relevant assets.
- The transfer is based on an agreement (particularly the sale, exchange, lease, leasehold or joining of a company by way of capital contribution).

Change of supplier

Generally, the rules on employer succession set out in the *Labour Code* apply (*see above, Initial outsourcing*).

Termination

Generally, the rules on employer succession set out in the *Labour Code* apply (*see above, Initial outsourcing*).



10. If employees transfer by operation of law please describe the terms on which they do so, including any effect on pensions, employee benefits or other matters (including collective agreements) that the transfer may have.

General terms

If any of the customer's employees perform the activity to be outsourced, employer succession usually occurs by operation of law resulting from the outsourcing transaction. In these circumstances:

- The supplier automatically employs the employees who perform work in relation to the activity to be outsourced.
- The rights and obligations under those employees' existing employment relationships automatically transfer, at the time of succession, to the successor employer.

Therefore, the existing employment agreements do not require amendment or renegotiation.

Pensions

Employees' social insurance, including their right to a pension, is automatically transferred to the transferee along with the other terms of their existing employment contract (*Act LXXX of 1997 on persons entitled to social security services and private pension and the resources of these services (Social Security Act)*). Following employer succession, the transferee must (*Social Security Act*):

- Report changes to the competent authorities.
- Register data.
- Deduct social security contributions.

Employee benefits

As employees transfer to the transferee on their existing employment terms, all contractual and statutory employee benefits transfer and remain unchanged.

Specific employee benefits, such as share option schemes, can create difficulty if they cannot be replicated by the transferee. The parties often seek specific solutions in co-operation with the employees' representatives.

Other matters

If the transferor operates a collective bargaining agreement (CBA), the working conditions prescribed (apart from employees' weekly and daily timetables) must be observed by the transferee in relation to the employees affected by employer succession, until any of the following (*Labour Code*):

- The termination or expiry of the transferor's CBA.
- The transferee concludes a separate CBA.
- At least one year from the date of the outsourcing.

If the transferor and transferee operate CBAs, the working conditions stipulated in the transferee's CBA only apply in relation to the employees affected if they are more favourable for employees than those set out in the transferor's CBA.

11. How is redundancy pay calculated?

The employee is entitled to redundancy pay if his employment relationship was terminated either:

- By the employer with ordinary notice.
- As a result of the dissolution of the employer without legal succession.

The amount of redundancy pay is equal to one month of the employee's average salary if he has been employed by the employer for at least three years. The amount of redundancy pay increases in accordance with the length of the employment relationship, for example:

- Two months of the average salary, if at least five years of employment.
- Three months of the average salary, if at least ten years of employment.

The amount of redundancy pay will be further increased with the sum of three months of the employee's average salary if the employment relationship is terminated within a five-year period before the employee becomes entitled to his pension (*Labour Code*).

12. To what extent can a transferee harmonise terms and conditions of transferring employees with those of its existing workforce?

The transferee cannot use employer succession as a reason to amend the employment agreements in a way that is detrimental to the employees. However, certain working conditions (for example, the work timetable (*see Question 10*)) can be unilaterally modified by the transferee after employer succession through company instructions or policies.

Where a proposed change in the employees' place of work has one of the following effects, the employment contract must be amended (subject to the employees' express consent):

- Results in daily commutes increasing by a duration set out in the Labour Code.
- Constitutes a disproportionate or substantial detriment to the employees in relation to:
 - their personal or family lives;
 - other factors, such as costs.

If employees do not agree to the change, the transferee can terminate the employment relationship by ordinary notice for a reason relating to its operation.

13. To what extent can dismissals be implemented before or after the outsourcing?

Employees' employment relationships cannot be terminated by ordinary notice for a reason solely related to the employer succession. This rule binds the transferor and the transferee.



However, the employment relationships of employees affected by employer succession can be terminated before or after the date of outsourcing by:

- Extraordinary notice, mutual agreement or with immediate effect during the probationary period.
- Ordinary notice for reasons connected to the employee's behaviour or ability.
- Ordinary notice if the termination relates exclusively to the fact that the transferee is unable to continuously employ a certain group of employees affected by employer succession due to economic reasons. In these circumstances, the rules on collective redundancy can apply, depending on the number of employees affected.

14. To what extent can particular services only be performed by a local national trained in your jurisdiction?

Although there are so-called regulated professions under Hungarian law, for typically outsourced services in Hungary (for example IT, human resources and payroll), there are no such national citizenship and/or qualification requirements under Hungarian law.

15. In what circumstances (if any) is it possible for the parties to structure the employee arrangements of an outsourcing as a secondment?

It is possible for the parties to structure employee arrangements as a secondment if all the following conditions are met:

- The subject matter of the transfer is not a separate and organised unit of employer's material and non-material assets (*see Question 9*).
- The transferee does not pay any consideration to the transferor.
- The transferor and the transferee are connected through their ownership structures.
- The secondment does not last longer than 110 working days during a calendar year (or, under certain conditions, fewer days).

In practice, secondment is not a viable alternative to employer succession due to its temporary nature, and because in most outsourcing transactions, material and non-material assets are transferred along with employees, so the rules on employer succession apply.

16. What information must the transferor or the transferee provide to the other party in relation to any employees?

The Labour Code provides a general information obligation to be fulfilled by the transferor (rather than an exhaustive list). The transferor must provide the transferee, before employer succession, with all relevant information about the rights and obligations existing under the existing employment relationships, including the:

- Number of employees.
- Terms and conditions of employment.

17. Please describe any notice, information and consultation obligations which arise for the transferor and the transferee in relation to employees or employees' representatives.

The transferor and the transferee must, no later than 15 days before the date of outsourcing:

- Provide information concerning the conditions of employer succession to one of the following (in order of priority):
 - the local trade union branch;
 - the workers' council;
 - the committee formed from the representatives of non-organised employees.

Information to be provided includes:

- the planned or proposed date of employer succession;
- the reasons for the employer succession;
- the legal, economic and social consequences affecting employees.
- Initiate consultation talks to reach an agreement concerning other proposed measures that affect the employees with one of the following (in order of priority):
 - the local trade union branch;
 - the workers' council;
 - the committee formed from the representatives of non-organised employees.

If employees do not form a committee or appoint a representative, all employees working for the customer must be informed. In addition before making a decision on outsourcing, employers must provide the local trade union branch and workers' council with the draft outsourcing agreement, and ask their opinions.

Failure to comply with the information and consultation obligation can have the following consequences:

- The local trade union branch and the workers' council can file lawsuits.
- In certain cases, the outsourcing agreement is deemed invalid by operation of law.

DATA PROTECTION

18. Please outline any applicable legal or regulatory requirements and issues which may arise on an outsourcing. How are they typically dealt with in the contract documentation?

Data protection and data security

The Data Protection Act regulates the processing of personal data. The following data protection issues can arise on an outsourcing:

- The transferring and processing of the personal data of transferring employees. The parties must comply with the Data Protection Act and the Labour Code.



- The processing of other personal data transferred to the supplier. The supplier is usually only entitled to process the personal data as a technical data processor (that is, it is entitled to use personal data exclusively in accordance with the purposes and instructions set by the customer acting as data controller).
- The transferring of personal data outside the European Economic Area (EEA). Transfer of personal data outside the EEA is lawful provided that either (*Data Protection Act*):
 - the data subject has given his express consent;
 - the transfer is provided for under an Act, and the adequate level of protection of personal data in the third country is ensured during the processing or technical processing of the transferred data.

The data controller and the technical data processor must ensure data security. They must take all technical and organisational measures and implement procedural rules necessary to ensure compliance with the relevant legislation (primarily with the Data Protection Act).

Banking secrecy

The Credit Institutions Act regulates the processing of bank secrets. The following issues can arise on an outsourcing:

- **Confidentiality of bank secrets.** Any person having access to a bank secret must keep it confidential indefinitely.
- **Transfer of bank secrets.** Bank secrets can be transferred to any third party only if:
 - the client of the financial institution has given his consent, indicating the scope of the transferable bank secrets, in a public deed or in a private document of full probative value or in the contract concluded with the financial institution; or
 - the transfer is authorised by the Credit Institutions Act.

For outsourcing regulated by the Credit Institutions Act, bank secrets can be transferred to the supplier to the extent it is necessary for the pursuance of the outsourced activity on the basis of the authorisation of the Credit Institutions Act.

Confidentiality of customer data

During the processing of customer data qualifying as personal data, the parties must comply with the Data Protection Act (see *above, Data protection and data security*). Typically, detailed confidentiality provisions of outsourcing contracts cover the processing of customer data. Complex global outsourcing contracts can prescribe safeguarding procedures and reconstruction procedures for the supplier regarding customer data.

SERVICE SPECIFICATION AND LEVELS

19. How is the services specification typically drawn up and by whom?

The system of services provided by the supplier is usually complex. Detailed technical specification of the services described in the master services agreement is usually:

- Drawn up by the parties together.
- Attached as a separate schedule to the master services agreement.

If detailed technical specification of the services is drawn up after the signing of the master services agreement, a schedule containing the customer's requirements is attached to the master services agreement. Based on this, the supplier must draw up detailed technical specification of the services within a defined period of time following the signing of the master services agreement.

20. How are the service levels and the service credits scheme typically dealt with in the contract documentation?

Services provided under an outsourcing contract must be measurable and of a quality equal to best industry practice. Accordingly, the parties usually draft a system of objective measurable criteria known as service level agreements (SLAs). Service levels can be different for the transition period and the final mode of operation (during which the supplier provides a full range of services under finalised SLAs, with full liability). Generally, a complex performance assessment mechanism is built around service levels, including:

- The description of the methods of measuring service levels.
- Monthly reporting obligations.
- Service credits and service debits.

Outsourcing contracts usually provide for four levels of supplier performance:

- Full comfort level.
- Required level.
- Lowest acceptable level.
- High business impact level.

The system of service credits and service debits is based on the level of supplier performance. The supplier pays service credits as automatic compensation if its performance fails to meet the required level. Suppliers usually include a clause in the outsourcing contract providing for payment by the customer of service debits if the supplier exceeds the required level, and includes provided services on full comfort level.

There is usually a settlement system to determine the aggregated amount of service credits payable by the supplier. Service credits are typically calculated as a percentage of the service fees. The aggregated amount of service credits is then deducted from the monthly service fees payable by the customer.



CHARGING METHODS AND KEY TERMS

21. Please describe the charging methods that are commonly used on an outsourcing (for example, risk or reward, fixed price, cost or cost plus, pay as you go, resourced-based charges, use of minimum charges and so on).

Under an outsourcing contract, the customer usually pays monthly service fees. These are calculated based on various methods, depending on the type and volume of services.

Fixed price

Generally, the customer pays:

- Fixed-base fees for a pre-defined volume of services.
- Extra fees for the services provided over the pre-defined volume of services (see below, *Variable price*).

It is critically important to contractually define as precisely as possible the volume of each type of service covered by the fixed-base fees. For certain services where costs and volume are less predictable, the fixed-price approach may not be suitable.

Variable price

The customer pays extra fees for services provided over a pre-defined volume of services. These fees are usually calculated on the basis of unit prices for each type of service, but the outsourcing contract should contain the exact criteria to be used.

For certain services where the costs and the volume are less predictable, the variable pricing model is the only reasonable choice (see above, *Fixed price*).

22. Please briefly describe any other key terms used in relation to costs, such as charge variation mechanisms and indexation.

The customer usually insists on including certain measures to control prices, for example:

- **Indexation.** This is the adjustment of service fees by the yearly inflation rate.
- **Benchmarking.** This is the assessment and adjustment of service fees based on actual market prices.
- **Charge variation mechanism.** This involves the party proposing changes preparing a comprehensive impact assessment of the changes, including cost impact, as part of the procedure for managing changes (see *Question 5, Common structure*).

CUSTOMER REMEDIES AND PROTECTIONS

23. If the supplier fails to perform its obligations, what remedies and relief are available to the customer under general law?

Damages

If the supplier causes unlawful damage, it must pay for the damage caused unless it can prove that it acted as generally expected in the circumstances. The customer that has suffered damage must prove the damage and the causal relationship between the actions of the supplier and the damage.

Termination

If the supplier defaults in its performance of the outsourcing contract, the customer can rescind the contract under certain conditions. Outsourcing contracts usually contain detailed descriptions of defaults entitling the customer to terminate.

24. What customer protections are typically included in the contract documentation to supplement relief available under general law?

Further customer protections relating to supplier default include:

- Complex performance assessment mechanisms, including monthly reporting obligations and audit rights.
- Service credits that can be considered automatic compensation for underperformance.
- Indemnity from the supplier for loss suffered in specific circumstances.
- Other forms of financial penalty.
- Extraordinary termination rights in defined cases, for example, material breaches or insolvency.
- Insurance held by the supplier to cover damages caused in the course of providing the services.
- Parent company guarantees provided by the supplier, ensuring that the:
 - supplier's parent company performs instead of the supplier;
 - supplier performs in accordance with the contractual conditions.
- Step-in rights (that is, temporary rights for the customer to take over the provision of the services or have a replacement supplier to take over, where the supplier fails to perform the services adequately).
- Governance or escalation procedures under which appointed relationship managers are responsible for reaching agreements on problematic issues and for escalating them to higher levels if a solution cannot be found.
- Benchmarking. See *Question 22*.



WARRANTIES, INDEMNITIES AND INSURANCE

25. What warranties and/or indemnities are typically included in the contract documentation?

Typical supplier warranties and indemnities include that it:

- Is entitled to conclude the outsourcing contract and perform its obligations.
- Will provide the services in a timely and professional manner in accordance with the best industry practice and all applicable laws.
- Will indemnify the customer against damages suffered due to the supplier's actions.
- Will indemnify the customer against future liability in relation to employees transferred to the supplier.
- Possesses certain qualifications, licences or authorisations necessary for the provision of the services.

Typical customer warranties and indemnities include:

- That it is entitled to conclude the outsourcing contract and perform its obligations.
- That information provided during the negotiation stages is accurate, complete and not misleading.
- Assurances concerning title, conditions and maintenance of the assets transferred to the supplier, including that:
 - all of the obligations relating to the assets that arose before the transfer date are fulfilled; and
 - the use of transferred assets by the supplier will not infringe third parties' intellectual property rights.
- That it will indemnify the supplier against historic liability in respect of employees transferred to the supplier.

26. What limitations are imposed by national law on fitness for purpose and quality of service warranties?

Services must be (*Civil Code*):

- Fit for the purpose for which other similar services are normally used.
- Of a quality equal to that which is normally expected of other similar services.
- Fit for the purposes defined by the customer, provided the customer communicated these purposes at the time of the conclusion of the contract and the supplier agreed.

27. What provisions may be included in the contractual documentation to protect the customer or supplier regarding any liabilities and obligations arising in connection with outsourcing, including those relating to employee arrangements?

See Questions 24 and 25.

28. What types of insurance are readily available in your jurisdiction, and to what extent?

For outsourcing contracts concluded between suppliers and customers registered in Hungary, liability insurance is usually required of the supplier.

For global outsourcing contracts covering, among others, the provision of services in Hungary, a more sophisticated system of insurance might be required, including:

- Commercial General Liability Insurance.
- Professional Liability Insurance.
- Comprehensive Crime Insurance.
- All-risk Property Insurance.
- Workers' Compensation and Employer's Liability Insurance.

TERM AND NOTICE PERIOD

29. Does national law impose any maximum or minimum term on an outsourcing? If so, can the parties vary this by agreement?

Generally, Hungarian law does not impose any maximum or minimum term on outsourcing. In most cases, the duration of the outsourcing contract depends on the parties' agreement.

However, if public procurement processes apply, the term of the contract is affected by the tender notice. If the contractual arrangement is a framework agreement, the maximum duration is four years.

30. Does national law regulate the length of notice period required (maximum or minimum)? If so, can the parties vary this by agreement?

Generally, Hungarian law does not regulate the length of notice period required to terminate an outsourcing agreement. The parties specify the notice period in the outsourcing contract. The length of notice period varies according to the grounds of termination.

Suppliers often seek to exclude parties' rights to termination by ordinary notice. For a material breach of contractual duties or insolvency, parties may be entitled to terminate the outsourcing contract by extraordinary notice with immediate effect. It is advisable to contractually specify the breaches that justify immediate termination.



TERMINATION AND TERMINATION CONSEQUENCES

31. What events justify termination of an outsourcing without giving rise to a claim in damages against the terminating party (for example, fundamental breach, repudiatory breach, insolvency events and so on)?

A party can rescind an outsourcing contract if the other party has (*Civil Code*):

- Delayed performance of the contract, and performance is no longer in the first party's interest.
- Materially defaulted, and repair or replacement are not viable.

In addition, the customer can rescind a contract for work at any time, but must pay for the damage caused to the supplier. The supplier can rescind a contract in specific cases, for example if the customer does not allow the supplier to enter the site from where the supplier provides services.

32. In what circumstances can the parties exclude or agree additional termination rights (for example, for breach, change of control, convenience and so on)?

The parties can exclude or extend termination rights provided for by Hungarian law.

Typically, outsourcing contracts list events justifying termination, including:

- Material breaches of contractual obligations.
- Persistent breaches of contractual obligations.
- Insolvency.
- Change of control.

33. What implied rights are there for the supplier to continue to use licensed IP rights post-termination? To what extent can these be excluded or included by contract?

Generally, there are no implied rights for the supplier to continue using licensed IP rights post-termination. The parties can agree that the supplier can use IP rights post-termination. However, the customer is usually unwilling to agree to the extension of licences unless it obtains benefits in return.

34. To what extent can the customer gain access to the supplier's know-how post-termination and what use can it make of it?

The parties agree on the extent to which the customer can access the supplier's know-how post-termination. Usually, the supplier's know-how qualifies as confidential information and can only be

used in connection with the provision of the services during the term of the outsourcing contract. However, the parties can agree that if the supplier develops know-how in connection with the provision of services, the customer is provided with a limited licence to continue using that know-how post-termination.

LIABILITY, EXCLUSIONS AND CAPS

35. What liability can be excluded? In particular, is it possible for the supplier to exclude liability for indirect and consequential loss and also any loss of business, profit or revenue?

The parties can exclude or limit liability, apart from liability for:

- Damages caused intentionally, by gross negligence or crime, and liability for harm to life or health.
- Breach of contract caused intentionally, by gross negligence or crime, and for breaches causing harm to life or health.

Liability for breach of contract cannot be excluded or limited unless reduced consideration or other advantages offset the disadvantage of the exclusion or limitation of liability.

Generally, suppliers exclude liability for:

- Indirect and consequential losses.
- Loss of business, profit and revenue.

It is critical to contractually document that:

- All exclusions or limitations of the supplier's liability for breach of contract are in compliance with the Civil Code.
- Reduced consideration or other advantages offset the disadvantage of the exclusion or limitation of liability.

36. Are the parties free to agree a cap on liability? If so, how is this usually fixed?

The parties can agree on a financial limit on liability, subject to certain restrictions (*see Question 35*). It must be contractually documented that:

- The cap on supplier's liability complies with the Civil Code.
- Reduced consideration or other advantages offset the disadvantage of the cap.

In practice, the cap is usually a fixed amount.



TAX

37. What are the main tax issues that arise on an outsourcing in relation to:

- Transfers of assets to the supplier?
- Transfers of employees to the supplier?
- Value added tax (VAT) or the equivalent sales tax on the service being supplied?
- Service taxes?
- Stamp duty?
- Corporation tax?
- Other significant tax issues?

Transfers of assets to the supplier

Transfers of the following assets to the supplier, with or without consideration, are subject to VAT if the customer had the right to deduct VAT on those assets at the time of purchase:

- Tangible assets (for example, assets and real estate).
- Intangible assets (for example, software and patents).

In this case the applicable VAT rate is typically 25%. If the customer did not have the right to deduct VAT when purchasing the assets to be transferred (for example, where the assets are exclusively purchased and used for tax-free activities), VAT is not payable on the transfer.

The taxable amount for VAT is the consideration set out in the agreement. If the transfer occurs without consideration, the taxable amount for VAT is the purchase price of the asset, or of a similar asset, or, without this price, the production value of the asset established at the time of the transfer.

If the sale price or consideration of the asset set out in the agreement is higher than its book value on the date of transfer, the customer is liable to pay corporate tax at 10% on the first HUF500 million of the tax base and 19% on any amounts above this threshold.

Transfers of employees to the supplier

No tax is due on transfers of employees to the supplier.

VAT or sales tax

VAT at 25% is due on an outsourcing service provided by a Hungarian supplier to a Hungarian customer, if they are Hungarian taxpayers.

In cross-border outsourcings, the following must be considered to determine whether VAT is due:

- Whether the customer or supplier is subject to Hungarian taxation.
- The geographical location of the premises directly affected by the service.
- The nature of the outsourcing service (for example, an IT service or an accounting service).

For example, if a German taxpayer supplier provides IT system operational services to a Hungarian taxpayer customer, the place of performance for VAT purposes is Hungary. As the supplier is a taxpayer registered in another EU member state, the customer must pay Hungarian VAT on the basis of the reverse charge principles (under which the buyer is responsible for paying VAT).

If the supplier charges VAT (or the customer charges VAT under the reverse charge rules), the following rules apply to recovering VAT:

- The customer can recover VAT in full if it purchased the outsourcing services exclusively for pursuing taxable activities.
- If the customer uses the outsourcing services exclusively for tax-free activities, it cannot deduct VAT on those activities.
- If the customer pursues taxable activities and tax-free activities, it can recover any VAT relating to the taxable activities. For example, if a customer uses 65% of its supplier's service for taxable sales activities, and 35% for tax exempt activities, it can recover 65% of the VAT.

Service taxes

From 2010, companies operating in certain business sectors are subject to a special tax, including:

- Financial services providers.
- Telecommunications services providers.
- Energy suppliers.
- Retail store chains.

Telecommunications services providers are liable to pay this tax based on net sales revenue derived from telecommunications activity. Tax payment obligation differs according to the level of net sales revenue, as follows:

- Where the net sales revenue is HUF0 to HUF100 million, at 0%.
- Where the net sales revenue is HUF100 million to HUF500 million, at 2.5%.
- Where the net sales revenue is HUF500 million to HUF5 billion, at 4.5%.
- Where the net sales revenue is more than HUF5 billion, at 6.5%.



Stamp duty

The supplier must pay stamp duty if any of the following are transferred for consideration within the framework of an outsourcing transaction:

- **Real estate.** The rates vary depending on the value of the property:
 - 4% for property worth less than HUF1 billion; and
 - 2% for property worth more than HUF1 billion, on the value above HUF1 billion.

The maximum amount of stamp duty per property is HUF200 million.

- **Intangible property related to real estate.** The rates vary depending on the value of the property, as above (*see above, Real estate*). The maximum amount of stamp duty per property is HUF200 million.
- **A motor vehicle.** The rates vary depending on the displacement capacity of the vehicle's engine:
 - HUF18 per cubic centimetre if the displacement capacity is less than 1,890 cubic centimetres; or
 - HUF24 per cubic centimetre if the displacement capacity is more than 1,890 cubic centimetres.

Corporation tax

The corporate income tax rate is 10% for the first HUF500 million of the tax base, and 19% above this threshold.

Other

The supplier must pay local business tax on the adjusted revenue of the outsourcing service. The tax base is the revenue less the material costs and subcontractor costs. The rate is typically 2% of the tax base. In addition, an innovation contribution at 0.3% is due on the same tax base. Economic enterprises that are not deemed to be SMEs must pay the innovation contribution to the government's Innovation Fund of Research and Technology. (SMEs are enterprises whose net income or balance sheet total is lower than EUR10 million and who have fewer than 50 employees.)

CONTRIBUTOR DETAILS



JÁNOS TAMÁS VARGA

VJT & Partners

T +36 1 501 9900

F +36 1 501 9901

E vargajt@vjt-partners.com

W www.vjt-partners.com



ZOLTÁN TARJÁN

VJT & Partners

T +36 1 501 9900

F +36 1 501 9901

E tarjanz@vjt-partners.com

W www.vjt-partners.com

Qualified. Hungary, 1997

Areas of practice. Outsourcing; TMT; private equity; employment.

Recent transactions

- Advised Hewlett-Packard/EDS on the client's high calibre IT outsourcing agreement with the Budapest District Heating Limited.
- Advised ING Insurance on the outsourcing of the administrative function of the client, including drafting the outsourcing agreement and advising on employee transfer issues.

Qualified. Hungary, 2008

Areas of practice. Outsourcing; data protection; IP; commercial.

Recent transactions

- Advised Hewlett-Packard/EDS on the client's high calibre IT outsourcing agreement with the Budapest District Heating Limited.
- Advised ING Insurance on the outsourcing of the administrative function of the client, including drafting the outsourcing agreement and advising on employee transfer issues.