

Restraint of Competition in Joint Stock Companies and Limited Liability Companies under Turkish Law

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Pursuant to the Turkish Commercial Code (“TCC”), joint stock companies shall be managed and represented by a board of directors, while limited liability companies shall be managed by all partners unless otherwise provided for in the articles of association. Article 320 of the TCC refers to Article 528 of the Code of Obligations in determining the duty of care imposed on the board members. Members of the board of directors in a joint stock company and partners in a limited liability company are fiduciaries who have a duty of care and a duty of loyalty to the company. Members of the board of directors and partners have to discharge their duties with normal care and prudence in the best interest of the company. In order to further ensure that the members of the board of directors and partners act in accordance with their duties as fiduciaries, they are subject to restraint of competition under the TCC. In this article, the regulation of the restraint of competition clause for joint stock companies and limited liability companies within the framework of the Turkish Commercial Code will be explained in depth.

Restraint of Competition Clause in Joint Stock Companies

Article 335/1 of the TCC sets forth the restraint of competition imposed on members of the board of directors of joint stock companies. Pursuant to Article 335/1 of the TCC, unless otherwise provided for by a general assembly resolution, members of the board of directors are prohibited from (i) conducting commercial activity on their own behalf or on behalf of others within the company’s field of activity and (ii) being a general partner with unlimited liability in any kind of company doing business in the same field of activity as the company. As mentioned above, board members of a joint stock company owe a duty of care and a duty of loyalty to the company. The restraint of competition clause set forth in the TCC is mainly based upon such duties imposed on board members by laws regulating commercial partnerships. In order to comply with their duties of care and loyalty, board members must discharge their duties in good faith and with a degree of diligence, care and skill that an ordinarily prudent person would exercise under similar circumstances in a similar position and should not engage in self-dealing nor usurp corporate opportunities.

As mentioned above, prospective liability of board members for competing with the company can be circumvented if such actions were already permitted or later ratified by a general assembly resolution. Furthermore, although not specifically provided for in the TCC, the restraint of competition imposed on board members can be eliminated by inserting a provision into the articles of association eliminating such liability. In the event that such liability is ruled out with a provision set forth in the articles of association, current and future board members will be immune from liability arising out of acts that violate restraint of competition, as long as such provision remains in the articles of association. However, if the permission to compete is granted by a general assembly resolution, only the board members who were in office when such resolution was taken and board members who were appointed with such resolution will be allowed to compete with the company without violating the restraint of competition clause set forth in Article 335/1 of the TCC.

The scope of the restraint of competition clause can also be extended by adding a provision to the articles of association. However, such an extension should

not be against good faith and should not restrict the constitutional rights of board members, such as the right to employment and the right to compete.

Although not specifically addressed in the TCC, if permission or dispensation to compete has been revoked by a general assembly resolution, the company should reimburse the board members who have incurred losses as a result of such revocation. However, if the company reserved its right to revoke such permission or dispensation, board members will not be able to claim reimbursement for losses they incurred as a result of such revocation.

Scope of Restraint of Competition in Joint Stock Companies

Pursuant to Article 319/II of the TCC, the board of directors or general assembly may assign its duty to manage the company partly or wholly to one or more board members or to officers who are neither board members nor shareholders of the company if the board of directors and/or general assembly are authorized to do so by the articles of association. In such circumstances, restraint of competition will be deemed to have been imposed on such officers who are appointed as representatives of the company and who are granted the right and obligation to manage the company.

The scope of restraint of competition is also limited to the area in which the company regularly conducts business. For instance, if a company is conducting natural gas business in Istanbul only, members of the board are not restrained from conducting the same business on their own behalf or on the behalf of others in Manisa.

Conditions on Restraint of Competition

A joint stock company is entitled to conduct business only in its field of activity, which should be stated in its articles of association. If the company conducts business in a field other than the ones stated in its articles of association, such transactions shall be void due to a lack of capacity. For this reason, in practice, given the difficulties associated with amending the articles of association, founders usually include many business fields in addition to the one in which they actually intend to operate when specifying the company's field of activity for the articles of association. However, since the scope of restraint of competition is limited to the field of activity set forth in articles of association of the company, if the company is not regularly conducting business in

all the fields listed in its articles of association, the scope of restraint of competition should be limited to the fields in which the company is actually doing business. However, if the company later starts to conduct business in other fields listed as its fields of activity in its articles of association, these fields will be included within the scope of restraint of competition.

On the other hand, there is a dispute over whether the scope of restraint of competition includes activities that are not within the scope of the company's field of activity but that are necessary to conduct its business. It should be borne in mind that although the activities that are necessary to conduct the business of the company are excluded from the scope of restraint of competition, since board members owe duty of loyalty to the company, they should act accordingly and not perform such activities if doing so harms or is likely to harm the company.

In order to determine the scope of restraint of competition, the kind of activities that will be subject to restraint of competition should be determined. The term commercial activity used in provisions regulating restraint of competition means activities performed to gain profit. Since activities in the same field as the company operates in performed by board members for their own personal needs cannot be considered commercial activity, such activities will not be subject to restraint of competition. For instance, a board member of a joint stock company whose field of business constitutes selling and purchasing cars may purchase a car for his/her own use without violating the restraint of competition clause set forth in the TCC.

There is no statement in the restraint of competition clause of the TCC determining whether the act of engaging in a commercial activity must be continuous or whether engaging in one-time commercial activity is enough to be considered within the scope of restraint of competition. For this reason, engagement of a board member in a one-time commercial activity can violate the restraint of competition clause. However, if the acts of a board member violating restraint of competition occur only one time, the company may not impose sanctions for such breach at its discretion.

Pursuant to the TCC, board members may not engage in commercial activity on their own behalf or on behalf of others in the same business field as the company operates in. Although not stated in the restraint of competition clause of the TCC, board

members also should be deemed to have been restrained from engaging in commercial activity under their own names. Engaging in commercial activity under one's own name means the board members engaging in commercial activity related to the company's field of business by interacting with customers personally. It should be borne in mind that the board members are also restrained from having third parties engage in commercial activity on their behalf.

Board members of a joint stock company may not become partners in another company operating in the same business field as the company operates in with unlimited liability. Since board members are only restrained from participating in another company with unlimited liability, board members' participation in another body not designed as a general partnership or other company types listed in the TCC will not violate the restraint of competition clause of the TCC.

As a result, board members of a joint stock company may be shareholders of other joint stock or limited liability companies and may become partners with limited liability of limited liability partnerships. However, a board member's participation in the above-mentioned companies/partnerships will not violate the restraint of competition clause as long as such a member does not undertake to conduct commercial activity on behalf of the partnership or company and is not appointed as a board member, manager or partner with unlimited liability, since such undertakings constitute conducting business on behalf of others and violate the restraint of competition clause set forth in the TCC.

On the other hand, it should be borne in mind that the participation of board members of a joint stock company in another company as a board member, manager or unlimited liability partner constitutes violation of restraint of competition only if both companies are conducting commercial activities within the same business field.

Restraint of Competition Clause in Limited Liability-Companies

Pursuant to Article 540 of the TCC, a limited liability company is managed by its partners. Unless otherwise provided for in the articles of association, all partners are "managers" and have a right and duty to represent the company and manage its business together. This means all partners owe a duty of loyalty to the company and therefore all of them will be sub-

ject to restraint of competition. However, unless otherwise provided for with a shareholders' resolution, incoming partners will not have the right or duty to manage the company with the other partners, therefore such partners will not be subject to restraint of competition.

If provided for in the articles of association or with a shareholders' resolution, management duty may be left to one or more partners and in such cases, only these partners will be entitled to represent and manage the company as managers. Pursuant to Article 547 of the TCC, only partners who are appointed as managers will be subject to restraint of competition. In the event that persons who are appointed as managers of a company are not also partners, those persons will be subject to restraint of competition as if they were partner managers since there is no difference between non-partner managers and partner managers in terms of authorities and liabilities. In a limited liability company, a partner who is appointed as manager shall not conduct commercial activity in the same field of activity on his/her own behalf or on behalf of others or participate in any other enterprise as a partner, with limited or unlimited liability or become manager of a limited liability company. This restraint may be extended to all partners with a provision included in the articles of association of the company.

Managers will be subject to restraint of competition as long as they serve as managers of the company. However, in the event that restraint of competition is extended to all partners with a provision set forth in the articles of association, all partners will be subject to restraint of competition as long as they remain partners.

The conditions and scope of restraint of competition imposed on managers of a limited liability company are similar to the conditions and scope of restraint of competition imposed on board members of a joint stock company with a few exceptions. In limited liability companies, the scope of restraint of competition is also limited to the area and business field in which the company is actually operating. Moreover, managers of a limited liability company are restrained from conducting commercial activity in the same field of activity as the company on their own behalf or on behalf of others. However, unlike board members of a joint stock company, managers of a limited liability company are restrained from participating in any other enterprise as a partner with limited liability as well. Also, managers of a limited liability company are specifically restrained from becoming managers

of other limited liability companies conducting the same commercial activity within the same business field as the company within the framework of the TCC, whereas board members of a joint stock company are subject to such restraint since they owe a duty of care to the company.

Legal Consequences of Breach of Restraint of Competition

Article 556 of the TCC refers to the applicable articles of the TCC regulating board members' liability in joint stock companies when defining the terms of the liability of managers of limited liability companies. For this reason, legal consequences of restraint of competition in joint stock companies and limited liability companies will be discussed in one section.

Article 335 of the TCC sets forth the remedies available for violations of the restraint of competition clause of the TCC. Pursuant to Article 335 of the TCC, the joint stock company may make a claim for, inter alia, (i) damages to recover losses caused by the breach or (ii) may consider the agreement as having been made between the company and the third party and disgorge the profits (unearned profits) made by the disloyal breaching board member by entering into such agreement.

Since there is a contractual relationship between board members and the company, the board member will be deemed at fault when there is a violation of restraint of competition under Article 96 of the Code of Obligations. Therefore, a board member needs to prove that he/she was not at fault in order to rule out his/her liability for damages.

Although not specifically stated as a remedy in Article 335 of the TCC, a board member who acts in violation of the restraint of competition clause of the TCC may be dismissed from board membership by a general assembly resolution.

In a limited liability company, dismissal of managers for violation of restraint of competition is also available as a remedy. However, dismissal of managers in a limited liability company differs based upon their status and the way in which they were appointed as managers. Managers who are also partners and

who were appointed as manager in the articles of association may only be dismissed with just cause by a court decision taken upon one or more partners' request. In such cases, a violation of the restraint of competition clause of the TCC will be considered just cause. In the event that a manager who is also a partner was appointed by a shareholders' resolution, such manager may be dismissed by another shareholders' resolution taken by a majority vote. On the other hand, managers who are not partners may be dismissed with a shareholders' resolution at any time.

In addition, in limited liability companies, managers who violate the restraint of competition clause can be squeezed out, since such remedy is available in such companies when there is just cause and, as mentioned above, violation of restraint of competition is considered just cause.

In the event that restraint of competition has been breached by one or more board members in a joint stock company, board members who have not violated restraint of competition will decide which remedy will be enforced. Since the TCC refers to provisions regulating liability of board members of a joint stock company in terms of managers' liability in limited liability companies, non-breaching managers who are also partners will decide the remedy to be enforced in case of a breach of restraint of competition.

Conclusion

Consequently, we can conclude that, board members of a joint stock company and managers of a limited liability company are subject to restraint of competition within the framework of the TCC with a purpose to ensure their compliance with their duty of loyalty. Considering the board members' and managers' ability to access all kind of information related to the business of the company, restraint of competition clauses are the mechanisms set forth mainly to protect the shareholders of the companies who do not have a right to manage the company. Since directors have a right to access all information and documents related to the company all the time, the directors who do not have a share in the company are required to comply with the restraint of competition obligation as well.