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Order In The House – Accountability Of The Board Of Directors For Corruption In Turkish Companies

Quite often when opining on the status of the anti-bribery and corruption legislation in the Republic of Turkey, we are approached with the question as to whether or not Turkish legislation in battling corruption obliges, or encourages companies to adopt measures to protect against, review and address any risks associated with non-compliance. This question particularly carries relevance when relayed through businesses that are subject to the UK Bribery Act – and the short and simple answer is that there is no black-letter law which obliges Turkish companies to adopt, to paraphrase the UK Bribery Act, "*adequate procedures designed to prevent persons associated with the commercial organisation to undertake bribery.*"[1] However, this paper shall argue that despite the non-existence of a provision clearly obliging enterprises to adopt measures to prevent corruption, the Board of Directors of a company does have a duty of due care, and failure to meet this duty when coupled with a corruption-related offence would open the members of the Board of Directors to restitution lawsuits filed by the shareholders.[2]

I. Corruption-Related Offences

In order to evaluate the extent to which Board of Directors Members could be held liable for corrupt company activity, it will be useful to set the frame as to what a corruption-related offence is, and when a corruption-related offence is considered a "company activity".

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1 Bribery Act 2010 c.23 s.7(2)

2 In this paper, while the term "**Director**" or a "**Board Member**" is used to address the Board of Directors Members of a joint-stock company ("*anonim şirket*"), the same principle can also be applied for the managers of Turkish limited liability companies ("*limited şirket*").

Corruption-related offences are typically those listed under Section Four of the Turkish Criminal Code No. 5237 (the "**Criminal Code**"). The offences that can be committed by private individuals (as opposed to public officials) are bribery ("*rüşvet*") as defined under Article 252 and onwards; influence peddling ("*nüfuz ticareti*") as defined under Article 255; and money laundering ("*suçtan kaynaklanan malvarlığı değerlerini aklama*") as defined under Article 282. While there may be other offences which relate to corrupt behaviour[3], the above offences are the most infamous and common. It can also be argued that, though not directly the subject matter of this paper, breaches of competition regulation may also be considered as corruption-related offences, particularly when connected with a public service (such as a public tender).

So when is a corruption-related offence a "company activity"? Obviously, any formal decision adopted by the Board of Directors of a company, or a transaction signed by the representatives of the company, which by their nature constitute corruption-related offences would directly be attributable to the company. However, corrupt acts are rarely this obvious. Admittedly, there is little guidance in literature and precedents towards when a crime is committed personally, and when it is deemed to have been committed by a legal entity. One of the main points of criticism towards Turkish anti-corruption legislation is that it offers little in terms of sanctions against legal entities[4]. Indeed, whether or not legal entities can be perpetrators in terms of Criminal Code is still a matter of debates[5].

For the purposes of civil law accountability, however, the issue of direct criminal liability would not be binding. Therefore, it would be safe to argue that a corruption-related offence is a company activity when it is performed by the directors, representatives, employees or

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[3] Such as bid rigging (Article 235); abuse of trust (Article 155) etc.

[4] European Commission Commission Staff Working Document Turkey 2015 Report, pg.16-21

[5] Nevzat Toroslu, *Ceza Hukuku Genel Kısım* (9th Edition Savaş Yayınları Ankara 2006) pg. 342

intermediaries of a company, and in order to secure and/or advance the interests of the company, or to protect the company itself.

II. The Duty of Supervision and Due Care

The Turkish Code of Commerce No. 6102 (the "**TCC**"), although enacted after approximately sixty years of application of the previous code of commerce, offers unsatisfactory guidance as to the inherent duties of Directors. Article 369 of TCC states that "*Board of Directors Members and other persons vested with managerial authority are obliged to serve with the care of a prudent manager and to preserve the interests of the company in good faith.*" The reasoning of TCC argues that the standard of due care that a director is subject to is not that of a "prudent merchant" to which a commercial enterprise in its entirety should abide by. Rather, as stated in the reasoning, Board of Directors Members are expected to adhere by the business judgment rule, whereby they would be deemed to have fulfilled their duty of due care if they have made an informed decision. It is unfortunate to note that the Board of Directors' duty of due care is simply viewed from a profit and loss perspective in the reasoning, and good corporate governance is not mentioned at all.

To further complicate the issue of responsibility, Article 553 Paragraph 3 of TCC states, in defining the liability of the Board of Directors Members, that "*no person may be held liable for breaches of and non-compliance with the articles of association and laws which are outside his or her control; this principle of non-liability may not be annulled by arguing the duty of supervision and due care.*" Again, the reasoning of the relevant article is no less confusing when it states that the relevant article was included to prevent liability lawsuits against the members of the Board of Directors as "*it has been observed in practice that Board of Directors members were held liable under a duty of supervision beyond human capability for breaches of the articles of association and laws.*" This is problematic on many levels, but

especially because (a) TCC does not offer any guidance as to what is outside or inside the control of a Board of Directors Member; (b) though a breach of laws and the articles of association is generally easy to detect, TCC does not define what non-compliance is (this issue is further complicated in the Turkish wording, where the term used is "*yolsuzluk*" which can mean both non-compliance and actual corruption); and finally (c) no satisfactory explanation is given as to what the actual problem in practice was, and how it has been tackled by this wording. Certainly the problem in application was not judicial discretion, or else, the Parliament would not have tried to exclude judicial discretion by preventing the argument of supervision and due care, but on the other hand, leave crucial terms such as "control" and "non-compliance" begging for a definition, which have to be filled by judicial discretion.

A very reasonable approach to tackle the legislation's heavy handedness with definitions would be to accept that "*a person who does not use and supervise his duties and authorities as necessary, would be* ipso iure *breach those responsibilities […] for example, if the Board of Directors member has not attended meetings, was not informed about the decisions and resolutions taken on those meetings, did not use his right to request information and review […] has never asked for information about the operations of the company from management, or has reviewed the books and records of the company, then this person would not be able to benefit from the protection against liability set out in Article 553 Paragraph 3 of TCC.*"[6] Therefore, a Board of Directors member, having authority granted by TCC, and perhaps further extended by the articles of association, is expected to use this authority to stay informed about the company. The issue of control shall come into play only when a Board of Directors member has used these authorities.

6 Hasan Pulaşlı, *Şirketler Hukuku Şerhi Cilt 1* (2nd Edition Adalet Yayınevi Ankara 2014) pg. 1138

The definition of control relates to the partial or full transfer of management to third parties in line with Articles 367 and 371 of TCC which enable the vesting of signature and representation authority to persons employed by the company who might not be Board of Directors members of the said company, such as General Managers, Financial Directors etc. Article 553 Paragraph 2 of TCC states that "*organs and persons who transfer a right or duty arising out of law or the articles of association to another party, shall not be liable for the actions and decisions of these persons unless it can be proven that they did not act with reasonable care in the selection of these persons.*" Therefore, construed together with Article 553 Paragraph 3, a Board of Directors who divest partial signing and representation authority to a general manager hired by the company, shall not be liable for the acts and actions of this general manager unless it can be proven that they did not act with reasonable care in appointing the general manager to the duty, as the acts of the said general manager are outside the Board of Directors members' control. Though it is not (again) explicitly stated in TCC or its reasoning, legal literature agrees that the transfer of the right of management does not include the transfer of the right of supervision, and therefore Board of Directors members are still expected to supervise those persons who are appointed by the Board[7].

All this discussion, however, might be entirely academic due to a recent amendment introduced to Article 371 of TCC. For context: in the spring of 2014, for reasons unknown (and not relevant to the subject of this paper) the Ministry of Customs and Commerce ordered Trade Registries in Turkey to stop the registration of company signature instruments (signature circulars) which included monetary limits. As expected, when this resulted in chaos for big companies and conglomerates whose day-to-day affairs are entirely reliant on said limitations, the Parliament hastily adopted an amendment to TCC's Article 371 to enable said limitations to be included in companies' internal directives, which were solely tools of

7 *ibid.* pg. 1139, İsmail Kırca (Çağlar Manavgat / Feyzan Hayal Şehirali Çevik), *Anonim Şirketler Hukuku Cilt 1* (Ankara 2013) pg. 614-615

corporate governance, which then could be registered. However, the final sentence of the said Article states that "*the Board of Directors is jointly liable for any and all damages that may be caused to the company or to third parties*" by persons to whom signature and representation authority is vested. It is obvious from the penmanship of the said Article that its drafting was rushed but the question has to be raised – as an amendment to TCC, in construing the liability of Board of Directors members, do we adopt the principle of *lex posterior derogat priori* and therefore entirely ignore the limitations of liability set out in Article 553 when determining the Board of Directors' liability for the misdeed of a representative appointed by an internal directive; or do we adopt the principle of *lex specialis derogat generali* and thus argue that though the Board of Directors is jointly liable for the damages caused by parties assigned though an internal directive, this is in any event subject to the limitations of Article 553? The Parliament could have avoided this discussion by a simple reference to Article 553 in the amendment. Although the Parliament's silence on this matter, by a very literal reading of the law, be construed to accept the former principle, commercial sense dictates that any liability imposed on Board of Directors members would always be subject to the limitations under Article 553.

In summary then, it appears to be reasonable to accept that (a) the Board of Directors members are liable against the shareholders and to third parties when they breach their duties arising from laws and the articles of association and damage the company; (b) this liability is not lessened when a director does not use his or her rights and authorities to supervise the company; (c) the Board of Directors remains liable for the acts and actions of persons to whom management and representation are vested in; subject to the condition that (d) the acts and actions of these persons were outside the Board of Directors' control and supervision.

Actions to trigger the liability of the Board of Directors may be brought, as per Article 555 of TCC, by the company (through the resolution of the Board of Directors itself) or by the

shareholders, and the shareholders may only request restitution to be made in the name of the company.

III. Corporate Corruption and Accountability of the Board Members

Corruption-related offences rarely occur in a vacuum. Whether it is through the imposition of a "win-or-get-out" or though the adoption of an "I don't want to know" policy[8] the *mens rea* of a corporate criminal is typically shared by individuals higher in the management chain. The scope of corruption in corporate governance disasters such as Enron, World.com, Parmalat shows that top tier management and the Board of Directors members are at the very least accomplices in corporate crimes. The corruption-related offences listed above carry a similar tune – though it is practicable for small bribes to be withdrawn from a company's petty cash fund, concealed and then listed as expenses under a name that is hard to trace, large amounts of bribes in order to secure a contract, or the favourable disposition of a high-level public official, are typically buried under financial data. The irregularity in the accounts, when hard to conceal, would have to then include the "input" of accountants and auditors, and ultimately the Board of Directors members who are tasked by law to review and approve financial statements to said shareholders.

Going through a corruption-related investigation is a very harrowing procedure for a company. Personnel are interviewed (by both legal counsel and by the prosecution) as business grinds to a halt when computers and correspondence are copied page by page for evidence. Even a serious accusation of bribery can greatly hurt the reputation and business of a successful company. A conviction will very likely mean that it will lose or default in contracts, especially those which include an ABC clause to allow a fast-track exit without compensation, as is typical now in transactions with US, UK, and the EU Member States.

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8 Michael Benson and Sally Simpson, *White-Collar Crime An Opportunity Perspective* (Routledge NY 2009) pg. 55

A shareholder in such a company would understandably not receive well the news that his or her investment value has been lessened overnight by the corrupt activity of the Board of Directors[9]. It can be argued then, in line with all the above explanations, that this shareholder would have course of action against the Board of Directors and request from the Courts to order the Board of Directors to compensate the company for any direct damages (liquidated damages, damages arising from the loss of contract) and possibly indirect damages (such as losses of profit). A charge of money laundering would also bring along with it the seizure of bank accounts, and as common practice in Turkey in the last year, the complete seizure and shutdown of the company itself though the appointment of curators. Although the facts of the lawsuit would have to be closely reviewed, a shareholder could argue that the Board of Directors have failed in their duty to supervise the company, and therefore a corruption-related offence was performed, and the company was subsequently damaged.

In any event, the lawsuit that might be brought by a shareholder, as mentioned above, would be reliant on the facts, and the limitations of liability under Article 553. To illustrate by three examples:

Example A: In order to secure the favour of the relevant administration to prevent an investigation, one of the Board of Directors members of a company instructs the accounting department for the payment of the private school expenses of the chairman of the relevant public administration.

The corruption-related offence in this case would be bribery under the Criminal Code, and occurs directly on the Board of Directors level. It is very likely in this case that the remaining Board of Directors members would be able to detect, and at least try and prevent this unusual

9 Understandably this would largely rely on shareholder activism towards securing share value through vigorous corporate governance, however, this also is a daunting task for a shareholder – see Peter Gottschalk 'Financial Crime in Business Organizations: An Empirical Study' [2011] JFC 76 pgs 2,7

expense. The Board of Directors member who gives the bribe is without doubt directly liable towards the shareholders for any damages that this may cause to the company. The extent of liability of the remaining Board of Directors members would have to reviewed in connection as to whether or not they would be able under their duties and authorities prescribed by law to know of this offence.

Example B: In order to ensure that the proceeds received from other companies over rigging public tenders are legalized, under the instruction of the Contracts Manager and the Chief Financial Officer employed by the company and authorized partially with management and signing authority, the accounting department records the proceeds as consideration received for "consultancy services".

The corruption-related offence in this case would be money laundering, and again without doubt the Contracts Manager and the Chief Financial Officer would be liable against the company. The Board of Directors members would again be subject to a test of whether or not they would have been able to obtain information on this issue through the performance of their duties prescribed by law, however this time, they would be released from liability if they can prove that they had displayed reasonable care and diligence in the appointment of the said Contracts Manager and the Chief Financial Officer.

Example C: The company has missed a deadline to renew a permit vital for its business due to the oversight of an employee in the licensing department. Afraid that he will lose his job, the said employee withdraws money from the petty cash fund to make a donation in the company's name to a charitable organization, whose chairman is in the capacity to put in a favourable word with the permitting authority to ensure that the application for renewal may be processed despite the missed deadline.

The corruption-related offence in this case would be influence peddling. However, the burden of proof towards claiming the Board of Directors' negligence will be very high and entirely on the claimant, and unless a chain of correspondence or e-mails can prove that someone sitting on the Board of Directors was aware of this, the directors can safely rely on Article 553 protecting them from liability for breaches of law outside their control.

IV. Conclusion

Although an explicit duty of due care is not placed on the shoulders of a company in the sense of the UK Bribery Act, the nature of the Board of Directors' obligation to supervise a company and act prudently would entail that they conduct their duties and use their rights prescribed to them by law, and be liable towards shareholders if an issue under their control and their supervision leads to a corruption-related offence. In Turkey, where despite the global trend, the fight against corruption is moving backwards[10] due to a lack of a public tone from the top and an actual, evolving and consistent public policy against corruption[11], perhaps the invocation of a claim of personal liability against a corrupt Board of Directors member by a vigilant shareholder might prove a deterrent against bribery.

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