

Origins of Culpa in Contrahendo and its Application in the Turkish Commercial Code

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Historical Analysis and an Evaluation in Light of International Legislation

The classical sources of debt liability, that is, torts, contracts and unjust enrichment, form the basis for legal arrangements in juridical legislation. These offenses have no applicable answer for legal disputes that result from the development of expectations in the social and economic line but seem together to bring a tendency to accept new grounds for debt. The liability of confidence results from this approach and requirement.

The context of liability resulting from confidence was initially proposed by Eckard Rehbinder in a thesis published in 1969 called “Konzernaußenrecht und allgemeines Privatrecht” which has since gained a respected status in legal literature. Furthermore, Wiedemann and Fleischer have defended this opinion. The opinions discussed in the thesis were given no further consideration in doctrine and Rehbinder’s opinions only made scientific advances and were recognized for their value in the context of the core scientific discussion following the “Wibru Holding AG vs. Swissair Beteiligungen AG” judgment by the Federal Supreme Court of Switzerland. The judgment has received great prestige and led to new legal processes and developments.

“Wibru Holding AG vs. Swissair Beteiligungen AG” Judgment

The judgment, dated November 15, 1994, regards the case of a company incorporated as “Swissair Beteiligungen AG,” later “IGR Holding Golf and Country Residences AG” as a 100% allied company of “Swissair Luftverkehr AG” in July 1987, which undertook to provide services as luxury accommodations near golf courses. In this context, long-term memberships were granted to clients at notably high rents which were to be paid in advance, while the clients granted others the right of use as long as the clients consented. In the following period, “Wibru Holding AG” the other party in the related case, paid the rent in advance and gained membership.

Despite the number of membership applications being far lower than expected and “IGR Holding” experiencing financial issues, the company continued to cite extraordinary interest in the project and a rising number of members in letters sent to clients, a state-

ment which lacked truth entirely. While the company continued its risky and reprehensible approach at an even more serious level, Swissair too played its part and continued to give assurances about this company to the relevant clients; Swissair supported its actions within the scope of this project by referencing itself and the power it symbolized to the public. As the financial troubles could not be overcome, the parent company “Swissair Beteiligungen AG” decided to sell “IGR Holding,” yet the members weren’t informed about the actual reason; the truth remained concealed. The parent company indicated that would continue to play a role by purchasing the minority shares of “Euroactividade AG” and would still be in control behind the scenes. Clients were informed about the transfer (between IGR Holding AG and Euroactividade AG) and in the letters to clients it was also stated that the corporate resolution was that the project had not reached the operational stage at that time and the membership contracts were to be terminated, thus rendered payments would be returned to the relevant parties.

The local trial court rejected claims for a refund in the lawsuit brought by “Wibru Holding AG” against “Swissair Beteiligungen AG” in 1991 on the grounds that “IGR Holding” had been functioning as an allied company of “Euroactividade AG” since 1989 and it had also been ruled bankrupt. Thus the bankrupt company did not return the payments despite the claims. However, the Swiss Federal Supreme Court accepted the appeal request.

Swissair was in fact not a party to the contract despite being a factor in the making of the contract, management of the consumer portfolio and procurement of participation. The Supreme Court thus ruled Swissair responsible, widening the scope of recognition of liability with a statement that there should be full disclosure and that abuse of confidence was the root cause.

The concrete case is not judged to be a contractual obligation of the defendant to the plaintiff, nor was there an unlawful act so it cannot be considered tort liability. The Supreme Court found that the parent company must be held liable for acts against good faith. It must be ascertained for each concrete case whether the parent company created reasonable expectations and caused disappointment unlawfully. It is then indicated that in such a case the parent company has an obligation to reveal it. The Supreme Court assumes there would be no damage then because people, when informed fully and correctly, act in accordance with that information.

The most considerable result of the judgment is that, for the first time, the Federal Supreme Court of Switzerland evaluated liability of confidence outside the framework of tort, contract, or unjust enrichment and as a unique source of obligation. The result has great importance not only in relation to conglomerates (şirketler topluluğu), but also to the law of obligations.

This judgment was the first time the Supreme Court accepted the existence of culpa in contrahendo liability that was not based on the principles of tort liability.

The context of culpa in contrahendo liability should be explained here. Execution of a contract is a long process that includes the preparation, delivery, execution and enforcement stages and assigns parties different obligations and duties. According to Provision 2 of the Civil Code, those entering into a contract with each other to execute a legal transaction are obliged to act in accordance with the principle

of good faith, provide each other complete and correct information, protect personal wealth and assets and give the required attention and planning for all of these matters. In this context, fault in conclusion of a contract (culpa in contrahendo), causes liability for losses that result from an act contrary to good faith. With this judgment, liability for the confidence of third parties was accepted and the requirement of the existence of a special legal relationship, similar to that between two parties at the stage of contract preparations, was underlined.

Other significant judgments of the Swiss Supreme Court are listed below:

- Ringer Case, dated 10/10/1995
- Omni Holding Case, dated 11/06/1996
- Motor Columbus Case, dated 04/16/1998
- Liegenschaftenschätzer Case, dated 12/23/2003

The chronological course of the Swiss Supreme Court’s judgments also has substantial value as an indicator of a consistent approach by the court.

Legal criticism of confidence liability as an independent grounds for debt centers on the limits of liability, conditions of application and uncertainty of legal outcomes.

Another criticism is that confidence is also important as regards other sources of debt so that there is no possibility to define the theory as distinct and unique.

Confidence liability is divided into two categories; liability arising from legal appearance and liability arising from material confidence created.

In liability arising from legal appearance, the appearance does not reflect the real legal situation but the results still reflect the true situation. In such cases, the affected person can claim execution and compensation of expectation losses.

Liability for material confidence created is necessary to compensate the losses of the affected person resulting from unfulfillment of confidence.

With Regulation §311 BGB, coming into effect in Germany on January 1, 2002, culpa in contrahendo liability acquired legal status.

This liability arises from the beginning of the discussion of a contract or other transactional relationship,

a preparatory stage at which the parties disclose their own legal status and situation to influence and affect the other party. This can be thought of as someone having entered into a store as a potential customer but with no definite intention to buy, or looking for a table at a restaurant. It is necessary to refer to a transactional relationship to invoke this liability; a merely social connection is not considered satisfactory. This aims to limit liability and responds to criticism of the theory.

To invoke liability arising from contractual discussions, the status of a case as a contract or tort has an important effect on considerations like the time limit, distribution of onus probandi (burden of proof) and liability of any auxiliary person. In contractual liability, there is no contrary provision: the time limit is ten (10) years. The plaintiff has no obligation to prove fault and if an employee is liable, an employer may not discharge his/her responsibility. In the liability arising from a tort, the time limit is one (1) year and the plaintiff is obliged to prove that the defendant is at fault. Employers also have the right to discharge employees of responsibility.

The conditions required for confidence liability are as follows:

Confidence must exist.

Protective confidence must be based on objective criteria and be constructed before the person who suffered losses. It is required that the person who suffered losses is aware of the existence of confidence and such confidence should direct and hold sway over his/her actions. In the liability resulting from a contract or tort, confidence is considered a secondary factor but, in the liability resulting from confidence the existence of confidence is considered a basic factor.

The confidence created should be acted upon to be protected.

This means that the person who suffered losses should be acting in good faith and the confidence should direct and hold sway over his/her actions. Clearly this element should be evaluated according to the specific characteristics of each actual case.

A special legal relationship is required.

Even if there is no contractual relationship between the parties, there should be a confidence and loyalty relationship beyond the limits of a casual connection

as originates from torts. In this context, the Swiss Supreme Court judgment Ringer Case is significant.

Participation in the legal transactional field is expected.

Although confidence liability does not originate from a legal transaction but is a legal basis for liability, its applicability depends on a legal transactional connection existing between the parties. This provision serves to limit liability.

A disposition or transaction is affected as a result of the confidence.

The confidence created must have caused losses serving as the basis of the actions by the trusting party. The confidence must be formalized with an action or transaction attributed to such confidence. In this regard, the effect should be shown as the execution, non-execution or abstention from something.

Obligations of protection should be violated.

Related with the principle of good faith laid out in Article 2 of the Civil Code, confidence created imposes a special legal relationship between the parties. This relationship imposes an obligation to take the necessary measures to protect the worth and profits of the other party. The scope, content, and whether any violation has occurred in a specific situation are determined according to the details of each unique case.

Loss must have arisen.

Abuse of confidence should cause a loss to the trusting party. Intangible losses may be compensated in this context.

Loss connotes a decline in the assets of a person outside his/her control and without consent. A decline can be demonstrated as a decrease in asset value, an increase in liabilities or deprivation from profit. Losses require compensation when the losses would not have arisen had there not been a breach of confidence.

The existence of a loss should be proven by the claimant under general onus probandi (burden of proof) rules.

The principle of causality must be fulfilled.

A causal link must exist between the confidence cre-

ated and the action taken by or position of the trusting person. This causality can be shown if it is proven the damaged person would have acted differently if he/she had been informed of the real situation; thus, there should be causality between confidence and the action taken based on that confidence. However, if the same actions would have been taken for different reasons had the true situation been known, it is not possible for the injured party to claim a causal link or, therefore, losses.

The fault requirement must be met.

The obligation of protection must be unjustly violated. Confidence liability is considered a type of responsibility caused by involvement in the legal field; thus implying that primarily principles related to contractual obligations should be applied. Any level of fault, including slight negligence, is adequate for liability. In addition, any fault of a third party should be considered in determining the amount of compensation.

Unlike liability resulting from a tort, a contractual obligation requires the legal capacity of the person against whom the injured party makes the accusation. The same principle is also valid regarding liability of confidence. Therefore, if the party has no legal capacity it is not possible to consider confidence liability.

In the case of legally incompetent or underage persons who have legal capacity, Article 161 of the Civil Code applies, and if they have acted with the consent of their legal guardian(s), they should be held legally liable.

Evaluation in Light of Turkish Legislation

Clearly developments internationally and judgments of the Swiss Supreme Court have affected the provision of the Turkish Commercial Code addressing liability of confidence. In fact, there is no explanation regarding the provision governing its origin in Turkey.

Provision 209 is not the only provision of legislation setting forth liability for conglomerates. The Code includes other provisions addressing liability of parent and associated companies. Three of these provisions relate to the connections between the parent company and associated company, while the other one relates to the individual responsibility of a board member resulting from a tort.

In Provision 202/1-b and c, shareholders of an as-

sociated company or its creditors are granted legal capacity to initiate a legal proceeding against a parent company or its board members if loss has not been balanced as stipulated because of the use of the dominance of the parent company in violation of the law and to the detriment of the associated company.

Provision 202/2 allows shareholders to claim compensation for losses from the parent company for matters that have substantial importance as regards the company such as mergers, divisions, liquidations, issuance of securities, major amendments of the articles of association etc. provided that an annotation is made on the related resolutions noting that they were executed as a result of the use of dominance and not a valid reason for the associated company. If there is a complete loss of dominance for the associated company in connection with instructions given by the parent company and binding for the associated company which have not been balanced duly, it is legally permitted to sue the parent company or its board members.

According to Provision 199/4, which relates to board members of the parent company, they have the right to request various information regarding the situation of the associated company; however, if such proceeding has been initiated beyond their own goals and for the benefit of a third party, the member shall be considered liable for the results of his/her action.

Provision 209 differs from various aspects of the others. Their subject matter is different and so they cannot be considered jointly applicable. Provisions 202/1-b and c and 206/1 permit the exculpation of liable parties, but this is not possible under Provision 209. Liability arising from Provision 202 is subject to a two (2) year time limit but in other provisions there is no specific time limit. The parties to compensation claims aside from Provision 209 are the parent company, the board members of the parent company, the shareholders of the associated company and the creditors of the associated company, whereas under Provision 209 the parent company and third parties are the plaintiff and defendant. The commonality of these five (5) actions is that all of them are compensation claims.

According to Provision 209, "the parent company is liable for the confidence resulting from the use of reputation when the reputation of corporate groups ensures confidence for the society and consumers." Turkey will be the first state in continental Europe to regulate the liability of confidence in corporate

groups with a code provision.

Conditions of Provision 209:

The group of companies must be as described in Provisions 195 and 197.

The provisions defining group of companies are Provision 195 and Provision 197, which are closely related.

According to Provision 195/4, group of companies is defined as “companies associated directly or indirectly with the parent company, composing a group of companies together with one another.” The parent company should be a commercial company (TTK Provision 124/1 lists commercial companies as; general partnerships, special partnerships, joint stock companies, limited liability companies and cooperatives.), an institution (a real person, ordinary company, association, foundation or public legal entity, according to Provision 195/6). However, the associated company must be a commercial partnership.

A group of companies requires two elements. First, the factors listed in Provision 195 are accepted as an indication of dominance. A commercial company that directly or indirectly has any of the following of another commercial company is considered a dominate company;

- i) Majority of its votes,
- ii) The right to select enough board members to form the majority necessary for taking resolutions,
- iii) In addition to its own votes, individual or group voting agreements with other shareholders or partners that give it the majority of votes.

A commercial partnership can dominate any other commercial partnership under a contract (Provision 198/3) or in any other way; in all such cases it forms a group of companies. In other words, the dominance relationship will carry weight regardless of evidence to the contrary.

Provision 195/2 regulates the establishment of dominance. If a commercial partnership has the majority of any other commercial partnership or has enough shares to take a resolution regarding management matters, it is accepted as sufficient proof that it has dominance over the other company, unless the contrary can be proven.

Provision 197 regulates the situation of mutually participating capital partnerships in which members of

a group of companies have at least one-quarter (1/4) of each others' shares: this is considered mutual participation. Provision 196 regulates the calculation of such shares. The said companies have dominating power over other companies, while the second one should still be considered an associated company. If mutually participating companies have dominance over each other, then both of them are considered associated and parent companies.

The “condition of being considered a group of companies as defined in Provisions 195 and 197” is thus an objective condition.

The group of companies must have a standing capable of inducing the confidence of the society and customer.

Although standing has been used with different meanings and functions in the related provisions of the Commercial Code, under Provision 209 there is no doubt that as a key function, standing has been used in the sense of reputation. Reputation also induces confidence. It is different from being recognizable and well-known, while including and resulting from these attributes. Development and especially longevity are not only subject to the actions or status of the related person, but also depend on the evaluation and perceptions, including the time and location, of third parties and is a dynamic situation. “Standing/reputation is born of material and immaterial interaction between the parties.”

However, defining the legal function and meaning of standing in accordance with Provision 209 of the Commercial Code causes some difficulties and contradictions. In the context of the provision, one must both have trusted and claim to have suffered a loss as a result of that confidence in relation to the same party and such a situation leads to some hesitation as to whether standing can be used as a legal criterion. Actually, this contradiction was apparent and the problem was based in the perspectives of classical contractual and tort liability. In fact, that is the core point which distinguishes it from other sources of debt. Losses result from the injured party's own actions.

At this point it is necessary to clarify the concept of standing and how Provision 209 is different from the *Wibru/Swissair* decision.

Commercial Code Provision 209 refers to the *Wibru/Swissair* decision. The Swiss Supreme Court did not consider whether the *Swissair* company was well-

known, its standing or whether that standing was high enough to create confidence. Still, the plaintiff, Wibrü AG, claimed in its allegations that when executing the membership contract, it relied on the financial situation, power and image of Swissair, not IGR, which was financially weak. The basic reason for liability was not the standing and confidence which resulted from the standing of Swissair in society, but rather the confidence created before Wibrü AG by the substantial indirect relationship and legal connection between the two companies, which was based on such confidence and was not terminated at the appropriate time. There is no clarification requirement that the reason for confidence must be social standing, or that confidence had been created by the effect of social standing. The evaluation in the judgment makes it clear that creating confidence in the actual situation is considered adequate.

It is possible that over time the standing of a group that was formed independently from the actual situation could play a role in the formation of this confidence. The Swiss Supreme Court also did not emphasize whether the standing had reached a certain level in its Musikvertrieb/Motor-Columbus and Omni Holding judgments.

Provision 209 differs from the Wibrü/Swissair judgment, its source, on this point. It can also be said that while Provision 209 matches the Wibrü/Swissair judgment in the intended aim and legal result, the conditions giving rise to this liability differ. In other words, similar legal results are built on different foundations.

In the Turkish Commercial Code's regulation on the confidence liability of groups of companies, the conditions leading to the creation of liability are determined carefully. Although the concept originates from the Wibrü/Swissair judgment, the legislature designed its own standards when codifying the essence of the judgment and made "standing" the key aspect for the standards envisaged in Provision 209.

In this way, the legislation aims to eliminate the omission in the Wibrü/Swissair judgment, which had led to criticism and a clarification, albeit a partial one, in the Musikvertrieb/Motor-Columbus judgment. To this end, the criteria and limits of the scope of application of the provision regarding the individual liable in this regard is addressed. Statements are included such as "Not every group of companies is included in this provision. A group must reach a sufficient level of standing that establishes trust with society or consumers to be included in this provision. This

is determined according to each actual case." This viewpoint is supported in the legal manifesto of Provision 209. Nonetheless, the regulation as written includes several risks.

Not every parent company, but only those of groups of companies whose standing has reached a "level that establishes trust with society or consumers" are included in the scope of this provision. In this way, the notion of "standing/group standing" is given a technical function determining (limiting) the scope of application of the provision, as in the procedure of law-making. This notion appears in the second part of the provision as one of the conditions giving rise to liability for "the use of standing," giving the notion "standing" a function in material law. According to that, a reputation sufficient to establish confidence is not sufficient to create liability, but rather it also must have been used in the actual case. Furthermore, the utilization of standing must have established trust with the third party.

The concept "standing of the group of companies at a level establishing confidence with society or consumers" may comprise the most ambiguous part of the scope of application of Provision 209. This uncertainty particularly originates from the following issues:

- Whether the standing of the group is at a level that establishes confidence with society or consumers can only be decided by an expert in almost every case.
- "A level to establish confidence" is normatively indefinite.
- It is not clear what method should be used to evaluate the level of standing or at which period of time (continuous, periodical or during the interval of the confidence) and in which location (the entire country, city of the parent/related associated company's registered office or region of the injured party) the level of standing shall be based.
- The group of companies may consist of multiple companies conducting business in different areas.
- There is constantly change and improvement in the market.

Another important point is the meaning of the terms "society" and "consumers" included in Provision

209. It is thought that these terms are interchangeable. It is impossible to establish the exact boundary between them.

The type, size and composition of the group of companies determine that its standing must be measured by society or consumers. It is not precisely understood whether the relevant community or the entire society is meant by the term "society." The term "consumers," as mentioned before, undoubtedly refers to a more wide-ranging concept than it does under the related provision of the Law on the Protection of the Consumer (Law no. 4077). It is stated that the term "society" refers to a segment of society representative of the whole and which can only be selected by a sampling taken without regard to whether one is a consumer of the goods and services produced/traded by the group of companies, and the term "consumers" means people who could potentially profit from, use or benefit from goods and services produced/traded by the group of companies.

Additionally, "the standing must be used," and this is an essential condition for liability. Being a group of companies or a part of a group of companies alone does not entail liability as long as the reputation is not used. In this context, the aim is to establish trust and/or create an impression before the third party that the parent company has equal contractual liability in the project being done. The use of standing may be general or the standing may be used in a specific instance.

Use of the trade name or the name of the group of companies or its logo, regardless of whether they are registered trademarks and which are components of standing, used only by the associated company or parent company for the benefit of the associated company without targeting any specific person, with annexes or alone in advertisements or other publications within an actual legal relationship and only for general purposes is not considered sufficient for liability. This situation is not considered use of standing. It is accepted that such use counts as an introduction, characterizing or noting membership in the group of companies.

For the parent company to be liable, such components of standing must be used in accordance with the expectation of economic benefits of the conglomerate, parent company or another associated company or the parent company and a specific person must be targeted, for example in relation to a party negotiating a contract.

Use of the components of standing should be the result of free consent and not a legal requirement.

It does not matter whether the third party is aware that responsibility is borne when the group of companies' standing has reached the level of giving confidence to society or consumers when entering into a relationship with the associated company. In respect of this, if it is accepted that the standing of a conglomerate has reached at a certain level as an objective condition, then use of this standing and confidence created before the other party as a result thereof is considered a subjective condition. The sense of trust that has been created must be expanded into action.

At that point, the core consideration is not what meaning the parent or associated company has attributed to its own actions, but how these have been perceived by the other party. In particular, meaningless or unclear matters should be interpreted to the detriment of the party who unilaterally prepared the announcement or notified the public. This means that the accepting third party should be acting in good faith whether or not there is a deal.

The parent company will be responsible to whom? The terms "society" and "consumers" are unclear as they explain in sociological terms and do not explain who should be the plaintiff. The plaintiff should be the person who has executed a special legal relationship with the associated company on the basis of confidence created but whose trust was misused by the other party in violation of good faith. It is immaterial whether these are real persons or legal entities, merchants or non-merchants. In such liability, the associated company is not subject to severe liability with the parent company. Secondary liability is assigned to the associated company.

Conclusion

In conclusion, as much as the provision has brought a new drive and different vision to Turkish law, it is thought that the provision falls short of satisfying the meaning and importance ascribed to it and will cause many controversies in the future because it refers to technically vague notions and terms, creates possible issues with proof, provides unilateral protection, refers to those restricted as "a group whose credit is at a level establishing trust with society or consumers" and states that restricted parties are expected to act carefully and attentively and avoid "behavior that will cause damage" in order not to lose their standing. Thus, Provision 209 cannot be

considered a provision that can be used frequently.

At the same time it exempts from liability many groups of companies which have no standing and therefore are not considered reliable only because they are not trusted by society/consumers at the necessary level as well as any uninformed and negligent acts that these companies commit in their commercial affairs aiming to defraud and misuse society and consumers. The way the provision was designed and written also provides the judiciary great freedom to act and allows for arbitrary treatment. Consequently, it will be even more important for the Turkish judiciary to act prudently and delicately in respect to this article and decisively about its importance and place.

The Turkish Supreme Court discussed the matter and the rule of confidence liability in detail in its decision YHGK, E. 2010/13-593, K. 2010/623, T. 1.12.2010. While the new code bringing the rule into Turkish legislation for the first time has not entered into effect, it has still been widely accepted. We can predict that the Turkish Supreme Court will be a loyal follower of the rule and the rule will potentially spark a great deal of legal discussion.

Bibliography:

In the writing of this article general mot à mot or content quotations have been taken from the publications indicated below:

- XII Levha Publication, Assistant Professor Dr. Asuman Yılmaz, 1st Edition, Istanbul, 2010
- A New Institution in Turkish Company Law: "The Liability of the Parent Company for the Confidence (similar to the Doctrine of Constructive Fiduciary Duty in Anglo-Saxon Law)" (Art. 209 Bill of TCC): An Evaluation in Light of the Judgments of Federal Supreme Court of Switzerland, Assistant Professor Dr. Halit Eker, Niğde University, İİBF Commercial Law Discipline Member
- E. 2010/13-593, K. 2010/623, T. 1.12.2010 Judgment of the Turkish Supreme Court, YHGK

Due to length and content, in the editing of this article, conceptual discussions have been avoided with an aim to give a general and brief legal opinion regarding the new institution, confidence liability.