

Piercing the Corporate Veil under Turkish Law (the *Alter Ego* Theory)

It is widely recognized that a company has a legal personality that is distinct from those of its shareholders. Accordingly, while doing business with a company, one is not dealing with its shareholders, but with an artificial entity to which the law attributes a separate personality.

In capital companies such as joint stock companies (*anonim şirket*) or limited liability partnerships (*limited şirket*), the liability of shareholders towards the company's creditors are limited to the amount of their respective contribution to the equity capital of the company¹. This means only companies (not their shareholders) are responsible for the debts they incur. In other words, from the separate legal personality of companies derives an invisible shield of limited liability in favor of their shareholders.

Occasionally, shareholders of a certain company (which may be either natural persons or legal entities) intentionally use the same to escape from liability towards the creditors of the relevant company. This approach triggered the development of the piercing the corporate veil, which is also known as the *alter ego* theory (the **Theory**). The Theory suggests that only in exceptional situations where the principles of equity necessitate doing so, the rights and obligations of a company may also be treated as those of its shareholders. This results in the corporate veil being lifted and the shareholders, who have been hiding behind that, being held liable. The Theory is used when a company is insolvent or when it is operated as a mere business tool of a certain natural person or legal entity to avoid exposure to legal liability.

- **The Theory under Turkish legislation**

The Turkish Commercial Code does not contain any provision explicitly allowing the piercing of the corporate veil. Therefore, the Theory is taken into consideration by the courts on a case-by-case basis and applied when really necessary. One should bear in mind that he cannot resort to the Theory every time he wants to chase the shareholders of a certain a company. The general rule, which provides that only the company (not its shareholders) is liable for the debts the company incurs, remains untouched.

The Draft Turkish Commercial Code, which is before the Parliament for discussion, does not expressly refer to the Theory. However, it regulates "group companies" whereby under specific circumstances a parent company could be held liable for its affiliates' debts.

- **Application of the Theory by the Turkish Court of Appeals**

Although some isolated judgments of the Turkish Court of Appeals (the **Court**) contain traits of the Theory, the Court had never expressly admitted it until its judgment dated 12 May 2006 and numbered 2005/8774E., 2006/5232K. (the **Judgment**). The Judgment related to a case involving two sister companies and the application of the Theory was based on the following grounds: (i) financial identity of the two sister companies; (ii) participation of the sister companies to a common enterprise; (iii) similarity of the scope and objective of both companies; and (iv) commercial and financial unity between the companies.

The legal ground of the Judgment was Article 2 of the Turkish Civil Code, which provides that "*Every person is bound to exercise his rights and fulfill his obligations according to the principles of equity. The legal order does not protect the evident abuse of rights.*" Within the framework of the Judgment, the Court disregarded the separate legal personalities of the two sister companies because (i) the corporate structure had been being used to escape from a financial obligation; (ii) the companies were operated so that one could be held responsible for the acts of the other; and (iii) to do so would lead to justice being served.

¹ Such rule is not applicable to the public debts of limited liability partnerships, e.g., tax debts, whereby the liability of shareholders is proportional to their stake in the equity capital of the relevant partnership.

- **Conclusion**

Although the Court admits the existence of the Theory, it is still not possible to discern any broad principle indicating the circumstances where a court shall pierce the corporate veil. Evolution of the Theory by further decisions of the Court should be awaited. Anyway, it can be inferred from the Judgment that the Court will tend to adopt a fact-based approach as regards the application of the Theory, and the circumstances of each case will be reviewed thoroughly. It is also clear that the corporate veil will not be lifted simply because it would be in the interest of justice. Otherwise, judicial security may be impaired.