Ivan Rubinić [*]
Dejan Bodul [**]

JEL Classification G33, G34, G38
Review article

REGULATION OF THE "TOO-BIG-TO-FAIL" ENTITIES IN THE REPUBLIC OF CROATIA[1]

The contemporary stand among scientists is that the role of the state, within mixed market economies, should be reduced to the task of ensuring the institutional framework in order to protect the free market. However, occurrences of the "too-big-to-fail" entities constitute a challenge for the government regarding its ability to manage economic affairs in the traditional manner. Given that the nature of these entities makes them relevant on the verge of their own collapse, the authors focused on the legal and economic aftermath of their failures.

The authors undertook extensive research into this topic with the primary goal of arguing that government regulation, in the cases of collapsing "too-big-to-fail" entities, is necessary for achieving stability of the system. After researching of the government's role both in theory and practice, the authors displayed the findings of the analysis of the legal possibilities within the bankruptcy law of the Republic of Croatia. The historical and practical context of the research is the implementation of the legislation in the complex case of Agrokor Group.

[*] I. Rubinić, MA, Faculty of Law, University of Rijeka (E-mail: irubinic1@pravri.hr).

[**] D. Bodul, Ph. D., Assistant Professor, Faculty of Law, University of Rijeka (E-mail: dbodul@pravri.hr).

The paper was received on July 11th, 2017. It was accepted for publication on February 23rd, 2018.

[1] This work has been supported by the Croatian Science Fundation under project „6558 Business and Personal Insolvency – the Ways to Overcome Excessive Indebtedness".

Ultimately, the authors argue that the magnitude of the collapsing "too-big-to-fail" company requires government intervention in order to preserve economic stability in the region, in addition to maximizing social welfare.

Key words: strategic companies and companies of special interest, systemically important companies, too-big-to-fail companies.

1. Introduction

The European Union (hereafter EU) member states are faced with a structural challenge with inconsistent policies regarding the collapsing "too-big-to-fail" legal entities (hereafter "TBTF"). The standpoint of the European Commission is as follows: "*Sometimes government authorities spend public money supporting local industries or individual companies. This gives them an unfair advantage over similar sectors in other EU countries ... It is the Commission's job to prevent this, allowing government support only if it is genuinely in the wider public interest"* (European Commission, 2017). The lack of a narrow definition in the Commission's stand enables wide interpretation of the intervention. Hence, the span of the governments' policies, on the EU level, embodies everything from neoliberalism to state intervention. It is primarily the result of a country's declining economic power and its continued commitments towards citizens. For example, by the end of 2002, the British government provided a loan to the British Energy Group. In 2003, the French government intervened to save the Alstom corp. In 2005, the Italian government prevented the foreign takeover of two local financial institutions (Antoveneta and BNL). In the same year, the French government interfered in PepsiCo's plan to own Danone and, with the support of the German government, Porsche intervened in the Volkswagen Group.

The inconsistent government regulations came into mainstream focus during the Recession 2007/2008, causing the opening of "Pandora's box" and division among economists worldwide. This recent and prevalent shift towards interventionism proves to be a consequence of the fundamental requisitioning of the liberal maxim: "minimal state-maximal market", which did not bypass The Republic of Croatia (hereafter RC).

Within the given context, the purpose of this paper is to investigate the role of the government's regulation of economic activities. This will be achieved by defending the argument that regulation, in the case of "TBTF", is necessary condition of stabilizing the economy and achieving the maximum level of a nation's welfare, given the circumstances.

Given that contradictory "TBTF" policies aren't isolated novelties, the object of the research is to investigate the newest "TBTF" policy within the EU.

The research is carried out in eight sections. Upon the introduction, the authors provided a concise literature review of the existing works within the domain of bankruptcy law in the RC. The third section presents the theoretical case of government intervention regarding "TBTF" companies. The fourth section displays the terminology and legal practice within the RC, with the focus on both entities of strategic and special interest, as well as entities of systemic interest. The fifth section analyses the obligation to initiate the bankruptcy proceedings, consequences of violations for the companies of strategic and special interest, and legal possibilities in the midst of opening bankruptcy proceedings. The sixth section focuses on the deviation from the standard bankruptcy legislation within the RC and the overview of comparative EU cases. In the subsequent section, the matter is analysed using the latest "TBTF" case – The Agrokor Group (hereafter AG). Finally, in the concluding section, the confirmation of the necessity of government intervention in the case of "TBTF" firms will question the need for rethinking the uniform economic policies on the EU level.

2. Literature Review

In the RC, there exists a considerable number of scientific works dealing with the extensive domain of insolvency legislature. The topic of bankruptcy, liquidation, and reorganization of bankruptcy proceedings is becoming a field that increasingly attracts the attention of economic and legal experts (Sajter, 2008. and 2010.; Schönfelder, 2002.). Within the domain of legal literature, the most relevant works come from Dika (1998.) and Eraković et. al. (1997.), who can be considered pioneers, from the legislative point of view.

Economists are putting emphasis on empirical research, where the costs and duration of bankruptcy proceedings, as well as the level of the creditors' settlements, are imperative (Sajter, 2007.). The object of research is often the re-evaluation of the efficiency of national bankruptcy proceedings, via various comparative analyses (Grdić et. al., 2009.).

The recent trend shows a growing number of studies dealing with both the mitigation of the weaknesses within existing bankruptcy regulation and the improvement of the bankruptcy proceedings from both theoretical[2] and practical[3]

[2] Dika (2012), Garašić (2007;2012), Vuković and Bodul (2012).
[3] Hrastinski Jurčec (2007) and Čuveljak and Kružić (2012).

viewpoints. The abovementioned resulted in the revision of the procedure measures, which enacted change in bankruptcy legislation[4].

It is worth noting that the existing investigations failed to address what is perhaps, the pivotal question regarding how the interactions between market participants affect the decision-making process concerning the transformation of the institutions. The authors' stand is that this question is of central importance within the national legislation and that is, to a big extent, unanswered within the existing body of literature.

Comprehensive economic and legal literature can be limiting and misleading regarding its inability to provide adequate remedies to crucial economic issues. This is especially relevant in the case of "TBTF" legal entities. Hence, this research represents an original and systematic analysis of the existing reasons for the implementation of the "Act on emergency receivership in systemically important companies for the RC."

3. Government Regulation and the "Too-big-to-fail" Legal Entities

The complexity of the government regulation phenomenon brings about the use of a holistic approach in its investigation, which is both indispensable and notoriously difficult.

For this reason, within the scope of this paper, the focus is placed on the economic domain of the public interest theories of regulation. According to Morgan and Yeung (2007), regulation is understood as state intervention into the economy by making and applying legal rules. The authors are defining public interest theories of regulation as a desire to pursue collective goals, with an aim of promoting the welfare of the community. Public interest theories of regulation can be considered a necessary exercise of collective power through government, in order to remedy market failures (Levine and Forrence, 1990.). This is where market failures are considered as the failure of an idealized system of price-market institutions which are supposed to support desirable activities or to stop undesirable ones (Bator, 1958.).

Market failures are defined as the number of ways in which markets may depart from the perfect competitive ideal (Green et al., 1995.), and are comprising of externalities, public goods, market power, and the asymmetry of information.

[4] Čuveljak (2015), and Galić et al. (2015).

If the effects of the multiple failures are reinforcing themselves to the advantage of one entity, then any such entity outgrows the domain of microeconomics and becomes a systemic issue that may endanger overall stability. In this case, such an entity can be described as "TBTF"[5].

The most adequate framework for defining the "TBTF" entity is established in a statement written by Bernanke as: *"A "TBTF" firm is one whose size, complexity, interconnectedness, and critical functions are such that, should the firm go unexpectedly into liquidation, the rest of the financial system and the economy would face severe and adverse consequences. Governments provide support to "TBTF" firms in a crisis, not out of favoritism or particular concern for the management, owners, or creditors of the firm, but because they recognize that the consequences, for the broader economy, for allowing a disorderly failure greatly outweigh the costs of avoiding the failure in some way. In the midst of the crisis, providing support to a "TBTF" firm usually represents the best of bad alternatives; without such support there could be substantial damage to the economy"* (Bernanke, 2010:20). Furthermore, Bernanke states that there are three severe issues that a legislator needs to consider when dealing with the "TBTF" entity. First, there is the issue of the moral hazard that can potentially arise as a consequence of the creditor's beliefs that an institution will not be allowed to fail. Second, the existence of the "TBTF" firm creates an uneven playing field between big and small firms, resulting in deviation from perfect competition and free market distortion. Third, "TBTF" firms can become major risks to overall financial stability.

Given all the above, it can be concluded that a "TBTF" firm can, to an extent, be studied as the ultimate market failure, and when such an entity is facing collapse, it becomes obvious that a social system cannot function without some degree of compulsion (Musgrave, 1941.).

Therefore, it is necessary that the government intervenes, with respect to the free market, by mitigating the negative effects, protecting the playing field and maximizing welfare.

4. Overview of Pre-bankruptcy and Bankruptcy proceedings in the RC

Acknowledging the perplexity of the analysed topic, the authors deem that it is necessary to explain the terminology used. This requires defining the fundaments of insolvency proceedings, as well as differentiating between legal entities of interest.

[5] The term "TBTF" was popularized by Sorkin (2009).

Insolvency proceedings are pre-bankruptcy and bankruptcy proceedings. Pre-bankruptcy proceedings can be initiated if the court determines an inability to execute existing duties. This is determined if the court discovers, with certainty, that the debtor cannot meet existing duties by the due date. Bankruptcy proceedings can be initiated if the court determines the existence of grounds for bankruptcy, i.e. insolvency and overindebtedness. The implementation and goals of the pre-bankruptcy and bankruptcy proceedings are governed by the RC's Bankruptcy Act (hereafter BA), published in the Official Gazette (hereafter OG) No. 71/2015, in September 2015. Pursuant to Article 4 of the BA, the pre-bankruptcy proceeding is considered as the right of, not the obligation of, the subject. The goal of pre-bankruptcy proceedings is to reorganize the subjects that are financially "healthy" and prosperous, but experience a severe obstacle manifesting in the untoward balance sheet (BA, Art. 3).

Bankruptcy is a non-contentious *sui generis* judicial proceeding in which the collective settlements of all creditors are collected from the property of the insolvent debtor. This is achieved via property liquidation or various methods of reorganization. During the bankruptcy proceedings the reorganization plan can be carried out (BA, chapter 8). Even though there exists a distinctive difference between liquidation and reorganization, both options come with the same two goals. The first is a settlement of all creditors and fulfilment of their property claims. The second is a termination of the subject that is not in a position to carry out their duties (BA, Art. 2).

The subject of pre-bankruptcy and bankruptcy proceedings can be a legal person, as well as the property of the individual debtor[6].

Keeping in mind that pre-bankruptcy and bankruptcy proceedings affect all legal entities, regardless of their size and economic relevance, the government of the RC had to implement regulations that function as a safety net in case the collapse of the legal entity endangers the country's stability.

In an attempt to do so, the government enacted legislation establishing a list of companies and other legal persons of strategic and special interest for the RC (OG, No. 120/2013, 74/2015, 44/2016). Subjects of strategic interest for the RC are those in which the RC participates as a shareholder and those in which the RC fulfils its economic and strategic goals. Strategic goals are defined as: legal

[6] Pre-bankruptcy proceedings cannot be executed on financial institutions, credit unions, investment companies and companies for managing investment funds, credit institutions, insurance and reinsurance companies, leasing companies, payment institutions and institutions for electronic money. In addition, pre-bankruptcy and bankruptcy proceedings cannot be carried out for the RC and funds financed from the RC's budget, units of local and regional self-government and special treatment is ensured in the case of a legal entity whose main activity is the production of weapons and military equipment.

and efficient fulfilment of transferred public authorities, security, health insurance, important infrastructure, undisturbed supply to the citizens and business subjects, and insurance of economic services involved in activities of common interest. Companies and other legal persons of special interest are subjects in which the RC holds a majority stake and which are in need of restructuring, recapitalization, privatization, and which carry high value added and profit. Companies and other legal persons of special interest to the RC are also subjects whose stocks are listed on regulated capital markets, in which the RC owns less than 50% of the shares and, led by the common interest, strives to achieve economic goals.

Regardless of their special status, entities of strategic and special interest are confronted with market liberalization and they have to adapt to the free market, with the purpose of avoiding provision of illegal state subsidies and avoiding the creation of unfair competition.

The second attempt in updating the safety net in case of a collapse of the "TBTF" entity came as the deviation from the pre-bankruptcy and bankruptcy regulation that emerged recently as the insolvency regulation titled: "Act on emergency receivership in systemically important companies for RC" (OG, No.32/2017). This Act defines that the systemic importance of an individual company arises from its size, connectedness with business partners, interconnectedness of its business, and its dominant market position within the RC.

Due to its specific nature, this Act will be the subject of inquiry in subsequent sections.

5. The Obligation to Initiate Bankruptcy Proceedings and Consequences of Violations for the Companies of Strategic and Special Interest

Grounds for bankruptcy, as the financial state of the debtor, initiate the opening of the bankruptcy proceedings. They represent the legally relevant fact that the debtor, over a long period of time, is not capable of handling their obligations.

Prior to the BA 1996. (OG, No. 44/1996), the practice involved the court's reluctance to initiate the opening of the bankruptcy procedure, due to all arising difficulties. This resulted in the prolongation of the bankruptcy procedure commencement and extended active market participation for the entities that could not remain efficient in the competitive surroundings.

Such a negative practice was corrected by enacting the "contemporary" BA (OG, No. 71/2015). This BA defined reliable criteria, through which the decision

to open bankruptcy proceedings is made. With the new BA, rules are updated regarding the authorization of the debtors and creditors to submit the petition to open bankruptcy proceedings. It is determined that the petition, in the name of the debtor, can be submitted by either: a person authorized to represent the debtor, the member of the board of directors in the case of a plc.[7], the debtor's liquidator, a member of the supervisory board, or a member of the LCC if the debtor does not have a supervisory board or authorized representatives (BA, Art. 109). Another innovation is the rule that the Financial Agency[8] (hereafter FINA) is obliged to file the petition to open bankruptcy proceedings if the register of the Agency shows that the legal person has a non-performed basis for payment in a period of 120 consecutive days. In such a scenario, FINA must file the petition within eight days, starting from expiry of the abovementioned period (BA, Art. 110). Moreover, the Companies Act (OG, 111/1993-110/2015) and the Criminal Code (OG, 111/1993-61/2015) determine the obligation of the opening of bankruptcy proceedings. Failure to respect these regulations can be prosecuted as a criminal offense.

When the grounds for bankruptcy are determined, in the case of entities of strategic and special interest for the RC, the responsible persons are obliged to file the petition for the opening of the bankruptcy proceedings. If they do not act accordingly, they are personally responsible for the potential damage caused to the creditors (BA, Art. 110). If an authorized person does not file the petition for the opening of the bankruptcy proceeding within the period prescribed by law, the Court will require advanced payment for the costs of the bankruptcy proceedings within eight days (BA, Art. 113).

5.1. Legal Possibilities During the Opening of Proceedings

The BA allows the initiation of pre-bankruptcy proceedings both before and outside of the bankruptcy proceeding, for the special category of legal entities, including companies of strategic and special interest for the RC. Once the bankruptcy proceeding has been opened, it is usually followed by the "classic" liquidation bankruptcy proceeding. This implies that the focus is cast on the liquidation of debtor's property and the distribution of proceeds to the creditors. Only occasionally and with the support of creditors will a bankruptcy trustee file for the reorganizational plan in individual bankruptcy proceedings.

---

[7] Croatian abbreviation d.d. and d.o.o. is substituted for English version plc. and LLC, respectively.

[8] FINA is leading Croatian company in the field of financial mediation and the application of information technologies. Additional information available on: http://www.fina.hr.

In the context of this paper, it is imperative to note that within typical legislation regarding the liquidation of the debtor's property, conflict with regulation that ensures free market competition and state subsidies does not exist. In this scenario, the bankruptcy trustee has several options for liquidating the property. The first is the sale of individual assets or rights held by the debtor. The second is the sale of the share(s) of the debtor's property, and the third is the sale of the debtor's property in its entirety. The decision regarding which option will be utilized by a bankruptcy trustee depends on the creditors' decisions.

After the reporting hearing[9], if it is not in contradiction to the decision made by the assembly of creditors, the bankruptcy trustee is obliged to liquidate the bankruptcy estate in accordance with the decision made by the assembly of creditors and the creditors committee (BA, Art. 229). Moreover, if creditors do not decide on the method and terms of the liquidation, the bankruptcy trustee will make the decision (BA, Art. 229).

In any case, the standard regulation that applies, even in the case of companies of strategic and special interest for the RC, is that the bankruptcy trustee is obliged to promptly (BA, Art. 11) initiate the actions regarding the liquidation of the bankruptcy estate.

6. The Importance of the Act on Emergency Receivership in Systemically Important Companies for the Republic of Croatia

In April 2017, the Act on emergency receivership in systemically important companies of the RC (OG, No.32/2017) became effective. When it comes to the RC, the term "systemically important" is a synonym of "TBTF". Hence, this Act represents a novelty in the RC legal system in terms of introduction of the institute of emergency receivership.

From the point of view of procedural law, the Act's procedural competence lies exclusively in the Commercial Court of Zagreb. The procedure is urgent and during the period of emergency receivership it is forbidden to initiate either the liquidation of the debtor's property, or pre-bankruptcy and bankruptcy procedures. Within the procedure, the provisions of the BA are applied after the provisions of the Act. The parties in this Act's proceedings are: the emergency commissioner, the advisory board, and the council of creditors.

[9] Under this term, the Authors assume what is, in RC terminology, known as the „Institut izvještajnog ročišta".

The process begins with a proposal for the opening of the procedure of emergency receivership. In this case, the entities authorized for opening the procedure are the debtors themselves or a creditor under the debtor's approval. In case of emergency receivership, regarding the legal consequences, the same rules apply as in the bankruptcy proceedings.

The emergency commissioner has the all rights and commitments of the bankruptcy trustee. During the period of emergency receivership the court can, on the commissioner's demand and with the obtained approval of the council of creditors, decide to end the procedure. In this case, the bankruptcy proceeding will be open if the given set of circumstances determines that there is no probability to restore the economic balance of the entity over an extended period, given the existence of grounds for bankruptcy. Secondly, upon receiving the information from the commissioner, the court can suspend the procedure if, within the deadline for filing the claims, not a single claim is submitted or the court does not approve the settlement between the debtor and the creditor. Hence, the procedure of emergency receivership ends with the legally binding decision of termination of the emergency receivership, by implementation of the settlement, or 15 months from the day the procedure was opened.

The procedure of emergency receivership can be initiated in the case of a plc. and all of its subsidiaries and affiliated companies, given the grounds for bankruptcy, and if the company is of systemic importance for the RC.

According to the Act on emergency receivership, it is defined that a plc. of systemic importance for the RC is a company that individually, or with its subsidiaries and affiliated companies, fulfils two conditions. First, in the calendar year preceding the year in which the petition to open the emergency receivership procedure was filed the legal person must have employed more than 5.000 workers. Second, the existing duties of the debtor must exceed 7.5 billion HRK[10] on the day of filing the petition to open the procedure[11].

Within the context of the Act on emergency receivership, subsidiaries and affiliated companies are entities with headquarters in the RC, founded in accordance with the legislation of the RC and in which the debtor holds at least 25% stake. The Act on emergency receivership cannot be implemented on credit institutions or financial institutions, as defined in the regulation of the European Parliament and of Council No. 575/2013.

---

[10] If the duties are denominated in foreign currency, their HRK counter value must exceed 7.5 billion.

[11] Additionally, the procedure of emergency receivership will be implemented for the companies that do not fulfill the abovementioned conditions, assuming they are considered to be subsidiaries or affiliated companies in accordance with the Companies Act (Art. 475).

Upon presenting the criteria required to be classified either as strategic or special interest companies, or as systemically important companies, the most relevant legal entities in the RC are presented in the following table.

Table 1:

RANKING OF LEGAL ENTITIES BY NUMBER OF EMPLOYEES IN THE RC IN 2015.

Name of the legal entity	No of employed	Strategic or special interest for the RC	Ownership structure	Does the entity satisfy basic criteria for systemic importance?
KONZUM d.d.	12.602	NO	P	YES
HP-HRVATSKA POŠTA d.d.	8.882	YES	S	YES
ZAGREBAČKI HOLDING d.o.o.	8.008	NO	S	NO
INA-INDUSTRIJA NAFTE d.d.	7.605	YES	S/P	YES
HRVATSKE ŠUME d.o.o.	7.602	YES	S	NO
HEP-OPERATOR SUSTAVA d.o.o.	7.485	YES	S	NO
HŽ INFRASTRUKTURA d.o.o.	5.046	YES	S	NO
ZAGREBAČKA BANKA d.d.	4.061	NO	P	NO
HRVATSKI TELEKOM d.d.	3.889	NO	S/P	NO
BOXMARK LEATHER d.o.o.	3.808	NO	P	NO

Source: Authors' calculations based on Lider (2016)

Note: P: private-owned; S: state-owned; S/P: mixed ownership.

The table provides the ranking of legal entities according to number of employees (measured as hours worked), and is published by magazine Lider (2016). One can conclude that only three companies are fulfilling the first condition for a systemically important company, while only one company is privately owned. It must be noted that the listed companies are presented individually and that some of them are subsidiaries or affiliated companies of larger groups. Therefore, this ranking serves as an approximate guideline suggesting the existence of a small number of companies that can claim the status of systemic importance. The arising question is how the entity can become of systemic importance if it is not considered strategic or special prior to that labelling. The justification of such a practice can be found only if the domain of strategic and special interest and the

domain of systemic importance are not mutually dependent, which is a controversial conclusion.

6.1. Comparative EU member countries legislation

Inability to execute "regular" bankruptcy proceedings, when it comes to "TBTF" entities, was not the invention of the Act on emergency receivership. When faced with an equivalent problem, as presented in the introduction, several EU member countries decided to alter their legislation. Due to this, two comparable pieces of legislation most relevant when it comes to dealing with the bankruptcy of the "TBTF" companies will be presented within this section.

During 1990, the Goodman Group, which was of strategic importance to the Republic of Ireland, was in state of imminent collapse. In order to secure overall stability, the Irish legislators enacted the Companies Act (1990) which introduced the institute of Examinership. Regardless of the substantial criticism attached to the Examinership process, the institute was updated in 1999, and still exists as an integral part of the Irish bankruptcy legislature. In short, the High Court of Ireland appoints the examiner to prepare the reorganization plan acknowledging (and not discriminating against) the rights of a company's creditors. The process can last up to 100 days and has a purpose of providing the company facing insolvency and over indebtedness a period of protection from creditors, during which the examiner needs to investigate the company's economic prospects and propose a potential scheme of arrangements that can yield the company's recovery.

Similar circumstances forced the Republic of Italy to enact their version of "TBTF" bankruptcy legislature. The collapse of the Parmalat S.p.A. in 2003 resulted in the enactment of the special insolvency procedure - Law Decree 347/2003 (known as "Marzano Law"), while the problems with the Alitalia S.p.A. lead to the amendment of the Law Decree in 2008. To apply for the "Marzano Law", the debtor company must employ at least 500 employees (during the one-year preceding its insolvency) and must have accrued debts of at least 300 million euros. In such a scenario, the Italian Court can direct the insolvent company through extraordinary administration proceedings, where an appointed extraordinary commissioner manages the restructuring plan aimed at the protection of the company and employees.

Contemplating the above, regardless if the subject is emergency receivership, examinership or extraordinary administration proceedings, it can be concluded that a "TBTF" company outgrows "standard" economic and legal domain and demands government intervention.

7. The Case of Agrokor Group

Since the foundation of the RC, the collapse of AG is the first case that can, due to its magnitude, importance and interconnectedness, be labelled as "TBTF."

AG is the largest privately owned company in the RC and one of the largest companies in South-eastern Europe. The Group consists of 28 companies (61 subsidiaries) operating across more than ten countries with more than 100 reputable brands.

Comprehensive research of such a colossal establishment usually entails dealing with the issues pertaining to overcoming the strict domain of economics. Some examples of this are the companies' connections with the legislators, preferential access to credit, preferential status regarding auditors' assessments and credit agency ratings, rent seeking activities, and other indicators of monopolistic power. Regardless of their relevance, the abovementioned topics will not, due to the limitation of the paper, be included in this brief synopsis. In addition, it is worthy to note that AG is the only firm that satisfies the criteria of systemic importance[12], and that it is the only privately owned company that was not, prior to becoming systemically important, listed as a company of strategic and special interest of the RC.

The purpose of the concise analysis presented in this paper is to show that the failure of the Group, alone, would cause severe disturbances in performance of the entire country, leading to contraction, or in the worst case scenario, resulting in crisis.

Furthermore, the reader must bear in mind that the spillover such a crash would initiate, in the form of domino effects and economic multipliers, would be catastrophic. The Group's creditors and suppliers would be first in line. Some of them would face severe liquidity and solvency problems, while others would file for bankruptcy. The entire economic system would soon be permeated with contraction, negative expectations, and lack of trust causing a downward spiral effect. It can be concluded that measuring the total significance of the company's existence for the RC would be an extremely ambitious pursuit.

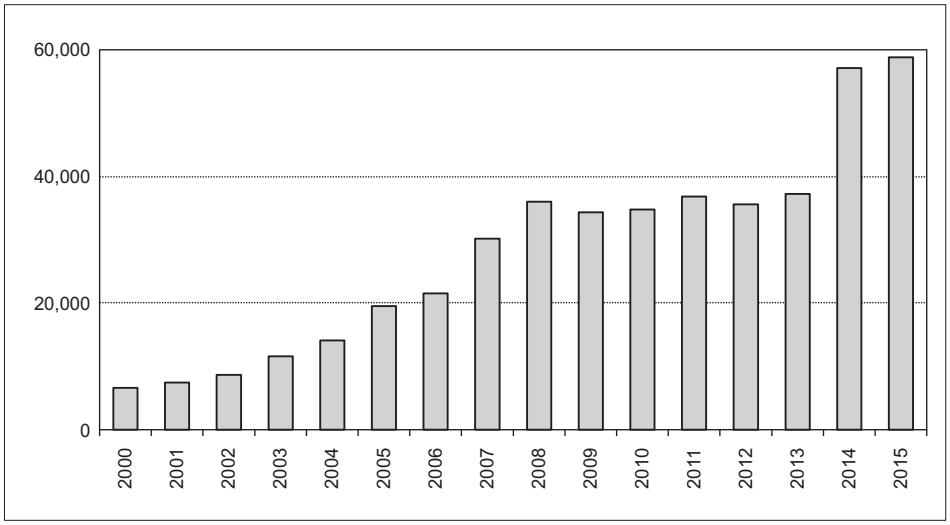
Keeping in mind the possibility of severe obstacles that can arise in a comprehensive analysis, the authors of the paper are not focusing on the outcome of the domino effect in its entirety. The authors are merely focusing on the case of the "TBTF"-AG, presenting the arguments that confirm the necessity of the government intervention.

[12] See Table 1 and note that KONZUM d.d. is a subsidiary of Agrokor Group.

The analysis is conducted using data retrieved from AG's annual, consolidated financial reports and AG's sustainability reports[13], and it commence with the display of the first indicator - the effect of AG collapse on the labour market.

Figure 1:

NUMBER OF EMPLOYEES IN AGROKOR GROUP (2000-2015)



Source: Authors' calculations based on AG sustainability reports.

On 31.12.2015, the Group employed 58.635 workers, among which 28.550[14] or 48% were employed in the RC. The comparison of the number of employed in 2015 and the total persons employed in the RC (CBS, 2015) shows that the Group accounts for 1.9% of total employment in the country. In the case of bankruptcy, this significant number would lead to massive layoffs, a decrease in purchasing power, and a decline in aggregate demand.

The second indicator is the share of the company within the gross domestic product of the RC. The assessment of AG share within the GDP of the RC was evaluated based on the information on the company's value added. Such a comparison is important, not solely as a performance indicator, but also as a measurement of the company's contribution to the GDP (Căruntu and Lăpăduşi, 2012).

[13] Big data limitation is HANFA's (2017) concerns in the validity of the consolidated report.
[14] Employed for a fixed or specific period of time.

The value added represents the key benchmark, since it is the value that the entity has added in a certain period (Morely, 1978; Mandal and Goswami, 2008), i.e. the wealth that the company was able to create (Sizner, 1994).

The value added of AG is computed from the company's annual, consolidated financial reports (2000-2015)[15] using Cox's (1979) additive method formula:

$$GVA = PBT + EC \quad (1)$$

where GVA is gross value added, PBT is profit before taxes, EC is employee cost, D is depreciation, and I is interest.

Table 2:

THE VALUE ADDED OF AG (2010-2015) EXPRESSED IN THOUSANDS OF HRK

	2010.	2011.	2012.	2013.	2014.	2015.
PBT	365.241	418.063	262.101	269.164	89.508	1.632.189
EC	2.868.960	3.032.274	2.954.787	2.746.065	3.345.493	4.768.209
D	779.487	866.243	922.355	988.234	1.168.342	1.620.709
I	1.292.331	1.437.250	1.854.955	2.040.664	2.502.361	2.769.039
GVA	5.306.019	5.753.830	5.994.198	6.044.127	7.105.704	10.790.146

Source: Authors' calculations based on AG annual financial reports.

The GVA of AG was calculated by taking into consideration profit before taxes, gross employee costs increased by gross cost of management, amortization of the long-term assets, and gross financial expenses. AG's value added experienced, remarkable average annual growth of more than 16%, resulting in the value added exceeding 10 billion HRK in 2015.

Since AG is an international company, when the GVA is known, the question that arises is how to determine the size of GVA that is created within the RC. For this purpose, the estimation of the GVA within the RC was conducted assuming

[15] Financial report follows the development of the economic and financial state of the AG, on day 11 July 2017 (when this paper was submitted for publication). The process of the company's restructuring, that occurred since, lead to revision of the financial reports which is not taken into account under the realm of this paper.

homogeneous labor, meaning that the portion of the created GVA is distributed equally among all the workers, regardless of the country of employment. In this case, the GVA produced in the RC is calculated by taking into consideration the share of AG's total employment in the RC.

Table 3:

THE ESTIMATED SHARE OF GROSS VALUE ADDED OF AG IN REPUBLIC OF CROATIA (2010-2015) EXPRESSED IN MILLIONS OF HRK

	2010.	**2011.**	**2012.**	**2013.**	**2014.**	**2015.**
% of total employment employed in RC	73.0	71.4	70.0	70.3	59.5[16]	48.7
GVA AG in RC	3.874	4.109	4.196	4.251	4.229	5.254
GDP RC	328.041	332.587	330.456	329.571	328.109	333.837
Share of AG I. GVA in GDP of RC	1.2%	1.2%	1.3%	1.3%	1.3%	1.6%

Source: Authors' calculations based on AG annual financial reports and sustainability reports.

The share of the GVA of AG in GDP of the RC is fairly large. The company's share, within total output of the country, exceeds 1.6%[17].

Presented findings coincide with Šonje (2017a) who concluded that the share of AG within the RC's GDP is between 1.8% and 2%. The abovementioned author (2017b) warned about the importance of another indicator that is of great concern when contemplating potential consequences of the company's collapse, the debt-to-equity ratio.

[16] Due to the lack of data, the share of employment in the RC in 2014 was calculated as the mean value of preceding and succeeding year.

[17] It is worth noting that the result is merely an approximation of the economic reality. For a precise calculation of this share, the available dataset from the consolidated report is insufficient.

Table 4:

THE USAGE OF FINANCIAL LEVERAGE IN AG (2010-2015) EXPRESSED IN THOUSANDS OF HRK

	2010.	2011.	2012.	2013.	2014.	2015.
Total segment assets	26.522.603	29.164.204	30.754.070	33.084.027	50.403.615	52.819.676
Total segment liabilities	20.412.500	22.549.170	25.627.383	28.558.866	43.211.178	45.300.578
Total equity	6.110.103	6.615.034	5.126.687	4.525.161	7.192.437	7.519.098
Debt-to-equity ratio (expressed in %)	334%	341%	500%	631%	601%	602%
Shareholder equity as a % of total assets	23%	23%	17%	14%	14%	14%

Source: Authors' calculations based on AG annual financial reports.

With shareholder equity making up only 14% of the total assets and with 6 units of debt per unit of equity, AG resembles more of a financial institution than a company involved in production and retail. With aggressive usage of debt for growth financing, the negative spillover of AG's collapse would be both long-lasting and extremely complex. It must be said that in 2016 and early 2017, the situation became even worse since the company simultaneously reported business losses and increase of debt, as well as a massive exposure to individual creditor[18].

Before ending this analysis, two major issues need to be mentioned. The first deals with the share of AG in the RC's revenues. This component consists of two major parts: taxes and social contributions. Based on the information from the consolidated financial reports, AG's contribution to the revenue of the RC cannot be calculated since the information is not provided on a national level. However, based on the other indicators, it is a straightforward conclusion to come to that this contribution is significant. The second issue is the company's exposure to the suppliers, enhanced by the use of the bill of exchanges and debentures. This indicator is relevant in the case of "TBTF" companies since it is a root cause of the domino effect, starting with the weakest link and endangering the stability of the country.

[18] Sberbank (1.1 billion EUR).

In the end, it can be concluded that the collapsing AG, with 1.9% of the total employment in the RC, 1.6% of the RC's GDP, a substantial contribution to the revenues, a huge debt-to-equity ratio and low stakeholders' equity, and vast exposure to suppliers, must be backed by the government in order to protect economic stability and avoid crisis.

7.1. Legal consequences of Agrokor Group's case

The European Parliament and the European Council issued the Regulation on insolvency proceedings No. 1346/2000 that contained the legal framework for the EU cross-border insolvency. The Regulation's goal was implementation and governance of the efficient cross-border insolvency proceedings. The crucial part of the Regulation on insolvency proceedings was the introduction of the principle of recognition of the insolvency proceedings and the consequences that this recognition may have for the EU member countries.

In 2006, the European Court of Justice published judgment on Eurofood IFSC Limited (Case C341/04) that was of prime interest when it comes to cross-border insolvency proceedings. Eurofood Ltd. was an insolvent Irish company and wholly owned subsidiary of the Italian company, Parmalat S.p.A.. When Eurofood Ltd. was faced with insolvency, the Irish court appointed a provisional liquidator to manage the affairs. Shortly after, an Italian judge opened the main proceedings in Italy. The two parallel proceedings occurred because the courts of Ireland and Italy, based on different criteria, had decided that the Eurofood's main centre of interest was located in their own country.

The European Court of Justice decided to treat the subject according to 22nd recital of the Regulation on insolvency proceedings: "decision of the first court to open proceedings should be recognised in the other Member States without those Member States having the power to scrutinise the court's decision"[19].

With the aim of mitigating the above-mentioned problem, the European Parliament and the European Council introduced the re-casted Regulation on insolvency proceedings (848/2015), which became effective 26.06.2017 and regulated groups of companies with over 20 articles. This is crucial in the case of AG for two reasons. First, the treatment of the groups of companies was not mentioned within the Act on emergency receivership, nor within its proposal. Second, given that AG has expanded outside the RC, initiating the emergency receivership brought about

[19] See Wesells, B. (2007).

the problem of legal recognition of the decision to open the procedure of emergency receivership within international legislation[20].

With regard to the recognition of the emergency receivership procedure, within the territory of the Republic of Bosnia and Herzegovina (hereafter FBiH), the doctrine states that the recognition of the RC's Act would violate national rules. This would happen since initiation of the procedure of emergency receivership in case of the AG would affect the companies within the FBiH that AG bought via acquisition, some of which are financially stable. Initiation of such a practice would be contrary to the existing bankruptcy rules in the FBiH. These were the legal grounds on which the Cantonal Court of Sarajevo refused to recognize the process of emergency receivership within the FBiH. In addition, the government of the FBiH enacted national regulation on the Procedure of Extraordinary Supervision in Business Organizations of Systemic Importance for the FBiH, with a tendency toward avoiding the negative legal implications of the collapsing "TBTF" companies within its borders.

In the case of the Republic of Serbia (hereafter RS), the implications of AG's emergency receivership were even more severe given that the Group is directly or indirectly participating within 17 companies within the RS. Soon after the enactment of the Act on emergency receivership, the Commercial Court in Belgrade responded by issuing a rejection of the recognition of the emergency receivership process within the RS[21].

Additionally, the government of the Republic of Slovenia has been actively involved in AG's issues due to the fact that the AG holds majority stake in the Slovenian Mercator Group. The Supreme Court of Ljubljana refused to recognize the process of emergency receivership and has implemented the so-called "Lex Mercator" that came as the result of the protectionism stance that the Republic of Slovenia took to protect its interests and economic stability.

Before ending this section on the vast number of legal consequences, it is worth noting that the High Court of Justice (2017) in London accepted AG's emergency receivership stating the following: "in my judgment the evidence adduced and submissions made on this application satisfy me that the criteria for recognising the extraordinary administration proceeding in Croatia as a foreign main proceeding within the CBIR have been met in the present case, and therefore I will grant recognition as sought in the application".

Given that some of the subsidiaries of AG represent "TBTF" firms in other countries; it comes as no surprise that other countries have to oppose the regula-

[20] See Garašić, J. (2017).

[21] Similar stand was taken by the Commercial Court of the Republic of Montenegro.

tion made to protect the interests of the RC. This is an additional argument supporting the thesis that the uniform EU policy regarding the collapsing "TBTF" entities is essential for maintaining the stability on a supranational level in the same way the government regulates on a national level.

8. Conclusion

Occurrences of the collapsing "TBTF" entities constitute a challenge for the governments' abilities to manage economic affairs in the typical manner. This challenge arises as a clash between the government's role in protecting the country's wellbeing and the *laissez faire* paradigm, with competition at its core. On one hand, if the government intervenes, the free market will experience a disturbance. On the other hand, by nature of the "TBTF" entity, the country's economic stability comes into question.

With that in mind, the central argument of this research is that the government does not have the privilege to wait for the positive aftermath of the creative destruction process when dealing with the collapsing "TBTF" entity.

This argument was analysed using the latest practical example that occurred in Croatia – The Agrokor case. The research included the analysis of government regulations, with a focus on insolvency proceedings. When the legal entity is facing insolvency, regulations require initiation of the pre-bankruptcy and bankruptcy proceedings, given the existence of the grounds for bankruptcy. Such a practice is governed by the BA with the purpose of protecting the creditor's rights. It is well defined and, from the theoretical point of view, it leaves no space for misinterpretation. However, all business subjects are not of equal significance and, therefore, contrary to the theory, the BA cannot be applied in a same way. Keeping that in mind, the first step toward division of the legal entities based on their economic importance was complete when the government of the RC published the list of entities with strategic and special interests. This was the first step towards acknowledging that certain entities are essential for the fundamental role of the government, which is preserving the macroeconomic stability and mitigating all potential threats. Regardless of their status, the companies of strategic and special importance for the RC did not have any privileged treatment in the event of their collapse, i.e. when the grounds for bankruptcy occurred, the companies were legally obliged to file for the proceedings.

This changed recently when the RC faced the greatest risk in the sphere of collapsing "TBTF" entities. The crash of AG brought to life a new dilemma: how can the government stay neutral when the failing company accounts for 1.9% of

total employment, 1.6% of the added value, a substantial share in the RC revenues, and massive exposure to other legal entities? How can a government design an economic policy when a failure of such magnitude consequentially causes a domino effect and endangers the economic wellbeing of the entire country? Even though such a situation was not a unfamiliar concept in other EU countries, the lack of uniform regulation on the level of the EU left the Croatian government to deal with it on a national level. Accordingly, the RC's government implemented the Act that recognized AG as the "TBTF" entity, i.e. as a company of systemic importance. The "Act on emergency receivership in systemically important companies" disallowed the regular initiation of the insolvency procedure, even though the grounds for bankruptcy were present. As shown, it introduced an innovation into the sphere of "TBTF" companies and confirmed that government intervention is necessary. In this case, the legislation's aim is to serve as the agent between the debtor and the creditors, with the simultaneous goal of protecting the economic stability, as well as the property of creditors, debtors, and the public goods.

However, due to the vast number of controversies existing on the theoretical and political agendas, the question of when and to what extent the government needs to act, is a decision that is made *ad hoc*, in a way that is discretionary and circumstantial.

This requires a deeper research into the uniform policy in the EU and harmonization of national policies accordingly, because the necessary government intervention should be implemented with minimal negative consequences for other market participants.

Finally, from the legislative and economic, as well as the theoretical and practical viewpoints, the complexity of the subject of this research results in an omission of many relevant topics within the realm of this paper. Therefore, the challenge for any future inquiries in "TBTF" domain (as well as AG) is to expand the investigation of the field with the purpose of securing common interests, working toward optimal economic performance, and managing the socioeconomic system in a sustainable way.

BIBLIOGRAPHY

Bankruptcy Act, Official gazette, No. 71/2015 and No. 104/2017.

Bator, M. F. (1958)."The Anatomy of Market Failure", Quaterly Journal of Economics, Vol. 72, No. 3, pp. 351-79.

Bernanke, B. (2010),"Statement before the Financial Crisis Inquiry Commission: Board of Governors of the Federal Reserve System", available at: www.federalreserve.gov (02.05.2017).

Căruntu, C., Lăpăduşi, M. L. (2012), "Methods used in determining the value added used in the assessment of the company's real economic power", Annals of the University of Petroşani, Economics, Vol. 12, No. 1, pp. 33-48.

CBS [Croatian Bureau of Statistics]. (2015), "Employment and Wages", available at: www.dsz.hr (01.05.2017).

Companies Act, Irish Statute Book, 33/1990; 30/1999.

Companies Act, Official gazette, 111/1993-110/2015.

Cox, B. (1979). Value Added – An Appreciation for the Accountants concerned with Industry. London: Institute of Cost and Management Accountants.

Criminal Code, Official gazette, 111/1993-61/2015.

Čuveljak, J. (2015), "O novom Stečajnom zakonu", Pravo i porezi, No. 7-8, Zagreb: RRiF.

Čuveljak, J., Kružić, D. (2012), "Stečajni plan - zadnja u nizu kriznih strategija za preživljavanje insolventnih korporacija", Collection of papers University of Mostar Faculty of Economics, pp. 19-40.

Dika, M. (1998). Insolvency Law. University of Zagreb: Faculty of Law.

Dika, M. (2012), "Predstečajna nagodba - Pretpostavke, pokretanje, tijela, sudionici, provedba postupaka, učinci, stavljanje izvan snage", in Zakon o financijskom poslovanju i predstečajnoj nagodbi, Zagreb: Narodne novine, p. 44.

Eraković, A., Momčinović, H., Šepić, N. (1997). *Stečajni zakon s komentarom i primjerima*. Zagreb: RRiF.

European Commission. (2017),"Government support for industry (state aid)", available at: ec.europa.eu (08.05.2017).

European Court of Justice (2006), "Judgement of the Court in case C-341/04", available at: https://curia.europa.eu/ (07.02.2018).

European Parliament and Council (2013),"Regulation (EU) No. 575/2013", Official Journal of the European Union, available at: eur-lex.europa.eu (25.05.2017).

European Parliament and Council (2015), "Regulation on insolvency proceedings No. 1346/2000 and No. 848/2015", Official Journal of the European Union, available at: eur-lex.europa.eu (07.02.2017).

Galić, A., Garašić, J., Hrastinski Jurčec, Lj., Marković, N., Periša, I., Radić, N. (2015). *Reforma hrvatskog insolvencijskog prava*. Zagreb: Inžinjerski biro d.d.

Garašić, J. (2007), "Final Distribution in Bankruptcy Proceedings", Collection of papers of the Faculty of Law University of Rijeka, Vol. 28, No. 1, pp. 1-32.

Garašić, J. (2012), "Bankruptcy plan after 2012 amendments to Bankruptcy Act", in Uzelac, A., Garašić, J., Maganić, A., Djelotvorna pravna zaštita u pravičnom postupku, University of Zagreb, Faculty of law, pp. 469-490.

Garašić, J. (2017), "Izvanredna uprava države nad povezanim društvima", Zbornik 55. Susreta pravnika, Hrvatski savez udruga pravnika u gospodarstvu, Zagreb, pp. 5-29.

Grdić, Z. Š., Radolović, J., Bagarić, L. (2009),"The Solvency of Companies in Croatia and in European Union", Economic Review, Vol. 60, No. 5-6, pp. 250-266.

Green, J. R., Mas-Colell, A., Whinston, M. (1995). *Microeconomic Theory*. New York: Oxford University Press.

HANFA. (2017), "30. Sjednica Upravnog vijeća Hanfe", available at: www.hanfa.hr (08.05.2017).

High Court of Justice (2017), "In the matter of Agrokor dd and in the matter of the cross-border insolvency regulations 2016", available at: https://high-court-justice.vlex.co.uk/ (07.02.2018).

Hrastinski Jurčec, Lj. (2007), "Pravni položaj stečajnog upravitelja u stečajnim postupcima", Zagreb: Inžinjerski biro d.d.

Law Decree, Gazzetta Ufficiale della Republica Italiana, 347/2003; 166/2008.

Levine, M. E., Forrence, J. L. (1990). "Regulatory Capture, Public Interest and the Public Agenda: Toward a Synthesis", Journal of Law, Economics & Organization, Vol. 6, Special issue, pp.167-197.

Lider. (2016), "1000 Najvećih hrvatskih tvrtki prema ukupnom prihodu u 2015.", available at: www.lider.media (30.04.2017).

Mandal, N., Goswami, S. (2008), "Value Added Statement (VAS) – A Critical Analysis", Great Lakes Herald, Vol.2, No.2, pp. 98-120.

Morely, M. F. (1978). *The Value Added Statement*. The Institute of Chartered Accountants of Scotland. London: Gee and co. Publishers Ltd.

Morgan, B., Yeung, K. (2007). *An Introduction to Law and Regulation: Text and Materials*. New York: Cambridge University press.

Musgrave, R. A. (1939), "The Voluntary Exchange Theory of Public Economy", Quarterly Journal of Economics, Vol. 53, No. 2, pp. 213 – 237.

Odluka o izmjeni i dopuni odluke o utvrđivanju popisa trgovačkih društava i drugih pravnih osoba od strateškog i posebnog interesa za Republiku Hrvatsku, Official Gazette No. 44/2016.

Sajter, D. (2007),"Regional indications of corporate bankruptcies in the Republic of Croatia", Econviews, Vol. 19, No. 1-2, pp. 31-42.

Sajter, D. (2008). *Economic Aspects of Bankruptcy and Restructuring in Bankruptcy*, Osijek: University of J. J. Strossmayer.

Sajter, D. (2010), "Procedure and Practice of Bankruptcy Restructuring in the Republic of Croatia", Collection of papers of Faculty of Law University of Split, Vol. 47, No. 3, pp. 729-744.

Schönfelder, B. (2002), "An Economic Analysis of the Bankruptcy Law: a Survey of the Literature", Financial Theory and Practice, Vol. 26, No. 3, pp. 675-690.

Sizner, J. (1994). An Insight into Management Accounting. London: Pitman Publishing Ltd.

Šonje, V. (2017a), "Agrokor prvi dio: veličina i ekonomski učinak", available at: www.arhivanalitika.hr (29.04.2017).

Šonje, V. (2017b), "Agrokor drugi dio: Kontekst za Lex", available at: www.arhivanalitika.hr (29.04.2017).

Sorkin, A. R. (2009). *Too Big to Fail: The Inside Story of How Wall Street and Washington Fought to Save Financial System and themselves*. New York: Viking Press.

The Agrokor Group. (2009-2015),"Sustainability report", available at: www.agrokor.hr (01.05.2017).

The Agrokor Group. (2010-2015), "Annual Financial Report", available at: www.agrokor.hr (01.05.2017).

Vuković, A., Bodul, D. (2012), "Bankruptcy Law in Transition-A Comparative Review, Croatian Challenges and Potential Solutions", Collection of papers of the Faculty of Law University of Split, Vol. 49, No. 3, pp. 633-661.

Wesells, B. (2007),"The Changing Landscape of Cross-border Insolvency Law in Europe" Iuridica International, Vol. 12, pp. 116-124.

Zakon o postupku izvanredne uprave u trgovačkim društvima od sistemskog značaja za Republiku Hrvatsku, Official Gazette No.32/2017.

REGULACIJA „TOO-BIG-TOO-FAIL" KOMPANIJA U REPUBLICI HRVATSKOJ

Sažetak

U teorijskim analizama prevladava stajalište kako ulogu države unutar mješovitog gospodarstva treba svesti na osiguranje institucionalnog okvira za nesmetano egzistiranje slobodnog tržišta. Međutim, globalna zbivanja u domeni „too-big-to-fail" subjekata predstavljaju ogroman izazov za vlade glede sposobnosti efikasnog upravljanja ekonomskim aktivnostima i očuvanja sustava slobodne konkurencije. Posljedično, koncepti poput trgovačka društva od strateškog, posebnog ili sistemskog značaja počinju preuzimati sve važniju ulogu u vođenju ekonomskih politika diljem svijeta. Uvažavajući činjenicu da priroda „too-big-too-fail" kompanija čini te kompanije relevantnima nadomak propasti, fokus se u radu stavlja na pravne i ekonomske posljedice poslovnog kolapsa. Autori analizi pristupaju iz perspektive stečajnog prava posebno naglašavajući pravne okvire unutar kojih zakonodavac mora pronaći optimalno rješenje kao bi uklonio ili umanjio tržišne neuspjehe. Nakon predstavljanja uloge države u teorijskom i praktičnom smislu, autori pristupaju analiziranju pravnih mogućnosti posrnulih „too-big-to-fail" kompanija unutar zakonodavnog okvira Republike Hrvatske. Puna kompleksnost proučavane materije analizirala se na primjeru Agrokor Grupe gdje se potvrdila teza rada da u slučaju kolapsa „too-big-too-fail" kompanije državni intervencionizam predstavlja nužnost. U konačnici, zaključuje se da ekonomski značaj „too-big-to-fail" kompanije kojoj prijeti propast, nedvojbeno, zahtijeva državnu intervenciju s ciljem očuvanja ekonomske stabilnosti i maksimiziranja društvenog blagostanja.

Ključne riječi: stečaj, kompanije od strateškog i posebnog značaja, kompanije od sistemskog značaja, too-big-to-fail kompanije.