



## **Non-liability of the Shareholders and Piercing the Corporate Veil**

*Authors: Gönenç Gürkaynak Esq., Nazlı Nil Yukarıoç and Gülşen Pazarbaşı of ELIG Gürkaynak Attorneys-at-Law*

### **1. Introduction**

A legal entity is defined as “groups of persons organized as entity on its own and independent property groups constructed for special object” under Article 47 of the Turkish Civil Code No. 4721 (“TCC”). Under Turkish laws, legal entity owns its assets; such assets are dedicated to the purposes of the legal entity and legal entity is liable only with such assets. Legal entity is entitled to be part to the legal transactions as an independent person, separately from its founders and is liable for such transactions against third parties.

Likely, shareholders of joint-stock companies (“Company”) are not responsible for any transaction of the Company but the Company itself is responsible for such transactions. Liability of the shareholders of the Company is limited and no additional liability can be set forth against the shareholders. This constitutes “the principle of separation” between the shareholders and the Company and “a veil” between the shareholders and third parties. In some cases, the shareholders of the Companies may benefit from this separation, damage the Company and third parties by hiding behind the independent structure of the Company. The theory of piercing the corporate veil which has been first introduced and developed by the American Laws has been then accepted and applied by Turkish courts in order to prevent misuse of the principle of separation.

This theory aims to prevent inequitable result derived by the persons hiding behind the Company by lifting the corporate veil.

### **2. Non-liability of the Shareholders of the Companies**

In principle, the only liability of the shareholders of the non-public Companies is to pay capital subscription as per Article 480 of the Turkish Commercial Code No. 6102 (“TCC”) which is referred to as the “principle of single debt” in the doctrine. As this article is amongst the mandatory provisions of the TCC, any provision of the articles of association of the Company or the general assembly resolution contrary to such principle shall be invalid. Said that, there are exceptions to such principle under the TCC as follows: (i) the shareholders would be obliged to pay agio (premium) in addition to the share price if it is set forth to issue shares having a price higher than their nominal value under the articles of association of the Company or general assembly resolution; (ii) the articles of association of the Company may impose on shareholders to fulfill certain obligations of recurring and non-monetary character in addition to the obligations arising from capital subscription in the Company which the share transfer is subject to Company’s approval; (iii) obligation of loyalty of the shareholders; and (iv) several notification requirements under the TCC (e.g. Article 198 of the TCC).

Accordingly, any debt of the Company could only be demanded from the Company but not from the shareholders or affiliated companies of the Company. Although this is an essential principle of corporate law and debt enforcement and bankruptcy law, Turkish courts may rule that the real person



or/and legal entity shareholders misuse this principle and are liable for the debts and legal transactions of the Company. Like so, third parties may apply the shareholders due to the debt of the Company.

### **3. Piercing the veil of incorporation**

As mentioned above, “piercing the veil of incorporation” is not the general rule but an exception that only the courts may resolve on and under certain circumstances. In case the shareholders commit fraud or breach a liability arising from an agreement or damage third parties unlawfully by hiding behind the Company, this would constitute breach of Article 2 of the TCC, among other regulations e.g. Article 50/3 of the TCC, which states that in exercising rights and in performing duties, every person must act in accordance with good faith and that the law does not protect explicit abuse of a right. This article brings the prohibition of the abuse of rights as a general limitation as the lawmaker is aware of the impossibility of the regulation of each and every kind of relation between persons.

As there is no specific legislation regulating the issue of “piercing the corporate veil” under Turkish laws, the circumstances which require piercing the corporate veil have been set forth and developed by the jurisprudence of the Turkish courts based on the foregoing Article 2 of the TCC, the principle that the law does not protect explicit abuse of a right. The circumstances where piercing the corporate veil applies can be listed as follows:

#### **3.1. Assets or Areas of Shareholders and the Company Blending into Each Other**

The “principle of single debt” is based on the separation of the assets of shareholders and the Company. In some cases, such separation would not be possible due to the accounting fraud or other reasons as it may not be clear whether some individual assets belong to the Company or shareholders. Allocation of the corporate vehicle to the use of a shareholder or transfer of an asset of an affiliate company to another by the mother company can be given as examples to such case. In that case, real person or legal entity shareholder would not be able to allege the separation of the assets and would be responsible for the debts of the Company with its own assets.

#### **3.2. Deficiency of Equity Capital**

Deficiency of equity capital occurs when shareholders do not fulfill their liabilities about payment of the capital subscription or when the Company does not have a share capital adequate to cover its activities. In case the Company carries out its activities with an insufficient equity, the shareholders would not benefit from the principle of single debt. That said, insufficient equity would not be enough for piercing the corporate veil on its own and the courts would seek existence of other conditions reflecting the misuse of the Company before piercing the corporate veil.

#### **3.3. Dominance of a Particular Group on the Company**

In case of abuse of the Company by its shareholders for their other commercial benefits, dominance of a particular group on the Company would be questioned. If dominance causes loss of third parties, the principles of separation of assets and independence would not be applicable and the areas of responsibilities and assets of the Company and its dominant shareholders would be considered as a whole.

Accordingly, 19<sup>th</sup> Civil Chamber of Court of Appeals (2005/8774 E., 2006/5232 K., 15.05.2006) considers that “...although different legal entities...seem to exist, their shareholders...are the same at the time of the agreement...The concept of different legal entities cannot be taken into account...The conflict between the parties has to be assessed within the framework of good faith and equity...These companies should be jointly liable for the debt...”.

A recent decision of the 9<sup>th</sup> Civil Chamber of Court of Appeals (2015/2147 E., 2016/11690 K., 10.05.2016) reveals that “the organic link between the such companies are determined by the addresses of the companies, scope of their activities, their shareholders and representative being the same and the legal relation between them. The claim is that the company uses other companies as shell companies and the representatives, addresses and scope of activities of these companies are the same and therefore there is an organic link between the defendant companies...”.

#### **4. Conclusion**

Under Turkish laws, the Company and its shareholders have separate assets and are deemed as separate persons and in principle none of them is liable for the other’s liability. Although this is the rule, in case the corporate veil is used for a fraud or a breach of the contract or in order to damage third parties by hiding behind the corporate veil, Turkish courts would assume this as the misuse of the principle of separation of the Company and shareholders and in order to secure the justice they would hold the shareholders behind the corporate veil liable. In any case, the implementation of Article 2 of the TCC should be in an exceptional and limited manner as the principle of separation is essential.

Article contact: Gönenç Gürkaynak, Esq.

Email: [gonenc.gurkaynak@elig.com](mailto:gonenc.gurkaynak@elig.com)

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