

# Reform in Duties of Directors in Turkish Public Companies: Legislative Experiences From UK Companies

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## ABSTRACT

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This article is related to the duties of directors in public companies within the jurisdiction of two countries; namely, Turkey and the United Kingdom. Since public companies have a more important role in economic life compared to private companies, the focus is directed onto public companies hereinafter. The countries in study have only one type of company that can be held to public; Joint Stock Company in Turkey and Limited Liability Company in the UK. Having these two types of public companies as basis, this article aims to analyze duties of directors in both countries, and to find out main similarities and differences between the two countries in terms of the content of the duties.

### Keywords

Company Law, Board of Directors, Duties, Responsibilities, Joint Stock Company, Limited Liability Company, British Law System, Turkish Law System.

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## ÖZET

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Bu makale, Türkiye ve İngiltere'deki halka açık şirketlerde yönetim kurulu üyelerinin görev ve sorumluluklarına ilişkindir. Ekonomik hayatta halka açık şirketlerin özel şirketlere kıyasen daha önemli bir yere sahip olduğunu düşündüğüm için bu makalemden yönetim kurulu üyelerinin görev ve sorumluluklarını incelerken halka açık şirketleri esas aldım. Bahsi geçen ülkelerde halka açık şirket tipleri Türkiye'de yalnızca anonim şirketler; İngiltere'de ise yalnızca limited şirketler olduğundan makalede yalnızca bu iki şirket tipine yer verilmiştir. Makalenin amacı iki farklı ülkedeki halka açık şirketlerde yönetim kurulu üyelerinin görev ve sorumluluklarına ilişkin benzerlikleri ve farklılıkları saptamaktır.

### Anahtar Kelimeler

Şirketler Hukuku, Yönetim Kurulu, Görev, Sorumluluk, Anonim Şirket, Limited Şirket, İngiliz Hukuk Sistemi, Türk Hukuk Sistemi

## LIST OF ABBREVIATIONS

|            |                           |
|------------|---------------------------|
| <b>A.</b>  | Article                   |
| <b>BOD</b> | Board of Directors        |
| <b>CA</b>  | Companies Act             |
| <b>CC</b>  | Civil Code                |
| <b>CO</b>  | Code of Obligations       |
| <b>CMB</b> | Capital Market Board      |
| <b>CML</b> | Capital Market Law        |
| <b>GA</b>  | General Assembly          |
| <b>JSC</b> | Joint Stock Company       |
| <b>LLC</b> | Limited Liability Company |
| <b>S.</b>  | Section                   |
| <b>TCC</b> | Turkish Commercial Code   |
| <b>TR</b>  | Turkey                    |
| <b>UK</b>  | United Kingdom            |

## Introduction

In this study, corporate legal systems of two different countries focusing on duties of directors in public companies will be examined. The Board of Directors of a company has been one of the most significant areas in the commercial environment. In order to examine this specific subject field first, a general information about corporate legal systems of the two countries and their legislations will be given and then features of a public company and duties of directors will be mentioned.

In addition, this paper will compare and contrast the similarities and differences in both countries in terms of their corporate systems, especially in terms of duties of directors. Comparing and contrasting related duties and differences in these similar duties will be examined to determine which country's legislation on duties of directors is more advantageous and as a result, this paper will discuss necessary changes relevant to these duties.

This article will be based mainly on the legislations of both countries, and these subjects and arguments will be explored in depth with knowledge from a range of sources; such as books, articles and online sources. Additionally, my supervisor provided some guidance on the content and the ideas about more specific subjects that can be of importance, while discussing the similarities and differences between the United Kingdom and Turkey.

Taking these together, I find that comparing the duties of directors in both countries, putting emphasis on similar regulations in both countries, and examining them in detail to explore the differences between the legislations of these two countries was an enlightening experience.

## I. Companies in Turkish Legal System

### A. General Information About Turkish Companies

#### 1. The Concept of Company and Its Definition

In Turkey, company law is governed primarily by the Turkish Commercial Code ("TCC") which has recently been adopted. Besides the TCC, the Civil Code ("CC") and the Code of Obligations ("CO") contain some provisions regulating Turkish company law<sup>1</sup>. The new TCC "was passed by the Grand National Assembly of Turkey on January 13<sup>th</sup>, 2011. After being signed by the President, it was published in the Turkish Official Journal on February 14<sup>th</sup>, 2011"<sup>2</sup>. The corporate governance approach of the new TCC adopted four main principles that have universal characteristics within the context of corporate governance; full transparency, fairness, accountability and responsibility<sup>3</sup>. The TCC consists of six main chapters: Enterprise Law, Company Law, Securities Law, Transportation Law,

1 AGN INTERNATIONAL, **Brief Summary of Turkish Tax System**, <http://www.agn-waa.org/publications/Tax%20GuiDe%20TurKeY%202010.pdf>, (Access date 04.07.2014).

2 TEKINALP, Ü. "Introduction To The New Commercial Code And The Reform Of Limited-liability Companies", **The Rabel Journal**, Year 2013, Volume: 77, Number: 1, p.70.

3 PWC, **New Turkish Commercial Code: A Blueprint For The Future**, [https://www.pwc.com.tr/en\\_TR/TR/publications/ttk-assets/pages/ttk-a\\_blueprint\\_for\\_the\\_future.pdf](https://www.pwc.com.tr/en_TR/TR/publications/ttk-assets/pages/ttk-a_blueprint_for_the_future.pdf), (Access date 04.07.2014).

Maritime Commercial Law and Insurance Law. The first chapter of the Company Law is dedicated to general principles of company law. Contrary to expectations, the TCC does not include any provision defining the company and determining its elements. On the other hand, the CO Article 620 which is regulating partnership, defines company as “an agreement between two or more people putting their labor and assets together in order to achieve a common target”, and this definition is accepted as a general definition which is valid for all types of companies <sup>4</sup>.

Companies are legal entities that compromise of people that come together with a legitimate common aim and an intention of making profit and sharing it<sup>5</sup>. Based on the definitions partaking in law and doctrine, the elements of a company can be detected as person, agreement, capital, common purpose and the fact of working together in order to achieve this common purpose (*affection societatis*)<sup>6</sup>.

## 2. Companies in TTC

Commercial Companies are counted in the TCC as a finite number (*numerous clauses*), and it is not possible to form another commercial company other than these<sup>7</sup>. These are as follows:

- Collective Company (TTC A. 211-303).
- Commandite Company (TTC A. 304-328).
- Joint Stock Company (TTC A. 329-563).
- Limited Company (TTC A. 573-644).

Although it is not regulated in the TCC, Cooperatives are also counted as commercial companies according to the article 124/I of the TCC <sup>8</sup>. Each commercial company type counted in the TCC has its own legal entity (TCC A. 124/I) contrary to the partnership that is regulated in article 620 of the CO that does not have any legal entity. If the company does not have a legal entity, then the primary liability belongs to partners.

For commercial companies, firstly, specific provisions related to each company type regulated in the TCC should be applied, and if there is no provision there, CC’s general articles related to legal entities are applied. In case of an absence of provisions about related subject in CC, the CO’s related provisions about partnership are applied as applicable (TCC A. 126).

## 3. Company Types

There are two main types of companies; namely, sole traders and capital companies. Sole trader is a type of the company in which personalities of partners, their commercial

4 ALAŞEHİR TICARET BORSASI, **Anonim Şirketler**, <http://www.atb.org.tr/uploads/AnonimSirketler.PDF>, (Access date 12.07. 2014).

5 KARAHAHAN, S., **Şirketler Hukuku**, Mimoza Yayınları, Konya, 2013, p.22.

6 KARAHAHAN, **2013**, p.22.

7 KARAHAHAN, **2013**, p.26.

8 KARAHAHAN, **2013**, p.26.

standings, economic powers and assets remain at the forefront. Collective Companies and Commandite Companies can be classified as sole traders based on Article 124/II of the TCC. Capital Company is a type of company in which capital is more important than identities and personalities of partners. Joint stock companies, limited liability companies and partnerships limited by shares are classified as capital companies. In capital companies, liability of partners pertaining to corporate debts is limited and is towards the company. Creditors cannot refer to personal assets of partners. Partners do not have any personal liability due to corporate debts. In capital companies, liabilities of partners are limited by the shares and they are committed to the company<sup>9</sup>.

### **B. Publicly- Held Company**

In Turkish Company Law, the only company type that may offer its shares to the public and trade its shares on the stock exchange is known as the Joint Stock Company (“JSC”)<sup>10</sup>. The concept of publicly held joint stock company first came to light in 1963-1964 in the State Legislation about Framing and Encouragement of Capital Markets which was aiming to regulate Capital Markets<sup>11</sup>.

In terms of their function in economic life, JSCs are the ones having a significant importance among these different types of companies. One of these functions is collecting smallholders and steering them to investments and ensuring social justice in the economic field by spreading the concept of property among society, and in order to meet this purpose, shares of joint stock companies should be distributed among the investors; in other words, the number of publicly-held joint stock companies having many partners should increase<sup>12</sup>.

The main code regulating JSCs is the TCC. A publicly held JSC, “as emphasized by Cadbury’s first corporate governance report, is a category not fully covered by the TCC”<sup>13</sup>. Although it has been mentioned in the article 346 of the TCC that shares of joint stock companies can be offered to public during establishment<sup>14</sup>, the TCC has not been designed for a specific class of joint stock companies; it covers both private and public ones. After the Capital Market Law (“CML”) coming into force, the JSC, which wants to offer their shares to public, follows the CML which regulates the ways of public offering and the methods of selling, the capital system to be preferred, the share of profit to be issued, the number of bonds to be exported, accounting standards to be applied and obligations towards the Capital Market

9 KARAHAN, 2013, p.29.

10 AGN INTERNATIONAL, 2012, p.3.

11 YANLI cited in KILIÇ, S., *Halka Açık Anonim Şirketlerde Bilgi Alma Hakkı*. Post Graduate Thesis, Ankara, Ankara University, 2007, p.4.

12 UNAL cited in KILIC, S., 2007, p.4.

13 PWC, 2011, p.34.

14 ALTAŞ, S., *Yeni Türk Ticaret Kanununa Göre Anonim Şirketler*, Seçkin Yayıncılık, Ankara, 2013, p.63.

Board (“CMB”)<sup>15</sup> which is “the regulatory and supervisory authority in charge of the securities markets in Turkey”<sup>16</sup>.

The CMB’s primary function is “to foster securities market development in Turkey and to contribute to the efficient allocation of financial resources in Turkish economy. It is also responsible for determining the operational principles of the capital markets and providing adequate protection for investors”<sup>17</sup>. The CMB, which is the administrative body in charge of public markets and the body which sets the securities market’s main principles, was established by the first CML (Law No. 2499, 30 July 1981)<sup>18</sup>. The CML enacted in 1981 governed regulations on the issuance of securities instruments and the underlying provisions on Intellectual Property Offices. “All securities and certain private placements publicly offered in Turkey need to be registered with the CMB. The registration is mandatory whether the company’s existing shareholders are selling part of their shares to the public or the company is issuing new shares and offering the shares as part of a capital increase”<sup>19</sup>. The Istanbul Stock Exchange is the only securities exchange in Turkey “established to provide trading in equities, bonds and bills, revenue-sharing certificates, private sector bonds, foreign securities and real estate certificates as well as international securities. It is supervised by the CMB to ensure proper operation”<sup>20</sup>.

Although the CML has different regulations compared to the TCC concerning joint stock companies, the CML is not a code that should be taken as the only source which regulates everything related to joint stock companies. However, “public offering of shares is conducted in accordance with the CML, and is applied in conformity with the regulations of the CMB”<sup>21</sup>. The CML article 3/I e) defines a publicly held corporation as “a joint stock corporation, the shares of which are offered to public or are deemed to be offered to public” and a public offer as “a general call made through any means for the purchase of capital market instruments and the sale realized after this call” in article 3/I f)<sup>22</sup>. Public offering is the fact of issuing call to public in all kinds of means by aiming the capital market instruments to be purchased, inviting the public to be a founder of or a partner to a joint stock company<sup>23</sup>. To put it differently, companies can go to public in different ways; the shares of which are offered to public (CML S. 3/e) or are deemed

15 KILIC, 2007, p.9.

16 CAPITAL MARKETS BOARD OF TURKEY, **Our Mission**, <http://www.cmb.gov.tr/indexcont.aspx?action=showpage&menuid=0&pid=0&submenuheader=-1> (Access date 10.07.2014), p.1.

17 AZIZ, E./ COLLAK, O., “Taking a Company Public In Turkey”, **International Financial Law Review**, Year: 2005, Volume: 24, Number:3, p.83.

18 SOMAY, M. “Sources of Corporate Governance Rules and Practices”. **Corporate Governance 2010**, Law Business Research Ltd., London, 2010, p.230.

19 AZIZ/ COLLAK, 2005, p.85.

20 AZIZ/ COLLAK, 2005, p.84.

21 ALTAS, 2013, p.63.

22 CML cited in ALAŞEHİR TICARET BORSASI, 2008, p.116.

23 ALAŞEHİR TICARET BORSASI, 2008, p.116.

to be offered to public and the shares of which are traded on exchange (CML S. 16/1)<sup>24</sup>.

Real or legal entities which want to offer their shares to the public will have to provide a commitment to offer its shares to the public. "The respective shares will then be offered to the public, and that part of the sold shares, which corresponds to the nominal value, will be paid to the company, while all of the unsold shares will be left to the party who made the commitment. Public offerings will have to be performed in compliance with the CMB communiqués"<sup>25</sup>. "Pursuant to the CML, no capital may be collected from the public without the permission of the CMB in the guise of establishing companies, increasing capital or other such activities"<sup>26</sup>. "The CMB regularly promulgates new communiqués and is continuously improving secondary legislation to ensure a transparent and sound capital markets environment"<sup>27</sup>.

As it can be understood from its definition mentioned earlier, the first condition of being a publicly held company is to be founded as a joint stock company. It has been pointed out that only the TCC can be applied to private joint stock companies which are not held in public; while both the CML and the TCC can be applied to public joint stock companies. Even though both the TCC and the CML can be applied to public companies, the first one that should be applied should preferably be the CML<sup>28</sup>. In other words, public joint stock companies are firstly subject to the CML<sup>29</sup>. Aiming to focus on duties of directors in public companies in both countries, this article is going to focus on the JSC in Turkey, owing to the fact that it is the only one that can be held in public in Turkey.

### C. Basic Characteristics of Joint Stock Companies

The TCC makes three organs compulsory for joint stock companies. These are; general assembly ("GA"), board of directors ("BOD") and auditors. GA is the organ which has the broadest authority compared to the others. Although both of them are organs of a company, BOD is different from GA in terms of being permanent<sup>30</sup>. The declarations that are used and explained by the general assembly and the power exercised are related to the internal affairs of the company. Auditors are the parties who are responsible for controlling the acts and transactions of the company. Board of directors, which derives its power from the general assembly, is the organ that directs and represents the company, and it is the organ that has the binding authority. Board of directors is the second most important organ after the general assembly. The partnership named San Giorgio that was founded in 1407 in Genoa has been accepted to be the first joint stock

24 KARAHAN, 2013, p.337.

25 KULELİ, T., "New Rules for Turkish Joint Stock Companies", **Private Das Gel-Magasin**, Year: 2011, Volume: 4, p.42.

26 INCI, P./ YALÇIN, U., "Liabilities Of Board Members Under The New Turkish Commercial Code", **Hergüner Bilgen Özeke Newsletter**, 2012, p.5.

27 AZIZ/ COLLAK, 2005, p.83.

28 KILIC, 2007, p.28.

29 KARAHAN, 2013, p.337.

30 PULAŞLI cited in KARAHAN, 2013, p.389.

company in the history<sup>31</sup>. However, today's joint stock companies were started to be founded after the end of the 16th century in Turkey, and the first joint stock companies started to be regulated after the Commercial Code dated to 1850s<sup>32</sup>.

Characteristics of the JSC, its foundation, its partnership structure, its capital and its insolvency are regulated in the TCC, in between the articles 329 and 563 . Article 329/I of the TCC defines joint stock company as "a company the capital of which is certain and divided into shares, and which is solely responsible for its debts as an amount of its assets", and in the second part, it is mentioned that "shareholders are solely responsible to the company, and their responsibility is limited to their subscribed shares". Pursuant to article 338 of the TCC, one real or legal person is now enough to establish a JSC. The TCC states that "one" or "more" shareholder founders are required for the incorporation of a joint stock company. This single shareholder joint stock company is a significant change introduced by the new TCC, satisfying a major need in the establishment of a joint stock company. Through application of this new concept in single-member JSCs, the formation of publicly held companies will be greatly simplified and accelerated<sup>33</sup>.

Considering the developments in the EU Law, the TCC launches the joint stock company with a sole shareholder (TCC A. 338/1). "Three essential functions of this regulation are 1) to reconcile the legal regime with the economic truth 2) to establish a new model for investors who require limited liability 3) to constitute a model facilitating the launching and the conduction of group of companies, institutionalization of enterprises and further the establishment of foundations"<sup>34</sup>. One of the reasons why JSCs are preferred is due to its structure enabling a foundation between family members, which gives the opportunity to go to public, and the fact of being convenient for multi-partnered structure and the easiness of shares to be passed on to other hands<sup>35</sup>.

A joint stock company is "a company whose capital is fixed and divided into shares which makes it more suitable to be incorporated for all kinds of economic purposes and scopes, but may not be formed for an unlawful purpose"<sup>36</sup>. In a JSC, capital is divided into shares. In Turkish law, the word "pay" or "share" is used with several meanings. "It refers to a part of the share capital, but it also signifies a single unit of shareholders' aggregate rights. Because of this rule, a shareholder enjoys these rights according to the number of shares that are held"<sup>37</sup>. JSCs have two types; the classic, private ones

31 KARAHAN, **2013**, p.335.

32 KARAHAN, **2013**, p.335.

33 TEKİNALP, **2013**, p.95.

34 DELOITTE, **The New Turkish Code Of Commerce Rules Regarding The Corporations In A Nutshell**, İstanbul, 2011, p.6.

35 KARAHAN, **2013**, p.335

36 CEREBRA, **The New Turkish Commercial Code**. [http://www.dce.gov.ro/Materiale%20site/Indrumar\\_afaceri/cod\\_com\\_%20Turcia2013.pdf](http://www.dce.gov.ro/Materiale%20site/Indrumar_afaceri/cod_com_%20Turcia2013.pdf), (Access date 10.07.2014), p.13.

37 TEKİNALP, **2013**, p.96.



regulated by the TCC which are closed to the public, and the other ones regulated by the CML and which are open to public<sup>38</sup>.

As it was mentioned earlier while talking about publicly held joint stock companies, during the formation of a JSC, at least one of the founders “commits himself to making a public offering of the shares to which he subscribes within two months of the date of the company’s registration and to paying the value of subscription with the proceeds from the sale of such shares”<sup>39</sup>. In publicly held joint stock companies which have essential importance on the development of the capital market, the property of capital and its administration are entirely separated, and smallholder owners generally leave their administrative rights to the directors of the company<sup>40</sup>. “The board of directors and the management are authorized to make decisions with regard to all kinds of business and transactions required to perform the scope of activity of the company, excluding those which are subject to the authority of the general assembly according to the law and articles of the association”<sup>41</sup>. According to the TCC, regarding the economic importance of joint stock companies, the board of directors, which has the power of representation and direction besides having binding authority, must be liable under some circumstances<sup>42</sup>. For this reason, especially in public companies, board membership which constitutes responsibility is an even more important position compared to the board membership in private companies, due to the fact that members are under the obligation of directing a property belonging to the public<sup>43</sup>.

#### D. Board of Directors

BOD is the body of a JSC that is responsible for managerial acts in internal affairs and that represents the company in external affairs<sup>44</sup>. As it is regulated in the part entitled “Operation Basis” in CMB’s annunciation, BOD should conduct its activity by pursuing certain principles; such as transparency, equity and responsibility in publicly held companies<sup>45</sup>. While regulating the functions of BOD, CMB’s annunciation regulates BOD’s duties and responsibilities, and states that while making strategic decisions, BOD represents and directs the company by considering company’s risk, growth and return

38 KILIC, 2007, p.1.

39 TEKİNALP, 2013, p.95.

40 OSORKHAN, U., **Anonim Ortaklıklarda Yönetim Kurulu Üyelerinin Hukuki Sorumluluğu**. Post Graduate Thesis, Ankara, Ankara Üniversitesi, 2004, p.1.

41 CEREBRA, 2013, p.17.

42 GÜVEN, İ., **Anonim Şirketlerde Yönetim Kurulu Üyeleri Ve Hukuki Sorumluluğu**, 2009, p.1.

43 OSORKHAN, 2004, p.1

44 UYSAL, L. “6762 Sayılı Türk Ticaret Kanunu Ve Türk Ticaret Kanunu Tasarısı Kapsamında Anonim Şirketlerde Yönetim Kurulu Ve Yönetim Kurulu Üyelerinin Hukuki Sorumluluğu”. **Türkiye Barolar Birliği Dergisi**, Year: 2009, Volume: 80, p.317.

45 ERDOĞMUŞ, A., **Anonim şirketlerde yönetim kurulu üyelerinin görevleri, hakları ve sorumlulukları anlamında yeni Türk Ticaret Kanunu ne gibi önemli yenilikler getirmiştir?**, <http://www.erdogmusdanismanlik.com>, (Access date: 02.07.2014), p.8.

balance with a rationalist and cautious understanding of risk management; it considers long-term profit of the company and defines its strategic aims, determines the financial and human resources that the company may need, controls the management performance of the company and observes the legal compliance of its activities<sup>46</sup>. The concept of management has two different meanings; first of all, it covers all management works, and secondly, it reflects the executive organization of the company<sup>47</sup>. According to A. 374 of TCC, "the BOD and the management, to the extent delegated to them, shall be authorized to make decision with regard to all business and transactions required to perform the company's scope of activity, excluding those subject to the authority of the GA by law and the articles of association"<sup>48</sup>.

"A joint stock company may have a board of directors which consists of one or more persons assigned by the articles of association or elected by the general assembly"<sup>49</sup>. TCC A. 359/I states that one member is sufficient for the incorporation of a JSC, which means that the BOD of a JSC can be comprised of one single member. Another issue which is mentioned by the TCC is that legal entities can be a member of board, and that legal entities can also be responsible for their acts<sup>50</sup>, which shows that the TCC paves the ways for legal entities to be a part of the BOD by A. 359/II. It is stated that "in the event a legal entity is elected as a member of the BOD only one real person, determined by the legal entity on its behalf, shall also be registered and announced with the legal entity<sup>51</sup> duty to the fact that they need organs in order to use their civil rights (CC m. 47)<sup>52</sup>. To put it differently, with the TCC, both individuals and legal entities can be appointed as board members; however, "for the avoidance of any doubt, a legal entity may only be represented in the Board by one individual representative"<sup>53</sup>. Only this registered person can participate in and vote on behalf of the legal entity at the meetings" by aiming to provide security to the company, to the shareholders and to the creditors<sup>54</sup>. The Commercial Code does not bring any limit to minimum or maximum number of Board members to be appointed. Beside this, as per A. 359, it is no longer mandatory to be a shareholder of a company in order to be a board member<sup>55</sup>.

46 ERDOĞMUŞ, 2013, p.8.

47 SOYKAN cited in DEDEAĞAÇ, E./ SAPAN, O. (2013). **Anonim Şirketlerde Yönetim Kurulu Ve Sorumluluğu**, 1st Edition, [ebook] ARCS Ofset Matbaacılık, Ankara. <http://www.ankarabarusu.org.tr/Siteler/2012yayin/2011sonrasikitap/anonim-sirketlerde-yonetim-kurulu.pdf>, (Access date 11.07.2014), p.8.

48 DEDEAĞAÇ & SAPAN, 2013, p.42.

49 CEREBRA, 2013, p.17.

50 DEDEAĞAÇ/ SAPAN, 2013, p.9.

51 KEPKEP, B. (2012). **Board of Directors Under The Turkish Commercial Code**, <http://www.jdsupra.com/legalnews/board-of-directors-under-the-turkish-com-14032/>, (Access date: 08.08.2014).

52 UYSAL, 2009, p.317.

53 KEPKEP, 2012, p.1

54 ALTAŞ, 2013, p.177.

55 KULELİ, 2011, p.42.

It is clear that regarding the relationship between the company and the BOD, the latter is classified as an organ of the company. However, the relationship between board members and the company is complicated and disputable. In doctrine, it is defended that this relationship between board members and the company is based on an attorney or on a service agreement<sup>56</sup>. Although some authors, such as ÖZDEĞİRMENCİ may defend that "the relationship between the company and the board members is accepted as a "service agreement" under law and such agreements impose a loyalty obligation on the board members" and so that the board members are found to be under obligation to consider the interest of the company and to prefer the interest of the company over his/her own interest<sup>57</sup>, according to BOZKURT, the relationship between board members and the company should be classified as an attorney agreement unless otherwise stated<sup>58</sup> and in general, as BOZKURT defends; the relationship between board members and the company is accepted to be based on an attorney agreement<sup>59</sup>. However, the BOD's power of attorney is not limitless; to put it in another way, the BOD cannot represent the company in every respect<sup>60</sup>.

In TCC, boards of directors have been designed to be company organs which can be easily convened, which can take decisions expeditiously, and whose functional areas are clearly defined; their members possess ultimate rights of purview and access to information both within the board and throughout the company and may, when necessary, have recourse to the courts in order to exercise such rights. In this new system a board may, by means of organizational regulation, delegate any respect of their company's management to one or more company officers save for those authorities and duties which the law states are non-delegable and inalienable<sup>61</sup>.

The Board of Directors of a joint stock company has been one of the most significant areas in the commercial environment, and its absence can even cause the dissolution of the company according to the TCC A. 530/I. "The reason for such significance of BOD could be due to the fact that, the BOD is the representation and administration body of a joint stock company among third parties or another reason for such significance

56 BOZKURT, T., "Türk Ticaret Kanunu Ve Tasarısı Çerçevesinde Anonim Şirketlerde Yönetim Kurulu Üyelerinin Hukukî Sorumluluğu :Üyelerin Özellikle Doğrudan Doğruya Verdikleri Zararlardan Doğan Sorumlulukları Ve Yargı Uygulaması", **Türkiye Barolar Birliği Dergisi**, Year: 2009, Volume: 83, p.155.

57 ÖZDEĞİRMENCİ, E., **Liabilities of the Board of Directors in a Joint Stock Company in the Consideration of the Current Turkish Commercial Code**, 2010, p.6.

58 BOZKURT, 2009, p.155.

59 ARSLANLI cited in ÖTLEGEN, M. Z., **Anonim Otaklıklarda Yönetim Kurulu Üyelerinin Hukukî Sorumluluğunu Sona Erdiren Nedenlerden İbra Ve Zamanaşımı**. Post Graduate Thesis, Ankara, Ankara Üniversitesi, 2003, p.27.

60 KARAHAN, 2013, p.396.

61 TEKİNALP, 2013, p.99.

could be on the basis that majority of the shareholders desire to manage the company and in doing so they would like to elect their own directors"<sup>62</sup>. In addition to this, being an organ of the company, the BOD should be audited frequently due to the fact that the BOD is the representative and managerial body of a corporation and, at the same time, while conducting the business of the corporation, it act as a proprietor<sup>63</sup>. For the abovementioned reasons, I would like to draw attention to the title "Board of Directors of a Joint Stock Company" under the Turkish Commercial Code and would like to examine its duties and responsibilities in detail.

### **E. Duties and Responsibilities of the Board of Directors**

The board is the unit responsible for the management and representation of the company. While analyzing and evaluating transactions of the BOD, its duties and powers should be considered together owing to the fact that power is needed in order to achieve the duties. Otherwise, if the duties are assigned without power, it cannot be accepted from the BOD to function properly<sup>64</sup>. The duties which can be applied to all shareholders in sole traders can just be applied to the board members and managing directors in JSCs. The board owes legal duties primarily to the company, and indirectly to its shareholders and creditors. The power of the BOD can be based on law or can arise from the article of association<sup>65</sup>. The primary duties of the board members are to:

Although the main duty of members of the board is to participate in board meetings unless there is a legal restriction (TCC A. 393) or a personal restraint and to present an opinion and to object to the decision which they doesn't approve<sup>66</sup> in general terms, their duties can be stated as follows: "management, representation, keeping the books of the company accurately, duties regarding the general meeting, execution of the decisions of the general meeting, arranging company accounts and annual reports, duties in case of a decrease in assets, duties in case of a decrease or increase in the capital, duties in case of the termination or receivership of the company, duty of the registry and announcement, duties arising out of bonds, duties of care and loyalty"<sup>67</sup>. And regarding their actions and their duties, board members are liable to the joint stock company, shareholders and the creditors. According to ÖZDEĞİRMENCİ, this is not a personal liability but a joint liability<sup>68</sup>.

62 ÇELEBİ, N. (2009). **Board Of Directors Of A Joint Stock Company In The Light Of Draft Turkish Commercial Code** <http://www.mondaq.com/x/85028/Corporate+Governance/Board+Of+Directors+Of+A+Joint+Stock+Company+In+The+Light+Of+Draft+Turkish+Commercial+Code> (Access date 18.07. 2014).

63 OSORKHAN, **2004**, p.1.

64 KARAHAN, **2013**, p.391.

65 POROY/ TEKİNOĞLU/ ÇAMOĞLU cited in KARAHAN, **2013**, p.396.

66 KARAHAN, **2013**, p.423.

67 ÖZDEĞİRMENCİ, **2010**, p.2.

68 ÖZDEĞİRMENCİ, **2010**, p.4.

## 1. Duty of Care and Duty of Loyalty (A. 369)

The TCC explains the concept of duty of care and duty of loyalty of the BOD with the business judgment rule dealing with the concept of a prudent businessman.

### Duty of Care

Duty of care can be named after the duty of being attentive. Behavior can just be an internal attitude or can concern an action. Besides thinking and deciding carefully, directors are also expected to bring their decisions into action carefully<sup>69</sup>. Article 369 of the TCC states that “BOD members and third parties in charge of management shall be held liable for prudent performance and protection of the company’s interests”. Under the TCC, board members are required to act prudently and diligently, while carrying out their duties and the business of the company<sup>70</sup>. In accordance with that provision “the board members and third parties in charge of management are liable for performing their duties with due care of a prudent manager and to protect the company’s interests in good faith”<sup>71</sup>. “Being cautious” is a behavioral pattern and “taking precautions” is an act. The one that makes the act a habit is the one that transforms the precaution into an adjective for himself and the one who becomes a “cautious and prudent business man” which is what law wants<sup>72</sup>.

What is meant by “acting as a prudent businessman” is acting with the knowledge, experience and prudence that can be expected from him. Prudent businessman standards accept that board members can make the right decision according to corporate governance principles, and these are based on the principle of not holding the members liable when a risk arises while making these decisions<sup>73</sup>. In other words, if the BOD’s decision is made after doing all necessary researches and after collecting all necessary information from relevant people, in that case, even if the company has lost money, negligence should be besides the mark<sup>74</sup>. The concept of a “prudent businessman” is not only a way of measurement for negligence or fault, but also means the objective behavior in acts. But it does not cover the caution behind the objective expectation and behind the control<sup>75</sup>. To give an example to act as a prudent businessman, in case of an economic crisis or any other sectoral risks, board members and directors should evaluate the situation in details regarding all possibilities and to take necessary precautions, they should follow the developments in the market and determine the ones that

69 BATTAL, A., “Yeni Türk Ticaret Kanununda Anonim Şirket Yönetim Kurulu Üyelerinin Sorumluluk Rejimi”, **Akdeniz Üniversitesi Hukuk Fakültesi Dergisi**, Year: 2012, Volume: 2, p.32.

70 SOMAY, 2010, p.232.

71 CEREBRA, 2013, p.20.

72 BATTAL, 2012, p.32.

73 PWC, **A.Ş.lerde Yönetim Kurulu Üyeleri ve YK Üyelerinin Hukuki Sorumluluğu**, <https://www.okul.pwc.com.tr/images/uploadfile/content/635224429755498499.pdf> (Access date: 04.07.2014), p.8.

74 DEDEAĞAÇ/ SAPAN, 2013, p.52.

75 DEDEAĞAÇ/ SAPAN, 2013, p.52.

the company may be interested in, and by doing all these they should aim to protect the interest of the company<sup>76</sup>.

Article 553/3 of the TCC draws the lines of this measurement by stating that “a BOD member cannot be held liable for the violation of law, the articles of association or fraudulent activities which are beyond his/her control. This unaccountability may not be challenged based on duties of care and supervision”. In addition to these, A. 557 of the TCC defends and necessitates that the prudence and the caution should be evaluated based on the person itself; “in case more than one person is liable to compensate for the same damage can be attributed personally, shall be jointly liable of the damage with the others. The claimant can sue more than one liable person for the entire damage and can ask the judge to determine the damage liability of each of the defendants in the same case”.

The law just mentions the degree of the duty of care, not its necessity, which shows that board members are definitely under the duty of care<sup>77</sup>. Some people believe that duty of care is an objective duty, and there is no need to consider the subjective qualities of board members; such as knowledge, ability etc. According to ÖZGÖDEK, the duty of care must have a character independent of any personal matters explained above, and should not have a character with personal features<sup>78</sup>. In other words, he defends that the duty of care of board members is not of a subjective, *idiosyncratic* character, but is on the contrary an objective (independent of personal matters) one. However, the objectivity of the duty of care of the BOD should be discussed between the board members of JSCs having same qualifications, status and size. Board members of a public joint stock company and the ones of a small-scaled company should not be compared, due to the fact that the same knowledge and experience as a public JSC’s board members cannot be expected from board members of a small-scaled company<sup>79</sup>. This is the reason why sometimes it is needed to make the objective average prudent businessman standards subjective<sup>80</sup>.

‘The TCC requires board members to act as cautious executives and protect the interests of the company while performing their duties in accordance with the principle of good faith. A cautious executive must make business judgment rules in accordance with the principles of corporate governance’<sup>81</sup>. This is the reason why the justification of the article 369 of the TCC criticizes the previous TCC, stating that it leaves the care totally out of the coverage or that it hardly covers the concept of care in terms of protecting the private capital connected to the field of operation, in relations with associates and

76 ERDOĞMUŞ, **2013**, p.4.

77 KARAHAN, **2013**, p.428.

78 ÖZGÖDEK, D. G., “Evaluation of the Principle of “Duty of Care” In Terms of the Responsibilities of the Board Members of Corporations”, **Ankara Bar Review**, Year:2008, Volume: 2, p.67.

79 PULAŞLI cited in UYSAL, **2009**, p.365.

80 BATTAL, **2012**, p.33.

81 INCI/ YALCIN, **2012**, p.3.

in terms of dividend and finance policy<sup>82</sup>. The article 369 of the TCC, as it is mentioned in its justification, defines the care with the prudent businessman standards and puts emphasis on company's interests and it accepts good faith as a criterion for this. The fact of looking after the company's interest should be applied according to the good faith principle. The main function of the "Bona Fide" rule is to draw a limit in exercising rights and fulfilling obligations, and moreover to serve largely to interpret judicial rules, particularly codes, and completing loops. Judges will also make use of these rules while creating jurisdiction or using discretionary powers<sup>83</sup>. So, protecting company's interest in conformity with good faith means to act according to the objective standards and behavioral patterns that the good faith principle requires to be<sup>84</sup>. After stating all these, it is clear that the duty of care of board members, which they must strictly follow while representing and managing the company, is important socially and legally as much as commercially<sup>85</sup>.

### Duty of Loyalty

JSC as a legal entity, through the GA, should trust the people whom they are chosen to govern and to represent the company, and board members should respond this trust with the duty of loyalty<sup>86</sup>. It is mentioned above that article 369 of the TCC sets forth the level of duty of care and duty of loyalty of BOD members. BOD members are obligated to act as cautious executives and to protect the interests of the company, while performing their duties in accordance with the principle of good faith. "A cautious executive must make business judgments pursuant to the principles of corporate governance. Articles 203 and 205 of the TCC are reserved. As long as the BOD members act as cautious executives in good faith, no liability arises"<sup>87</sup>. The reason for the existence of duty of loyalty is to prevent the directors having the secret of the company from endangering them, because of other interests and from damaging the company<sup>88</sup>.

Duty of loyalty has keeping the business secrets and considering the company's interest in the first place at its heart<sup>89</sup>. Even though the TCC does not include any provision directly referring to the liability of secrecy, while the justification of the article 369 and its content stating the necessity of looking after the company's interest according to good faith are evaluated together, it can be said that these statements

82 DEDEAĞAÇ/ SAPAN, 2013, p. 55.

83 PULAŞLI cited in ÖZGÖDEK, 2008, p.69.

84 BATTAL, 2012, p.34.

85 ÖZGÖDEK, 2008, p.69.

86 KIRCA/ MANAVGAT cited in KARAHAN, 2013, p.428

87 KOCAMAN, E./ PELİT, N., **Liabilities Of The Board Of Directors In Joint Stock Corporations Under Turkish Commercial Code**, [http://www.koicuoglu.av.tr/Home/OpenDocument/ebulletinliabilitiesoftheboardirectorsinjsc\\_d5F3Lnk8](http://www.koicuoglu.av.tr/Home/OpenDocument/ebulletinliabilitiesoftheboardirectorsinjsc_d5F3Lnk8), (Access date: 03.08.2014).

88 DOMANIÇ cited in KARAHAN, 2013, p.430

89 PULAŞLI cited in KARAHAN, 2013, p.428

bring with the liability of secrecy for board members<sup>90</sup>. Duty of care is regulated as an independent duty without referring to any other duties. However, duty of loyalty cannot be evaluated without the obligation of faithfulness<sup>91</sup>. The duty of loyalty regulated in this article means to protect the company's interest in conformity with the good faith principle. This provision becomes important especially when there is a conflict between company's interest and shareholders'/partners' interest occurs<sup>92</sup>. The relationship between the BOD and the JSC is based on confidence. For this reason, board members should be loyal to the company and its shareholders, and they should value company's interest over everything else and keep the company's secrets<sup>93</sup>. Keeping the secret of the company means not giving the partnership certificate to any body or not sharing it with anyone, not keeping its copies or photocopies and giving back some documents at the end of their duty period as a board member<sup>94</sup>. The duty of keeping secret continues even after the duty period ends.

## 2. Non-compete Obligation (A. 396)

Board members should try to prevent the unfair competition within the scope of the company by regulating the rules covering this issue<sup>95</sup>. This provision puts the board member under the obligation of an extensive loyalty to the company apart from making them rely on the prohibition of competition, and oblige the insiders having secret information from the company to obey to the prohibition of trade<sup>96</sup> (DEDEAĞAÇ & SAPAN, 2013, p.53). Article 396 states that "no board member can conduct any transaction of a commercial nature falling under the scope of activity of the company in his/her account or any other person's account without obtaining permission from the GA, and he/she cannot participate in a company involved in the same kind of commercial business as a partner with unlimited liability" (TCC). So, the first condition for a breach of competition is a business which falls under the scope of activity of the company, which can be defined as de facto activities that company is dealing with.

In this article, the aim is to prevent board members from doing a business transaction which falls under the scope of activity of the company; in other words, to prevent board members from putting their own interest, the shareholders' interests and the natural people's or legal entities' interests who are close to them in the first place compared to the company's own interest. This provision makes it essential for the BOD to take the necessary precautions and to bargain in accordance with the competition conditions in order to protect company's interests in case of a conflict of interests. The

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90 DEDEAĞAÇ/ SAPAN, **2013**, p. 55

91 BATTAL, **2012**, p.32.

92 BATTAL, **2012**, p.33.

93 UYSAL, **2009**, p.365.

94 BAHTİYAR cited in UYSAL, **2009**, p.366.

95 ERDOĞMUŞ, **2013**, p.15.

96 DEDEAĞAÇ/ SAPAN, **2013**, p. 53.



company can claim compensation from the board member in case of a breach of non-compete obligation or alternatively, instead of the compensation, “the company may consider the concerned transaction as it was made in the name of the company and claim any benefits arising from that transaction”<sup>97</sup>. As it can be understood from the literal of the article 335, the TCC just banned the commercial affairs that fall under the scope of company’s activities; so, it can be deduced that the ones cannot be classified as commercial affairs should be outside of the breach of competition<sup>98</sup>.

### **3. Prohibition to Conduct Transaction with Company and to Become Indebted to Company (A. 395)**

#### **Prohibition to Conduct Transaction with Company**

In spite of the fact that freedom of contract is valid in Turkish law, this is not an absolute norm and one of the exceptions to this norm arises from the transaction between board members and the company<sup>99</sup>. According to the article 395 of the TCC, “a board member cannot conduct any transaction with the company in his/her or any other person’s name without permission from the GA. If this provision is violated, the company can claim the transaction is null and void”. This means that board members cannot conduct any transaction of a commercial nature that relates to the scope of the company’s activity in his or her name or in the name of any other persons without obtaining permission from the general assembly, which shows that A. 395 sets bounds to the fact of board members doing business on his or any other person’s name,<sup>100</sup> and the only exception to this provision is stated as the permission of the GA. In order to carry out the prohibition of conducting transaction with the company, the company should claim nullity through the GA<sup>101</sup>. Furthermore, “board members cannot be involved in a company that has the same type of business as a partner with unlimited liability”<sup>102</sup>.

Although it can be thought at the first sight that non-compete obligation and prohibition of conducting a transaction with the company covers the same issues, after examining both provisions, it is clear that they do not have much in common due to the fact that in article 396/I, the company that board member does business with can be any company; the important thing here is the existence of the fact of doing business with another company that falls under the scope of activity of the company which s/he is a member of. On the other hand, in article 395/I, the situation is a bit different; in that case, it is prohibited for a board member to do a business directly with the company which that s/he is a member of.

97 CEREBRA, **2013**, p.25.

98 UYSAL, **2009**, p.360.

99 KARAHAN, **2013**, p.429.

100 DEDEAĞAÇ/ SAPAN, **2013**, p. 58.

101 KARAHAN, **2013**, p.429.

102 CEREBRA, **2013**, p.25.

### **Prohibition of Becoming Indebted to the Company**

Article 395/II of the TCC puts forward the following: “the board member, his/her relatives specified in Article 393 (who are not shareholders, and a person of his/her lineal consanguinity or his/her spouse or one of his/her blood and in-law relatives up to third degree, including the third degree cannot borrow cash from the company), 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 cannot become indebted in cash or in kind to the company. The company cannot provide surety, guarantee or security for these persons, undertake liability or take over their debts. Otherwise, the creditors of the company can start execution proceedings directly against these people for the debt of the company in the amount for which the company is liable”.

It is stated that without obtaining permission from the general assembly, the board member cannot conduct any transaction mentioned above with the company directly or indirectly, due to the fact that they should care about the interest of the company and should “provide that the company business is conducted in compliance with the legislature and the articles of incorporation of the company”<sup>103</sup>. To the contrary, creditors of the company may directly pursue these persons for the company debts to the amounts for which the company is liable for<sup>104</sup> and “if such permission is not obtained, the company may claim that the concerned transaction is invalid. However, the counter party may not make such a claim”<sup>105</sup>.

### **4. Prohibition of Participating in Discussions in Cases of Conflict of Interests (A. 393)**

As it is mentioned earlier, JSC carries its business through the BOD which is the organ responsible from the management of the company. In order to fulfill this duty, the BOD should make decisions via board meetings. Article 393/1 of the TCC brings a prohibition about a fact that can be classified as a conflict of interest; “a board member cannot participate in discussions regarding matters which lead to a conflict between interests of the company and personal interests of the member or a person of his/her lineal consanguinity or his/her spouse or one of his/her blood and in-law relatives up to and including the third degree”. The TCC aims to prevent board members from participating in a meeting about any conflicts of interests that may occur between the company's interests and personal interests of board members or the aforementioned individuals<sup>106</sup>.

Another situation regulated in article 393 that requires board members not to participate in a board meeting is, “in cases where acting in good faith requires the

103 ÖZDEĞİRMENÇİ, 2011, p.4.

104 CEREBRA, 2013, p.25.

105 CEREBRA, 2013, p.25.

106 DEDEAĞAÇ/ SAPAN, 2013, p. 63.

non-participation of a board member in the discussion"<sup>107</sup>. If integrity requires non-participation of the board member in discussions, then the prohibition may be applied. "In cases where there is doubt or in cases where the conflict of interest is not known by the board, the concerned member is obliged to declare it and abide by the prohibition so that the board should vote to make the final decision. The member concerned cannot participate in this voting"<sup>108</sup>.

## II. Companies in British Legal System

### A. General Information About British Companies

Although the notion of "corporation" covers more than the notion "company", in the UK, the word 'company' has been used for a long time and even the main code regulating the corporate law has been entitled as Companies Act since 1862, and this act makes it clear that a company is a corporation<sup>109</sup>. Companies Act 2006 ("CA"), which is the one that is still in force, is the one that regulates and codifies duties of directors for the first time<sup>110</sup>. A company, for the lawyer, "is an organizational form, provided by the law, through which the suppliers of the various inputs necessary to achieve a certain objective can come together and coordinate their activities of a business nature and designed to earn profits"<sup>111</sup>. All companies should be formed according to the CA, which can be qualified as the primary source regulating companies. According to CA 2006, companies "are separate legal persons that may, amongst others, own property, enter into contracts, sue and be sued"<sup>112</sup>. The notion that "the company is a legal person separate from its shareholders, directors, creditors, employees, indeed from anyone else involved in it, is fundamental to the conceptual structure of company law"<sup>113</sup>. British company law not only focuses on the relationships between and within three different groups: shareholders, directors, and creditors, but also "seeks to regulate, to some extent, the mechanisms by which people join or leave one of these groups as well as their rights and duties once they have joined a group"<sup>114</sup>. British company law is regulated on a shareholder basis which means that "shareholder primacy would be maintained as a key principle of UK company law ... and this is reflected in the structure and framework of UK company law, which requires directors to advance shareholders' interest as a whole"<sup>115</sup>.

107 DEDEAĞAÇ/ SAPAN, 2013, p. 63.

108 CEREBRA, 2013, p.25.

109 LOWRY, J./ REISBERG, A., **Pettet's Company Law: Company Law & Corporate Financ**, Pearson, London, 2012, p.15.

110 FOLLAND, N., "Directors' Duties", **Practical Law For Companies**, Year: 2007, Volume:18, Number:1, p. 19.

111 CRAIG, P, **Introduction to Company Law**, Oxford University Press, Oxford, 2010, p.2.

112 KERSHAW, D., **Company Law in Context**, Oxford University Press, Oxford, 2012 p.12.

113 CRAIG, 2010, p.9.

114 CRAIG, 2010, p.4.

115 ACCA, **Shareholder Primacy in UK Corporate Law: An Exploration of the Rationale and Evidence**, The Association of Chartered Certified Accountants, London, 2011, p.5.

In accordance with CA 2006, a company can be formed with limited or unlimited liability, and to benefit from limited liability, the company's constitution must provide that liability of its members is limited<sup>116</sup>. If there is no provision limiting the liability of members, then, in that case, this company is called an unlimited company and "this type of companies has no limit on the liability of its members"<sup>117</sup> and limited companies in the UK can be formed as either limited by shares or guarantee. "Companies limited by guarantee are often used for bodies carrying out quasi-governmental or non-profit functions"<sup>118</sup>.

## **B. Public & Private Company**

A company can be founded as a private or a public company according to CA 2006, "English company law, unlike that most of other European countries, deals with both public and private companies in the same Act"<sup>119</sup>. The vast majority of provisions in the Act 2006 apply equally to both public and private companies. However, in certain contexts, "public companies are subject to more onerous regulation"<sup>120</sup>. A public company can be defined as "a company with a certificate of incorporation that states it is a public company and that has complied with all the necessary provisions of the Act as registration or re-registration as a public company"<sup>121</sup> and a private company can be defined as any company that is not in public.

Generally, companies are established as private companies and then converted to public companies. The reason behind this is to collect and build the necessary amount while being a private company, and to become large enough to be a public company which can benefit from offering its shares to the public<sup>122</sup>. It should be realized that, in economic terms, "some public companies are quite small, perhaps smaller than some of the larger private companies. The mere fact that its legal type is "public" does not of itself guarantee economic size"<sup>123</sup>. Although, for some reasons, it may seem that being a public company is more advantageous than being a private company because of being able to offer shares to the public for investment by advertisement (S. 755); they are subject to a greater degree of regulation by the law compared to private companies.

Essentially, the distinction in terms of capital raising between the two types of companies is that the law presumes that in private companies, the investment is largely provided by the founding members either through their personal savings or from bank

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116 KERSHAW, **2012**, p.11.

117 SEALY, L.S./ WORTHINGTON, S., **Cases And Materials In Company Law**, Oxford University, Oxford Press, 2013, p.20.

118 KERSHAW, **2012**, p.11.

119 SEALY/ WORTHINGTON, **2013**, p.21.

120 KERSHAW, **2012**, p.12.

121 SEALY/ WORTHINGTON, **2013**, p.21.

122 LOWRY/ REISBERG, **2012**, p.16.

123 LOWRY/ REISBERG, **2012**, p.15.

loans, and that, in public companies, the intention is to raise large amounts of money from the general public"<sup>124</sup>. Other than the distinction in terms of capital raising, there are other differences between private and public companies; a public company may offer shares to the public. A private company may not do this, and private companies can be established as limited or unlimited companies; however, "public companies can be founded only as a company limited by shares" (CA 2006, S. 4(2))<sup>125</sup>.

Focusing on public companies that can only be founded as companies limited by shares, the concept of LLC and its features should be examined.

### C. Basic Characteristics of Limited Liability Companies

The establishment of a limited liability company is permitted by Limited Liability Act in 1855<sup>126</sup>. According to the principle of limited liability, "the rights of the company's creditors are confined to the assets of the company and cannot be asserted against the personal assets of the company's members"<sup>127</sup>. There are two types of limited liability companies: namely, companies limited by shares and those limited by guarantee. In a company limited by shares, "a member is not liable for the company's debts beyond the amount remaining unpaid on his or her shares"<sup>128</sup>, and in a company limited by guarantee, "a member is only liable to make a contribution to the assets of the company in the event of its being wound up, and the amount of this contribution is fixed at the outset by the company's constitution"<sup>129</sup>.

The company limited by shares is the most preferred company type in the UK regarding the easiness of carrying an economic activity<sup>130</sup>. In a company limited by shares, "a member is only liable to pay what he agreed to pay for the shares which may be paid or unpaid"<sup>131</sup>. It refers to the restricted liability fixed by "the terms of issue of the shares or by the company's constitutional documents"<sup>132</sup>. It should be mentioned that limited liability has no relation with the liability of the company, because the liability which is limited is the liability of members, not the company's. In other words, "creditors' rights can be asserted to the full against the company's assets"<sup>133</sup>. Limited liability is "widely regarded as a mechanism that encourages entrepreneurship and makes a

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124 DIGNAM, A./ LOWRY, J., **Company Law**. Oxford University Press, Oxford, 2010, p.64.

125 DIGNAM/ LOWRY, **2010**, p.65.

126 MALTBY, J., "UK Joint Stock Companies Legislation 1844-1900: Accounting Publicity And "Mercantile Caution"". **Accounting History**, Year: 1998, Volume: 3, Number: 1, p.23.

127 CRAIG, **2010**, p.10.

128 SEALY/ WORTHINGTON, **2013**, p.21.

129 SEALY/ WORTHINGTON, **2013**, p.21.

130 LOWRY/ REISBERG, **2012**, p.15.

131 KERSHAW, **2012**, p.12.

132 SEALY/ WORTHINGTON, **2013**, p.20

133 CRAIG, **2010**, p.10.

major contribution to the law of business organizations"<sup>134</sup>, due to the fact that limited liability promotes free transfer of shares. Other than that, "shares with limited liability are fungible; they trade at one price regardless of the identity of seller or purchaser; so, limiting the amount of investigation and negotiation needed on the part of the buyer. This facilitates the control of agents through the market price of those shares"<sup>135</sup>.

Having public company as our focus, the type of a company limited by shares and its features is more important, in order to understand the reason why this type of a company is chosen to be a public company, and all these advantages make it clear why the company limited by shares is more preferable and why it is found more suitable to offer its shares to public.

#### **D. Board of Directors**

The separation of ownership and control can be shown as one of the defining characteristics of the corporate form<sup>136</sup>. It means that the parties that own the company and the ones that manage the company are not the same parties. "Shareholders own the corporation, but the board of directors controls the corporation and is responsible for managing the business and affairs of the corporation"<sup>137</sup>. In other words, directors are "obligated by statute to manage their corporate charge on behalf of the shareholders, to the benefit of the corporation and shareholders"<sup>138</sup>.

Board of Directors can be named as the main organ of a company and is classified as the agent of the company, due to the fact that "any physical act that has to be done in order to make a company a party to voluntary transaction has to be done by a human being acting on the company's behalf"<sup>139</sup>, and that the one that acts on the company is the BOD. UK Companies generally have a single or unitary board<sup>140</sup>. The CA 2006 tells nothing about the function of the board; however, S. 154 of the Act states that "a private company must have at least one director and that a public company must have at least two directors, thereby requiring that a public company has a board of directors"<sup>141</sup>. BOD is the main organ of a company, because of being the decision making body which manages a company. In this body, directors are the key decision makers and the managers, and this is valid "for organizations in the private sector and public sector, and whether a company is a family business or part of a transnational group"<sup>142</sup>. Directors

134 FREEDMAN, J., "Limited Liability: Large Company Theory and Small Firms", **The Modern Law Review**, Year: 2000, Volume: 63, Number: 3, p.317.

135 FREEDMAN, **2000**, p.328.

136 BERLE and MEANS cited in NOWICK, E. A., "A Director's Good Faith", **Buffalo Law Review**, Year: 2007, Volume: 55, Number: 2, p.462.

137 Del. Code Ann. Tit. 8, S. 141(a) cited in NOWICK, **2007**, p.463.

138 NOWICK, **2007**, p.458.

139 MAYSON, S.W./ FRENCH, D./ RYAN, C., **Company Law**, Oxford University Press, Oxford, 2013, p.610.

140 KERSHAW, **2012**, p.234.

141 KERSHAW, **2012**, p.252.

142 BELCHER, A., **Directors' Decisions and the Law: Promoting Success**, Routledge, London, 2014, p.1.

do not only represent the company, do business and act on behalf of the company, but also regarded as the company itself in some situations<sup>143</sup>.

Having a BOD has some advantages and disadvantages; "concentrated expertise, relative independence from the company's various stakeholders and the efficiency of centralized decision-making"<sup>144</sup> can be counted among advantages. The disadvantage of having a BOD is that "the directors may manage the company in their own interests rather than in the interests of those they are supposed to serve"<sup>145</sup>. Although it seems that it has more advantages than disadvantages, this one disadvantage is enough to give irreparable harms to the company. This is the reason why sometimes being a director is not easy and requires a responsible and a prudent approach. Therefore, while appointing directors, the power to appoint directors should be exercised carefully by prioritizing company's benefit as a whole, without thinking of any other personal benefits or interests<sup>146</sup>. Because, after becoming a director, even his/her personal actions can be related to the company or can affect company's interest.

In corporate management theory, "the idea has been mooted that the board of directors should not simply be a senior executive committee, but ought to take a broad-ranging, long-term view of the company's activities and objective"<sup>147</sup>. Directors and board members should evaluate lots of things at the same time: they should consider both sides of an act, take necessary precautions in order to consider what is the most beneficial for the company, in order to protect company from potential harms. The position of the directors can be classified as a fiduciary one, and "directors are obligated to act with a primary fidelity to their beneficiary"<sup>148</sup>, in order to fulfill their duties properly. Lots of people want to be a director just to take the advantages of limited liability, "so as to exploit their entrepreneurial skills and instincts, and may not be temperamentally suited to statutory control or constitutional restraint"<sup>149</sup>. Therefore, it is absolutely true that being a director is easy, but being a responsible one is not, due to the fact that being a responsible director requires fulfilling lots of duty with an intensive care.

## E. Duties of Directors

According to KERSHAW, "a duty is an obligation to conduct yourself in a particular way or not to conduct yourself in a particular way"<sup>150</sup>. Because of the fact that directors are viewed as agents of the company and as such, they are subject to "the full rigor of the

143 LOWRY/ REISBERG, **2012**, p.142.

144 SEALY/ WORTHINGTON, **2013**, p.309.

145 SEALY/ WORTHINGTON, **2013**, p.309.

146 SEALY/ WORTHINGTON, **2013**, p.280.

147 DEAN, J., **Directing Public Companies**, Cavendish Publishing Limited, London, 2001, p.8.

148 BAINBRIDGE cited in NOWICK, **2007**, p.466.

149 FEAVER, L. **Director's Duties**, [http://www.city.ac.uk/\\_data/assets/pdf\\_file/0010/133966/Directors-duties.pdf](http://www.city.ac.uk/_data/assets/pdf_file/0010/133966/Directors-duties.pdf), (Access date: 17.07.2014).

150 KERSHAW, **2012**, p.313.

fiduciary duties developed by equity to ensure strict compliance with the overriding principle that fiduciaries must not benefit from their position of trust<sup>151</sup>.

Managing other people's property, directors have different kinds of duties in common law; the first and perhaps the most important one is the "duty of loyalty to the company which requires them not to put themselves in a position in which their personal interest and that of the company may conflict. Secondly, they have a duty to use the powers given to them by the company's constitution for the purposes for which the powers were intended and not for some other purpose. Thirdly, they have a duty to show reasonable care and skill in doing whatever they undertake on behalf of the company"<sup>152</sup>.

Duties of directors were regulated and governed by so many different sources until today as common law, equity and case law; section 170 of the Companies Act 2006, which is the main source of UK Company Law in our day and "which made the duties more accessible"<sup>153</sup>, makes references to common law rules and equitable principles and states that the duties of directors should be interpreted according to these principles<sup>154</sup>. Part 10 of the CA 2006, covering general duties of directors, begins by "addressing the scope and nature of the duties in S.170 and it the goes on to lay down the substantive duties owed by directors to the company"<sup>155</sup>. The rules regulating duties owed by directors are mandatory ones that cannot be derogated from. In other words, "the nature of duties cannot be altered by any means, including altering the corporate constitution"<sup>156</sup>.

### To whom are the duties owed?

It is mentioned above that directors are the agents of the company. "In the law, neither the company nor the board of directors is an agent of a principal shareholder. It follows clearly, therefore, that the duties directors owe are owed to the company that they serve. These duties are not owed to shareholders, individually or collectively, or to any other constituency or group that has a relationship with the company"<sup>157</sup>. Section 170 of the CA makes it clear that duties are owed to the company and because of that, only the company has the right to bring actions in case of a breach of duties.

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151 DIGNAM/ LOWRY, **2010**, p.312.

152 HOFFMAN, L., "Duties of Company Directors", **European Business Law Review**, Year: 1999, Volume: 10, Number: 3-4, p.78.

153 GODDARD, R. , Directors' Duties. **The Edinburgh Law Review**, Year: 2008, Volume: 12, Number: 3, p.472.

154 ATTENBOROUGH, D., "How Directors Should Act When Owing Duties to the Companies' Shareholders: Why We Need to Stop Applying Greenhalgh", **International Company and Commercial Law Review**, Year: 2009, Volume: 20, Number: 10, p.345.

155 LOWRY/ REISBERG, **2012**, p.159.

156 KERSHAW, **2012**, p.450.

157 KERSHAW, **2012**, p.331.



### 1. Duty to Act Within Powers (S. 171)

The directors are obligated to act according to company's constitution and they are not allowed to use their power outside of their scope of authority. In other words, directors cannot act contrary to the constitution. "Even if the directors believe that action contrary to the constitution would promote the success of the company, they are not free to take it"<sup>158</sup>. Older cases such as *Smith and Fawcett* [1942] Ch 304<sup>159</sup> put emphasis on the fact that "they must exercise their discretion bona fide in what they consider-not what a court may consider-is in the interests of the company, and not for any collateral purpose". This shows us that company's constitution provides the framework of directors' power of authority "within which the directors are required to confine the exercise of their discretion rather than being simply an element which they are obliged to take into account"<sup>160</sup>.

### 2. Duty to Promote the Success of the Company (S. 172)

Directors are expected to be careful and act prudently while making their decisions, and they are expected to make good or reasonable decisions by considering the interests of the company. "English law separates these expectations into two separate duties: the duty to promote the success of the company (previously, the duty to act in good faith in the best interests of the company); and the duty of care, skill and diligence"<sup>161</sup>. To start with, the first duty, the "success" in the duty to promote the success of the company is a subjective concept, and, for this reason, it should be determined on a company-by-company basis, due to the fact that it cannot be expected from large and small companies to have the same success and that "it is for the directors to interpret the company's objectives and make practical decisions about how best to achieve them"<sup>162</sup>. But, in general terms, it can be said that success means the long-term sustainable economic income and profit arise from the increase in financial value.

The duty to promote the success of the company, which is mainly based on the duty of loyalty by directors before codification, can be counted as the main fiduciary duty of directors<sup>163</sup>. This duty which can be named as the sub-duty of the duty of loyalty, "regulates the exercise of discretion by directors; it provides the law's standard of competence in relation to the quality of the decision or action as distinct from the process that led up to the decision or action, which is regulated by the duty of care"<sup>164</sup>.

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158 CRAIG, 2010, p.157.

159 *Smith and Fawcett* [1942] Ch 304. [Case study].

160 CRAIG, 2010, p.157.

161 KERSHAW, 2012, p.334.

162 SEALY/ WORTHINGTON, 2013, p.339.

163 KEAY, A., "Good Faith And Directors' Duty To Promote The Success Of Their Company", **The Company Lawyer**, Year: 2011, Volume: 32, Number: 5, p.138.

164 KERSHAW, 2012, p.334.

As in *Item Software (UK) Ltd v Fassihi*<sup>165</sup>, Fassihi, who used to be the director of the Item Software, was dismissed because of the breach of his duty to act bona fide in the interests of the company by stealing the company's customer. Fassihi made Isoterm terminate its distribution agreement with Item Software, and made them enter into a new agreement with his own company. This shows that this duty is applicable to all the activities of directors without making discrimination and that it necessitates the trust and confidence between the company and its directors.

Before CA 2006, there used to be a requirement about acting in the company's best interests, which "required the promotion of the success of the company, but not in its own right as a separate legal person, but for the benefit of the shareholder constituency"<sup>166</sup>. However, current duty refers directly to member interests as a whole, rather than indirectly through the "best interest of the company". "The success of the company is not about the individual interests of members, but about their interests as members of an association with the purposes and the mutual arrangements embodied in the constitution; the objective is to be achieved by the directors successfully managing the complex of relationships and resources which comprise the company's undertaking"<sup>167</sup>. According to CRAIG, since the company is a legal entity that can have no interests, this duty can clearly be named as a shareholder-centered statement of rule<sup>168</sup>. This is the reason why the interests of a company have long been understood to mean the interests of its members, including the interests of present and even future members as a whole. For most companies, acting in the 'company's interests' means acting to promote shareholder value, due to the fact that the interests of the members will usually be in increasing the value of their shareholding<sup>169</sup>. The CA also states that "this duty has effect to any enactment or rule of law requiring directors, in certain circumstances, to consider or act in the interests of the company's creditors. Therefore, in times of insolvency or threatened insolvency, the duty to consider creditors' interests remains as well"<sup>170</sup> which shows that the list in S. 172 does not include everything and that sometimes directors should consider other relevant factors which do not fall into this list.

### **Good Faith**

Regarding this duty, good faith is another notion that should be examined, owing to the fact that S. 172 regulating this duty emphasizes the good faith of directors. The CA states that while aiming to promote the success of the company, it is important for

165 *Item Software (UK) Ltd v Fassihi* [2004] EWCA Civ 1244. [Case study].

166 KERSHAW, 2012, p.382.

167 SEALY/ WORTHINGTON, 2013, p.339.

168 CRAIG, 2010, p.155.

169 KERSHAW, 2012, p.336.

170 DAVIDSON, R., "The Companies Act 2006: Directors' Duties And Promoting the Company's Success", *Butterworths Journal of International Banking and Financial Law*, Year: 2007, Volume: 22, Number: 11, p.632.

directors to make their decisions in good faith. Good faith duties can arise “within employment relationships, fiduciary relationships, insurance contracts and other areas”<sup>171</sup>. In order to oblige directors to act in good faith or penalize them for not acting in good faith, an affirmative definition of good faith is needed<sup>172</sup>. Good faith in this context means that “they must deal with the trust property properly, and solely for the benefit of the beneficiaries”<sup>173</sup>.

It is mentioned earlier that the duty in section 172 is subjective. The section states that “**a director of a company must act in a way that he considers, in good faith, would be most likely to promote the success of the company...**” (CA 2006). Acting in good faith should be accepted as a continuing duty, especially while evaluating whether it is in the best of the company. A decision which can be classified as in the best interest of the company in a certain period of time may not be considered as in the best interest of the company in another period of time regarding the circumstances. If it cannot be considered in the best interests of the company; then, according to good faith, the director must change and realign the decision with the company’s interests<sup>174</sup>. It is the director himself who should “judge and form a good faith judgment about what is to be regarded as success for the members as a whole”<sup>175</sup>, and this is the court which will decide whether directors act in good faith or not, by considering all the circumstances.

The duty to act *bona fide* in the best interests of the company is “sometimes loosely conceived of as the pre-eminent duty from which other duties stem or as an aspect of the overarching duty of loyalty, which directors owe to their company”<sup>176</sup>. According to DIGNAM & LOWRY, there were two significant problems with this duty: the first one is related to its enforceability, because it could only be enforced in the same way as any other fiduciary duty owed to a company by its directors (S. 309(2) CA 1985). Either the company had to sue for its breach, or a shareholder had to bring a derivative action. Secondly, it was difficult to identify the precise scope of the duty for the purposes of determining whether it had been discharged or not. Directors were not bound to give the interests of the priority of employees over those of shareholders”<sup>177</sup>.

### 3. The Duty to Exercise Independent Judgment (S. 173)

The duty to exercise independent judgment can be classified as another aspect of the duty of good faith. Directors must exercise independent judgment without taking directions or orders from anyone else. According to DIGNAM & LOWRY, this is an “incident

171 CHEYNE, J./ GRIERSON, S./ TAYLOR, P., “Commercial Good Faith”, **The New Zealand Law Journal**, Year: 2001, p.245.

172 NOWICK, **2007**, p.458.

173 LOWRY/ REISBERG, **2012**, p.162.

174 KERSHAW, **2012**, p.351.

175 LOWRY/ REISBERG, **2012**, p.165.

176 AHERN, D. “Nominee Directors’ Duty to Promote the Success of the Company: Commercial Pragmatism and Legal Orthodoxy”, **The Law Quarterly Review**, Year: 2011, January, p.126.

177 DIGNAM/ LOWRY, **2010**, p.329.

of the over-arching duty to promote the success of the company laid down in section 172<sup>178</sup>. The main aim here is to prevent directors from being affected by third parties and to prevent them from making their decision according to anything else than the company's interest. This duty to exercise independent judgment can be breached in some cases. So, there should be a legal framework regulating the circumstances under which this duty can be counted as breached or not breached. According to SEALY and WORTHINGTON, this duty to exercise independent judgment is not breached "if the director merely takes advice, or acts in accordance with an agreement duly entered into by the company, or acts in a way permitted by the company's constitution"<sup>179</sup>.

#### 4. Duty to Exercise Reasonable Care, Skill and Diligence (S. 174)

According to KERSHAW, "a director must make decisions that they considers will promote the success of the company, and the exercise of corporate power must be for a proper purpose"<sup>180</sup>. It is mentioned before, while explaining the duty to promote the success of the company, that directors are expected to act carefully and prudently by considering company's success and interests while making a decision. Duty of care, skill and diligence covers mostly the same areas. Therefore, duty of care can be classified as a pre-condition of duty to promote the success of the company, owing to the fact that a director cannot promote the company's success and consider company's interest without being carefully and acting prudently, which makes him/her exercise reasonable care, skill and diligence. Although the section refers to care, skill and diligence, "there is only one duty provided here which is applicable to all activities undertaken by the director in his function as director. There are not separate duties of care, skill and diligence".<sup>181</sup>

There are mainly two different views about director's duty of care; objective and subjective views.

Subjective standard is one that is specified by reference to what a person with the director's actual abilities are able to achieve. In other words, the less qualified or more incompetent the director, the less the law would expect of that person. Objective standard is formulated by reference to what a reasonable director in the position of the actual director could be expected to achieve, irrespective of what the actual director was capable of achieving.<sup>182</sup>

According my point of view, subjective view is more applicable and fair, due to the fact that, as stated before, the same degree of care cannot be expected from the directors of small-scaled and large-scaled companies. As it is stated in *Re City Equitable Fire*

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178 DIGNAM/ LOWRY, **2010**, p.332.

179 SEALY/ WORTHINGTON, **2013**, p.350.

180 KERSHAW, **2012**, p.410.

181 KERSHAW, **2012**, p.448.

182 CRAIG, **2010**, p.150.

Insurance Co Ltd [1925] Ch. 407<sup>183</sup> “the larger the business carried on by the company, the more numerous, and the more important the matters that must of necessity be left to the managers ...”, which shows that generalization cannot be made in terms of the degree of care expected from a director.

The provision regulating the duty of care uses the word “reasonable care” to define the degree of care expected from directors. Reasonable care means “the level of care that would, hypothetically, be provided by an average person qualified to operate in the relevant walk of life, whether it be surgery or driving a car”<sup>184</sup>. In other words, the term reasonable care has a large scale which covers the degree of care from no care to complete care, which means that the law can always select a care below reasonable care<sup>185</sup>. The standard of care is regulated in S. 214 (4) of the Insolvency Act 1986. By S. 214 (4), the director was required to behave as “a reasonably diligent person having both the general knowledge, skill and experience that may reasonably be expected of a person carrying out the same functions as are carried out by that director in relation to the company and the general knowledge, skill and experience that director has”.

For some people, duty of care can be classified as fiduciary duty and according to this view, directors are expected to use the amount of care which a prudent and careful man would use. “This standard of conduct -the care which ordinarily careful and prudent men would use in similar circumstances- is clearly very generous to directors, as it, by its terms, requires nothing more than the normal level of care a person would use in his business”<sup>186</sup>. So, it may be more convenient to change this standard by replacing the word “men” with “businessmen”. However, according to the modern view, “duty of care is not a duty of a fiduciary character, but is to be assimilated to the well-known duty to avoid negligence imposed by the common law. Thus, duty of care is to be distinguished from all the other duties which are categorized as fiduciary duties or duties of loyalty”<sup>187</sup>. It is important to remind that this duty is owed to the company; not to the members. “As well as liability to the company, breach of this duty may show unfitness to be concerned in the management of the company and so, lead to disqualification under the Company Directors Disqualification Act 1986 s 6”<sup>188</sup>.

## 5. Duty to Avoid Conflicts of Interest (S. 175)

Duty to avoid conflicts of interest is one of the core duties of directors. Section 175 (1) provides that “a director must avoid a situation in which they has, or can have, a direct or indirect interest that conflicts, or possibly may conflict with the interests of the company” (CA, 2006). The duty to avoid conflicts of interest covers the duty of

183 Re City Equitable Fire Insurance Co Ltd [1925] Ch 407. [Case study].

184 KERSHAW, **2012**, p.418.

185 KERSHAW, **2012**, p.418.

186 EISENBERG cite in NOWICK, **2007**, p.458.

187 CRAIG, **2010**, p.154.

188 SEALY/ WORTHINGTON, **2013**, p.353.

loyalty in some points and also falls within one of the duties mentioned earlier, such as the duty to promote the success of the company. “Directors have personal interests, desires, aspirations, and ambitions. In certain circumstances, those personal interests and concerns may come directly into conflict with the interests or the success of the company”<sup>189</sup>, and this duty tries to make directors avoid from situations where their interests and the company’s interest conflict. Any situation “which ostensibly gives rise to a conflict between the director’s personal interests, and his duty to the company, is treated as a situation from which the director cannot benefit; or can only benefit after protective procedures have been complied with”<sup>190</sup>.

The result of some conflicts can have a direct effect on the increase in the director’s personal wealth, while other conflicts are less apparent. Taking *Aberdeen Rly Co v Blaikie Bros* [1854] 1 Macq 461<sup>191</sup> as an example, the chairman of the BOD of a company entered into a contract on behalf of the company with his own firm. Although in that case “his duty to the company imposed on him the obligation of obtaining these chairs at the lowest price, his personal interest would lead him to an entirely opposite direction, would induce him to fix the price as high as possible”. The provision needs to make some points clear about what is covered with the conflict of interest. The Acts states that this duty applies “in particular to the exploitation of any property, information or opportunity (and it is immaterial whether the company could take advantage of the property, information or opportunity). This duty does not apply to a conflict of interest arising in relation to a transaction or arrangement with the company”<sup>192</sup>. Regarding this provision, directors are not under a duty to avoid transactions or arrangements with the company. However, directors “must disclose any interest in a transaction or arrangement that the company is proposing to enter into or that has already been entered into, whether their interest is direct or indirect. Once declared, no authorization is required, and this is the same as the position before the Act”<sup>193</sup>.

## 6. Duty to Not to Accept Benefits from Third Parties (S. 176)

Duty to not to accept benefits from third parties tries to prevent directors from being influenced by third parties. Third parties can influence directors’ decisions by offering bribes or secret commissions to them. This provision states that directors must not accept any benefits “their being a director or their doing (or not doing) anything as director” (S. 175, CA, 2006). According to SEALY and WORTHINGTON, “this duty is clearly related to the no conflict duty in S. 175, since duty, too, is not infringed, if acceptance of the benefit cannot reasonably be regarded as likely to give rise to a conflict of interest

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189 KERSHAW, **2012**, p.476.

190 LOWRY/ REISBERG, **2012**, p.172.

191 *Aberdeen Rly Co v Blaikie Bros* [1854] 1 Macq 461. [Case study].

192 COMPANY ACT cited in DAVIDSON, **2007**, p.631.

193 FEAVER, **Director’s Duties**.

(S. 176(4))<sup>194</sup>. Benefits are not defined in the CA 2006. However, it can be defined as “a favorable or helpful factor, circumstance, advantage or profit”<sup>195</sup>. A benefit may be financial or non-financial, of any shape or size. “S. 176(4) ensures that trivial benefits are not caught by the provision, and S. 176(3) covers payment of normal salary and benefits. The most significant difference between S. 175 and S. 176 is that there is no provision for authorization by the board of directors”<sup>196</sup>.

## **7. Duty to Declare an Interest in a Proposed (S. 177) or in Existing (S. 182) Transaction or Arrangement**

### **S. 177**

S. 177 regulating duty to declare an interest in a proposed transaction or arrangement states that “directors with direct or indirect interests in transactions proposed by the company must declare to the other directors the nature and the extent of those interests, unless it is an interest or involves a transaction, of which the director is unaware”<sup>197</sup>. The declaration of interest must be done before the company enters into the transaction or arrangement, so that necessary precautions can be taken. By including indirect interest, lawmaker tries to cover the transactions that a director is not a part of and widens the duty’s scope of application.

### **S.182**

If the company enters into a suspicious transaction, the director is under a new and continuing duty to disclose interests in substantially similar terms in S. 182. Contrary to S. 175, in this section, the director need not be a party to the transaction or arrangement for this duty to apply. “There are separate requirements for directors to declare their interests in transactions or arrangements that the company has already entered into”<sup>198</sup>.

Section 175 (duty to avoid conflict of interest) and S. 177 and S. 182 (duty to declare an interest in proposed or existing transaction or arrangement) are framed to “encompass the equitable obligations which are generally described, respectively, as the “no conflicts’ rule, the ‘no-profits’ rule and the ‘self-dealing’ rule”<sup>199</sup>. These above mentioned provisions covering these principles can all be classified as incidents of the core fiduciary duty of loyalty.

## **Conclusion**

This article aims to examine the British and Turkish Company laws in terms of the public companies and duties of their directors. I compare the British and Turkish company law

194 SEALY/ WORTHINGTON, **2013**, p.408.

195 **Oxford English Dictionary**, Oxford University Press, Oxford, 2012, p.43.

196 SEALY/ WORTHINGTON, **2013**, p.408.

197 SEALY/ WORTHINGTON, **2013**, p.409.

198 DAVIDSON, **2007**, p.631.

199 DIGNAM/ LOWRY, **2010**, p.338.

and investigate whether similarities exist between these two countries regarding duties of their BODs.

Duties of board of directors of these two countries are examined in detail in the previous part of this article, in order to allow a clearer comparison, and to evaluate the advantages of duties in both countries to their board members. Without having a general knowledge about company laws of these countries, it is not possible to evaluate their advantages and disadvantages.

To start with, it should be mentioned that law systems of these two countries have completely different bases; British law system is based on common law principles and Turkish law system is based on civil law principles. Common law is generally uncodified, while civil law is codified. In other words, common law is generally based on precedents that put judges in the foreground. However, in the civil law, "the judge's decision is consequently less crucial than the decisions of legislators and legal scholars who draft and interpret the codes, due to the fact that the judge's role is just to establish the facts of the case and to apply the provisions of the applicable code"<sup>200</sup>.

To examine the public companies in these two countries, company types that can be held to public are determined firstly. In the UK, Limited Liability Company is the only type of public companies, while in Turkey, the only type of the company that can offer its shares to public is Joint stock Company. For this reason, this article mainly focuses on these respective companies.

Company Act 2006, which regulates the company law in the UK, suggests that provisions are generally valid for every type of companies. This indicates that there are no specific provisions according to the different types of companies. However, some specific provisions about public companies include the definition of public offer and the number of board members in a public company. Although the TCC has different sections regulating different types of companies, it makes no differentiation between public and private JSCs. To put it differently, present provisions under JSCs are valid for both types; public and private ones. Public companies in Turkish Law are mainly regulated using a different code called CML that includes the definition of public companies, the ways to offer shares to public and other relevant rules specific to public companies.

The first important conclusion from the discussion of two countries is, according to the CA S. 7, "a company is formed under this Act by one or more person" and according to TCC A. 338, "one or more shareholder founders are required for incorporation of a joint stock company". This shows that LLC in the UK and JSC has no differences in terms of their establishment. Although similarly in both the UK and TR that one person is enough to establish a company, some discrepancy arises while concerning the number of board members. S. 154 states that "a public company must have at least two directors" and adds that "a company must have at least one director who is a natural person" in S. 155. This shows that legal entities can be a board member under one condition; having

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200 BERKELEY **The Common Law and Civil Law Traditions**, <https://www.law.berkeley.edu/library/robbins/CommonLawCivilLawTraditions.html>, (Access date: 05.08.2014), p.2.



another natural person board member. In Turkey, according to A. 359, “the joint stock company shall have a BOD which consists of one or more persons” and “in the event a legal entity is elected as a member of the BOD, only one real person, determined by the legal entity on its behalf, shall also be registered and announced with the legal entity”. Although the UK requires the BOD to be comprised of at least two people, in terms of having a legal entity as a board member, both countries share the same opinion that legal entities cannot be a member on their own without a natural person. In Turkey, this natural person is just the representative of this legal entity; however in the UK, this natural person is another member of the board; not its representative.

More specifically, directors are classified as agents of the company in British Company Law, while they are considered as attorneys in Turkish Company Law. Although two different concepts are used, they both refer to the same relationship of representing the company.

Moreover, commenting on the duties of directors in a public company in these two countries, the first thing that should be mentioned is that the CA uses the concept of duty while the TCC mostly uses the concept of prohibition while referring to the duties. But in both countries, contradictions to these provisions referring to these different concepts result in the same way; liabilities of directors.

The following part will be a review of the comparison of duties between two different legislations. The first common duty in both countries is the duty of care. This is covered as “duty of care & loyalty” in the TCC and as “duty to exercise reasonable care skill and diligence” in the UK. The TCC uses the concept of prudent businessman, while the CA uses the concept of reasonable care that can be expected from a normal person to refer to the degree of care expected from directors. Directors are businessmen, and they have more responsibilities than normal people. In that case, the degree of care expected from a businessman and a normal person cannot be of the same level. Directors are not only representing the company, but also managing the company; hence, this puts them under pressure to be more careful while making decisions, due to the fact that they are managing someone else’s property and their decisions can affect other people’s interests.

Both countries adopt an objective view while evaluating the degree of care expected from a director and deciding whether they violates his duty of care. Adopting a strong objective view that is not flexible and that cannot be changed according to different circumstances does not seem true, due to the fact that there are lots of other factors affecting the care; such as knowledge, experience, and logic. In other words, the same degree of care cannot be expected from two different directors having different backgrounds. So, it should be something between objective and subjective standards that are inclined to the flexibility according to the circumstances. Although both countries adopt an objective standard about the duty of care, Turkey’s understanding of the objective standard is closer to the one mentioned above, which is somewhere between objectivity and subjectivity considering different circumstances. In addition to this, evaluating the degree of care expected from a director according to the prudent

businessman principle is more convenient compared to the reasonable care of a normal man principle. In my perspective, in terms of duty of care, adapting the TCC related article to the CA would be more efficient.

In the TCC, the duty of care is related to the duty of loyalty, and both of them are covered in the same provision. In the CA, there is no duty entitled specifically as the duty of loyalty. However, the duty of loyalty of the TCC and the duty to avoid conflict of interest in the CA can be matched, owing to the fact that duty of loyalty is mainly expected from directors to protect the interests of the company. It has been mentioned already that managing a company is a big responsibility as directors are responsible for managing the company, gaining the trust of owners to consign their company to them. So, duty of loyalty of board members can be described as a response to company's trust towards them. The TCC tries to protect the secrets of the company in order to protect the company's interest, which suggests that the duty of loyalty includes keeping the business secrets in itself, which brings the liability of secrecy. This is something that is not covered in the CA; however, it is based on the same aim to protect the interests of the company.

Furthermore, the TCC, especially while referring to the duty of care and loyalty, puts an enormous emphasis on the concept of good faith. According to the TCC, directors should fulfill their duties in good faith. Having good faith is an indicator of care and prudence, and these two qualifications are the ones expected from directors while performing their duties. The CA also puts emphasis on good faith, especially while referring to the duty to promote the success of the company, which can be classified as the core duty of directors related to other duties. Both countries based the duties of their directors on the good faith principle.

It is stated that some duties covering same subject with the CA are named as prohibitions in the TCC. One of these prohibitions in the TCC is the prohibition of participating in discussion in cases of conflict of interest. The same subject is covered by the CA as duty to avoid conflict of interest as mentioned above. This duty in the UK is also related to the duty of not accepting benefits from third parties, due to the fact that benefits from third parties can influence directors' decisions and endanger company's interest accordingly.

Another prohibition regulated in the TCC is the prohibition to conduct transaction with company. The reason behind this regulation is to prevent board members from doing a transaction with the company without having the permission of the GA. This prohibition aims to prevent conflict of interests that can arise between the company and the directors. Contrary to the TCC provision, in CA 2006, there is no prohibition preventing directors from conducting transaction with company; on the contrary, the provision entitled duty to declare an interest in existing transaction or arrangement to enable directors to conduct transactions on condition that directors should declare interests, in case a direct or indirect interest arises from the transaction.

Although there are different duties entitled with different names in both the CA and

the TCC, the main aim underlying on each provision regulating the duties of directors is protecting the company's interest in both countries by acting in good faith. Regarding this, it can be said that the duty to promote the success of the company is the core duty regulated in the CA, which covers many other duties within its scope, due to the fact that all duties have the same basis to protect the interests of the company. This duty cannot be evaluated separately from other duties. It covers even some duties from the TCC that cannot be matched with a duty in the CA as non-compete obligation or as prohibition to become indebted to company.

As a whole, the TCC mostly talks about the liabilities of directors, while the CA talks about their duties. Some of the duties considered in the CA are regulated as prohibitions that directors should avoid in the TCC. Other than this, some differences between regulations are also stated. Even provisions covering the same issues are different from each other in terms of content. But in terms of result, all of them cause liability of directors. Although the result in case of a breach is always the same, this does not mean that the degree of liability will be the same.

The TCC's provisions are more strict compared to the CA provisions regulating the duties of directors. The first reason for this deduction is the wording of the provisions; the TCC uses the word "prohibition" or "obligation", which have more pressure on directors compared to the CA, which prefers to use the word "duty", which gives more space to board members. Another factor behind this deduction is that the CA has lower expectations from directors compared to the TCC. The differences between the degrees of care of these two countries can be an example to prove this low expectation of the CA.

Although freedom helps people to have more accurate decisions in certain circumstances, this can harm company and company's interest in case of a misuse. Directors are not ordinary people or ordinary employers. They have a serious responsibility in managing a company. Being human beings, people have weaknesses regarding money and power. In that case, strict provisions can sometimes help directors to act within certain limits and more in good faith and constrain them to be more careful while thinking about company's interests and to distinguish company's interests from their own interests. But, this pressure arising from provisions should never be too strict to prevent directors from having accurate decision or taking initiative while heading the company.

## **Appendices**

### **Related Articles of TCC**

Part Four

### **Joint Stock Company**

Section One

### **General provisions, incorporation and fundamental principles**

A) General Provisions

## **I - Definition**

**Article 329-(1)** A joint stock company is a company whose capital is certain and divided into shares and which is solely responsible for its debts as an amount of its assets.

**(2)** Shareholders are solely responsible to the company and their responsibility is limited to their subscribed shares.

## **II - Joint stock companies that are subject to special laws**

**Article 330-(1)** The provisions in this Section shall apply to joint stock companies that are subject to special laws, with the exception of certain provisions.

**III-Purpose and scope Article 331-(1)** Joint stock companies can be incorporated for any economic purposes and scopes not legally prohibited.

## **IV -Minimum capital amount**

**Article 332-(1)** The capital stock representing the entire capital subscribed in the articles of association cannot be less than TRY50,000. The initial capital cannot be less than TRY100,000 in non-public joint stock companies which have adopted the registered capital system disclosing the authorisation ceiling given to the BOD. This minimum capital amount can be increased by the Council of Ministers.

**(2)** Within the meaning of the New Law, the initial capital in joint stock companies which adopt the registered capital system is the mandatory capital which must be possessed at stage of incorporation and when initially adopting the system, whereas the issued capital is the capital which represents the total of nominal values of the entire shares issued.

**(3)** Non-public joint stock companies can leave the registered capital system with permission of Ministry of Industry and Trade when they cease to qualify for the system; they shall also be removed from the system by this Ministry even in the absence of their claim if they lose the qualifications required for entry to the system.

**(4)** The provision in Article 12 of Capital Markets Law No. 2499, dated 28 July 1981, will remain valid.

## **V-Government supervision**

### **1. Permission**

**Article 333-(1)** Joint stock companies whose operational areas are determined and declared with the communiqué published by Ministry of Industry and Trade are established with permission of Ministry of Industry and Trade. The amendments to the articles of association of these companies shall also be subject to the permission of this

Ministry. The inspection of the Ministry can be carried out only in terms of whether there is any contradiction to the mandatory provisions in the law. Apart from this, regardless of nature, scope of activity and the legal position of the joint stock company, its incorporation and amendments to its articles of association are not subject to the permission of any authority.

## **2. Representation of public legal entities on the board of directors**

**Article 334-(1)** The state, special provincial administration, municipalities and other public legal entities, even if they are not shareholders, can have the right to appoint a representative to the BoD of public service joint stock companies under the provision stated in the articles of association.

**(2)** The board of representatives of public legal entities holding shares in the companies described in paragraph 1 can be removed from appointment only by these public legal entities.

**(3)** The representatives of public legal entities on the BoD shall have the rights and duties of the members elected by the GA. Public legal entities are responsible to the company, its creditors and shareholders for the actions and transactions carried out by their representatives on the company's BoD. The legal entity's right to recourse will remain valid.

B) Incorporation

### **I-Incorporating act**

**Article 335-(1)** The company shall be incorporated upon the founders' declaration stating their decision to incorporate a joint stock company in the articles of association approved by a notary and prepared in accordance with law and in which the founders absolutely committed to pay the entire capital.

**(2)** The provision in paragraph 1 of Article 355 will remain valid.

### **II - Incorporation documents**

**Article 336-(1)** The articles of association, the declaration of founders, fair value reports, agreements with founders and other entities related to incorporation and the transaction auditor report are incorporation documents. All incorporation documents shall be placed in the registration file and a copy of each shall be kept by the company for a period of five years.

### **III - Founders 1. Definition**

**Article 337-(1)** Real persons and legal entities who have subscribed to a share and signed the articles of association are founders.

**(2)** If the founders perform the transactions stated in paragraph 1 on behalf of a third party, this person shall also be considered as a founder in terms of liability resulting from incorporation. The third party cannot claim that he/she was unaware of the matter which is known or is required to be known by the person acting on his/her behalf.

## **2. Minimum number**

**Article 338-(1)** One or more shareholder founders are required for incorporation of a joint stock company. The provision in Article 330 will remain valid.

**(2)** If the number of shareholders decreases to one, the BoD shall be notified of this situation in writing within seven days as of the date of the transaction causing this result. The BoD shall register and announce that the company is a single-shareholder joint stock company within seven days of the date of receipt of this notification. Furthermore, in the event the company is incorporated by a single shareholder or the shares come to be held by a single person, the name, domicile and nationality of the single shareholder shall be registered and announced. A shareholder who fails to announce this and the BoD that fails to register and announce this shall be responsible for any damage incurred.

**(3)** The company cannot acquire or have acquired its own shares if it becomes a single shareholder.

## **IV - Articles of association 1. Contents**

**Article 339-(1)** The articles of association must be in writing and the signatures of all founders must be authorized by a notary.

**(2)** The following shall be written in the articles of association: a) company's trade name and location of the headquarters b) company's scope of activity with its fundamental points specified and defined

- c) company's capital and the nominal value of each share, condition and circumstance of their payment
- d) whether share certificates are registered or bearer; privileges provided for certain shares; transfer restrictions
- e) rights and non-monetary assets contributed as capital and their values; amount of shares to be given in consideration of these, in case of an acquisition of a business and non-monetary assets; consideration of goods and rights purchased by the founders on behalf of the company for the incorporation of the company and amount of the fee; the allowance or the bonus that needs to be paid to those who provided services during the incorporation of the company
- f) benefits to be provided from the company profit to the founders, members of the BOD and other persons
- g) number of members of the BOD; members who are authorized signatories on behalf of the company.

- h) invitation for GA; voting rights i) if duration of the company is limited to a period, such period j) the form of announcements related to the company k) types and amounts of capital shares subscribed by shareholders l) accounting period of the company (3) The members of the first BoD shall be assigned the articles of association.

## 2. Mandatory provisions

**Article 340-(1)** The articles of association can depart from the provisions in the New Law relevant to joint stock companies only if allowed in the New Law. The supplementary provisions of articles of association allowed to be stipulated by other laws shall be effective specifically for that law.

### V - Approval of subscription

**Article 341-(1)** The subscription of the entire shares constituting the basic capital which was made by the founders in the articles of association shall be approved by a notary annotation to be affixed to the articles of association.

### VI - Capital in kind

#### 1. Assets that can be contributed as capital in kind

**Article 342-(1)** Assets without such restriction as measure, pledge and encumbrances on them, which can be convertible to cash and which are transferable, including intellectual property rights and virtual environments, can be contributed as capital in kind. Service, personal effort, commercial reputation and non-due receivables cannot be contributed as capital.

**(2)** The provision in Article 128 will remain valid.

### 2. Evaluation

**Article 343-(1)** Enterprises and non-monetary assets to be acquired during incorporation with capital in kind shall be evaluated by experts assigned by the commercial court of first instance at the location of the company's headquarters. The valuation report must explain in detail and with justifications the existence of receivables, the possibility of collection and compliance with Article 342, and that the selected evaluation method is appropriate. Shares amount and Turkish lira equivalence related to each asset contributed as capital in kind shall be explained satisfactorily and in accordance with the accountability principle. The founders, the transaction auditor and stakeholders can object to this report. The expert report approved by a court is definitive.

### VII - Payment of shares

#### 1. Capital in cash

**Article 344-(1)** At least 25 percent of the nominal value of the shares subscribed in cash must be paid before registration and the remaining shall be paid within 24 months

following the registration. The entire issuance premium of shares shall be paid before registration.

**(2)** The provisions in the Capital Markets Law relevant to the payment of shares are reserved.

## **2. Location of payment**

**Article 345-(1)** Cash payments shall be made into a special account opened on behalf of the company which will be incorporated, at a bank which is subject to Banking Law No. 5411, dated 19 October 2005, and this account can be used only by this company. The fact that the amount stated in law or articles of association for subscribed shares has been paid and a higher amount than foreseen in the law has been paid for subscribed shares shall be proven with a bank letter to be addressed to the Trade Registry. Upon the submission of a letter prepared by the registration office confirming that the company has acquired a legal personality, the bank shall pay the amount concerned only to the company.

**(2)** If the company is unable to acquire legal personality within three months as of the date of notarization stated in paragraph 1 of Article 335, the amounts shall be paid by the bank to their owners, upon the submission of a letter prepared by the registration office confirming this matter.

## **3. Shares to be offered to public**

**Article 346-(1)** The equivalent of shares subscribed in the articles of association, determined and also guaranteed in the articles of association to be offered to the public at latest within two months as of the registration of the company shall be paid from the income from the sale. The public offering of share certificates shall be initiated in accordance with the capital markets legislation. At the end of the sale period, the nominal value and issuance premium less expenses if any shall be paid to the company and the amount that will remain after the expenses are deducted shall be paid to shareholders offering their share certificates to the public.

**(2)** The total amount of shares offered to public but not sold within the prescribed period and 25 percent of the equivalent of shares not offered to public within the prescribed period shall be paid within three days after the two-month period.

## **VIII - Shares Premium**

**Article 347-(1)** A share cannot be issued at a price less than its nominal value and shares cannot be issued at less than fair value. Shares can be issued at more than fair value if there are provisions in the articles of association determined by GA resolution.



## **IX - Benefits of Founders**

**Article 348-(1)** Granting a benefit resulting in a decrease of the company's capital, such as paying money and giving shares to founders for their efforts during the incorporation of the company, is prohibited. Rules in the articles of association that conflict with this article are invalid. However, after legal reserves stipulated in paragraph 1 of Article 519 and a dividend of 5 percent for the shareholders are allocated from the distributable profit, one-tenth of the remaining amount shall be paid to founders as redeemed shares.

**(2)** Joint stock companies incorporated after the effective date of this law shall cancel redeemed shares before public offering without any payment. Otherwise, redeemed shares are invalid by themselves.

**(3)** If there is distributable profit, founders get profit as stated in the articles of association even the company decides to not distribute any profit.

## **X- Founders declaration**

**Article 349-(1)** A declaration regarding incorporation shall be signed by the founders. The declaration shall be prepared accurately and completely in accordance with the principle of providing information in a true and fair manner. If capital in kind is contributed or if an enterprise or a non-monetary asset is acquired, the declaration must contain explanations, justifications and definite expressions regarding the appropriateness of the amount given, the necessity of such capital and the acquisition and the benefit of these for the company. In addition, securities acquired by the company, their acquisition cost, information regarding the valuation and analysis of financial or if necessary consolidated financial statements for the last three years of those who have issued this securities, significant commitments undertaken by the company, connections, prices, commissions regarding the purchase of machinery and similar goods and of any asset and all kinds of debts shall be explained by comparison with equivalents.

**(2)** Furthermore, the benefits with justification provided for the founders shall be stated in the declaration. Those who have subscribed shares for the purpose of public offering and the number of shares subscribed, the relationship of those who have subscribed shares with another; if these are included in a group of companies, their relationship with the group, the fees paid to the transaction auditor inspecting the corporation and to others providing services shall be explained in the declaration with comparing equals.

## **XI-Commitment for public offering**

**Article 350-(1)** In accordance with Article 346, in the event a share is subscribed for public offering, the public offering shall be considered as approved by the founders, BOD or any authorized body.

## **XII-Transaction auditor report**

**Article 351-(1)** The report regarding the audit of the incorporation shall be prepared by one or more transaction auditor. The transaction auditor shall declare that all shares have been subscribed; that the minimum amount of the share equivalent, stated in the law or in the articles of association, has been deposited in the bank in accordance with the law and that the bank letter in this regard has been made available; that there is no indication that this liability has been evaded; that a valuation has been made for contribution and acquisition in kind by experts appointed by the court and that the report which has been certified by the court has been presented in the file; that the benefits of the founders comply with law; that there is no express non-conformity regarding the declaration of founders and that there is no over-valuation and no obvious corruption in the transactions, that all other incorporation documents have been made available and that the required notary approvals and permissions have been obtained in line with the accountability principle with statement of justifications.

## **XIII - Transfer of share subscription before incorporation**

**Article 352-(1)** Transfer of share subscription before the company's registration shall be invalid as regards the company.

## **XIV - Termination court case**

**Article 353-(1)** A joint stock company cannot be declared null and void. However, if the interests of creditors, shareholders or public are being risked or violated during the incorporation of the company, on the request of the BOD the Ministry of Industry and Trade, the related creditor or shareholder the commercial court of first instance at the location of the company's headquarters shall rule on the termination of the company. The court shall take necessary measures on the date the court case is opened.

**(2)** The court can give time to complete pending matters and to correct matters conflicting with the articles of association or with the law.

**(3)** The evidence and all required information shall be included in the court application. Once the trial stage commences no additional evidence or proof can be presented unless court determines that a concrete reason exists for the plaintiff to present additional evidence and information. In the event of such findings, the court can set a deadline for the presentation of such material. REWORDED, PLEASE NOTE.

**(4)** The court case must be opened within the three-month prescription period as of the registration and announcement of the company.

**(5)** When a court case has been opened, the definitive court decision shall be, immediately and ex officio, registered with the Trade Registry and announced in Turkish Trade

Registry Gazette. In addition, the BoD shall declare the registered and announced matter in at least one national newspaper with a circulation of at least 50,000 and publish it on its Web site.

### **XV -Registration and announcement of the company**

**Article 354-(1)** The full version of the articles of association of the company shall be registered with the Trade Registry at the location of the company's headquarters and announced in Turkish Trade Registry Gazette within 30 days as of obtaining permission for the incorporation of a joint stock companies from the Ministry of Industry and Trade and other companies incorporated in accordance with sub-clause 1 of Article 335. Apart from those listed below, the provision in paragraph 1 of Article 36 shall not be applied for the registered and announced articles of association. These points are as follows:

- a) date of articles of association
- b) company's trade name and headquarters
- c) duration of the company, if any
- d) company's capital, the method and terms of its payment and the nominal values of shares, privileges, if any
- e) types of shares, and whether they are bearer or registered shares f) representation of the company
- g) names and surnames, titles, domiciles and nationalities of members of the BoD **and** those who are authorized to represent the company.
- h) form of announcements to be made by the company; the way the decision of the BoD shall be notified to shareholders in case there is a provision relevant to this in the articles of association

**(2)** Branches shall be registered with the Trade Registry at their location by reference to the Trade Registry of the headquarters.

**(3)** Expert report in accordance with Article 343 is registered and announced.

### **XVI -Acquiring legal personality**

**Article 355-(1)** The company shall acquire legal personality upon registration at the Trade Registry.

**(2)** Those who conduct transactions and enter into commitments on behalf of the company before registration shall be personally and successively responsible for these transactions and commitments. However, if it is declared that transactions and commitments have been carried out on behalf of the company that will be incorporated in the future and if such commitments have been accepted by the company within the three-month period following the registration of the company with the Trade Registry, the company shall be exclusively responsible for these transactions.

**(3)** Unless accepted by the company, the incorporation costs shall be paid by the founders. They shall not have any right to recourse to shareholders.

Section Two

## **Board of Directors**

A) In general

### **I - Appointment and election**

#### **1. Number and qualifications of the members**

**Article 359-(1)** The joint stock company shall have a BOD which consists of one or more persons assigned by the articles of association or elected by the GA. At least one member who is authorized for representation must be a Turkish citizen domiciled in Turkey.

**(2)** In the event a legal entity is elected as a member of the BOD only one real person, determined by the legal entity on its behalf, shall also be registered and announced with the legal entity; in addition the registration and an announcement shall be immediately declared on the company's Web site. Only this registered person can participate in and vote on behalf of the legal entity at the meetings.

**(3)** The members of the BOD and the real person registered on behalf of the legal entity must be able to act in full capacity. At least one-quarter of the members of the BOD must be university graduates. This requirement is not be applicable in the case of boards consisting of a single member.

**(4)** If a member of the BOD is terminated, then this person cannot seek re-election to the BOD.

#### **2. Representation of certain groups on the board of directors**

**Article 360-(1)** Provided that it is stated in the articles of association, certain share groups, shareholders consisting of a certain group in terms of their qualities and nature, and minorities can be granted the right to be represented on the BOD. For this purpose the articles of association can stipulate that board members shall be elected from among shareholders comprising a certain group, certain share groups and minorities, or that the right to nominate a candidate for the BOD can also be granted to them in the articles of association. It is mandatory that the candidate nominated by the GA as a board member or who is a member of the group and the minority to whom the right to nominate is granted shall be elected absent fair cause to oppose that candidate. The number of board members performing representation in this way cannot exceed half of the members of the BOD in public joint stock companies. The regulations regarding independent board members remain in force.

**(2)** The shares entitled to be represented on the BOD according to this article shall be considered as privileged shares.

### 3. Insurance

**Article 361-(1)** If the damage incurred by the company through the fault of board members while performing their duties is insured at a price exceeding 25 percent of the company capital and the company is secured, in the case of public companies this matter shall be announced in the bulletin of the CMB and if the shares are listed on a stock exchange this shall also be announced in the stock exchange bulletin, and such matter shall be taken into account in the assessment of compliance with the principles of corporate governance.

### 4. Term of appointment

**Article 362-(1)** BOD members are elected for a term of no more than three years. Unless otherwise specified in the articles of association, board members may be candidates for re- election.

**(2)** The provision in Article 334 will remain valid.

## II - Vacancy on the board

**Article 363-(1)** Without prejudice to the provision in Article 334, in the case of a vacancy on the board for any reason, the BOD shall elect a person who meets the legal requirements as a board member on temporary basis and submit him/her to the approval of the first GA. A member elected in this way shall perform his/her duties until the GA meeting at which he/she is submitted for approval, and in the event his/her membership is approved he/she shall complete the appointment term of his/her predecessor.

**(2)** If a board member goes bankrupt or under interdiction, or if he/she loses the legal conditions or the qualifications required to be a member stated in the articles of association, this person's membership shall automatically terminate without any proceeding.

## III - Dismissal from appointment

**Article 364-(1)** Even if board members have been assigned through the articles of association, in case of fair cause and despite the existence or absence of a relevant item on the agenda, they can be dismissed from the board by resolution of the GA. The legal entity who is a board member can, at any time, replace the person registered in his/her name.

**(2)** The provision in Article 334 and the right to indemnity of the member removed from appointment remain in force.

B) Management and representation

## **I - In general**

### **1. Principle**

**Article 365-(1)** The joint stock company shall be managed and represented by the BOD. The exceptional provisions in the law remain in force.

### **2. Division of duties**

**Article 366-(1)** Every year the BOD shall elect a chairman, and at least one vice chairman from among its members to replace the chairman in case of absence. The articles of association may stipulate that the chairman and the vice chairman, or one of them, be elected by the GA.

**(2)** The BOD can establish committees and commissions which can also have board members for the purpose of monitoring the course of business, having reports prepared regarding matters to be presented to the board, enforcing BOD decisions or for internal audit purposes.

### **3. Delegation of management**

**Article 367-(1)** In accordance with an internal regulation to be drawn up by the board based on a provision to be inserted into the articles of association, the BOD can be authorized partially or fully to delegate management to one or more board members or to a third party. This regulation shall organize the management of the company; it shall define the duties required for management, indicate their positions, and particularly specify who is subordinated to whom and who is obliged to provide information. The BOD shall, upon request, inform in writing the shareholders and the creditors who can make a persuasive case that their interests are worthy of protection.

**(2)** In the event management is not delegated the company shall be managed by all board members.

### **4. Commercial representatives and commercial agents**

**Article 368-(1)** The BOD can appoint commercial representatives and commercial agents.

### **5. Duty of care and duty of loyalty**

**Article 369-(1)** BOD members and third parties in charge of management shall be held liable for prudent performance and protection of the company's interests.

**(2)** The provisions in Articles 203 to 205 remain in force.

## II. Authority to represent

### 1. In general

**Article 370-(1)** Unless otherwise stipulated in the articles of association or unless the BoD comprises one member, representational authority shall be exercised by the BoD by affixing two signatures.

**(2)** The BoD can delegate this authority to one or more executive directors or to third parties, but at least one board member must have representational authority.

### 2. Scope and limits

**Article 371-(1)** Those who are authorized to represent can carry out on behalf of the company all manner of business and legal transactions within the purpose and scope of activity of the company and can use the trade name of the company for this purpose. The company reserves the right to recourse arising from transactions contrary to law and the articles of association.

**(2)** Transactions conducted with third parties outside the scope of activity by those who are authorized to represent the company shall bind the company, provided it is proven that the third party was aware that the transaction is outside the scope of activity or they were capable of being aware as a requirement of the situation. The announcement of the company's articles of association shall not be solely sufficient evidence to prove this matter.

**(3)** The restriction on representational authority shall not be effectual against third parties in good faith; however, the restrictions which are registered and announced in relation to limiting representational authority solely to the business of the headquarters or a branch or to the exercising thereof jointly are valid.

**(4)** The fact that the transaction performed by authorized persons is against the articles of association or the GA resolution does not prevent third parties, acting in good faith, from making claims due to that transaction.

**(5)** The company shall be responsible for tort by those authorized to represent or manage while performing their duties. The company reserves its right to recourse.

**(6)** Regardless of whether the company is represented by a single shareholder during the conclusion of a contract, in single-shareholder joint stock companies the validity of such contract between this shareholder and the company requires that the contract be in written form. This requirement shall not apply to contracts regarding daily, insignificant and ordinary transactions according to market conditions.

### 3. Form of signature

**Article 372-(1)** Persons entitled to sign on behalf of the company shall affix their signatures under the trade name of the company. The provision in paragraph 2 of Article 40 will remain valid.

**(2)** The headquarters of the company, the location where it is registered and the registration number shall be indicated in the documents prepared by the company.

### 4. Registration and announcement

**Article 373-(1)** The BOD shall submit the notarized copy of the resolution indicating the persons authorized to represent and the forms of representation to the Trade Registry for registration and announcement.

**(2)** Following the registration of representational authority at the Trade Registry, any legal defect regarding the election or appointment of the concerned persons can be put forward by the company against third parties, provided it is proven that the legal defect is known by these persons.

## III-Duties and powers

### 1. In general

**Article 374-(1)** The BOD and the management, to the extent delegated to them, shall be authorized to make decision with regard to all business and transactions required to perform the company's scope of activity, excluding those subject to the authority of the GA by law and the articles of association.

### 2. Non-delegable duties and powers Article 375-(1) The non-delegable and indispensable duties and powers of the BOD are

as follows:

- a) Top-level management of the company and giving instructions in this regard.
- b) Determination of the company's management organization.
- c) Establishment of the necessary system for financial planning to the extent required, and for accounting and finance audit.
- d) Appointment and dismissal of managers and persons performing the same function and authorized signatories.
- e) High-level supervision of whether the persons in charge of management act in accordance with the law, articles of association, internal regulations and written instructions of the BoD.
- f) Keeping the share book, resolution book of the board and the GA meeting and discussion register, preparation of the annual report and corporate governance disclosure and submission thereof to the GA, organization of GA meetings, and enforcement of GA resolutions.
- g) Notifying the court regarding the company's state of excess of liabilities over assets.



### 3. Capital loss, excess of liabilities over assets.

#### a) Liability to convoke and notify

**Article 376-(1)** If it is clear in the last annual balance sheet that half of the sum of the capital and statutory reserves is unsecured due to loss, the BoD shall immediately convoke the GA and submit the remedial measures it considers appropriate.

**(2)** According to the last annual balance sheet, if it is clear that two-thirds of the sum of the capital and statutory reserves are unsecured due to loss, unless the GA immediately convoked decides to fully supplement the capital or to be satisfied with one-third of the capital, the company shall automatically terminate.

**(3)** If suspicions are raised that the company's liabilities exceed its assets, the BoD shall have an interim balance sheet prepared based on the going concern value and based on liquidation value of the assets and shall give it to the auditor. The auditor shall inspect this interim balance sheet within seven business days and shall present his/her evaluation and proposals to the BoD in the form of a report. The proposals of the early detection committee regulated in Article 378 must also be taken into account in the proposals of the auditor. If it is clear in the report that the assets are not sufficient to cover the receivables of creditors of the company, the BoD shall notify the commercial court of first instance at the location of the company's headquarters of this situation and shall file a claim for bankruptcy. This shall be done provided that before the adjudication of bankruptcy, the company's creditors representing an amount sufficient to cover the company's deficit and to eliminate the indebtedness of the Company accept in writing that they will be ranked after all other creditors and that the legitimacy, authenticity and validity of this declaration or contract is verified by experts assigned by the court which shall be notified of the request for bankruptcy by the BOD. Otherwise the application made to the court for an expert inspection shall be considered as notification of bankruptcy.

#### b) Postponement of bankruptcy

**Article 377-(1)** The BOD or any creditor can request the postponement of bankruptcy by presenting to the court an improvement project indicating the objective and actual sources and measures, including the new capital contribution in cash. In such case, Articles 179 to 179/b of the Execution and Bankruptcy Law shall be applied.

### 4. Early risk detection and management

**Article 378-(1)** For companies whose shares are listed in the stock exchange the BOD is required to set up an expert committee to run and to develop the system for the purpose of early detection of the causes that jeopardize the existence of the company, its development and continuity of the business unit in danger, of applying the necessary measures and remedies in this regard, and of managing the risk. In other companies a similar committee, if deemed necessary and if the BOD is notified in writing by the

auditor, shall be constituted and shall submit its first report at the end of the month following its constitution.

**(2)** In a bimonthly report to the BOD, the committee shall evaluate the situation, indicate the dangers, if any, and suggest remedies. The report shall also be sent to the auditor.

## **5. Company's acquisition of its own shares or acceptance thereof as pledge**

### **a) In general**

**Article 379-(1)** A company cannot acquire and accept as pledge its own shares in return for consideration, at an amount which exceeds or will exceed as a result of a transaction, one-tenth of its basic or issued capital. This provision shall also be applicable to the shares which a third party acquires or accepts as pledge in his/her name, but in the account of the company.

**(2)** In order for the shares to be acquired or accepted as pledge in accordance with the provision in paragraph 1, the GA must have authorized the BOD to act in this matter. This authorization, which can be granted for a maximum of five years, must show the lower limit and upper limit of the price which can be paid for shares to be acquired and the total nominal values of the shares to be acquired or accepted as pledge. The BOD must state in each of its proposals for permission that the legal requirements have been met.

**(3)** In addition to the requirements set out in paragraphs 1 and 2, after the prices of the shares to be acquired are deducted, the company's remaining net assets must be at least equal to the sum of the reserves that may not be distributed according to law and articles of association, and of basic or issued capital.

**(4)** In accordance with the above-mentioned provisions only shares that have been paid in full can be acquired.

**(5)** The provisions in the paragraphs above shall also be applied in case that the parent company's shares are acquired by its subsidiary. The CMB shall determine the regulation needed in accordance with the principles of transparency and in regard to the price of the companies whose shares are listed in the stock exchange.

### **b) Evasion of law**

**Article 380-(1)** Legal transactions which the company performs with a person for the acquisition of its shares with regard to granting an advance, a loan or security, shall be null and void. This nullity provision shall not be applied to transactions within the scope of activity of credit and finance organizations and to legal transactions in regard to granting an advance, a loan or security to the employees of the company or of its dependent companies for the purpose of acquiring the company's shares. However, these exceptional transactions shall be invalid if they reduce the reserves which the company is obliged to allocate according to law and the articles of association, if they violate the

rules in Article 519 regarding the expenditure of legal reserves and if they make it impossible for the company to allocate the legal reserves stipulated in Article 520.

**(2)** Furthermore, a regulation between the company and a third party which grants this person the right to acquire the company's own shares in the account of the company, of its dependent company or of a company the majority shares of which are possessed by the company, or which stipulates such a liability for this person in this regard, shall be null and void if the transaction is in conflict with Article 379 in the event these shares were acquired by the company.

**c) Prevention of an imminent and serious loss**

**Article 381-(1)** In the event it is necessary to avoid an imminent and serious loss, a company can acquire its own shares in accordance with Article 379 in the absence of a GA resolution regarding authorization.

**(2)** In the event the shares are acquired as above, the BOD shall provide the first GA with written information regarding:

- a) Reason and purpose of the acquisition
- b) Number of acquired shares, sum of their nominal values and percentage of the capital they represent
- c) Price and terms of payment

**d) Exceptions Article 382-(1) A company can acquire its own shares without being subject to the provisions in Article 379 in the following cases:**

- a) If it is applying the provisions of Articles 473 to 475 relevant to decreasing its basic or issued capital.
- b) If it is a requirement of the universal succession rule. c) If such acquisition is arising from a statutory purchase liability.
- c) Provided that the full price is paid and if it is intended for the collection of a company receivable through execution proceedings.
- d) If the company is a securities and investment banking company.
- e) Gratuitous acquisition Article 383-(1) A company can acquire its own shares gratuitously provided that their prices are fully paid.

**(2)** The provision in paragraph 1 shall apply comparably in the event a subsidiary acquires shares in the parent company gratuitously.

**f) Disposal**

**Article 384-(1)** According to sub-clauses (b) to (d) of Article 382 and to the provisions in Article 383, the acquired shares shall be disposed of as soon as their transfer is possible without causing any loss to the company and in any case within three years as

of their acquisition, unless the sum of these shares owned by the company and by the subsidiary exceeds 10 percent of the company's basic or issued capital.

**g) Disposal in case of an acquisition contrary to law**

**Article 385-(1)** Shares acquired or accepted as pledge in a way contrary to Articles 379 to 381 shall be disposed or the pledge on them shall be released within six months from the date of their acquisition or acceptance as pledge.

**h) Capital decrease Article 386-(1)** Shares that cannot be disposed in accordance with Articles 384 and 385 shall be redeemed immediately through a decrease of capital.

**i) Provisions reserved Article 387-(1)** Provisions in other laws regarding the company's acquisition of its own shares will remain valid.

**j) Prohibition of subscription of its own shares Article 388-(1)** A company cannot subscribe to its own shares.

**(2)** Subscription to the company's shares by a third party or a subsidiary in its own name but on behalf of the company shall be considered as the company subscribing to its own shares.

**(3)** In case of an act contrary to paragraphs 1 and 2, the shares in question shall be considered as subscribed to by the founders while incorporating the company and by the board members while increasing the capital, and they shall be responsible for the share prices. During the founding of the company and while increasing capital, board members who have proved that they are faultless in the subscription contrary to law shall be exonerated from responsibility.

**(4)** The provisions in paragraphs 1 and 3 shall be applied to subsidiaries subscribing to the shares of the parent company by analogy. The shares in question shall be considered as subscribed to by the board members of the subsidiary. Members are responsible for the share prices.

**k) Exercise of rights**

**Article 389-(1)** The company's own shares acquired by the company and the shares of the parent company acquired by the subsidiary shall not be taken into account while calculating the parent company's GA meeting quorum. Excluding the acquisition of gratis shares, the company's own shares taken over by the company shall not grant any shareholding rights. The voting right pertaining to the parent company shares acquired by the subsidiary and affiliated rights shall be suspended.

## **IV - Board meetings**

### **1. Resolution**

**Article 390-(1)** Oshall convene with the majority of all members and make its decisions with the majority of the members present at the meeting. This rule shall apply also in the event the BOD convenes in an electronic environment.

**(2)** The board members cannot vote to represent each other nor are they allowed to participate in the meeting by proxy.

**(3)** In the event the votes are tied the matter shall be left to the next meeting. If the votes are tied at the second meeting as well, the matter in question shall be deemed to be rejected.

**(4)** In the event none of the board members request a discussion, BoD resolutions on a proposal regarding a certain matter made by one of the members can be taken by obtaining the written approval of a majority of all members. All members of the BoD must receive the same proposal. Approvals are not required to be on the same paper; however, all papers containing approvals must be attached to the board resolution register or converted into a resolution containing the signatures of approvers and attached to the board resolution book to ensure the validity of the resolution.

**(5)** The resolutions shall be valid only if they are in written form and signed.

### **2. Null and void resolutions**

**Article 391-(1)** The court can be asked to determine that the board resolution is null and void. In particular this applies to resolutions that:

- a) contradict the principle of equal treatment
- b) do not comply with the basic structure of the joint stock company or do not maintain the principle of protecting the capital
- c) violate the rights of shareholders or restrict or make these rights difficult to exercise
- d) are within the non-delegable authorities of other bodies and relevant to the transfer of these authorities

### **3. Right to information and to inspect**

**Article 392-(1)** Each board member can request information, ask questions, and conduct an inspection regarding all business and transactions of the company. The request of a board member for any book, record, contract, correspondence, or document to be brought to the board meeting, inspection or discussion thereof by the board or members, or a request for information from a manager or employee concerned with any matter cannot be rejected. If rejected, the provision in paragraph 4 shall apply.

**(2)** Persons and committees in charge of company management, as well as all board members, are required to provide information at board meetings. A member's claim regarding this matter cannot be rejected and the member's questions must be answered.

**(3)** Every board member can obtain information outside of board meetings, from people in charge of managing the company regarding the course of business and about certain individual tasks, with the permission of the chairman of the board, and if required to perform his/her duty, he/she can request from the chairman of the board the company books and files for inspection.

**(4)** If the chairman rejects a member's claim to obtain information, to ask questions and to conduct an inspection as set forth in paragraph 3, the matter shall be brought to the board within two days. If the board does not convene or rejects this claim, the member can apply to the commercial court of first instance at the company's headquarters. The court can review the claim without a hearing and deliver an order; the court's order shall be final.

**(5)** The chairman of the board cannot obtain information and inspect company books and files outside of the board meetings without permission of the board. Should a request by the chairman be rejected, the chairman can apply to the court in accordance with paragraph 4.

**(6)** The board member's rights arising from this article cannot be restricted or abolished. The articles of association and the BoD can extend the members' rights to information and inspection.

**(7)** Each member of the board can ask the chairman in writing to convene the BOD.

#### **4. Prohibition of participation in discussion**

**Article 393-(1)** A board member cannot participate in discussions regarding matters which lead to a conflict between interests of the company and personal interests of the member or a person of his/her lineal consanguinity or his/her spouse or one of his/her blood and in-law relatives up to and including the third degree. This prohibition shall also be applied in cases where acting in good faith requires the non-participation of a board member in the discussion. If in doubt about the existence of such conflict, a decision shall be made by the BOD, and the member involved may not participate in this voting. Even if the conflict of interest is unknown to the BOD, the concerned member is obliged to declare it and abide by the prohibition.

**(2)** A board member who acts in contravention of these provisions, members who do not object to the participation of the concerned member in the meeting while the conflict of interest objectively exists and is known, and board members who decide in favour

of the participation of the said member in the meeting shall be liable for damages incurred by the company in regard to this matter.

**(3)** The reason for non-participation in the discussion because of this prohibition, and related transactions, shall be written in the resolution of the BOD.

#### **V - Pecuniary rights of board members**

**Article 394-(1)** Provided that the amount is determined by the articles of association or the GA resolution, board members can be paid an honorarium, salary, bonus, a premium and a portion of the annual profit.

#### **VI -Prohibition of conducting transaction with company, to become indebted to company**

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

**(2)** The board member, his/her relatives specified in Article 393, 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 cannot become indebted in cash or in kind to the company. The company cannot provide surety, guarantee or security for these persons, undertake liability or take over their debts. Otherwise, the creditors of the company can start execution proceedings directly against these people for the debt of the company in the amount for which the company is liable.

**(3)** Provided the provision in Article 202 remains valid, companies in the group of companies can provide surety and guarantee for each other.

**(4)** Special provisions of the Banking Law remain valid.

#### **VII -Non-compete obligation**

**Article 396-(1)** No board member can conduct any transaction of a commercial nature falling under the scope of activity of the company in his/her account or any other person's account without obtaining permission from the GA, and he/she cannot participate in a company involved in the same kind of commercial business as a partner with unlimited liability. The company shall be free to file a claim for compensation from the board members acting in contravention of this provision, or instead of compensation, to consider the transaction conducted as made in the name of the company and to file a lawsuit and claim any benefits arising from contracts made in the account of third parties belong to the company.

(2) Board members other than the one who has acted contrary to the provision in paragraph 1 shall have the right to exercise one of the rights stated above.

(3) These rights shall become statute barred three months from the date on which the other board members learned that the said commercial transactions have been conducted or that the board member has participated in another company, and in any case one year after they were conducted.

(4) The provisions relevant to the responsibilities of board members remain valid.

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