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The Firm has distinguished itself in the field of academic research and publications, particularly in the area of international commercial law, and continuously strives to keep abreast of all changes and developments in current legislation. Erdem & Erdem is primed to utilize our knowledge to the best potential of your company’s business and legal affairs.

At Erdem & Erdem, we provide services using a multi-skilled team. We are proud of our ability to combine the talents of attorneys across different disciplines to meet our clients’ needs.

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- Banking and Finance
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- Arbitration
- Corporate General Advice
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- Competition
- Privatization
- Environmental
- Labor and Employment
- Insurance Law
- Litigation
- Aircraft Finance and Leasing
- Shipping and Maritime
- Intellectual Property
- Tourism
- Tax
- Transportation
- Real Estate
- Private Clients
Joint liability

H Ercüment Erdem of Erdem & Erdem discusses board of director liabilities following 2001’s banking crisis

In the nineties, almost all of the extraordinary bank deprivations in Turkey resulted from uncontrolled and unregulated banking transactions. Bank deprivations predominantly occurred as a consequence of bank owners siphoning off funds. When the deprivations reached $5.5 billion, 18 banks were transferred to the Saving Deposit Insurance Fund (SDIF), according to unofficial reports. The bank failures apparently resulted from uncontrolled bank letters of guarantee and easily distributed loans that violated credit limitations via back-to-back and fiduciary loan transactions.

Restructuring of the banking system in Turkey (including the adoption of Banking Act No. 5411 (Banking Act) which became effective on October 19 2005) started with the implementation of an extensive banking sector restructuring programme following the 2001 crisis. As a result, the new system provides a more controlled mechanism with regards to the liability of the Board of Directors.

The reasoning of the Banking Act states that recent bank failures result from a lack of application of corporate governance principles in banking transactions. The Act also notes that the unlimited management rights of controlling shareholders resulted in the use of banks’ resources in an uncontrolled and inadequate manner. This lead to the misuse of depositors’ funds as well as damage to the minority shareholders.

Additionally, in order to increase the efficiency of supervision and control, such duties were transferred to a newly established Banking Regulation and Supervision Agency (BRSA) from the Treasury Undersecretariat and the Central Bank in 1999.

Following the adoption of the Banking Act and the increase of the functionality of BRSA, Turkey overcame the effects of the Economic Crisis of 2001, but only in 2005. The Banking Act aims to develop a strong corporate governance mechanism to avoid any similar crisis in the future.

This restructuring of the Turkish banking system with higher ratios than the US or the EU provided a self-defence against future crisis and this is probably why the Turkish banking system has not been as deeply affected as the US or EU banking systems during the last economic crisis.

Banking framework

All banks in Turkey are subject to the Banking Act. In general terms, the Banking Act regulates the banks and their legal interactions. Although the Banking Act does not specifically define a bank, a definition can be derived from banking legislation as well as banking practice in Turkey. According to the Banking Act, the term bank covers deposit banks, participation banks and development and investment banks.

Deposit banks are the institutions operating primarily for the purpose of accepting deposits and granting loans. This is done in their own names, for their own accounts and includes the Turkish branches of institutions established abroad. Participation banks operate primarily for the purposes of collecting funds through special current accounts and participation accounts, and granting loans. Development and investment banks have the purposes of granting loans and/or to fulfill the duties assigned to them by their special laws, other than accepting deposits or participation funds.

Broadly, the aim of the Turkish banking legislation is to provide constant supervision and control over the banks in order to eliminate liquidation and solvability complications. The Banking Act intends to prevent the breach of legal obligations of banks through a strong control mechanism, rather than solving problems once the depositors have been harmed.

Banks are a special type of joint-stock company which in many ways both resemble and diverge from joint-stock companies. Therefore, banking legislation in Turkey has a combined structure. On the one hand, a bank has a distinctive nature which separates it from other commercial enterprises. Therefore, banks are regulated by a private act (The Banking Act) in an exclusionary manner. On the other hand, since banks are essentially joint-stock companies, the Turkish Commercial Code (TCC) also has a secondary but a wide scope of application over banks in Turkey.

The establishment of banks is subject to approval from the BRSA and the Ministry of Industry and Trade which approve the establishment of the bank and its joint-stock company structure respectively.

Pursuant to Article 7(a) of the Banking Act, banks shall be established as joint-stock companies. Additionally, a bank shall have at least five shareholders and a minimum paid-in capital of TL 30 million, which shall be fully paid in cash and free from collusion (Article 7(f) of the Banking Act).

Regardless of their number of shareholders, banks will not be subject to the provisions of the Capitals Market Law unless the bank goes public or gets involved in activities specified in Chapter V of the above-mentioned Law.

Liability of the board

Article 23 of the Banking Act regulates banks’ board of directors. Pursuant to these provisions, the board of directors is not only the decision-making body, but is also responsible from the supervision and control of the bank transactions. First and foremost, the board of directors is responsible for evaluating the compliance of bank’s transactions with legislation, regulations and internal directions. The board is also responsible for the establishment and proper functioning of internal controls, auditing, and risk analysis and the transparency of the financials.

In order to maintain the credibility of the bank and establish reliable control mechanisms, the Banking Act and TCC prescribe strict regulations for the structure of the board of directors. Article 23 of the Banking Law states that boards of directors shall be composed of a minimum of five persons including the general manager, all of whom shall have the characteristics specified by law for the founders.
Moreover, the board of directors has the power to create subcommittees under its own supervision to preserve efficient control of the bank's transactions.

Unlike previous legislation, the Banking Act does not regulate the liability of boards of directors, except for their personal bankruptcy in case of deprivation. Instead, the Banking Act refers to Article 320 and 336 to 341 of TCC. In addition, members of the board of directors can be held liable in accordance with the Turkish Code of Obligations’ provisions regarding torts and breaches of contract.

Article 336 of TCC sets forth the liability of boards of directors of a joint-stock company. Pursuant to the Article, members of the board of directors are not personally liable for agreements or transactions concluded by them on behalf of the bank. However, the Article also provides for situations in which the board of directors will be liable to the company, to individual shareholders, and to the creditors of the company.

Under TCC, the members of the board of directors are jointly liable. In case of non-performance of an obligation entrusted to the board of directors, all members of the board will be jointly liable.

The principle of full solidarity dominates the internal relationship of joint liability of the board of directors. Therefore, regardless of the degree of fault, a plaintiff can claim compensation from one or all of the members of the board of directors. Members of the board do not have to contribute to the fault in order to be jointly liable since all members are under the obligation to supervise and control the bank's transactions. Additionally, no member of the board can ask for his penalty to be reduced based on his lack of intent since the penalty does not rely on the intention of the member to initiate a crime, but his lack of supervision. Decisions by the Court of Appeals follow the same logic.

In order to be freed from the liability, members of the board of directors have the right to prove that they are not at fault. The board member can prove his innocence pursuant to Article 338 of the TCC if he gave a negative vote to the transaction subject to liability, recorded his vote in the minutes, and informed the auditors with regards to his vote.

In the case of joint liability, the claimant has an independent right to claim from each member of the board. Hence, if one or some of the members of the board of directors, partially or completely, terminate the debt by performance or set-off, the other members shall also be discharged in proportion of the paid amount. The claimant can continue to claim the performance of the unpaid portion from the members jointly.

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**Draft Commercial Code**

Complications that arose out of the 2001 crisis paved the way for the construction of a controlled supervision and regulation system, as well as joint liability of the board of directors. In the same manner, the draft Commercial Code adopts a new system called differentiated solidarity, instead of full succession. Article 557 of the Draft states that:

“In case more than one person is liable to compensate for the same damage, each of them, regarding the fault and the circumstance, to the extent the 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.”

Following the reasoning of this Article, the joint liability shall not be understood as an aggravated liability. The joint liability provided by the Draft is a liability where more than one person is jointly liable *vis-à-vis* the prejudiced party for the damage that they caused together.

Differentiating succession means the liability of members of board of directors shall be determined with respect to the circumstances, the severity of the fault, the consent or help of the prejudiced party.

Therefore, the liability of a member of the board of directors shall not be determined regardless of whether the damage was caused jointly or not. Following the reasoning of the Article, the judge will determine the type and scope of the compensation by taking into consideration the circumstances, the degree of the fault or negligence. In other words, liability of each member of the board of directors will be determined in accordance with the fault or negligence attributable to them.

Following the economic crisis of 2001, boards of directors at the banks transferred to the SDIF were subject to several liability claims based on TCC. Most of the claims are still pending and board members are under the heavy pressure to be held liable regardless of the degree of their fault. The new system proposed by the draft aims to establish a balance between liability and the degree of fault. Although the draft is still under discussion at the National Assembly, its writers have understood the deficiencies of the current liability system and tried to find a more balanced one. Practice and the court application will show to the extent to which the new liability system can fulfill the expectations of the market.

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