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ONE TIER AND TWO TIER BOARD SYSTEMS IN HUNGARY AND CROATIA WITH SPECIAL EMPHASIS ON THE PROBLEM OF CORPORATE GOVERNANCE IN CROATIA'S NATIONAL OIL COMPANY INA

I. INTRODUCTION AND GENERAL OVERVIEW OF THE ONE-TIER AND TWO-TIER BOARD MODELS

A comparative analysis[2] of corporate conduct leads us to the conclusion that two different board models[3] can be distinguished in corporate governance practice, namely a unitary and dualist regime, better known as one-tier and two-tier board models.

Within the one-tier model, the functions of decision making and supervising are not delegated to separate corporate bodies, but exercised by a unitary board. The one-tier board consists of executive directors and non-executive independent directors,[4] hence latters have the function to oversee the operation of the board. This corporate governance practice is applied by anglo-saxon corporations particularly in the United States and in the United Kingdom, although as a result of convergence of company laws many other states allow investors to apply a one-tier model, even those which strictly denied the solution in the past.

The two-tier board model has mainly German origins,[5] thus wide spread in continental Europe. While German company law can be considered as an influential one, many central European countries – including Hungary – originally transplanted it's provisions and followed the models of corporate governance set up by German laws, especially the provisions of the German stock corporations act, the Aktiengesetz. The two-tier model defines a governance system in which two main company organs play key role in corporate conduct. The board of directors is responsible for the strategic managemnet of the company as an executive body. Besides, a supervisory board oversees the actions of the board of directors in interest of the corporate ownership (shareholders). The theory of corporate law defines the supervisory

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[2] See HOPT, Klaus J. – LEYENS, Patrick C., *Board Models in Europe - Recent Developments of Internal Corporate Governance Structures in Germany, the United Kingdom, France, and Italy*, European Company and Financial Law Review. 2004. Vol. 1. p. 143-148.

[3] See PAPP, Tekla, *Corporate Governance – Társaságirányítási rendszerek*, 185-197. in ACTA CONVENTUS DE IURE CIVILI TOMUS X. (Szerk PAPP, Tekla, LECTUM KIADÓ, Szeged, 2009) p. 194.

[4] See CLARKE, Donald C., *Three Concepts of the Independent Director*, Delaware Journal of Corporate Law (2007) Vol. 32. p. 73-111.

[5] See HOPT, Klaus J., *The German Two-Tier Board: Experience, Theories, Reforms* , in: COMPARATIVE CORPORATE GOVERNANCE: THE STATE OF THE ART AND EMERGING RESEARCH (Szerk: HOPT, Klaus J. and others, Oxford, 1998) p. 227-228.

board as an internal oversight body distinguishing it's role from the aspects of external supervisory duties excercised by the auditors.

In consideratin of the original purpose of our article, namely to demonstrate and solve an extraordinary interesting stituation occured in the governance practice of Croatia's National Oil Corporation (INA) we would first like to introduce the theoretical background of the above mentioned conduct practices with special regards to the legal background and some other interesting theoratical approaches. Following these guidelines the legal background of different board systems will be introduced. Second we would like to refer two interesting issues, already been raised many times by academic and business society. First one relates to the question which structure of the corporate governance can be considered better? Business effectiveness and ethics could be highly improved with the application of a model which is unquestionably better than the other one. However, such analysis can only results in merely theoretical conclusions, as business practices alway depend on the real content of governance. Second, it is in question whether two structures are converging and getting closer to each other, or on the contrary showing signs of divergence.

1. Ownership Structures and Board Models

a) One-tier Board Structure and Plural Shareholder Structure in the Anglo-saxon States

While in Central Europe majority shareholders dominate markets and corporations, in the United Kingdom and moreover in the United States a plural shareholder structure can be considered as typical. The large blockholdings are not as usual as in Europe within the ownership structure of corporations, which partially derives from the attitude of citizens, showing much more intention to invest their savings in securities and they are more involved in taking risks of capital market investments. Therefore, the market capitalization of corporations is higher, but ownership control is not as influential. In this plural structure the board enjoys a particularly important role in corporate governance. Comparing with Europe, a higher level of board authority is experienced in the United States but on the other hand shareholders have a higher level of financial rather than strategic interests. All of these attributes result in a compromise between shareholders and managers setting up a collective purpose accepted by both parties: the maximization of shareprice. In case sharholders are satisfied by gaining profit through their corporate stockholdings they place their confidence in company executives and are disposed to vote on lucrative remuneration packages. Anglo-saxon traditions of business law provisions do not separate the functions of decision-making and supervising by setting up two different company organs for these purposes. Instead a unitary board excercises both functions where as above mentioned executive and none-executive directors take place.

As an aspect of legal regulation in the United States we would like to emphasize the importance of the provisions on boards and directors set up by the Delaware Code, while Delaware corporate law has a powerful influence in the United States.[6] Also the provisions of

[6] See HALÁSZ, Vendel, *Comparative analysis of stock purchase from the viewpoint of trade law*, in STUDIA IUVENUM IURISPERITORUM (Edited by DRINÓCZI, Tímea, Pécs, 2008) p. 41.

the Model Business Corporation Act had been adopted in many member states and are also addressing the concerning issues on board models. Section 141 (a) of the Delaware Code provides: „The business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a board of directors,…"[7] Section 8.01 (a) of the Model Business Corporation Act also sets up the requirement of a board, stating: „each corporation must have a board of directors", while Section 8.01 (b) sets up the standard of a unitary system providing: „All corporate powers shall be exercised by or under the authority of the board of directors of the corporation, and the business and affairs of the corporation shall be managed by or under the direction, and subject to the oversight, of its board of directors,..." [8]
Both the Delaware Code and Model Business Corporation Act are setting up rules on the number of directors and standards of qualification and both describe a system of oversight and responsibilities including the establishment of board committees and the removal of directors.
In coherence with the above mentioned regulations there are two primary fiduciary duties of directors principally set up by courts, namely the duty of loyalty and the duty of care.[9]
Crisis oriented reforms had also shown influential on board operation and the role of directors. During the econimic crisis of the 1930s, the Securities and Exchange Act of 1934 created an authority, the Securities and Exchange Commission to oversee the markets, the regulators and the issuers. Besides, the markets themselves including the New York Stock Exchange (NYSE) and the National Association of Securities Dealers (NASDAQ) also exercise an influential self-regulative competence. The Enron and Worldcom Scandals of 2002 shocked both the markets and the investors, thus the consequnces reulted int he passage of the Sarbanes-Oxley Act of 2002. The act provided significant governance ammendments int the United States with special regards to the role of audit committees and independent board members.[10] Proceeding to the 2007-2008 financial crisis, the Dodd-Frank Wall Street Refirm and Consumer Protection Act came in to effect in july 21, 2010. The act restructured the financial regulatory environment of the United States and excercised a massive influence on governance issues in the banking sector. As an aspect of executive remuneration, there had been numerous questions and ideas raised regarding overcompensation scandals during the events of the financial crisis. The passage of the Emergency Economic Stabilization Act and especially the Troubled Asset Relief Program (TARP) in 2008 brought special criteria on director's bonuses for those corporations that had been helped out by the State.
In the United Kingdom there are numerous laws setting adequte provisions on corporate actions. The Companies Act of 2006 is a comprehensive regulation that applies UK companies,[11] however particular regulations on board operations are not included in the act. The laconic provisions on boards wthin the Companies Act only set up minimal requirements.

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[7] See Delaware Code Section 141 (a)
[8] See Model Busieness Corporation Act Section 8.01 (a)-(b)
[9] See GARRETT, Allison Dabbs, *A Comparison of United Kingdom and United States Approaches to Board Structure*, The Corporate Governance Law Review (2007) Vol. 3. p. 101.
[10] See GARRETT, Allison Dabbs, *A Comparison of United Kingdom and United States Approaches to Board Structure*, The Corporate Governance Law Review (2007) Vol. 3. p. 100-108.
[11] See GARRETT, Allison Dabbs, *A Comparison of United Kingdom and United States Approaches to Board Structure*, The Corporate Governance Law Review (2007) Vol. 3. p. 97.

As Section 154 (2) provides: „A public company must have at least two directors." As a result, detailed provisions on board structures take place in self-regulatory codes (like the UK Corporate Governance Code, the former Combined Code on Corpoerate Governance). Jonathan Charkham[12] has remarked, before the advent of the self-regulatory codes, even the largest British company „could legally be run by two directors, like the Consulate of the Roman Republic."

The self-regulatory Combined Code on Corporate Governance, – latterly the UK Corporate Governance Code – was based on former reports on corporate governance. As Allison Dabbs Garett[13] refers, Cadbury Report in 1992 was the first comprehensive review of corporate governance practices ever conducted. Later it was followed by other major reports: the Greenbury Report, the Hampel Report, the Turnbull Report, the Higgs Report and the Smith Report.[14]

The UK Corporate Governance Code (former Combined Code) includes many aspects of the above mentioned reports. The Code applies to UK listed companies and it is based on the concept of a self-regulatory „comply or explain" model. When listing ont he stock exchange the issuer shall accept the recommendations as best best practice and shall explain it's differing practice in case of non-compliance. The Combined Code on Corporate Governance had given a role model for many European countries during the process of issuing corporate governance codes on best practices. Accordingly, the UK Corporate Governance Code provides: „The Code is not a rigid set of rules. It consists of principles (main and supporting) and provisions. The Listing Rules require companies to apply the Main Principles and report to shareholders on how they have done so. The principles are the core of the Code and the way in which they are applied should be the central question for a board as it determines how it is to operate according to the Code."[15]

Concerning the role of directors and the one-tier boars model the UK Corporate Governance Code as a „soft-law" fills out the gaps left by the legal regulation especially the Companies Act of 2006. The Code provides, that „Every company should be headed by an effective board which is collectively responsible for the long-term success of the company."[16] Besides the Code obviously sets the requirement of the operation of a unitary board with the active participation of non-executive[17] directors: „Every company should be headed by an effective board which is collectively responsible for the long-term success of the company.[18]… As part

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[12] See CHARKHAM, Jonathan, *Keeping Good Company* (Oxford University Press, 1995) p. 262. With regards to our original context Charkham was quoted by Paul L. Davies, see DAVIES, Paul L., *Board Structure in the UK and Germany: Convergence or Continuing Divergence?* p. 8. Available: SSRN: http://ssrn.com/abstract=262959 or DOI: 10.2139/ssrn.262959. Originally released: International and Comparative Corporate Law Journal (2001) Vol. 2. p. 435-456.

[13] Professor, Jones School of Law, Faulkner University.

[14] See GARRETT, Allison Dabbs, *A Comparison of United Kingdom and United States Approaches to Board Structure*, The Corporate Governance Law Review (2007) Vol. 3. p. 96-97.

[15] See UK Corporate Governance Code – Comply or Explain (Chapter)

[16] See UK Corporate Governance Code – The Main Principals of the Code – Section A: Leadership

[17] See SALE, Hillary A., *Independent Directors as Securities Monitors*, Business Lawyer (2005-2006) Vol. 61. p. 1379.

[18] See UK Corporate Governance Code – Section A.1.

of their role as members of a unitary board, non-executive directors should constructively challenge and help develop proposals on strategy."[19]

Providing recommendations on the operation of the unitary boards, the Code emphasizes the importance of regular board meetings, board committees and appropriate insurance in respect of legal actions against the directors. The Code's provisions strictly emphasize the importance of separation of functions regarding the CEO's and the chairman's position describing just the opposite practice followed by US corporations, where the CEO usualy also holds the position of the chairman. The Code's provisions recommend the board to be sufficient sized, but it should not be so large as to be unwieldy. Additionally, at least half of the board should consist of non-executive directors.

As a conclusion, anglo-saxon states support a unitary board model which had improved much in the past ten years through the experiences arising from the great corporate scandals. The aspects of anti-fraud measures brought independent directors and board committes in the spotlight, however in the United States an increased level of responsibility and internal control were set by the post-Enron legislation. The one-tier model has the advantage, that non-executive directors are active members of the baords contrary to the members of the two-tier model's supervisory board members. Thus they are able to gain sufficient indformation regarding corporate affairs and can directly raise questions ont he board's meetings. As an improved level of best practice it is optimal for the non-executive directors to hold their own apart sessions with the absence of executive directors where the independents can discuss confidential agendas. Board committees should also operate with an increased involvement of non-executive directors. The issues of accounting affairs and remuneration policy became crucial in light of crisis oriented experiences, so the role of audit- and remuneration board committees also improved much in the last few years.

b) Two-tier Board Structure and Concentrated Shareholder Structure in Continental Europe and Hungary

Contrary to the anglo-saxon states the corporations of continental europe are characterized by a concentrated ownership structure[20] regarding a major blockholder frequently excercising controlling influence or a group of individuals or institutional investors holding strategic blocks of shares.[21] A concentrated ownership structure enables majority owners to effectively oversee management actions,[22] moreover they have decisive role in the appointnmennt of the company executives. This type of corporate structure is generally governed by a board of

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[19] See UK Corporate Governance Code – The Main Principals of the Code – Section A: Leadership

[20] See HALÁSZ, Vendel, *Comparative analysis of stock purchase from the viewpoint of trade law*, in STUDIA IUVENUM IURISPERITORUM (Edited by DRINÓCZI, Tímea, Pécs, 2008) p. 53.

[21] See BAUMS, Theodor – SCOTT, Kenneth E., *Taking Shareholder Protection Seriously? Corporate Governance in the United States and Germany*, American Journal of Comparative Law (2005) Vol. 53. p. 40.

[22] See COOLS, Sofie, *The Real Difference in Corporate Law Between The United States and Continental Europe: Distribution of Powers*, Delaware Journal of Corporate Law (2005) Vol. 30. p. 765.

directors responsible for strategic decision making and supervised by a board of supervisors[23] with participation of either shareholder and employee delegates.[24]

Nevertheless, this regime of corporate governance usually delegates less power to the board of directors comparing to the above described anglo-saxon structure. The original German approach often contemplate corporations as articulations of various interest, instead of directly chategorizing them as concentration of capital. We should take the fact into consideration, that the spheres of corporate inetrests became more complex by this time, so we can view the tarditional German approach as a kind of early stakeholder theory.[25] The German Aktiengesetz provides mandatory obligation for corporations to operate in frame of a two-tier board structure, therefore the structure of corporate governance should incorporate in the above mentioned two corporate bodies.

After the political changes of late 1980's, Hungarian legal regulation followed the framework of German company law, so in the early 1990s the transplantation of a mandatory applicable two-tier governance system was obvious. Meanwhile anglo-saxon investors became more and more involved in the Central European countries including Hungary, the original concept has been modified. The 2006 review of Hungarin company law suggested that shareholders should have the option between one-tier and two-tier models.

The Hungarian Act IV of 2006 on Business Associations provides: "Where the articles of association of a public limited company so provides, it shall be controlled by the board of directors under the one-tier system instead of the management board and the supervisory board. In this case, the board of directors shall discharge the duties of the management board and the supervisory board conferred upon them by law."[26]

However, this specific provision is only enabling departure from general provisions in Article 33 (1) a): "Establishment of a supervisory board shall be mandatory: a) for public limited companies, except for any public or private limited company that is controlled by the one-tier system;..." By Article 243 (1), the administrative duties of corporations are handled by the management body, consisting of minimum three and maximum eleven members, all natural persons.[27]

Regarding the supervisory board, Article 34 (1) provides that it shall consist of minimum three and maximum fifteen members. Article 34 (2) states, that the supervisory board shall act as an independent body. Unless otherwise prescribed by law or the memorandum of association, the supervisory board shall elect a chairman and, if necessary, a deputy chairman from among its members. The supervisory board shall have a quorum if two-thirds of its

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[23] See MÜLBERT, Peter O., *Die Stellung der Aufsichtsratmitglieder*, in CORPORATE GOVERNANCE (Szerk. FEDDERSEN, Dieter – HOMMELHOFF, Peter – SCHNEIDER, Uwe H., Otto Schmidt-Verlag, Köln, 1996) p. 99, 122-123.

[24] See JUNGMANN, Carsten, The *Effectiveness of Corporate Governance in One-Tier and Two-Tier Board Systems*, European Company and Financial Law Review (2006) Vol. 3. p. 426-474. Also see HOPT, Klaus J., *Board Models in Europe – Recent Developments of Internal Corporate Governance Structures in Germany, France, and Italy*, European Company and Financial Law Review (2004) Vol. 1. p. 135-168.

[25] See FREEMAN, R. Edward, *Strategic Management – A Stakeholder Approach* (PITMAN, Boston – London – Melbourne – Toronto, 1984) p. 31.

[26] See Hungarian Act IV of 2006 on Business Associations – Article 308.

[27] See Hungarian Act IV of 2006 on Business Associations – Articles 33-34.

members, but at least three members, are present. The supervisory board shall pass resolutions with a simple majority.

Hungarian company law is not unique in sense of enabling option between the two models, moreover EU regulation of Societas Europeae follows the same concept. Council Regulation (EC) No 2157/2001 of 8 October 2001 on the Statute for a European company (SE) also suggests both one-tier and two-tier model for investors. Article 39 and 40, provides that "The management organ shall be responsible for managing the SE" and „The supervisory organ shall supervise the work of the management organ. It may not itself exercise the power to manage the SE." Meanwhile Article 43 states, that an „…administrative organ shall manage the SE…", as a one-tier board.

The comparison of the two structures points out, that two-tier structures suffer potential risks deriving from their reactive roles while supervising strategic decisions. Supervisory boards – at least theoretically – only have the chance to oversee board actions but it cannot effect the decision making process itself. Many states – including Germany – prefer the two-tier board model, but at the same time recognized the occurrence of the described problem. German company laws were amended by the Gesetz zur Kontrolle und Transparenz im Unternehmensbereich (KonTraG) of 1998 and the Transparenz- und Publizitätsgesetz (TransPuG) of 2002. Since then – as Carsten Jungmann[28] emphasizes –, it has become an additional task of the management board to inform the supervisory board on intended business policy and corporate planning.[29]

However, the two boards are characterized by a demonstrable difference in connecton with the flow of informations. While non-executive board members of one-tier-models have the opportunity to directly gain informations during the board meetings, the members of the supervisory boards are only are only permited to recieve their informations from the managment board. Hence, those informations can be filtered, while non-executve directors can form base their judgement on original informations.

On the other hand, there is an additional issue significantly effecting the operation of two-tier boards in practice – namely the problems arrising from co-determination. One-tier board systems deny the concept of employee representation in the board, however two-tier structures prefer employee participation in the supervisory bodies. In German companies with 2.000 or more employees, 50% of the supervisory board shall consist of employee delegates. In Hungary co-determination rules are not as stict a sin Germany, but in accordance with the original concept of the dualist corporate governance system. Article 38 (1) of the Hungarian Act IV of 2006 on Business Associations provides: "If the annual average of the number of full-time employees employed by the business association exceeds two hundred, the employees shall have the right to partake in the supervision of the company, unless there is an agreement between the works council and the management of the business association to the contrary. In this case the representatives of the employees shall comprise one-third of the

[28] Dr. iur., LL.M. (Yale), M.Sc. in Finance (Leicester) Wissenschaftlicher Assistent, Buccerius Law School in Hamburg.

[29] See JUNGMANN, Carsten, The *Effectiveness of Corporate Governance in One-Tier and Two-Tier Board Systems*, European Company and Financial Law Review (2006) Vol. 3. p. 452.

members of the supervisory board." However, these are lex minusquamperfecta provisions and are often not followed in practice.[30]

Material issues of best practice are always decisive, while they are filling out formal frames. As a result, they are always more important than processual methods of governance. Therefore, we can conclude that none of the two board models can automatically be considered better than the other. However, in corporate practice a higher level of business integrity and higher standards of improved governance practices can indeed earn winner's title to certain boards, no matter if they are functioning as unitary or dualist structures.

2. Is there Convergence or Divergence between the two systems?

Finally, the question can be raised, whether the dualist and unitary systems of corporate governance are converging or diverging with eachother. This analysis was originally the idea of professor Paul Davies,[31] who in his articel „Board Structure in the UK and Germany: Convergence or Continuing Divergence?" layed down the conclusion that tendencies are still – or continuosly – working out divergence. The idea of convergence was based on the experience, that a certain „rise of the monitoring board„[32] could be experienced int he anglo-saxon system of corporate governance in the 1970s.

Notwithstanding these concepts professor Davies concluded, that divergnece of the two systems can still be pointed, stating that on the formal level convergence may have emerged, but on the level of functions further divergence can be experienced. According to this concept we may share the idea, that a feasible trend of convergence can only occure if the structure of shareholdings changed in Germany. Additionally, in the UK stakeholders have historically been protected outside company law rather than through it, so the debate of the 1970s had silenced.[33]

II. Corporate Governance in Croatian Legal and Economical Environment

DIFFERENT MODELS OF CORPORATE GOVERNANCE HAD DEVELOPED WITHIN SPECIFIC HISTORICAL, ECONOMICAL, CULTURAL AND LEGAL CONDITIONS. GIVEN THE FACT THAT CROATIAN COMPANY LAW WAS LARGELY MODELED ON GERMAN LEGISLATION AND COMPANY LAW TRADITION[34]*, IN THE TIME COMPANIES ACT WAS INTRODUCED (HEREINAFTER REFERRED TO*

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[30] See Hungarian Act IV of 2006 on Business Associations – Article 38 (1).

[31] Cassel Professor of Commercial Law at the London School of Economics and Political Science.

[32] See DAVIES, Paul L., *Board Structure in the UK and Germany: Convergence or Continuing Divergence?* p. 2. Available: SSRN: http://ssrn.com/abstract=262959 or DOI: 10.2139/ssrn.262959. Originally released: International and Comparative Corporate Law Journal (2001) Vol. 2. p. 435-456.

[33] See DAVIES, Paul L., *Board Structure in the UK and Germany: Convergence or Continuing Divergence?* p. 24. Available: SSRN: http://ssrn.com/abstract=262959 or DOI: 10.2139/ssrn.262959. Originally released: International and Comparative Corporate Law Journal (2001) Vol. 2. p. 435-456.

[34] It was the intention of the legislator to make the Croatian law easily identifiable to foreign investors by adopting the German Company law model. Taking into account the fact that German law was already amended by the European Union regulations and directives on companies, it is apparent that solutions that have been

AS: CA)[35] *THERE WAS NO POSSIBILITY TO SELECT BETWEEN DIFFERENT BOARD MANAGEMENT STRUCTURES AND OPT FOR ONE-TIER SYSTEM OF CORPORATE GOVERNANCE, BUT BOTH THE MANAGEMENT AND SUPERVISORY BOARD HAD TO BE ESTABLISHED BEFORE FILLING AN APPLICATION FOR THE ENTRY OF THE COMPANY IN THE REGISTER OF COMPANIES.*

CA WAS AMENDED SEVERAL TIMES, PRIMARILY BECAUSE OF CROATIA'S LEGAL OBLIGATION TO APPROXIMATE EXISTING LEGISLATION TO THAT OF EUROPEAN UNION. AMONG OTHER THINGS, IN 2007 ACT ON AMENDMENTS TO THE COMPANIES ACT INTRODUCED NEW SUBSECTION 2A IN THE PART WHICH REGULATES MANAGEMENT BOARD STRUCTURES. ACCORDING TO ARTICLE 272A OF THE ACT ON AMENDMENT, IN THE BASIC DEED OF PUBLIC LIMITED COMPANY – THE ARTICLES OF ASSOCIATION - IT MAY BE DETERMINED THAT THE COMPANY HAS A MANAGEMENT BOARD IN PLACE INSTEAD OF A MANAGEMENT AND SUPERVISORY BOARD. FOLLOWING THE FACT THAT COUNCIL REGULATION (EC) NO 2157/2001 OF 8 OCTOBER 2001 ON THE STATUTE FOR A EUROPEAN COMPANY (SE) GRANTED OPPORTUNITY TO CHOOSE BETWEEN a supervisory organ and a management organ (two-tier system) or an administrative organ (one-tier system),[36] depending on the form adopted in the articles of association, as well the fact that some European countries offer such *OPT FOR DOMESTIC COMPANIES, CROATIAN LEGISLATOR HAD ACCEPTED AN ARGUMENT THAT GRANTING AN OPPORTUNITY TO CHOOSE BETWEEN ONE-TIER AND DUAL TIER SYSTEM STRUCTURE MAY BE AN INTERESTING OPTION FOR THE OWNERS OF CROATIAN COMPANIES, DEPENDING ON THEIR TEMPORAL INTEREST AND ANALYSIS.*

FEW STUDIES SUGGEST THAT SO FAR ONLY SMALL NUMBER OF PUBLIC LIMITED LIABILITY COMPANIES IN CROATIA CHOSE TO AMEND THEIR STATUTES AND TURN TO THE ONE-TIER SYSTEM OF CORPORATE GOVERNANCE.[37] *IT SEEMS THAT NO MATTER WHAT ARE THE THEORETICAL ADVANTAGES OF EACH SYSTEM, REASONS FOR STICKING WITH DUAL TIER SYSTEM IN CROATIA MAINLY LIE IN LEGAL HERITAGE AND TRADITION, WHILE CHANGE TO ONE-TIER SYSTEM WILL CONTINUE TO TAKE PLACE RARELY AND SPORADICALLY, MOSTLY BECAUSE OF THE OWNERS PREFERENCE AND THEIR LINKAGE WITH ONE TIER SYSTEM ABROAD.* [38]

USUALLY, BOARD'S STRUCTURE IS CHARACTERIZED BY THE EXISTENCE OF BOTH EXECUTIVES AND NON-EXECUTIVE DIRECTORS WHILE THE TWO-TIER SYSTEM CONSISTS OF A SUPERVISORY BOARD AND AN EXECUTIVE BOARD OF MANAGEMENT WHERE THERE IS A CLEAR SEPARATION BETWEEN THE FUNCTIONS OF SUPERVISION AND MANAGEMENT. IN GENERAL, THE MANAGEMENT BOARD IN ONE-TIER SYSTEM AND THE SUPERVISORY BOARD IN THE TWO-TIER SYSTEM ARE ELECTED BY SHAREHOLDERS AND TYPICALLY, BOTH THE MANAGEMENT BOARD AND THE SUPERVISORY BOARD IN THE TWO-TIER SYSTEM APPOINT THE COMPANY DIRECTORS – MEMBERS

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adopted in Croatian CA fully met the European and international standards, many years before Croatia has started accession talks with EU.

[35] Companies Act 1993 (Zakon o trgovačkim društvima) OG 111/93, 34/99, 121/99, 52/00, 118/03, 107/07, 137/09. The act regulates different types of business forms (sole traders, general and limited partnerships, economic interest grouping, public and private limited liability companies). The Companies Act was last amended in 2009 to reflect recent developments in German and European company law.

[36] See Art. 38 of Council Regulation (EC) No 2157/2001 of 8 October 2001 on the Statute for a European company (SE) OJ L 294 , 10/11/2001 P. 0001 – 0021.

[37] About case of Arenaturist d.d. see, for instance, Maurović, Lj. *et. al.* „The One-Tier System on Corporate Governance – Croatian Practice" (Monistički ustroj tijela dioničkog društva), paper available on the website: http://hrcak.srce.hr/38201.

[38] Cf. ibid., str. 1.

OF THE MANAGERIAL BODY. ACCORDING TO THE CA THE MANAGEMENT BOARD APPOINTS ONE OR MORE EXECUTIVE DIRECTORS FOR A MANDATE, THE DURATION OF WHICH IS DETERMINED IN THE LINE WITH THE ARTICLES OF ASSOCIATION, BUT FOR NO LONGER THAN SIX YEARS. IF MORE THAN ONE EXECUTIVE DIRECTOR IS APPOINTED, ONE MUST BE APPOINTED THE CHIEF EXECUTIVE DIRECTOR.[39]

IF THE COMPANY HAS A MANAGEMENT BOARD IN PLACE INSTEAD OF A MANAGEMENT AND SUPERVISORY BOARD, EXECUTIVE DIRECTORS MAY BE APPOINTED FROM AMONG THE MEMBERS OF THE MANAGEMENT BOARD, BUT ONLY SUCH THAT THE MAJORITY OF MEMBERS OF THE MANAGEMENT BOARD ARE NOT EXECUTIVE DIRECTORS.[40] *ALSO, IF MORE THAN ONE EXECUTIVE DIRECTOR IS APPOINTED, THEY ARE AUTHORIZED TO MANAGE THE COMPANY BUSINESS EXCLUSIVELY JOINTLY ALTHOUGH THE ARTICLES OF ASSOCIATION OR THE RULES OF PROCEDURE ON THE WORK OF EXECUTIVE DIRECTORS AS PASSED BY THE MANAGEMENT BOARD MAY DETERMINE A DIFFERENT MANNER OF MANAGING COMPANY'S BUSINESS. IT IS IMPORTANT TO CALL AN ATTENTION TO THE RULE THAT THE AUTHORITIES GRANTED BY LAW TO THE MANAGEMENT BOARD MAY NOT BE TRANSFERRED TO THE EXECUTIVE DIRECTORS. FOR AN EXAMPLE, WHEN THE MANAGEMENT BOARD REPRESENTS THE COMPANY BEFORE ONE OF THE EXECUTIVE DIRECTORS, THAN NONE OF THE EXECUTIVE DIRECTORS MAY PARTICIPATE IN THAT REPRESENTATION.*[41] *NAMES OF THE EXECUTIVE DIRECTORS HAVE TO BE ACCESSIBLE IN THE COURT REGISTER SO DIRECTORS ARE OBLIGED TO SUBMIT AN APPLICATION FOR ENTRY INTO THE COURT REGISTER AND TO SUBMIT THE APPROPRIATE SUPPORTING DOCUMENTS TO THE REGISTRY COURT IN THE SAME MANNER AS PRESCRIBED FOR MEMBERS OF THE COMPANY MANAGEMENT BOARD.*

ALTHOUGH, IN EXPRESS TERMS art. 272a of the CA Amendments 2007 suggests that no combination of one-tier and dual-tier corporate governance is possible; at the moment in Croatia we are witnessing one rather strange case. *NAMELY, IN OIL COMPANY INA D.D.* at the moment one strange board system is in place, system which shows phenomena of both corporate governance structures – one tier and dual tier system. *THAT APPEARANCE HAS BEEN TO SOME EXTENT COVERED BY THE MEDIA, BUT ON THE OTHER HAND, UP TO NOW, NO LEGAL ANALYSIS OF THE CURRENT SITUATION HAD BEEN CARRIED OUT TO THE PUBLIC. EVEN THOUGH IT IS HARD TO BRING OUT COMPLETE STUDY OF THE CASE WITHOUT INFORMATION FROM INSIDE, SOME CONCLUSIONS MAY BE DERIVED FROM AVAILABLE COLLECTION OF FACTS AND STATEMENTS.*

1. In short about privatization of INA oil company and its present model of corporate governance

IN THE TIME OF THE WRITING, INA-INDUSTRIJA NAFTE D.D. (INA D.D.) IS A JOINT STOCK COMPANY WITH THE HUNGARIAN OIL COMPANY MOL RT HOLDING 47.26 PERCENT OF SHARES,

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[39] See art. 272l of the CA.
[40] Ibid.
[41] See art. 272l para 2 in conjuction with art. 272d para 1 of the Amendments. Ordinary, the company is represented by the executive directors.

THE REPUBLIC OF CROATIA HOLDING 44.84% PERCENT OF THE SHARES, WHILE THE INSTITUTIONAL AND PRIVATE SHAREHOLDERS HOLD 7.9 PERCENT. INA D.D. SHARES HAVE BEEN LISTED ON THE LONDON AND ZAGREB STOCK EXCHANGES SINCE 1 DECEMBER 2006.[42]

AS A STRATEGIC COMPANY FOR THE REPUBLIC OF CROATIA A SPECIAL LEGAL FRAMEWORK FOR INA AND OTHER STRATEGIC COMPANIES WAS FORMED IN 1990S. CONSEQUENTLY, IN 1996 THE ACT ON PRIVATIZATION WAS PASSED WHICH DETERMINED THAT STRATEGIC COMPANIES WOULD BE PRIVATIZED ACCORDING TO A SPECIAL LAW. CONSISTENTLY THE ACT ON PRIVATIZATION OF INA WAS PASSED IN 2002.[43] *BASED ON THE ABOVE MENTIONED ACT THE SALE OF 25 % PLUS ONE SHARE TO A STRATEGIC INVESTOR, TRANSFER OF 7 PERCENT OF SHARES TO CROATIAN HOMELAND WAR VETERANS, SALE OF 7% PERCENT OF SHARES TO EMPLOYEES AT PREFERENTIAL TERMS, AND THE SALE OF AT LEAST 15 % OF SHARES TO OTHER CROATIAN CITIZENS, DOMESTIC LEGAL ENTITIES AND FOREIGN INVESTORS WAS DETERMINED.*[44] *IT IS WORTH TO NOTE THAT SAME ACT ON PRIVATIZATION OF INA ALSO REGULATED THE KEEPING IN STATE OWNERSHIP OF 25 % PLUS ONE SHARE WHICH WOULD BE PRIVATIZED ON THE BASIS OF SPECIAL LAW AFTER CROATIA JOINS EU.*

IN 2003, HUNGARIAN MOL OFFERED 505 $ FOR 25% PLUS ONE SHARE OF THE INA AND MOL WAS ELECTED AS A STRATEGIC PARTNER AT AN INTERNATIONAL TENDER. AFTER MOL HAD ENTERED THE OWNERSHIP STRUCTURE, A SHAREHOLDERS AGREEMENT BETWEEN THE CROATIAN GOVERNMENT AND MOL – HUNGARIAN OIL AND GAS PLC. WAS SIGNED ON JULY 17, 2003.[45] *THE SHAREHOLDERS AGREEMENT WAS CONCLUDED FOR INDEFINITE PERIOD OF TIME, UNTIL BOTH PARTIES CONTINUE TO HOLD AT LEAST 25% + 1 SHARE OWNERSHIP OF INA.*[46]

LATER, IN 2005, 7% OF SHARES WERE TRANSFERRED TO THE CROATIAN VETERANS' FUND AND POLITICAL DECISION HAS BEEN MADE TO CONTINUE PRIVATIZATION OF INA THROUGH AN INITIAL PUBLIC OFFERING (SO CALLED IPO). [47] *BY USING THE IPO MODEL A TOTAL OF 17% OF SHARES WAS SOLD TO CROATIAN CITIZENS AND INSTITUTIONAL INVESTORS. IN ORDER TO AVOID SITUATIONS OF UNLICENSED BUYING AND SELLING OF SHARES BY THE CERTAIN GROUPS OF WEALTHIER CITIZENS ON BEHALF OF OTHERS CITIZEN'S RIGHT TO PARTICIPATE IPO, MAXIMUM AMOUNT FOR THE SUBSCRIPTION OF BLOCK SHARES WAS LIMITED TO 38,000 KUNA PER CITIZEN (APPROX. 5200 €).* Citizens' interest for the shares was fairly large and at the end price was set at 1,690 kuna per share plus one bonus share for each 10 shares subscribed if within one

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[42] Info from INA's website: http://www.ina.hr/default.aspx?id=246., last consulted December 16 2011. INA d.d. was established on 1 January 1964, when Naftaplin (oil and gas exploration and production company) merged with the oil refineries in Rijeka and Sisak. Today, INA is a medium-sized European oil company with a leading role in oil business in Croatia and a significant role in the region in the areas of oil and gas exploration and production, oil processing, and oil and oil products distribution. Its head office is located in Zagreb. As at 31 December 2010 there were 14,703 persons employed at the Group and 9,061 persons employed at the INA, d.d respectively.

[43] See Act on Privatization (OG 21/96) and Act on Privatization of INA (OG 32/2002).

[44] Same in Gentelman's Agreement, political and economic monthly review, Vol. 1(2) , p. 9.

[45] It has been alleged that *WITH THIS CONTRACT MOL GAINED GREATER CONTROLLING RIGHTS WHICH WERE DISPROPORTIONAL TO ITS OWNERSHIP SHARE. ISSUE OF THE COMPANY'S MANAGEMENT WAS REGULATED IN THE PART 7 OF THE AGREEMENT (UGOVOR O MEĐUSOBNIM ODNOSIMA DIONIČARA KOJI SE ODNOSE NA INA-INDUSTRIJA NAFTE D.D.) WHICH REGULATED NUMBER OF MEMBERS OF AFOREMENTIONED BOARDS AS WELL RIGHTS TO DIRECTLY APPOINT MEMBERS OF MANAGEMENT AND SUPERVISORY BOARDS.*

[46] See Art 13. p. 1 and 2 of the Shareholders Agreement (Duration and Termination of Agreement).

[47] Gentelman's Agreement, loc. cit.

year the shares were not sold.[48] In 2008 MOL announced a voluntary offer to take over all the remaining shares which were not owned by the Croatian Government. Since Act on the Takeover of Joint Stock Companies sets the legal minimum - price in the takeover bid that cannot be lower than the highest price at which the offerer and the persons acting in concert with him have acquired the voting shares in the period of one year before the obligation was created,[49] MOL's offered 2,800 kuna to the Croatian public. Although MOL's offer had its strong political connotation in the time it was announced which was followed with initial public resistance to sell their shares to MOL, as well with involvement of institutional investors in the market of INA's shares, after completing the bidding for the takeover MOL has increased its position to earlier mentioned level of 47.26% of shares, thus becoming the largest single shareholder.[50]

AS A LOGICAL CONSEQUENCE OF THE CHANGE IN OWNERSHIP STRUCTURE, CROATIAN GOVERNMENT AND MOL HAVE AGREED TO AMEND THE 2003 SHAREHOLDERS' AGREEMENT TO BETTER REFLECT THE NEW OWNERSHIP STRUCTURE IN THE CORPORATE GOVERNANCE OF THE COMPANY. THEREFORE, THE MAJOR CHANGES ACCORDING TO THE 2009 AMENDMENT TO THE SHAREHOLDERS' AGREEMENT[51] *WERE RELATED TO THE QUESTION OF THE COMPANY MANAGEMENT.*

UNDER THE NEW PROVISIONS ON COMPANY MANAGEMENT MOL TOOK OVER THE DOMINANCE IN THE MANAGEMENT AND THE SUPERVISORY BOARD ALTHOUGH IT WAS NOT A MAJORITY SHAREHOLDER. AT PRESENT, THE SUPERVISORY BOARD OF INA CONSISTS OF NINE MEMBERS (INSTEAD OF SEVEN MEMBERS ACCORDING TO THE 2003 AGREEMENT) WITH FIVE APPOINTED BY THE MOL, THREE BY CROATIAN GOVERNMENT WHILST EMPLOYEES ARE ENTITLED TO NOMINATE ONE BOARD MEMBER IN ACCORDANCE WITH APPLICABLE LAWS.[52] *MANAGEMENT BOARD STRUCTURE HAS ALSO BEEN MODIFIED SO MANAGEMENT BOARD OF INA NOW CONSISTS OF 6 MEMBERS, THREE MEMBERS APPOINTED BY THE CROATIAN GOVERNMENT AND THREE BY THE STRATEGIC PARTNER.*[53] *WHILE THE RIGHT TO APPOINT PRESIDENT OF THE SUPERVISORY BOARD LIES WITHIN THE POWER OF CROATIAN GOVERNMENT, THE STRATEGIC INVESTOR – MOL IS ENTITLED TO NOMINATE THE PRESIDENT OF THE MANAGEMENT BOARD. IT HAS BEEN ALSO AGREED THAT IN THE CASE OF EQUAL NUMBER OF VOTES, THE VOTE OF THE PRESIDENT OF THE*

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[48] Ibid.

[49] See art. 16 para 2 of the Act on the Takeover of Joint Stock Companies (OG 109/2007, 36/2009).

[50] Gentelman's Agreement, op.cit., p. 10-11.

[51] Amendment to the Shareholders' Agreement was signed on 30 January 2009 between MOL Plc. and the Governement of the Republic of Croatia together with Gas Master Agreement, a frame contract for the separation and sale of gas storage and trading activities of INA together with agreements on long-term gas supply to the Croatian market. This contract which was made confidential has been made public after the strong public and media pressure on November 10, 2009. It is also worth noticing that the pressure arised after the former prime minister of Croatia dr. Ivo Sanader was suspected of selling the controlling rights to the MOL for 10 million $ after meeting a MOL CEO in one restaurant in Zagreb. It is expected that this affair will be brought to a trial, which is expected to start in early 2012. It will be interesting to see further development of the situation in this case and possible indictment as well to envisage consequnces of possible convinction, especially in terms of termination of the Amendments of the Shareholders' Agreement if it stands in relation to the bribe that is being allegedly payed to the former prime minister.

[52] See amended art. 7 of the Amendment of the Shareholders' Agreement (*HEREINAFTER REFERRED TO AS: AMENDMENT).*

[53] See art. 7.2. of the Amendment.

MANAGEMENT BOARD IS DECISIVE.[54] *STRANGE ENOUGH, AMENDMENT CONTAINS A NEW SET OF RULES TITLED EXECUTIVE DIRECTORS AND EXECUTIVE COMMITTEE.*[55] *UNDER SUCH RULES EXECUTIVE DIRECTORS INCLUDING THE CHIEF EXECUTIVE DIRECTOR ARE APPOINTED BY THE MANAGEMENT BOARD AND THEY ARE RESPONSIBLE FOR THE DAILY OPERATION OF EACH BUSINESS UNIT AND FUNCTION (CORPORATE SERVICES, REFINING AND MARKETING, FINANCE, RETAIL ETC.). IT IS ALSO SPECIFIED THAT EXECUTIVE DIRECTORS WILL NOT BE THE MEMBERS OF THE INA'S MANAGEMENT BOARD.*[56]

AT THE VERY END OF THE PART OF THE AMENDMENT THAT DEALS WITH NEW MANAGEMENT STRUCTURE, IT HAS BEEN SAID THAT THE CONTRACTING PARTIES HAVE AGREED TO REVIEW AND CONSIDER THE EXISTING STRUCTURE OF CORPORATE GOVERNANCE IN ORDER TO INCREASE THE EFFICIENCY OF DECISION-MAKING PROCESS, INCLUDING BUT NOT LIMITED TO THE PURPOSE OF ANALYZING THE POSSIBILITY IMMANENT TO THE ONE-TIER SYSTEM OF CORPORATE GOVERNANCE AFTER OR EVEN BEFORE THE SECOND ANNIVERSARY OF THE AMENDMENT.[57]

NEVERTHELESS, ALTHOUGH DECISION TO TURN TO THE ONE-TIER SYSTEM OF CORPORATE GOVERNANCE HAS NEVER BEEN BROUGHT NEITHER IT WAS EXPRESSLY FIXED IN THE AMENDMENTS THAT THE GENERAL ASSEMBLY MEETING WILL BE HELD WITH PURPOSE TO CHANGE THE CORPORATE GOVERNANCE MODEL, AT FIRST GLANCE IT SEEMS OBVIOUS THAT A COMBINATION OF ANGLO-SAXON ONE-TIER SYSTEM OF CORPORATE GOVERNANCE AND CONTINENTAL LEGAL DUALISTIC SYSTEM WAS CREATED, SINCE BESIDES THE MANAGEMENT AND SUPERVISORY BOARD, A NEW STRUCTURE – A BOARD OF EXECUTIVE DIRECTORS WAS ALSO FORMED. IF SO, IT IS IN QUESTION WHETHER SUCH A SYSTEM IS IN ACCORDANCE WITH THE LAW – I.E. WORDING OF CA, WHAT ARE THE CRUCIAL ELEMENTS WE NEED EXAMINE IN ORDER TO REACH AN ANSWER AND IF COMBINATION REALLY EXISTS – WHAT SHOULD COULD BE DONE TO RESOLVE SUCH A STRANGE SITUATION.

2. A Combination of One Tier and Dual Tier System – Confusion or Reality?

HAVING TWO DIFFERENT TYPES OF MANAGING BOARDS IN A SINGLE COMPANY - BOARD OF EXECUTIVE DIRECTORS TOGETHER WITH THE MANAGING BOARD IN A SINGLE COMPANY SIGNIFIES ABOUT UNUSUAL SITUATION, IF THE INSOFAR KNOWN TRADITIONS OF CORPORATE GOVERNANCE PRACTICES ARE TAKEN INTO ACCOUNT. COMPANY LAW THEORY (TOGETHER WITH EXAMINED LEGAL PROVISIONS) CLEARLY SUGGESTS THAT IN ONE-TIER MODEL ONLY ONE SINGLE MANAGEMENT BOARD EXISTS AND THAT IT MANAGES THE COMPANY AND SETS THE FOUNDATIONS FOR CARRYING OUT THE BUSINESS ACTIVITIES.[58] *CONTRARILY, WHEN IT COMES TO INA, IT IS SELF-EVIDENT THAT BESIDES THE SUPERVISORY BOARD, THERE ARE TWO BOARDS RESPONSIBLE*

[54] See art. 7.2.2. of the Amendment.
[55] See art. 7.5. of the Amendement.
[56] These facts can be easily checked on the INA web page, in the subpage of corporate governance where the list and names of all the members of the boards are listed (http://www.ina.hr/default.aspx?id=1857).
[57] See art. 7.6. of the Amendment.
[58] See, for example, Jungman, Carsten, „The Effectiveness of Corporate Governance in One-Tier and Two-Tier Board Systems", European Company and Financial Law Review 3/426 (2006).

FOR CARRYING OUT THE BUSINESS ACTIVITIES - MANAGEMENT AND BOARD OF EXECUTIVE DIRECTORS. STILL, DEEPER ANALYSIS INDICATES THAT THE PROBLEM IN QUESTION MAY BE ANALYZED FROM TWO, IN ESSENCE, OPPOSITE PERSPECTIVES.

First perspective relates to the fact that CA allows issuing of *so called* commercial power of attorney, which essentially is an instrument in writing by which company management may appoint one or more of its employees to operate certain parts of company day-to-day businesses. When appointed, agents may enter into contracts and do other things as are necessary and usual when running part of the company business. However, CA limits the powers arising from such an instrument that may be granted with commercial power of attorney, so agent will have to have a special authorization to sell property, borrow money, to promise or contract to answer for the debt, to sue and represent the company before courts etc.[59] Available information suggest that appointed executive directors in INA run certain types of company business – finance, retail, exploration and production, marketing and similar. In the same time, an excerpt from the court register evidences that executive directors are not registered in the court registry, although a clear requirement of the CA exists, one which sets an obligation for the executive directors to submit an application for entry into the court register in the same manner as CA prescribes such obligation for the members of the company management board in two-tier system.

Does this mean that INA does not have the board of executive directors but in reality the board which is composed of the company employees with commercial power of attorney, people that are authorized to manage day-to-day business of the company on the basis of previously issued authorization? Fact is that Shareholders' Agreement does not regulate competences of the Executive Committee in detail, but articulates only that executive directors will be responsible for the daily operation of each business unit; neither executive directors nor their competences are mentioned in the Articles of Association, as amended in June 2009.[60] Everything that has been said so far deepens the doubts of what is the legal position of the INA's Executive Board at the moment. Sure enough, fact that INA has Executive Board beside the regular management and supervisory board leads to confusion all of those who potentially want to cooperate and enter into business with this respectable and powerful oil company.

Problem of the compliance of the structure of corporate governance in INA with Croatian legislation had its mention in some media as well. As it was reported this year, two diverging legal opinions were issued. According to the announcement from INA webpage,[61] INA management board sought an independent legal opinion from one law firm based in Zagreb which confirmed that the structure of corporate governance and appointment of executive directors is in the line with the wording of Croatian legislation. On the contrary, conclusions given in the analyses of another law firm which was commissioned by the Croatian part of the Supervisory Board of INA concludes that the board of executive directors may not manage the company business instead of management, particularly if one internal document called

[59] See art. 55 and 56 of the CA.
[60] See Articles of Association of INA d.d., clean version, Zagreb, 2009.
[61] See http://www.ina.hr/default.aspx?id=3835.

"the list of the responsibilities and decision making" is being taken into account. According to the statement of the President of the INA Supervisory Board, first law firm which ruled in the favor of the Management controlled by the Hungarian owner did not have at disposal such a document when drafting a legal study. He continued; "The list of the responsibilities and decision making presents a document that is below the level of Shareholders' Agreement, but in the same time that's document that actually regulates the management of the company. Without this material first law firm was not able to make a complete analysis of the compliance of the management model to the Croatian Law."[62]

Truth is that full assessment of the INA's model of corporate governance is not an easy task to do, especially if we take into account that most of INA's internal documentation, neither diverging legal opinions were ever been made public. In that case, the only analysis that can be made is the one based on the systematic examination of available documents; CA, Amendments of the Shareholders' Agreement and Articles of Association of INA.

Provisions of the Articles of Association clearly answer the question of who is authorized to conduct company business - the Management Board manages the business. It is authorized and responsible to take all actions and to issue resolution necessary for the successful management of the Company within the limitations of the law and Articles of Association.[63] Granting the power of attorney is also being regulated in the Articles of Association; the Management Board may, with the consent of the Supervisory Board grant power of attorney to one or more persons.[64] However, art. 19 of the Articles of Association speaks about *prokura* (procuration), type of the power of attorney different than commercial power of attorney since it implies wider range of powers than the latter.[65] If proper analogy is applied, it would be hard to find the reason against the possibility to appoint certain group of people to perform certain types of daily operations on the basis of commercial power of attorney, even without special consent of the Supervisory Board since essentially these are two different instruments. In any case, if the members of INA's Executive Board operate on the basis of commercial power of attorney their powers should clearly distinguish from the powers of the Management and remain in the limits that CA sets for the instrument called commercial power of attorney. If, by chance, managerial functions of Management and Executive Board and its directors overlap, so for example if the executive directors are entrusted not only with the management of the daily affairs within their sector of business, but with responsibility to judge on company's strategy and with setting the foundations for carrying out the business activities, than it is apparent that the structure in question shows elements of both systems of corporate governance. In that case, executive directors are responsible for the business usually done by the management in two tier model, while management does the function of

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[62] See daily newspaper „Vjesnik" dated May 15 2011., „Štern: Inom treba upravljati Uprava, a ne izvršni direktori" (Stern: Ina has to be handled by the Management, not by the Board of Executive Directors").

[63] See art. 11 of the Articles of Association of INA (clean version, 2009). It is continued in the same article that the Management Board is authorized to adopt a set of Rules of Procedure on the manner in which the Management Board is to manage the company. These rules may be passed only with prior approval of the Supervisory Board.

[64] See art. 19 of the Articles of Association.

[65] See art. 44-55 of the CA.

supervision, which is entrusted to the regular supervisory board. To the contrary, if managerial power is vested in the Management Board, e.g. by the articles of association, it has to be possible to clearly distinguish between the functions of the management and control, even if a special commitee of entrusted agents for daily operations is formed, no matter what is the name of the commitee in question. Yet, it is obvious that formulations such as „Executive Board", „Executive Committee", „Executive Director(s)" lead to confusion, particularly if the blurry provision of art. 7.6. of the Amendments about the need to increase the efficiency of decision making process *via* one-tier system of corporate governance is taken into account.[66] Now when CA clearly distinguishes between two systems of corporate management, the term "executive directors" may be used only in the sense given by the law. Keeping this term in companies with the two tier model of corporate governance may lead to a confusion and result in the possible false representation. But answer to the question what would be the sanction for keeping these terms functional cannot be found in the text of CA. It seems rather that the solution of this question lies not within the extent to which the CA is enforced, but within the specific case of possible misrepresentation.

III. CONCLUDING REMARKS

The primary aim of this paper was to explain theoretical background and structural differences between two main types of corporate governance models – one-tier and two-tier board systems. While the one-tier system presents a form of board structure characterized by one single board comprising both executive and non-executive directors, two-tier system consists of a supervisory board and management where there is a clear separation between the functions of supervision and management. So which is the right model? As yet, there isn't one. Despite globalization and EU model of approximation of the laws, corporate governance patterns continue to differ because business practices, patterns of ownership, business customs, labor laws etc. in the countries concerned are not uniform. Fact remains that good corporate governance practices require more than just effective board structures.

Coming after political changes in the early 1990s both Hungarian and Croatian legislators decided to follow the framework of German company law where two-tier governance system is mandatory for joint stock companies. Later on, in 2006 and 2007 more modern approach was introduced in Hungary and Croatia in order to allow shareholders to choose between two systems, depending on their preferences.

Fact that practice does not always go hand in hand with theory, has its actualization in the case study of INA, Croatia's oil and gas exploration and production company owned mostly by the Hungarian oil company MOL Rt and the Republic of Croatia. Although a brief look at the system of corporate governance in INA shows elements of both one-tier and dual-tier system, deeper research suggests that the existence of supervisory and management board together with the board of executive directors may be in accordance with the law if strict separation of control and management exists and if the management is ultimately responsible

[66] See supra ref. 54.

for managing the company’s business. If the latter is the case, problem that remains anyways concerns a usage of adequate terminology in sense of the board naming, in order to eliminate possibility of a confusion and misrepresentation, especially against the third parties.