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Source / Izvornik: **Central European journal of comparative law, 2020, 1, 69 - 85**

**Journal article, Published version**

**Rad u časopisu, Objavljena verzija rada (izdavačev PDF)**

Permanent link / Trajna poveznica: <https://um.nsk.hr/um:nbn:hr:118:309405>

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Download date / Datum preuzimanja: **2024-11-19**

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DIGITALNI AKADEMSKI ARHIVI I REPOZITORIJI

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## Limited Liability Companies in Croatia<sup>3</sup>

- **ABSTRACT:** *This article aims to provide an overview of the main features of the limited liability company (hereinafter: LLC) in Croatia. LLCs are the most common company type in Croatian business practices. This is because of low amounts of minimum share capital, limited liability of shareholders, freedom of shareholders to regulate own internal relations and the LLC's internal organization, which is regulated by the articles of association and holds fewer formalities to function. Interestingly, most LLCs are established as a single shareholder LLC, followed by two and three shareholders LLCs. This supports the finding that Croatian LLCs are often closely held companies, whose founders also act as directors and employees of the company. Since 2012, it is possible to form a simple LLC for a minimum share capital of 10 KN (cca. 1.32 EUR), and as of 2020, LLCs can even be established online. Thus, the simplicity and cost effectiveness to establish an LLC remain its primary advantage. Mandatory provisions that shareholders must respect are inter alia capital requirements and capital maintenance, formation, and competencies of the management board and shareholders' meeting. The shareholders' meeting is superordinate to other LLC bodies, allowing directors to be appointed and dismissed at any time. Shares are alienable and inheritable, but their transfer may be limited by the LLC's articles of association. In certain cases, shareholders can be held personally liable for the LLC's obligations (e.g., in the event of abuse of limited liability, partial payment of capital contributions, and the LLC's dissolution without liquidation). Further specifics and current challenges of LLCs in Croatia will be analysed in detail.*
  
- **KEYWORDS:** LLC, capital requirements, capital maintenance, bodies, membership rights, piercing the corporate veil.

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3 This paper is written under support of the University of Rijeka project (uniri-drustv-18-43) 'Legal Aspects of Companies Restructuring and Transition Towards New Corporate Governance Culture'.



## 1. Introduction

In December 1993, the Croatian Parliament enacted a new Companies Act (hereinafter: CA)<sup>4</sup> that was modelled on the German and Austrian Company Law. The fundamental principles set forth in the CA included a uniform code that regulated both partnerships and companies. In addition, the CA regulated groups of companies, reorganization measures (mergers, divisions, conversions) and the legal status of foreign companies. It has been amended several times during the period of 1993 to 2019.

The total number of active LLCs (in Croatian: društvo s ograničenom odgovornošću) was 98925, plus 37015 simple LLCs in September 2019,<sup>5</sup> thereby accounting for 98.6% of the total number of active companies in Croatia. Dispositive provisions of the CA outweigh mandatory provisions regarding the relations between shareholders. This constitutes one of the fundamental differences between LLCs and joint-stock companies. Mandatory provisions for LLCs regulate *inter alia* formation and registration, capital requirements and capital maintenance, capital increase and reduction, bodies and their liabilities towards shareholders and creditors, and dissolution of the LLC.<sup>6</sup> On the other hand, shareholders are free to arrange internal relations, such as the pertinent issue of distribution of voting rights and dividends (irrelevant of the share capital paid by each member), and restrictions on transferability of shares. If the parties fail to use their party autonomy while drafting their articles of association, the CA provides for default rules to be applied.

## 2. Regular LLC and simple LLC

Introduced in 2012, the simple LLC became popular because of reduced formation costs and a minimum amount of share capital of only 10,00 HRK (ca. 1.32 EUR), the nominal value of each share being no less than 1,00 HRK (ca. 0.14 EUR).<sup>7</sup> The simple LLC was modelled on the German entrepreneurial company.<sup>8</sup> It should be emphasized that the simple LLC is not a different form of company but yet slightly distinct from a regular LLC. Although the same rules apply to both regular and simple LLCs, as shall be analysed, there are a few exceptions where the legislator provides a different solution for simple LLCs.

The simple LLC can only be formed under a simplified procedure if it has less than five shareholders and one director. A model protocol composed by the notary must be used for the formation of a company. This also serves as a list of shareholders and persons empowered to manage the company's business. Capital contributions must

4 Companies Act, Official Gazette, Nos. 111/93, 34/99, 121/99, 52/00, 118/03, 107/07, 146/08, 137/09, 125/11, 152/11, 111/12, 68/13, 110/15, 40/19.

5 Croatian Bureau of Statistics, September 2019.

6 Barbić, 2010, pp. 18–19.

7 Barbić, 2010, p. 8.; Jurić, 2020, pp. 390–400.

8 Jurić, 2020, pp. 402–404.

be cash only and paid in full prior to filing the application to register the company. Contributions in kind are not allowed pursuant to Art. 390a CA.

Further, it must form statutory reserves, comprising a quarter of the annual surplus, minus losses carried forward from the previous year. Conversely, the regular LLC does not have this obligation. These reserves may only be used for the following: (a) capital increase from company funds; (b) compensation of an annual deficit, in so far as it is not covered by profits carried forward from the previous year; and (c) compensation of losses carried forward from the previous year, in so far as they are not covered by an annual surplus (Art. 390a CA). Thus, simple LLCs are encouraged, although not obliged, to transform into regular LLCs, after the business proves to be successful.

### 3. Capital requirements and capital maintenance of the LLC

#### ■ 3.1. *Capital requirements and payment of capital contributions*

The LLC's share capital must amount to no less than 20.000,00 HRK (cca. 2.632,00 EUR). The nominal value of each share must amount to no less than 200,00 HRK (cca. 26,32 EUR) and each shareholder may subscribe several shares in formation of the LLC.<sup>9</sup> The amount of the nominal values of the individual shares may be determined differently. The total of the nominal values of all shares must equal to the share capital (Arts. 389 and 390 CA). If contributions in kind are to be made, the object of the contribution in kind and the nominal value of the share to which the contribution in kind refers, must be specified in the articles of association. The value of the contributions in kind must be audited and shareholders must draft a report on company formation.<sup>10</sup>

Shareholders may determine the amount and date of cash pay-out contributions for shares either by means of the articles of association or shareholder decision.<sup>11</sup> CA sets the minimum amount and deadline for cash pay-out contributions when forming an LLC. Prior to registration, each shareholder must pay at least a quarter of the nominal value of a share (Art. 390 CA). The total amount of all cash pay-outs should not be less than a quarter of the amount of share capital. Since 2019, the CA introduced a deadline for payment, and personal liability for unpaid cash distributions, which shall be discussed later in this article.

Contributions in kind must be fully effected prior to the registration of an LLC. If, at the time of applying for registration of an LLC, the value of contribution in kind

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<sup>9</sup> Except for simple LLC or online registration of an LLC.

<sup>10</sup> Audit is not necessary if contributions in kind are listed securities or if they were previously assessed by the certificated judicial assessor (Art. 185a CA).

<sup>11</sup> By the articles of association, it may be stipulated that shareholders are allowed to take a decision to call in additional payments (additional contributions). If the obligation to pay an additional contribution is not limited to a specified amount, each shareholder, if he has fully paid the capital contribution, shall have the right to be exempt from payment. If they are not needed to cover a loss in share capital, any payment in additional contributions may be repaid to shareholders (Art. 391 CA).

does not equal the nominal value of the share subscribed to thereby, the shareholder must pay a cash contribution of the shortfall (Art. 390 CA). These provisions also apply to future capital increases of the LLC. Shareholders may not be exempt from the obligation to pay capital contributions, except in the case of a capital reduction in the amount of that contribution by which the share capital has been reduced (Art. 398 CA).<sup>12</sup>

In the event of a delayed payment of the capital share, the defaulting shareholder must pay default interest (Art. 399 CA). They may also be issued a renewed request to make the payment within a specified grace period, under penalty of their exclusion, of the share for which payment was unfulfilled. After fruitless expiry of this period, the defaulting shareholder shall be declared to have forfeited their share and any partial payments made to the company. A shareholder who has been excluded shall remain liable for any losses the company incurs on account of the defaulted amount of the original capital share, which may be called in against the share at a later point in time (Art. 400 CA). The legal predecessors of an excluded shareholder shall also be held liable for any unfulfilled obligations to pay capital contributions on the part of an excluded shareholder. The legal predecessor acquires the excluded shareholder's share against payment of the outstanding amount (Art. 401 CA). If payment of the outstanding amount cannot be collected from any of the legal predecessors, the company may sell the share by way of public auction (Art. 402 CA). Where an original capital share can neither be collected from the person obligated to pay it nor covered by the sale of the share, the remaining shareholders must raise the shortfall in proportion to their shares. Amounts that cannot be collected from individual shareholders shall be distributed proportionally amongst the remaining shareholders (Art. 403 CA).<sup>13</sup>

If the LLC becomes bankrupt, shareholders are jointly and severally liable for payment of unpaid capital contributions, should such payments be necessary to settle the LLC's creditors (Art. 404 CA).

### ■ 3.2. *Distribution of profit and prohibited payments to shareholders*

Shareholders can claim the annual surplus plus any profit carried-forward and minus any losses carried-forward, in so far as the resulting amount is not excluded from the distribution amongst shareholders by law, articles of association, or by a shareholders' decision on the appropriation of earnings. Profit shall be distributed in proportion to the contributions paid for shares. Similarly, the articles of association could stipulate an alternative criterion for distribution (Art. 406 CA).<sup>14</sup> The LLC is not obliged to form reserves from the profit, but they may be envisaged by the articles of association (Art. 406a CA).<sup>15</sup>

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12 Jurić, 2020, pp. 395–397.

13 Barbić, 2010, pp. 193–218.

14 Barbić, 2010, pp. 285–295.

15 Capital reserves, reserves for own shares, reserves envisaged by the articles of association and other reserves. Barbić, 2010, 279–285.

The assets the LLC requires to maintain its share capital should not be paid out to shareholders (Art. 407 CA). Prohibited payments must be reimbursed to the LLC. If the shareholder was acting in good faith, reimbursement may only be requested in so far as it is necessary to settle the LLC's creditors. If the reimbursement cannot be collected from the shareholder or directors, the remaining shareholders shall be liable, in proportion to their shares, for the amount to be reimbursed, to the extent as is necessary to settle the LLC's creditors. The LLC's claim shall become statute-barred after five years from the end of the day on which the prohibited payment was made.<sup>16</sup>

### ■ 3.3. *Purchase and pledge of own shares*

The LLC shall not purchase or take in pledge its shares for which the capital contributions have not yet been paid out fully (Art. 418 CA). It may purchase own shares for which capital contributions have been paid in full, only if at the time of the purchase it could form reserves in the amount of the expenditures for the purchase (reserves for own shares), without reducing the share capital or reserves to be formed in accordance with the articles of association, and which may not be used to make payments to shareholders. Total amount of secured claims shall not exceed the value of the shares taken in pledge. If the value of the shares taken in pledge is lower, this amount shall not exceed the value of assets above the share capital. The infringement of these provisions does not render the acquisition of or taking of the shares in pledge ineffective. However, the legal obligations in respect of a prohibited acquisition or acceptance of own shares in pledge shall be null and void.<sup>17</sup>

## 4. Transfer and pledge of shares

Shares are alienable and inheritable. If a shareholder purchases further shares in addition to their original share, these shall remain legally independent. The parties must conclude two contracts for the transfer of the shares: the contract stating the transferor's obligation to transfer the share and the transfer agreement. Both must be in the notarial form to be valid. However, if the first contract fails to meet this requirement, a validly concluded transfer agreement shall validate the entire transfer of the share (Art. 412 CA). Insofar as relations within the LLC are concerned, legal acts performed towards the transferor, as well as those performed by the transferor prior to notification of the share transfer to the LLC, shall be valid in relation to the acquirer of the share (Art. 415 CA).<sup>18</sup>

Amendments to the articles of association are not necessary for the transfer of shares.<sup>19</sup> The articles of association may impose some restrictions on the transfer of

16 Barbić, 2010, pp. 295–299.

17 Barbić, 2010, pp. 312–317.

18 Barbić, 2010, pp. 177–178.

19 Barbić, 2010, pp. 103–115.

shares, such as requiring the company's consent for transfer.<sup>20</sup> In that case, a shareholder who intends to transfer the share may, if they have not obtained consent from the company, request the permission of the commercial court to transfer the share. The court shall permit the transfer of the share when there are no justified reasons to deny permission, and the transfer is conducted without causing damage to the LLC, its shareholders, or creditors. Even if the court has permitted the transfer of shares, the shareholder cannot transfer shares to a person of their choice, if the LLC notifies them within one month after the court decision has become final, that it approved transfer of that particular share to another person under the same conditions (Art. 413 CA). In cases of inheritance of shares, the articles of association may stipulate that the heir shall transfer the share to another shareholder or to a person designated by the LLC, if the heir and such person have not agreed otherwise, at a price corresponding to the share value, as expressed in the LLC's latest financial statements (Art. 414 CA).<sup>21</sup>

A shareholder may pledge their share, that is, use it as collateral. The pledge agreement must be concluded in a notarial form. The pledge of the share must be entered into the share register and the Court Register through submission of the list of shareholders (Art. 412 CA).<sup>22</sup> The transferor of the share must file an application for the entry of the transfer of share into the LLC's share register (Arts. 410 and 413 CA).<sup>23</sup> Personal creditors of shareholders can enforce claims on their shares held in the LLC (Art. 232 of Execution Act).<sup>24</sup> The execution of shares of LLCs is complex in light of the fact that company law rules and articles of association can affect the process of execution.<sup>25</sup> For example, if the articles of association provide for restrictions of the transferability of shares, it is uncertain as to which should prevail: execution procedure or company law. According to some views of practitioners, if the articles of association provide the pre-emption right, the court should inform the shareholders of the assessed value before the sale of shares on auction, so that the shareholders can exercise their pre-emptive right.<sup>26</sup>

In any case, personal creditors of the shareholders are not entitled to cancel the company in order to enforce their claim towards shareholder-debtors, as they would be in the case of partnerships.<sup>27</sup>

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20 E.g., ban on transfer of shares during LLC's existence or during certain period from LLC's formation, pre-emptive right, determination of person who may acquire shares etc. Barbić, 2010, p. 116. Share with obligation to pay an additional contribution shall be transferable only upon the LLC's consent (Art. 412/4 CA).

21 Barbić, 2010, pp. 119–128.

22 Barbić, 2010, pp. 137–141.

23 Directors shall keep the LLC's share register. Directors shall without undue delay submit to the Court Register a list of shareholders. In the event of a change in the person of a shareholder or the extent of their participation, the owner, in relation to the company, of a share shall be deemed to be only whoever has been included as such in the share register and the list of shareholders entered in the Court Register (Arts. 410 and 411 CA). Barbić, 2010, pp. 171–184.

24 Execution Act, Official Gazette, Nos.112/2012, 25/2013, 93/2014, 55/2016, 73/2017.; Mihelčić, 2012, p. 7.

25 Miladin, 2008, p. 510.

26 Marković, 2006, p. 124.

27 Art. 100 of CA.

## 5. Bodies of the LLC

Mandatory LLC bodies comprise the management board and the shareholders' meeting. Conversely, the supervisory board is not required. The shareholders' meeting is superordinate to other LLC bodies and may give mandatory instructions to the management board, while shareholders may bring decisions on the management of the LLC. Consequently, directors may be dismissed at any time.<sup>28</sup>

### ■ 5.1. *The management board and directors' liability*

The management board consists of one or more directors. The number of directors are provided for under the articles of association. A director may be any natural person with the capacity to act.<sup>29</sup> The shareholders decide on appointment of directors, unless otherwise provided by the articles of association (Arts. 422 and 423 CA).<sup>30</sup> Appointed directors may be dismissed at any time by a shareholders' decision.<sup>31</sup> Likewise, a director may resign at any time by means of a written form (424a CA). An application for entry in the Court Register must be made for each change to any director and for the termination of a director's power of representation (Art. 425 CA).<sup>32</sup>

Director duties are as follows: (a) manage the business and represent the LLC; (b) ensure proper book-keeping and compose reports and annual financial statements of the LLC; (c) convene the shareholders' meeting, prepare proposals of its decisions, and enforce them; (d) submit applications for entry in the Court Register; and (e) initiate bankruptcy proceedings. Regarding the LLC's management and representation, when several directors have been appointed, they are all jointly entitled to manage and represent the LLC, unless otherwise provided by the articles of association. Directors manage and represent the LLC in accordance with the articles of association, decisions of shareholders, and mandatory instructions of the shareholders' meeting or the supervisory board (Arts. 422 and 427 CA).<sup>33</sup>

Furthermore, directors conduct company affairs with the due care of a prudent businessman, keeping business secrets of the LLC. The business judgement rule applies to their liability. Directors who breach their duties are jointly and severally liable to the

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28 Barbić, 2010, pp. 319–326.

29 A director cannot be a) a member of the LLC's supervisory board and b) a person punished for certain criminal offences during five years after the finality of the judgement or a person against whom a safety measure was pronounced prohibiting them to engage in an activity which falls under the business activities of the LLC, during the period while the aforesaid prohibition remains in force.

30 This decision may be brought by the supervisory board, certain shareholders or government body which is a shareholder. Shareholders may be appointed for LLC's directors by the articles of association (Art. 424 CA).

31 They may be also dismissed by the supervisory board or a shareholder if they have appointed a director or by a court decision if there are important grounds therefor.

32 Barbić, 2010, pp. 328–348.

33 Barbić, 2010, pp. 357–366.



LLC for any incurred damage. In case of dispute, directors bear the burden of proof to demonstrate that they employed the due care of a prudent businessman.<sup>34</sup> Directors are liable for damage if, in violation of the CA, they undertake the following: (a) return capital contributions to shareholders, (b) pay interests or dividends to shareholders; (c) purchase or take in pledge own shares of the LLC; (d) distribute the LLC's assets; (e) make payments after the occurrence of insolvency or over indebtedness; and (f) pay remuneration to members of the supervisory board or grant loans from the LLC's assets. In the latter cases, the claim for damages may also be asserted by creditors if they are unable to settle their claims from the LLC. Where compensation must be paid to settle the LLC's creditors, the directors' liability cannot be abrogated because they acted in compliance with a decision brought by the shareholders, whether through a mandatory instruction of the shareholders' meeting or the supervisory board. The claims for damages prescribe after five years (Art. 430 CA).<sup>35</sup>

The claim for damages against directors may be made only with previous approval of the shareholders' meeting (Art. 441 CA). The LLC is represented in the litigation by the supervisory board or a special representative appointed by the shareholders' meeting. Shareholders whose combined shares make up at least one-tenth of the share capital may claim for damage against the directors if the shareholders' meeting refused to approve such a claim. The claim must be made within three months after the date of which the shareholders' meeting refused approval.<sup>36</sup> If the claim is dismissed as unfounded, and if it is established that it was malicious, the plaintiff shall indemnify damages incurred to the defendant (Art. 453 CA). Minority shareholders make the claim on their behalf, but they can only demand that defendants compensate damages incurred to the LLC.<sup>37</sup>

### ■ 5.2. *The supervisory board*

The supervisory board is not a mandatory body of the LLC. Its formation may be envisaged by the articles of association.<sup>38</sup> However, the formation of a supervisory board is prescribed by the CA for large LLCs (Art. 434 CA).<sup>39</sup>

The supervisory board consists of three members. Although the articles of association may foresee that the supervisory board has more than three members, the number must always be uneven (Art. 435 CA). Any natural person with the capacity to act may be appointed into the supervisory board, whereas the CA prescribes who

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34 They are also liable for damages incurred in the LLC's formation or by undue influence of third persons and shareholders on the LLC's directors and the supervisory board members.

35 Barbić, 2010, pp. 391–399.

36 Identical case is when shareholders put a proposal to make such a claim to the management board but omitted to put the proposal on the agenda of the shareholders' meeting.

37 Barbić, 2010, pp. 399–402.

38 The simple LLC cannot have a supervisory board.

39 E.g., for an LLC with more than 200 employees the supervisory board is mandatory under a special law; for an LLC with share capital above 600.000,00 HRK and with more than 50 shareholders; for an LLC who is a controlling company of other companies within a group of companies. Barbić, 2010, pp. 403–407.

cannot be a member (Art. 437 CA).<sup>40</sup> The shareholders' meeting elects members of the supervisory board. One-third of its members may be appointed by certain shareholders who are determined by the articles of association (Art. 437 CA).<sup>41</sup> The supervisory board members are elected and appointed for a maximum of four years, with the possibility of re-election and re-appointment. Elected members of the supervisory board may be dismissed at any time through a shareholder's decision.<sup>42</sup> Similarly, a member of the supervisory board may resign at any time through written form. An application for entry in the Court Register must be made for each change of person of any supervisory board members (Art. 439 CA).<sup>43</sup>

The powers of the supervisory board are determined by the articles of association. The duties of the supervisory board are as follows: (a) supervise directors; (b) represent the LLC in relation to directors; (c) compose a report on the supervision of directors and submit it to shareholders; (d) convene the shareholders' meeting; (e) give mandatory instructions to directors with regard to the LLC's management; and (f) provide consent for particular operations of directors regulated by the articles of association, or by a decision of the supervisory board in individual cases (Art. 439 CA).<sup>44</sup> Further, it provides consent for agreements concluded between directors and the LLC, for loans granted to directors from the LLC's assets and on the repeal of the prohibition of competition.<sup>45</sup> The CA provisions on the liability of directors apply to the liability of supervisory board members, respectively.<sup>46</sup>

### ■ 5.3. *The shareholder's meeting*

Shareholders may exercise their rights in the LLC through the shareholder's meeting or outside of it. Directors and the supervisory board members may participate in the work of the shareholders' meeting. The shareholder's meeting decides upon issues pursuant to the CA and the articles of association of the LLC. The CA differentiates between matters over which the shareholders' meeting has exclusive jurisdiction and those that can be transferred to other LLC bodies (Art. 441 CA).<sup>47</sup>

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40 A member of the supervisory board cannot be: a) the LLC's director, b) a member of the supervisory boards in ten other companies, c) a director in a company controlled by the LLC, d) a director of another company in whose supervisory board there is one of the LLC's directors and e) a person punished for certain criminal offences in the specified period or a person against whom a safety measure was pronounced, prohibiting them to engage in an activity which falls under the LLC's business activities.

41 A member of the supervisory board may be appointed by the commercial court in case of emergency (Art. 439 CA).

42 Appointed member may be dismissed by the shareholder who appointed them. All members of the supervisory board may be dismissed by a court decision if there are important grounds therefor.

43 Barbić, 2010, pp. 412–421.

44 Should the supervisory board refuse to give such consent, directors are authorized to request consent from the shareholders' meeting. The shareholders' meeting decides on consent by at least three-fourths of all votes.

45 If an LLC does not have a supervisory board, these consents are given by shareholders.

46 Barbić, 2010, pp. 407–411.

47 Barbić, 2010, pp. 437–445.

Matters falling under the scope of its exclusive jurisdiction are as follows: (a) the approval of the annual financial statements, the appropriation of earnings, and the approval of the work of directors and the supervisory board members within the previous financial year; (b) the repayment of additional contributions; (c) the election and dismissal of the supervisory board members; (d) the assertion of claims for compensation of damage to which the LLC is entitled in relation to directors and the supervisory board members and the appointment of a special attorney if the LLC cannot be represented by directors or by the supervisory board; (e) the approval of agreements by which the LLC acquires objects or rights for which the paid price exceeds the amount of one-fifth of the share capital, if concluded two years after the LLC's registration; (f) the amendments of the articles of association; (g) the increase or reduction of share capital; (h) approval of the LLC's reorganization measures and entrepreneurial agreements; and (i) the LLC's dissolution.

The shareholders' meeting need not be held if all shareholders agree in writing about a decision, or if they declare acceptance through submitting their votes in writing regarding a decision (Art. 440 CA).<sup>48</sup>

The shareholder's meeting can be convened by directors, the supervisory board, liquidators, minority shareholders and persons or LLC's internal bodies which are determined by the articles of association. They meet at least once a year<sup>49</sup> and whenever the company's interests so require. Furthermore, a meeting is convened without delay if it is evident that the LLC has lost one-half of its share capital (Art. 442 CA). Notice of the shareholder's meeting must be given no less than seven days prior to the day of the meeting,<sup>50</sup> in a way provided for under the articles of association.<sup>51</sup>

The decisions of a shareholder's meeting is valid if the meeting is attended by shareholders or their representatives whose shares represent at least one-tenth of the LLC's share capital. The quorum may be abolished or increased by the articles of association. If there is no quorum, and the articles of association do not provide otherwise, a new shareholders' meeting must be convened with an identical agenda. Nevertheless, irrespective of the quorum, valid decisions may be adopted at such a meeting (Art. 444 CA).<sup>52</sup>

The shareholder's meeting makes decisions with a majority of the votes cast, unless otherwise provided for by the CA or the LLC's articles of association.<sup>53</sup> Each 200,00 HRK of the nominal value of a share grants one vote,<sup>54</sup> unless otherwise provided

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48 There are a few exceptions to this rule. Barbić, 2010, pp. 427–431.

49 The annual shareholder's meeting must be held in the first eight months of the current financial year for the previous financial year.

50 Barbić, 2010, pp. 446–455.

51 The default rule is via registered mail to all shareholders (Art. 443 CA).

52 Barbić, 2010, pp. 455–458.

53 E.g., decisions on amendments to the articles of association, the increase or reduction of share capital, the approval of LLC's reorganization measures and entrepreneurial agreements, and on the LLC's dissolution, are made by a majority of at least three-fourths of all votes cast. These decisions must be in notarial form. Barbić, 2010, pp. 462–464.

54 In a simple LLC, each 1,00 HRK of share capital grants one vote.

for by the articles of association.<sup>55</sup> A shareholder may vote in person or by a representative with the power of attorney in written form. A shareholder who is to be discharged or exempt from an obligation by a decision, has neither a voting right in this connection, nor can he exercise that voting right for another (Art. 445 CA).<sup>56</sup>

The directors must, on request and without undue delay, provide each shareholder with information on the LLC's affairs and allow them to inspect the LLC's books and documents. They may refuse to provide information or permit inspection when there is a concern that the shareholder could use the latter for non-company purposes, thereby putting the LLC or an associated company at a significant disadvantage. Such a refusal requires a decision of shareholders, or directors in cases where the LLC has a supervisory board. Each shareholder who has been denied access to information can make a request to the commercial court to be granted this information or inspection of files within fifteen days from the shareholder's decision (Art. 447 CA).<sup>57</sup>

#### ■ 5.4. *Two-shareholder LLCs comprising of equal shares*

On 1 June 2017, the central Court Register counted 18393 registered LLCs as a two-shareholder LLC, which represents ca. 15% of LLCs in Croatia.<sup>58</sup> The most common practice is that these shareholders hold equal shares. In the case of a deadlock, where shareholders cannot reach an agreement and neither side prevails, shareholders are left with few options. Ideally, shareholders should provide for internal dispute resolution mechanisms to help them resolve their disagreements. However, to the best knowledge of the author, there is no such practice to date.

Shareholders in a deadlock and unable to reach an agreement, can request that the court withdraw the LLC (Art. 420/2 CA), for the expulsion of the other shareholder (Art. 420/3 CA) or dissolution of the LLC (Art. 468 CA).<sup>59</sup> In the first two cases, one of the shareholders exits the LLC, while in the last, the company ceases to exist. For withdrawal from the LLC, if not otherwise provided for in the articles of the association,<sup>60</sup> the shareholder must prove the existence of a justified reason. Pursuant to the CA, withdrawal is practicable when other shareholders or LLC bodies cause damage to the shareholder, if they prevent the shareholder from exercising its rights in the LLC, and if the LLC body imposes disproportionate commitments onto the shareholder.<sup>61</sup> For the expulsion of the shareholder, if not otherwise provided for in the articles of the association, the LLC or the shareholders must prove the existence of the important reasons,

55 E.g., limiting or expanding voting rights (regardless of the nominal value of shares), giving the right to veto to a shareholder for certain or all decisions, block of shares with voting rights.

56 Barbić, 2010, pp. 256–271.

57 Barbić, 2010, pp. 241–252.

58 For comparison, during the same duration there were 80644 one-member LLCs.

59 Čulinović-Herc, Marinac Rumora and Braut Filipović, 2018, p. 64.

60 In this case, the requirements, procedure and consequences of such withdrawal or exclusion of a shareholder from the LLC must also be determined.

61 By withdrawal of a shareholder, their membership in the LLC ceases, and he is entitled to reimbursement of the market value of their share as at the time of the withdrawal (Art. 421 CA). Barbić, 2010, pp. 156–171.

such as the behaviour of the shareholder undermining the achievement of the LLC's goal, and therefore, their membership becoming burdensome for the LLC.<sup>62</sup> However, there is only a handful of withdrawal and expulsion cases found in case law.<sup>63</sup>

For the dissolution of the LLC, the shareholders (holding at least 10% of share capital) must also prove the existence of an important reason before the court, where the inability to reach an agreement due to the deadlock in the shareholder's meeting is considered to be one of those reasons.<sup>64</sup> In the authors' opinion, shareholders should be continuously encouraged to use their autonomy while drafting the articles of association, in order to provide for viable solutions in the event of the shareholders' disagreement.

## 6. Minority right shareholders

The CA recognizes the minority shareholders as a group of shareholders in need of additional rights to boost their position towards majority shareholders. The threshold is often 10% of share capital, which provides them with the necessary standing to undertake various actions – both within the LLC and before court.

Shareholders whose combined shares make up at least one tenth of share capital<sup>65</sup> shall be entitled to request that a meeting be convened, stating the purpose and the grounds therefor. They shall also have the right to request amendments to the agenda, at least three days after the notification of the shareholders' meeting is published or received. If the request is not complied with, or there is no person to whom the request can be directed, the minority shareholders may themselves convene the meeting, or make the announcement by giving notification of the matter to be addressed (Arts. 442 and 443).<sup>66</sup>

Each shareholder may propose an audit of the LLC's annual financial statements. If shareholders refuse such a proposal, the commercial court may appoint one or more auditors, on request of shareholders whose shares together make up at least one tenth of share capital. The court shall grant such a request only if major violations of the CA or articles of association are likely to have been committed (Art. 450 CA).<sup>67</sup> Shareholders are also entitled to request a judicial appointment of the LLC's liquidators for important reasons (Art. 471 CA).

Shareholders with at least 10% of share capital can file a lawsuit for compensation of damages caused by the breach of duties of directors or supervisory board members, in cases where other shareholders or the management board refused to

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62 The court shall pronounce exclusion of the shareholder, on condition that the LLC pays them compensation for the market value of the share within the specified period.

63 Čulinović-Herc, Marinac Rumora and Braut Filipović, 2018, p. 68.

64 Barbić, 2010, p. 576.

65 This threshold may be lowered by the articles of association.

66 Barbić, 2010, pp. 449–450; Slakoper, 2009, pp. 421–424.

67 Barbić, 2010, pp. 465–468; Slakoper, 2009, pp. 424–431.

take such an action (Art. 453 CA). However, minority shareholders are responsible for damages caused by such proceedings if it is established that these proceedings were commenced *mala fide* or due to gross negligence.

In the situation where the director of the LLC is also its shareholder, other shareholders have an additional right: the right to request revocation of the director-shareholder before the court, if there exists an important reason for the revocation (Art. 424 (2) CA). A shortcoming of this solution is that after the revocation, the shareholders must appoint another director, while the minority shareholders again cannot prevail in terms of their choice. A small number of these disputes in case law is thus unsurprising.<sup>68</sup>

## 7. The single shareholder LLC

The single shareholder LLC is the most common form of LLC in Croatia. It can be established by the statement on its formation in notarial form (Art. 387 CA). Prior to the LLC's registration, the shareholder may pay capital contributions partially, in which case he must provide appropriate guarantees (unlike the regular LLC) for payment of the remaining capital contributions (Art. 394 CA). The single shareholder LLC may form another single shareholder LLC, without any additional requirements, in comparison to the other founder of the LLCs.<sup>69</sup>

If the LLC was formed by more shareholders with partial payment of capital contributions, and subsequently (within three years after the LLC's registration) becomes a company with a single shareholder, within three months following the consolidation, the shareholder must a) make full payment of capital contributions, b) provide guarantee to the LLC for the payment of the remaining capital contributions, or c) transfer part of the shares to a third party.<sup>70</sup> If he fails to do so within an additional period determined by the court, the court shall issue a decision on the LLC's dissolution (Art. 398 CA).

On the other hand, it is not necessary to convene the shareholder's meeting to adopt decisions within its jurisdiction. If all the LLC's shares are held by one shareholder, or in addition by the LLC, he must document the decision in written form, and sign the document without undue delay upon adoption of the decision (Art. 440 CA).

If the sole shareholder is simultaneously the sole director or one of the directors of the LLC, their legal transactions with the LLC may be performed only with the LLC's special approval.<sup>71</sup> These legal transactions shall be documented without undue delay following their performance, in the written form. These documents are not required

68 Čulinović-Herc and Braut Filipović, 2017, p. 417.

69 Barbić, 2010, pp. 56–61, Slakoper, 2009, pp. 590–592.

70 Slakoper, 2009, pp. 592–594.

71 The approval may be given by articles of association or by a decision of the supervisory board or the shareholder's meeting.

when it comes to transactions concluded under the usual conditions, being the LLC's ordinary course of business (Art. 426 CA).<sup>72</sup>

## 8. Piercing the corporate veil

Due to the LLC being a separate legal entity with its own assets, shareholders are not liable for the LLC's obligations. Their duty is to pay capital and additional contributions that exist until the LLC's dissolution. Nevertheless, the CA imposes personal liability of shareholders for LLC's obligations under certain conditions.<sup>73</sup>

If a shareholder abuses their limited liability in the LLC, they may not rely on exemption from personal liability for the LLC's obligations under the CA (Art. 10 (3) CA). Furthermore, the shareholder shall be liable for the LLC's obligations if they (Art. 10 (4) CA) a) abuse the LLC as a legal person to attain their personal interest, b) abuse the LLC as a legal person, thereby causing damage to the LLC's creditors, c) use the LLC's assets as their personal assets, contrary to the CA, and d) reduce the LLC's assets for their benefit or for that of another person, although he knew or should have known that the LLC would not be capable of performing its obligations to third parties. Usually, the burden of proof lies on the plaintiff, who must prove such abuse of the shareholder. Conversely, in cases described under Art. 10 (4) of the CA, the burden of proof lies with the shareholder who must prove non-existence of such an abuse.<sup>74</sup>

Piercing the corporate veil usually arises in cases when the company is undercapitalised,<sup>75</sup> in relations between parent companies and subsidiaries<sup>76</sup> and in mixing of the company's assets with personal assets of shareholders.<sup>77</sup> As to the number of these disputes in case law, there are more than 100 final judgements pertaining to piercing of the corporate veil in joint-stock companies and LLCs. Thus, this matter is moderately represented in court disputes.

## 9. Novelties and current challenges faced by LLCs in Croatia

In April 2019, a new amendment to the CA was introduced, bringing about several important novelties for Croatian LLCs. The most important component is the introduction of the simplified termination of the LLC, that is, dissolution of the LLC without liquidation, which is less costly and less time consuming for all LLC parties. The decision must be reached unanimously by all shareholders. The condition to be met

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72 Barbić, 2010, p. 364.

73 Barbić, 2008, pp. 296–298.

74 High Commercial Court of Croatia, 2003, Pž-1522/03.

75 E.g. High Commercial Court of Croatia, 2003, Pž-636/03.

76 E.g. High Commercial Court of Croatia, 2003, Pž-1760/02.

77 E.g. High Commercial Court of Croatia, 2004, Pž-6369/03.

is that the LLC does not have any obligations towards creditors and employees.<sup>78</sup> In order to protect creditors, CA provides that shareholders shall be jointly and severally liable with their personal assets for the remaining LLC's obligations if they appear within two years from date of publication of entry of the LLC's dissolution in the Court Register (Art. 472a-472f CA).<sup>79</sup> This system proved to be extremely popular in practice. Thus, since April 2019 there have been over 1000 LLC terminations under this simplified procedure.

Furthermore, the 2019 amendments introduced additional rules for shareholders who have not paid the full amount of cash contributions. Under Art. 390 (2) of CA, the remaining cash contributions must be paid in full within one year from registration of an LLC. Shareholders who have not paid the full amount of cash contributions shall be jointly and severally liable, with their personal assets, for all company obligations up to the amount of all unpaid cash contributions. They may evade this liability if they pay capital contributions in full before the entry of formation or capital increase of the LLC in the Court Register.<sup>80</sup> In the authors' opinion, this newly introduced personal liability is contrary to the principle of limited liability of shareholders for a company's obligations.

Since 2020, LLC and simple LLC may be registered online via websites of the Court Register, without a proxy and a notary in the process of formation (Art. 397 (a-e) CA). Online registration may be used only for forming LLCs where share capital is entirely paid in cash. LLC's shareholders and directors may access websites only in person with authentication certificates (eID or FinaCertRDC). The model protocol and application to register the company are available in the electronic form and are generated in the Court Register system.<sup>81</sup> It is yet to be seen how online registration will function, although there are serious concerns regarding its practice, primarily due to possible identity abuse and money laundering issues.

## 10. Conclusion

LLCs are the most popular company type in Croatian business practice. This is not surprising, as its formation and functioning is simpler and less costly in comparison to joint-stock companies. Furthermore, shareholders enjoy the limitations of their

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78 The decision must be in notarial form and published on the Court Register website. All shareholders must give the statement on non-existence of LLC's obligations and on acceptance of the personal liability for remaining LLC's obligations, if they appear after entry of the LLC's dissolution, in the Court Register. LLC's assets shall be distributed between shareholders, in accordance with the plan on distribution of LLC's assets. Such dissolution shall be approved by a decision issued by commercial court. Shareholders, creditors, and public bodies may challenge the court decision.

79 Jurić, 2020, pp. 534–536.

80 Jurić, 2020, p. 396.

81 Jurić, 2020, pp. 404–407.



liability towards the LLC's creditors, as well as freedom to regulate their internal relations. The simple LLC, with a minimum share capital of 10,00 HRK (ca. 1.32 EUR), additionally promotes its popularity. Since 2020, it is possible to register the LLC from home, utilizing the online registration on the Court Register website, which has been introduced as another measure to simplify LLC formation.

However, Croatian LLCs face similar challenges that those in comparative jurisdictions face. Two shareholders LLCs remain a conundrum if shareholders ever enter into a 'deadlock' at the shareholders' meeting. The problem of relations between minority and majority shareholders are barely tackled, by means such as possibility of withdrawal by the shareholders from the company or through expulsion of an unwanted member.

In the authors' opinion, shareholders should be enticed to use party autonomy when drafting the articles of association, which could most effectively enhance their position during disagreements with other shareholders. The Croatian legislature has demonstrated a willingness to shape LLCs in line with the needs of business practice. However, this proves to be a continuous challenge. Only time and practice will show which measures were successful, and which should be revised in further amendments to the CA.

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