ON THE "PIERCING THE VEIL" THEORY AND RULING NUMBER 582/7383 DATED 2 NOVEMBER 2000 BY THE 19TH CHAMBER OF THE TURKISH SUPREME COURT

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Abstract

The decision 2000/7383 of the 19th Chamber of the Court of Appeal dated 2 November 2000, has a special importance regarding that a recent highly sensitive issue of Turkish doctrine is debated before a judicial body. The decision is the outcome of a process, where guarantor of a cash-loan issued by a local bank is prosecuted on the grounds that the debtor did not pay the loan installments.

The 'piercing the veil' theory, which also exists in American law as well as in some other legal systems in the world, has been discussed in the Turkish doctrine for the last eight years but recently argued before the courts.

In this article, not only the above-mentioned decision by the Court of Appeal but also some other cases incorporating the element of non-citizenship will be analyzed or referred to.

I.

The "piercing the veil" theory has been the subject of some study in Turkish legal doctrine over the last eight years[1] and recently has also begun appearing before Turkish courts in various forms and manifestations. With one exception however, none of those courts have yet handed down their rulings. In this article, we shall be analyzing and assessing this ruling, which was handed down by a local court and upheld by the Turkish Supreme Court of Appeal, as well as various assertions put forth in a number of cases

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incorporating the element of non-citizenship. Our article reports on the progress in Turkish law of *Durchgriff*, a concept that is recognized and implemented in German law and has been the subject of a variety of monographs, articles, and court rulings for more than half a century.

II.

In the case leading to decision E.2000/5828, K.2000/7383 (2 November 2000) by the 19th Chamber of the Turkish Supreme Court of Appeal, an individual identified as "E. Y.", who was a joint guarantor for a cash loan that had been taken out by a corporation and who was also one of the corporation's major stockholders, received a notice from the bank demanding payment of the loan's installments that had not been paid by the debtor corporation. The bank made this demand on the grounds that E. Y. had personally cosigned the lending agreement as a guarantor. The bank initiated prosecution against E. Y. seeking an order for provisional distraint however the action was later converted into a request for a court-ordered bankruptcy on the basis of article 43 (2) of the Law on Debt Collection and Bankruptcy. In other words, the bank was asking the court to declare E. Y. a bankrupt. When E. Y. objected to this, the plaintiff bank initiated a suit in the İstanbul Commercial Court of First Instance. In the defendant's response to this suit it was asserted that E. Y. was not a person who was subject to bankruptcy. Thereupon the bank again petitioned the court, declaring that this individual was a major stockholder in and manager of fourteen corporations and that he personally conducted the commercial activities of these corporations and demanding that the "veil be pierced" on the grounds that he was abusing the corporate entity status of these corporations. The plaintiff also pointed out that E. Y. was the president of an association ("M") that had been founded by industrialists and offered this fact as evidence that E. Y. qualified as a "merchant" in the eyes of the law. In his response, the defendant claimed, in addition to lodging objections on procedural grounds, that he was not a merchant but a partner in a company, that being the president of an association of industrialists did not automatically make one a merchant in the eyes of the law, and that therefore a court could not order his bankruptcy. During the trial it was demonstrated that E. Y. was an elected member of the İstanbul Chamber of Commerce's assembly and that he was registered with the İstanbul Chamber of Maritime Trade. In a written statement from the president of the latter organization that was submitted to the court, it was declared that E. Y. was in fact registered with that chamber as a "merchant".

In its ruling on the case, the local court said:

On the basis of the documents that have been submitted it is patently obvious that the defendant is an incorporating stockholder in many companies, that he is the president of the M association, and that he is a member of the boards of directors of numerous companies. The claim that someone who is a member of firms and a founder of numerous companies may not be a merchant becomes somewhat incomprehensible within the framework of the defendant's defense. Given that even someone who has a trifling government monopolies dealership or a grocery store qualifies as a merchant, neither the claim that someone who has founded and is president of an assortment of companies may not be a merchant nor the grounds for making such a claim is understandable. For this reason, it is necessary to rule in favor of a court-ordered bankruptcy on the grounds that the plaintiff's petition for such an order is justified.

The local court's judgment was appealed by the defendant. On 2 November 2000 the 19th Chamber of the Supreme Court of Appeal handed down its decision (E.2000/5828, K.2000/7383), saying:

In view of the adduced evidence on which the [local court's] decision was based and for compelling reasons, we uphold the ruling that the defendant, ..., who in particular is a partner and manager in the firms of Razi Kağıt AŞ, Procat AŞ, Protur AŞ, Basram AŞ, Ferh AŞ, Lazza Gıda AŞ, Atam Kimya AŞ, 404 Kimya AŞ, Bak Otomotiv AŞ, OMC Otomotiv, ABMG Otomotiv AŞ, who has declared himself to be an industrialist to the organization known as MÜSİAD, and who undertakes administrative duties at the İstanbul Chamber of Commerce must be regarded as a merchant even though he may not himself have a personal commercial registration of his own.

III.

The rulings of both the local court and of the 19th Chamber of the Turkish Supreme Court are known in practice as "decisions that pierce the veil". This name is not the result of any mention by name of the theory of piercing the veil being made in the court decisions: neither ruling makes any reference to the theory. One could say that the decisions are called this because the name of the theory is used in the plaintiff's petitions and because the

material events that shaped the course of the suit were interpreted in that way.

1. a) There are two basic grounds, neither of which are related to or complement one another, on which the court's decision could have been based. The first of these is the fact that, as the Supreme Court notes in its ruling, that E. Y. a "real" (*ie* non-corporate) person who "has declared himself to be an industrialist to the organization known as MÜSİAD" and who "undertakes administrative duties at the İstanbul Chamber of Commerce." While it is not specifically mentioned, the facts that E. Y. had also been elected to a position on the ICC's professional committee and that the president of the Chamber of Maritime Commerce stated, in a written deposition, that E. Y. was registered with that organization as a "merchant" could also have played an influential role in the court's decision. This justification however has nothing to do with the piercing the veil theory. Instead it has to do with the question of the conditions under which a real person who lacks a commercial registration may be considered to be a "merchant" in the eyes of the law. For this reason, the issue must be considered not in the context of the piercing the veil theory but rather within the framework of article 14 of the Turkish Commercial Code (TCC:14), which sets forth the conditions under which real persons *acquire the standing of "merchant"*, or *are considered to be merchants"*, or even *incur the responsibilities of a merchant.* Under TCC:14, being registered with a commercial registrar is not a prerequisite for any person–particularly a real person–either to be a merchant or even to be considered to be a merchant. As is stipulated in TCC:14/2, a commercial registration is one of the conditions under which a person may be considered to be a merchant; however, it is not the only one. Both real persons and corporate entities may also become merchants or be considered to be merchants even if they have no commercial registration. Nevertheless, TCC always links the circumstances of "acquiring the standing of a merchant", "being considered to be a merchant", and "incurring the responsibilities of a merchant" with the notion of "commercial enterprises". *To acquire the standing of a merchant* it is necessary to operate a "commercial enterprise" on one's own behalf, even if only partially (TCC:14/1). *To be considered to be a merchant* it is necessary to have publicly announced through "circulars, newspapers, radio, or other advertising media" that one has set up and opened a "commercial enterprise" or else to have so announced by having the "commercial enterprise" registered by a commercial registrar. *To incur the responsibilities of a merchant* one must carry on

transactions either under his own name or, in the capacity of a partner, under the name of a non-commercial partnership or of another partnership that is not considered to exist juridically in any way whatsoever: such a person is considered to be liable like a merchant towards bona fide third parties exactly as if he had opened a commercial operation. On the other hand, under TCC, neither performing duties for chambers of commerce or industry, nor being on the committees of professional organizations (which is the situation in the case at hand), nor being the founder or head of an industrialists' association results in one's acquiring the status of merchant, being considered a merchant, or incurring the responsibilities of a merchant. Undertaking duties in chambers of commerce and industry does not imply that one is operating a commercial enterprise, or has publicly announced that one has been opened, or is acting as if a commercial enterprise exists.

b) Neither the local court nor the Supreme Court made any reference to TCC:14 and for that reason it is impossible to know whether or not either court based its ruling on TCC:14 or, if it did, which clause of the article it applied or by what interpretation it reached its conclusions. That said, the fundamental principle of TCC:14 is that of a "commercial enterprise". Neither the local court nor the Supreme Court gave consideration to that however, basing their decisions instead on the issue of acquiring merchant status with the assumption of duties for a chamber of commerce and with occupying the position of president of an industrialists' association. In point of fact, there is no need to have merchant status in order to undertake positions of authority in professional chambers nor is it even necessary to actually be a member of the organization: the representatives of corporate-entity merchants or of commercial enterprises may undertake duties in professional associations and be elected to their professional committees.

2. a) The second legal basis, which both courts did make use of, is the fact that E. Y. was both the founder of and the major stockholder in a large number of joint-stock companies. The implication of this justification is that E. Y. in fact operated a number of commercial enterprises through these companies and E. Y. was actually the owner of those commercial enterprises despite the appearance of their being owned by those companies. It is at this point that one may advance the view that the piercing the veil theory was employed in this case–even though it is not specifically referred to by name. The reason is that if one arrives at the conclusion as the result of one's assessment that a joint-stock company is actually being run by E. Y., then one can also say that E. Y. is operating the commercial enterprises of

those companies as well. This in turn leads to the conclusion that the status of these joint-stock companies as corporate entities is being abused,[2] that the distinction between partner (that is, the real person E. Y.) and the corporate entity is not genuine but artificial in its nature. Abuse of corporate entity status, which is to say *creating an artificial distinction* between the corporate entity and a real person who is deliberately concealing himself behind the veil of that status, has the potential to thwart the application of various rules of law and to cause third parties to suffer a loss.[3] It may be said that both courts have applied the doctrine of *subjective abuse* (*subjective Missbrauchslehre*) as proposed here.

b) For the veil to be pierced, it is not sufficient simply that someone be the manager of and a major stockholder in a large number of commercial companies: in addition, it is necessary to show and prove that these commercial partnerships–which is to say, the corporate entities–have been set up artificially simply in order to protect the individual (or individuals) behind the corporate veil. If this were not the case, then the veil would need to be "pierced" in every firm that belongs to a holding company. Both in rulings made by foreign courts as well as in generally accepted doctrine, there are numerous criteria that have been applied to establish the disingenuousness of companies whose veils are to be pierced such as *inadequate capitalization;*[4] *control of a subsidiary by the parent,*[5] in which the interests of the corporate entity and those of its sole principal stockholder conflict with each other and the latter's interests are given precedence; a situation, known as *confusion of assets,*[6] in which the properties of the corporate entity and of the partner are not segregated from one another; *failure to comply with the company's formative procedures;*[7] and *having far too few people in the company's employ.*[8] All these criteria serve as evidence that a company is the product of deception or a ruse whose veil needs to be pierced.

In the case under study, neither court chose to examine such criteria or reach a conclusion on that basis in their rulings. In many British and US court decisions on the other hand, the fact that someone is the major stockholder in a large number of commercial enterprises has been held to be sufficient grounds without there being any further need to examine whether or not the element of deception was involved.[9] This in turn creates the impression that the piercing the veil theory was not fully applied in these rulings however both of them undoubtedly must have been based on the theory.

IV.

1. In some situations where piercing the veil is at issue, the element of foreignness may also be present, in which case the petition to have the veil pierced in a company whose headquarters are located in another country may be made to a *lex fori* court, to a Turkish court for example. Inasmuch as a situation such as this is apt to come up frequently in an increasingly globalized world, it will be worthwhile here to examine such an issue with respect to what problems might come up from the standpoint of Turkish law and to point out what provisions of law might be applicable. For example, a Turkish plaintiff might need to initiate a suit not against a foreign company with which he has some legal relationship or by which he may have been wronged but rather against another foreign company which is its parent or against that company's sole stockholder. In doing so, the plaintiff might petition a Turkish court to have the company's veil pierced on the grounds that this foreign parent or sole stockholder is concealed by it. In such cases two issues will need to be debated, the first being the capacity of the foreign parent to be a party to the suit. In other words, can a suit be initiated against the foreign parent in a Turkish court? The second is the question of whether or not the Turkish court can order that the veil be pierced. An ancillary issue is, if the answer to the second question is "yes", then which country's laws are to be applicable in piercing the veil? It leads, in other words, to the problem of whether the action of piercing the veil is to be subject to the rule of *lex fori* (which is to say, Turkish law) or to the governing law of the place where the foreign parent (corporation) is located.

2. Being designated as a plaintiff or defendant is a procedural concept and in international private law, procedural issues are unquestionably subject to the rule of *lex fori.* On the other hand, the capacity of suing and being sued is a *capacity* and, as such, it is a concept that is different from that of being designated as a plaintiff or defendant. According to article 8/4 of Turkey's *Private International and Procedural Law* (PIL:8/4), the personal status of corporate entities is subject to the governing law of the place where their administrative headquarters are located. The law applicable to the capacity of a corporate entity involves the capacity to have rights and to act on issues concerning personal status. The capacity of corporate entities to be a party in lawsuits is also subject to the same law.[10] For this reason, the question of the capacity to be a party to a suit is closely connected with the issue of piercing the veil which is under examination here. It is not possible to dissociate capacity to be a party from PIL:8/4.

3. The problem of piercing the veil may be resolved by taking the *personal status* of the corporate entity as the point of departure.[11] This is because the rules of law which serve to distinguish between a corporate entity and the individuals who make it up–which pierce the veil in other words–are the same ones that will be applicable when actually piercing that veil. These rules seek to balance and protect the rights and interests of both the corporate entity and the person petitioning to have the veil pierced. What is involved here is the personal status of the corporate entity and therefore the provisions of PIL:8/4 apply. As is the situation in many other countries so too in Turkish international private law, the applicable law when determining whether or not it is possible to put aside the principle that corporateness will be recognized in corporate entities and pierce the veil and, if it is possible, when determining the conditions and consequences is, as will be discussed below, that of the place where the corporate entity's administrative headquarters are located.[12] This is because the area of scope and applicability of the personal status of corporate entities is quite extensive.[13] A corporate entity's personal status is applicable to all its rights and capacities to undertake actions as well as to its winding-up, to the responsibilities of its members or partners, and to the relationships among its partners. It is therefore both justifiable and logical that it should be applicable in the situation of piercing the veil because, inasmuch as a corporate entity's personal status governs its legal existence and capacity as well as the recognition of both, it should also govern any limitations to be imposed upon it. Piercing the veil clearly entails a limitation on a corporate entity's capacity.

4. It is also accepted that the reasons why a creditor may seek to pierce the veil have no impact on what is to be the applicable governing law.[14] This is because in situations where the veil is to be pierced it is important, from the standpoint of ensuring recognition of the legitimacy of the action, to arrive at a fair and evenhanded result from the standpoint of all creditors and to make sure that all creditors and debtors know in advance what the applicable rules will be. For this reason it is proper that the corporate entity's personal status should apply when that entity's veil is to be pierced. Both the need to ensure legitimacy and the interests of the parties involved demand that all creditors be treated equally regardless of what the legal justification for piercing the veil may be. In addition, the interests that the partners themselves may have in knowing in advance what their responsibilities involve are another justification for this approach. Equitable treat-

ment and advance knowledge in piercing the veil are only possible if that action is bound by the rule of personal status.

5. In a suit in which there is a foreign-national element present, a Turkish judge will, on his own recognizance, apply the foreign rule of law, this being a requirement of PIL:2. The question in piercing the veil therefore is "Does the foreign country whose law is to be the governing one in this case have a legal rule that makes the piercing the veil theory applicable?" The piercing the veil theory has not been made a part of the statutory framework in any country of which we are aware and certainly not in the United States, Great Britain, Germany, Switzerland, or Austria, even though it has been recognized in court rulings in those countries. (In the US, the theory has been applied rather more extensively in some states than in others.) When applying the piercing the veil theory in any case, a Turkish court will look to see whether or not the theory is recognized as being constant in similar cases ruled upon by the superior courts of the country whose law is to be applicable. He will consider, in other words, whether or not the theory has acquired the status of a "case law". It is not an essential requirement that the rule that is applied automatically under PIL:2 be a legislated statute: confirmed rulings and legal precedents–case law in other words–also qualify as "applicable law" in the sense required by PIL:2. When determining whether or not corporate entity status has been abused or fraud has been committed in a country where the piercing the veil theory has been accepted in this way, courts have based their decisions own such criteria as "contravention of legal rights or perpetrating a violation of a statutory or other positive duty", "absence of formalities of corporate existence", "inadequate capitalization", "personal use of corporate funds", "perpetration of fraud by means of the corporate vehicle", "control of subsidiary by the parent", and "use of control by the parent to commit fraud or a dishonest and unjust act in contravention of legal rights" as well as many others.[15] This fact does not imply the absence of an applicable foreign rule of law in the sense of PIL:2. Similarly case law, in the form of precedents, will also dictate under what conditions the theory has become constant. Such constancy points to the existence of a legal rule and thus satisfies the requirements of PIL:2

Endnotes

1 Gülören Tekinalp & Ünal Tekinalp, "Perdeyi Kaldırma Teorisi", *Reha Poroy'a Armağan* (İstanbul, 1995), 387-405; Mustafa Dural, "Tüzel Kişilik Perdesinin Aralanması (ya da tüzel kişinin tabanına başvurulması)", *15th Anniversary Symposium of the Capital Market Board, May 1998* (Ankara, 1999), 97-107; Veliye Yanlı, *Anonim Ortaklıklarda Tüzel Kişilik Perdesinin Kaldırılması ve Paysahiplerinin Ortaklık Alacaklılarına Karşı Sorumlu Kılınması* (doctoral thesis, İstanbul, 2000).

2 Rolf Serick, *Rechtform und Realitt juristischer Personen* (Berlin & Tübingen, 1955); Ulrich Drobning, *Haftungsdurchgriff bei Kapitalgesellschaften* (Frankfurt & Berlin, 1959), 94; Gülören Tekinalp & Ünal Tekinalp, "Perdeyi Kaldırma Teorisi", *Reha Poroy'a Armağan* (İstanbul, 1995), 387; Yanlı, 251 (footnote 1).

3 Compare Dural, 97 (footnote 1), 100, and elsewhere, Rona Serozan, *Tüzel Kişiler* (İstanbul, 1994), 18 and elsewhere.

4 Robert Charles Clark, *Corporate Law* (1986), 71 (footnote 4); Karsten Schmidt, *Gesellschaftsrecht*, (Köln, Bonn, & München, 2002), § 9 IV 4, Tekinalp & Tekinalp 396 (footnote 1). For the various types of capital inadequacy see Yanlı, 88 and elsewhere as well as the references given there.

5 Clark, 72 (footnote 4) and 73; Schmidt, § 9 IV 3 (footnote 4); Tekinalp & Tekinalp 396/7; Yanlı, 119 (footnote 1).

6 Brändel, *Grosskommentar Aktiengesetz* (Berlin & New York, 1992) § 1 AktG N. 103; Reuter, Münchener Komm, Vor § 21 BGB; Tekinalp & Tekinalp, 396 (footnote 1); Yanlı, 237 (footnote 1) and elsewhere

7 Clark, 73 (footnote 4).

8 Clark, 72 (footnote 4) and 73.

9 Charles & Morse, *Company Law* (London, 1991), 28; Gower, *Modern Company Law* (London, 1979), 72.

10 Gülören Tekinalp, Ergin Nomer & Ayşe Odman, "Private International Law: Turkey", *International Encyclopaedia of Laws*, general editor R. Blanpain (The Hague, London & Boston, 2001), nr 230, 231.

[11] Ebenroth, *Münchener Kommentar Bürgerliches Gesetzbuch Bd: 7, Einführungsgesetz Internationales Privatrecht* (München, 1990) Art. 10, N. 328, 329; Staudinger & Grossfeld, *Internationales Privatrecht, Internationalesgesellschafterecht* (Berlin, 1981), 257 and elsewhere; Mann, "Bemerkungen zum Internationalen Privatrecht der Aktiengesellschaft und des Konzerns, Wirtschaftsfragen und Gegenwart", *Bärz Festschrift*, 220, 234.

[12] Tekinalp & Tekinalp, 403 (footnote 1).

[13] Gülören Tekinalp, *Milletlerarası Özel Hukuk, Bağlama Kuralları* (İstanbul, 2002), 74 and elsewhere

[14] Ebenroth, Art. 10, N. 331 (footnote 11); Lorenz *Produktenhaftung und Internationaler Durchgriff*, IPRAX, 3 (1983) 85 and elsewhere. For a contrary view see Bernstein, "Durchgriff bei juristischen Personen, insbesondere Gesellschaften in Staatshand", *Festschrift für Zweigert* (1981), 37, 57.

[15] These particular criteria are taken from various state court rulings made in the United States and are cited in Clark 71 (footnote 4) and 73.