

### NEW CODE'S APPROACH TO THE BOARD

In the last couple of years, especially after the negative effects of the economic depression in 2008 have started diminishing, there has occurred a significant increase in the number of foreign capital companies who are keen on being active in Turkey. Turkey is considered as an emerging and white hope market and instead of penetrating into the market alone, foreign investors mostly prefer to cooperate with local investors. This is a situation advantageous for both parties in many aspects. However, the joining of a number of parties from different cultures and with different backgrounds surely creates certain pressure on all sides with respect to protection of interests against consequences coming out of the partnership.

As a result of these developments, application of corporate governance principles has now been on a new level of significance. Accordingly, appointment and functioning of the Board of Directors (the "Board"), which is the managing organ of a joint stock company, also becomes important, as is surely beyond doubt that the role of a well-informed, well-trained and active Board is

absolutely essential for the success of a joint stock company.

The new Turkish Commercial Code No: 6102 (the "New Code") which is to become effective as of 1 July 2012 sets forth material changes for the formation and functioning of the Board in joint stock companies.

This article aims to provide information on these new arrangements and a comparison of the Board related provisions under the Turkish Commercial Code No: 6762 (the "Code") which is currently in effect with those provisions under the New Code.



### Improved Board Structures

By virtue of the New Code, the structure of the Board will change dramatically. The following are the most significant changes introduced to Turkish legal system: (i) a Board may consist of a single director; (ii) directors do not have to be shareholders; (iii) legal entities may be appointed as directors; (iv) majority of the directors are from among professionals; (v) group of shareholders may be represented in the Board; and (vi) a Board may delegate its management power.

#### Single Director

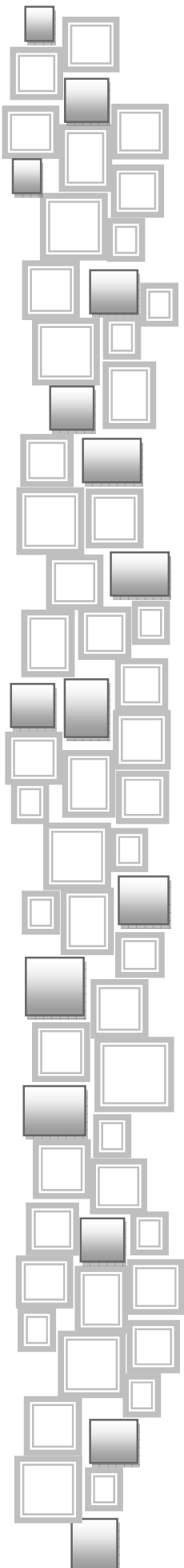
As per the Code, the Board must consist of at least 3 directors. The lawmaker has considered the developments in the modern business law environment and enabled the formation of a valid Board which may consist of a single director. The motive for this change is indicated as the developments in the European Union Law. Also it is a mirror implication of the possibility to establish a joint stock company with a single shareholder. The Code stipulates that a joint stock company must have at least 5 shareholders whereas the New Code provides that a joint stock company may be established by a single shareholder. Furthermore, a Board which consists of a single director will undoubtedly facilitate management of small sized joint stock companies.

Many have criticized this provision on the grounds that the word "board" associates with a group or persons and a Board consisting of a single director contradicts with this meaning. Counter-arguers state that the word "board" actually refers to an organ of a joint stock company rather than a group of people and in modern business law, the understating with respect to the word "board" and its indication of a group or persons have fallen from grace.

*An active, informed, independent and involved board is essential for ensuring a company's integrity, transparency and long-term strength.*

#### Non-Shareholder Directors

Under the Code, the directors in the Board shall own at least 1 share of the company or represent a legal entity having at least 1 share of the company before they assume duties as directors. Currently this provision does not prevent a non-shareholder to be appointed as a director; however, before such director starts performing its duties or exercising his rights as a director in the Board, he shall become a shareholder. This obligation has forced the creation of artificial shareholding with a view to getting around the mandatory requirements. The underlying purpose of this non-functioning rule is to make the members of the Board assume responsibility for their actions and the share owned by them is seen as a security for this liability. In practice, especially for publicly held joint stock companies, this approach has totally lost its meaning and therefore the lawmaker removed this rule when issuing the New Code. In addition to the above, by



way of enabling non-shareholders to become directors, the conflicts which are likely to arise subsequent to the dismissal or resignation of the director have been avoided.

#### **Legal Entity Director**

The Code prohibits a legal entity to become a director in the Board. In the event a legal entity desires to be represented in the Board, the only resort to this request is the appointment of a real person representing the said legal entity as a director in the Board. Even though the real person director is an authorized representative of the legal entity, he shall be personally liable for his actions taken during the term of his office on the grounds that his actions as a director of the Board cannot be attributed to the legal entity. However, the provisions relating to representation are determined under the Code of Obligations and accordingly, if a person has been duly granted with the authority for representing an entity, the consequences of the actions taken by virtue of the instructions received by such entity shall be binding upon the entity. The regulation under the Code however is an exception to this rule.

Under the New Code, this issue has been reversed. Legal entities are entitled to be appointed as directors and the liabilities arising thereof shall be on them. This way, the company, the shareholders and the creditors of the company will be reassured that the legal entity giving the instructions will not be hiding behind its real person representative in case of a conflict.

Since a legal entity cannot attend the Board meetings personally, a real person representative will be appointed in its name to attend the Board meetings and act on behalf of the legal entity. Such appointment shall be registered at the trade registry then published in the Trade Registry Gazette. The registration of the real person representative has a constitutive effect on the grounds that such representation embodies the legal entity's status as a director by way of its real person representative. Publishing the matter in the Trade Registry Gazette is for explanatory purposes before third parties. The lawmaker under the New Code's preamble has stated that the registration and publishing obligation has been envisaged with a view to preventing the legal entity director to assign different real persons for each time the Board convenes which would jeopardize uniformity of the Board. The appointment or dismissal of the real person representative is solely at the discretion of the legal entity director. The general assembly shall not be entitled to assign such representative or appointment with respect thereto shall not be determined under the articles of association. However, the company may always request the legal entity director to dismiss a real person representative due to a just cause.

#### **Professional Board**

By virtue of the New Code, the lawmaker intends to form a Board, mostly consisting of professionals, which will focus on taking actions and resolutions in line with requirements of the business and relevant markets and not with the interests of the shareholders.

With a view to ensuring the appointment of sufficiently qualified directors in the Board, the New Code stipulates that at least  $\frac{1}{4}$  of the directors shall have university degrees. This way, the lawmaker supports a well-

informed and conscious management mentality capable of operating internal audit mechanisms.

#### **Shareholders Groups Represented in the Board**

The New Code enables the generation of groups of shareholders along with groups of shares by specifying that the directors may be appointed from and among a certain group of shareholders or minority shareholders or the directors may be appointed from among those candidates selected by a certain group of shares or owners of the minority shares. For the closed joint stock companies, all directors may be elected this way. However, for the publicly held joint stock companies, at most  $\frac{2}{3}$  of the directors may be elected from among a certain group of shareholders or minority shareholders or from among those candidates selected by a certain group of shares or owners of the minority shares. The remaining  $\frac{1}{3}$  directors shall either be appointed by way of the articles of association or elected by way of a general assembly resolution.

#### **Delegation of Management Power**

The New Code provides for a more detailed structure for delegation of management power when compared to the Code. The New Code analyses delegation of management and representation powers separately. In line with the current arrangement, under the New Code, the representation power cannot be assigned to a person who is not a director. At least one director shall be authorized for representation of the company. With respect to the management power, the New Code brings a new approach to the current system. The management power can be delegated to a person who is not a director. This way, the New Code enables the directors to fulfill their duties without being a director.

For duly delegation of management power, there shall be a provision set forth under the articles of association. Furthermore, the Board shall issue an internal regulation which shall set out the organizational structure, methods of delegation of duties and powers and the arrangement of relation between the directors and those who were delegated the powers. By way of such internal regulation, duties and responsibilities of all directors will become apparent and a management path which will enable the company to reach its goals and purposes as shown under the articles of association will be set forward.

#### **Final Remark**

In a nutshell, the New Code introduces initiatives for the Board with respect to its formation and functioning. The aim of the lawmaker was to take a step forward for meeting the needs of today's joint stock companies as well as the modern business law and the laws of the European Union. In this age, national borders do not prevent international partnerships so why should local codes of law stand in the way?