

## Liabilities of Board Members – 1:

### Legal Liability of Board of Directors Members

According to the Turkish Commercial Code [“TCC”], the governing and representative body of a joint stock corporation is the “board of directors” [“Board”]. Board members are obliged to carry out their duties with the due care of a cautious manager and to protect the interests of the corporation in good faith. Board members can be held liable for the damages incurred by the corporation, the shareholders, or creditors in cases where they fail to fulfil their duties arising from the law or the articles of association. [TCC Art.553(1)]

#### I. What are the Statutory Liabilities of Board Members?

- ✓ **Governance and representation of the joint stock corporation is both a right and a responsibility for Board members.** Therefore, Board members must partake in the courses of action necessary for the governance of the corporation. In this context, some of the responsibilities of Board members are as follows: participating in Board meetings, giving suggestions, taking part in discussions and dissenting in matters that are contrary to corporate interests.
- ✓ Board members **must act in accordance with the principle of equal treatment** in matters regarding shareholders’ rights and positions within the corporation [TCC Art. 357].
- ✓ Board members **must manage and represent the company with care and commitment [TCC Art. 369]**, This is an objective duty of care. This means that the duty of care expected from the Board member is beyond the care they show in their own work—they must act as if they were a careful and prudent manager in a similar qualified company under the same conditions.
- ✓ Board members **are obliged not to compete with the corporation**, as an essential component of their duty of loyalty. Accordingly, Board members cannot carry out a commercial transaction which falls within the scope of the company's business on behalf of themselves or someone else, without the permission of the general assembly [TCC Art. 396/1].
- ✓ Board members **are under the obligation of confidentiality**. This obligation means that a Board member cannot disclose information that is discussed in meetings or acquired outside the meeting as part of their duty. While the obligation of confidentiality is not clearly regulated in the law, it is accepted as a part of the duty of loyalty arising from the relationship between the Board member and the corporation.
- ✓ Board members **cannot perform transactions with the corporations on behalf of themselves or anyone else without the permission of the general assembly**. Otherwise, the corporation has the right to invalidate the transaction [TCC Art. 395/1].
- ✓ **Non-shareholder Board members and their non-shareholder relatives are prohibited from borrowing cash from the corporation**. The corporation cannot provide security, guarantee or collateral to the aforementioned persons, cannot assume liability, nor can it take over the debts of those persons [TCC Art. 395/2].
- ✓ Board members **cannot attend meetings in certain cases**. Accordingly, a Board member cannot attend a meeting on matters where their personal interests or the personal interests of one of their descendants, spouse, or blood relatives up to the third degree, including the third degree, conflict with the interests of the company [TCC Art. 393].
- ✓ Moreover, there are also several special liability cases regulated in various articles of the TCC. These types of responsibility are as follows; [i.] Liability arising from illegality of documents and statements [TCC Art. 549], [ii.] False statements about the capital and knowledge of insolvency [TCC Art. 550], [iii.], Liability for corruption in valuation [TCC Art. 551] and [iv.] Responsibility arising from illegal crowdfunding [TCC Art. 552].

In addition, it is possible to stipulate additional obligations for Board members in the articles of association of the corporation. In such a case, Board members must also act in accordance with these obligations, and any actions to the contrary may lead to legal liability.

## II. When does the Legal Liability of the Board Members Arise?

The conditions of legal liability are determined in the Turkish Code of Obligations. Accordingly, the conditions sought for the emergence of legal liability are damage, illegality, fault, and causal link.

### ✓ **Damage must have occurred.**

In order for the Board member to be held liable, a damage must have occurred. Damage is a prerequisite for liability. At this point, the concepts of direct and indirect damage should be discussed.

#### **Damage that causes legal liability in joint stock corporations can arise either directly or indirectly:**

While direct damage is a decrease in the assets of the company, shareholders and/or creditors, indirect damage is the reflection of the damage in the assets of the company to the assets of the partners and creditors. Turkish law primarily recognizes direct damage. Compensation for indirect damage can only be requested if it is explicitly stated in law.

In most cases, actions of Board members primarily harm the corporation itself. The decrease in the assets of the company may indirectly cause losses for the creditors and shareholders. Such damages are referred to as "indirect damages". Accordingly, Article 555 of the TCC provides that every shareholder, along with the corporation itself, may request compensation for damages incurred by the corporation, while Article 556 regulates the debtors' right to request compensation in case of bankruptcy. In a lawsuit filed by shareholders or creditors for indirect damage, the company's loss is an indispensable condition [conditio sine qua non] of the lawsuit. Thus, the company, the shareholders who are subject to loss by reflection, and the creditors in case of bankruptcy can demand compensation for the loss to the company. In this case, although compensation for the entire loss can be claimed, the payment is made to the company and not to the shareholders or creditors themselves. This constitutes an exception to ordinary civil procedure.

However, in exceptional cases, it is also possible for the creditors or shareholders to incur direct losses even when the corporation itself does not suffer any loss. These types of direct damages occur especially in cases where the preemptive right of the shareholder is violated in the capital increase, the shareholder is not paid appropriate dividends, and the shareholder is prevented from attending the general assembly meeting or voting in the meeting. In these cases, shareholders and creditors may request indemnification for their direct damages. In such cases of direct damage, the release of the Board members does not prevent the shareholders' and creditors' right of action.

### ✓ **The Board member must have caused damage by their unlawful act.**

Board members can only be held liable due to violations of statutory responsibilities or those arising from the articles of association.

### ✓ **Save for exceptional cases of strict liability designated by law, in order for a Board member to be held liable, they must have caused the damage by fault.**

As is clear from the wording of Article 553/1 of the TCC, liability of Board members is dependent on fault. Since the degree of fault is not determined by law, it is commonly accepted that actions in negligence are sufficient for liability to arise. However, the severity of the fault is important in determining the amount of compensation. In this respect, whether Board members have acted in violation of the duty of care and loyalty regulated in Article 369/1 of the TCC should be evaluated. As explained above, the duty of care and loyalty envisaged here is not a subjective duty, but an objective one determined considering the prudent managerial behaviour set by the legislator.

### ✓ **There must be a causal link between the damage caused and the unlawful act committed by the fault of the Board member.**

Existence of a causal link is an indispensable element in liability cases. Even in cases where the action of the Board member is normally suitable to cause damage, if it is understood that the damage was actually caused by another reason, the causal link is deemed to be severed, and the Board member cannot be held liable.

## III. Determining Liabilities of the Board Members in Accordance with the Principle of Differentiated Solidarity

Pursuant to the principle of differentiated solidary adopted in Article 557 of the TCC, absolute joint liability accepted in the former Turkish Commercial Code No. 6762 has been abandoned, and a system that foresees the obligation of compensation in proportion to the damage caused separately by each Board member has been adopted. Thus, a Board member does never have to pay compensation exceeding the damage they have caused. Differentiated solidarity provisions are applicable in cases where the loss is caused by the actions of more than one Board member.

The judge hearing the liability case decides on the amount of compensation each responsible Board member has to pay, taking into account the reasons for reduction for each member. Reasons for reduction may be the degree of fault, fault of a third party, fault of the injured party and consent of the injured party. The maximum amount of individual liability determined by the judge for each Board member corresponds to the upper limit of the liability of that particular Board member. Thus, no further amount can be requested from the Board member upon the payment of this upper limit.

#### **IV. Competent Court**

Liability cases against Board members can be filed in the commercial court of first instance where the corporation's headquarters is located.

#### **V. Termination of Liability**

Liability of the Board member is terminated in the following cases:

##### **✓ Proof of faultlessness of the Board member as per TCC Art. 369**

A Board member may be relieved of liability if they can prove that the damage occurred despite them acting in compliance with the obligation to perform their duties with the care of a prudent manager and to act in the interests of the company in good will, as regulated in Article 369. To learn more about this obligation commonly called the business judgment rule and its importance, please see our article "[The Significance of Business Judgment Rule for Board Members in Turkey](#)".

##### **✓ Expiration of the statute of limitations**

According to Art. 560 of the TCC, compensation against the liable parties can be claimed in 2 [two] years following the date the plaintiff becomes aware of the damage and the identity of the liable person, and 5 [five] years at most following occurrence of the damage. However, a separate statute of limitations applies in cases where the Board members have been released from liability by the shareholders. Accordingly, if the general assembly resolved on the release of Board members, shareholders who did not participate in the release decision must raise their claim related to the actions covered by the release decision within 6 [six] months [TCC Art. 558/2-c].

Moreover, should the act causing the claim is subject to a longer statute of limitations under the Turkish Criminal Code, this longer statute will be applicable to claims for compensation as well.

##### **✓ Release of Board member**

In joint stock corporations, the general assembly may release the Board members from liability by approving the transactions made by them during the relevant accounting period in terms of their economic and legal consequences. Essentially, release is the acquittal of the Board members through a resolution adopted by the shareholders at a general assembly meeting. It should be noted that it is not the Board who is released, but each individual Board member.

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