LEGAL LIABILITY OF THE MEMBERS OF THE BOARD OF DIRECTORS IN JOINT-STOCK COMPANIES

Seda Seyman
Institute of Social Sciences, Dokuz Eylül University, İzmir, Turkey
sedaseyman@gmail.com

Abstract

The second book regulates trade companies including articles 124 to 644 of the Turkish Commercial Code numbered 6102. Classification of trading companies in the Turkish Commercial Code; joint stock companies, collective companies, limited companies, commandite companies and cooperative companies. The board of directors is a necessary board for joint stock companies, and the company in general continues to operate with the decisions taken in this board. In this regard, the external affair activities of joint stock companies, with resolutions of the board of directors is executed. When the obligations non performance, the members of the Board of Directors become liable both legally and criminally. The purpose of article, Legal Liability of The Members of The Board of Directors in Joint Stock Companies is the issue and discussed; a study has been carried out within the framework of the purpose, scope and consequences of the legal responsibility.

Keywords
Member of the Board of Directors, Legal Liability, Member of the Board of Directors in Joint Stock Company, Board of Directors, Joint Stock Company
1. Introduction

It is a legal liability of joint-stock companies to have a board of directors as an organ. The company is represented and managed by the board of directors. Thus, external affairs of the company are conducted by the decisions made by the board of directors. Members of the board of directors are legally liable to the company in terms of their decisions and actions in the event of conditions by the law. In other words, if members of the board of directors breach their duties under the law and the articles of association, they will be liable for any loss. Turkish Commercial Code (TCC) includes detailed provisions regulating liabilities of members of the board of directors which can be categorized as general liabilities and specific liabilities.

2. General Liabilities

The general provision related to liabilities of members of the board of directors is stated in TCC Article 553. According to TCC 553;

“(1) If founders, board members and liquidators negligently breach their obligations stipulated by law and the articles of association, they shall be liable both to the company and to the shareholders as well as the creditors of the company for their damage incurred therefrom.

(2) Organs or persons, who has assigned a duty or an authority, with which they are entrusted by law or the articles of association, to other persons, shall not be liable for the acts and decisions of such persons who has taken over these duties and authorities, unless it is proven that they have not acted with reasonable diligence when selecting these persons.

(3) No one can be held liable for frauds or breaches of the law or the articles of association to the extent these are beyond their control; this non-liability may not be revoked based on the duty of care and supervision. (Translated by Aydogan & Emirler, 2016)”

In accordance with the regulation, if founders, members of the board of directors, directors and liquidators breach their duties under the law and the articles of association, they will be liable to the company, shareholders and creditors for the losses. In this regulation, making members of the board of directors, delegates and liquidators liable as organs pro forma, those who are not organs pro forma but effective in decision-making and have the power to make decisions independently, and those named de facto organs must be considered as directors (Pulasli, 2014; Sener, 2017; Tekinalp, 2012; Altay, 2011; Camurcu, 2015). The basis for the liability regulated by the provision is breaching their duties under the law or the articles of association.
The transfer of the power of management or representation is regulated by Section 2 of the article. By Section 2 thereunder, on condition that two terms are met, organs or persons transferring their power of management or representation shall not be liable. The first term requires the transfer of authority or duty to be done in accordance with the law, and the second necessitates a considerable amount of attention during the determination of those to take over the authority or duty. Within the scope of this article, the company will be able to claim for the direct or indirect losses shareholders and creditors have faced.

3. Specific Liabilities

As well as general liabilities regulated by TCC Article 553, several specific liabilities have been designated based on the actions leading to liabilities. Some of these are; “Irregularity of documents and statements” (TCC Art. 549), “Disinformation on capital subscriptions and being aware of insolvency of subscribers” (TCC Art. 550), “Falsified valuation” (TCC Art. 551), “Raising money from public” (TCC Art. 552), as to irregular exercise of company power incurring liability “Irregular power” (TCC Art. 202) and as to not creating a company website or not publishing requested documents incurring liability “Website” (TCC Art. 1524) titled articles.

3.1 Liability Arising from Illegality of Documents and Declarations

Liability resulting from illegality of documents and declarations is regulated by TCC Article 549. According to article 549;

(1) Any liability arising from the losses due to inaccurate, forged, fake or untrue documents, issue prospectuses, warranties, statements and guarantees relating to certain transactions such as establishment of the company, capital increase and reduction, merger, division, changing the type of the company and issuance of securities or due to disguise of facts or other irregularities shall be incumbent on the issuers of such documents or statements, and if acted negligently, their accomplices. (Translated by Aydogan & Emirler, 2016)

There are two significant points in this regulation. First of all, the types of transactions are designated in the regulation. These include such ones as establishment of the company, capital increase and reduction, merger, division, changing the type of the company and issuance of securities. However, the transactions implied are not only those stated in the regulation, inasmuch as the statement includes the phrase such as. Thus, any irregular documentation or statement related to the transactions presenting similar qualities to the ones in the regulation will
result in liabilities even though they are not stated in the regulation specifically (Pulasli, 2015; Pulasli, 2009; Camurcu, 2015). Secondly, persons issuing documents or making statements as to these transactions are liable whether they are guilty or innocent. In this regard, these persons are stipulated strictly liable by the law (Pulasli, 2009; Tekinalp, 2012; Altay, 2011; Kendigelen, 2012; Camurcu, 2015). Finally, it must be stated that the law stipulates that persons involved in the process are strictly liable even though they have not issued any documents or statements as to those transactions (Pulasli, 2009; Kendigelen, 2012; Altay, 2011; Bahtiyar, 2014; Camurcu, 2015).

It is stated clearly by the article that irregularity of documents and statements are inaccurate, forged, fake, or untrue documents, issue prospectuses, warranties, statements and guarantees, disguise of facts or other irregularities (Camurcu, 2015).

Right of action in the event of irregularity of documents and statements belongs to persons suffering from losses due to issued documents and statements, and these persons may include shareholders, those having lost their status as shareholders owing to issued documents or statements, buyers or sellers of securities (Pulasli, 2014; Camurcu, 2015). This issue is stated in the preamble to the article as follows; “The aggrieved parties’ have active capacity to sue regarding general liability cases, yet shareholders, those who have ceased to be so due to such transactions, security buyers or subsequent owners of these securities could be considered as ‘the aggrieved parties’ depending on the qualities of concrete case.”

It has been argued in terms of doctrine if a joint-stock partnership itself has the right of action in case of an irregularity of documents and statements. Some claim that a joint-stock company is not able to commence an action on the basis of TCC Article 549, for it states that an action can be commenced for the compensation of losses due to transactions conducted in accordance with irregular documents and statements; however, only if a joint-stock company meets the conditions, will it be able to commence an action on the basis of TCC Article 553 (Altay, 2011; Camurcu, 2015). Others claim that a joint-stock partnership has the right of action if the company itself has suffered from losses owing to irregular documents and statements, insomuch as those suffering from losses due to transactions conducted in accordance with irregular documents and statements can commence an action for compensation on the basis of TCC Article 549 (Pulasli, 2014; Pulasli, 2009; Camurcu, 2015). We believe that the argument supporting the idea that a joint-stock partnership itself has the right of action has a point, in that
it is possible for a joint-stock company to commence an action if it has suffered from irregularity of documents and statements, since it is stated in the preamble to the article that active capacity to sue belongs to the aggrieved party.

Another point that needs to be mentioned here is passive capacity to sue. In the article, liable persons are not expressed distinctively, yet they are stated as those who issue such documents or statements, and if acted negligently, their accomplices. Persons who possess passive capacity to sue are stated in the preamble to the article as follows; “As for the passive capacity to sue, persons who have that are ‘issuers’ and ‘accomplices’ involved in actions mentioned in the article. These shall be determined via doctrine and jurisdiction.” In accordance with this regulation, in the scope of liability, not only members of the Board of Directors or delegates, but also anyone, even if they are neither, issuing mentioned documents or statements have passive capacity to sue.

### 3.2 Disinformation on Capital Subscriptions and Being Aware of Insolvency of Subscribers

Capital maintenance principle is one of the fundamental principles in a joint-stock company. Disinformation on capital subscriptions and being aware of insolvency of subscribers, a reflection of capital maintenance principle, are regulated by TCC Article 550. According to article;

1. If the capital has not been fully subscribed or it has not been paid up in accordance with the articles of association or law; those who have pretended that it has been subscribed or paid up, and if acted negligently, the authorized persons of the company shall be deemed to have subscribed these shares and therefore, be jointly liable to pay their prices and the losses incurred therefrom, together with the interest thereon.

2. Liability arising from non-performance of the foregoing obligation shall be incumbent upon those who knew that these subscribers were insolvent or those who accepted such a failure. (Translated by Aydogan & Emirler, 2016)"

The purpose of the provision is to protect the registered capital of a joint-stock company, which is why it is a regulation protecting the interests of both shareholders and creditors, and it includes two actions leading to liability. The first of the forbidden actions is disinformation on capital subscriptions. With regard to this provision, those who pretend that the capital has been fully subscribed or paid up under the law and the articles of association even if it has not will be strictly liable. Besides, executives of the company are also liable if acted negligently.
It is stated in the preamble to the article as to what should be understood from the authorized persons of the company that the authorized persons of the company is a broad concept and it includes members of the board of directors and transaction auditors. Considering this regulation in the preamble, instead of limiting the authorized persons of the company only to members of the board of directors and delegates, it is necessary to include all employees of a joint-stock company and everyone involved in the fulfillment of the actions mentioned in the article negligently.

Those who pretend that the capital has been fully subscribed or paid up under the law and the articles of association even if it has not and if acted negligently, the authorized persons of the company shall be deemed to have subscribed these shares and therefore, be jointly liable to pay their prices and the losses incurred therefrom, together with the interest thereon. Those who are strictly liable for the actions mentioned in the article and the authorized persons of the company who have acted as accomplices are jointly and severally liable. It is stated in the preamble that the basis for joint and several liability shall be designated by TCC Article 557 (Pulasli, 2014; Altay, 2011; Camurcu, 2015).

There has been a regulation in TCC Article 550 Section 2 as to liability in the event of being aware of insolvency of subscribers. According to article TCC Article 550 Section 2; “Liability arising from non-performance of the foregoing obligation shall be incumbent upon those who knew that these subscribers were insolvent or those who accepted such a failure. (Translated by Aydogan & Emirler, 2016)” In accordance with this regulation, those who accepted a subscription even though they are aware that a shareholder who contracted an engagement to subscribe the capital during the establishment of the company or a capital increase is insolvent of subscription are liable for the joint-company’s loss due to insolvency of subscription. What makes this regulation different from the first section is that while in Section 1, there is a pretension to have a capital subscription even if it does not exist, in Section 2, there really is a capital subscription, yet the shareholder is insolvent of subscription (Tekinalp, 2012; Pulasli, 2015; Camurcu, 2015). Those who accept such a subscription even though they are aware of insolvency could be the founders who were aware of such a failure during the establishment of the company (Pulasli, 2014; Camurcu, 2015). Members of the board of directors who accepted a subscription even though they are aware that the shareholder who contracted an
engagement to subscribe the capital during the capital increase is insolvent of subscription will also be liable.

The type of liability regulated by TCC 550 Section 2 is fault liability, since the possibility that founders or members of the board of directors become liable in accordance with the preamble of the article arises from the fact that the subscription has been accepted despite the awareness of insolvency (Tekinalp, 2012; Bahtiyar, 2014; Camurcu, 2015). It also needs to be pointed out that in order for a liability to occur in accordance with the article, there must be an awareness of the insolvency by founders or a member of the board of directors, not a possibility to be aware of the insolvency (Tekinalp, 2012; Altay, 2011; Camurcu, 2015).

3.3 Falsified Valuation

Another liability of members of the board of directors is regulated by TCC 551 under the title of falsified valuation. According to article;

“1) Those who overvalued the contributions in-kind or acquisition of real rights or enterprises as against their peers; disguised the characteristic or position of the real right or enterprise; or made falsifications in any other manner shall be liable for the losses arising therefrom. (Translated by Aydogan & Emirler, 2016)”

As mentioned before, capital maintenance principle is fundamental in a joint-stock company, and several provisions contributing to this principle by protecting a joint-stock company’s asset, its sole guarantee, has been put into force under several articles of the law. TCC Article 551 is also a reflection of capital maintenance principle.

It has been stated in the preamble to the article that although the provision is the repetition of the former TCC Article 307, there are also some differences. There is no manipulation to be able to put the provision into practice.

Stated in the preamble to the article, overvaluing the contributions in-kind or acquisition of real rights or enterprises as against their peers and disguising the characteristics or position of the real right or enterprise are given as examples to falsified valuation. As a consequence, falsified valuation is not limited to the examples mentioned in the article, for it also includes the phrase; or made falsifications in any other matter. The manners that can be recognized as falsified valuation are exemplified in the preamble to the article as follows; Overvaluing the contributions in-kind or acquisition of real rights or enterprises as against their peers; or disguising the characteristic (i.e. land as building, public building as plant, or residence as
tourist facility) or position (i.e. acting as if there was a zoning status, issuing the zoning status to be better than it really is, or not issuing the zoning status) of the real right or enterprise; or making falsifications in any other manner (i.e. acting as if the founders had accepted though they have not or receiving reports from someone other than an official referee) shall be qualified as falsified valuation.

The article is based on faulty actions. In other words, one must be faulty in falsified valuation to be able to liable (Tekinalp, 2012; Kendigelen, 2009; Altay, 2011; Ucsik & Celik, 2013; Yasaman, 2013; Camurcu, 2015). It has been stated that the expression overvalued ... as against their peers in the preamble to the article is significant in identifying the fault, and such expressions as “high”, “obvious”, or “considerably high” have intentionally been avoided. There are two reasons behind this intention. One reason is that such adjectives will result in difficulty to interpret, and the second is that it leads to hesitation in recognizing the variety of measures as legal, since the court is expected to finalize the case in terms of both fault investigation and discretion. Supposing strict liability is considered, because it can result in liability even in faulty determination of peers, fault liability is accepted as the basis for the article.

It is stated in the preamble of the article that active capacity to sue belongs to the joint-company itself, shareholders and creditors. The doctrine states that the company the right of action due to the fact that partnership suffers from losses directly, and shareholders and creditors have the same right, as they suffer indirectly (Tekinalp, 2012; Camurcu, 2015). As for passive capacity to sue, it is mentioned in the preamble to the article that it depends on the concrete case. According to the doctrine, persons liable depend on the time when the valuation is fulfilled. If the valuation is conducted during establishment, founders are liable. On the other hand, if the valuation is done after the establishment of the company, members of the board of directors, managers, commercial agents or their representatives, referees, lawyers or municipal official could be considered as liable (Pulasli, 2014; Tekinalp, 2012; Camurcu, 2015). Thus, it can be concluded that persons liable for falsified valuation could be anyone whether they possess a role as an organ or not, if acted negligently (Ucisik & Celik, 2013; Camurcu, 2015).

3.4 Raising Money from Public

Another liability of members of the board of directors is regulated by TCC 552 as follows;
"Without prejudice to the provisions of the Capital Market Law, raising money from public by way of calling on people in any manner whatsoever so as to increase the capital of the company or establish a new company is prohibited. (Translated by Aydogan & Emirler, 2016)"

By the regulation in the article it is illegal to raise money from public by way of calling on people in order to increase the capital of the company, establish a new company or a promise to do so without prejudice to the provisions of the Capital Market Law. The purpose of the provision is stated in the preamble of the article; “To prevent fundraising with a view to establishing a joint-stock company, especially abroad, or increasing the capital without the permission of Capital Market Board, to take precautions in the event of such an action, and to preclude such companies from defrauding the public. (Translated by Aydogan & Emirler, 2016)”

The number of the reasons for raising money from the public is not limited to that in the article. No faultiness is needed to put the provision into force, and even if the company acts in good faith. Consequently, those who have performed actions or transactions mentioned in the article or implied by the article will be liable regardless of faultiness (Ucisik & Celik, 2013; Camurcu, 2015). In order for persons to be considered liable, they do not have to possess a role as an organ within the joint-stock company or be a part of the company actively (Camurcu, 2015). Those who have active capacity to sue are the ones who have provided money for such reasons as the establishment of a joint-stock company or capital increase and have suffered from losses.

A final point to mention is that, on the basis of the preamble to the article, if there is not one but more persons liable for raising money from public, they will be liable jointly and severally in accordance with TCC Article 557.

3.5 Liabilities Arising from Irregular Exercise of Company Power

The regulation related to liabilities arising from irregular exercise of company power is included in TCC Article 202. According to the first section of the provision;

“(1) a) The controlling company may not exercise its power in a way that would make the controlled company incur loss. Unless the loss has been actually compensated within that fiscal year or an equivalent claim right, with specific information as to the time and method, has been granted to the controlled company no later than the end of that fiscal year, the controlling company may not direct the controlled company to enter into transactions such as transfer of
business, asset, funds, personnel, receivables or debt; to reduce or transfer its profits; to encumber its assets with real or personal rights; to undertake liabilities such as standing surety, guaranty or bill guaranty; to make payments; without relying on a just cause, to take decisions or measures that have a negative effect on its productivity or operations such as not renewing the facilities, restricting or ceasing the investments or; to avoid measures that will help the company grow.

b) If the loss has not been compensated within that fiscal year or an equivalent claim right has not been granted within the specified time, any shareholder of the controlled company may demand that the controlling company and the board members of controlling company, who caused the loss, compensate the company's loss. Instead of compensation, the court may, per se if it is equitable in that specific case or upon request, order that the shares of the claimant shareholders be purchased by the controlling company as per paragraph (2) of this Article or may decide on another suitable or acceptable solution.

c) The creditors may also demand that the company's losses be compensated as per subparagraph (b) even if the company has not gone bankrupt.

d) The compensation claim is rejected if it is proven that the transaction causing the loss would have been undertaken or abstained from being undertaken by the board members of an independent company, who would, under the same or similar circumstances, act diligently as a prudent director and protect the rights of the company in compliance with the principle of honesty.

e) Article 553, 555 to 557, 560 and 561 are applied, by analogy, in the lawsuit filed by the shareholders and creditors. If the registered office of the controlling enterprise is located overseas, the lawsuit may be initiated before the commercial court of the controlled company's domicile. (Translated by Aydogan & Emirler, 2016)"

The controlling company is not supposed to exercise its power in a way that would make the controlled company incur loss. The ways in which the controlling company may make the controlled company incur loss are stated in the law, and these are; to direct the controlled company to enter into transactions such as transfer of business, asset, funds, personnel, receivables or debt; to reduce or transfer its profits; to encumber its assets with real or personal rights; to undertake liabilities such as standing surety, guaranty or bill guaranty; to make payments; without relying on a just cause, to take decisions or measures that have a negative
effect on its productivity or operations such as not renewing the facilities, restricting or ceasing
the investments or; to avoid measures that will help the company grow.

While there are ways in which company power is exercised unlawfully, the controlling
company will not be exercising its power unlawfully on the controlled company if the loss has
been actually compensated within that fiscal year or an equivalent claim right, with specific
information as to the time and method, has been granted to the controlled company.

Unless the loss has been compensated or an equivalent claim right has been granted
within that fiscal year, every shareholder of the controlled company may claim compensation
from the controlling company and its board members causing loss. It has been regulated that the
judge, upon request or on his own motion, may decide that the controlling company shall
purchase the shares of the claimant shareholders instead of compensation, or may reach another
appropriate and reasonable decision as long as equity is provided in the concrete case. As well as
the shareholders, the controlled company itself has the right of action to claim compensation for
the losses even if it has not gone bankrupt.

The conditions in which compensation may not be delivered as a verdict are stated in
TCC Article 202 Paragraph d. It states that the compensation claim is rejected if it is proven that
the transaction causing the loss would have been undertaken or abstained from being undertaken
by the board members of an independent company, who would, under the same or similar
circumstances, act diligently as a prudent director and protect the rights of the company in
compliance with the principle of honesty.

According to the regulation in Paragraph e of the article, Article 553, 555 to 557, 560 and
561 are applied, by analogy, in the lawsuit filed by the shareholders and creditors. If the
registered office of the controlling enterprise is located overseas, the lawsuit may be initiated
before the commercial court of the controlled company's domicile.

There is a regulation related to shareholders’ rights to demand in TCC Article 202
Section 2, which states that shareholders who object to general assembly resolutions in such
transactions as merger, division, change the type of the company, abolition, issuing securities
and fundamental change in the articles of association by means of exercise of power and without
any valid and reasonable cause for the controlled company, or who have their negative vote
minuted or submit their written objection to such resolutions of the board of directors may
demand in court that the controlling enterprise compensate for the losses or purchase their shares
at least in stock exchange value or, if such a value does not exist or not compatible with equity, in its real value or another determined by a generally accepted method. The determination is grounded on the latest data considering the date of the trial. An action for compensation or demand for share purchase becomes a statute barred action two year after the general assembly resolution or the declaration of the board of directors’ decision.

3.6 Liabilities Arising from Not Creating a Website or Not Publishing Required Information

Liabilities of a company arising from not creating a website or not publishing required information are regulated by TCC Article 1524. According to article;

“(1) Capital companies that are subject to independent audit as per Article 397 (4) are obliged to set up a website in three months after the company is registered at the trade register and to create a separate section for publication of the statutory announcements of the company. If the contents that must be published on the website is subject to a specific time limit by this Law, the company has to publish these contents within the specified time limit. If there is no time limit specified, the contents are published no later than five days after the occurrence of the related transaction or event or, if registration or announcement is obligatory, after the registration or announcement. The contents that must be published until the opening of the website from the date the company was established are published on the website on the date website is opened.

(2) Non-compliance with the obligations set forth in paragraph (1) results in annulment of the related resolutions, emergence of the consequences of non-compliance with the Law and the liability of the negligent board members and managers. Penal provisions are reserved.

(3) The section, which is allocated for information society services in the website, is accessible by everyone. The exercise of the right to access may not be conditioned and may not be limited by setting standards such as having to be a related person or having to have an interest. Upon breach of this rule, anyone may take a legal to remove the obstacle.

(4) The date and the inscription of "directed message" is indicated in parentheses at the top of the content published in the relevant section. This Inscription may only be changed in accordance with this Law and the regulation referred to in this paragraph. A message posted in the relevant section of the website is deemed to have been directed. The registration of the
website under a number and other related matters are regulated by the Ministry of Customs and Trade under a regulation.

(5) Unless a longer period is specified in this Law or other related laws or administrative regulations, the content published on the website is kept there six months as of the given date; otherwise the content is deemed unpublished.

(6) The provisions of this Article and other related articles of this Law do not apply to capital companies that are not subject to independent audit. (Translated by Aydogan & Emirler, 2016)"

Capital companies that are subject to independent audit as per TCC Article 397 Section 4 are obliged to set up a website in three months after the company is registered at the trade register and to create a separate section for publication of the statutory announcements of the company. If the contents that must be published on the website is subject to a specific time limit by this Law, the company has to publish these contents within the specified time limit. If there is no time limit specified, the contents are published no later than five days after the occurrence of the related transaction or event or, if registration or announcement is obligatory, after the registration or announcement. The contents that must be published until the opening of the website from the date the company was established are published on the website on the date website is opened. Non-compliance with these obligations results in annulment of the related resolutions, emergence of the consequences of non-compliance with the Law and the liability of the negligent board members and managers.

4. Conclusion

In order for a board member to be found liable for the losses of shareholders or creditors of a joint-stock company, losses, faults, causal relation or negligence of duties for the organ are sought. While it is not possible for persons who suffered indirectly due to the loss of another to demand compensation under the liability law, there has been made a specific regulation regarding joint-stock companies in the law, and therefore shareholders and creditors who suffered indirectly due to the loss of another have been given the right to demand compensation.

References