A LEGAL EFFECT OF EUROPEAN UNION’S BUSINESS LAW POLICY: SINGLE MEMBER COMPANIES IN TURKISH LAW

Abstract:
The concept of single-member company has been studied in the doctrine by lawyers and economists for more than hundred years. Single-member companies have become widespread by virtue of the European Union’s legal instructions and mostly subsequent acceleration of states’ legislation efforts in order to allow foundation of single-member companies pursuant to their national laws. The dangers which single-member companies may generate are matters of discussion as well as the possible benefits of single-member companies to the national and international markets. Authorization of a single-member company foundation is one of the most important changes that were brought by Turkish Commercial Code with its entry into force in 1 July 2012. It is understandable from analysis of company foundation statistics provided by official authorities that incorporation of a company by a single member is widely embraced by market players. Presently, the European Union labours with a directive proposal which aims formation of new and more practical single-member company type. The outcome of these economic policy borne legal efforts will have significant effects on Turkey as a current member of the European Customs Union and a candidate country for the European Union, and foreign investors who plan to invest in Turkey.


JEL Classification: K20, K22, M20
I. INTRODUCTION

Aristotle’s definition of human as a ‘social animal’ indicates one of the most crucial and generally acknowledged qualities of humanity which is ability to cooperate in order to reach a particular goal. It has been argued whether this cooperation’s aim is societal or individual. It can be claimed that purposes which are perceived as societal generally may have individual basis in the final analysis.

As Adam Smith asserts in his book named as Wealth of the Nations that preference of individual benefits over societal ones is consistent with both biological evolution of humanity (from the perception of survival of the fittest principle) and economic tendencies (from the concept of homo economicus). At this point it should be accepted that -either it may be a consequence of mechanic or organic solidarity- cooperation generally provides more benefits than individual efforts for and by people. Hence, people get organized in order to provide a fertile environment for cooperation and division of labor. In a nutshell, it may be concluded that individual benefits are the underlying cause of cooperation and division of labor.

The foundation of company by a group of people in business life can be deemed as a result of above mentioned economic realities and natural tendencies. As the companies appeared sometime in history, economic and technological circumstances have been played a great role for the determination of general requirements for company foundation. The statutory minimum number of founders for company incorporation may be perceived as one of these timely requirements. However, technological improvements have allowed one person to found a company and gain equivalent or more benefits in comparison to company foundation by a group of people. This development has initially compelled practice to accept concept of single-member company (’SMC’), then its legal recognition and regulation.

It is an inevitable outcome of human and nature relationship that law as a part of superstructure has a strong relationship with current economic conditions as a base. It is

2 Smith claims that people prioritize their individual benefits over benefits of society. Additionally he states that people’s incentive for cooperation is based on its increasing returns. Adam Smith, 1776, Milletlerin Zenginliği, transl. Haldun Derin, İş Bankası Yayınları, 2006, p.14.
better to contribute to this evolution by rational legislative activities rather than resisting. As above-mentioned individual benefit maximization preference in the historical appearance of companies is reconsidered, the legalization efforts of SMC foundation are subject matters of law and economics for approximately last thirty years because practical necessity for SMC foundation is getting stronger for that time period.

Following the legalization of SMC foundation under the influence of neoliberal politics that prioritizes demands of market, Turkish Commercial Code (‘TCC’) with its entry into force in 1 July 2012, has authorized company incorporation by one person as well. This article aims to explain conceptualization and regulation of SMC foundation according to TCC, especially by addressing to the reader with little or no familiarity to Turkish commercial law, to assess results of legalization of SMC foundation, and to make observations in respect to recent developments in the field of European and Turkish business law regarding further legislative efforts for SMCs.

In order to reach the above-mentioned purpose, concept of company, its definition, and components will be stated initially. Afterwards, different appearances of SMC concept in Roman and Anglo Saxon law systems will be exemplified. Then, the circumstances which paved the way for legalization of SMC foundation will be explained and both favorable and negative features of SMC from the point of view of lawyers and market players will be specified. After determination of possible legal measures which can be taken against said negative features, the development process of legalization in the European Union (‘EU’) and Turkey will be expressed. After that, embracement degree of SMC in Turkish business life after its legalization with TCC will be discussed in the light of statistics which were obtained from official authorities of Turkey. Subsequently, a new draft directive on single-member companies labored by the EU, its aims and critics against it will be emphasized. Finally, determinations that are stated throughout the article will be summarized and reader’s attention will be drawn to some prospective and practical points.

II. THE CONCEPT OF SINGLE MEMBER COMPANY

A. Definition and Components of Company

For scientific works, it is a prerequisite that meaning and borders of concepts must be explained sufficiently. ‘Company’ is the essential concept of this article. There is not a precise definition of ‘company’ in TCC. Hence, it is useful to search etymological root of this word. ‘Company’ derives from Latin word composition ‘Cum Pannes’ which means
people who get together to break bread.\(^6\) In Turkish, the word of company finds voice in the word of ‘şirket’ which is originally an Arabic word. ‘Şirket’s root is ‘şrk’ in Arabic and it means ‘partnership’.\(^7\) In German, ‘Gesellschaft’ stands for ‘company’ and it derives either from ‘Geselle’ which means ‘journeyman’ or from ‘Gesellen’ which means ‘to participate or to be together’.\(^8\) Terminological definition of company is stated in Turkish Legal Dictionary as two or more persons associated together by providing their labor and goods with an agreement in order to reach a goal.\(^9\) A very similar definition of company is provided in the Article 620 of Turkish Code of Obligations.\(^10\) Turkish doctrine lists five components of a company on the basis of this article: (i) persons (ii) agreement (iii) capital (iv) common goal (v) affectio societatis.

B. Persons Component in Legal Traditions of Roman and Anglo Saxon Laws

Throughout the historical development of company law, question regarding minimum number of members for company incorporation had been discussed and answered differently. For a long time, the concept of SMC had been found contradictory in itself (contradiction in adjectio) because of above-mentioned etymological and terminological meanings of the concept. Hence, general opinion of the doctrine was inclined to accept more than one founder for a company. One of the exceptions which can be cited as an example is ‘peculium’ in Roman law. Peculium means “son’s or slave’s savings which are under their independent management with the father’s or master’s consent.”\(^11\) Through peculium, limited liability principle, which is one of the most significant features of today’s companies, had come into existence. In other words, separation of individual and commercial property had appeared.\(^12\) Besides, peculium exemplifies SMC foundation and maintenance since it was mostly deemed to belong to one person who is either the son or the slave. As one of the successors of Roman law, German law acknowledged SMC very long time ago. After German High Imperial Court’s ruling in 28.11.1888, it was qualified lawful for a company to become SMC by the way of share transfer.\(^13\) Right alongside,\(^14\)


\(^10\) Turkish Code of Obligations art. 620/1: “An ordinary partnership agreement is an agreement according to which two or more parties combine their labours and assets in order to realize a common purpose.”

\(^11\) Poroy (Tekinalp/Çamoğlu), Ortaklıklar, 13. edt., İstanbul, p.20.


with the House of Lords’ Salomon v. Salomon decision, SMC foundation with straw men was found lawful in 1897. As it is apparent from these examples, SMCs were allowed in the practice of law both in continental and Anglo Saxon law systems. Before going into more details, ways of SMC appearance/existence are expressed in the following section.

C. Ways of SMC Appearance/Existence

SMC can exist in three different ways. First of all, a company can transform to a de facto SMC when shareholders number decreases to one. Second way is dishonest foundation which occurs by fulfilment of minimum founders number with straw men. And finally, company foundation by one person (ex nihilo) is the third way. The first two ways have been accepted in various legal systems accompanied by some measures taken against misuse of limited liability. However legalization of SMC foundation in the first place is a relatively new development and therefore it is the main subject matter of this article.

D. Legalization of SMC Foundation and Its Background

Before all else, underlying reasons of authorization efforts of SMC are required to be expressed. Now, it is better understood that law transforms itself anyway at all rather than displaying resistance against economic circumstances. After the termination of the Cold War, neoliberal economic thought has gained an influential role in determination of world politics. This way of thinking has acknowledged importance of small and middle size enterprises (‘SMEs’) in economic growth and has triggered the initiation of reforms so as to increase efficiency. The most significant elements of these reforms were authorization and encouragement of SMC foundation. In this way, de facto SMCs would have legal basis as well as the need for straw men for company foundation would be prevented. Besides, establishment of corporate organization and takeover of SMEs would become easier. Moreover, direct foreign investments’ attention would be drowned and this will affect market positively. It can be concluded that another important change is allowing universities and research institutions to found SMCs easily in order to facilitate works of research centres and relevant departments.

E. Possible Dangers of SMC Foundation

The practice of SMC foundation has possible dangers from legal and economic perspectives as well as its above-mentioned positive features. Hiding borders of individual and commercial properties of single member and unfair utilization of corporate veil are two of the most substantial dangers. Additionally, principle of management’s
independence from capital is under the danger of breach when single-member constitutes the board of directors and/or general assembly by himself/herself/itself. Moreover, SMC chains may cause difficulties for determination and fulfilment of liability issues. This can affect economic life adversely in the long run. It is required to be noted that unlimited borrowing rights rather than SMC foundation and its limited liability are at the core of this economic problem. As it is stated in the doctrine, companies which have more than one member may also provide an environment for unfair utilization of limited liability and corporate veil.

F. Possible Precautions against Dangers Arisen from SMC Foundation

As it is understandable from above-mentioned positive and negative features, SMCs may function as a sword or a shield. The law and legal structure should provide fruitful environment for the appearance of positive features and preventive conditions for negative features. Increased minimum capital requirement and its securitization by an instrument of guarantee can be stated as primary precautions. Besides that public disclosure of single member characteristic of a company is an effective way in order to prevent delusions of especially creditors. Moreover, restrictions for creation of SMC chains and easier application of piercing the corporate veil are also outstanding measures. Other precautions for that matter have been discussed in the legal literature for a long time.

G. Legalization and Proliferation of SMCs with the Influence of EU Law

The positive and negative features of SMCs and possible precautions against misuses are stated above in order to holistically investigate SMCs. Now, legalization and proliferation of SMC foundation under the influence of EU law will be specified in more detail.

The milestone for the legalization of SMC foundation was European Council’s 89/667/EC’s 12. Directive (‘Directive’). This Directive provided two options to the EU members. As the one way, they could allow SMC foundation. Otherwise they had to create a merchant status whose liability is limited to properties that are allocated for his/her commercial undertakings. As it is emphasized in the literature, main purpose of the Directive was to institutionalize one person business organization with limited liability

in order to protect them threat of bankruptcy in the EU. The Directive has been criticized by legal scholars arguing that it provides two options to member states and leaves the detailed regulations to member states’ national laws. Especially, regulation of minimum capital requirement and precautions against SMC chains are left to member states. This extensive entitlement for the application of directive to member states has intercepted harmonization of the EU law. For instance, Portugal preferred the option of creating a new status rather than allowing SMC foundation (authorized SMC foundation later on), and Belgium and Italy took some measures in order to prevent SMC chains.


H. Legalization of SMC Foundation in Turkey

As a candidate country for the EU membership and current member of European Customs Union, Turkey has legalized SMC foundation in TCC with its entry into force in 1 July 2012. As it is settled in TCC, joint stock companies and limited liability companies can be founded as SMCs. It is undoubted that Directive and economic circumstances were underlying reasons for legalization of SMC foundation in Turkish law. Turkish legislator stated in the preamble of the Article 338 of TCC that Directive was considered in the process of law making. Besides expected positive effects of legislation are exemplified there. The preamble ends as following: “Single member company, inter alia, can be utilized as a controlling company in a conglomerate; can serve for institutionalization, can facilitate foundation business. It also accordant with honesty and legal realism since it prevents fake company foundation by straw men.”

As it is emphasized in the preamble, Turkish legislator attempted to provide better provisions in order to prevent said general dangers of misuse. In this regard, Articles 338 and 574 regulate minimum number of people for a company foundation, and legal requirements in the case of decrease of member number to one; Article 371/6 and 629/2 regulate requirement of a written agreement between the company and the single-member; Article 408/3 and 616/3 regulate requirement of a written statement for the decisions taken by the single-member acting in the capacity of general meeting.

22 Tekinalp, p.44.
23 Preamble of Article 338 of Turkish Commercial Code.
I. SMC Foundation in Turkey

a. Special Regulations of TCC for the Single-member Joint Stock Company

One or more shareholder founders are required for foundation of a joint stock company. If the number of shareholders falls to one, this is notified to the board in writing within seven days from the date of the transaction giving rise to such fall. The board shall registers and announces within seven days as of the receipt of the notification that company is a single-member joint stock company. Furthermore, if the company is established by one shareholder or the shares come to be held by one shareholder in due course; the name, residence, and nationality of this shareholder shall also be registered and announced. Otherwise, the single shareholder, who fails to make the notification, or the board, who fails to make the registration and announcement, shall be liable for any damage incurred therefrom. The company may not acquire its own shares so as to become a single-member company.

Besides that in a single-shareholder joint stock company, contracts between the shareholder and the company shall be valid only if drawn up in writing regardless of whether the company has been represented by the shareholder in the process of conclusion of the contract. This rule does not apply to contracts relating to transactions, which are deemed day-to-day, insignificant and ordinary under market conditions.

The single owner shall have all the powers vested in a general assembly in a single-shareholder joint stock company. In order for resolutions, which are passed by the single owner in his capacity as the general assembly, to be valid, they must be in writing.

b. Special Regulations of TCC for the Single-member Limited Liability Company

If the number of members falls down to one, this shall be informed to the managers in writing within seven days from the date of the transaction giving rise to such decrease. The managers shall cause the single-member limited liability company, name, domicile, and nationality of the single owner announced and registered, with the trade register until the end of the seventh days as of being notified; otherwise they shall be liable for any damages arising therefrom. Same obligation is valid for the cases in which company is founded by one member. The company may not acquire its own registered capital shares so as to become the single member of the company.

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The single member vested with all the authorities of a members' general assembly in a single-member limited company. Resolutions passed by the single member in his/her capacity as members' general assembly become valid if they are in written form.

In single-member limited liability companies, contracts between the sole member and his company shall be valid only if they are drawn up in writing regardless of whether or not the company is represented by that single member in the process of conclusion of the contract. This rule does not apply to transactions that are considered day-to-day, insignificant and ordinary under market conditions.

J. Current Practice of SMC Foundation in Turkey

After five years as of the legalization of SMC foundation in Turkey, it is possible to test the predictions made by the Turkish legislator. For instance, did SMC foundation become a preferred way of company foundation today? The statistics regarding limited liability and joint stock company foundation in Turkey between January 2013 and May 2017 are provided by The Union of Chambers and Commodity Exchanges of Turkey's database. According to this statistics, 25.413 of 47.602 joint stock company foundations - in this period - are SMC foundations. This means that 53.3% of the joint stock company foundations are SMC foundations. Also, 124.980 of 208.564 limited liability company foundations - in this period - are SMC foundations. That is to say, proportion of the SMC foundation is 59.9% for the limited liability company foundations.

As it is obvious from the statistics, SMC foundation way both in joint stock companies and in limited liability companies has received a great deal of attention. 58.7% of the company foundations between January 2013 and May 2017 are single-member company foundations. This interest has continued in stability for last five years when the monthly statistics are taken into consideration. Besides there is not well-known case related to SMC foundation in the high courts. As a result, it can be stated for now that SMC foundation has not caused extraordinary dangers in Turkish commercial law and practice.

K. Recent Development Regarding Single Member Companies in EU Law

While Turkey was working on adjusting its law in accordance with the Directive, EU has started legislation process of Societas Unius Personae ("SUP") in order to facilitate

trans-borders company foundation in the EU as it is aimed in Europe 2020\textsuperscript{29} Paper, which manifests the EU’s ten years growth policy. As a predecessor of SUP works, legislation of Societas Privata Europaea ("SPE")\textsuperscript{30} was attempted in 2008 in order to pave the way for easier organization and management of SMEs and bigger enterprises in the EU. Nevertheless these efforts have become unsuccessful. Then, SUP has appeared on the agenda of the EU in 2012. With these efforts, the EU endeavours to create a new type of company similar to German limited company (\textit{GmbH}) and American limited company (\textit{LLC}).\textsuperscript{31} After 2012, two major public consultations have been made in order to enhance the draft directive.\textsuperscript{32} Then, the draft directive got more support as it had displayed its capacity to meet economic expectations of the market.

If the current draft becomes a directive, online company foundation and registration will be one of the most significant changes since it enables citizens of an EU member state to found a company in another EU member state where they are not physically present.\textsuperscript{33} The list of documents which can be required by states for company foundation is given in the directive in an exhaustive way. This online company foundation method has been criticized by notaries as well as Economic and Social Committee ("EESC")\textsuperscript{34} regarding possible security risks. On the other hand, EESC criticizes this way of foundation since it can be used by big companies for tax avoidance and breach of mandatory company regulations of national laws.\textsuperscript{35} For instance, by using online SMC foundation, German mandatory regulation on employee participation to management boards can be disabled. Hence, EESC has recommended enhancing SUP by integrating some provision regarding employee participation to managerial boards.\textsuperscript{36} Collaterally, Germany and Spain among others prevent activities for SUP unless a change made as such.\textsuperscript{37} However, the balance of interest and security risks are viable according to Presidency of European Council Report.\textsuperscript{38} These and some other changes which can be brought by

\begin{thebibliography}{99}
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\item PROPOSAL, Article 14.
\item OPINION, p.4.
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\item Klaus J. Hopt, p.7.
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SUP will be influential in Turkish law due to Turkey’s position regarding European Customs Union and EU.

III. CONCLUSION

As it is explained in a compendious manner above, company foundation by one person is legalized in most of the countries under the influence of globalization and neoliberal economic politics.

Turkey, as a current member of the European Customs Union and a candidate country for the EU membership, has authorized SMC foundation by Turkish Commercial Code with its entry into force in 1st July 2012.

As it is obvious from the statistics regarding SMC foundation after its legalization, SMC foundation is embraced by the market players in Turkey. 58,7% of company foundations between January 2013 and May 2017 are single-member company foundations.

SMC foundation’s positive effects on the economy are accepted in the business circles. However, as the main target of this legislation, SMEs’ assessment must be taken into consideration by post facto consultations. The utilization of this way of company foundation for tax avoidance and breach of national laws must be prevented.

With the efforts for SUP directive, the EU attempts to create a new type of company rather than developing current SMC structure. This may affect the EU company law dramatically. Turkish lawyers must follow these developments of the EU company law because the EU regulations have a great importance on law and economics of Turkey.

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