

Winds of Change - the Extent of the Board of Director's Liability

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The Board of Directors ("BoD") is the most effected corporate body in terms of the corporate governance rules stipulated in the New Turkish Commercial Code (the "New TCC") to enter into force in July 2012. Under the New TCC, the liabilities of the BoD members are modified and regulated in detail. This article aims to provide a brief outline of the amendments and innovations to be put into force with the implementation of the New TCC as it relates to the liabilities of the members of BoD.

Pursuant to the provisions of the Current Turkish Commercial Code (the "Current TCC") in relation to the liability of BoD members whilst executing their duties, the BoD members may not be held personally liable for any transactions and contracts concluded on behalf of the company. The BoD members can be jointly liable towards the company, its shareholders, and its creditors in the following circumstances:

- If amounts subscribed by the shareholders in the share capital of the company are not duly paid,
- If dividend distributions are not made out of net profit or reserves allocated for such purpose;
- If the statutory books of the company are non-existent or not duly kept;
- If the decisions of a general assembly meeting are not executed without any reason;
- If the other statutory duties or duties under the Articles of Association ("AoA") of the company are not fulfilled, whether intentionally or in negligence.

Consistent to the Current TCC and the New TCC, a member of a BoD may be held liable for his breach of duties only if damage is incurred either by the company, its shareholders or credi-

tors and negligence is attributable. Therefore, under the Current TCC and the New TCC, BoD members may be relieved from liability if they prove that no negligence is attributable to them.

The rule for the liability of BoD members applicable under the Current TCC, whereby any or all of the BoD members are liable for losses against the company, the shareholders and the creditors, will be changed once the New TCC comes to force. According to the New TCC, where more than one of the BoD members are liable for compensation of a damage incurred by the company, each of the BoD members could also be held liable in proportion to the degree of their negligence and as far as the essentials of the case requires. Accordingly, a BoD member who is not negligent may not be held liable and the ones who are negligent will be held liable proportionate to the degree of their negligence.

Liability in Delegation of Management and Representation Powers

According to the Current TCC, members of the BoD may delegate their management and representation powers, partially or entirely, to another member of the BoD or to a manager. Members of the BoD will not be held liable for the acts of the delegated member/manager. According to the New TCC it is explicitly stated that in case of delegation of powers, members of BoD will only be held liable if it is proved that they did not act with a reasonable duty of care while choosing these delegates.

The New TCC separates the management representation powers of the BoD. The BoD may be entitled to delegate its powers, partially or entirely, to certain members of the BoD and or to third parties under a special provision included in the

AoA of the company and an internal directive to be issued regarding the delegation of management of the company. This directive will define management functions, duties and the reporting chain within the company.

Unless otherwise provided by the AoA or if the BoD is not compromised of one member, the authority to represent and bind the company will be used by two BoD members. The BoD may be entitled to delegate its representation power. Please note that at least one BoD member must always hold the power of representation.

Non-delegable Duties and Responsibilities

Non-delegable duties and responsibilities of the BoD stated under the New TCC are as follows:

- High-level management of the company and giving related instructions and orders
- Determination of the company's organization plan.
- Establishment of the organization for the financial planning, to the extent required by the accountants, financial auditing and management of the company.

“TCO”) regarding the duty of care of the BoD members. These provisions require the BoD to act as prudent company executives while performing their duties. According to the New TCC, members of the BoD and third parties engaged in company management should be responsible in acting with the care expected from a “cautious executive”. The members of the BoD will not be held liable where damage or loss occurs, if the BoD member acted cautiously. The New TCC does not make any reference to the TCO in order to prevent ambiguity.

The duty of loyalty is unquestionably regulated in the New TCC. It states that the BoD members are responsible for protecting the interests of the company in compliance with the principles of good faith.

Liability of Recently-Appointed BoD Members for Past Actions

Under article 337 of the Current TCC recently appointed BoD members may be liable if they do not inform the Statutory Auditors of any ‘evident irregularities of their predecessors’. However, this should be very narrowly interpreted and is applicable only under exceptional circumstances. Please note that the New TCC does not introduce any provisions to substitute Article 337 of the TCC.

Moreover, the New TCC has introduced a new provision. Pursuant to Article 553/3 of the New TCC, 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.

Accordingly, it may be theoretically argued that recently appointed BoD members will not be held liable for the actions of their predecessors, unless they are directly involved in such action or it is within their control. Nevertheless, implementation of this new regime will be formed by jurisprudence and secondary legislation.

Liability of BoD Members of a Subsidiary

According to the New TCC, a parent company may instruct its wholly owned subsidiary to take certain actions which are detrimental to the profitability of the subsidiary, provided that such instructions are in line with the predetermined and solid policies of the parent company or the group companies. The members of the BoD of the subsidiary, who carry out such instructions, cannot be held liable for the consequences arising subsequently.

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- Appointment and dismissal of managers and persons at the same status as the managers and authorized signatories.
- High level auditing of managers and representatives with regard to their compliance with laws, AoA, internal directives and written instructions of the BoD.
- Keeping a share ledger, a board resolution ledger and a general assembly meeting books, the preparation of annual activity report and declaration of corporate governance and the submission of the same to the general assembly, the preparation of general assembly meeting minutes and the enforcement of general assembly meeting resolutions.
- Notification of the court in the event of insolvency.

Fiduciary Duties and Responsibilities

The Current TCC makes reference to the provisions of the Turkish Code of Obligations (the

The Release of BoD Members

According to the New TCC, shareholders and creditors of the joint stock company are entitled to file a lawsuit against the members of the BoD. The "release of the BoD members" is one of the mandatory items that should be included in the agenda and be discussed at an ordinary general assembly meeting. Once the shareholders decide to release the BoD members from their liabilities that may arise through their actions pertaining to the financial term for which the general assembly is convened, such resolution cannot be revoked. Nevertheless, shareholders who attended the meeting and objected to such resolution may file a lawsuit against the BoD members within 3 (three) months from the date of the resolution, *i.e.* the date of the general assembly meeting. The BoD members may not be released from their obligations arising from incorporation and capital increase unless 4 (four) years has passed as of the date of registration

- Inaccuracy of the documents and declarations
- Misrepresentation on share capital and being aware of incapability to satisfy capital under-taking
- Irregularity in valuation of in-kind capital
- Failure to keep company books
- Failure to launch company web site
- Breach of confidentiality duty
- Collection of capital from the public without the permission of the Capital Markets Board with the aim or promise of establishing companies, increasing capital and using this money contrary to the aim of collection

Liability of BoD Members Due to Non-Payment of Public Debts of the Company

An important liability of BoD members which must be stressed, though not a part of the TCC but remains unchanged and effective, is stipulated under the Tax Procedural Law and Law on Collection Procedure of Public Receivables. Pursuant to Tax Procedural Law, authorized representatives of the company are obliged to fulfil tax obligations. In the event that such authorized representatives do not fulfil their obligations, taxes and the related receivables, which are totally or partially not satisfied by the company's assets shall be paid by such authorized representatives from their private assets.

The law on the Collection Procedure of Public Receivables extends the liability of the representatives by contemplating that the public debts other than the taxes will also be collected from the private assets of the representatives and that the debts will be paid by the representatives if the company cannot or it is evident *prima facie* that they cannot pay such public receivables. Please note that BoD members are held severally and jointly liable for taxes and other public receivables that have accrued in their office terms.

Conclusion

Liabilities of the BoD members are stipulated much more explicitly in the New TCC. The clearer corporate governance rules in the New TCC, such as non-delegable duties of BoD members, provide a more precise understanding of the liabilities of BoD members. In addition to the relatively more explicit provisions of the New TCC, case law and secondary legislation along with the interpretation of scholars and practitioners will also be essential. This will inspire confidence to the BoD members in performing their duties and investors will be encouraged by this reform in one of the key platforms of corporate governance.

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of the company. However, if the minority shareholders are against the resolution of the general assembly regarding the release of the BoD members, such resolution may not be approved by the general assembly.

Criminal and Legal Liability

The New TCC provides separate provisions regarding legal and criminal liability for certain activities conducted while managing and representing a joint stock company. In this respect, the persons who commit these acts will bear such liability accordingly. Please note that the liability explained under this provision is not exclusive for BoD members. To the extent the managers of a joint stock company breaches such provisions of the New TCC, they may be held legally or criminally liable for such activities. These general rules refer not only to the BoD members, but everyone who may be concerned by committing these actions by their acts or omissions. Sanctions for such breaches vary from fines to several years of imprisonment. These actions are, *inter alia*, listed as follows:

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