# COMMERCIAL LAWS OF CROATIA
## AN ASSESSMENT BY THE EBRD

**October 2013**

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Legal system

Constitutional and political system

Croatia’s Constitution, adopted after its first democratic elections in 1990, took shape as a reflection of strong Croatian national identity and consequent opposition to Serbian attempts at creating a Greater Serbia. It heralded the foundation of an independent democratic Republic, organised around a bicameral Parliament (or Sabor) consisting of the lower House of Representatives (or the Zastupnicki Dom) and the upper House of District Delegates (Zupanijski Dom). Its executive powers were shared between a powerful presidency and the Government, the latter’s cabinet being formed by the Prime Minister who, upon distribution of Parliamentary seats, enjoys the confidence of a majority.

Changes to this organisational system came about as a consequence of the reorganisation of powers under former President Franjo Tudjman and the ruling Croatian Democratic Union (HDZ) during the 1990s. Following Tudjman’s death in 1999, the opposition parties united against the HDZ and won both parliamentary and presidential elections in early 2000. The new Government amended the Constitution so as to curb presidential authority, largely shifting the power to dissolve Parliament into the Government’s and Parliament’s hands, thereby giving greater recognition to regional administration and minorities, as well as eliminating presidential control over the security services. To further democratise the system, the veto powers of the upper house were removed in November 2000, progressing naturally into a full abolition of the upper house were removed in November 2000, thereby creating a unicameral legislative government. A number of amendments to the Constitution were adopted as part of the EU accession process, notably, in 2010.

The EU accession process has prompted several reforms to the country’s legal system in order to align it with EU standards, in particular in the judiciary sector, the fight against corruption and organised crime, and in implementation of policies to help economic recovery. In the 2012 progress report on Croatia, the European Commission noted the progress made in the country’s preparations for accession and also identified a number of areas where further improvements are necessary in order to fully meet all membership requirements. Notably, the implementation of the judicial reform strategy and action plan were to be continued. Furthermore, the government proposed new enforcement legislation to Parliament. The track record of results in fighting corruption and organised crime continue to be developed and the initial steps have been taken for the setting up of the Conflict of Interest Commission.

Judicial system

Croatia’s judiciary comprises courts of general jurisdiction dealing with civil and criminal matters, as well as specialised commercial and administrative courts. The general courts are made up of 67 first instance “municipal” courts, appeals from which lie to one of fifteen second instance “county” courts. The commercial courts have seven courts at first instance, with appeals lying to the High Commercial Court. These courts have jurisdiction over any disputes between legal entities (non-natural persons), as well as over certain types of disputes, such as those relating to insolvency, intellectual property and competition. For administrative law matters, there are four specialised first instance courts, appeals from which lie to the High Administrative Court. The Supreme Court is the final instance of appeal in all matters, and has two departments, civil and criminal, with commercial appeals being heard by the civil department.

The State Judicial Council is responsible for making recommendations to Parliament concerning judicial appointments and discipline. It is composed of eleven members, a majority of whom are judges. The Judicial Academy is responsible for professional development and qualification of judges, and offers a range of subjects as part of its initial and continuous training programme. Previously there was no formal requirement for a candidate judge to undertake specialised training; however, from January 1, 2013, completion of a two-year education program at the Academy has become a prerequisite for appointment to judicial office.

As in other pre-EU accession countries, the harmonisation process has served as a catalyst for the upgrading and modernising of the country’s legislation. However, it also generated a degree of legal instability as new laws were introduced to reflect the acquis, which in turn affected the predictability and quality of judgments. Nevertheless, the EBRD Judicial Decisions Assessment found court judgments in commercial law matters in Croatia to be generally predictable and of reasonably good quality. The Assessment found the major concern to be the slow pace of justice. Commercial courts continue to suffer from substantial backlogs. In 2011 there was a 10 per cent rise in the number of commercial cases, accompanied by an increase in the complexity of cases. Insolvency cases rose by 225% against 2010, as a consequence of the recession. Judges have at their disposal certain statutory tools for tightening procedural discipline, such as awarding penalties and costs in respect against litigants whose conduct is aimed at frustrating proceedings (such as unreasonable and repeated applications for adjournments, or failure to submit documents on
time). However, these powers are almost never used. Alternative dispute resolution mechanisms are available, including in relation to commercial mediation, however, tangible results have not yet been seen; in the last three years less than 4% of commercial litigation ended in settlement.

Another major concern identified in the Assessment relates to difficulties with the enforcement of judgments in commercial matters. This is consistent with data from the EBRD / World Bank Business Environment and Enterprise Performance Survey, where only 30% of Croatian respondents considered that judgments were regularly or always enforced. Recent reforms have been directed at this problem. For example, in 2011 a new system was introduced for enforcement of judgment debt against bank accounts. Previously, a judgment creditor had to identify the debtor’s bank account number in order to collect funds; and each bank developed its own practice. Since 2011 the Croatian Financial Agency has been entrusted with power in relation to the enforcement of judgment debt against bank accounts under a new uniform procedure, which has shown signs of speeding up the enforcement process. Another measure aimed at increasing the efficiency of the enforcement system has been transferring routine enforcement powers to specialised enforcement departments of municipal courts. However, the system has not yet become fully operational and it is too early to judge its effect.

Croatia has made significant changes to its judicial system since the start of the EU accession process. Further measures to strengthen contract enforcement and judicial capacity would include:

- Providing further systematic and specialised training to judges in commercial law matters, including on the use of tools designed to promote timely enforcement among litigants; establishing comprehensive and up-to-date court judgment databases; further strengthening the enforcement system, including through provision of greater public information on enforcement procedures and strengthening enforcement institutions’ capacity; and measures to promote the use of commercial mediation.

**Recent developments in the investment climate**

The completion of EU accession negotiations is a key milestone for Croatia. The country joined the European Union on 1 July 2013 after a convincing endorsement of the Accession Treaty in a referendum and subsequently by parliament. However, the economy is back in recession. Croatia experienced one of the most protracted recessions in the region as a result of the global financial crisis. After two years of declining output in 2009-10, and zero growth in 2011, GDP declined by 1.3 and 2.1 per cent respectively in first and second quarters of 2012 on the back of weak domestic demand and a decline in gross fixed capital formation. These trends reflect both spill overs from the ongoing Eurozone crisis and the persistence of deep structural problems.

Specifically, regional connections in the energy sector need further development. In addition, there is scope to develop further the power transmission and distribution network in order to adapt to increased wind power generation.

Reforms to the business environment are under way. Enterprises in Croatia continue to face a number of persistent problems, according to cross-country studies. The 2013 World Bank Doing Business Report places Croatia at 89th out of 183 countries on overall ease of doing business, down one place from the previous year. Dealing with construction permits and protecting investors are identified as particular problems in this report. The government is planning to decentralise the process of granting construction permits to the county level and to introduce e-permitting. In addition, a new law on investment promotion was adopted by parliament in September 2012.

The banking sector is well developed but credit is falling. The banking system is well developed by regional standards, and the capital adequacy ratio is strong at above 20 per cent as of June 2012. However, the overall non-payment of suppliers is severely affecting working capital, with an increasing number of corporate accounts blocked due to the failure to meet official payments. The level of non-performing loans had risen to 13.3 per cent by June 2012. Deleveraging intensified in the second quarter of 2012. Negative credit growth was recorded for five consecutive months to July 2012.

**Freedom of information**

Croatia passed a new freedom of information law (FOI) in 2013; one of the primary new developments was the creation of an Information Commissioner, elected by the Parliament, with an oversight capacity and ability to apply administrative sanctions. Also the
law states a requirement to proactively publish information issued by public bodies. Prior to the enactment of this law Croatia had amended the law on Access to Information in 2010, but this had been overturned by the Constitutional Court in 2011 as this had not been approved by procedures recognised by the Constitution. The original FOI law had been approved in 2003 but the Council of Europe reviewed implementation of the law and found it to be very slow. This and other actions resulted in further calls for it to be amended.

The new law had been approved as part of the process to bring Croatia in line with the Acquis Communautaire for its accession to the EU in 2013.

In the area of insolvency law, the new Act on Financing and Pre-Bankruptcy Settlement introduces pre-bankruptcy settlement proceedings, aimed at operational and financial restructuring of a debtor in order to ensure survival of its operations following insolvency. The effectiveness of this regime remains to be tested.

Croatia has made significant improvements to its judicial system since the commencement of the EU accession process. Further areas of improvement include such measures as further systematic and specialised training of judges in commercial law matters, establishing comprehensive and up-to-date court judgment databases, further strengthening of the enforcement system and introduction of measures that encourage commercial mediation.

The country has made substantial progress towards creating a well-functioning energy efficiency sector, but further efforts should be undertaken towards creating a sector-specific energy efficiency framework, compliant with EU standards, as well as putting in place necessary implementation arrangements and ensuring appropriate capacity building.

Finally, with a comprehensive government approach to Public Private Partnerships (PPP) development and implementation of the new Concessions Act, PPPs have potential in the near future, although some important elements necessary for the financing of PPP projects are still missing.

Commercial legislation

Since the commencement of the EU accession process, Croatia has made significant improvements in numerous areas of commercial legislation. Although Croatia’s legislative framework is greatly compliant with EU standards, some key challenges remain.

Provisions on taking non-possessory pledge over movable assets and rights are currently part of the Croatian Enforcement Act, while the Property Law contains only provisions related to possessory pledge. This kind of fragmentation has resulted in increased and arguably unnecessary transaction costs. It is therefore recommended to consider a revamp of secured transactions by bringing them into the sphere of property law. Facilitating factoring transactions by factoring legislation might help improve overall access to finance by making factoring services more transparent and legally certain. Broadening the scope of information covered by the credit bureau (insurance, trade credit and utilities) would improve the quality of credit referencing and costs of information asymmetry.

Numerous improvements in Croatian corporate governance have taken place mainly as a result of compliance with the EU acquis communautaire. As a result, the corporate governance culture is improving, but some key challenges still remain.
The EBRD has developed and regularly updates a series of assessments of legal transition in its countries of operations, with a focus on selected areas relevant to investment activities. These relate to investment in infrastructure and energy (concessions and PPPs, energy regulation and energy efficiency, public procurement, and telecommunications) as well as to private-sector support (corporate governance, insolvency, judicial capacity and secured transactions).

Detailed results of these assessments are presented below starting with infrastructure and energy and also private sector development topics.

The completed assessment tools can be found at www.ebrd.com/law.

**Infrastructure and Energy**

**Concessions and PPPs**

A set of modern legislation was introduced in the past few years, first in 2008 and then reworked further recently, consisting of the 2008 Concessions Act as amended as of 12 December 2012 (the "Concessions Act"), Public Private Partnerships Act enacted in 2008 and largely reworked in its new edition of 10 July 2012 (the’’PPP Act’’), a number of Government endorsed documents including notably the Strategic Framework for the Development of Public-Private Partnerships in the Republic of Croatia and a Framework Programme for the construction, reconstruction and Modernisation of Public Building using a contractual PPP Model.

The authorities clearly used the natural slowdown in PPP markets influenced by the current extended economic crisis and advanced the Croatian policy, legal and institutional environment lately. The legislative framework indeed seems fair and comprehensive. It has many necessary rules and contains clear procedures. Furthermore, the establishment of the PPP Agency has been a clear positive step in cementing the authorities’ recent efforts in promoting PPP. During the 2012 EBRD Assessment of the PPP/Concessions Laws throughout its countries of operations (undertaken before the new laws were enacted) the Croatian laws were viewed in high compliance with the best international standards (see Chart 1).
In general, the latest amendments to the Concessions Act aim at providing better control over the implementation of concession contracts and establishing a clear distinction between concession contracts and public procurement contracts.

However, some important elements that are generally necessary for the financing of PPP projects are still missing, which might raise potential concerns on the bankability of PPP projects. Neither the Concessions Act nor the PPP Act provide for possible government support or guarantee or offer comfort to lenders with respect to financial security. In addition, although arbitration is provided for PPP dispute resolution, an explicit possibility to apply international arbitration would be welcome.

The new regime’s practical implementation is somewhat difficult to assess because arguably the most visible project (Zagreb airport development), recently initiated under the new regime, and is still at an early stage with completion of construction envisaged in 2015 with 30 year service ahead. The most recent EBRD PPP assessment has found the Croatian framework to be of “medium effectiveness” (see Chart 2).

So far the PPP based models have been used in the transport sector (motorway, airport) and in social infrastructure (e.g. education) with a number of new projects foreseen in the pipeline in transport, energy and social infrastructure.

With a well contemplated and comprehensive Government approach to PPP development and implementation PPPs in Croatia have high potential in the near future subject to bankability issues.
Chart 2 – How the PPP law is implemented in practice in Croatia

Note: The extremity of each axis represents an ideal score, that is, a fully effective legal framework for PPPs.  
Source: EBRD 2012 PPP Legal Indicator Survey (LIS).
Electricity

An Energy Community Treaty (EcT) signatory, Croatia applied for membership in the European Union (EU) in 2003. Accordingly, Croatia has accepted an obligation to harmonise its legislation, including its energy legislation, with the EU legal framework. The recent EBRD energy law reform dimensions assessment project has shown that regulatory independence and tariff structure are the key strengths of the country’s electricity framework, while public service obligations and market framework are its key weaknesses (see Chart 3).

Chart 3 – Quality of energy (electricity) legislation in Croatia

Note: The spider diagram presents the sector results for Croatia in accordance with the benchmarks and indicators identified in an assessment model. The extremity of each axis represents an optimum score of 100 that is full compliance with international best practices. The fuller the “web”, the closer the overall regulatory and market framework approximates international best practices. The results for Croatia are represented by the green area in the centre of the web.

Source: EBRD 2011 Energy Sector Assessment

The Ministry of Economy, Labour and Entrepreneurship (MELE) is assigned primary responsibility over the energy sector. The implementing regulatory body is the Croatian Energy Regulatory Agency (HERA), which in 2007 replaced the previous body (the Croatian Energy Regulatory Council), established in 2002. HERA is an autonomous legal entity, led by a Steering Committee.

Market participants are the Transmission System Operator (TSO), Distribution System Operator (DSO) and generation, transmission, distribution and supply (in one company, unbundled), and customers. The electricity market has been fully open to all customers since 2008, though as a practical matter, the former vertically integrated utility, Hrvatska Elekroprivreda (HEP), remains the only supplier of electricity in the country and is the primary importer of electricity (with electricity imports around 36%, as a consequence there has been steady increases in recent years due to increased consumption and severe droughts).

HEP has been unbundled and TSO and DSO are legally, financially and functionally separated. HEP remains state-owned and still retains through a holding company formation majority control over generation, transmission, distribution, trade and retail supply. The Croatian Energy Market Operator (HROTE) was established in 2005 by HEP and transferred to the state in 2007. HEP produces the majority of domestic production through its’ subsidiary HEP-Proizvodnja d.o.o. and a joint venture
company with RWE - TE Plomin d.o.o. HEP is also a co-owner of Krško Nuclear Power Plant in Slovenia (50% ownership), and energy produced in NPP Krško is used for supplying Croatian customers. New production that is not connected to HEP is primarily new renewable production, and is still in the developing stages.

The wholesale market model is based on bilateral contracts (between eligible customers and supplier for supply; and between supplier/trader and producer for sale). The market is split into the provision of electricity as a public service to tariff customers and the free market. In 2008, several amendments to the electricity legislation brought important changes to the sector. The Electricity Market Act of 1 July 2008 made all customers eligible, i.e., free to choose their electricity supplier. The amendments also require that HEP Operator distribucijskog sustava d.o.o. (hereinafter: HEP ODS) act as the energy operator performing all the tasks of a distribution system operator, including those of a public supplier. Eligible household customers who do not wish to exercise the right of an eligible customer or do not succeed in finding a supplier have a right to electricity supply from the suppliers of tariff customers (the public supplier). A small customer must choose a supplier before 30 June 2009 and conclude a contract on supply with said supplier; also in that period the small customer has a right to electricity supply from a tariff customer supplier. By the end of 2008, all customers using high voltage, a majority of customers using medium voltage and a part of small customers concluded a contract on supply with a supplier of eligible customers based on market criteria, which makes up to 33% of the total electricity delivered to customers. Amendment to the methodology on providing balancing energy services in the electric power system sets forth the unit price of electricity balancing for electricity calculation for eligible customers who have not found its suppliers in the prescribed period. In July 2009, the Agency adopted one more amendment to the methodology by which this price is more precisely defined.

Regulated pricing includes generation for households, transmission, distribution and retail/supply for households (pursuant to a new tariff system, adopted in 2006, for the unbundled sector). Currently a cost-of-service approach is being used without incentive components. Addition of incentive requirements would benefit industry performance and is reflective of best practices. A Government Decision on implementation of measures for mitigating electricity price increases for households (OG 75/08) was in force from 2 July 2008 to 30 June 2009, when tariffs were increased 20%. Thus, steps are being taken to make tariffs more cost-reflective, while understanding transitional needs of households so that higher costs are integrated in a gradual manner. Daily high-low tariffs are in place for tariff customers, as well as tariffs for transmission and distribution (applicable for eligible customers).

Different tariff models exist for customers depending on different combinations of high-low tariffs and reactive power measurements. There is a tariff system involving demand side management, but it is not widespread; overall efforts towards efficiency would benefit from additional use of demand side management. Though HERA enacts the methodology for calculating tariffs, the Government defines the amounts of tariff items based on a proposal from the MELE. HERA provides its opinion but does not set the tariffs. HERA is able to make the initial proposal for a change in tariffs, or the licensee may do so, but again, HERA is not able to set the tariffs.

The TSO provides Third Party Access (TPA) to the network on a regulated basis. HERA may grant TPA exemptions limited for new investment consistent with best practices. HEP Supply is the public service supplier for tariff customers. Generation for tariff customers is also a public service, carried out by HEP.

Foreign investment is not restricted, and though HEP is currently state-owned, its privatisation is permitted and under consideration. As noted, MELE authorises new generation capacity; HERA decides whether to call and organise tenders for new generation capacity under 50 MW and the Government addresses tenders above 50 MW.

HERA has appointed a council for regulatory affairs and a council for customer protection, which meet on an ad hoc basis, but at least two times a year.

These councils make recommendations and opinions which are not binding on HERA, but can be publicly disclosed at HERA’s discretion. The structure is a positive one, though it could be used to greater effect through increased meetings, transparent reporting, and an active role in a consultation process to assist the ongoing transformation of the sector.
Gas

The gas sector is unbundled and the market open by law as of August 2008, meaning that all customers are deemed eligible and can freely choose a supplier and negotiate a price, though in practice, as with electricity, one entity dominates the market. The recent EBRD energy law reform dimensions assessment project has shown that regulatory independence is the key strength of the country’s gas framework, while public service obligations is its key weakness (see Chart 4).

![Chart 5 – Quality of energy (gas) legislation in Croatia](chart)

Note: The spider diagram presents the sector results for Croatia in accordance with the benchmarks and indicators identified in an assessment model. The extremity of each axis represents an optimum score of 100 that is full compliance with international best practices. The fuller the “web”, the closer the overall regulatory and market framework approximates international best practices. The results for Croatia are represented by the green area in the centre of the web.

Source: EBRD 2011 Energy Sector Assessment

Croatia has one natural gas producer, INA, which is the parent company of the Prirodni Plin the wholesale and retail supplier, and also the gas importer; one TSO, Plinacro, which was ownership unbundled in 2002 and is 100% state owned; 38 distribution system operators, 13 of which are legally unbundled and 25 to which the 100,000 or fewer customer exemption applies; and 39 suppliers, one of which is also a wholesale supplier. The DSOs are either privately or municipally owned. Gas storage was ownership unbundled in 2008.

Tariffs are regulated for gas distribution, gas transmission, gas storage and gas supply of tariff customers. Currently a cost-of-service approach is being used without incentive components. There are two possibilities for setting rates: (1) the system operator calculates and proposes the amount of tariff items to MELE and, based on the opinion obtained from HERA, MELE proposes the amount of tariff items to the Government of the Republic of Croatia which approves it; or (2) HERA calculates and proposes the amount of tariff items to MELE and, based on opinion obtained from the system operator, MELE proposes the amount of tariff items to the Government which finally approves it.

The Government, subject to the proposal of the Minister and after obtaining HERA’s opinion, sets connection fees and fees for increase in connected load. In 2007, a revised Gas Market Act was adopted. Open access is guaranteed by law. Access is controlled by the TSO or relevant DSO and supervised by HERA and MELE. Distribution networks in new territories are awarded through a concession-granting procedure. New network rules for the gas transmission system and the first network rules for the gas distribution system were passed in April.
2009, regulating technical conditions for the operation, management and development of the transmission/distribution system; connection to other parts of the gas system; connection to the transmission/distribution system; and measurement rules in gas transmission/distribution. HERA resolves access complaints, subject to judicial review.

MELE is responsible for monitoring and forecasting supply and demand on the gas market, planning the construction and development of additional capacity, and proposing and taking measures in the case of a crisis situation. The TSO is responsible for proposing a five-year transmission system development plan and the Minister approves the plan after MELE obtains an opinion from HERA. This allows the regulator to remain an active participant in the planning process, which becomes increasingly important with the recent opening of the gas market and efforts to expand the regional gas market in South East Europe. This will become of increasing importance as the gas infrastructure is developed further (Croatia is in the process of working toward interconnection with Hungary).

Those entities supplying gas to tariff customers as of 31 July 2008 hold the public service obligation of gas supply for a period of five years. After that period, the public service provider shall be selected by tender. Pursuant to the General Conditions of Natural Gas Supply, the TSO and DSOs are obligated to establish a system of gathering data on the reliability of gas delivery by 31 December 2010 and to propose to MELE the standard reliability of gas delivery by 31 December 2011. The minister shall, after obtaining an opinion from HERA, establish the criteria for standard reliability of gas delivery and for determining charges for any deviations from standard reliability of gas delivery by 1 July 2012.
Energy efficiency/renewable energy

Croatia’s legislation in the energy efficiency / renewable energy sectors is centred on the Energy Act (November 2012) (as amended) and the Strategy of Energy Development (October 2009), (the “Strategy”).

The Strategy is the centrepiece of Croatia’s policy framework for the broader energy and renewable energy (RE) sector. The Strategy was adopted in 2009 as part of the country’s preparation for accession to the EU. The Strategy sets forth the following three key policy objectives for the country: guaranteeing energy supply security, a competitive energy system and sustainable energy sector development. Specifically, the Strategy sets out a target of 20% renewable energy share of the final gross energy consumption by 2020 in line with the acquis.

The adoption of the new Energy Act in November 2011 (the “Energy Act”) replaced the previous Energy Act of 2001. As the title suggests, the Energy Act covers the energy sector, including the RE sector and was adopted in response to the need of harmonising Croatian legislation with the EU energy acquis, in particular with a view to implementing the EU Third Energy Package of 2009. As a major step toward energy sector liberalisation, for the first time energy companies were allowed to set the electricity and gas prices they would charge the users. The tariffs have to be approved by the country’s independent energy sector regulator (HERA) but the government cannot keep them universally low as before. The Energy Act provides for protection for the socially vulnerable consumers.

Further, the Energy Act introduces the system of guarantees of origin of electricity and a support tariff system for the production of RE and cogeneration. The broad scope of the Energy Act in the part regarding RE does not regulate in detail the production of energy from renewable energy sources (RES) and the terms of incentives for the sector, which are left to be provided for in special laws and a secondary framework. The regulations adopted before the Energy Act became effective, including those regarding tariffs and incentives for electricity produced from RES and cogeneration are superseded in the part where their provisions are in conflict with the Energy Act. New implementing regulations are to be issued within the prescribed transition periods. Further, the Energy Act envisaged the establishment of the National Agency for Energy Efficiency and Renewable Energy.

Croatia ratified the Kyoto Protocol to the United Nations Framework Convention on Climate Change (the “Kyoto Protocol”) in 2007, though with low emissions as a baseline, Croatia has had difficulty meeting its agreed-upon targets.

The current policy framework for the energy efficiency (EE) sector of Croatia is envisaged in the Strategy. Improving energy efficiency is one of the government’s priorities under the Strategy, with a goal of a 9% decrease in energy consumption by the application of EE measures by 2016.

Similar to the RES sector regulation, the regulatory framework for the EE sector has recently been upgraded, with the adoption of the Energy Act. In the area of EE regulation, the Energy Act introduced a system of guarantees of origin of electricity as well as a requirement to set out a minimum EE share of the country’s energy balance. Further regulation of energy efficiency is carried out by special laws (such as the Act on Energy End-Use Efficiency), some of which remain to be fully harmonised with the EU energy efficiency acquis.

While the basic framework for the sector has been set out, further legislative efforts need to be undertaken. Adoption of a wide range of implementing regulations is expected to be on the government’s agenda, in order to fulfil its legal commitments towards the EU. Several credit lines have been opened by international financial institutions, including the World Bank and the EBRD, to finance RE projects.

Similar to the RE sector, a comprehensive, sector-specific energy efficiency obligations compliant with EU standards for the EE sector need to be introduced. In particular, further progress has to be made with respect to energy efficiency in the energy production, transport distribution and final consumption, and in particular implementing regulations have to be adopted regarding EE requirements for various stages of exploitation of energy facilities or labelling. The establishment of the National Agency for Energy Efficiency and Renewable Energy would set a good practice for specialised institutional capacity for the sector. EE financing programmes, including the UNDP, have been set up or are being considered by international donors.

With the basic framework for the RES sector recently being upgraded, the government should focus its efforts on setting forth the secondary regulatory framework, with a particular attention on implementation in order to provide for a well-functioning regulatory environment. Investments in the transmission and distribution network will be necessary to accommodate the growth of intermittent RE. Setting up appropriate capacity building should also be one of the key objectives of the government, with setting up the National Agency for Energy Efficiency and Renewable Energy as well as supplying necessary training both to government and local players.
Croatia has been undertaking considerable efforts to create sound policy and regulatory framework for the efficient functioning of the EE sector. However, the existing framework requires further efforts, in particular as it concerns adoption of specialised EE law and relevant implementing regulations. For further alignment with the energy efficiency acquis, the country will have to adopt implementing legislation, in particular regarding energy performance of building. Institutional capacity building may be required of state agencies competent for energy efficiency improvements, including the new National Agency for Energy Efficiency and Renewable Energy. A public awareness campaign should be a part of the country’s strategy towards the promotion of energy efficiency at a household level.

Private energy service companies (ESCO) model should be given further consideration, with the establishment of relevant institutions, such as an ESCO fund, which would be an important step in the build-up of a well-functioning EE sector.

The country has made substantial progress towards creating well-functioning RES and EE sectors but further efforts should be undertaken towards creating a comprehensive, compliant with the EU standards regulatory framework as well as putting in place necessary implementation arrangements and ensuring appropriate capacity building.

**Telecommunications**

The main legislation governing the electronic communications sector in Croatia includes the Croatian Electronic Communications Act (2008, amended in 2011) plus the Laws on General Administrative Procedure, Consumer Protection, Misdemeanours and related legislation. The Croatian telecommunications sector legislation is now aligned with the EU regulatory framework, including the European Union (EU) 2009 package. Croatia implemented full formal liberalisation of electronic communications in 2003, with a general authorisation procedure for all electronic communications networks and services implemented in 2008. Croatia was the first (in 2011), and remains the only country in the southeast European region, to bring its regulatory framework fully into line with the EU 2009 framework. The country acceded to the EU in 2013. The EBRD’s most recent assessment has found the Croatian framework largely in line with international practice (see Chart 5).

Fixed penetration is relatively high for the region at 40%, matching the average EU penetration level. Competition is also maturing, with alternative operators having gained over 40% market share in provision of voice telephony services, although one of the major alternative fixed operators is 100% owned by the incumbent, Hrvatski Telekom (HT). Further liberalisation of wholesale markets in 2011 has helped to fuel fixed broadband growth, which has already reached a penetration of in excess of 20%, well above the regional average of approximately 10%. The fixed broadband market continues to be dominated by HT. Croatia has three mobile network operators: HT (T-Mobile) leading, VIPnet not far behind and Tele2 trailing with around 15%. Mobile penetration exceeded 100% some time ago and mobile broadband subscription is growing fast. The mobile broadband growth is being driven by the rising penetration of smartphones and other mobile broadband devices such as tablet computers.
The Bank does not currently have direct investments in the sector in Croatia; however (at a technical and business level) the harmonisation of domestic legislation and regulation with the most recent EU framework makes the overall environment for the sector significantly attractive for investment, promotes broader competitiveness across the economy and aids social development. Croatia’s overall legal/regulatory risk scored 89 (100 is the lowest risk). Croatia has thus been found to be in lowest risk category (see Chart 6).

In common with EU member states, Croatia, now acceded to the EU, is subject to the ongoing legal and regulatory reforms necessary to remain part of the evolving Europe-wide market for electronic communications.

Croatia can be seen to have fulfilled the EU accession requirements for information society and media in terms of aligning its legislation with the EU acquis. Implementation of the new framework is also continuing apace. These actions, in themselves, make Croatia an attractive destination for sector investment in the region. To maintain this attractiveness, however, the authorities will need to ensure continuing even and effective implementation of the EU based framework and refrain from measures which could negatively impact investor sentiment, such as the special sector taxes that characterised the sector up to mid-2012.

**Key:** Extremities of the chart = International best practice

**Note:** The diagram shows the quality of the legal framework as benchmarked against international standards (European Union). The extremity of each axis represents an ideal score of 100 per cent, that is, full compliance with international standards. The fuller the “web”, the closer the overall telecommunications legal framework of the country approximates these standards.

**Source:** EBRD 2012 Electronic Communications Comparative Assessment.
Chart 6: Comparison of the overall legal/regulatory risk for telecommunications in Croatia with international practice

Key: Extremities of the chart = International best practice
Note: The diagram shows the quality of the legal framework as benchmarked against international standards (European Union). The extremity of each axis represents an ideal score of 100 per cent, that is, full compliance with international standards. The fuller the “web”, the closer the overall telecommunications legal framework of the country approximates these standards.

Source: EBRD 2012 Electronic Communications Comparative Assessment.
Public procurement

The public procurement sector in Croatia is regulated by the Public Procurement Act (Official Gazette 90/2011) and Act on the State Commission for Supervision over Public Procurement Procedures, Official Gazette 21/2010 (PPL) and several secondary regulations. The law has been adopted within the EU accession process and is harmonised with the 2004 EU Public Procurement Directives.

PPL provides for modern and rather comprehensive regulation of the public procurement sector in accordance with EU policies. PPL clearly promotes competition and transparency in public procurement and incorporated several transparency and integrity safeguards, including good access to information on procurement opportunities and decisions, tenders as default procedures and standard deadlines for tender submission. PPL provides adequate policy enforcement instruments, including an independent review body in charge of complaints related to public procurement. As occurs frequently under EU policies, the law is less comprehensive when it comes to regulating efficiency of public procurement; the ‘value for money’ approach is not visibly incorporated into the procurement process and transaction costs of procurement procedures are high for suppliers and contractors as well as contracting entities.

Overall, the PPL is based on sound principles with no major weaknesses, as it provides for several procurement procedures suitable for contracts of different scope and type. However, in certain aspects PPL is not up to date; electronic communication and eProcurement tools are not mandatory and PPL does not require procurement monitoring and public contract administration (see Chart 7).

Chart 7 - Croatia’s quality of public procurement legislation

Note: The chart shows the score for the effectiveness of the national public procurement laws. The scores have been calculated on the basis of a questionnaire on legislation that is developed from the EBRD Core Principles for an Efficient Public Procurement Framework. Total scores are presented as a percentage, with 100 per cent representing the optimal score for each Core Principles benchmark indicator. The bigger the “web” the higher the quality of legislation.

Source: EBRD 2011 Public Procurement Assessment

Under the Bank’s operations, the EBRD Procurement Policies and Rules may not be imposed as there is low to medium procurement risk in conducting procurement under the local system.
Croatian legislation could improve by adopting some procurement efficiencies and increasing the accountability of contracting entities (see Chart 8). Rules on submitting tenders are outdated; there is no general requirement to publish online all tender documents and procurement reports (the new EU policies currently under development require a more modern and more efficient approach to procurement regulation).

The quality of national procurement regulation is comparable with other EU Member States in the EBRD region; however, the new Croatian laws do not embrace recent EU policy developments, they remain bureaucratic and are not as modern as in some other countries in the EBRD region (e.g. Albania, Georgia, and FYR Macedonia). In the 2010 EBRD assessment report for Croatia severe implementation problems were highlighted and these are expected to still be an issue. Since 2010 the laws were changed again and institutional capacities may not be up to the challenges related to implementing new legislation in practice.

In the 2012 survey Croatia’s procurement framework scored good compliance with international best practice, with basic standards and safeguards in place, but in principle it could be better. There is a lot of room for improvement in terms of economy and efficiency of the public procurements as well as introducing eProcurement processes and tools.

**Chart 8 - Quality of public procurement practice in Croatia**

**Note:** The chart shows the score for the extensiveness of the national public procurement laws. The scores have been calculated on the basis of a questionnaire on legislation that is developed from the EBRD Core Principles for an Efficient Public Procurement Framework. Total scores are presented as a percentage, with 100 per cent representing the optimal score for each Core Principles benchmark indicator. The bigger the “web” the higher the quality of legislation.

**Source:** EBRD 2011 Public Procurement Assessment
Private Sector Support

Access to finance

Applicable legislation on the topic includes Law on Ownership and Other Real Rights, the Land Registry Law, the Enforcement Law, the Law on the Registry of Court and Notary Public created Security, and the Leasing Law.

The Law on Ownership and Other Real Rights (The Property Law) together with the Land Registry Law provides detailed, comprehensive and well developed framework for creating mortgage over movable property. A mortgage is created by execution of a written agreement between the owner of an immovable property whose signature needs to be certified and the mortgage creditor, and registration of the agreement into the land registry. The law allows the securing of revolving loans as long as the maximum amount of debt is registered. The Land Registry is operated at the municipal courts throughout the country, in the specialised land registry divisions. Ambitious land registry reform started several years ago with the aim to fully computerise all data (transfer of data from land registry books into electronic files) and to complete and update the registration of all titles. Most of the data is now publicly accessible on-line and what was once an overly time consuming procedure has been considerably shortened. However the system still suffers from not being centralised and the speed of registration varies drastically between courts (ranging from a couple of days in the north to a couple of months in the southern regions of the country).

In order to secure a loan by security over immovable property, the market has used a combination of mortgages as governed by the Property Law, and a fiduciary transfer of ownership based on the Enforcement Law. The instrument’s appeal was the fact that the secured creditor would act as fiduciary owner of the collateral and would be able to use the enforcement procedures led by notary public, which are considered more efficient. The Croatian National Banks reports show that the usage of this instrument is slowly giving way to the traditional mortgage probably due to improved mortgage enforcement procedures.

Provisions on taking pledge over movable assets and rights are currently part of the Croatian Enforcement Act as the Property Law only provides for possessory pledge. Regulating secured transactions through the Enforcement law, apart from being conceptually wrong, has naturally created legal uncertainty and made transactions costs much higher than necessary. For example, since the security agreement is in essence part of a voluntary enforcement process, it has to be notarised, increasing costs.

Registration of non-possessory pledges created in accordance to the Enforcement Act is made at the ‘Registry of Court and Notary Public created Security’ (the ‘Pledge Registry’) operated by the state-owned Financial Agency. The Pledge Registry is a full document filing system against the name of the pledger (as opposed to a modern approach based on notice filing); it is operated electronically, and is publicly accessible on-line. Apart from introducing the Pledge Registry, the Law on the Registry of Court and Notary Public created Security (the Pledge Registry Law) contains substantive law provisions introducing the concept of floating charge over tangible assets, thus adding to the already terribly fragmented regulation of security rights.

Financial and operative leasing is regulated by the Leasing Law. The law provides a modern legislative framework for undertaking leasing transactions. Leasing companies are regulated, require licenses and are supervised by the Croatian Financial Markets Supervisory Agency (HANFA). Although in a mild decline in recent years the Croatian leasing market is relatively developed with real-estates and cars representing the most leased objects.

There is no special legislation for factoring apart from general “assignment of claim by contract” provisions of the Obligations Law which provides a basis for assigning account receivables. As a result there is no definition of factoring services or types of factoring transactions which can help increase legal certainty of factoring transactions and hence reduce involved costs and risks of re-characterisation of transactions. The Croatian government decided to introduce a new law that would provide legislation of factoring transactions and regulation of factoring business. The EBRD is providing technical assistance to the Croatian Ministry of Finance in drafting the necessary legal framework.

A private credit information registry was set up by Croatian Banks in 2007 as a credit information sharing platform among its members (banks). Over time, access to the registry has been expanded and it now includes leasing and credit card companies which are affiliated to the banks. This excludes insurance companies, utility companies and other financial institutions which are not affiliated to the banks and their potentially valuable information. There are currently no laws or central bank’s regulation that would specifically regulate the operations of credit information reporting systems apart from the general framework of protection of personal data provided in the Personal Data Protection Act.

Improving access to finance, especially for SMEs, is an important part of the EBRD’s mission. The Ministry of Finance is currently working on introducing a factoring law and the EBRD is providing them with technical assistance.
The legal framework for taking security over movable assets and rights has historically been fundamentally weakly set up as a part of the enforcement law. This is bringing legality of certain everyday market transactions in question and raises overall costs of the transactions. It is recommended to consider revamp of secured transactions by bringing them into the sphere of property law. Facilitating factoring transactions by legislation of factoring might help to improve overall access to finance by making factoring services more transparent and legally certain. Broadening the scope of information covered by the credit bureau (insurance, trade credit and utilities) would improve the quality of credit referencing and costs of information asymmetry.

**Capital Markets**

In Croatia, the basic legislation on the securities market is comprised of the Capital Market Act enacted in 2008, the Investment Funds Act and the Law on Croatian Financial Services Supervisory Agency both enacted in 2005. The Capital Market Act focuses on the establishment, activities, supervision and termination of investment companies, market operators and operators of payment and settlement systems; the offering of investment services and the performance of investment activities; the offering, listing and trading of securities on the organised market; the reporting requirements in connection with securities; market abuse; the deposit of financial instruments and the settlement and payment of transactions with financial instruments and the authority. Finally, it details activities of the Croatian Financial Services Supervisory Agency for the implementation of the new Act.

Oversight of the Croatian capital market is undertaken by two bodies: the Croatian National Bank, which supervises credit institutions, and the Croatian Financial Services Supervisory Agency, which supervises the securities market, pension funds and insurance companies. The Agency was established as an independent legal entity on 1 January 2006 pursuant to the Act on Croatian Financial Services Supervisory Agency. The Act also provides for the dissolution and transfer to the Agency of authority from the Insurance Companies Supervisory Authority, the Croatian Securities Commission and the Agency for Supervision of Pension Funds and Insurance. The fundamental objectives of the Agency are the promotion of stability in the financial system and the maintenance of transparency and legality in securities markets operations. The Agency is an Ordinary Member of IOSCO.

The Zagreb Stock Exchange (the “Exchange”) is the only stock exchange operating in Croatia and is the biggest stock exchange in terms of trading volume operating in Balkans.

In line with accession of Croatia to the European Union there have been a number of laws and regulations adopted in Croatia, mostly in 2011 and 2012. These laws were adopted in order to implement various EU Directives like Settlement Finality, Market Abuse or Collateral Directive. As these laws were adopted in rather short amount of time some uncertainties or lack of clarity exists (please see further below).

In terms of regulated markets, the Croatian market seems to be rather nascent and with low activities in terms of IPOs, however, the Zagreb Stock Exchange is very ambitious and plans to integrate with other Balkans’ exchanges in order to be able to compete with such exchanges like Vienna or Warsaw.

In terms of money markets, there has been number of reforms aiming at implementing such concepts like netting and close-out netting, however, in respect of the enforceability of the “close-out netting” provisions of the ISDA Master Agreement, there is currently no court practice in Croatia. Moreover, it would be advisable that the Croatian parliament passes certain amendments to the laws that are currently in force that would resolve current uncertainties, i.e. primarily resolve the legal discrepancy between Article 111 of the Croatian Bankruptcy Act and Article 8 of the Croatian Financial Collateral Law (both relate to enforceability of netting and their provisions are conflicting). Similar situation applies to the pre-bankruptcy netting.

The Bank places the highest priority on regional support for Croatian corporates, commercial finance of national and municipal infrastructure, SME finance and tourism. No capital markets related projects are either planned or already undertaken.

In terms of capital markets development USAID works on integration of stock exchanges in the Balkan Region in order to increase their attractiveness to issuers and also investors. Within this project, USAID is planning to implement a special IT system that would allow for more efficient execution of cross-border trades. Currently, there appear to be no legal or regulatory changes identified for the implementation of this project. USAID is discussing possible cooperation with the EBRD on this project.

The government has also developed the draft Law on Securitization but its status is currently unclear.

In terms of the legal framework of capital markets it is recommended to further harmonize the Croatian legal framework with the EU framework and clarify provisions relating to netting and close-out netting. Moreover, the draft Securitization Law shall be made available for public consultation before its adoption.

As Croatia is a small economy with an even smaller capital market, it should possibly focus on progressing the steady development that would prevent a deterioration of the market; integration
with other Balkan regulated markets could be an important step in competing with such stock exchanges like Vienna or Warsaw. The uncertainty of various legal provisions should be eliminated.

Corporate governance

The primary source of corporate governance legislation in Croatia is the Company Act, which entered into force in 1995 and has been extensively amended since then, especially for the purpose of harmonising national legislation with the Acquis Communautaire. Corporate governance is also regulated by the Capital Market Act, issued in 2008, as amended; the Credit Institutions Act, enacted in September 2008, as amended; and the Takeover Act, which entered into force in 2007 (with the exception of some provisions to become effective after Croatia’s accession to the EU).

The Company Act is mainly deriving from the German model. The Act details the requirements for setting up and running commercial companies in Croatia. In 2008, the Act introduced the possibility for companies to be organised under the one-tier system. However, the two-tier system with a supervisory board and a management board is still the predominant corporate structure favoured in Croatia and is mandatory for banks.

The Capital Market act regulates the conditions for establishment, operation, supervision and liquidation of investment firms, market operators and settlement system operators; the conditions for the provision of investment services and performance of investment activities and related ancillary services; the rules for trading on a regulated market; the conditions for offering securities to the public and admission of securities to a regulated market; the disclosure requirements relating to listed securities and the authority of the Croatian Financial Services Supervisory Agency.

The Credit Institutions Act governs the conditions for the establishment, operation and dissolution of credit institutions with registered offices in Croatia, as well as their prudential supervision; and the conditions under which legal persons with registered offices outside Croatia may provide banking and/or financial services in Croatia.

The Takeover Act was adopted as part of Croatia’s gradual move to bring its laws into compliance with the Acquis Communautaire (i.e., it transposes Directive 2004/25/EC on takeover bids). The Takeover Act improves shareholders’ protection in the takeover process and details rights and obligations of the acquirers.

In 2007, a voluntary Code of Corporate Governance for companies listed on the Zagreb Stock Exchange was developed by the Croatian Financial Services Supervisory Agency (HANFA) and the Zagreb Stock Exchange. The Code was revised in 2010 and came into effect on 1 January 2011. The revised Code is based on the “comply or explain” mechanism: listed companies are required to state in their annual reports (which are also published on their websites) whether they comply with the Code and state the reasons for non-compliance.

Croatia has undertaken substantial legal and regulatory changes that have led to a number of improvements in the framework for corporate governance. This includes the introduction of Takeovers Act and the Capital Market Act, substantial amendments to the Companies Act, and the creation of a single supervisory authority for capital markets, insurance, and private pensions (HANFA). The issuance of the Code of Corporate Governance is also a positive improvement. However, some substantial challenges still remain. The legal framework contains some critical gaps, especially with regard to conflicts of interest, disclosure of financial and non-financial information, including related party transactions and ultimate (beneficial) ownership (see Chart 11).
With regards to the corporate governance of banks, the Credit Institutions Act and related regulations are well developed, creating sound legislative framework for corporate governance in banks. Banks must be organised under a two-tier system, where the supervisory board - which must not include executive directors - is responsible for appointing the management board. The framework details the duties of loyalty and care for board members and sets forth rigorous qualification criteria for the management board members but not the supervisory board members. While the Code of Corporate Governance requires listed banks to undertake board evaluation, very few banks in practice perform such evaluations.

The Audit Act requires all banks to set up audit committees, yet such committees do not appear to include only supervisory board members but also executives, which have a potential for conflicts of interest. Further, the law and banking regulations do not require banks to appoint an independent chief risk officer with direct access to the board. Banks publish a good amount of information on their websites, including ownership structures, names of the board members and their organisational structures. The majority of listed banks seem to publish on-line the completed Corporate Governance Code’s Annual Questionnaires, where they disclose, names of independent directors, bank committees, other engagements of the board members and information about compliance with the code requirements. However, there is no clear requirement and banks do not generally disclose information about board committees, as their composition; and experience of committee members. The results of EBRD’s most recent assessment of the corporate governance framework in Croatia demonstrates that speed of disclosure and redress being the weakest aspects of how this framework works in practice (see Chart 12).
The issues outlined above are all relevant for the EBRD’s direct investments in Croatian banks and companies. No investee companies’ corporate governance related suits have been reported.

The composition of the audit committee should be better detailed so as to ensure the necessary qualification, independence and expertise for the effective performance of its functions. The role of independent directors on the supervisory board and board committees should be clarified. In banks, fit and proper criteria for the supervisory board members and the role of the supervisory board in systemically important subsidiaries should be strengthened. Risk management expertise on the supervisory board should be strengthened; remuneration policies should be aligned to prudent risk management; banks’ supervisory boards should consider developing nomination policies and self-evaluations exercises in order to maintain board’s effectiveness and an appropriate mix of skill.

Numerous improvements in Croatian corporate governance have taken place mainly as a result of compliance with the Acquis Communautaire of the EU. The level of corporate governance culture is currently improving as a result of the above, but some key challenges still remain.
Insolvency

Croatia’s applicable legislation for the insolvency sector is centred on the Bankruptcy Act of 1996 (as amended in 1999, 2000, 2003, 2004, 2006, 2010 and 2012) (the “Bankruptcy Act”). The Bankruptcy Law applies to legal entities and to individual debtors who are sole proprietors or tradesmen, subject to certain exclusions or qualifications for State or State-related entities.

Chart 13 – Quality of insolvency legislation in Croatia

Note: the extremity of each axis represents an ideal score, that is, legislation fully in line with international standards such as the World Bank’s Principles and Guidelines for Effective Insolvency and Creditor Rights Systems, the UNCITRAL Working Group’s “Legislative Guidelines for Insolvency Law”; and others. The fuller the ‘web’, the better the quality of the legislative framework.

Source: EBRD Insolvency Sector Assessment 2009

The Insolvency Sector Assessment (the “Assessment”) completed in late 2009 concluded that the Croatian insolvency law provisions were of a very high quality in all aspects, other than reorganisation. The Assessment found that the law in this area was deficient, since reorganisation was only permitted following the commencement of bankruptcy proceedings. Like liquidation, reorganisation, which involves the preparation of a reorganisation plan, is a court-supervised procedure. Nevertheless, the Bankruptcy Act enables a debtor to initiate bankruptcy proceedings early if it demonstrates that it is under a threat of insolvency, namely that it is probable that it will not be able to meet its payment obligations as they fall due.

The Croatian insolvency law is modelled on German insolvency law; hence there is an obligation on management of the debtor to petition for bankruptcy within 21 days of cash flow insolvency (inability to pay debts as they fall due) or over-indebtedness (insufficiency of assets to meet existing liabilities). The requirement to file for over-indebtedness will not apply where it can be reasonably assumed that the debtor will be able to meet its payment obligations regularly as they fall due. Furthermore, a debtor will be considered cash flow insolvent if it has unsettled liabilities with the bank that carries out the debtor’s payment transactions for a period exceeding 60 days and such liabilities ought to have been settled from the debtor’s accounts without its consent.

Under the Bankruptcy Law, creditors are classified by rank according to their claims. Payments due to the State for unpaid taxes and other forms of State revenue and certain amounts owed to employees have the highest priority. This is different to the position in some jurisdictions, such as England & Wales, where the statutory priority of amounts owed to the State in insolvency has been abolished in
favour of other unsecured creditors. Secured creditors that have security over an object or right that has been recorded in a public register can enforce that right directly outside of the bankruptcy proceedings. All security which is unregistered or not capable of registration is thus only capable of realisation by the trustee in bankruptcy and any sales costs will be deducted before the proceeds are distributed to creditors.

Insolvency law is cross-sector and affects all sectors where the EBRD has either an equity or a debt stake. Moreover, it impacts on the willingness of creditors generally to invest in the country and therefore also to enter into joint ventures with the EBRD.

The latest reform to the Bankruptcy Law took place in 2012. We are not aware of any further proposed reforms.

Like many other countries, Croatia would benefit from an examination of its Bankruptcy Law to verify the effectiveness of reorganisation measures in order, where possible, to strengthen these to ensure the potential survival of the business following insolvency.

Croatia has the main tools of a modern insolvency law, providing both for liquidation and for reorganisation of the debtor’s business.