DUTY OF CARE AND LOYALTY WHILE RUNNING JOINT STOCK COMPANIES UNDER THE TURKISH COMMERCIAL CODE

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ABSTRACT

Duty of care and loyalty are among the general principles regulated under the provisions of the Turkish Commercial Code in relation to joint stock companies. But, who owes these duties and for whom they are owed is argumentative. The standard of care prescribed in the Turkish Commercial Code is also open for arguments. In addition, their application in the case of controlled and controlling companies which is taken as an exception to the general rule is exposed to divergent views. In this article, the author argues that members of the board of director, managers and any person who has or exercises managerial power owe duty of care and loyalty for the company, shareholders and third party creditors. The standard of care prescribed in the Code is also a slightly different version of the American Business Judgment Rule. And finally, there is a room for the application of the principles in the context of a fully controlled company. To reach these conclusions, the author analyzed Turkish laws and different secondary sources.

Key Words: Board of directors, duty of care, loyalty, standard of care, cautious manager.

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TÜRK TİCARET KANUNU BAKIMINDAN ANONİM ŞİRKETİN YÖNETİMİNDE ÖZEN VE BAĞLILIK YÜKÜMLÜLÜĞÜ

ÖZET

Özen ve bağlılık yükümlülükleri, anonim şirketlerle ilgili olarak, Türk Ticaret Kanununda düzenlenen genel ilkeler arasındadır. Ancak, yükümlülüklerin kime karşı ve kimin lehine olduğu tartışmalıdır. TTK'da öngörülen özen derecesi de tartışmalara açıktır. Buna ek olarak, genel kuralın istisnası olarak kabul edilen tam hakimiyet halinde bulunan bir şirkette durumunda bunların uygulaması farklı görüşlere maruz kaldıkları görülmektedir. Bu yazıda, yazar, yönetim kurulu üyelerinin, yöneticilerin ve yönetim yetkisine sahip olan ya da yetkisini kullanan kişinin şirkete, ortaklara ve üçüncü kişi alacaklılara özen ve bağlılık yükümlülüğü altında olduğunu ileri sürmektedir. Kanunda öngörülen özen derecesi de Amerikan Business Judgment Rule'unden biraz farklı olarak öngörülmüştür. Ve, son olarak, tam hakimiyet halinde bulunan bir şirkette prensiplerin uygulanması için alan bulunmaktadır. Bu sonuçlara varmak için, yazar kanunlardan ve farklı ikincil kaynaklardan yararlanmıştır.

Anahtar Kelimeler: Yönetim kurulu, özen yükümlüğü, bağlılık, özen derecesi, tedbirli yönetici.

INTRODUCTION

With the need to accommodate new economic conditions, technological advancements, the bid to join the European Union and subsequent efforts to harmonize commercial laws of the country with the European standards, the new Turkish Commercial Code Number 6102/2011 came up with a number of different regulations from its predecessors; both the 1926 and 1956 Commercial Codes. The provisions on duty of care and loyalty are among such regulations in the Commercial Code. Duty of care has been regulated under the Turkish commercial laws since the 1926 Commercial Code while duty of loyalty is a new institution. The 1920 Commercial Code provided for a subjective standard of care to the extent of the board members'/managers' personal skills and diligence. To the contrary, the 1956 Commercial Code adopted an objective standard of a prudent business man. The current Commercial Code also adopted an objective standard of care but, with the standard of cautious manager. Those who have managerial power with in a company owe duty of care to the company, shareholders and creditors to the extent of a cautious manager. The rationale of the Code contends that the new code adopted the Business judgment rule even if there are some arguments against it.

Unlike the duty of care, the duty of loyalty is prescribed for the first time in the new Turkish Commercial Code. It prescribes prioritization of the interests of the company over the interests of the board members/manager themselves or any other interest. In this article, the identity of holders of duty of care and loyalty, those for whom the duty is owed, the content and levels of the duties under the new Turkish Commercial Code are deeply explained. To that end, related provisions of the Turkish Commercial Code have been analyzed and, various secondary sources are consulted.

I. DUTY OF CARE

Ownership and control are usually separated in corporations. While the owners are shareholders, a corporation is under the control of board of directors and/or managers. It is generally agreed in corporate law that those who manage a company owe duty of care for they are running the property

belonging to others. But, from and for whom the duty of care is owed and the standard of care are usually argumentative.

There is almost a universal consensus that members of the board as well as other officials who have roles in the management of a company owe duty of care. The criterion in this regard is having the power in decision making concerning the management of the company. In Germany, for example, duty of care concerns dejure, defacto & shadow board members, managers and other officers[1]. Under the Turkish Commercial Code, "…members of the board and third parties in charge of management…" owe duty of care[2]. This also concerns managers appointed by the board, business representatives, agents, chiefs, branch managers and officers that have a certain role in decision making[3]. In addition, it is valid in one man company which has only one board member and, possibly, only a shareholder[4]. Further, it also binds independent board members that may be appointed by the government under article 334 of the Commercial Code[5]. The representatives of juridical board members should also hold the duty. In case of liability, however, the juridical person may be held liable for the physical person had been acting on its behalf[6].

There are divergent views regarding to whom the duty of care is owed. In the common-law legal system, board members/managers owe duty of care

1 **Madisson, Karin** (2012) 'Duties and Liabilities of Company Directors Under German and Estonian Law: A Comparative Analysis' The Riga Graduate School of Law (RGSL), Research Papers No. 7,
<http://www.rgsl.edu.lv/uploads/files/7_Karin_Madisson_final.pdf> l.a.d. 23.02.2017.

2 See Türk Ticaret Kanunu 6102 (2011) (Turkish Commercial Code) Hereinafter TTK, article 369.

3 **Doğrusöz, Bumin/ Onat, Öznur/ TÖRALP, Funda** (2011) Türk Ticaret Kanunu: Gerekçe, Karşılaştırmalı Maddeler, Komisyon Raporları, Önergeler ve Karşılaştırmalı Tabloları ile (Madde 1-849), Ankara, Afşaroğlu Matbaasi, p. 483.

4 **Tekinalp, Ünal** (2015) Sermaye Ortaklıklarının Yeni Hukuku, 4. Edition, İstanbul, Vedat Kitapçılık, p. 280.

5 See TTK, article 334(3).
The Code recognized the possible representation of the state in boards of joint stock companies which are established to provide social services even if the state has no share. The rationale of the article stipulates that board members who are the representative of the state may be taken as independent board members.

6 See TTK, article 359 (2-3)

only to the company, but not to shareholders and creditors[7]. In the continent, on the other hand, the duty of care extends not only to the company but also to the shareholders and creditors. Under the Turkish law, article 369 of the commercial code does not indicate for whom the duty of care is owed. The provision in general terms provides that they have the duty of care while discharging their obligation without specifying for whom the duty is owed.

In the Turkish doctrine, there are tendencies to rely on article 553(1) of the Code and assert that duty of care is owed not only for the company but also to shareholders and third party creditors. The rationale of article 553(1) indicates that the liability under article 553(1) also applies for the violation of duty of care and loyalty. But, extending the duty of care for shareholders and creditors based on article 553 seems unfounded for article 553 is about the liability of board members/managers in case they fail to discharge their obligations. For example, shareholders and third party creditors may claim against the members of the board/ managers if they suffered damages due to the failures of the latters to discharge the duty of care they owed to the company. This, however, does not mean board members/managers owe duty of care for shareholders and/or third party creditors. There are, however, other grounds that enables the extension of the duty of care for both shareholders and creditors.

Shareholders have rights and duties against the company like the right to participate in the general assembly[8]. While exercising their rights and trying to discharge their duties, board members/managers, as persons responsible to represent and manage the company, have the duty to arrange situations. For example, they may call the general assembly and shareholders have the right to participate in the meeting. Therefore, it may be argued that members of the board/managers have the duty of care towards the shareholders and creditors in helping them exercise their rights and try to discharge their obligations.

The Turkish Commercial Code requires board members/ managers to observe the duty of care while discharging their obligation that arises either from the law or article of association. It is also valid in case directors transfer

7 **International Finance Corporation** (2015) A Guide to Corporate Governance Practices in the European Union, Washington, p. 51.

8 **Bilgili, Fatih/ Demirkapı, Ertan** (2017) Şirketler Hukuk Dersler, 5. Edition, Bursa, Dora Basın Yayın Ltd., p. 211-212

their power[9]. They owe duty of care while selecting the person to whom power is to be transferred[10]. There are ambiguities, however, whether the duty of the directors also continue after they transfer their power or not[11]. In the Swiss law, the duty of care persist in selecting the person, give appropriate instruction and supervising him/her after the transfer[12]. Sub article 2 of article 553 of the Turkish commercial Code restricted the liability of the board and/or board members only to the care they should take in selecting the person for whom the power is to be transferred. But, under article 375 of the Turkish Code, there are a number of powers that the board may not transfer to another person like the supervisory power of the board. In addition, the rationale of article 553(2-3) of the Turkish Code clearly explains that the supervisory role of the board members shall remain with them even after they transfer their power. Therefore, it is more logical to extend the duty of care of board members even after they transfer their power[13].

There are also claims in the Turkish doctrine that the duty of care not only provide a standard of care that should be observed while discharging other obligation, it also formulates an independent obligation by itself[14]. So, the company/ shareholders/creditors may claim against the board members/ managers for failing to observe their duty of care even if it is not related with another specific obligation[15].

9 According to article 367 of the Turkish Commercial Code, the board of directors may transfer part or all of its managerial powers to some of its memebers or another third party based on an internal by law prepared in line with the article of association. But, Article 375 of the code also restricted this power by prohibiting the transfer of some managerial powers like supervisory powers.

10 See TTK, article 553(2).

11 **Uysal, Levent** (2009) '6762 Sayılı Türk Ticaret Kanunu ve Türk Ticaret Kanunu Tasarısı Kapsamında Anonim Şirketlerde Yönetim Kurulu ve Yönetim Kurulu Üyelerinin Hukuki Sorumluluğu', TBB Dergisi, V:81, s. 1-34.

12 **Uysal**, p. 187

13 From the essence of the Turkish Commercial Code, the directors are bind by the duty of care they owe to the company/shareholders/creditors while discharging the powers that they had not transferred or cannot be transferred in addition to the duty of care they should show while selecting the person for whom power is to be transferred.

14 **Çamoğlu, Ersin** (2007) Anonim Ortaklık Yönetim Kurulu Üyelerinin Hukuki Sorumluluğu, 2. Edition, İstanbul, Vedat Kitapçılık, p. 66

15 **Çamoğlu,** p. 66.

The standard of care expected from members of the board /managers is the other important subject in relation to duty of care. Standard of care usually have two components; the skill, knowledge and experience that the board member/managers should have on the one hand and the level of care expected from a board member/manager on the other[16]. It requires the duty to acquire some basic understandings about the business activities of the corporation and the duty to keep oneself informed of major changes in the business[17].

In determining the level of care, there is a need to balance between two apparently contradicting factors. For one thing, those who manage a corporation should be accountable for their decisions. On the contrary, the management should have discretionary areas that enable it to take some risks in decisions making without being personally liable for the possible negative outcomes[18]. Legislations in relation to the duty of care, therefore, should accommodate "executive freedom and effective accountability"[19].

In the ancient Roman law, the standard of care expected from a person acting on behalf of another person (including from persons acting in the name of a corporation) had been the standard of a good family father (*bonus pater familia*)[20]. They were expected to show diligence and care to the extent of a good father. This has been changed over time in the western world.

In the United States, the standard of care expected from board members is governed under the principle of the Business Judgment Rule. The Business Judgment Rule underscores that board members/managers are not liable unless they made a decision in bad faith. The rule tried to put objective criteria that focuses on procedural correctness of the decision making rather than the correctness of the decision itself[21]. This is usually justified by the fact

16 **Madisson**, p. 18.

17 **Kutcher A. Robert,** Breach of Fiduciary Duties, <http://apps.americanbar.org/abastore/products/books/abstracts/5310344_chap1_abs.pdf>, l.a.d. 03.14.2017.

18 **Madisson**, p. 3.

19 **Needles E. Belvered/Turel, Ahmed/Sengur D.Evren/ Turel, Asli** (2012) 'Corporate Governance in Turkey: Issues and Practices of High Performance Companies' Accounting And Management Information Systems, V: 11, No:4, p. 515.

20 **Madisson**, p. 7.

21 **Griffin, F. William / Davis, Malm / D'Agostine, P.C.** (2011) Fiduciary Duties of Officers,

that "it is difficult for the judge to decide that another decision than the decision of the board would have been" better[22].

According to the American Law Institute, a decision of board members should embrace the following five characteristics in order to be justified under the Business Judgment Rule[23].

i. The decision should be a commercial decision that has been made in relation to the business activity of the company;
ii. It should be meant to advance the interest of the company;
iii. It should not be made to advance one's or third party interests;
iv. The decision should be made in good faith;
v. The decision should be made after collecting necessary information.

Coming to the Turkish law, the duty of care has been regulated under the Turkish Commercial law since the 1926 Commercial Code. Under the 1926 Commercial Code, the standard of care has been a subjective standard to the extent of the board members'/managers' personal skills and diligence.[24] This was changed to the standard of 'prudent person' in the 1956 Commercial Code. Unlike the 1926 Commercial Code, the 1956 Commercial Code requires an objective standard of care.[25] But, requiring a 'prudent man' standard of care from directors has been found very hard and the

Directors, and Business Owners**,** <http://www.davismalm.com/1BE153/assets/files/News/Griffin_CH8_Fiduciary_Duties.pdf>, l.a.d. 25.06.2017.

22 **Davies, Pual** (2000) The Board of Directors: Composition, Structure, Duties and Powers, <https://www.oecd.org/daf/ca/corporategovernanceprinciples/1857291.pdf> l.a.d. 18.07.2017.

23 **Kervankıran, Emrullah** (2007) 'Alman Hukukunda Business Judgement Rule'nın Kodıficasıyon, Türk Ve America Hukuku Ile Karşılaştırmalı Bir Değerlendirme' Prof. Dr. Hüseyin Ülgen'e Armağan, I: 2, p. 253-258.

24 **Doğanay, Ismael** (2004) Türk Ticaret Kanunu Şerhi, 4. Edition, İstanbul Beta.

25 The 1956 commercial code cross refers the duty of care requirement to the law of obligation. Article 320 of the former Turkish commercial code number 6762, cross refers to article 528 of the Turkish law of obligation which finally reaches at article 321 of the law of obligation. Accordingly, the duty of care expected from board members/managers had been to the standard of a prudent business man while he does his business. The duty of a business man depends on his profession, experience, information that he knows/ should know/ etc. Therefore, there are arguments that the duty of care provided under the former law also contains subjective standards. For further information see Emrullah Kervankıran, supra note 23, at 259-260.

interpretation of Turkish Courts had proved harsher as well as unjust towards board members[26]. Therefore, the current Commercial Code adopted a different approach.

5. Duty of care and duty of loyalty

Article 369 - (1) Board members and third parties in charge of management have the duty to discharge their obligations with a care of a cautious manager and to protect the interest of the company in line with the rules of loyalty

(2) This is without prejudice to the provisions of articles 203 to 205 of this Code.

The Code adopted the cautious manager standard. The ideal man taken as an objective standard is not an ordinary man. First, it is a manager who has the ability to manage a company. S/he also is a cautious manager who takes measures cautiously. Cautious means the person who knows to work with research reports, arrange information flows with in the institution, audit reports, gives due consideration for rational thinking, is able to examine, compare and contrast[27]. The rationale of article 369 stipulates that board members/managers need not be experts in the business areas of the company. But, they need to acquire the knowledge, skill and experience required to identify issues that need expert advices, examine advices provided by experts, supervise the company, examine important information, reach a decision after examining available information and follow up the execution of the decisions[28].

The rationale of article 368 of the Code clearly states that the New Code has adopted the Business Judgment Rule[29]. In the Turkish doctrine, however, there are arguments for and against the position of the rationale. The view of

26 **Altaş, Soner** (2011) Yeni Türk Ticaret Kanununa Göre Anonim Şirket Yönetim Kurulunun Yönetim Ve Temsil Yetkisinin Kapsami Ve Devri, http://archive.ismmmo.org.tr/docs/malicozum/105malicozum/5%20soner%20altas.pdf>, l.a.d. 11.03.2017.

27 **Tekinalp**, p. 280.

28 **Tekinalp**, p. 280.

29 **Doğrusöz/ Onat/ Töral,** p. 483.
The rationally, however, stipulates that article 93 the German Joint Stock Corporation Act should not be taken as the source of the provision dealing with duty of care and loyalty (article 369). This may indicate that the USA case law has been taken as the source of the provision.

the majority is that the duty of care provided in the Turkish Commercial Code is the business judgment rule. If so, is the Business Judgment rule adopted in the Commercial Code identical with the Business Judgment Rule adopted by American courts? As discussed above, the Business Judgment Rule as it is adopted in the United States reduced standard of care to a duty to comply with certain procedures in decision making and good faith requirements. Further, under the Business Judgment Rule, as adopted by the US case laws, the burden to prove a violation of duty of care by a board member or manager falls on the claimants[30].

The Turkish Commercial Code simply provides that the standard of care expected is to the level of care of a "tedbirli yönetici" (catious manager). But, the phrase "cautious manger" indicates that the board members/ managers are not expected to foresee the consequence of their decisions contrary to the prudent business man standard[31]. This indicates that they are simply required to make a decision in line with certain procedures, but not to foresee the outcomes of their decision.[32] It is also an objective standard so that the personal qualities of an individual director and his diligence while performing his personal activities won't be considered[33].

The rationale of the Code also contend that "members of the board may not be held liable even if their decision caused harm to the company so long as they decide after searching for and taking relevant information in to consideration."[34]Article 553(3) the Code also strengthen this argument as it asserts that no one is liable for causes that are beyond his control even if they are contrary to contract or law and this may not be disproved by showing the

30 **Kutcher**, p. 12.

31 **Turanlı, Hüsnü** (2016) 'Anonim ortaklıklarda yönetim kurulu üyelerinin basiretli iş adamından tedbirli yöneticiye (business judgement rule) şeklinde değişiklik gösteren sorumluluğu' Ticaret ve Fikri Mülkiyet Hukuku Dergisi, I: 2, V:1, p. 85.

32 This does not mean that they should not think what the outcome of their decision will be. But, they are required only to decide based on available information and they are not liable if the consequence went wrong so long as they do not act in bad faith. They should also try to think different risks that may result from various causes like market changes and uncertainties. (see **Doğrusöz/ Onat/ Töral,** p. 483.)

33 **Pulaşlı, Hasan** (2015) Şirketler Hukuku Genel Esaslar, 3. Edition, Ankara, Adalet Yayınevi, p. 474.

34 **Doğrusöz/ Onat/ Töral,** p. 484.

duty of care or control the person owes. The Code makes it clear that liability of board members is a fault based liability[35].

During deliberations on the draft, there have been critics on the softness of the article. The correction of the phrase "tedbirli yönetici" (catious manager) as "işbilir tedbirli bir yönetici" (a manager who is caution and knows busines) was proposed[36]. All this shows that the new Code has adopted the Business Judgment Rule and brought the liability regime in line with the universal principle[37].

The duty of care prescribed under the Turkish Commercial Code, however, differs from the one adopted by the American courts on the burden to proof the violation of the duty. Under the American system, the burden to prove a violation of duty of care by a board member or manager falls on the claimants[38]. The draft Turkish Code had adopted this rule as it is. Article 369(3) of the Draft Turkish Code used to provide that "*While discharging their duties in the meaning of this article, (board) members and managers are presumed to have acted in due care*." But, it was cancelled by the Justice Commission of the Parliament before the adoption of the Code[39]. Proving the violation of duty of care by claimants in the absence of clear indications of what amounts violation would have been very difficult[40]. Therefore, in case of damages caused by their decisions, board members/managers have to prove that the damage occurred despite the fact that they had discharged their duty of care. This is similar with the German law[41].

35 **Poroy, Reha/ Tekinap, Ünal, Çamoğlu, Ersin** (2014) Ortaklık Hukuku Giriş, Adi Ortaklık, Ticarer Ortaklıklarına İlişkin Genel Hukumler, Kolektif, Komandit, Anonim, Halka Açık Anonim, 13. Edition, İstanbul, Vedat Kitapçılık, p. 389.

36 **Moroğlu, Erdoğan** (2005) Türk Ticaret Kanunu Tasarı Değerlendirme Ve Öneriler, 3. Edition, Ankara.

37 **Poroy/ Tekinap/ Çamoğlu**, p. 79.

38 **Kutcher**, p. 12.

39 **Dedeağaç, Ender / Sapan Oğuzhan** (2013) Anonim Şirketlerde Yönetim Kurulu Ve Sorumluluğu, Ankara, Arcs Ofset Matbaacılık, p. 54.

40 **Arkan, Sabih** (2005) Türk Ticaret Kanunu Tasarısına İlişkin Değerlendirmeler**,** Ticaret Hukuku Araştırma Enstitüsü, Türk Ticaret Kanunu Tasarısı Konferans Bildirimler-Tartışmalar, Mayıs 13-14, Banka ve Ticaret Hukuku Araştırma Enstitüsü, p. 53.

41 **Kervankıran**, p. 262.

II. DUTY OF LOYALTY

The principle of loyalty in corporate law is a requirement of making decisions in the interest of the company. It is a "fair process of non interested directors to show entire fairness."[42] Loyalty is putting the interests of the company and/or the shareholders before one's interests or of third parties[43].

Historically, duty of loyalty had not been regulated under the former Turkish Commercial Codes[44]. Article 369(1) of the current Code, however, states that *"members of the board and management officials are under obligation … to protect the interests of the company based on the rules of loyalty*."

Members of the board and officials who are empowered to exercise management powers have duty of loyalty. The criterion, therefore, is having role in the management of the company. Therefore, all directors and managers, whether they are appointed by the general assembly or under the article of association, whether they are independent directors appointed by the state or managers to whom power is transferred are bound by the duty of loyalty. In addition, commercial representatives and commercial agents who may be appointed by the board are also bound if they are authorized to exercise managerial powers. The principle is also valid even in the case of one man company and/or one man board.

The second point is for whom the duty is owed. The code states that board members and individuals who have managerial role should "protect the interests of the company based on the rules of loyalty." The interest of the company may not necessary mean the interest of the shareholders. In legal literature, there are three different approaches in defining what the interest of the company is; the contractual approach, the institutional approach and the interest of the firm approach. According to the contractual approach, the

42 **Bernard S. Black** (2001) The Principal Fiduciary Duties of Boards of Directsors: Presentation at third Asian Roundtable on Corporate Governance Singapore, <http://www.oecd.org/daf/ca/corporategovernanceprinciples/1872746.pdf> l.a.d.04.05.2001.

43 **Tekinalp**, p. 280.

44 **Doğrusöz/ Onat/ Töral**, p. 484.

interests of the company means the interests of the shareholders[45]. The institutional approach, on the other hand, contends that the interest of the company includes not only the interest of the shareholder but also the interest of creditors, the society, the state, etc.[46]. Finally, the interest of the firm approach claims that the interest of the company includes the interest of the shareholders, employees and creditors[47].

The rationale of article 369 of the Code stipulates that duty of loyalty requires board members/managers to put the interests of the company before their interests, the interests of majority holders or shareholders or any third party and their relatives[48]. In case there is a conflict of interest between the interests of the company and the interests of shareholders or creditors, board members/managers should put the interests of the company first. But, does it mean the duty of loyalty concerns only the company and not for shareholders and creditors?

Different arguments may be put in place to extend the duty of loyalty board members/managers owe for shareholders and creditors under the Turkish law. For example, the fiduciary nature of the relation between the shareholders and the board members/managers may be a ground. Consequently, board members/managers should put the interests of the shareholders and creditors of the company before their personal interests or the interests of third parties other than the company in relation to their obligation in the company.

Duty of loyalty contains a number of concrete obligations. The rationale of the Code dictates that duty of loyalty contains prohibition of related party dealings, avoiding conflict of interests, prohibition of competition within the company and confidentiality[49].

45 **Gerner, Carsten/ Peach, Philipp/ Philipp, Edmund**, 'Annex to Study on Directors' Duties and Liability' <http://ec.europa.eu/internal_market/ company/docs/board/2013-study-reports_en.pdf>, l.a.d. 27.06.2017.

46 **Gerner/ Peach/ Philipp,** p. 299.

47 **Gerner/ Peach/ Philipp,** p. 299.

48 **Doğrusöz/ Onat/ Töral**, p. 483- 4.

49 **Doğrusöz/ Onat/ Töral**, p.484; **Deryal, Yahya** (2005) Ticaret Hukuku**,** 8. Edition, Trabzon, p. 287

A. RELATED PARTY DEALING AND THE ARM'S LENGTH PRINCIPLE

There are different in defining what related parties are. But, generally, there are two approaches in defining what related parties are. While the first approach tries to specify certain persons as 'related parties' the second approach uses "a general wording …to allow any person capable of exercising an influence over another party in the making of decisions to be qualified as a related party."[50] The Turkish commercial code principally takes the first approach in which a board member, his/her spouse, his/her relatives in the direct line, one of his/her collateral relatives in consanguinity or affinity up to and including the third degree, the personal companies of which the said member and his/her relatives in question are partners, and joint stock companies in which they have at least 20 percent shareholding are taken as related parties[51].

Historically, related party dealing has been rejected in its totality. Accordingly, any dealing a board member and/or his nearest persons made with the company used to be considered as null and void[52]. But, currently, in the major legal systems, related party transaction is regulated, not totally prohibited. In Germany, related party transactions and multiple representation are prohibited unless they are permitted by the general assembly or through the article of association[53]. Even if they are permitted, however, they should follow the arm's length principle and serve the interests of the company[54]. Related party dealings need board approval and a board member may not use corporate assets, corporate opportunities & may not accept gifts for his service in the company from outside sources[55]. In French law, there are prohibited transactions, regulated transactions which need board approval and ordinary business transactions that can be concluded without board approval so long as they are made at arm's length between directors/managers and the company[56].

50 **Luputi, Laura,** 'Reporting Related Party Transactions and Conflicts Of Interest'<https://www.oecd.org/daf/ca/corporategovernanceprinciples/ 32387391.pdf>, l.a.d. 05.03.2017.

51 See TTK article 394.

52 **Kutcher**, p. 5.

53 **Madisson**, p. 19.

54 **Madisson**. p. 20.

55 **Madisson**. p. 340.

56 **Gerner/ Peach/ Philipp**, p. 300.

Under the Turkish law, related party dealing is regulated under article 395 of the commercial code. The law prohibits some transactions between board members/managers and the company while it regulates others.

Article 395 - (1) *A board member cannot conduct any transaction with the company in his/her or any other person's name without prior permission from the general assembly. If this provision is violated, the company can claim the transaction is null and void. The counterparty cannot make such a claim.*

From the provision, the prohibition is valid if the transaction is made with a board member without the approval of the general assembly even if the company is not represented by the concerned member in the specific transaction. The prohibition, however, do not encompass all transaction between board members and the company. Under the former Commercial Code, it was expressly provided that the prohibition encompasses only commercial transactions. From the generally accepted principles and legal doctrines, it is contended that consumer contracts, transactions in relation with items that have fixed prices and transactions made for the sole benefit of the company are not, for example, included in the prohibition in the current Commercial Code too[57].

There are also prohibited transactions that related parties may not conduct with the company even with the approval of the general assembly. They may not become indebted in cash or in kind to the company; the company may not provide surety, guarantee or security for these persons; undertake liability or take over their debts. Neither the general assembly nor the board has the power to allow such transactions. Exception to these prohibitions is the case of group of companies. Members of a group company may guarantee the debts of each other and may stand surety to each other provided that they comply with the special regulations of group companies[58]. However, the approval of the board of corporations and subsidiaries is required in their transaction with their related parties in case the transaction is more than 5% of the their assets[59].

57 **Bilgili/ Demirkapı**, p. 280-281.

58 See TTK articles 202 and 395.

59 **Turkish Republic Communiqué on corporate governance**, (Published in the Official Gazette dated 3 January 2014 and numbered 28871), Article 10

B. PROHIBITION OF PARTICIPATION IN BOARD MEETINGS

The rational for the prohibition of a board member from participating in board meetings is preventing potential conflict of interests that may hinder a member of the board from discharging his duty of loyalty. According to article 393 of the Commercial Code, a board member has the duty to disclose potential conflicts of interests. Therefore, disclosing conflict of interest is one sort of the duty of loyalty. Other board members also have to object the participation of the said board member in the meeting and doing so is their duty of loyalty.

The potential conflict of interests that prohibits a board member from participating in board meetings are categorized in to-two under the article. The first category includes matters which lead to a conflict between interests of the company on one hand and personal interests which are outside the company of the member or his/her spouse or his/her relatives in the direct line or one of his/her collateral relatives in consanguinity or affinity up to and including the third degree. The other one contains any condition in which good faith requires the none participation of the member[60].

The rationale contends that an interest which a board member or his relatives may have with in a group (not individual interests) and interests which he and his nearest relatives may have within the company like appointment in new positions, etc are not covered under the article[61]. But, it is difficult to buy the argument of the rationale. The provision specifically prohibits board members from participating in board meetings in which their personal interests or the interests of their nearest relatives conflict with the interests of the company. It also has a general rule that prohibits board members not to participate in the board meetings whenever rules of good faith so requires. Therefore, a board member may be prohibited not to participate in meetings of the board whether the conflict of interest is due to the direct or indirect interest he or his relatives have with the transaction in the agenda or whether the interest is within or outside of the company. In addition, a member of a board may be prohibited from attending meetings in which the interests of the personal companies of which the said member and his/her relatives in question are partners, and joint stock companies in which they have at least 20 percent shareholding are in the agenda.

60 See TTK, article 393.

61 **Doğrusöz/ Onat/ Töral,** p.522.

C. PROHIBITION OF COMPETITION WITH THE COMPANY

The current Turkish law preserved the provision of the former law on prohibition of competition and has similar ruling with the Swiss law[62]. Its main objective is to avoid potential conflict of interests and the prohibition encompasses directors in all share companies including one man company[63]. The Code prohibits competition in two forms. The first one is prohibition to engage in any business that falls under the scope of the activities of the company in his/her account or any other person's account without obtaining permission from the general assembly[64]. But, there is no clue how and in what circumstances the general assembly may permit such transaction. This may be regulated either in the article of association or other internal bylaws of the company.

The second way is prohibition of having shares in another company. Accordingly, a board member may not have a share in a accompany involved in the same kind of commercial business as a partner with unlimited liability[65]. Therefore, there is no prohibition if a board member have a share in another limited liability company. But, may a board member be a board member in more than one competing limited liability companies? It doesn't seem. Participation in the board of more than one competing companies creates conflict of interest in all the activities of the board member. Due to this reasons, the code prohibited/regulated transactions between a company and another company in which a board member or his relatives have at least 20 percent shareholding. Further, since the relation between the company and members of the board/managers is characterized as agency relation, an agent may not act on behalf of more than one competing companies as the same place and time[66].

If a director fails to comply with the above prohibition, the company may require compensation or consideration of the business performed by the director as if they are performed on behalf of the company[67]. In addition, the

62 **Doğrusöz/ Onat/ Töral**, p. 525.

63 **Tekinalp**, p. 282.

64 See TTK, article 396.

65 See TTK, article 396.

66 See TTK, article 104.

67 See TTK, article 396(1).

general assembly may remove the director from the board[68]. It is important to note that there is no need to prove the fault of the concerned director in order to establish the violation[69].

D. USING CORPORATE OPPORTUNITIES AND CONFIDENTIALITY

A director/manager may be encountered with a business opportunity while running the business of the company. The principal rule had been the exclusive benefit rule in which board members/managers are required to act for the exclusive interest of the company and avoid any form of self-dealing[70]. But, this approach has been changing. Under the German law, for example, there are two scenarios. If the new opportunity is outside the working area of the company, there is no problem if a board member/manager uses the opportunity. If the new opportunity is in the business area of the company, however, it is argumentative whether the board member/manager may use it for him/herself or not with or without the permission of the board[71]. Under the Turkish Commercial Code, putting the interest of the company before one's interest is the duty of loyalty. Therefore, we may argue that using the opportunity personally is not acceptable.

Board members/managers also have obligation of confidentiality. Even if there is no clear provision in the Code, the rationale of article 369 of Turkish Commercial Code contends that the Code puts obligations of confidentiality beyond doubt. The confidentiality obligation lasts forever even after the board member/manager left the position[72].

III. THE CASE OF GROUP OF COMPANIES AS EXCEPTION TO THE GENERAL DUTY OF CARE AND LOYALTY

Sub article 2 of article 369 of the Turkish Commercial Code has provided for exceptions to the duty of care and loyalty rule. The sub article

68 **Pulaşlı**, p. 480.

69 **Karahan, Sami** (2015) Şirketler Hukuku, 2. Edition, Konya, Mimoza Yayınları, p. 430.

70 **Brudney, Victor** (1997) 'Contract and Fiduciary Duty in Corporate Law', B.C.L. Rev. V: 38, p. 595-629.

71 **Madisson**, p. 21.

72 **Arslan, Ibrahim** (2004) Şirketler Hukuku Bilgisi, 9 Edition, Konya, Mimoza Yayınları, p. 210.

reads as "the provisions in Articles 203 to 205 remain in force". The exception is related with the obligations of board members of a fully controlled dependent company in a group of companies. In case of a fully controlled dependent company, the controlling company have the right to instruct the controlled company even if the instructions are to the disadvantage of the controlled company and board members/managers of the controlled have the duty to execute it. But, the instruction should be in accordance with the general policies of the group of companies and should not exceed the solvency or endanger existence of the company or can cause significant assets loss. Members of the board/managers are not liable for executing such instructions[73]. But, this may not totally relief the directors of the dependent companies.

Article 205 of the Code clearly stipulates that members of the board/managers and related persons may not be liable if the controlled company incurs loss due to the instructions given within the scope of article 203 and 204. The rationale of article 205 also underscored that the non-liability of board members/managers and others is only in relation with instructions given under the conditions laid down under article 203. Further, the rationale of 204 clearly states that board members/managers may not rely on article 205 if the instructions given by the controlling company are contrary to article 204. Therefore, it does not relieve them from their duty of care. They should take the care of the cautious managers in, among others, asserting whether the instructions of the controlling company are in line with the general policy of the company and they have not a characteristic that clearly exceeds the dependent company's solvency and that can endanger its existence or can cause significant assets loss.

The case in relation to duty of loyalty is similar even if there are some writers who claims that the exception is only for duty of care, not for loyalty[74]. In legal literature, the duty of loyalty still remains valid in case of group

73 See TTK, article 203-205.

74 **Altaş, Soner** (2011) Yeni Türk Ticaret Kanununa Göre Anonim Şirket Yönetim Kurulunun Yönetim Ve Temsil Yetkisinin Kapsamı Ve Devri, http://archive.ismmmo.org.tr/docs/malicozum/105malicozum/5%20soner%20altas.pdf>, l.a.d. 11.03.2017, p. 250.

companies in which board members/managers of the controlled company should act in the interest of the controlled company, not the controlling company or to the group[75]. They may not be in a position to put the interest of the controlled company over the interest of the group under the Turkish context for they are obliged to execute the instructions of the controlling company even if the instructions are to the detriment of the controlled company. But, they are bound by the duty to put the interest of the company over all other interests other than the controlling company. In addition, they should strive to protect the interest of the dependent company within the context of its dependency. Further, the prohibition of competing with the company and participation in certain meetings, personal dealings and confidentiality like obligations are still valid.

CONCLUSION

Duty of care & loyalty are among the general obligations of board members/managers of a joint stock company under the Turkish Commercial Code. They both are principally regulated under article 369 of the code. While the duty of care has been provided in the Turkish Commercial Codes since the 1926 Commercial Code, duty of loyalty is a new institution in the 2011 Turkish Commercial Code Number 6102.

Under the Turkish Commercial Code, board members, managers and officers who have a managerial power in a joint stock company owe duty of care to the company, shareholders and creditors. The Code adhered to the business judgment rule by stipulating a standard of care to the level of a cautious manager standard which is an objective standard. Board members and/or persons who have managerial role are not personally liable if a decision caused a loss so long as they can prove that they have made the decision following appropriate procedures.

Duty of loyalty is also a general duty board members/ managers and officers who have a managerial power in the company owe to the company. It

75 **G20/OECD Principles of Corporate Governance:** OECD Report to G20 Finance Ministers, <https://www.oecd.org/daf/ca/Corporate-Governance-Principles-ENG.pdf>, l.a.d. 05.02.2017.

is all about putting the interests of the company, shareholders and creditors before any other interest. Unlike the duty of care, however, there is no standard provided in the Code for duty of loyalty.

Finally, the relation between the controlling and controlled companies in a group of companies has been presented as an exception to the rules of duty of care and loyalty. This, however, does not mean that there is no duty of care and/or loyalty on a fully controlled company board members/ managers. Members of the board/managers in a fully controlled company are bound by both the duty of care and loyalty in a way that fits the legal status of the company.

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