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YÜKSEK LİSANS TEZİ

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ONAY SAYFASI

Enstitümüz AB Hukuku Anabilim Dalı Yüksek Lisans öğrencisi Betil ÇELİKBİ'nin ***"THE CONCEPT OF SINGLE-MEMBER COMPANY IN EU LAW AND ITS REFLECTIONS IN TURKISH LAW"*** konulu tez çalışması.....tarihinde yapılan tez savunma sınavında aşağıda isimleri yazılı jüri üyeleri tarafından oybirliği / ~~oyçokluğu~~ ile başarılı bulunmuştur.

Onaylayan:

Prof. Dr. Sibel ÖZEL	Danışman	.....
Yrd.Doç. Dr. Murat T.YÖRÜNG	Jüri Üyesi	.....
Yrd. Doç. Dr. Yıldıray SAK	Jüri Üyesi	.....

Onay Tarihi

Prof. Dr. Mustafa KARTAN

29.06.2011...tarih ve 2011/01... Sayılı Enstitü Yönetim Kurulu kararı ile onaylanmıştır.

ABSTRACT

This study with the title of "The Concept of Single-Member Company in EU Law and Its Reflections in Turkish Law" explores the historical background of single-member company concept and the need for recognition of such company form in various jurisdictions; since, single-member company is an economic reality of the globalized world of the twenty first century. This study approaches the single-member company concept as an important instrument for the realization of full freedom of establishment and for the competition between companies in EU Member States and companies in other states.

The EU legislation and jurisprudence of the ECJ are among the main elements of harmonization, which facilitate the cross-border establishment of companies under Arts 49 to 54 TFEU. In particular, the methods of implementation of the 'Twelfth Council Directive on single-member private limited liability companies' is one of the core elements which are investigated in this study; since, the purpose of such directives is to achieve a high level of harmonization and guarantee the freedom of establishment.

The ultimate aim of this study is to determine whether the provisions of the Twelfth Directive are adequate to achieve a high level of harmonization and, further, to set forth whether these implications in the EU law dimension have proper reflections to the applications in Turkey, as an EU candidate country. In that case, the debate is whether regulating the single-member company form is consistent with the Turkish company law theory and whether it responds the needs of the developing commercial life.

ÖZET

"AB Hukuku'nda Tek Kişilik Şirket Kavramı ve Bu Kavramın Türk Hukuku'ndaki Yansımaları" adlı bu çalışmada, yirmi birinci yüzyıl küresel dünyasının ekonomik bir gerçeği olan, tek kişilik şirket kavramının tarihsel temelleri ve bu şirket tipinin çeşitli yargı çevrelerince kabul görme gereksinimi incelenmektedir. Çalışma, tek ortaklı şirket kavramını, Avrupa Birliği sınırları içinde serbest dolaşımın sağlanması ve Avrupa Birliği üyesi devletler ile diğer devletlerdeki şirketlerin uluslararası rekabeti bağlamında, önemli bir araç olarak görmektedir.

Bu çalışmadaki tartışma noktalarının birer parçası olarak, Avrupa Birliği'nin İşleyişine İlişkin Antlaşma'nın 49 ve 54. maddeleri arasında düzenlenen, şirketlerin sınır ötesi yerleşimini kolaylaştıran Avrupa Birliği müktesebatı ve Avrupa Birliği Adalet Divanı içtihatları, Avrupa Birliği'nde şirketler hukukunun uyumlaştırılmasının temel unsurlarındandır. Özellikle, Avrupa Birliği şirketler hukuku alanındaki direktiflerin amacı; yüksek seviyede uyumlaştırmayı sağlamak ve yerleşim serbestisini koruma altına almaktır. Bu bakımdan, Tek Kişilik Sınırlı Sorumlu Ortaklıklara İlişkin Avrupa Konseyi On İkinci Yönergesi'nin üye devletlerin yerel hukuklarında uygulanma metodları bu çalışmada araştırılan esaslı unsurlardandır.

Bu çalışmanın temel amacı On ikinci Yönerge hükümlerinin, yüksek seviyede uyumlaştırma amacını gerçekleştirmeye yetip yetmediğini belirlemek, öte yandan, Avrupa Birliği Hukuku boyutundaki bu düzenlemelerin, Avrupa Birliği üyeliğine aday bir ülke olarak, Türkiye'deki uygulamalara doğru yansıyıp yansımadığını ortaya koymaktır. Bu bağlamda tartışma, tek kişilik şirket kavramının Türk şirketler hukuku teorisi ile bağdaşıp bağdaşmadığı ve gelişen ticari yaşamın ihtiyaçlarına cevap verip vermediği noktasında oluşacaktır.

ABBREVIATIONS

Art.	Article
AJCL	The American Journal of Comparative Law
BATİDER	Banka ve Ticaret Hukuku Dergisi
BD	Board of Directors
BG	Bundesgericht (Swiss Federal Supreme Court)
BGBl.	Bundesgesetzblatt (German Federal Law Gazette)
BGE	Bundesgerichtsentscheide (Judgement of the Swiss Federal Supreme Court)
BGH	Bundesgerichtshof (German Federal Court of Justice)
BGHZ	Entscheidungen des Bundesgerichtshofs in Zivilsachen (Civil Judgments of the German Federal Court of Justice)
BTHAE	Banka ve Ticaret Hukuku Araştırma Enstitüsü
CLPE	Comparative Research in Law and Political Economy
CMLR	Common Market Law Review
Colum. L. Rev.	Columbia Law Review
Comp. Law.	Company Lawyer
E.	Esas No.
EBLR	European Business Law Review
EBOR	European Business Organization Law Review
EC	European Community
EC Treaty	Treaty establishing the European Community
ECFR	European Company and Financial Law Review
ECGI	European Corporate Governance Institute
ECJ	Court of Justice of the European Union
ECR	European Court Reports
Ed.	Edition
EEC Treaty	Treaty establishing the European Economic Community
ELRev.	European Law Review
EU	European Union
GA	General Assembly

HLR	Harvard Law Review
IBLJ	International Business Law Journal
ICCLJ	International and Comparative Corporate Law Journal
ICCLR	International Company and Commercial Law Review
ICLQ	International & Comparative Law Quarterly
İBD	İstanbul Barosu Dergisi
HD	Hukuk Dairesi
JBL	Journal of Business Law
JCLS	Journal of Corporate Law Studies
K.	Karar no.
Member States	Member States of the European Union
No.	Number
OJ	Official Journal
p.	Page
para.	Paragraph
UK	United Kingdom
US	United States
TFEU	Treaty on the Functioning of the European Union
The Board	Board of Directors
Tul. L. Rev	Tulane Law Review
WBFV	Wet op de Formeel Buitenlandse Vennootschappen (The Dutch Law on the Formal Foreign Companies)
YLJ	Yale Law Journal

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INTRODUCTION

From a general point of view, the purpose of harmonization of EU company laws is to ensure that, companies can establish themselves all over the Union by creating an internal market for their products and services.

The harmonization instruments of the European company law are the EU legislations, namely, Treaty provisions, directives, regulations; and the jurisprudence of the ECJ. Since, the crucial element for constructing a competitive internal market is the cross-border mobility of companies, the case-law of the ECJ on the right of establishment has been brought to bear on national company laws and corporate practice. In order to reach an adequate level of competitiveness, the companies within an internal market should be made capable of transferring their seats freely, without being forced to re-incorporate or without dealing with problems like recognition or other domestic law requirements. Therefore, national company laws, which restrict the free movement of companies or the exercise of the fundamental freedoms, have been set aside. Although, an immediate uniformity in field of company law cannot be expected, as far as, characteristics and historical backgrounds of each Member State are different, transposition of EU legislation into the domestic company laws takes a crucial part in harmonization, which will be an important discussion point of this study.

EU Member States have all undertaken extensive reforms on their company legislations. Taking initiative in order to make corporate governance more effective, was an outstanding feature of recent European company law reform. In parallel, company law reform has been taken in the direction with the wish to simplify the burdens particularly on small and medium sized enterprises ("SMEs"). In order to create an environment favorable to SMEs and to emphasize the need to encourage developments of those enterprises, the Twelfth Council Directive on single-member private limited liability companies ("Twelfth Directive") was introduced in 1989, in the EU dimension. The Directive would harmonize the law governing single-member companies and provide a common legal instrument for such companies throughout the Community. The Directive placed emphasiz on the absence of such business form in certain Member States and on the differences between the national laws of the Member

States, which allow the formation of single-member companies. The realization of single-member companies is considered as an economic reality and an important tool in achieving EU company law harmonization.

The new Member States have gone through fundamental reforms to facilitate a modern market economy and to implement the EU *acquis communautaire* into their company laws. Such reforms in the EU dimension also have reflections in Turkey; as it is a candidate country of the EU which agrees to implement the EU *acquis* in its domestic laws. Regarding the area of single-member companies, in the current Turkish Commercial Code there is not any regulation about such a company form but *de facto* presence of single-member companies is disregarded. However, in the near future, Turkey will be going through fundamental changes in its company law with the entry into force of the new Turkish Commercial Code. One of the innovations that the new Code presents is the introduction of single-member companies.

The main purpose of this study is; firstly, to set out the concept of single-member company from an EU perspective, however, with a comparative analysis with various other legal orders; secondly, to examine the reflections of such company form in Turkish law. This research does not have the primary ambition of investigating the relationship of conflict-of-law rules and companies' freedom of establishment. These subjects are only mentioned, as a complementary, in order to express the logic and purpose of the harmonization of European company laws which is considered as an instrument in accomplishing the full freedom of establishment of companies in the EU.

In order to achieve this, in the first chapter of this study, in order to give an overview of the European company laws, the harmonization tools, such as Treaty provisions, regulations regarding EU company types and company law directives will be addressed; then, the relationship between harmonization and freedom of establishment of companies will be taken into account. Under this heading, the concept of freedom of establishment and its applications in single-member companies will be mentioned in short. Then, two conflicting private international law theories, the real seat and incorporation theories, which are brought about by the dissimilarities in the Member States' company laws, will be explored. In order to demonstrate how the

jurisprudence of the ECJ has developed in time, recent case-law regarding the freedom of establishment of companies will be summarized. After that, the relationship between the national private international law theories in respect of determination of the governing law of a company, and the freedom of establishment of companies will be discussed. The debates regarding the questions; whether the application of the real seat theory should be regarded incompatible with the freedom of establishment of companies; and whether the Treaty provisions on freedom of establishment included a hidden conflict-of-laws norm, which set forth the application of the incorporation theory, will be explored. Lastly, the effect of ECJ's jurisprudence over national laws of Member States will be considered.

In the second chapter, the main research subject, which is the concept of single-member companies, will be dealt with. The historical background of single-member company form will be scrutinized in detail; starting from the similar institutions of Roman law to the realization of single-member company in modern company law. Then a comparative analysis will be made regarding the single-member company form, in various other legal orders. After discussing the US, Chinese and Swiss legal orders, the realization of single-member companies under EU law will be examined. In order to make a comprehensive inquiry, legal basis, history and scope of the Twelfth Directive will be set forth and its provisions will be examined in detail. Fallowing these, the status and validity of single-member companies, before and after the implementation of the Directive, will be revealed. Consequently, the problems and handicaps which can be faced regarding the single-member companies, such as straw men formations, veil-piercing, *alter ego* problems, problems regarding corporate groups and undercapitalization, will be examined. In addition to these, the scope of the authority of the sole shareholder and the transactions with the company will be discussed.

In the third chapter of this study, the reflections of the single-member company form in Turkish law will be analyzed. In line with the second chapter, the third chapter starts with an overall evaluation of the single-member company form; the positive and negative views regarding the single-member companies. Then, the situation in the

current Turkish Commercial Code will be mentioned. Although not legally regulated under Turkish law, in practice, there exist many *de facto* single-member companies. Such companies are generally constituted when all shares in a multi-member company are consolidated in the hands of a single shareholder or when a company is formed with nominal shareholders, or with straw men, in order to meet the statutory requirements.

In the last part of the third chapter, the recent reforms in Turkish law will be discussed; which are made in order to legitimize this situation and in response for economical needs for realization of single-member companies. Then, the underlying objectives for the introduction of the single-member company concept in the new Turkish Commercial Code, which will enter into force on July 1, 2012, will be mentioned. Finally, the third chapter ends with the examination of the innovative provisions of the new Turkish Commercial Code regarding the functioning of the single-member joint-stock and private limited liability companies.

I CHAPTER 1: THE HARMONIZATION PROCESS OF EU COMPANY LAWS

1.1 GENERAL

There is not a clear boundary between the company laws of Anglo-Saxon systems and Continental systems. Under the influence of the EU legislation, English company law has been moving closer to Continental systems.[1] Pursuant to EC Treaty,[2] the harmonization program of company laws began in 1968. It has been a very hard task to achieve, not only because of the diversity in company law systems, but also because Member States strongly hold on to the policies behind their national provisions; thus it is difficult to reach to a consensus. Nonetheless the program has kept on producing several solutions besides Treaty clauses.[3] Those harmonization tools include various directives and many company types which I will be addressing in the following of this study.

The main discussion of this study is specifically one of the company law harmonization directives, which is the Twelfth Directive on single-member private limited liability companies.[4] But before analyzing this Directive in detail, the core elements of the company law harmonization, freedom of establishment and the jurisprudence of ECJ and private international law theories, as a complementary, will be examined.

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[1] H. R. Hahlo and J.H. Farrar (Editors), **Hahlo's Cases and Materials on Company Law**, London: Sweet&Maxwell, 1987, p.43.

[2] Consolidated Version of the Treaty Establishing the European Community, http://eur-lex.europa.eu/en/treaties/dat/12002E/pdf/12002E_EN.pdf, (last accessed on 04.05.2010).

[3] George A. Bermann, Roger J. Goebel, William J. Davey and Eleanor M. Fox, **Cases and Materials on European Community Law (American Casebook Series)**, US: West Publishing Co., 1993, p.542.

[4] (2009/102/EC), OJ L 258, 1.10.2009, p.20–25, Before October 21, 2009 the numbering was different, Twelfth Council Directive of 21 December 1989 on single-member private limited-liability companies, (89/667/EEC), OJ L 395, 30 12 1989, 40-42.

1.2 HARMONIZATION TOOLS

1.2.1 Treaty Provisions

The crucial function of approximation[5] of European company laws is to eliminate the disparities in national laws which prevent the economic intercourse between the Member States. There are many specific provisions in the EC Treaty where the means of approximation are defined and the procedures of the approximation differ from one provision to another.[6] Therefore, I will only discuss the most specific provisions in this study.

The provisions for company law harmonization mainly derive from Articles 3, 44 and 94 of the EC Treaty. The Art. 3(c) and (h) EC envisages, respectively, an internal market composed with the "*abolition(…)of obstacles to the free movement of goods, persons, services and capital"* and the approximation of laws *"for the proper functioning of the common market"*. Thereto, Art. 94 EC (now Art. 115 TFEU[7]) specifies the tools which are used for the approximation of laws and gives an authorization to the European Council ("the Council") to act after a proposal from the European Commission ("the Commission") in order to provide the functioning of the common market through the issuing of the directives. Expressly, it can be concluded that company law directives are generally based on Art. 44(2) (g) EC[8] (now Art. 50(2) (g) TFEU), which provides that the Council and the Commission shall carry out their duties, *"by co-coordinating to the necessary extent the safeguards which(…)are required by Member States of companies or firms(…)with a view to making such safeguards equivalent throughout the Community"*. When Art. 94 is compared with Art. 44, whose aim is to serve the specific objective of the freedom of establishment, the

[5] Many different words, such as; "approximation", "harmonization" and "co-ordination", are used in the Treaty in order to define the process for the adjustment of national laws but as *Stein* clearly states, these terms do not indicate different concepts, Eric Stein, **Harmonization of European Company Laws: National Reform and Transnational Coordination**, Indianapolis: Bobbs-Merrill Co., 1971, p.11.

[6] Stein, Harmonization, p.9-10.

[7] Consolidated Version of the Treaty on the Functioning of the European Union, http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:2008:115:0047:0199:EN:PDF, (last accessed on 04.09.2010).

[8] Such as; First, Second, Third, Fourth, Sixth, Seventh, Eighth, Eleventh and Twelfth Directives, which will be discussed later in this study, Eddy Wymeersch, "Company Law in Europe and European Company Law", April 2001, Ghent University, Financial Law Institute Working Paper No. 2001-06, http://ssrn.com/abstract=273876, (last accessed on 10.03.2010), p.3; Klaus Hopt, "Company Law in the European Union: Harmonization or Subsidiarity?", Saggi, Conferenze e Seminari des Centro di studi e ricerche di diritto comparato e straniero, Rome 1998, http://servizi.iit.cnr.it/~crdcs/crdcs/frames31.htm, (last accessed on 19.01.2010).

main difference seems to be the voting system. Art. 94 seeks unanimity in the Council, where Art. 44 allows decisions by qualified majority. Thus, from some point of view, it makes the impact of Art. 94 limited in company law arena[9].

It can be stated that the debates about this issue have been lessened as it is now possible to adopt all company directives with a qualified majority under the harmonization objectives of Art. 95 EC (now Art. 114 TFEU). This makes the concept of harmonization, a tool for the realization of an internal market as the general objective of the EC Treaty.[10] As a result, the provisions which are related with the establishment of companies can also be related to the proper functioning of the internal market.[11] Thus, all of these provisions can be collected together under the harmonization process.[12]

Last but not least, Art. 308 EC (now Art. 352 TFEU) provides a general power to facilitate the development of the Union by the issuing of regulations. According to Art. 308 the Council must act unanimously on a proposal from the Commission following consultation with the European Parliament. This Article forms the legal basis for the proposals for collaboration through the European Economic Interest Groupings and for the European Company concepts,[13] which will be discussed in the fallowing section.

1.2.2 EU Company Law Regulations and Types of Companies

In order to give brief information about the regulations, we can state that a regulation is entirely binding and directly applicable in all Member States. They are being used when an intervention of the Member States' legal orders is in question, namely, when innovative legal instruments, which need recognition in all Member States, are introduced in the European company legal order.

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[9] Stein, Harmonization, p.50.
[10] *See*, Art. 3(c), (h) EC.
[11] Wymeersch, Company Law in Europe, p.2-3.
[12] For a detailed analyses of the character and procedure of harmonization under these articles *see*, P. J. G. Kapteyn and P. Verloren Van Themaat, **Introduction to the Law of the European Communities After the Coming Into Force of the Single European Act**, Laurence W. Gormley (Editor), 2nd Ed., London: Kluwer Law International, p.477-479.
[13] James Kirkbride, "European Company Law Harmonisation: A Study", **ICCLR**, 5(8), 1994, p.279.

The European institutions are eager to establish several supranational company forms that will facilitate cross-border business, both in internal and external relations of the EU.[14] Therefore, in pursuance of this objective, the Council of Ministers has achieved progress in several fields of corporate law, particularly in the adoption of legal instruments in the form of Council Regulations; such as, the Council Regulation 2137/85 on the European Economic Interest Grouping,[15] the Council Regulation 2157/2001 on the Statute for a European Company,[16] the Council Regulation 1435/2003 on the Statute for a European Cooperative Society[17] and the Proposal for a Council Regulation on the Statute for a European Private Company,[18] Additionally, there have been unsuccessful draft proposals,[19] as well as the amendments,[20] of different corporate forms, such as the Proposal for a Council Regulation on the Statute for a European Association[21] and the Proposal for a Council Regulation on the Statute for a European Mutual Society.[22]

It needs to be stressed that, only the most crucial forms of companies will be examined in this study, in order to express the logic under the European company law harmonization.

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[14] Christopher Bovis, "Company Law Developments at European Union Level - the European Cooperative Society, the European Mutual Society and the European Association", **Comp. Law.**, Vol.16, No.3, 1995, p.85.
[15] Council Regulation 2137/85 on the European Economic Interest Grouping [1985] OJ L199/1.
[16] Council Regulation (EC) No 2157/2001 of 8 October 2001 on the Statute for a European company; *see* also, Council Directive 2001/86/EC of 8 October 2001 supplementing the Statute for a European company with regard to the involvement of employees [OJ L 294, 10.11.2001].
[17] Council Regulation (EC) No 1435/2003 of 22 July 2003 on the Statute for a European Cooperative Society [OJ L 207, 18.08.2003]; *see* also, Council Directive 2003/72/EC of 22 July 2003 supplementing the Statute for a European Cooperative Society with regard to the involvement of employees [OJ L 207, 18.08.2003].
[18] Proposal for a Council Regulation of 25 June 2008 on the Statute for a European Private Company [COM (2009) 396], http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2008:0396:FIN:EN:PDF, (last accessed on 10.05.2010).
[19] For further information about the content of these proposals, *see*, Bovis, p. 86.
[20] Amended proposal for a Council Regulation (EEC) on the Statute for a European Association [1993] OJ C236/1 and the Amended proposal for a Council Directive supplementing the Statute for a European Association with regard to the involvement of employees [1993] OJ C236/14; *see* also, Amended proposal for a Council Regulation (EEC) on the Statute for a European mutual society [1993] OJ C236/40 and the Amended Proposal for a Council Directive supplementing the Statute for a European mutual society with regard to the involvement of employees [1993] OJ C236/56.
[21] Proposal for a Council Regulation (EEC) on the Statute for a European Association [1992] OJ C99/1; *see* also, Proposal for a Council Directive supplementing the Statute for a European Association with regard to the involvement of employees [1992] OJ C99/14.
[22] Proposal for a Council Regulation (EEC) on the Statute for a European mutual society, [1992] OJ C99/40; *see* also, Proposal for a Council Directive supplementing the Statute for a European mutual society with regard to the involvement of employees [1992] OJ C99/57.

1.2.2.1 The European Company

The European Company, *Societas Europaea*, ("SE") has a long history behind it.[23] When it is first proposed, the legislation is blocked because of a disagreement about the adequate degree of worker participation in this new company structure.[24] After many years of discussions of proposals for the SE, agreement is finally reached at the Nice Summit on December 8, 2000; then, Council Regulation 2157/2001 and Council Directive 2001/86 are unanimously adopted on October 8, 2001.[25] The idea behind the proposal for the SE Statute is, creating an EU model which is intended to exist along with the other company models under the national laws of the Member States and avoiding the legal constraints arising from the existence of different legal systems.[26] This formulation will allow a company to be established and operate throughout the EU with unified set of rules.[27]

There are five ways of forming an SE; formation by merger, which is available only to public limited liability (i.e. joint-stock) companies from different Member States; formation of an SE holding company, which is available to public and private limited companies, in cases where half of each companies capital is contributed and the companies have their central administration in different Member States or have subsidiaries or branches in Member States other than that of their central administration; formation of a joint subsidiary, which is available under the same circumstances to any legal entities governed by public or private law; formation by conversion of a public limited liability company previously formed under national law; finally, formation by establishing a subsidiary SE by an SE itself.[28]

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[23] The first proposal dates back to 1959. A detailed historical background is available in Marios Bouloukos, "The Legal Status of the European Company (SE): Towards a European Company 'A la Carte?' ", **IBLJ**, 4, 2004, p.489-517.

[24] Siun O'Keeffe, " 'Societas Europaea'- The European Company Statute", **EU Focus**, 70, 2001, p.2.

[25] Frank Wooldridge, "The European Company, the Successful Conclusion of Protracted Negotiations", **Comp. Law.**, Vol.25, No.4, (2004), p.121-128; Bouloukos, p.489.

[26] Europa- Summaries of EU Legislation, http://europa.eu/legislation_summaries/internal_market/businesses/company_law/l26016_en.htm, (last accessed on 26.02. 2010); For the advantages and deficiencies of this company structure, *see* also, Eric Morgan De Rivery and Claire Stockford, "The European Company", **IBLJ**, 6, 2001, p.711-722.

[27] Bouloukos, p.490; *see* also generally on SE, Wolf-Georg Ringe, "The European Company Statute in the Context of Freedom of Establishment", **Journal of Corporate Law Studies**, Vol.7, Part.2, October 2007, p.185-212.

[28] "*The European Company-Societas Europaea",* September 2008, CMS Legal Services EEIG, http://www.cms-cmck.com/Hubbard.FileSystem/files/Publication/4793e80c-28e9-4105-9af3-

The SE will meet the challenges of a globalized market and will achieve the purpose of the internal market as it facilitates cross-border restructuring for companies from different Member States and gives investors the key for a supra-national business vehicle. The SE is used in order to create a European identity and it also provides for the recognition of involvement of employees in EU companies. Furthermore, administrative costs of the companies are also reduced by this new entity.[29] The SE will have a share capital, a legal personality and it will be regarded as a public limited liability company, in all Member States, formed pursuant to the national legislation of the Member State in which it has its registered office.[30]

1.2.2.2 The European Economic Interest Grouping

The European Economic Interest Grouping ("EEIG") is a quasi-partnership established by the 2137/85 Council Regulation, which prevails over inconsistent national rules of Member States.[31] Although in some occasions the EEIG is falsely classified as a company, it is better to describe it as a statutory joint venture or partnership.[32] It introduces a new form of undertaking which will have some of the advantages of a company however it will be a non-profit body with a limited liability.[33] The EEIG is established with the intention to assist co-operation across national frontiers within the EU; thus, creating this instrument at the EU level, will automatically assist the establishment of the internal market. Therefore, the EEIG will provide services and a common framework for the co-operating businesses of different nationalities.[34]

The EEIG aims to enable natural persons, companies, firms or other entities, governed by public or private law, to cooperate effectively when carrying their business

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[29] O'Keeffe, p.2.

[30] Bouloukos, p.490.

[31] For a detailed study on the EEIG, *see*, Severine Israel, "The EEIG- a Major Step Forward For Community Law", **Comp. Law.**, Vol.9, No.1, 1988, p.14-22.

[32] Bermann/Goebel/William/Davey/Fox, p.579.

[33] Janet M. Dine, "The European Economic Interest Grouping (EEIG): Some Private International Law Issues", **Comp. Law.**, Vo.13, No.1, 1992, p.10.

[34] Europa- Summaries of EU Legislation:
EEIG, http://europa.eu/legislation_summaries/internal_market/businesses/company_law/l26015_en.htm, (last accessed on 10.03.2010).

transactions across frontiers. An EEIG must have at least two members from different Member States and the registered office of a corporate member must be in a Member State. Moreover the central administration or the principle activity, of at least two of the members must be in such a state. Since, an EEIG has its central administration or principle activities within the Union, a third member, who is a natural person, does not need to comply with this requirement. If that member carries an economic activity in the Union, it may in any case become a member of an EEIG even though its central administration is outside the Community.[35]

1.2.2.3 The European Private Company

The Council intends to propose the adoption of an additional supra-national type of company, the European Private Company, *Societas Privata Europaea*, ("SPE"), as a pendant to the SE.[36] The legal basis is the Proposal for a Council Regulation of 25 June 2008 on the Statute for a European Private Company,[37] which enables companies to be set up across the Union under the most uniform conditions and the proposed regulation applies from July 1, 2010 onwards. The Commission has seen a necessity to act because of the inconsistency between the number of SMEs and their cross-border activities.[38] Therefore, the SPE regulation intends to improve access for SMEs to the internal market. Then, it aims to establish an entity with limited liability, in order to create a simplified legal form to facilitate the setting up and running of SMEs by reducing the costs and obstacles of cross-border trade.[39] The advantages of such a company will be that it has the same structure in each Member State, when it is necessary it can move from one Member State to another. It is suggested that a SPE can be formed as a joint holding company on subsidiary, or by means of a merger, or the

[35] Mads Andenas and Frank Wooldridge, **European Comparative Company Law**, The UK: Cambridge University Press, 2009, p.377-381.
[36] *See*, Andrew Hicks and Robert R. Drury, "The Proposal for a European Private Company", **JBL**, Sep. 1999, p.429-451.
[37] COM/2008/0396 final, CNS/2008/013, http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:52008PC0396:EN:NOT, (last accessed on 10.03.2010).
[38] Carsten Peters and Philipp Wullrich, "'Borderless Flexibility': the Societas Privata Europaea (SPE) From a German Company Law Perspective", **Comp. Law.**, Vol.30, No.7, 2009, p.214.
[39] Europa- Summaries of EU Legislation: A European Private Company Statute, http://europa.eu/legislation_summaries/internal_market/businesses/company_law/mi0007_en.htm, (last accessed on 10.03.2010).

conversion of an existing company. Moreover, both the individuals and companies will be participating in the formation of a SPE.[40]

1.2.2.4 The European Cooperative Society

In order to ensure equal terms of competition and to contribute to its economic development, the EU decides to provide a union of enterprises operating at the same distribution level, for enterprises which are wishing to enhance their marketing capacity.[41] To achieve this, the 1435/2003 Council Regulation is adopted, which allows for the creation of the European Cooperative Society, *Societas Cooperativa Europaea*, ("SCE"). It is a form of organization recognized in all Member States, with adequate legal instruments capable of facilitating the development of their cross-border activities. The SCE can operate throughout the internal market with a single legal identity and expand its cross-border operations without the costly setting up of a network of subsidiaries.

The purpose of the formation of a SCE is to create a specific legal form for supranational and cross-border interaction between cooperatives as it provides a new possibility for the use of a cooperative as a legal entity in the European arena. In addition to the positive effects on the freedom of establishment and the internal market, there will also be new opportunities for cross-border cooperation for the multi-national companies. The creation of the SCE shows the growing demand for a common legal form for international forms of cooperation between cooperatives. The SCE facilitates the further cooperation between enterprises within the Community.[42]

The SCE can be incorporated by both natural persons and corporations that operate under the legislation of different Member States. It can be created by a cross-border merger between cooperatives in at least two Member States; furthermore, a national cooperative operating in a different Member State can also be converted into a

[40] Andenas and Wooldridge, p.414-415.
[41] Bartosz Makowicz and Faisal Saifee, "Societas Privata Europaea: The European Private Company", **Comp. Law.**, Vol.30, No.8, 2009, p.227.
[42] De Voort Hermes De Bont, "The Netherlands: The European Cooperative Society: A Mix of a Cooperative and a Public Limited Company", 2006, http://www.ealg.com/doc/EALG%20BRIEFING%20NETHERLANDS%20THE%20EUROPEAN%20COOPERATIVE%20SOCIETY..pdf, (last accessed on 19.03.2011).

European cooperative with an establishment or a subsidiary, without having to be wound up. Moreover, many special provisions have been adopted by the 2003/72/EC Directive[43] to promote the objectives of the community about the employee involvement in the SCE.[44]

1.2.3 EU Company Law Directives

After analyzing some specific company law regulations, it shall be emphasized that, in general procedures, the Commission prefers to issue regulations for their direct applicability. However, when company law harmonization is in question, directives are often used because of their easy adaptation to national systems of Member States.[45] While preparing an implementing legislation, if their national law is not consistent with the directive in question, Member States may use their discretion according to the needs of their legal systems.[46] This is basically the main reason for the issue of directives, in harmonization of company laws, among Member States. The common usage of directives also supports the view that, the harmonization does not mean a strict unification of European company laws[47] when directives are chosen as the primary instrument. This situation leads to criticisms; since, the methods, which are used in implementing the directives into national laws, can cause controversy. As a result, the unwillingness for uniformity can cause the creation of a "Delaware-like situation",[48] in which Member States can compete with each other by making softer rules to attract business.[49]

The EU Institutions have created variety forms of directives some of which are precise and detailed, whereas some others are flexible. They are generally examined in four categories.

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[43] Makowicz and Saifee, p.227.
[44] Europa- Summaries of EU Legislation: Statute for a European Cooperative Society, http://europa.eu/legislation_summaries/internal_market/businesses/company_law/l26018_en.htm, (last accessed on 20.02.2010).
[45] Charlotte Villiers, **European Company Law- Towards Democracy?**, Aldershot: Dartmouth/Ashgate, 1998, p.21.
[46] Art. 288 TFEU (ex. Art. 249 EC) suggests that, *"a Directive shall be binding (…) upon each Member State to which it is addressed, but shall leave to the national authorities the choice of form and methods"*.
[47] Villiers, p. 17, footnote 7.
[48] The concept of Delaware syndrome will be discussed later under the 'Incorporation Theory' heading of this study.
[49] Villiers, p.17.

1.2.3.1 First Generation Directives

First generation directives are considered to be under the influence of the modern nature of German company law.[50] These directives are considered to be prescriptive, leaving less discretion to Member States and supporting more uniformity.[51] Namely, the first generation directives are; the *First Council Directive*,[52] which was about the disclosure and publicity requirements of companies, the pre-incorporation and validity of obligations and the nullity of companies; the *Second Council Directive*,[53] which provides for minimum requirements of the formation of public limited liability companies and the maintenance, increase and reduction of share capital.

1.2.3.2 Second Generation Directives

Second generation directives are considered to have a more flexible approach than the first generation directives. Member States can use their own path as long as they do not cross the boundaries which are defined by these directives.[54] Another feature of the second generation directives is the lessened influence of German law. Instead, French law is used as a model, especially in the splitting up provisions of the *Third Council Directive*[55] and the *Sixth Council Directive*,[56] which are both concerned with the mergers and divisions of public limited liability companies.[57] the *Fourth Council Directive*[58] and the *Seventh Council Directive*,[59] respectively, concerns with the accounts of public and private limited liability companies and the consolidated accounts of such companies, are influenced by Anglo-Dutch as well as French and German principles.[60] Additionally, another second generation directive is the *Eight Council*

[50] Hopt, p.31.
[51] Villiers, p.30.
[52] (2009/101/EC), OJ L 258, 1.10.2009, p. 11–19, before 21 October 2009, First Council Directive of 9 March 1968, (63/151/EEC), OJ L 65, 14.3.1968, 8-12.
[53] (77/91/EEC), OJ L 26, 31.1.1977, 1-13.
[54] Villiers, p.36.
[55] (78/855/EEC), OJ L 295, 20.10.1978, 36-43.
[56] (82/891/EEC), OJ L 348, 31.12.1982, 47-54.
[57] Hopt. p.31.
[58] (78/660/EEC), OJ L 222, 14.8.1978, 11-31.
[59] (83/349/EEC), OJ L 193, 18.7.1983, 1-17.
[60] Mads Andenas, "EU Company Law and the Company Laws of Europe", **ICCLJ**, Vol.6, Issue 2, 2008, p. 24.

Directive,[61] which supplements the Fourth and Seventh directives and deals with the approval of the auditors of the annual and consolidated accounts of companies.

1.2.3.3 Third Generation Directives

The main feature of the third generation directives is that they are short and not detailed; therefore, they offer more discretion to Member States.[62] Namely, the third generation directives are the *Eleventh Council Directive*,[63] which governs the disclosure requirements in respect of branches opened in a Member State by specific types of companies governed by the law of another state; the *Twelfth Directive* on single-member private limited liability companies, which will be the main subject of this study.

1.2.3.4 Fourth Generation Directives

The fourth generation directives are considered to be framework directives and based on the expression of general principles rather than detailed prescription.[64] Moreover, they are under the influence of EU principles of subsidiarity and proportionality.[65] The *Thirteenth Directive*[66] on the coordination of company law concerning take-over bids was adopted on April 21, 2004 after many amendment procedures.[67] The *Tenth Directive*[68] on cross-border mergers of public limited liability companies, which supplements the Third Council Directive, was accepted. Additionally, a preliminary draft for a *Fourteenth Directive*[69] on the cross-border transfer of the registered office of limited companies awaits adoption, in order to facilitate the freedom

[61] (84/253/EEC), OJ L 126, 12.5.1984, 20-26.
[62] Villiers, p. 46.
[63] (89/666/EEC), OJ L 395, 30.12.1989, 36-39.
[64] Simon Deakin , "Reflexive Governance and European Company Law", 2007, CLPE Research Paper No. 20/2007, Vol.3 No.5, http://ssrn.com/abstractid=1002678, (last accessed on 10.02.2010), p.6.
[65] Villiers, p.48-49.
[66] OJ L 142, 30.04.2004
[67] *See*, Hopt, p.31.
[68] Directive 2005/56/EC of the European Parliament and of the Council of 26 October 2005 on cross-border mergers of limited companies, OJ L 310, 25.11.2005, 1. The original proposal was Tenth Council Directive concerning cross-border mergers of public limited companies (COM (84) 727 final), OJ C 23, 25.1.1985, 11-15.
[69] An outline of the planned proposal for a Fourteenth Company Law Directive can be found in http://ec.europa.eu/internal_market/company/seat-transfer/2004-consult_en.htm, (last accessed on 10.9.2010).

of establishment and another draft has been made for a directive on the liquidation of companies that has not been further developed by the Commission.[70]

There are many more company law directives which have been failed in adoption, such as the Proposed *Fifth Directive*[71] concerning the structure of public limited liability companies and the powers and obligations of their organs. Although it is one of the first proposals in European company law, it has not been adopted, as there has not been a full consensus on the provisions of the directive yet. Likewise, the preliminary drafts for a *Ninth Directive*[72] on groups of companies had also been discussed in the past but remained unaccepted.[73]

1.3 THE RELATIONSHIP BETWEEN COMPANY LAW HARMONIZATION AND FREEDOM OF ESTABLISHMENT OF COMPANIES

It is necessary to remind that EU company legislation has to be interpreted so that it is consistent with the TFEU on the right of establishment and to provide services and the free movement of capital.[74] The right of establishment is considered to be the core element of the EU company law as various directives are enacted under the Art. 50(2) TFEU (ex. Art. 44 (2) EC), which facilitates the harmonization of European company laws. Furthermore, the harmonization of European company laws has been given acceleration by the case-law of the ECJ and it is followed by the requirement of transposition in national company legislations. Eventually, new EU legislation gives effect to the freedom of establishment of companies, which results in regulatory competition.[75] Although there is no question of the total harmonization of company laws of Member States, national laws give attention the jurisprudence of the ECJ on the

[70] Andenas, EU Company Law, p.29.
[71] (COM (91) 372 final), OJ C 321, 30.11.91, 9.
[72] Proposal for a Ninth Directive Based on Art. 54, 3 (g) of the EEC Treaty on Links between Undertakings and, in particular, on Groups of Companies (EEC Doc. III- 1639/84-E).
[73] Andenas, EU Company Law, p.28-32.
[74] Andenas, EU Company Law, p.8.
[75] As EU law opens up the choice for the country of incorporation for enterprises in Europe, the competition between national company laws increases, Andenas, EU Company Law, p.7.

right of establishment and national provisions which constitute obstacle to freedom of establishment, have been set aside.[76]

In the fallowing section of this study, I will firstly indicate the issue of freedom of establishment of companies and its relation with competing conflict-of-law theories; then discuss how the ECJ deals with the conflict-of-law problems in the absence of Union harmonization measures. Lastly, I will examine the progress of the case-law of the ECJ regarding freedom of establishment of companies and its effects on domestic laws of Member States.

1.4 THE CONCEPT OF FREEDOM OF ESTABLISHMENT

1.4.1 General

The freedom of establishment[77] takes a crucial part in the economic contribution to the achievement of the internal market;[78] as, this right facilitates the efficient operation of commercial and financial entities throughout the Union.[79] We can explain the right of establishment as the right of an individual to go to another country and carry on an economic activity or to set up a business there. This right covers the setting up of agencies, branches or subsidiaries by nationals of a Member State established in the territory of any Member State and also it extends to companies constituted in accordance with the law of a Member State and having their registered office, central management or main establishment within the Union.[80] The companies, which the right of establishment applies, are defined as companies under civil or

[76] Luca Enriques, "Company Law Harmonization Reconsidered: What Role for the EC?", *ECGI Working Paper Series in Law*, November 2005, No. 53/2005, http://ssrn.com/abstract=850005, (last accessed on 10.02.2010), p.9-10.
[77] *See,* Paul Craig and Gráinne de Búrca, **EU Law: Text, Cases and Materials**, 4th Ed., New York: Oxford University Press, p. 806; P. S. R. F. Mathijsen, **A Guide to EU Law**, 8th Ed., London: Sweet&Maxwell, 2004, p.204-205.
[78] *See*, Gülören Tekinalp, Ünal Tekinalp, **Avrupa Birliği Hukuku**, Güncelleştirilmiş 2. Baskı, İstanbul: Beta Yayınları, 2000, p.343-348.
[79] Bermann/Goebel/William/Davey/Fox, p.542.
[80] Art. 43 and 48(1) EC (now. Arts. 49 and 54(1) TFEU); It is crucial to emphasize that the freedom of establishment demonstrates itself in two ways, namely, the right to carry out the principle business activities through a head office or main establishment in another Member State (Arts 43(1) 1 and 48 EC), which is considered as primary establishment; and the right of a company to set-up agencies, branches or subsidiaries (Arts 43(1) 2 and 48 EC), which is referred as secondary establishment, *see*, Werner F. Ebke, "Centros- Some Realities and Some Mysteries", **AJCL**, Vol.48, No.4, 2000, p.631; Some of the decisions of the ECJ concerns with primary establishment, such as *Daily Mail* and *Überseering* and some others concerns with secondary establishment, such as *Centros* and *Inspire Art*, *see*, Hans C. Hirt, "Freedom of establishment, International Company Law and the Comparison of European Company Law Systems after the ECJ Decision in *Inspire Art Ltd*", **EBLR**, Vol.15, No.5, 2004, p.1194, 1200.

commercial law including co-operative companies and other legal persons under public or private law with the exception of non-profit making companies.[81] It is clear that the purpose of the EC Treaty is to remove all discrimination between any of the nationals or the Member States in this respect;[82] but, in some cases there is an exception relating to the special treatment of foreign nationals on the ground of public order, public safety and public health but such provisions are to be co-ordinated within the Union.[83]

1.4.2 The Recognition and Freedom of Establishment of Single-Member Companies

1.4.2.1 The Concept of Recognition

Companies are creatures of law; thus, recognizing a foreign company means, giving effect to the legal rules of its place of incorporation. EU law preserves a duty to recognize a company that has been lawfully incorporated according to the law of another Member State;[84] however, it is for the ECJ to decide which rules must be recognized when a company moves within the Union.[85]

In this regard, it must be mentioned that Arts 43 and 48 EC was interpreted in connection with the provisions set forth in Art. 293 EC. When a company, organized in one Member State, wished to do business in another Member State, it first must be recognized there as a legal person, because the freedom of establishment of companies could not have been achieved without the assurance of recognition of such companies. Although the obligation for such recognition seemed to be implicit in the EC Treaty, the Member States undertook, explicitly in Art. 293 EC, to negotiate on securing 'mutual recognition of companies within the meaning of Art. 48 EC'. In other words, in case of a seat transfer of a company within the Union, the Member States should enter into negotiations for a uniform recognition of the legal personality of their companies.

[81] Art. 48(2) EC (now Art. 54(2) TFEU).
[82] Alan Campbell and Dennis Thompson, **Common Market Law**, London: Stevens&Sons, 1962, p.224.
[83] Art. 46 EC (now. Art. 52 TFEU).
[84] Jan Wouters, "Private International Law and Companies' Freedom of Establishment", **EBOR**, 2, 2001, p. 127
[85] Eva Micheler, "Recognition of Companies Incorporated in other EU Member States", **ICLQ**, Vol.52, 2003, p.526.

Unfortunately, the only attempt under Art. 293 EC was the 1968 Convention on the Mutual Recognition of Companies and Legal Persons ("1968 Treaty"), which was signed by the original six Member States, Belgium, Germany, France, Italy, Luxembourg and the Netherlands. Although the provisions of the 1968 Treaty had never entered into force, due to the lack of ratification by the Netherlands,[86] in Member States, which had ratified the 1968 Treaty, national case-law had given effect to some its rules in their domestic legal orders.

As an instance, Art. 9 of the 1968 Treaty provided that, if a single-member company lawfully existed in its state of origin, it could not be denied recognition in the other Member States on the ground of public order.[87] This provision had an impact on a judgment of the *Belgian Cour de Cassation*,[88] where a foreign single-member company was permitted to appear before the court, although the existence of a single-member company was against Belgian public order. In fact, until a change of the law in 1978, Belgian law, like many other states, accepted the concept of company as a "contract" and refused to recognize the validity of a single-member company.[89] However, the *Cour de Cassation*, concluded that, with the ratification of the 1968 Treaty, Belgian legislator admitted its positive attitude towards single-member companies.[90]

1.4.2.2 Freedom of Establishment of Single-Member Companies

With the establishment of the Twelfth Directive, the discussions on the validity of single-member companies have been disappeared today and all Member States allow a company to be initially formed by a single founder or acknowledge the existence of a company even if, after its formation, all of its shares are consolidated by a single

[86] 1968 Treaty has been considered as adhering to the real seat theory and at that time at that time the Netherlands has changed its legislation from the real seat theory to incorporation theory, Wouters, p.104-105; *see* also, Sibel Özel, "Avrupa Adalet Divanı'nın Inspire Art Kararı Üzerine Bir İnceleme", **Prof. Dr. Tuğrul Ansay'a Armağan**, Ankara: Turhan Kitabevi, 2006, p. 470.
[87] Eric Stein, "Conflict-of-Laws Rules by Treaty: Recognition of Companies in a Regional Market", *Michigan Law Review*, 1970, Vol.68, No.7, Heinonline Database, (last accessed on 17.12.2010), p.1349.
[88] *See*, Cour de Cassation, Anstalt Del Sol Case, 13 January 1978, *Arresten van het Hof van Cassatie* (1978) 568.
[89] Wymeersch, Company Law in Europe, p.4.
[90] It could be observed that an outdated rule was trying to be replaced by the Belgian case-law; since, in an old ruling of the Brussels Commercial Court, a German single-member private limited liability company was not recognized on the basis of private international law public order, *Tribunal de commerce* Brussels, 4 February 41938, *Journal des tribunaux* (1939) 173, *see*, Wouters, p. 124.

member. Unlike an EEIG or a SE, this new structure is designed to operate under the laws of Member States and not through the norms of substantive EU law.[91]

In this sense, we can draw a conclusion that a single-member company will be exercising its freedom of establishment in the same way as any limited liability company incorporated in any EU Member State does. Meaning that, a single-member company can either exercise the right of primary establishment, by transferring its decision-making centre, its headquarters or real seat from one member state to another, or; such a company can exercise its right of secondary establishment, by setting up of an agency, branch and subsidiary in the host member state. In order to benefit from secondary establishment one additional requirement is that; such a company must have been already established in the territory of one of the Member States.

In addition to these, a single-member company will be experiencing the same problems that a multi-member company may experience, while exercising its right of establishment.

Persons wishing to do business in the most favorable company law regime, through the SMEs or a single-member company, have increasingly made use of a company incorporated in the most exotic of jurisdictions solely with the purpose of circumventing their original county's less attractive company formation rules.[92] With regard to secondary establishment, the TFEU does not provide any definition for the term "established". Thus, in determining what is meant by "being established within the Union", it is suggested that, a company can be regarded as "established" if it pursues a genuine economic activity in any Member State.[93] As it is just mentioned, sometimes the only link a company has with its state of incorporation can be the presence of its registered office in that country. However, the ECJ has concluded that, the construction of a company in the state with the most favorable company law regime, for the sole purpose of circumventing the rules of the latter state, cannot itself constitute abuse of the right of establishment; even if, the company carries no business in the state of

[91] Takis Tridimas, "European Community Law - Movement of Capital and the Law Relating to Companies and Trade in Securities", *ICLQ*, 1990, Westlaw Database, (last accessed on 20.09.2010), p.694.
[92] Anne Looijestijn-Clearie, "Have the Dikes Collapsed? Inspire Art a Further Breakthrough in the Freedom of Establishment of Companies?", **EBOR**, 5, 2004, p.396.
[93] Looijestijn-Clearie, p.406.

incorporation but conduct its activities by a branch exclusively in the country with less favorable incorporation requirements.[94]

Consequently, it shall be bear in mind that, as the conflict-of-law rules vary from one state to another, as long as recognition is governed by different national rules, freedom of establishment cannot be successfully guaranteed; moreover, the need for recognition may arise. Therefore, according to some scholars, uniform conflict-of-law rules on this issue are necessary.[95] Since the coordination in the Union have developed, the national company laws resembles more and the need for uniform conflict-of-law rules is reduced, but it has not been eliminated, as the company laws continue to differ in many ways.[96] These laws are still a part of the Member State's national systems and this means that, it is still necessary to find the suitable conflict-of-laws rules in order to determine whether a foreign company shall be recognized as a legal person or which law shall govern a company's relationships.[97] In the fallowing section, I will be indicating the two most important private international law theories, which are used in the determination of the governing law of European companies.

1.5 CONFLICT-OF-LAW RULES IN EUROPEAN COMPANY LAWS

In the absence of Union harmonization measures, private international law deals with the question of which legal system applies a company incorporated in one country that has some foreign contact which gives rise to a conflict-of-laws;[98] and the governing law of a company is generally referred as *lex societatis*. Therefore, whether a foreign company will be recognized or denied recognition has been determined in each Member State by its own conflict-of-laws rules and these rules differ between Member States, culminating in two largely irreconcilable theories[99]: the incorporation theory[100] and the real seat theory.[101]

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[94] *See* generally *Inspire Art* and *Centros* cases, which will be dealt with in the following part of this Chapter when examining certain ECJ judgements within the framework of freedom of establishment.
[95] Heinrich Günther and Peter Georg Beitzke, "Anerkennung und Sitzverlegung von Gesellschaften und juristischen Personen im EWG-Bereich", 1964-65 ZHR 1, at 91 (cited from Stein, Harmonization, p.397-398).
[96] Beitzke, at 10 (cited from Stein, Harmonization, p.397-398).
[97] Sibel Özel, "Avrupa Birliği'nde Şirketlerin Yerleşim Serbestisinin Lex Societatis ile olan İlişkisi", **Prof. Dr. Erdoğan Teziç'e Armağan**, Galatasaray Üniversitesi Yayınları, Armağan Serisi No. 5, 2007, p.905-907.
[98] Hirt, p.1194.
[99] Ergin Nomer, **Devletler Hususi Hukuku**, 14. Baskı, İstanbul: Beta Yayınları, 2006, p.223.

1.5.1 The Incorporation Theory

Pursuant to the incorporation theory, which has been applied by the UK, Ireland, the Netherlands, Italy and Denmark[102] a company's governing law is determined by its place of incorporation. Since the theory accepts that, as in the instance of natural persons, a company's nationality and residence may be severed,[103] the centers of management and control can be maintained without considering the re-incorporation of the company. As a result, the legal status of the company can be determined regardless of the state in which its activity is effectively carried on.[104] According to this theory, since the company is a creature of the system under which it is incorporated, it is not possible to change the law governing the company; unless, it is dissolved and a new corporation is formed in another Member State. Under this system, the transfer of the seat of the company has no legal meaning because the company retains its legal status and remains subject to the jurisdiction of the state in which it is incorporated or in which it has its registered office.[105] The incorporation theory is considered as being the promoter of simplicity, predictability and certainty of law[106] and its application leads to the unrestricted recognition of companies, validly formed in another jurisdiction, in the host country. This theory allows the founders of a company to freely choose the legal system which they think appropriate and favors the company's mobility.[107] Besides these, the main criticism in respect of this theory is that it facilitates abuse through the creation of mailbox companies[108] or pseudo-foreign companies[109] in countries where the

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[100] It is referred as "*gründungstheorie*" in German.
[101] It is referred as "*sitztheorie*", in German, and "*siège reel*", in French.
[102] Federico M. Mucciarelli, "Company 'Emigration' and EC Freedom of Establishment: Daily Mail Revisited", **EBOR**, 9, 2008, p.283.
[103] Alexandros Roussos, "Realising the Free Movement of Companies", **EBLR**, Vol. 12, Issues 1/2, 2001, p.8.
[104] Eddy Wymeersch, "The Transfer of the Company's Seat in the European Company Law", March 2003, *ECGI Working Paper Series in Law*, No. 08/2003, http://ssrn.com/abstract=384802, (last accessed on 20.06.2010), p.4; *see* also, Robert R. Drury, "Migrating companies", **ELRev.**, 24(4), 1999, p.357.
[105] Paul L. Davies, **Gower-Davies: Principles of Modern Company Law**, 8th Ed., London: Sweet&Maxwell, 2008, p.142-146.
[106] Enrico Vaccaro, "Transfer of Seat and Freedom of Establishment in European Company Law", **EBLR**, Vol.16, No.6, 2005, p.1349; Stefano Lombardo, "Conflict of Law Rules in Company Law after Überseering: An Economic and Comparative Analysis of the Allocation of Policy Competence in the European Union", **EBOR**, Vol.4, Issue 2, 2003, p.310.
[107] Peter Dyrberg, "Full Free Movement of Companies in the European Community at Last?", **ELRev.**, Vol.28, No 4, 2003, p.529.
[108] Wymeersch, Transfer of the Company's Seat, p. 4.
[109] For a detailed information about pseudo-foreign corporations, *see,* Werner F. Ebke, "The 'Real Seat' Doctrine in the Conflict of Corporate Laws", **International Lawyer**, Vol.36, Fall 2002, p.1029-1031; Elvin R. Latty, "Pseudo-foreign corporations", **YLJ**, Vol.65, 1995, p.137.

incorporation procedure is simple and cheap and the requirements are low.[110] With conflicting interest, in order to attract the companies, the incorporation principle may lead the Member States to a competition in having the most lax company law regimes;[111] such competition is referred to as the "Delaware syndrome" or a "race to the bottom".[112] Moreover, it is also argued that the incorporation principle might harm the interests of employees, creditors and investors who deal with mailbox companies in the country where they have their central administration and run their principle business activities.[113]

1.5.2 The Real Seat Theory

According to the real seat theory, which has been applied by most of the continental Member States, such as Germany, Austria, France, Belgium, Spain, Greece, Portugal and Luxembourg,[114] only the state in which the company has its actual centre of administration has the power to regulate the company's internal affairs; thus, the company shall be subject to the law of the country where it has its real seat[115] (i.e. its centre of administration). In other words, according to real seat theory, the company shall have a genuine link with the state of whose legal system it pursues application. It is suggested that the real seat theory provides a Member State with greater control over foreign companies that have their central administration in its territory by allowing the host Member State to apply its national law to such companies.[116] Real seat theory is regarded as a protection theory. The shareholders' choice of law is curtailed in order to

[110] Such companies have no real connection to their state of incorporation other than the incorporation, Hirt, p.1213.
[111] Dyrberg, p.530.
[112] In the US, the incorporation principle applies between the states; and a company is free to select the state in which it incorporates and, as a corollary, which state law applies to them. This system has made it possible for companies to incorporate in the state which they perceive to have the laxest company regulations. This phenomenon is called the "Delaware syndrome", as the state of Delaware with its favourable company law regime, become the most attractive destination for US companies; *See* also, generally on "race to the bottom", Robert R. Drury, "The Regulation and Recognition of Foreign Corporations: Responses to the 'Delaware Syndrome' ", 1998, *Cambridge Law Journal*, Vol.57, http://exeter.openrepository.com/exeter/bitstream/10036/48873/2/drury.pdf (last accessed on 01.04.2010), p.165-194.
[113] Hirt, p.1195; Vaccaro, p.1349.
[114] Mucciarelli, p.283; For the analysis of company laws of some real seat countries, *see*, Manuel Garcia-Riestra, "The Transfer of Seat of the European Company v. Free Establishment Case-law", **EBLR**, Vol.15, No.6, 2004, p.1309-1311.
[115] There is no common definition for the term "real seat", but it is generally used as referring to the place where the fundamental management decisions of a company are being implemented on a day-to-day basis, Ebke, Real Seat Doctrine, p.1016.
[116] Wymeersch, Transfer of the Company's Seat, p.9.

protect the interests of minority shareholders, employees, creditors and third parties;[117] since, it is considered that certain groups of persons dealing with the company in the country where the company has its central administration, are most affected by its operations.[118] It is also referred by certain scholars that this theory has somewhat protected the EU from experiencing a Delaware-like situation.[119]

On the other hand, some problems are observed in the functioning of the real seat theory. First of all, it is considered to be difficult in a globalized economy to determine exactly where the real seat or central administration of a company is situated[120] and thus, to establish the *lex societatis*. Therefore, it is submitted that it may cause legal uncertainty for interested parties.[121] Secondly, it is argued that the real seat theory may constitutes obstacles to the mobility of companies and it is hardly compatible with the TFEU provisions of the freedom of establishment;[122] since, the transfer of central administration of a company validly incorporated in one Member State to another, will generally require the reincorporation of the company in the jurisdiction of the second state[123]

After analyzing positive and negative aspects of both theories we can conclude that both of two theories contain various different conceptions about companies. Furthermore, the discrepancy between them poses important obstacles to the migration of companies and these obstacles stems more from the real seat theory and less from the incorporation theory.[124] Therefore, it is important to discuss the reflections of these theories over the progress of the jurisprudence of the ECJ.

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[117] Lombardo, p.309.
[118] Roussos, p.8.
[119] Laura Jankolovits, "No Borders. No Boundaries. No Limits: An Analysis of Corporate Law in the European Union After the Centros Decision", **Cardozo Journal of International and Comparative Law**, Vol.11, Spring 2004, p.980.
[120] Lombardo, p.310.
[121] Hirt, p.1196.
[122] Dyrberg, p.530.
[123] Vaccaro, p.1350.
[124] António Frada De Sousa, "Company's Cross-border Transfer of Seat in the EU after *Cartesio*", 2009, Jean Monnet Working Paper 07/09, http://centers.law.nyu.edu/jeanmonnet/papers/09/090701.pdf, (last accessed on 10.05.2010), p.4.

1.6 THE JURISPRUDENCE OF THE ECJ REGARDING FREEDOM OF ESTABLISHMENT OF COMPANIES

Before examining some of the landmark ECJ decisions on the freedom of establishment of companies, it shall be emphasized that the decisions concern mainly about how relevant provisions of the TFEU overlay the international company laws of the Member States. The cases mostly deal with the divergence between the real seat theory and the freedom of establishment which arises because the real seat theory does not accept the possibility that a company is incorporated in one Member State but has its central administration in another Member State. Meaning that, the recognition of a company in another Member State, adhering to the real seat theory, is based on whether the company also has its central administration in the Member State of incorporation.[125]

1.6.1 Daily Mail

The facts of the *Daily Mail* case,[126] are as fallows; a UK Company, Daily Mail and General Trust plc. ("Daily Mail"), attempts to transfer its residence from the London to the Netherlands, in order to avoid a capital gains tax and advance corporation tax in the UK. According to the UK law, the consent of the Treasury is necessary to allow a company to transfer its central management while preserving its legal personality as a UK company.[127] Therefore, Daily Mail applies to the Treasury for transfer permission, as the Treasury refuses its application the Company commences proceedings in the High Court of Justice.[128] Then, the national court stays the proceedings and refers the issue to the European Court of Justice.

Before the ECJ, Daily Mail argues that an approval of the government for a seat transfer constitutes a restriction against the freedom of establishment grants by the EC Treaty and then claims that the EC Treaty confers on the companies the same right of primary establishment in another Member State as is conferred on natural persons. According to Daily Mail, transferring the central management of a company to another

[125] Hirt, p.1196-1197; *see* also, Wulf-Henning Roth, "From Centros to Überseering: Free Movement of Companies, Private International Law, and Community Law", **ICLQ**, Vol.52, No.1, 2003, p.177-208.
[126] Case 81/87 The Queen v. H. M. Treasury and Commissioners of Inland Revenue, ex parte Daily Mail and General Trust plc., [1988] ECR p.5483.
[127] Case 81/87, para.2.
[128] Case 81/87, para.8.

Member State, leads to the establishment of the company in that Member State because the company is locating its centre of decision-making there, which constitutes genuine and effective economic activity. On the other side, the UK argues that the Treaty has not given companies a general right to move their central management and control from one Member State to another and locating the central management and control of a company in a Member State, is not an implication of an effective economic activity on the territory of that Member State. As a result, it cannot be regarded as a proper establishment within the meaning of the EC Treaty.[129]

The ECJ begins its reasoning by recalling that companies are creatures of national laws which exist by virtue of the different national legislations that determine their incorporation and functioning. Some of the Member States require that not only the registered office but also the real head office, the central administration of the company, shall be situated on their territory, and the transfer of that central administration requires the winding-up of the company. Other Member States permits companies to transfer their central administration to a foreign country but that right is subjected to restrictions by certain states.[130]

The Court further discusses the disparities in national laws, regarding the connecting factors and then observes that the EC Treaty places the registered office, central administration and principal place of business on the same footing as the connecting factors. The Court adds that when the transfer of the seat of a company from one Member State to another without loss of legal personality is concerned, this shall be regulated by a convention between the Member States and such convention has not been concluded yet. Therefore, these issues must be dealt with by future legislations.[131] Finally, the Court comes to the conclusion the EC Treaty cannot be interpreted as "*conferring on companies incorporated under the law of a Member State a right to transfer their central management…to another Member State while retaining their status as companies incorporated under the legislation of the first Member State*"[132].

[129] Case 81/87, paras.12-13.
[130] Case 81/87, paras.19-20.
[131] Case 81/87, paras.21, 23.
[132] Case 81/87, para.24.

The *Daily Mail* judgment is often held to suggest that the provisions on freedom of establishment cannot successfully be invoked in order to overrule national rules on primary establishment. Thus, transfer of a company's seat is considered to be outside the remit of the freedom of establishment in relation to both the host Member State and the home Member State.[133] The decision is considered as a setback in the Court's protection of the freedom of establishment as the Court discourages the mobility of companies throughout the Community by excluding right of primary establishment from the meaning of Arts 43 and 48 EC. It also raises barriers for companies wishing to transfer their place of central administration to and from a real seat jurisdiction.[134]

1.6.2 Centros

It must be stressed that the ruling in *Centros*[135] raised the question whether the real seat principle was still applicable and whether the judgment of *Daily Mail* was still valid. It had also been subject to discussions that the *Daily Mail* case concerned a situation of the primary freedom of establishment whereas, in *Centros* only the secondary freedom of establishment was dealt with.[136]

Centros Ltd. was a private limited company which was registered by Danish residents Mr. and Mrs. Bryde in the UK. According to Danish law, Centros was regarded as a foreign limited company; therefore, it was entitled to do business in Denmark through a branch.[137] Without starting any business activity in the UK, Mrs. Bryde attempted to register a branch of Centros in Denmark; her application was turned down by the Danish trade registry office on the ground that, as Centros had not conducted any business in the UK, it was actually seeking to establish not a branch but a principal establishment and was intending to circumvent Danish law.

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[133] Wolf-Georg Ringe, "No Freedom of Emigration for Companies?", 2005, *EBLR*, Vol. 16, No. 3, http://ssrn.com/abstract=1085544, (last accessed on 15.02.2010), p.8-9; Jan Bohrenkämper, "Corporate Mobility across European Borders: Still no Freedom of Emigration for Companies?", **European Law Reporter**, 3, 2009, p.84.
[134] Roussos, p.12.
[135] Case C-212/97, Centros Ltd. v. Erhvervs-og Selskabsstyrelsen, [1999] ECR I-1459, http://eur-lex.europa.eu/, (last accessed on 10.05.2010).
[136] Ringe, No Freedom of Emigration, p.10, 12; Mads Andenas, "Free Movement of Companies", **Law Quarterly Review**, 119 (April), 2003, p.221-226; *see* also, Luca Cerioni, "A Possible Turning Point in the Development of EC Company Law: the Centros Case", **ICCLJ**, Vol.2, 2000, p.189; Eva Micheler, "The Impact of the Centros Case on Europe's Company Laws", **Comp. Law.**, Vol.21, 2000, p.181.
[137] Case C-212/97, para.5.

Fallowing the refusal of the Danish authorities, Centros brought proceedings before the *Østre Landsret* (the High Court of Eastern Denmark). As the *Østre Landsret* upheld the decision of the registry office, the company appealed to the Højesteret (the Supreme Court of Denmark). Throughout the proceedings before the *Højestret*, Centros claimed that it met the legal requirements for registration of branches of foreign companies and therefore had the right to set up a branch in Denmark; since, the EC Treaty granted this freedom of secondary establishment to the companies, which were formed in accordance with the law of a Member State. Then, the company supported its claim by making a reference to the Court's judgment in *Segers.*[138] Before the *Højestret*, the argument of the Danish registry office was that, the purpose of the setting up of a branch in Denmark was to avoid the minimum share capital and the idea behind their refusal was protecting creditors and other contracting parties and also by the need to prevent fraudulent insolvencies.[139] Upon these arguments, the *Højestret* stayed proceedings and addressed the issue to the ECJ as a preliminary ruling.

Before the Court, the Danish Government submitted that the situation should be an internal issue governed by Danish law, not Community law.[140] Then, the Danish Government basically argued that the only purpose of the company formation was to avoid the national provisions of Denmark and the attitude of Centros constituted an abuse of the freedom of establishment. Therefore, the government was entitled to take measures to prevent Centros from avoiding Denmark's national legislation.[141]

First of all, the Court concluded that this issue falls within the scope of Community law.[142] Then, it recognized the argument that the Member States could adopt some measures to prevent the abuse of the right of establishment and made reference to its previous judgments.[143] However, it also stressed that, the fact that a national of a Member State who wished to set up a company chooses to form it in the Member State whose company law rules were least restrictive and to set up branches in

[138] Case 79/85. Segers v. Bestuur van de Bedrijfsvereniging voor Bank- en Verzekeringswezen, Groothandel en Vrjie Beroepen, [1986] ECR p.2375, http://eur-lex.europa.eu/, (last accessed on 10.05.2010).
[139] Case C-212/97, para.12.
[140] Case C-212/97, para.16.
[141] Case C-212/97, para.23.
[142] Case C-212/97, para.20.
[143] Case C-212/97, para.24.

other Member States could not constitute an abuse of the right of establishment.[144] Furthermore, that the refusal of the Danish authorities to register the branch amounted to an infringement of the right of establishment, which could not be justified.[145]

The Court's judgment in *Centros*, not only reflects a broad interpretation of the secondary right of establishment, but also it includes the protection of the primary establishment which is dismissed in Daily Mail.[146] The consequence is that, restriction of entry and recognition to companies established in one of the Member States, which do not meet the connecting factor of the host state, cannot be further applied.[147] It is also referred by many scholars that *Centros* overrules the real seat theory.[148] This shows us the Court's changing view in abolishing the constrains on the free movement of companies, since, with a generous interpretation of the provisions on the right of establishment, *Centros* has given the possibility for citizens from one Member State to chose freely the State where to set up a company with the law of their choice.[149]

1.6.3 Überseering

Überseering[150] is a Dutch limited liability company, *besloten vennootschap met beperkte aansprakelijkheid* ("BV"), validly incorporated in the company registers of Amsterdam and Haarlem.[151] In 1990 the company acquired a piece of land in Düsseldorf and entered into a project-management contract with the Nordic Construction Company Baumanagement GmbH ("NCC") concerning the refurbishing of the buildings on that land. In 1994 all the company's shares were acquired by two German nationals, resident in Germany. After NCC completed the work, Überseering was not satisfied with the results therefore it sought compensation from NCC because of the defective work. As the company failed to obtain compensation, it brought an action

[144] Case C-212/97, para.27.
[145] Case C-212/97, para.30.
[146] For a comparative evaluation of Centros and Daily Mail, *see*, Seth B. Chertok, "Jurisdictional Competition in the European Community", *bepress Legal Series*, 2005, Working Paper 870, http://law.bepress.com/expresso/eps/870, (last accessed on 23.01.2010), p.11-14.
[147] Eddy Wymeersch, "Centros: A landmark decision in European Company Law", October 1999, Ghent University, Financial Law Institute Working Paper 99-15, http://ssrn.com/abstract=190431, (last accessed on 10.02.2010), p.13.
[148] Jankolovits, p.990.
[149] De Sousa, p. 17; for further discussions on this case, *see* also, Ebke, Centros- Some Realities, p.623-660.
[150] Case C-208/00 Überseering BV v. Nordic Construction Company Baumanagement GmbH (NCC), [2002] ECR p.I-9919, http://eur-lex.europa.eu/, (last accessed on 10.05.2010).
[151] Case C-208/00, para.2.

before the *Landgericht* (Regional Court) against NCC, but the *Landgericht* dismissed the action.[152]

According to German case-law, a company incorporated in another state which transfered its real seat to German territory would acquire legal capacity only if it was first dissolved in the state of incorporation and re-incorporated under German law. Relying on this, the *Oberlandesgericht* (Higher Regional Court) upheld the *Landgericht*'s decision to dismiss the action and stated that Überseering had located its actual centre of administration to Germany when its shares had been acquired by two German nationals. As a result, being a company incorporated under Netherlands law, Überseering did not have legal capacity in Germany and therefore, could not bring legal proceedings there.[153]

Then Überseering appealed to the *Bundesgerichtshof*, (the Federal Supreme Court of Germany) against the judgment of the *Oberlandesgericht*.[154] According to the *Bundesgerichtshof*, it was not clear from the case-law of the Court whether the freedom of establishment provisions prevented a company, which transferred its actual centre of administration to another country, to be connected to the location of its actual centre of administration for the purpose of determining its legal capacity.[155] Therefore, the *Bundesgerichtshof* decided to refer the issue to the ECJ as a preliminary ruling.

In the course of the case, NCC, Germany, Spain and Italy based their arguments on Art. 293 EC claiming that it was necessary to enter into a specific convention which ensured the mutual recognition of companies, until such a convention was adopted, the freedom of establishment could not be achieved.[156] They also submitted that their view was endorsed by *Daily Mail* case.[157].

But the ECJ denied this view and ruled that Art. 293 EC did not limit the legislative competence of the Member States. It only provided Member States to negotiate on the discrepancies of their domestic laws, by entering into conventions and

[152] Case C-208/00, paras.6-9.
[153] Case C-208/00, para.9.
[154] Case C-208/00, para.11.
[155] Case C-208/00, para.17.
[156] Case C-208/00, paras.23-28.
[157] *See*, Case 81/87, paras.23-24.

gave them an incentive to act 'so far as is necessary'.[158] Furthermore, the Court differed the ruling in *Centros* from *Daily Mail* on the ground that *Daily Mail* was concerned with the rules of the Member State in which the company was incorporated.[159] The Court stated that Daily Mail should be perceived as a case concerning the compatibility of national regulations with Arts 43 and 48 EC in relation to the transfer of the centre of administration.[160] The Court also noted that the legal capacity and capacity to be a party to legal proceedings must be respected by a Member State when a company, duly incorporated in another Member State, transferred its centre of administration there. As a result, the Court found that Überseering was entitled to exercise its freedom of establishment in Germany and thus, the transfer of its shares to German nationals did not cause the loss of its legal personality. Therefore, the refusal of the German government to recognize the legal capacity of Überseering was incompatible with Articles 43 and 48 EC.[161] In response, the German government claimed that the practice of the German courts was justified by the protection of creditors, minority shareholders and employees and also on fiscal grounds.[162] The ECJ admitted that, in certain circumstances such requirements might justify restrictions; however, denying legal capacity and the capacity to be a party to legal proceedings to a company duly incorporated in another Member State was not an appropriate way to reach the objectives of the German government because it amounted to an outright negation of the freedom of establishment.[163]

In *Überseering*, the Court admitts the possibility of a cross-border transfer of the seat of a company from one Member State to another, only from the side of the host Member State. After this judgment, a host Member State may not forbid anymore such transfer and deny that company's legal existence and capacity to be a party of legal proceedings on the basis of real seat theory.[164] The Court essentially grants every company in the EU, as long as it is existing and validly incorporated in its Member

[158] Case C-208/00, para.54.
[159] Case C-208/00, para.62.
[160] Case C-208/00, paras.65-66.
[161] Case C-208/00, paras.80-82.
[162] Case C-208/00, paras.88-89.
[163] Case C-208/00, paras.92-93.
[164] Looijestijn-Clearie, p.417.

State, the right to be fully recognized and conduct its activity in any other Member State to where it is has been transferring its central administration.[165]

1.6.4 Inspire Art

In *Inspire Art*,[166] like in *Centros,* freedom of secondary establishment was dealt with. In this case, the Member State refused the registration of a branch of a company, which did not conduct any commercial activities in its home state, for the reason that it did not comply with the requirements of its domestic law.[167]

Inspire Art Ltd ("Inspire Art") was formed in 2000 as a limited company in the UK, where it had its registered office. It had only one shareholder, authorized to act alone and in the name of the company, who lived in The Hague. A branch of the company was registered in the commercial register of the Amsterdam Chamber of Commerce without any indication of the fact that it was a formally pseudo-foreign company within the meaning of Art. 1 of the Dutch law on pseudo foreign companies, *Wet op de formeel buitenlandse vennootschappen*, ("WFBVC").[168] The Chamber of Commerce took the view that such indication was mandatory considering the fact that Inspire Art traded exclusively in the Netherlands.

Therefore, it submitted an application to the *Kantongerecht* Amsterdam (the national court) and required a statement to be added to the registration of Inspire Art in the commercial register, indicating that it was a formally foreign company. Inspire Art Ltd objected to this; claiming, firstly, that the company did not meet the conditions stated in Art. 1 of the WFBV and, secondly, even if the *Kantongerecht* decided that those conditions were met, the WFBV was contrary to Arts 43 EC and 48 EC. The *Kantongerecht* held that Inspire Art was a formally foreign company according to Art. 1 of the WFBV then it stayed the proceedings and referred the issue to the ECJ for a preliminary ruling.[169]

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[165] De Sousa, p.18.
[166] Case C-167/01 Kamer van Koophandel en Fabrieken voor Amsterdam v. Inspire Art Ltd., [2003] ECR p.I-1015, http://eur-lex.europa.eu/, (last accessed on 10.05.2010).
[167] *See,* Özel, Inspire Art Kararı, p.459-476.
[168] Case C-167/01, paras.34-35.
[169] Case C-167/01, paras.37-38.

First, the ECJ noted that such registration of Inspire Art as a formally foreign company automatically entailed some consequences under Arts 2 to 5 of the WFBV;[170] therefore, it was crucial to examine all those provisions, along with the freedom of establishment under the EC Treaty as well as the company law directives.[171]

The ECJ responded that Art. 1 of the WFBV[172] was in breach of the Eleventh Company Law Directive, because the Directive prohibited any disclosure rules that went further than the rules contained in it. The ECJ also stated that many provisions of the WFBV fell within the scope of the Eleventh Directive[173] and a number of these requirements concern the implementation, into Dutch law, of the obligations set out in the Directive,[174] but these requirements could not be regarded as constituting an impediment to the freedom of establishment.[175] However, the remaining disclosure requirements[176] were not included in the Eleventh Directive, which contained an exhaustive list of information to be disclosed by a branch; therefore, these requirements could not be justified under EU law.[177]

Then the ECJ proceeded to examine the sets of provisions established in the WFBV for their compatibility with Arts 43 and 48 EC Treaty. The ECJ fallowed its previous judgments in *Segers* and *Centros*. It confirmed that it was immaterial with regard to the application of the freedom of establishment that a company had been formed in one Member State with the only purpose of establishing itself in another Member State where its entire business activity is to be conducted. The fact that Inspire Art Ltd was incorporated in the UK for the sole purpose of circumventing Dutch law did not prevent it from invoking its right of freedom of establishment.[178] The Court clarified that the Netherlands company law rules on minimum capital and directors' liability were applied mandatorily to foreign companies when they carried on their activities exclusively in the Netherlands. Creation of a branch in the Netherlands by

[170] Case C-167/01, para.49.
[171] Case C-167/01, para.51.
[172] This article requires Dutch branches of pseudo-foreign companies to disclose that they are pseudo-foreign companies.
[173] Case C-167/01, para.55.
[174] Case C-167/01, paras.56-57.
[175] Case C-167/01, para.58.
[176] Case C-167/01, para.65.
[177] Case C-167/01, paras.70-72.
[178] Case C-167/01, paras.95-96.

such companies was subject to certain rules and had the effect of restricting the companies' freedom of establishment.[179] Therefore, the provisions of the WFBV relating to minimum capital and to directors' liability constituted restrictions on freedom of establishment.[180]

On the other side, the Dutch government maintained that the provisions of the WFBV were justified both by Art. 46 EC and by public interest then, argued that the purpose of the WFBV was the protection of creditors, effective tax inspections, fairness in business dealings and combating abuse of freedom of establishment.[181] The ECJ stated that none of these arguments fell within the ambit of Art. 46 EC.[182] Moreover, it examined if the relevant provisions of the WFBV satisfied the conditions established by the previous judgments of the ECJ. With regard to the protection of creditors, the Court pointed out that Inspire Art Ltd held itself out as a UK company; thus, its potential creditors were sufficiently informed that this company was subject to some other legislation than Dutch law.[183] Furthermore, about combating improper recourse to the freedom of establishment, the ECJ repeated its observations made in *Centros,* that the fact that a company was formed in one Member State with the sole purpose of benefiting from less restrictive rules, was not enough to prove the existence of abuse or fraudulent conduct which would make the host state deny that company the right of establishment.[184]

As a result, the ECJ concluded that the incompatibility of the minimum capital provisions with the freedom of establishment resulted in the penalties attached to non-compliance with those obligations being incompatible with Community law as well and decided that the provisions of national law relating to minimum capital and the personal joint and several liability of directors constituted a violation of the freedom of establishment and such a provision could not be justified.[185]

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[179] Case C-167/01, paras.100-101.
[180] Case C-167/01, para.104.
[181] Case C-167/01, paras.108-109.
[182] Case C-167/01, para.131.
[183] Case C-167/01, para.135.
[184] Case C-167/01, paras.136-139.
[185] Case C-167/01, paras.141-142.

After *Überseering*, it becomes clear that Member States have to recognize companies incorporated in other Member States however, which rules travel with the company when it moves within the Community still needs to be discussed. Briefly, it is still not clear which company law rules shall be given effect in the host Member State.[186] *Inspire Art* is the first case where the Court explicitly recognizes that the freedom of establishment entails a right of primary establishment.[187]

1.6.5 Sevic Systems

The German company SEVIC Systems AG[188] ("SEVIC") intended to merge with a company, Security Vision Concept SA, established in Luxembourg.[189] When SEVIC applied to have the merger registered, the local court in Germany (*Amtsgericht Neuwied*) rejected the registration of this merger in the national commercial register, on the grounds that the German law on transforming companies (*Umwandlungsgesetz*) allowed only mergers between German companies.[190] On appeal, the competent court (*Landgericht Koblenz*) referred the question whether the provisions of the *Umwandlungsgesetz* was compliant with the right of establishment to the ECJ for a preliminary ruling.[191]

Firstly, the ECJ asserted that merger situations fall under the right of establishment, since this fundamental freedom covered all measures for accession to another Member State and participation of the company in the economic life of that State under the equal conditions with the national companies.[192] Next, the ECJ examined whether there was a restriction on the right of establishment and noted a difference in treatment between German companies and companies from other Member States; the ECJ regarded the limitation of mergers to domestic companies as a restriction. The ECJ, then, examined whether this restriction could be justified by

[186] Micheler, Recognition of Companies, p.529.
[187] Chertok, p.37.
[188] Case C-411/03 SEVIC Systems AG v. Amtsgericht Neuwied, [2005] ECR p.I-10805, http://eur-lex.europa.eu/, (last accessed on 10.05.2010).
[189] Case C-411/03, para.2.
[190] Case C-411/03, para.7.
[191] Case C-411/03, para.10.
[192] Case C-411/03, paras.16, 18.

imperative reasons in the public interest and whether it was proportional.[193] The ECJ maintained that protection of the interests of creditors, minority shareholders and employees and preservation of the effectiveness of fiscal supervision and the fairness of commercial transactions could justify a restriction; however, a general prohibition of cross-border mergers went beyond what was necessary to pursue these objectives.[194] Finally, the ECJ concluded that a general refusal of the cross-border mergers in cases where a merger between two companies that were established in the same Member State, was not compatible with Arts 43 and 48 EC.[195]

The Court's judgment in *SEVIC Systems* shows us that the issue of freedom of establishment is much broader than the mere establishment of a subsidiary, branch, or agency in the host Member State. *SEVIC Systems* is regarded as a demonstration of the concept of freedom of establishment being extended to include merger situations involving a host Member State when that state's national legislation offers such an advantage for host state resident companies performing domestically.[196] In this ruling, the Court concludes that the freedom establishment under the EC Treaty is also applicable to cross-border mergers. Therefore, it is sometimes argued that the outcome of this judgment might cause a negative effect on the attractiveness of the SE.[197]

1.6.6 Cadbury Schweppes

Cadbury Schweppes Plc[198] ("Cadbury") is the parent company of the Cadbury Schweppes group, which includes two subsidiaries in Ireland, namely Cadbury Schweppes Treasury Services ("CSTS") and Cadbury Schweppes Treasury International ("CSTI"). Both are located in the International Financial Services Centre ("IFSC") in Dublin, where the tax rate is 10 per cent. In the view of the Commissioners of Inland Revenue, the UK legislation on controlled foreign companies ("CFC") applies to the two Irish companies; therefore, they claim corporation tax of £8,638,633 on the

[193] Case C-411/03, paras.22-23.
[194] Case C-411/03, paras.24.
[195] Case C-411/03, paras.28-31.
[196] Tom O'Shea, "Cartesio: Moving a Company's Seat Now Easier in the EU", **Tax Notes International**, Vol.53, No.12, March 2009, p.1074.
[197] *See*, Johannes Pieper, "European Cross-Border Mergers after Sevic", **Comp. Law.**, Vol.30, No.6, 2009, p.169-173.
[198] Case C-196/04 Cadbury Schweppes plc and Cadbury Schweppes Overseas Ltd v. Commissioners of Inland Revenue, [2006] ECR p.I-07995, http://eur-lex.europa.eu/, (last accessed on 10.05.2010).

profits made by CSTI in 1996. Then, Cadbury Schweppes appeals before the Special Commissioners of Income Tax, stating that the CFC legislation is contrary to Community law, and the Special Commissioners refers the issue to the European Court of Justice.

The Court stated that the fact that Cadbury was entitled to rely on freedom of establishment to benefit from lower taxes did not itself constitute abuse of the freedom of establishment and further, considered whether the CFC legislation was compatible with the Treaty.[199] The Court noted that the CFC legislation involved a difference in the treatment of resident companies on the basis of the level of taxation imposed on the company and this difference created a tax disadvantage for the resident company to which the CFC legislation was applicable.[200] The ECJ then held that the CFC legislation constituted a restriction on freedom of establishment and also added that a national measure restricting freedom of establishment may only be allowed in circumstances where it related specifically to wholly artificial arrangements aimed at escaping national tax.[201] The ECJ reviewed if the restrictions arising from the CFC legislation may be justified and noted that the CFC legislation was capable of preventing such wholly artificial arrangements; therefore, such legislation was suitable to achieve the objective for which it was adopted.[202]

The ECJ noted that the incorporation of the CFC and the conclusion of transactions were prompted by a desire to claim a tax reduction would not necessarily mean that a wholly artificial arrangement existed. For there to be a wholly artificial arrangement intended to avoid tax, there must be circumstances showing that the objective pursued by freedom of establishment had not been achieved. For the CFC legislation to comply with Community law there should be an exclusion, where the incorporation of a CFC reflects "economic reality". Also, that incorporation must correspond with a genuine establishment that pursues economic activity.[203] The ECJ emphasized that the creation of a fictitious, "letter box" or "front" company would have

[199] Case C-196/04, paras.35-39.
[200] Case C-196/04, paras.43, 45.
[201] Case C-196/04, para.51.
[202] Case C-196/04, paras.57-60.
[203] Case C-196/04, paras.63-66.

the characteristics of a wholly artificial arrangement and the fact that the economic activity could be carried out by the resident company was not enough to reach to the conclusion that the arrangement was a wholly artificial one.[204]

As *De Sousa*[205] also observes, it can be stated that in *Cadbury Schweppes*, the ECJ moves away from its *Centros* and *Inspire Art* decisions and without damaging the provisions on the right of establishment, allows Member States to apply measures against merely artificial arrangements which do not have any other 'autonomous rational explanation' than circumvention of that Member State's mandatory provisions.

1.6.7 Cartesio

The *Cartesio*[206] ruling had the chance to eliminate the differences in the treatment of outbound and inbound establishment. Although it narrowed the scope of real seat theory, it did not give freedom to emigrating companies.[207]

Cartesio is a *'betéti társaság'* (limited partnership) constituted in accordance with Hungarian law and registered in Hungary.[208] On 11 November 2005, it submitted an application to its local commercial court (*Bács-Kiskun Megyei Bíróság*) to amend its registration in the local commercial register so as to record an address in Italy as its commercial headquarters, while remaining registered in Hungary. The commercial court, however, rejected Cartesio's application. It held that Hungarian law did not offer companies the possibility of transferring their operational headquarters to outside Hungary while retaining their legal status as a company governed by Hungarian law. Therefore, in order to change its operational headquarters, Cartesio would first have to be dissolved in Hungary and then reconstituted in Italy. Cartesio brought an appeal against the decision of the commercial court before the *Szegedi Ítélőtábla* (Regional

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[204] Case C-196/04, paras.68-69.
[205] De Sousa, p. 27.
[206] Case C-210/06 Cartesio Oktató és Szolgáltató bt, [2008] ECR p.I-.9641.
[207] Petra Vargova, "The Cross-Border Transfer of a Company's Registered Office within the European Union", (**LL.M. Short Thesis**, Central European University, March 29, 2010), http://www.etd.ceu.hu/2010/vargova_petra.pdf, (last accessed on 15.07.2010), p.20; *see* also, Justin Borg-Barthet, "European Private International Law of Companies After Cartesio", **ICLQ**, Vol.58, Issue 4, 2009, p.1024-1027.
[208] C-210/06, para.21.

Court of Appeal at Szeged) and the Hungarian Court of Appeal referred the issue to the ECJ.[209]

The Court begins by reminding its reasoning in *Daily Mail* and reaffirms that companies are creatures of national law and exist by virtue of the national legislation which determines its incorporation and functioning. Moreover, Art. 48 EC takes into account that national laws vary widely as to the connecting factor required for incorporation and modification of that factor. Then, the Court recalls *Überseering* and states that a Member State has the ability to restrict a company's right to reserve its legal personality under its law when its centre of administration is transferred to a foreign country.[210]

The Court points out that the question of the connecting factor and its change is regarded as unsolved by the provisions on freedom of establishment and in the absence of a uniform Community law definition of companies it is for the applicable national law to solve this problem. Thus, a Member State has the power to define the connecting factor required of a company that wishes to be incorporated under its law; in this respect freedom of establishment does not apply. Besides this, a Member State has also the power to prevent a company from remaining incorporated under its national law if the company wants to move its seat to another Member State and break the connecting factor of the law of incorporation.[211]

The Court distinguishes the situation in which a company moving its seat to another Member State whilst remaining incorporated under the law of the Member State of origin, from the situation where a company moves to another Member State in order to convert into a company formed under the law of that Member State. In that case, a barrier to the conversion of such a company, without prior winding-up, into a company governed by the law of the Member State of incorporation entails to a restriction on the freedom of establishment and such a barrier will not be allowed, unless it can be justified by overriding requirements in the public interest.[212] For these reasons, the

[209] C-210/06, paras.23-25.
[210] C-210/06, paras.104-107.
[211] C-210/06, paras.108-110.
[212] C-210/06, paras.111-113.

Court finds that Arts 43 and 48 EC does not rule out legislation of a Member State which prohibits the transfer of the seat of a company incorporated under the law of that Member State to another Member State, while continuing to be a company governed by the law of the Member State of incorporation.[213]

Although *Centros* was followed in subsequent cases, *Daily Mail* was never pronounced dead by the ECJ[214] and the *Cartesio* case gave the Court the opportunity to revisit its *Daily Mail* judgment. It was observed in the *Centros, Überseering and Inspire Art* judgments that the Court did not give attention for the compatibility of Member State's private international law systems adopting the real seat theory; thus, it has required that Member States should abandon this theory.[215] Paradoxically in *Cartesio,* the Court has avoided burying the real seat theory and replacing it by the incorporation theory, on the contrary it seems to be trying to save what remains of the real seat doctrine.[216] *Cartesio* further indicates that real seat Member States must allow the seat transfer abroad with a change on the governing law, without being liquidated, through cross-border conversion. If Member States do not give this possibility they will be infringing the EC Treaty provisions on the right of establishment.[217]

1.7 RELATIONSHIP BETWEEN *LEX SOCIETATIS* AND PROVISIONS OF THE TFEU ON THE FREEDOM OF ESTABLISHMENT

1.7.1 The Question of the Conflict-of-Laws Dimension of the TFEU

For many years it had been subject to discussions whether a choice as regards conflict-of-laws should be derived in favor of one or other of the theories of

[213] C-210/06, para.124; It is noteworthy to recall the Advocate General *Poiares Maduro*'s opinion of 22 May 2008, in which; he states that national laws which allows the transfer of headquarters within a Member State's territory but not across borders, constitutes discrimination. He takes a different approach than the ECJ and points out that the Court's case-law on the right of establishment has became more flexible since *Daily Mail* and the attempts to distinguish *Daily Mail* from cases such as; *Centros*, *Überseering* and *Inspire Art*, are unconvincing. Additionally, he emphasizes that Member States might set certain conditions when before a company incorporated under its law transfer its headquarters abroad. However, Hungarian law did not require any conditions for the transfer but wanted the company to be dissolved but gave no grounds of justification and therefore he found that it was incompatible with the EC Treaty, Frank Wooldridge, "The Advocate General's Submissions in Cartesio: Further Doubts on the Daily Mail Case", **Comp. Law.**, Vol.30, No.5, 2009, p.145-146.

[214] Christiana HJI Panayi, "Corporate Mobility in Private International Law and European Community Law: Debunking Some Myths", Queen Mary School of Law, Legal Studies Research Paper No. 26/2009, http://ssrn.com/abstract=1437555, (last accessed on 20.07.2010), p.44.

[215] Robert R. Drury,"The "Delaware Syndrome": European Fears and Reactions", **JBL**, November 2005, p.716.

[216] De Sousa, p.52.

[217] De Sousa, p.52.

international company law.[218] Before the *Daily Mail* judgment, a number of scholars discussed that the provisions on freedom of establishment included a hidden conflict-of-laws norm that undermined the application of the real seat theory and confirmed the incorporation theory.[219] It had been more controversy with the *Daily Mail* judgment; but, the dominant opinion was that, Art. 54 TFEU (ex. Art 48 EC) did not contain a conflict-of-laws aspect and Member States were free to adopt the preferred rule.[220] *Wouters,* who was one of the defenders of this opinion suggested that although the reasoning of *Daily Mail* deserved many criticisms, the ECJ did the right thing by not making a choice between the two theories because, there were many different applications between the legal systems of the Member States in this field. He further explained that Art. 54 TFEU only required that a company be formed consistent with the law of a Member State and that its registered office, central administration or principal place of business were located within the Community; it does not necessitate the registered office to be placed in the Member State where the company was set up.[221] In its decisions in *Centros* and *Überseering*, the ECJ limited the effect of real seat theory as a conflict-of-law case-law rule that limits the recognition and the freedom of establishment of lawfully incorporated foreign companies. In doing so, the Court not only directly addressed the issue of freedom of establishment in accordance with Arts 49 and 54 TFEU, but also indirectly addressed the recognition of foreign companies.[222] Until the *Centros* case was decided, states were free to retain the real seat principle. This was a vital protection against the "race to converge", which the US had experienced as states clustered around the essential features of the Delaware model.[223]

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[218] Stein, Conflict-of-Laws Rules, p.1327.
[219] For the scholars arguing the incompatibility of real seat theory with Arts 43-48 EC, *see*, Wouters, p.115-116.
[220] It is regarded as a narrow approach to accept that Art. 54 TFEU provides for a hidden norm, which refers to the place of incorporation, Mucciarelli, p.294; for other supporting views, *see*, Lombardo, p. 310-312.
[221] *Roth* accepts that European law has an influence on the operation of the rules of company conflict-of-law rules, Wulf-Henning Roth, "Centros:Viel Lärm um Nichts?". Zeitschrift für Unternehmens- und Gesellschaftsrecht, 2/2000, p.333-334 (cited from Engin Akar, "Freedom of Establishment of Companies in The Light of Private International Law Theories", (**Yayınlanmamış Yüksek Lisans Tezi**, Marmara Üniversitesi Avrupa Topluluğu Enstitüsü, 2006), p.25.
[222] It was also declared by the EU Institutions that the denial of the recognition of a company which had its real seat in another country was a disproportioned measure, *see,* Report of the High Level Group of Company Law Experts on a Modern Regulatory Framework for Company Law in Europe, http://ec.europa.eu/internal_market/company/docs/modern/report_en.pdf, (last accessed on 23.09.2010), p.102-103.
[223] Deakin, p.10.

1.7.2 The Effects of the ECJ's Jurisprudence Over the National Laws of Member States

During the 20th century the real seat has become very dominant in determining the *lex societatis* around the continental Europe, though some Member States adopt merely a mitigated form of the real seat theory by giving a specific importance to the statutory seat.[224] Whereas, some Member States who apply the real seat theory have become aware of the disadvantages of this theory in terms of companies' mobility and permit inbound and outbound cross-border transfer of a company's seat. For instance, the Netherlands used to apply the real seat theory but abandoned it by a law of 25 July 1959.[225] Furthermore, since 1986, Portuguese Law allows companies to transfer their seat, with a change of their *lex societatis,* provided that specific requirements are fulfilled. According to Portuguese Law all kinds of transfers of a company's real seat alone are allowed, without losing its legal personality.[226] Furthermore, Italy, Spain,[227] and France also accept some form of seat transfer yet impose various conditions for such an inbound or outbound cross-border transfer to succeed.[228] Since the ECJ judgments signal the end of the real seat theory, some Member States appear to be more inclined than ever to abandon the real seat theory. The ECJ has clearly established in *Centros* and *Überseering*, it is a precondition of freedom of establishment that companies be recognized by any Member State in which they wish to establish themselves, without having to change into a legal form of that other jurisdiction.[229] Reacting to *Centros* decision, Austrian Supreme Court holds the real seat doctrine cannot be applied anymore because it violates the freedom of establishment guaranteed under the EC Treaty (now TFEU).[230] Belgium has a less strict attitude and seems to be

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[224] De Sousa, p.9.
[225] Drury, Regulation and Recognition, p.11.
[226] De Sousa, p.10.
[227] In principle, both apply the incorporation theory but if a company has its real seat in Italy or Spain, both requires that the company must also be incorporated under Italian or Spanish law respectively, Eva-Maria Kieninger, "The Legal Framework of Regulatory Competition Based on Company Mobility: EU and US Compared", **German Law Journal**, Vol.6, No.4, 2005, p.744.
[228] De Sousa, p.11.
[229] Kilian Baelz and Teresa Baldwin, "The End of the Real Seat Theory (Sitztheorie): the European Court of Justice Decision in Überseering of 5 November 2002 and its Impact on German and European Company Law", 2002, *German Law Journal* 3, http://www.germanlawjournal.com/index.php?pageID=11&artID=214, (last accessed on 15.03.2010), para.23.
[230] OGH, Beschluss v. July 15, 1999, 6 Ob 124/99z & 6 Ob 123/99b, [2001] 1 CMLR 38, *see*, Mathias Siems, "Convergence, Competition, Centros and the Conflicts of Law: European Company Law in the 21st Century", **ELRev.**, Vol. 27, 2002, p.50.

favoring the real seat principle, as far as public limited liability companies are concerned, unless general decree of the Code on Private international law gives preference to an international treaty or Law of the EU.[231]

Consequently, the *Cartesio* judgment could be considered a step back from the Court's integrationist case-law.[232] During the preliminary ruling of Cartesio, Hungary changed its law on Commercial Register. Since then, "*the Commercial Register differentiates between the registered office and real seat, and those don't have been within same place"*.[233] Lastly, recent developments show that even Germany, conceived to have of the strictest real seat regime, would finally abandon the real-seat theory in favor of the incorporation theory in order to increase the attractiveness of private limited liability companies.[234] In November 1, 2008 Germany passed a new reform bill on the German private limited companies[235] to facilitate the competitiveness of its domestic companies. Since then, it is not necessary for German private and public limited liability companies to have their real seat in Germany.[236] Additionally, another fundamental change will be the replacement of the real seat doctrine by the incorporation doctrine. Inspite of these, according to some scholars German courts still seem to be trying to save the seat theory and the German legislator may try to back away from this reform in the face of criticisms.[237]

As a result, we can conclude that the ECJ has never made a clear choice in favor of one of the two competing theories, therefore; a compromise between them may be the best solution in eliminating the contradiction between these two theories.

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[231] Drury, Regulation and Recognition, p.12.
[232] Bohrenkämper, p.90.
[233] Vargova, p. 25.
[234] *See*, Liam Davies, "Recent Reforms of the German GmbH", **Comp. Law.**, Vol.31, No.2, 2010, p.62-63.
[235] The Act to Modernise the Law Governing Private Limited Companies and to Combat Abuses, *Gesetz zur Modernisierung des GmbH-Rechts und zur Bekämpfung von Missbräuchen*, ("MoMiG") states that,*"The fact that EU foreign companies can choose to have their centre of administration seated in another state was previously perceived to be a competitive disadvantage. These foreign companies must be acknowledged as such in Germany. However, the reverse situation was not possible for German companies. As a result of the deletion of section 4a, subsection (2), of the Private Limited Companies Act, German companies will be able to base their centre of administration in a location that is not necessarily the same as that of their registered office. This centre of administration may also be in a foreign country*.", http://www.bmj.bund.de/enid/3afd99bdf35971ad6fee970a3790e2aa,cf1b3a706d635f6964092d0935363133093a0979656172092d0932303038093a096d6f6e7468092d093132093a095f7472636964092d0935363133/Press/Press_Releases_zg.html, (last accessed on 10.07.2010).
[236] Ayhan Kortunay, "Alman Limited Şirketler Hukukundaki Yeni Gelişmeler ve Türk Hukukuna Yönelik Bazı Tespitler, **BATİDER**, Cilt 25, Sayı 3, 2009, p.328.
[237] Bohrenkämper, p.90.

II CHAPTER 2: THE CONCEPT OF SINGLE-MEMBER COMPANY

2.1 HISTORICAL BACKGROUND AND ESTABLISHMENT OF THE SINGLE-MEMBER COMPANY FORM

2.1.1 Comparison of the Single-Member Company Form with the Institutions of Roman Law

The possibility of a legal entity to have only one member is a dramatic departure from traditional concept of a company;[238] since, a company is generally considered as a contract between at least two people. When we look at this contradiction from a wide angle, it is possible to observe that similar practices of single-member companies have been founded in Roman period as well.[239]

Roman *societas*, which has been used as a term corresponding to partnership, is a consensual contract between two or more persons who cooperate to reach a common purpose.[240] Partners contribute all their goods, money or labor to the partnership; they bring single goods or specific activities and they seek a profit, in proportions which can vary from one partner to another.[241] *Societas* does not possess separate assets or independent legal personality other than its partners and the partners have separate private assets. Therefore, when one of its partners leaves the partnership or dies, the partnership will terminate; eventually it will not be possible for the *societas* to continue

[238] In the following parts of this study for the purposes of comparison between several jurisdictions, I will try to use adequate terms such as; "single-member company" equivalent to "sole shareholder corporation". Exact equivalence between mechanisms is not aimed in this study. The word "company" is used as a general word for the business mechanism. Moreover, with regard to the translation of legal terms, some institutions do not have the same categorizations in different jurisdictions. For instance, a French "societe" is not the same as an English "company". As a solution to this lack of equivalence, while examining the national legal systems of several Member States in this study, I will not be treating the words "company" and "societe" as translations of each other. I will once cite the terms of the foreign systems in the original language then, I will use "company" as an equivalent term, for a comparative discussion, for further information on the differences in the usage of such legal terms, *see*, Nicholas H.D. Foster, "Company Law Theory in Comparative Perspective: England and France", **American Journal of Comparative Law.**, Vol. 48, Fall 2000, p.573-621

[239] Volker Ochs, **Die Einpersonengesellschaft in Europa, Nomos Verlagsgesellschaft**, Baden-Baden, 1997, p.36 (cited from Feyzan H. Şehirali Çelik, "Hukukun Ekonomik Gerçekliğe Yanıtı: Tek Kişilik Şirketler", **BATİDER**, Cilt 4, Sayı 1, Haziran 2007, p. 166).

[240] James Hadley, **Introduction to Roman Law: In Twelve Academical Lectures**, New York: D. Appleton and Co. 1902, p.230.

[241] Salvo Randazzo, "The Nature of Partnership in Roman Law", 2005, *Australian Journal of Legal History*, http://www.austlii.edu.au/au/journals/AJLH/2005/5.html, (last accessed on 07.02.2010).

to exist with a separate legal personality.[242] According to these, a *societas* can never be formed with a single-member. Contrary to *societas*, the institution of *universitas*, which is firstly established in Roman public law, does not have such a strict partnership understanding and can be represented with special organs. The *universitas* is considered as the basis of today's corporate legal personality;[243] for the reason that, it can be managed by officers and agents under regulations established by the corporate body itself. When a *universitas* is reduced to a single member, it preserves its legal status as a *universitas* and the sole member thereof possesses all the rights and privileges of it.[244] As a consequence, it can be observed that for the first time in Roman law, the concept of single-member company is *de facto* accepted with this institution.[245] Furthermore, in 1888, when German Imperial Court is faced with a dispute about whether a mining concern can be formed with a single-member and the Court has made a decision adhering to the concept of *universitas* in Roman law.[246] In the view of these facts, today companies are all considered as corporate legal personalities for which the concept of *universitas* constitutes a basis; therefore, although *universitas* is not accepted as a certain resource,[247] it can still be considered as a significant improvement on the concept of single-member company.[248]

Another main characteristic of single-member company is the separation between the partners' personal assets and company's assets which is first observed in Roman law with the practice of *peculium.*[249] According to Roman law, the children and slaves, can own and possess nothing, have no rights and cannot sue anyone in principle. However, sometimes masters of slaves and fathers of children allow them to own and control a kind of property called *peculium* that consists of the savings made by them or presents given to them in reward of their services.[250] If, however, the master/father allows the slave/children free administration of his *peculium*, the slave/children could

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[242] *See*, Reinhard Zimmermann, **The Law of Obligations: Roman Foundations of Civilian Tradition**, New York: Oxford University Press, 1996, p.451-460.
[243] Ochs, p.37 (cited from Çelik, p.166).
[244] The Catholic Encyclopedia, http://www.newadvent.org/cathen/04387a.htm, (last accessed on 10.02.2010).
[245] Ochs, p.37 (cited from Çelik, p.166).
[246] Ochs, p.37 (cited from Çelik, p.167).
[247] Çelik, p.167.
[248] İbrahim Arslan, **Tek Kişilik Anonim ve Limited Şirket**, Konya: Mimoza Yayınları, 2008, p.39.
[249] Ochs, p.37 (cited from Çelik, p.166-167).
[250] William Alexander Hunter, **A Systematic and Historical Exposition of Roman Law in the Order of a Code**, 4th Ed., London: Sweet&Maxwell Ltd., 1903, p.290-291.

transfer any portion of it meaning that the holder of the *peculium* can enter into contracts and conduct other business without the consent of the master/father. Any property or debts acquired became part of the *peculium*, and so they indirectly are acquired by the master/father. When the *peculium* becomes indebted to a third party, this person is able to sue the master/father, although only up to the value of the *peculium*.[251] Thus, by giving the *peculium* to a subordinate, the master/father achieves a limited liability in its regard and this can be regarded as one of the earliest examples of the distinction between the personal and partnership property.[252]

As it can be understand from the above, Romans have used the characteristics of the concept of single-member company in various institutions but they do not relate them with each other. This has situation has remained the same until the establishment of capital companies.

2.1.2 The Concept of Single-Member Company and Its Establishment in Modern Company Law

2.1.2.1 The Concept of Single-Member Company

A single-member company is a limited liability company which has only one shareholder. Such a company can be formed in three ways; firstly a company can genuinely be set up with only one shareholder from the beginning. Secondly, a company can be set up with a real owner and one or more other shareholders being nominal investors,[253] just to meet the statutory requirements on the minimum number of shareholders. Lastly, a company can be set up with more than one shareholder; with the subsequent departure of other shareholders, all shares of the company may be consolidated in the hands of single shareholder.[254]

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[251] Bruce W. Frier and Thomas A. J. McGinn**, Casebook on Roman Family Law**, New York: Oxford University Press, 2003, p.263.
[252] Ochs, p.37 (cited from Çelik, p.167).
[253] These nominal investors which are generally referred as "straw men" or "dummy shareholders", will be discussed later in this study.
[254] Ünal Tekinalp, **Tek Kişili Ortaklık: Tek Pay Sahipli Anonim Ortaklık**, İstanbul: Vedat Kitapçılık, 2011, p.12-15.

The concept of single-member company is regarded not consistent with the classical concept of company. The classical company law theory generally considers a company as a contract in which two or more persons engaged with a certain capital in order to reach a common purpose. Regarding the concept of company, single-member companies have been criticized in two main points. The first point to be criticized is that the single-member company is established with only one member; since plurality is an essential ingredient of the company contract, lack of true membership in the form of at least two genuine members contradicts with the logic of company. The second criticism attributed to the concept of single-member company is about the difficulty of separation between the private assets of the shareholder and the assets of the company.[255]

2.1.2.2 The Development of Single-Member Company Concept in Modern Company Law Theory

In early times, the legal systems in the Latin countries require a company to be organized essentially as a contract. In jurisdictions where the concept of single-member company is recognized, since the notion of single-member company is not compatible with the classical notion of company, there has been a need for reinterpretation of certain components. In German law, the statute of a company not only includes a consensus on the formation of that company but also it is regarded as the basis of that company. Accordingly, the concept of company is not considered merely as a union of persons; it indicates a special kind of organizational structure. In this context, the statute of single-member company is considered as the organizational structure on which the single-member company is based; thus, in that way, the handicap of the absence of a union of persons is dispelled. In case of a company of multiple members, the formation is based on an organizational statute; whilst, in case of single-member companies, the formation is based on an organizational act of will of one person alone.[256]

Throughout the 19th century, given the dominance of the doctrine of freedom of contract and the autonomy of the will, contractual thinking was embraced.[257] The

[255] The positive and negative views regarding single-member company will be discussed in detail in the third Chapter of this study.
[256] Çelik, p.172-174.
[257] Foster, p.598.

idea of company as an institution had become dominated as the liberal capitalist views of the 19th century left its place to state-centered ideas. In the Art. 34 of the French Commercial Companies Law[258] (as amended by Law 85-697 11 July 1985), concerning the companies with limited liability, the term "contract" left its place to the term "institution". Moreover, the first sentence of French Civil Code[259] Art. 1832 states that a company is instituted by two or more persons who bind themselves by a contract to appropriate their property or their work for a common object in order to share a profit. According to the second sentence of the same article, which is amended to provide for single-member companies,[260] a company can be instituted, in the situations provided for by statute, by the act of will of a single person.[261] For some, this article is cited to stress the notion of contract, but protagonists of the institution theory point out that the provision uses the word "instituted"; therefore, one can conclude that the notion of institution is to be found in this provision. [262]

Since a company is accepted as an institution more than a contract, in this way, a single-member company may be established without a contract through an act of will of one person alone. In the traditional concept of company, the formation of a company requires shareholders to have a common interest to reach to a "common purpose" and such activity necessitates more than one shareholder. As the essential prerequisite of plurality is absent, there can be no *affectio societatis*. Therefore, in case of a single-member company, we can talk about an organizational purpose rather than shareholders' common objectives. For instance, in German law, a new definition is brought instead of "common purpose" (gemeinsamer Zweck) which is called "association purpose" (Verbandszweck). Furthermore, it is accepted that there has been

[258] Law number 66-537 of 24 July 1966 on commercial companies.
[259] For the English text *see*, Legifrance, http://195.83.177.9/code/liste.phtml?lang=uk&c=22&r=556, (last accessed on 10.09.2010).
[260] Amended by Law number 85-697 of 11 July 1985.
[261] *"La societe est instituee par deux ou plusieurs personnes qui conviennent par un contrat d'affecter a une entreprise commune des biens ou leur industrie en vue de partager le benefice ou de profiter de l'economie qui pourra en resulted. Elle peut etre instituee, dans les cas prevus par la loi, par l'acte de volonte d'une seule personne."*; *see* generally, Gül Okutan, "Tek Kişi Ortaklığı", **Türk Hukukunun Avrupa Birliği Hukukuna Uyumu - Acquis Communautaire'nin Alınması - Açıklamalar, Derlemeler, Öneriler** (Proje Yöneticisi Prof. Dr. Ünal Tekinalp), İstanbul Üniversitesi Araştırma Fonu, Proje No: GP-17/07.03.2000.
[262] Foster, p.598.

a disparity between "company object" and association purpose and company object is a narrower concept which facilitates the achievement of association purpose.[263]

We can conclude that, regarding the single-member companies, a difficulty arises in the separation of the organization's assets from the private assets of the shareholder. A certain amount of capital shall be brought to the company in order to accomplish the organizational purpose of a single-member company. Therefore, a single-member must have two separate properties in order to have limited liability, but this limitation must not be abused by the sole member for the purpose of exploiting the interests of third parties. As a reflection of this issue, with an amendment of French Civil Code in 1985, French law changed its principle of 'the singular and unified character of the financial status of a natural person' and gave permission to natural persons to have two separate properties; therefore, laid the ground for the formation of single-member companies.[264]

2.2 THE SINGLE-MEMBER COMPANY CONCEPT IN VARIOUS LEGAL ORDERS

As it has been pointed out by *Rotondi*,[265] it is always hard to leave the traditional legal concepts and accept new institutions instead. The author has made a suggestion which received broad acceptance today; as he has prescribed, the idea that 'limited liability exists in a company with plurality of members' is released. Yet, it is now ordinary for a single individual to commit part of his assets separately and in terms of liability exclusively to the exploitation of a specific activity. Consistent with this view, in the fallowing part, I will scrutinize in debt how recognition of single-member company concept has taken place in various legal jurisdictions.

2.2.1 The United States Law

In the US law, one of the requirements of early general corporation acts was that there be a minimum of three directors, each of whom should be a shareholder of the

[263] Çelik, p.175-176.
[264] It shall be emphasized that single-member company with limited liability was first realized in Liechtenstein in its 1926 Code.
[265] Mario Rotondi, "Limited Liability of the Individual Trader: One-Man Company or Commercial Foundation", **Tul. L. Rev.**, 1973-1974, Vol.48, Heinonline Database, (last accessed on 02.11.2010), s. 989.

corporation.[266] Because of the use nominal shareholders, this provision ceased to have importance; however, like many traditional statutory provisions, it demonstrates the notion of some plurality of founders.[267]

A few US courts have argued that a corporation shall not be recognized as a separate entity when all its shares have been transferred to a single shareholder. It has been decided in one of the cases of the Supreme Court of Maryland, that when one person owns all the shares of a corporation, he becomes the owner of the corporate property, may sell and dispose of it and in short, becomes the corporation.[268] Moreover, in 1956, it is held in one of the decisions of North Carolina Supreme Court[269] that, when the number of shareholders of the corporation falls below three, the corporation will cease to exist and the remaining stockholders becomes personally liable on the obligations incurred during this period. The question of the validity of a single-member company under the statutory provision requiring three or more incorporators is examined in this decision.[270] The case is overruled by the North Carolina legislature and it is argued that no previous judicial decisions of the court will have led anyone to anticipate this rationale.[271] The decision of the Supreme Court is against a type of business organization that is so commonly practiced in many states of the US. Therefore, it has been criticized; since, these kinds of decisions are not seen very common in American corporation law.

The only solution seemed to be legislative enactment of national statutes which would remove the limitations on the single-member companies; therefore, in 1960 only Kentucky, Michigan, and Wisconsin[272] allowed a single incorporator. Whereas, the provisions of the Model Business Corporation Act, which was an unofficial document of the American Bar Association, had an influential effect on the corporate laws of

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[266] Elvin R. Latty, A Conceptualistic Tangle and the One-or Two-Man Corporation, *North Carolina Law Review*, 1956, Vol.34, Heinonline Database, (last accessed on 02.11.2010), p. 476-478.
[267] Henry G. Manne, "Our Two Corporation Systems: Law and Economics", **Virginia Law Review**, Vol.53, No.2, March 1967, p. 268.
[268] Maurice Wormser, "Piercing the Veil of Corporate Entity", **Colum L. Rev.**, Vol.12, No.6, June 1912, p.515.
[269] Park Terrace, Inc. v. Phoenix Indem. Co., 243 N.C. 595, 91 S.E.2d 584 (1956), *see*, "Corporations: The Three-Stockholders Requirement in North Carolina", **Duke Law Journal**, Vol.1960, No. 3, Summer 1960, p. 465-468.
[270] Manne, p.268.
[271] Latty, A Conceptualistic Tangle, p.470, 476.
[272] *See*, Elvin R. Latty, "Some Miscellaneous Novelties in the New Corporation Statutes", **Law and Contemporary Problems**, Vol.23, No.2, Spring 1958, p. 364.

many states; by 1969, twenty seven states had a provision permitting a single incorporator. This effect had continued and by 1982, a single incorporator was permitted in all but six jurisdictions. In practice, corporations gain existence before shareholders perform their capital contributions and the concept of incorporation is so trivialized that incorporators may not also need to be shareholders. Therefore with the effect of this, in 1990, only two states retain a minimum-number requirement for incorporators, which are namely; Arizona (General Corporation Law, Section 10-053) and Utah (Business Corporation Act, Section 16-10-48).[273] Consequently, the formation and operation of a single-member company and registration of such company is done almost with the same procedure of a multi-member private limited liability company.[274]

2.2.2 Chinese Law

Before the significant amendments to the Chinese Company Law in October 2005, a limited liability company was required to have two or more shareholders. The new Company Law now allows natural persons or legal entities to form single-member limited liability companies.[275] Except for the wholly state-owned limited company, the state-funded stock company set up for the purpose of overseas listing and the wholly-owned foreign enterprise ("WFOE"), no other company is supposed to be of the single-member company model.[276] A single-member WFOE has already been contemplated under the WFOE Law and in practice there are many single member WFOEs. On the other hand, domestic investors are not permitted to establish single-member limited liability companies. The new Chinese Company Law for the first time permits the establishment of such single-member companies by Chinese investors; however it sets certain requirements,[277]such as; the capital contribution must be paid as a lump sum when the Chinese single-member company is established; a natural person is allowed to establish only one single-member limited liability company; the company is required to

[273] Buxbaum, p. 251.
[274] Alison Cole, "Single-member Limited Liability Company", http://ezinearticles.com/?Single-Member-Limited-Liability-Company&id=138995, (last accessed on 21.10.2010).
[275] China Corporate Law- The Basics of China's Company Law, http://www.chinalawblog.com/2009/12/china_corporate_law_the_basics.html, (last accessed on 10.10.2010).
[276] *Issues Regarding One Man Companies*, http://www.asialaw.com/Article/1972007/Search/Results/Issues-Regarding-One-man-Companies.html?Keywords=China&PageMove=24, (last accessed on 10.10.2010).
[277] Chengwei Liu, **Chinese Company and Securities Law: Investment Vehicles, Mergers and Acquisitions, and Corporate Finance in China**, The Netherlands: Kluwer Law International, 2008, p.18.

make a financial statement audited by an accounting firm every fiscal year and if the shareholder of the company fails to separate his personal assets from the company's assets, the sole shareholder will be held jointly liable from the debts of the company.[278]

2.2.3 Swiss Law

The Swiss company law was set forth in the section 3 of the Swiss Federal Code of Obligations ("SCO") which was first adopted in 1881.[279] The major amendments to the SCO had been done in 1937 Reform[280] and the last amendment which was done in 2005 Reform law, entered into force in 1 January 2008.[281]

The 1937 SCO required at least three shareholders for incorporation in case of joint-stock companies; two shareholders in case of private limited liability companies. However, Swiss law implicitly recognized the single-member company form in 1919 with a Swiss Federal Supreme Court decision,[282] where it was held that the consolidation of all shares of a company in the hands of one shareholder would not cause the company to be wound up. The 1937 SCO ex. Art. 625 also provided that a joint-stock company may be wound up by a court decree upon the petition of a creditor or a shareholder if the corporation no longer had the necessary number of shareholders.[283] Cases of dissolution of single member companies are rare and actually, in practice, they are tolerated. [284]

When we consider single-member company decisions of the Swiss Federal Court around 1950s, we can see that the corporate entity of a company may be

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[278] Nils Krause and Chuan Qin, "An Overview of China's New Company Law, **Comp. Law**., Vol.28, No.10, 2007, p.317.

[279] For the German text of the SCO, *see*, http://www.admin.ch/ch/d/sr/220/index3.html, (last accessed on 02.03.2011).

[280] Amended in accordance with BG of 18 December 1936, in force since July 1, 1937 (AS 53 185; FF 1928 I 205 1932 I 217).

[281] Wording according to Section I 2 of the Act of 16 December 2005 (limited liability company law and changes in equity, cooperative, company registration and company law), in force since January 1, 2008 (AS 2007 4791, FF 2002 318, 2004 3969).

[282] BG Judgement of January 15, 1919, Rastello v. Filiberti, BGE 45 II 33, for the translation of the judgment *see*, Şener Akyol, **Medeni Hukukla İlgili İsviçre Federal Mahkemesi Kararları (BGE 38 II-BGE 47 II)**, İstanbul, 1980, p.109.

[283] Ünal Tekinalp, "Tarihi Gelişimi İçerisinde Tek ortaklı Şirketler Sorunsalı ve Türk Hukukunun Bu Konudaki Açılımı, **Prof. Dr. Hüseyin Ülgen'e Armağan Cilt 1**, İstanbul: Vedat Kitapçılık, 2007, p.583.

[284] When there is such a threat of dissolution, Swiss courts appear to hold that a corporation will be dissolved for failure to have the required number of shareholders only where there is misuse of the corporate form to the detriment of the public or creditors, Bernard J. Reverdin and Eric E. Homburger, "The American Close Corporation and Its Swiss Equivalent", *Business Lawyer*, 1958, Vol.14, Heinonline Database, (last accessed on 02.03.2011), p.275.

disregarded if the corporate form is used in an illegal manner or against the public order. In a Federal Court decision,[285] the company's legal independence is disregarded in connection with legal relations which are engaged by the controlling shareholder, who owns half of the shares and controls the other shareholders, has agreed not to undertake individually. The court finds that since the company is in the hand of its founder and serving his/her needs, the company and its controlling shareholder must be treated as one; thus, the corporation is bound by the agreement entered into by the controlling shareholder. In another decision,[286] the sole shareholder and the manager of a corporation become joint guarantors of a debt of the corporation. After the corporation has defaulted, another corporation that is controlled by the sole shareholder pays the debt. The shareholder is identical with the debtor company; thus, it is held that the payment to the second corporation is actually a payment by the sole shareholder. As a result, since the creditor has been paid, the second corporation cannot recover from him.[287]

When we consider the current situation in Swiss company law, we can state that the 2005 Reform Law brings the legislation on the private limited liability and joint-stock companies up to date. The revised law allows the incorporation of a joint-stock (SCO Art. 625) or a private limited liability company with a single natural or legal person (SCO Art. 772-775). The new law no longer requires joint liability for private limited liability companies' shareholders, who are in the past required to compensate for unpaid share capital withdrawals.[288] Moreover, the upper limit on the contribution capital is eliminated in case of private companies, but the minimum contribution capital has remained and it must be fully paid in.[289] Whereby, in case of joint-stock companies, half of each share must be paid up before incorporation (SCO Art. 632). In private limited liability companies, if it is not stated otherwise in the company statute, all shareholders have the right to be entitled as managers (SOC Art. 809). All shareholders

[285] BG judgment of December 11, 1945, Hussnigg v. Plica A.G. & Rohrfabrik Riischlikon, BGE 71-II 272, E. J. Cohn and C. Simitis, " "Lifting the Veil" in the Company Laws of the European Continent", **ICLQ**, Vol.12, No.1, January 1963, p.199.
[286] BG judgment of October 11, 1955, Wurm v. Libag, BGE 81II 455, Cohn and Simitis, p.199.
[287] Cohn and Simitis, p.199; Reverdin and Homburger, p.275-276.
[288] Thomas Rihm, "Switzerland: New life for GmbH", *International Financial Law Review*, February 2007, http://www.iflr.com/Article/1977359/Home/~/FAQ.html, (last accessed on 02.03.2011).
[289] Urs P. Gnos, "The New Swiss GmbH Law", Walder Wyss & Partners News Letter, April 2007, No.70, http://www.walderwyss.com/publications/472.pdf, (last accessed on 02.03.2011).

are bound by a duty of loyalty[290] to the company both in joint-stock (SCO Art. 717) and private limited liability companies. New law also imposes an express prohibition of activities, which compete with the company (SCO Art. 814(1)).

2.2.4 EU Law

The Twelfth Directive has been implemented in order to resolve the divergences created between the laws of EU Member States regarding single member companies as a result of legislative reform in certain countries. Since, the Twelfth Directive is used as a tool for the harmonization of EU Company laws, we will be dealing with the Twelfth Directive in the following part of this study. Thus, the basis and objectives of the Twelfth Directive; certain restrictions regarding the formation of single member companies; the powers of the single member and the issue of contracts between the single member and the company will be discussed in detail.

2.2.4.1 Legal Basis and History of the Twelfth Directive

The Twelfth Directive is considered as the most significant development of EU Company law regarding the SMEs.[291] It is consistent not only with the EU's policy of 23 November 1986 on creating an environment favorable to SMEs[292] but also with the Council's resolution of 22 December 1986 on the Action Programme on employment growth.[293] The Council makes an emphasis on the need to encourage both developments of SMEs in the Action Programme for SME's and single-member companies. The explanatory memorandum of a Commission document,[294] which contains a draft Directive that will harmonize the law governing single-member companies, places emphasis on the absence of such a business form in certain Member States and the differences between the national laws of those Member States which allow the formation of single-member companies. The draft Directive is expressed to be based specifically on Art. 54 of the EC Treaty (now Art. 50 TFEU), which has been

[290] For a recent case study on duty of loyalty in Swiss joint- stock companies *see*, Hasan Pulaşlı, "Tek Ortaklı Anonim Şirkette Yönetim Kurulu Üyelerinin Sorumluluğu ve İsviçre Federal Mahkemesi'nin Buna İlişkin Üç Kararı", **Prof. Dr. Reha Poroy'un Anısına Armağan**, BATİDER, Cilt 25, Sayı 4, 2009, p.97-132.
[291] Vincent J.G. Power, "Twelfth EEC Company Law Directive", **ICCLR**, Vol.1(3), p.C44.
[292] *See*, OJ 1986 C287/1, 14.11.1986.
[293] OJ C340, 31.12.1986.
[294] *See*, COM(88) 101 Final, OJ C 173, 02.07.1988, p.10.

interpreted widely as conferring a mandate for the comprehensive harmonization of EU company law.[295] The preamble to the draft Directive also makes reference to the Action Programme, and the need to provide a legal instrument for single-member companies throughout the Community. The legislative progress of the Proposal for a directive on single-member companies was quick; as the process from first draft to adopted text had been completed nearly in eighteen months.[296]

Indeed, at the time the Directive was proposed, not all Member States allowed single-member companies.[297] The formation of single-member company had been allowed under Danish law since 1973. The single-member company which was established as a result of all the shares in a company being acquired by a single shareholder subsequent to its formation has been recognized in Germany since the end of the last century. However, it was not until 1980 that the formation of single-member private limited companies was allowed in Germany. Single-member private companies were permitted in France by Law No. 85-697 of July 11, 1985; in the Netherlands by the law of May 16, 1986; in Belgium by the law of July 14, 1987. Draft legislation permitting the single-member company had been introduced before the Luxembourg Parliament for some time. The legislation for single-member proprietorship with limited liability was introduced in Portugal in 1986.[298]

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[295] According to *Wooldridge* the draft Twelfth Directive, which is designed to harmonize the law relating to the formation of single-member companies, is based upon "*a somewhat bold interpretation"* of Art. 54(3)(g) EC (now Art. 50(3)(a) TFEU), Frank Wooldridge, "The Draft Twelfth Directive on Single-Member Companies", **JBL**, January 1989, p.86.

[296] *"The Economic and Social Committee delivered its Opinion on the first Proposal in September 1988 and the Parliament approved the Proposal with suggested amendments in March 1989. The Commission presented an amended Proposal in May 1989 on which the Council adopted a common position in June 1989. The Parliament gave it a second reading under the co-operation procedure in October 1989 and voted in favour of three amendments, one of which was accepted by the Commission which submitted a re-examined Proposal in November 1989."* The Twelfth Directive was finally adopted on 21 December 1989, Vanessa Edwards, "The EU Twelfth Company Law Directive", **Comp. Law.**, Vol.19, No.7, 1998, p.212.

[297] Akar Öcal, "Avrupa Topluluğu Konseyinin Tek Ortaklı Limited Şirkete İlişkin Direktif Tasarısına Kısa Bir Bakış", **İktisat ve Maliye Dergisi**, Cilt 36, Sayı 6, 1989, p.244.

[298] Wooldridge, The Draft Twelfth Directive, p.86-87.

2.2.4.2 Scope of the Twelfth Directive

2.2.4.2.1 Evaluation of the Objectives of the Twelfth Directive

The fundamental objective of the Twelfth Directive is creating a common instrument which allows the limitation of liability of the individual entrepreneur in all Member States[299] and harmonizing European company laws with a flexible formula that will not affect the essential features of the different national systems.[300]

In the Commission report regarding the single-member companies, it is explained that the facilitation of the access of individual entrepreneurs to the status of company will be an important vehicle for business development in the internal market.[301] Moreover, the Commission draws attention to the fact that 92.4% of all enterprises in the EU are 'micro-enterprises' which have fewer than ten employees and this category makes much more contribution to employment than do large businesses.[302] Single-member companies usually belong to SMEs and these enterprises in the EU are considered as the greatest potential job creators.[303] Consequently, it can be concluded that the presence of the concept of single-member company is crucial in all market economies.

The second aim of the Twelfth Directive is to promote and guarantee the freedom of establishment of companies. The differences between the laws of Member States about the single-member companies shall be overcome and the advantages regarding competition status among the other company forms will be emphasized with this Directive.[304] Before the adaptation of the Twelfth Directive, only certain Member

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[299] Şükrü Yıldız, **TTK Tasarısına Göre Limited Şirketler Hukuku**, İstanbul: Arıkan, 2007, p.34; Neval Okan, "Avrupa Birliğinde Birleşik Krallık, İrlanda, Belçika ve İspanya Hukuklarında Tek Üyeli Özel Limited Ortaklıklar (Single-Member Private Limited Companies)", **Prof. Dr. Kemal Oğuzman'a Armağan**, İstanbul: Galatasaray Üniversitesi Hukuk Fakültesi Dergisi, No.1, 2002, p.516.

[300] Dragana Radenkovic Jocić, "A Single-member Company-Convinient or Not For the Founders", Facta Universitatis, *Economics and Organization*, Vol.2, No.3, 2005, http://facta.junis.ni.ac.rs/eao/eao2005/eao2005-03.pdf, (last accessed on 01.05.2010), p.210; *see* also, Karel Van Hulle, **Avrupa Birliğinin Şirketler Hukuku Müktesabatı ve Türkiye'ye Uyumu**, İktisadi Kalkınma Vakfı, 2003, s. 37-38.

[301] COM(88) 101 Final, OJ C 173, 2.7.1988.

[302] White Paper on Growth, Competitiveness and Employment: The Challenges and Ways Forward Into the 21st Century, COM (93) 700 Final (hereinafter cited as "White Paper"), http://aei.pitt.edu/1139/01/growth_wp_COM_93_700_Parts_A_B.pdf, (last accessed on 10.04.2010), p.71.

[303] White Paper, p.71.

[304] Jocić, p.212.

States allowed single-member companies to be formed, most other states preserved the requirement that there should be more than one member. Member States which did not let the setting up of the single-member companies either required the winding up of the company or imposed personal liability of the sole member; if all shares came to be held by a single shareholder.[305]

Another aim is to limit the single shareholder's liability which means defining whether the sole member bears losses only to the extent of his/her contributions,[306] without prejudice to the laws of certain Member States which exceptionally require the sole member to be liable for the obligations of his/her enterprise.[307] In other words, the Twelfth Directive provides a legal instrument allowing the limitation of liability by separating the individual property of the sole founder and the company; thereby, protecting the interests of creditors and the other partners of the company. The Twelfth Directive allows private or public single-member companies or sole traders with limited liability. It is important not to use this limited liability in an abusive way; as *Power*[308] states, *"it must not be used as a weapon of fraud: it should be a shield and not a sword"*. The Twelfth Directive also permits Member States to limit the number of single-member companies which an individual may form and also permits them to prohibit a company from forming a single-member company.[309] Therefore, we can conclude that the Twelfth Directive covers a limited number of issues about single-member companies and gives too much discretion to Member States; as a result, there are various different domestic applications for establishing a single-member company.[310] It is also observed in practice that the Twelfth Directive does not justify many expectations and there have been many criticisms and questions about whether harmonization can be achieved. Despite these views, the approach of the Member States can be different, such as in the case of the UK. In a Commission Consultation Paper on the Simplification of EU Company Law, the UK had taken a negative approach towards company law harmonization. First, it stated that the Twelfth Directive was designed to

[305] Wooldridge, The Draft Twelfth Directive, p.87; The rational under this practice was that the concept of company is regarded as a contract between at least two people, *see*, Jocić, p.211.
[306] Jocić, p.211.
[307] *See*, The Preamble to the Twelfth Directive, 5th recital.
[308] Power, p.45.
[309] Edwards, p.212.
[310] Edwards, 212; Çelik, p.183.

facilitate competitiveness by permitting companies to be set up with a single member in all Member States and added that where there was no cross-border issue, the facilitation of competitiveness should be left to the national laws. Moreover, the UK suggested that the directives should be leaving Member States the flexibility to decide the appropriate level of regulation. Therefore, the UK Government's view was that the Twelfth Directive should be repealed; if it was repealed, the Government would retain single member companies, but would simplify its procedures.[311]

In my opinion, it is clear that, with the maintenance of this Directive, all Member States provide for some sort of limited-liability to the sole shareholder. In addition to this, the Twelfth Directive will certainly have a positive effect on competitiveness in the EU level. Individuals will be more encouraged to set up businesses without the need to find another shareholder and even if the owner changes, with its separate legal personality, the company will have continuity.

After mentioning the scope of the Twelfth Directive, in order to determine the functioning of single member companies in the EU level, the provisions and the scope of the Twelfth Directive and its previously amended proposals will be examined in the following section.

2.2.4.2.2. Evaluation of the Articles of the Twelfth Directive

2.2.4.2.2.1 Models that the Twelfth Directive Suggests

The Union legislature suggests two models available for single-member companies. The first model[312] allows the formation of a single-member company with a separate property from the founder's. This property will be used for the needs of business activity and only this property can be liable to seizures by the creditors, in case

[311] *European Commission Consultation on the Simplification of EU Company Law and Accounting and Audit Regulation*, August 2007, www.bis.gov.uk/files/file41189.doc, (last accessed on 10.02.2010),

[312] This model is used in Portugal as it has provided limited liability for sole traders. In other words, Portuguese legislation provides that an individual trader may constitute an "individual limited-liability business" by allocating a proportion of his assets to it as the business's initial capital. Particularly, such assets are to be used merely for obligations arising from the business activity and they are the only assets to be used for such obligations, Edwards, p.213; Barbara Pasa and Gian Antonio Benacchio, **The Harmonization of Civil and Commercial Law**, Budapest: Central European University Press, 2005, p.356.

of insolvency of the company.[313] The second model[314] allows the formation of a company, which lacks the usual plurality of members. The Union legislators had chosen the second model and approved the choice made by certain Member States which had already regulated this institution. This choice had been justified with two main points; first of all, all Member States had sufficiently harmonized legislations in the company law arena because of the previously adopted directives which were developed for the protection of third parties. Therefore, it was likely to benefit from this body of law and avoid lying down completely different rules. This option had been chosen as to make sure that third parties had a certain scope of information similar to that available for joint-stock companies. Secondly, this company model was very flexible as the single-member could reach the collaboration of other investors using the existing company structure. Even if there was a short fall in the number of members, it was not mandatory for the remaining member to replace the members or dissolve the company.[315]

According to the previous version of the Twelfth Directive -89/667/EEC- which is repealed, Member States are obliged to bring into force the laws, regulations and administrative provisions consistent with the Directive; they are required by Art. 8 to implement the Directive by January 1, 1992 (Art. 8(1)) and are obliged to inform the Commission of their action (Art. 8(2)). Moreover, the Member States will be permitted to provide that, in the case of companies already in existence on January 1, 1992, the Directive shall not apply until January 1, 1993 (Art. 8(3)). In the amended version of the Twelfth Directive -2009/102/EC-, Art. 8 preserves the obligation of the Member States in communicating with the Commission about the implications of this Directive in their provisions of national laws. Moreover, another provision is added in the amended Directive, Art. 9, which reaffirms that the obligations of the Member States regarding the time limits for transposition into national law and application of the Directives[316] set out in Annex II, Part B will not be prejudiced.

[313] This model will be cited again in the next heading; "Form of Single-member Company".
[314] This model was used in Denmark since 1973, in Germany since 1980, in France since 1985, in Holland since 1986, in Belgium since 1987.
[315] Pasa and Benacchio, p.356.
[316] Directive 89/667/EEC, time limit for transposition: 31 December 1991; date of application: 1 January 1993 in the case of companies already in existence on 1 January 1992; Directive 2006/99/EC, time limit for transposition: 1 January 2007.

2.2.4.2.2.2 Form of Single-member Company

Art. 1 of the Twelfth Directive states that it will be applicable to the laws, regulations and administrative provisions of the Member States relating to types of company on the list in Annex I,[317] which includes companies equivalent in each member state to a private limited liability company. The first reason for choosing private companies to be the principal vehicle for single-member companies is the desire to encourage SMEs. Another reason is that, some Member States require public limited liability companies to have more than two members or more than one director; thus, it will be controversial and not consistent with the concept of single-member company. Lastly, the requirements of the Second Directive; which necessitate the public limited liability companies to have a minimum capital, make them less preferable.[318] Private limited liability companies are considered to be better for small enterprises and less complicated in nature. On the other side, Art. 6 permits Member States to allow single-member companies in the case of public limited liability companies, provided they fall within the definition of Art. 2(1) and the requirements of the Directive. Consistently, Member States adopt this approach gradually because such companies are, nonetheless, suitable forms for business transfer.

The Twelfth Directive also provides an alternative regime with Art. 7; it makes it possible for a Member State not to allow the formation of single-member companies and derogate from the Directive where its legislation enables an individual entrepreneur to set up an enterprise, the liability of which is limited to a sum devoted to a stated

[317] According to Annex I, the Twelfth Directive shall apply to the fallowing companies; in Belgium "Société privée à responsabilité limitée / de besloten vennootschap met beperkte aansprakelijkheid", in Bulgaria "дружество с ограничена отговорност, акционерно дружество", in Czech Republic "společnost s ručením omezeným", in Denmark "Anpartsselskaber", in Germany "Gesellschaft mit beschränkter Haftung", in Estonia "aktsiaselts, osaühing", in Ireland "Private company limited by shares or by guarantee", in Greece "Εταιρεία περιορισμένης ευθύνης", in Spain "Sociedad de responsabilidad limitada", in France "Société à responsabilité limitée", in Italy "Società a responsabilità limitata", in Cyprus "ιδιωτική εταιρεία περιορισμένης ευθύνης με μετοχές ή με εγγύηση", in Latvia "sabiedrība ar ierobežotu atbildību", in Lithuania "uždaroji akcinė bendrovė", in Luxembourg "Société à responsabilité limitée", in Hungary "korlátolt felelősségű társaság, részvénytársaság", in Malta "kumpannija privata/Private limited liability company", in the Netherlands "Besloten vennootschap met beperkte aansprakelijkheid", in Austria "Aktiengesellschaft, Gesellschaft mit beschränkter Haftung", in Poland "spółka z ograniczoną odpowiedzialnością", in Portugal "sociedade por quotas", in Romania "societate cu răspundere limitată", in Slovenia "družba z omejeno odgovornostjo", in Slovakia "spoločnosť s ručením obmedzeným", in Finland "osakeyhtiö/aktiebolag", in Sweden "aktiebolag", in United Kingdom "private company limited by shares or by guarantee", http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:32009L0102:EN:NOT, (last accessed on 10.01.2010).

[318] Edwards, p.212; *see* also footnote 312.

activity. Member States choosing such an arrangement will be required to provide safeguards which are equivalent to those imposed by the Directive or any other community provisions applicable to the single-member companies.[319] This provision is designed for Member States which are not eager to accept the idea of a single-member company.[320] Such Member States may nevertheless provide for limited liability for sole traders and this option is included in the Directive as it is chosen only in the Portugal.[321] In my opinion, Art. 7 produced much confusion as the actual form of this entity, it is not considered as a company or a legal entity; thus, this formula has been rarely used.

2.2.4.2.2.3 Requirements of Incorporation and Membership

Art. 2(1) of the Twelfth Directive provides that a company may have a sole member either when it is formed or when all its shares come to be held by a single person. It means that a company may be set up with a single-member from the beginning or it may arise as a result of the collection of all the shares in an existing company by a single shareholder. Thus, Art. 12(vi) of the First Directive, which provides that the reduction of the membership of a private company below two persons is a permitted cause of nullity of companies, is not applied in so far as concerns private companies.

The original Proposal, Art. 2(1) included a requirement that shares in a single-member company should be nominative (registered), but that requirement was later dismissed. As the Commission had explained, the aim of this requirement was to determine the identity of the shareholder but it became pointless as this identity was already shown in the company's statutes; as it was founded in the First Directive, it must be made public when the company was originally formed as a single-member

[319] It was stated in the Explanatory Memorandum, Bull. Supp. 5/88 ("Explanatory Memorandum"), p. 17, that, "*the Directive cannot afford to overlook the fact that for theoretical reasons certain Member States are reluctant to accept the idea of a one-member company. Such Member States may nevertheless provide for limited liability for sole traders"*. Member States must provide safeguards which are equivalent to those required by the Directives concerning advertising, annual accounts and consolidated accounts of private limited companies. "*Otherwise, different theoretical approaches which in practice have the same results in terms of the risks run by a sole trader and by the sole member of a company would ultimately provide varying measures of protection for similar interests throughout the Community"*, Power, p.C45.

[320] One of the conditions for using this option represented by Art. 7 is to arrange safeguards equivalent to a single-member company, Jocić, p.217.

[321] Edwards, p.213.

company and by virtue of Art. 3 of the Twelfth Directive in all other cases.[322] Art. 2(2) of the original Proposal stated that single-member company whose sole member was a legal entity may not be the sole member of another company. The aim that prohibition was to enable national legislation to prevent the creation of chains of companies,[323] since, the Directive supported the limitation of single-member companies as far as possible to SMEs. Art. 2(3) of the Proposal provided further that, where the sole member was a legal entity, Member States were to choose between one of two conditions. First, Member States could provide for unlimited liability for the company's obligations during the period of sole membership. On the other hand, they might instead provide that where the sole membership occurred after the setting up of the company, that liability would not be incurred unless another member was found within a year.[324] Instead of providing for either form of unlimited liability, as an alternative, Member States could both fix a minimum capital for single-member companies[325] and require the company and its sole member to be companies which at their balance sheet dates did not exceed the size of medium-sized companies within the meaning of Art. 27 of the Fourth Directive on Annual Accounts.[326] If the single-member company exceeded the size of a medium size company and the situation was not regularized within a year following the balance sheet date, the sole member would have unlimited liability for obligations of the company arising after that date.[327]

The proposed restrictions on the ability of a company to be the sole shareholder of another company, was not received well in Germany. They were found too restrictive for groups of companies, and not considered as effective in practice. Furthermore, it did not seem appropriate to include in a directive with a limited number of provisions which would affect directly the law of groups.[328] As a result of these complaints, the Commission was obliged to amend its Proposal and replace the prohibition in ex. Art. 2(2) and the conditions in ex. Art. 2(3) with a new provision, Art. 2(2), in the adopted

[322] COM(89)591 Final, at 3.
[323] Explanatory Memorandum, 5; These include single-member companies whose single-member is a legal entity being the sole member of another company.
[324] Art. 2(3)(a) of the original Proposal.
[325] Wooldridge, The Draft Twelfth Directive, p.88.
[326] Fourth Council Directive 78/660/EEC of 25 July 1978, OJ L 222, 14.8.1978, 11-31.
[327] Art. 2(3)(b) of the original Proposal.
[328] Edwards, p.213.

Directive[329] which provided that, Member States pending co-ordination of national laws relating to groups, may set forth special provisions or sanctions in cases where: "*(a) a natural person is the sole member of several companies; (b) a single-member company or any other legal person is the sole member of a company."* It was also explained in the preamble to the Twelfth Directive that the purpose the Art. 2(2) was to consider the differences which exist in certain national laws, for that purpose Member States may in specific cases put forward certain restrictions on the use of single-member companies or abolish the limits on the liabilities of sole members.[330] Member States were free to put forward rules to overcome the risks that single-member companies may constitute as a consequence of having single-members, especially to ensure that subscribed capital was paid.[331]

2.2.4.2.2.4 Publicity Requirements

As it has been stated at the beginning of this chapter, single-member company lacks some notions of classical company law and one of them is partnership relation; therefore, it is crucial to separate this concept from other types of companies for the benefit of third parties.

According to Art. 3 of the Directive, it is possible that a company can become a single-member company where all of its shares come to be held by a single person. If that happens then, that fact, together with the identity of the sole member, must either be recorded in the file or entered in the companies register within the meaning of Art. 3(1) and 3(3) of 2009/101/EC Directive (the First Directive)[332] or be entered in a register kept by the company accessible to the public. The permission of the latter option is considered to be unfortunate for the reasons that the alternative methods of publicity undermine the co-ordination; since, the option of disclosure in the company's own register means that the central register may not contain information which is not

[329] Explanatory Memorandum, 2-3, relating to the 1st amended Proposal.
[330] Okutan, p.589.
[331] 6th recital of the Preamble to the Twelfth Directive.
[332] Art. 3(1) and (3) of the First Directive require that the company's instrument of constitution shall be lodged in the central register, commercial register or companies register in the member state of incorporation and all documents which must be disclosed shall be kept in the file or entered in the register.

relevant for third parties.[333] If a single-member company is initially established in that form, the contracting third party may be aware of this; however, if a single-member company is subsequently formed as a result of a share transfer or death of other shareholders, the third party may not know this fact.[334] In my opinion, it is clear that this provision will be inadequate for the protection and interests of other parties. Thus, it is necessary to provide a more comprehensive clause, which includes detailed and effective disclosure requirements, on subsequently transformed single-member companies.

The amended Proposal of the Commission has an Art. 2 (a) reflecting a proposal by the Parliament that a company must mention on its letters and order forms[335] that it is a single-member company. However, the Council finds this as a bureaucratic and expensive requirement therefore not consistent with the objectives of the directive, which is creating more favorable conditions to small businesses. The Commission also points that displaying this information on the company's register does not afford any protection for creditors. Since liability is limited to the company's property, the crucial point for creditors is that the accounting directives are perfectly applied; strengthening the Member States' behavior regarding accounting duties is more important.[336]

2.2.4.2.2.5 Administration and Decision Making Procedure

Art. 4 provides that the sole member shall exercise the powers of the GA of the company (Art. 4(1)). In the original Proposal there was a prohibition against delegation by the sole member of the powers of the GA but it was dismissed consistent with the suggestion of the Parliament in order to facilitate the functioning of the single-member company.[337] Moreover, any decisions taken by the sole member, which was within the powers of the GA of the company must be recorded in minutes or drawn up in writing (Art. 4(2)). I am of the opinion that this part of the provision can be criticized as it does

[333] Edwards, p.213.
[334] Muzaffer Eroğlu "Single-member Companies in Turkish Law", July 11, 2008, http://ssrn.com/abstract=1158421, (last accessed on 02.10.2010), p.13.
[335] *See*, Art. 5(1) of the First Directive.
[336] Explanatory Notes to the Re-examined Proposal, 3.
[337] Explanatory Memorandum with Regard to the Amended Proposal, 4.

not specifically mention whether this 'writing' can be done in a casual way or not. In this sense, since the scope of GA's competence has not been harmonized on the EU level, the incentive is given to the each Member State to make provisions for appropriate penalties in case of a failure to comply with that rule.[338] As a consequence, it will be hard to conclude without hesitation that the third parties get sufficient protection from this provision.

It is a general application of most company laws that every year at least one shareholders meeting has to be called to adopt the annual report formally. It can be commonly seen in practice that in single member companies such a formal requirement may be overlooked by the single shareholder. However, I agree with the view that those formal handicaps may easily be abolished if it is accepted that all resolutions may be taken outside formal meetings.

In order to simplify the company law and make it less formal, an alternative solution is suggested by *Kluiver*,[339] which is that; if all shareholders sign the annual report, it may be assumed that there is a formal resolution to that effect, thus; such an application will do justice to a practice which is wholly acceptable.

2.2.4.2.2.6 Transactions Between the Single-Member and the Company

In accordance with Art. 5, agreements between the sole member and the company will be required to be recorded in minutes or drawn up in writing (Art. 5(1)) but Member States need not apply this rule to current transactions concluded under normal conditions of the company (Art. 5(2)) and in exceptional cases they can. It is clear that the company has a separate legal personality from its members. As the Commission clarifies any agreement between a company and one of its members carries the risk of a conflict of interest; in order to avoid this danger, relevant legislation has been enacted in all Member States.[340] However, this risk is higher in case of single-member companies; because, it is easy to defraud creditors who are not aware of

[338] Explanatory Memorandum, 8.
[339] Harm-Jan De Kluiver, "Towards a Simpler and More Flexible Law of Private Companies –A New Approach and the Dutch Experience", **ECFR**, 2006, p.56.
[340] Explanatory Memorandum, 8.

separate personalities of the company and its member.

The original Proposal provided the possibility of any agreement between the sole member and the company represented by him to be provided for in the company's statutes on the basis that such documents were reachable for interested parties at the companies register accordingly with the First Directive[341] but this idea did not last long. Furthermore, the Directive did not have any provisions regarding the effect of breaches of Arts 5(1) or (2). Along with the Art. 4, the Directive left it to the Member States to legislate on penalties or the consequences of non-compliance with the requirements of Art. 5. In this sense, we can state that Art. 5 can be the most differently implemented article into the national laws of Member States.

2.2.4.3 Implementation of Single-Member Company Concept in the National Laws of Several Member States

As the harmonization of the Twelfth Directive's provisions has taken place in the Member States, all have issued statutes or amended their legislation in the field of company law to accommodate the single-member company. It can be observed that the discretion given by the Directive to the Member States might result in diverse consequences among the national laws. The Member States may determine the relevant powers or permit delegation of the powers or define very different sanctions for any failure.

Under this heading, the implementation of single-member company concept will be examined in the relevant national laws according to their main elements.

2.2.4.3.1 United Kingdom Law

According to the UK Companies Act 1948 ("1948 Act"), in case of public companies, any seven or more persons, or, in case of private companies, any two or more persons can form an incorporated company with or without limited liability. (1948 Act Section 1) When the number of members of a company is reduced, in the case of a private company, below two, or, in the case of any other company, below seven, and it

[341] Edwards, p.214.

carries on business for more than six months with the remaining inadequate members, every person who is a member of the company at that time and is aware of the fact that it is carrying on business activities with fewer than two or seven members, shall be held severally and individually liable for the debts of the company (1948 Act, Section 31) and the company may be eventually wound up (1948 Act, Sections 222 and 224).

With the effect of the Twelfth Directive, the UK implemented the Eleventh Directive by Statutory Instrument 1992 no. 1699, "The Companies (Single-member Private Limited Companies) Regulations 1992", which amended various relevant provisions contained in the Companies Act 1985 ("1985 Act") and the Insolvency Act 1986.[342] With the amendments and additions to the existing provisions, the new legislation would be more appropriate for single-member companies and more consequent with the Twelfth Directive. The Companies Regulations 1992 included an additional section 1(3A) to the 1985 Act, this section made it possible to form a single-member private company which was defined there as a private company, limited by shares or by guarantee, which was incorporated with one member or whose membership was reduced to one person.[343]

As it was provided in the 1948 Act, section 24 of the 1985 Act originally preserved the provision that if a company carried on business with one member for more than six months that member would become jointly and severally liable with the company for the company's debts contracted during that time. However, the Companies Regulations 1992 amended this section and excluded it from applying to the private companies.

Under British law, a single-member cannot run the company. The company must still have at least one director and a secretary. This secretary cannot also be the sole director.[344] New section 322B, which is inserted in the 1985 Act, states that contracts between the company and the sole member, who is also a director of the company, must be in writing. If it is an unwritten contract, it must be set out in a written memorandum or recorded in minutes of the next director's meeting. If a sole member,

[342] Villiers, p.153.
[343] Okan, Tek Üyeli Özel Limited Ortaklıklar, p.518.
[344] Pasa and Benacchio, p.361.

who is a shadow director, tries to circumvent these formalities, he/she will be treated as a director (Section 322(B)3). It also provides that every officer of the company who fails to comply with this section will be subjected to a fine (Section 322(B)4), but such a breach of the formalities will not affect validity of the contract (Section 322(B)6). This section does not apply to contracts in the ordinary course of the company's business. The wording of this section is considered to be clearer than the wording of the Twelfth Directive which refers 'current operations under normal conditions' in its Art. 5(2).[345]

A single-member company can be incorporated by subscribing the sole member's name to a memorandum of association and otherwise complying with the requirements of registration (Section 1(3A)). The introduction of section 352A covers the need for disclosure of the fact that the company has only one member. If there is a fall in the number of members to one or an increase in the number of members to two or more, a statement to this effect will be necessary and the name and address of the members is also required. Failure to comply with this section leads to a fine.

Unless the company's articles of association specify anything to the contrary, the new section 370A provides that a single-member who is present in person or by proxy, constitutes a quorum at company meetings; if such a meeting takes place, it must be recorded in minutes. Moreover, section 382B expresses that if a single-member takes a decision, except by written resolution, the decision taken by the GA must be given to the company in writing.[346] The breach of the section leads to a fine but does not affect the validity of the decision (382B (ii),(iii)).

Villiers[347] considers the UK implementation of the Twelfth Directive as "minimalist". The author supports her opinion with the attitude of the Department of Trade and Industry ("DTI") who has declared its intention to keep reforms to a minimum to avoid complexity and cost. The UK has taken a narrow approach and does not extend the Directive to public limited liability companies until Companies Act 2006. It also does not take up the option in Art. 7 of the Directive to allow other types of undertakings to have limited liability.

[345] Villiers, p.154.
[346] Okan, Tek Üyeli Özel Limited Ortaklıklar, p.519.
[347] Villiers, p.155.

2.2.4.3.2 French Law

The French private limited liability company, *société à responsibilité limitée,* ("SARL"), was introduced into France by a law passed on 7 March 1925.[348] According to the Law of 7 March 1925 Art. 5, a SARL can be incorporated with at least two persons. Reform Law number 66-537 of 24 July 1966 on commercial companies ("Law No. 66-537") does not regulate the minimum membership requirement for SARLs; therefore Art. 1832 of the French Civil Code, which also requires two members for incorporation, is applied as a general provision. Furthermore, according to the French Civil Code, the concentration of all shares in the hands of a single shareholder does not dissolve the company; any interested party may apply to the Court and seek dissolution if the situation is not corrected within one year. In that case, the court may grant the company a period of six months to rectify the situation (Civil Code Art. 1844-5).[349]

Law number 85-697 of 11 July 1985 on the sole proprietorship with limited liability ("Law No. 85-697") made crucial amendments in the French Commercial Code[350] ("FCC") and the Civil Code.[351] The first sentence of the Civil Code[352] Art. 1832 states that a company is instituted by two or more persons who bound themselves by a contract to appropriate their property or their work for a common purpose in order to share a profit. According to the second sentence of the same article,[353] a company can also be instituted, in the situations provided for by statute, by the act of will of a single person. An exception is provided in order to enable the establishment of single-member companies.[354]

The formation of a single-member SARL has been permitted by the Law No. 85-697 Art. 2,[355] and it is currently regulated by Arts L223-1 to L223-43of the FCC.[356]

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[348] Andenas and Wooldridge, p.112.
[349] *See* generally, Hediye Sayın, "Tek Kişili Ortaklık", (**Yayınlanmamış Yüksek Lisans Tezi**, Anadolu Üniversitesi Sosyal Bilimler Enstitüsü, Ağustos 2008), p.43, etc.
[350] Law No. 66-537.
[351] Arslan, p.48.
[352]For the English text *see*, Legifrance, http://195.83.177.9/code/liste.phtml?lang=uk&c=22&r=556, (last accessed on 10.09.2010).
[353] As amended by Law No. 85-697.
[354] Çelik, p.175.
[355] Kemal Çevik, "Fransız ve Türk Hukukunda Tek Ortaklı Şirket/Sınırlı Sorumlu Ticari İşletme", **BATİDER**, Kasım 1998, p.38.
[356] Andenas and Wooldridge, p.112.

The FCC Art. 223-1, which is lastly amended by Law number 2008-776 of 4 August 2008, states that a SARL may be established by one or more persons. If it is established by a sole proprietor, it will change its name to *entreprise unipersonnelle à liability limitée*, ("EURL").[357] The rules applicable to this entity are generally those applicable to SARLs, insofar as they are compatible with the existence of a single-member.[358]

A single shareholder may have limited liability upon incorporation of the company or this situation may arise later, as a result of the concentration of all the shares in his/her own hands.[359] When the sole proprietorship with limited liability has only one person, it is referred to as "sole shareholder". The sole shareholder exercises the powers vested in the GA. The company is referred by a name which can be incorporated with the name of one or more partners, and must be followed by the words "limited liability" or the abbreviation "Ltd.", and the utterance capital (Art. L223-1).[360] The number of shareholders of a SARL shall not exceed one hundred (Art. L223-3).[361] Furthermore, all the company's shareholders are required to execute its statutes, either personally or via a proxy with a special authorization (Art. L223-6). The company's memorandum shall contain the form, duration, the business name, the registered office, the purpose of the company and the amount of the registered capital (Art. L210-2). A SARL that is constituted in obedience with these requirements shall have legal personality with effect from its registration in the commercial register (Art. L210-6). If the EURL is constituted as a result of the collection of all shares in the ownership of one shareholder, the company's status will not change.[362] The conversion in the current form of a company shall not give rise to the creation of a new legal personality (Art.

[357] Christopher Joseph Mesnooh, **Law and Business in France: A Guide to French Commercial and Corporate Law**, The Netherlands: Martinus Nijhoff Publishers, 1994, p.75-76; Andenas and Wooldridge, p.62.
[358] Andenas and Wooldridge, p.112.
[359] Before the above-mentioned law reforms, a legal entity with one shareholder was not consistent with the traditional concepts of French company law. Only one type of French legal entity *exploitation agricole a responsabilite limitee* (EARL*)* may have a single shareholder, *see*, Jocić, p.211; Reşat Atabek, "Tek Ortaklı Şirket", **BATİDER**, Cilt 14, Sayı 1, 1987, p.25.
[360] Law No. 85-697 Art. 2 which amended the Law No. 66-537 Art. 34; *see*, Çevik, p.44.
[361] It is the only type of company in French company law for which the legislator fixes a maximum number of members.
[362] Çevik, p.44.

L210-6).[363] The existing shares will be transferred to the single shareholder and the procedure will be completed with a written instrument.[364]

According to the Law No. 85-697 Art. 3,[365] if the sole shareholder of an EURL is a natural person he/she may not be the sole shareholder of another EURL. However this provision has been repealed by the Law no. 94-126 of 11 February 1994 Art. 5,[366] in the current situation a natural person can be the sole shareholder of several EURLs. But, on the other hand, an SARL may not have another EURL comprising only one person as its sole member.[367] In other words, an EURL cannot be the sole shareholder of another EURL. In case of a violation of this rule, any interested party may apply for the dissolution of the company. If the situation results from the concentration of all shares in the hands of a one shareholder, the application for dissolution may not be required less than one year. In that case, the court may grant the company a six months to regularize the situation; the court may not order the dissolution if compliance occurs until the judgment (Art. L223-5). If all shares in a limited liability company are collected in the hands one shareholder, the provisions of Art. 1844-5 of the Civil Code relating to dissolution shall not apply (Art. L223-4).[368]

There is no minimum capital requirement in SARLs[369] and shareholders bear the losses to the extent of their contributions (Art. L223-1). All the shares of the company must be fully subscribed by the members and they must be fully paid before the registration of the company in the commercial register, if they represent contributions in kind. At least one fifth of the face value of shares representing contributions in cash must be paid up and the balance may be paid within a deadline which may not exceed five years (Art. L223-7).[370] The shareholders may decide not to appoint an auditor if no contribution in kind exceeds a value of 7500 Euros and in any case that the amount of the consideration does not exceed half the capital. If the

[363] *See* also, Çevik, p.46
[364] This written instrument shall take the form required by Art.1690 of the French Civil Code, *see*, Andenas and Wooldridge, p.113; Çevik, p.44-45.
[365] Created by Law No. 85-697 Art. 3 which amended the Law No. 66-537 Art. 36-2.
[366] Çelik, p.187.
[367] Jocić, p.213; Çelik, p.188.
[368] The same provision was present in the Law No. 85-697 Art. 3 which amended the Law No. 66-537 Art. 36-1, Repealed by Order 2000-912 2000-09-18 Art. 4 OJ of 21 September 2000.
[369] Before the Law of 1 August 2003, the minimum capital required for formation of an SARL was 7500 Euros.
[370] The registered capital must be fully paid before new shares may be subscribed in cash.

company is formed by only one person, the auditor shall be appointed by the single-member (Art. L223-9).[371]

The SARL is managed by one or more natural persons; but need not be selected from the members of the company. They are appointed by the shareholders. In dealings between shareholders, the managers' powers are determined by the memorandum and articles of association. In dealings with third parties, the manager is given comprehensive powers to act on behalf of the company, but they must leave aside the issues which the law expressly reserves to the shareholders. In any case, the acts of the managers shall not be outside the scope of the purpose of the company (Art. L223-18).[372]

Contracts between the EURL and the single shareholder have to be acknowledged and recorded in the register of decisions. (Art. L223-19). The management report, inventory and annual accounts, which shall be drawn up by the manager, shall be approved by the sole shareholder. The sole member may not delegate these exclusive powers.[373] The decisions of the sole member regarding the GA shall be recorded and indexed in a register. If the decisions taken by the single-member constitute a breach of the provisions of this article, they may be cancelled at the request of any interested party (Art. L223-31).[374]

Managers and shareholders other than legal personality shall be prohibited from borrowing from the company or arranging the company to stand surety for them or having the company secure or guarantee their personal debts.[375] Any such arrangement shall be null and void (Art. L223-21).[376] The initial managers shall be jointly or severally liable to the company or to third parties for breaches of the legislative provisions applicable to SARLs, for breaches of the memorandum, their errors of

[371] If members decide not to appoint an auditor of the formation proceedings or if the stated value is different from that suggested by the auditor's report, the members shall be jointly liable for five years with respect to third parties for the value attributed to contributions in kind (Art. L223-9).
[372] According to this provision, company is also bound by acts of the manager which are not covered by the purpose of the company unless it proves that the third party knew that the act was outside the purpose of the company.
[373] Arslan, p.50.
[374] *See*, Çelik, p.194; Arslan, p.50.
[375] See, Jocić, p.216.
[376] Only if the company operates a financial establishment, this prohibition shall not apply to current commercial transactions of the company under normal conditions.

management and the damages resulting from the annulment (Art. L223-22).[377] The remaining provisions, which are compatible, and certain grounds of dissolution are common to all companies and partnerships; therefore, they are also applicable to EURLs.[378]

When other types of limited liability companies are examined in the French Commercial Law, it can be seen that *societe anonyme* ("SA") is the most commonly used organization for large firms wishing to attract new investments. [379] This company form used to require a minimum of seven shareholders but with the amendment of Act No. 420 of 15 May 2001 Art. 101A to the FCC, a simplified joint-stock company may be established by one or more persons. The provisions regarding the SAs are parallel with the French SARLs; moreover, the rules on public limited liability companies shall apply to the simplified joint-stock company where they are compatible.[380]

When a joint-stock company consists of one person, it shall be referred to as the "sole shareholder" and the sole shareholder bares the losses up to the amount of their contributions. If there is a single shareholder, they shall exercise the powers conferred on the partners. (Art. L227-1). If a single-member holds all the shares in a simplified joint-stock company, the provisions of Art. 1844-5 of the Civil Code on dissolution shall not apply (Art. L227-4). In companies consisting of a single shareholder, the annual report, accounts and consolidated financial statements shall be drawn up by the chairman. The sole shareholder shall approve the accounts, following the auditor's report, within six months of the end of the financial year; the sole shareholder may not delegate these powers. The decisions of the single shareholder shall be indexed in a register and if his/her decisions taken constitute a breach of the provisions of this article, they may be cancelled at the request of any interested party (Art. L227-9).[381]

[377] Jocić, p. 215.
[378] Andenas and Wooldridge, p.140; Sayın, p.46; Çevik, p.49.
[379] Jocić, p.217.
[380] Çelik, p.179.
[381] Sayın, p.47, footnote 225.

2.2.4.3.3 Italian Law

Italian system requires companies to be constituted with a multiple membership. In other words, plurality of the members must be present at the time of incorporation.[382] In this regard, possession of all shares by a single-member is not considered to be a normal situation[383] until two provisions were introduced in the Italian Civil Code ("ICC") in 1942; ex. Art. 2362[384] (in respect of joint-stock (public)) companies, *Società per Azioni* ("Spa")) and ex. Art. 2497(2) (in respect of private limited liability companies, *Società a responsabilità limitata* ("SRL")) which set forth that, in case of insolvency, debts and liabilities acquired during the period in which all shares of the company are held by a single person, are to be borne by the unlimited liability of that person.[385] The old Commercial Code of 1882 did not have such kind of provisions and their inclusion was suggested as a result of a series of court rulings during the 1920s and the 1930s.[386] It can be observed that the 1942 ICC permits creditors of single-member companies to appeal directly to the sole shareholder, but only in cases of bankruptcy. In addition, the concentration of all shares does not lead to the disappearance of the corporate legal personality,[387] but only to the personal liability for the single shareholder. In this case there is a derogation, in 1942 ICC, from one of the main principles of company law, which is that the shareholder of a limited liability company is only responsible to the extent of his/her contributions.[388]

Before the Twelfth Directive, Italy had no provision for limited liability single-member companies. The legislative Decree No. 88 of 3 March 1993[389] ("1993 Decree"), which implemented the Twelfth Directive, allowed this new institution. The 1993

[382] Alberto Mazzoni, "The One-person Corporation in Italian Law", **IBLJ**, 4, 1991, p.500; Pasa and Benacchio, p.359.
[383] Mazzoni, p.500.
[384] Here, referring to the original version of Art. 2362, which implies the joint liability of the sole shareholder. This provision is later amended to require compliance with certain disclosure requirements, failing which the sole member is held jointly liable pursuant to Art. 2325 ICC, in case the company is declared insolvent, Alberto Santa Maria, **European Economic Law**, 2nd Ed., The Netherlands: Kluwer Law International, 2009, p. 89.
[385] Santa Maria, p.91; Mazzoni, p.500; Çelik, p. 170-171.
[386] Mazzoni, p.500.
[387] The existence of the company thereby not affected, W. H. Balekjian, **Legal Aspects of Foreign Investment in the European Economic Community**, Manchester University Press, 1967, p.83.
[388] Santa Maria, p.91.
[389] Decreto Legislativo 3 Marzo 1993, n. 88 (GU n. 078 Suppl.Ord. del 03/04/1993).

Decree laid down some rules aimed at safeguarding the position of third parties and introduced important amendments to the ICC.[390] In the first place it changed the basic concept of a company by amending Art. 2247 of the ICC. Any company can now be constituted without executing a contract when the plurality of members joins to form a company. In this connection the heading "Definition of Company" (*nozione di società*) of Art. 2247 of the ICC, which lead the idea of exclusive applicability, is replaced with "Company Contract" (*contratto di società*), which restricts its application to the case of a company originated by contracts, thereby showing that a company can also be constituted by a unilateral act (now Art. 2463(1), ex. Art. 2475(3)).[391] As a result, an SRL may be formed by the act of a single person and may still maintain the single-member's benefit of limited liability.[392] However, the 1993 Decree did not apply this option which represented by the Twelfth Directive to Spas and not permit the existence of single-member Spas.[393]

The Italian company law reform which is enacted in January 2003[394] ("2003 Law Reform"), is considered to be the most important and far-reaching amendment to the company law section of the ICC since its enactment in 1942.[395] A positive outcome of this reform is that the recognition of the single-member company with limited liability extended to any Spa or any SRL. The 2003 Law Reform used the chance offered by the Art. 6 of Twelfth Directive and introduced the possibility of setting up a Spa with a single-member.[396] With this amendment, the sole shareholder of a Spa will not lose the privilege of limited liability, provided he/she pays out the whole legal capital that has subscribed and fulfils his/her obligations of disclosure with publicity in the registry of enterprises (Art. 2325(2)).

The amended version of Art. 2362 of the ICC under the heading of "Sole

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[390] Pasa and Benacchio, p.360.
[391] Santa Maria, p.155.
[392] The amended version of the Art. 2497(2) by the 1993 Decree provides that if the sole shareholder is a legal person or is at the same time the sole shareholder of another limited liability company, he/she shall have unlimited liability, Çelik, p.186-187.
[393] Bruno L. Cova, "Italy: Company Law: Implementation of EC Directives", **ICCLR**, Vol.4, No.6, 1993, p.C115.
[394] Legislative Decree 5/2003 and 6/2003 which it takes effective from January 1, 2004.
[395] Paulo Montalenti "The New Italian Corporate Law: An Outline", **ECFR**, 3, 2004, p.370; Stefano Cappiello and Gianmaria Marano, "The Reform of the Legal Framework for Italian Enterprises and the 2003 Company Law", **ICCLR**, Vol.14, No.6, 2003, p.216.
[396] Bruno L. Cova, "Implementation of the EC Company Law Directives in Italy", **ICCLR**, Vol.3, No.1, 1992, p.33; Montalenti, p.370.

Shareholder" (*unico azionista*) concerns with disclosure requirements of Spas which provides that, when all shares are owned by a sole shareholder or there is a change in the sole shareholder, the directors shall file a declaration for entry in the registry of enterprises containing the surname and name or corporate name, the date and place of birth or the date and place of the company's establishment, the domicile or headquarters and nationality of the sole shareholder. Furthermore, the third paragraph of the same Article states that the sole shareholder, or the party who ceases to be, may be discharged for the publicity requirements set forth in the preceding paragraphs. In addition to this, according to the ICC, the contributions may be either in cash or kind but, at the subscription of the deed of incorporation, at least twenty five percent of cash contributions must be deposited in a bank (Art. 2342 (2)). However, in case of a single-member company the whole capital must be deposited otherwise the single shareholder is personally held liable for obligations arising until the payment.

It can be observed from the above stated provisions that, ICC has introduced a general rule applicable to any form of company limited by shares, whatever its shareholding structure, which is that the company shall be liable for its obligations to the extent of its contributions. As it is mentioned before, there is an exception to this rule in case of insolvency, if all shares are owned by a single shareholder, the single-member shall have unlimited liability for the obligations of the company during the sole shareholding insofar as the whole share capital is not contributed in accordance with Art. 2342 or the disclosure requirements is not complied with pursuant to Art. 2362 (Art. 2325).[397]

The 2003 Law Reform gives a crucial importance to the problem of information available to third parties of acts concerning the single-member company. Particularly, the Italian legislature has regulated the disclosure aspect and another form of disclosure has been added to Art. 2250, with a paragraph 4, which requires each such company to indicate its status as a single-member company in all its acts and letterheads.[398] Consistent with this, when entire shares belong to a single-member, Art.

[397] Hülya Çoştan, "İtalyan Şirketler Hukukunun ve 2003 Tarihli Şirketler Hukuku Reformunun Genel Hatları", **BATİDER**, Cilt 24, Sayı 4, 2008, p.191.
[398] Pasa and Benacchio, p.359-360.

2470(4) imposes disclosure of the identity of the single-member SRLs in the commercial register. According to this provision, the directors are required to deposit a declaration in the register of enterprises indicating the surname and name or corporate name, the date and place of birth or the date and place of the company's establishment, the domicile or headquarters and nationality of the single shareholder.

The 2003 Reform Law envisaged the cases of unlimited liability of the single-member and amended 1993 Decree by abolishing the provision that excluded natural persons benefiting from limited liability where a private individual was the sole shareholder of more than one limited liability company.[399] Moreover, according to 2003 Reform Law Art. 2462(2) in case the SRL becomes insolvent, the single-member shall have unlimited liability for the obligations of the company during the sole shareholding insofar as the whole share capital, and any increase of it, is not contributed in accordance with Art. 2464 or the requirements of disclosure in the commercial register is not complied with pursuant to Art. 2470.[400] It is important to note that the Italian legislators have used the discretion given by the sixth "whereas" recital of the Twelfth Directive to provide for unlimited liability as a penalty in specific cases.[401]

Art. 4 of the Twelfth Directive requires a certain form for the single-member's decisions which are taken within the powers of the GA of the company and states that they must be recorded in minutes or drawn up in writing. However, there is not a special provision adopted in the ICC concerning this issue because the ICC already provides for a written form of the meeting in its Art. 2479.

For the contracts between the sole member and the company to be binding on the company's creditors, they must be indicated by the book of the BD or in a written document with a date certain prior to the attachment (Art. 2478(3)). With respect to Art. 2362, which concerns with Spas, such contracts can only be binding if they result from the book of shareholders' meetings and from resolutions of the BD or by a written document with a definite date that is prior to the attachment.

[399] Santa Maria, p.154.
[400] Çoştan, p.208.
[401] Pasa and Benacchio, p.360; Santa Maria, p.154.

While observing the characteristics of the regime of single-member SRLs and Spas in Italy, the main purpose seems to be facilitation of the development of SMEs. Especially the concern for the protection of third parties occurs, through devices for safeguarding the company capital, for forcing the identity of the single-member to be revealed,[402] it can be concluded that the Italian safeguards has gone beyond the minimum requirements of the Twelfth Directive.

2.2.4.3.4 Spanish Law

Spanish private companies, *sociedades de responsabilidad limitada*, ("SL") were introduced by the Law of 17 July 1953 on private companies, *Ley 17 de julio 1953 de la Sociedades de Responsabilidad Limitada,*("LSL 1953") which undergone the amendment by Law 19/1989 of July 1989. The LSL was subsequently repealed by Law 2/1995 of 23 March 1995 relating to Private Limited Liability Companies, *Ley 2/1995, de 23 de marzo, de Sociedades de Responsabilidad Limitada*, ("LSL 1995") and was further modified by the New Limited Liability Company Law 7/2003 of 1 April 2003, *Ley 7/2003, de 1 de abril, de la sociedad limitada Nueva Empresa*, ("LSLNE").[403]

Spanish implementation of the Twelfth Directive occurred late and indeed the Commission threatened to take legal action against Spain for her non-implementation of the Twelfth Directive.[404] In the Law of 17 July 1951 on public limited liability companies, *Ley de 17 julio de 1951 de Sociedades Anonimas,* ("LSA "1951") Spain did recognize the possibility of a company becoming a single-member company as a result of the concentration of all shares into the hands of one shareholder; this application was also fallowed by the LSL 1953. As a result, if a company was left with a single-member this would not lead to its immediate dissolution. Furthermore, the Law Regarding Stock Companies approved by Legislative Royal Decree 1564/1989 of 22 December 1989,[405] which was an amendment to the LSA 1951, did not have any regulation relating to the

[402] Pasa and Benacchio, p.
[403] Andenas and Wooldridge, p.84; Fernando Juan-Mateu. "The Private Company in Spain -Some Recent Developments", **ECFR**, Vol.1, April 2004, p. 61.
[404] An action was issued by the Commission against Spain for failure to implement the Twelfth Directive but was later dropped; Case C-94/95 [1994] OJ C 161, p.9, Villiers, p.153.
[405] Real Decreto Legislativo 1564/1989, de 22 de diciembre, de la Ley de Sociedades Anónimas.

single-member company.[406] The situation was not dealt with this amendment because, although a company would not be dissolved when its shares were collected into the hands of one shareholder, there was no certain time limit mentioned in which the company had to regain more members.[407]

The Spanish reforms appeared in the LSL 1995 adopts a comprehensive approach to the concept of single-member company. Thus, the provisions are applicable not only to private companies but also to public limited liability companies.[408] According to the explanatory memorandum to the LSL 1995, the single-member company will not only be a legal instrument for SMEs but also be available to public limited liability companies.[409] Moreover, the companies are permitted to be formed as single-member companies from the beginning or to become single-member companies after the concentration of all shares by one shareholder; the sole shareholder may be a natural or legal person (LSL 1995 Art. 125).

Although Spain seems to have a liberal attitude towards business enterprise and wants to make single-member companies widely available, the LSL 1995 shows a strict approach towards publicity requirements and goes beyond the requirements of the Twelfth Directive in protecting third parties against the risks of this company form.[410] In this respect, the formation of a single-member SL must be evidenced in a notarial deed[411] and Art. 126(1) requires a public document to be registered with the identity of the single-member where the company is constituted with a single-member, or becomes a single-member company, or where there is a change in situation or transfer of shares.

Further, Art. 126(2) requires continuous publicity on notepaper and in dealings and announcements.[412] If, after six months of becoming a single-member company, that fact has not been publicized in the register, the sole member will be fully liable for debts of the company contracted during its single-membership. However, once the fact is

[406] The minimum membership required for the formation of the company was maintained except with regard to companies founded by state bodies.
[407] Villiers, p.153.
[408] Monica Cornet, "The New Law Governing Private Limited Liability Companies in Spain", **ICCLR**, Vol.6(10), 1995, p.353.
[409] Villiers, p.154.
[410] Villiers, p.155.
[411] Andenas and Wooldridge, p.86.
[412] Okan, Tek Üyeli Özel Limited Ortaklıklar, p.523.

registered the member does not become liable for later debts (LSL 1995 Art. 129).[413] Consistent with the Twelfth Directive, the single-member shall exercise the powers of GA and must sign minutes or arrange for the directors to sign them (LSL 1995 Art. 127). Contracts between the single-member and the company must be in writing or be in the proper form established by law and must be recorded in a commercial register (LSL 1995 Art. 128(1)). The company's annual report should also make reference to such contracts. In case of insolvency of the single-member or the company, any contracts which have not been formally recorded will not benefit from limited liability (LSL 1995 Art. 128(2)). During a period of two years from following the signing of a contract, the single-member will remain responsible directly and indirectly to the company for any profits lost to the company as a result of that contract (LSL 1995 Art. 128(3)).[414]

The New Limited Liability Company Law of 1 April 2003 (LSLNE) presents two restrictions relating to the shareholders of a *sociedad limitada Nueva Empresa* ("SLNE"). It provides that, only natural persons may be members of a SLNE and a SLNE may be incorporated with one member but not more than five (LSLNE Art. 136.2). With this reform law, the maximum number of the initial partners has been reduced to five, although this can be increased if any incorporator gives later a part of its shares after the company's incorporation (LSLNE Art. 133.1). It must be bear in mind that these restrictions do not apply to an ordinary SL, which may have any number of incorporators, and whose members may be either natural or legal persons. LSLNE also prohibits companies, and sole shareholders of other SLNE, from founding another SLNE (Art. 135 and 136). Another novelty is that, SLNEs do not have to keep a register of its members (LSLNE Art. 137), which will lead to the simplification of the formalities. Thus, shareholders may prove their membership with a notarial deed of each operation and the directors have to inform all members about each operation of the company.[415] The directors of the SLNE must be shareholders (LSLNE Art. 139.3); finally, SLNEs are not allowed to be governed by a BD (LSLNE Art. 139).[416]

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[413] *See* also, Çelik, p.190-191.
[414] *See*, Michael Johannes Oltmanns (Editor), **European Company Structures A Guide to Establishing a Business Entity in a European Country**, The United Kingdom: Kluwer Law International, 1998, p.218-219.
[415] Juan-Mateu, p.64-65.
[416] *See*, Ignacio Farrando, "Evolution and Deregulation in the Spanish Corporate Law", Working Paper (06-25-2004).

We can observe that Spain has regulated precise rules for single-member companies. There have been many debates and a radical shift in the Spanish company law because the traditional concept of the company arises from a contract between two or more persons. The company is once regarded as a contract by which the money, property or work of two or more persons are brought together in order to gain profit, therefore; the notion of a company originating with a single-member contradicts with these principles. The inevitable result of this problematic leads to a reform, which offers broad recognition to the concept of single-member company.

However according to *Villiers*,[417] the demand made of a single-member company in Spain in terms of publicity and inevitable cost, causes limits on the success of this enterprise form. While agreeing with the author, I would like to add that Member States should interpret the Articles of the Twelfth Directive in a way that availed them to prepare detailed national regulations on the operation of single-member companies. Since, publicity is a crucial component in protection third parties and one of the important tools for distinction of a single-member company from a multi-member limited liability company, the rules on publicity can be fashionably strict. However, the regulations shall not, in any way, harm the attractiveness of this new investment form.

2.2.4.3.5 German Law

Germany adopted the Act on Limited Liability Companies, *Gesellschaften mit beschränkter Haftung Gesetz,* ("GmbHG"), in 1892. Significant changes were made to the GmbHG relating to matters such as loans from shareholders and the giving of information to them or the minimum shareholder requirements by the Act of July 4, 1980 (*Novelle*).[418] Yet, the most far reaching amendments to the 1892 GmbHG was made with the passing of the Act to Modernize the Law Governing Private Companies and to combat Abuses, *Gesetz zur Modernisierung des GmbHRechts und zur Bekampfung von Missbrauchen*, ("2008 MoMiG"), which took effect on November 1, 2008.[419]

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[417] Villiers, p.156.
[418] BGBl (1980)1.836.
[419] Frank Wooldridge and Liam Davies, "Recent reforms of the German GmbH", **Comp. Law**., Vol. 31, No. 2, 2010,

In case of German limited liability company, *Gesellschaften mit beschränkter Haftung* ("GmbH"), the shareholders bear no responsibility beyond their investment. In case of single-member limited liability company, despite the fact that it has only one shareholder, the separation of corporate and individual assets will still apply. However, there are exceptional situations established by the case-law, where the sole shareholder is held personally liable when there are abuses of this privilege.[420] Nevertheless, a crucial decision of the Federal Supreme Court, which legalized the single-member GmbH, supported the distinction in principle between legal personality and sole ownership;[421] thus, reinforcing the limitation of the single shareholder's liability.[422]

In case of stock corporation, *Aktiengesellschaft* ("AG"), the amendments of 1965 to the Act on Stock Corporations, *AktienGesetz* ("AktG"), demonstrated an attempt to replace the national-socialist view of the 1937 AktG and created a democratic framework in order to attract investment in the AGs.[423] There were minimum membership requirements in the formation of companies in German corporate law but it was observed that these requirements were circumvented in practice by the use of 'straw men' formations.[424] Therefore, according to the 1965 AktG, a company is not required to liquidate if and when its membership falls below the minimum requirement for its formation (1965 AktG § 262).

With the 1965 amendments, the merger of a subsidiary into its parent company is considered as "integration" (Einliederung) and in case of integration; the AG becomes in effect a business division of its parent AG.[425] The 1965 AktG necessitates that both the controlled company and the controlling undertaking shall be AGs and the controlling AG shall be the sole shareholder in the controlled AG (AktG § 319).[426] Developments after 1965 gave rise to new company legislation, such as the Conversion

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p.62.
[420] Tony Orhnial, **Limited Liability and The Corporation**, London: Croom Helm, 1982, www.books.google.com, (last accessed on 10.09.2010), p.65.
[421] BGHZ 22/266.
[422] Tekinalp, Tarihi Gelişimi İçinde Tek Ortaklı Şirketler, p.585.
[423] Orhnial, p.51.
[424] Orhnial, p.64.
[425] Sayın, p.55; Christian Campbell (Editor), **Legal Aspects of Doing Business in Europe [2009] II**, Yorkhill Law Publishing, 2009, www.books.google.com, (last accessed on 15.06.2010), p.GER-12.
[426] Petri Mäntysaari, **Comparative Corporate Governance- Shareholders as a Rule Maker**, Springer, 2005, www.springer.com, (last accessed on 10.01.2011), p.370.

Law (*Umwandlungsgesetz*) that facilitated the transformation of companies into other forms.[427]

It can be observed that the German company law has been amended several times, mainly to implement the EC Company law harmonization directives. Thus, it is important to make a detailed examination of German company forms in order to give sufficient information about the framework of single-member formation.

2.2.4.3.5.1 Single-Member Private Limited Liability Company (GmbH)

The GmbH can be defined as a company which can be formed by one or more shareholders who contributes to the capital without being personally liable. There is no limit to the number of founders or eventual shareholders.[428] The GmbHG, has not changed significantly, the only important amendment was the Act of July 4, 1980, which came into force on January 1, 1981, but this act only provided for a partial revision of the GmbHG. The 1980 Act allowed the incorporation of limited liability companies by a single shareholder.[429]

A GmbH may be formed by one or more natural or legal persons for any lawful purpose (GmbHG § 1). There is no restriction for a natural person or legal person to be the sole shareholder of more than one single-member GmbH.[430] The company's statutes must be executed in notarized form by all its founders (GmbHG § 2(1)) and must contain particulars of the name and registered office of the company (GmbHG § 2(3)). The first step for formation of a GmbH is the signing of the formation documents consisting of the memorandum of association and the articles of association. Although the company has been formally created after this procedure, it still lacks the status of a legal entity. Such legal personality will only be gained by the entry in the commercial register on verification of all foundation requirements. Only when these requirements are met, the company will benefit from the limited liability.[431] In other words, the

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[427] Orhnial, p.50-51.
[428] Jocić, p.212.
[429] Mathias Reimann and Joachim Zekoll, **Introduction to German Law**, The Netherlands: Kluwer Law International, 2005, p.18.
[430] Jocić, p.212; Çelik, p.186.
[431] Thomas Krecek and Daniela Weber-Rey, "Liability During the Process of Formation of a German Limited Liability Company ("pre-GmbH")", **ICCLR**, Vol.8, No.3, 1997, p.95.

GmbH does not exist prior to its entry into the commercial register of the domicile of the company; until the registration, it is called as "pre-incorporation company" (Vorgesellschaft) without status as a legal person. Therefore, before registration, anyone acting in the name of the company are themselves jointly and severally liable with the pre-incorporation company to the creditors for any liabilities incurred (GmbHG § 11).[432]

The list of shareholders has to be submitted to the commercial register initially with the formation of the company and subsequently each time the composition of shareholders changes (GmbHG § 40).[433] Whenever there is a change in the shareholding, the managing directors are required to submit an updated list to the commercial register. If there is a transfer or pledge of shares in GmbH, the notary notarizing the transfer of shares is obliged to submit the updated list of shareholders to the competent commercial register (GmbHG § 40 (2)).

Before the 2008 MoMiG, a single-member GmbH could not be registered until at least one fourth of the contribution required to be paid in cash had been paid to the company, and any agreed contribution in kind had been placed at the disposal of the company.[434] The sole shareholder was required to provide a security for any remaining part of the cash contribution which had not yet been paid.[435] This provision is repealed with the 2008 MoMiG, GmbH with a sole shareholder no longer requires a deposit for the outstanding capital contribution, there is now no need to provide any security when a GmbH is formed by a single shareholder,[436] the commercial register may only request this where there are significant doubts about the proper raising of capital.[437]

The application for entry in the commercial register must be signed in notarized form by all managers (GmbHG § 8 and 78). With the 2008 MoMiG, the court of registration can only ask for proof in case of substantial doubts as to the reliability of

[432] Jocić, p.215; This provision also applies to managing directors, BGHZ 80, pp. 129/130.
[433] Frank Dornseifer, "Germany", Frank Dornseifer (Editor), in **Corporate Business Forms in Europe: A Compendium of Public and Private Limited Companies in Europe** (211-294), Munchen: European Law Publishers, 2005, p.272.
[434] Andenas and Wooldridge, p.70.
[435] Andenas and Wooldridge, p.68.
[436] Wooldridge and Davies, p.62.
[437] Fatih Aydoğan, "Federal Almanya'da Limited Şirketler Kanunu'nda (GmbHG) Yapılan Değişiklikler (MoMiG)", **BATİDER**, Vol.25, No.3, 2009, p.397.

the assurance given by the managers that the contributions are at the company's final and free disposal (GmbHG § 8(2) sentence 2). Giving false information for the formation of the company leads to founding liability for the shareholder and the managing directors (GmbHG § 9a) as well as of punishability of these persons (GmbHG § 82(1)). The court of registration shall examine whether the company is properly set up and has properly applied for registration (GmbHG § 9c). If at the date when the company is registered the value of a contribution in kind has fallen below that is stated in the articles, the court shall refuse the registration (GmbHG § 9c). If it fails to do so because of misinformation or some oversight, then the contribution must pay the shortfall to the company in cash (GmbHG § 9(1)).[438]

The resolutions of the shareholders normally take place in a meeting (GmbHG § 48(1)). It is not necessary to take minutes of resolutions of GA but it is possible to agree to certain decisions by written agreements outside the shareholders' meeting (GmbHG § 48(2)). However, in the case of a single-member company, the shareholder is obligated to prepare and sign a record in writing without delay after the passing of the relevant resolution (GmbHG § 48(3)).[439] Some authors argue that the lack of application this provision leads to nullity of the decision. The others suggest that the sole shareholder cannot benefit from decisions that has not been recorded in minutes or drawn up in writing.[440]

Each manager may enter into binding transactions on behalf of the company. The managers may not represent the company in transactions with themselves, but the articles of association may enable them to do so.[441] It is provided that business transactions conducted between the single-member GmbH, represented by its shareholder-managing director, and its shareholder shall be recorded in writing and

[438] Gerhard Wirth, Michael Arnold and Mark Greene, **Corporate Law in Germany**, Munchen: C.H. Beck, 2004, p.10; Andenas and Wooldridge, p.69; A hidden contribution in kind does not eliminate the obligation to make a capital contribution, but the agreements on the contribution in kind are no longer considered invalid but remain in effect and the value of the contributed asset is credited against the remaining cash contribution obligation of the shareholder (GmbHG § 19(4)), Reform of the German Limited Liability Company Act (GmbHG)-Impacts on Private M&A Transactions, Hengeler Mueller Newsletter VI/2008, http://www.hengeler.com/fileadmin/medien/broschueren/PE_Newsletter_05_08.pdf, p.6, (last accessed on 01.02.2011)
[439] Reimann and Zekoll, p.167; Andenas and Wooldridge, p.306.
[440] For references of two opinions *see*, Jocić, p.215.
[441] Andenas and Wooldridge, p.301.

shall be completed immediately after the business has been conducted (GmbHG § 35(4)).[442] In case of a single-member GmbH, if the sole shareholder is the company's sole managing director at the same time, Art. 181 of the German Civil Code[443] will be applicable to the legal transactions between the sole shareholder and the company (GmbHG § 35(3)).[444]

2.2.4.3.5.2 Single-Member Joint-Stock Corporation (AG)

The basic statute governing the AG, has introduced various modifications for so-called "small stock corporations" (*kleine Aktiengesellschaften*) with the law of August 2, 1994.[445] Before the small AGs have been introduced, the minimum membership requirement for formation of an AG was five. Nevertheless, the single-member AG, which comes about through the concentration of all the shares in the hands of one shareholder subsequent to formation, has long been recognized in Germany. With the 1994 amendments, Art. 2 of the AktG, has permitted the formation of an AG with one or more shareholders, who may be a natural or legal person.[446]

The formation deed must include the names of the founders, the amount of the paid-in share capital[447] and certain information concerning the shares (AktG 23(2)).[448] The formation of an AG must be accompanied by the subscription for all the company's shares which must not be issued until the company is entered in the commercial register (AktG 41(4)). Such an issue may be for cash or be made in respect of contributions in

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[442] Daniela Weber-Rey, "Germany: Company Law: Single Member Companies", *ICCLR*, 1993, Vol.4, No.5, Westlaw Database, (last accessed on 17.09.2010), p.C88,

[443] This Article suggests that an agent may not, without permission, enter into a legal transaction in the name of his principal with himself in his own name, or as agent of a third party, unless the legal transaction consists exclusively in the fulfilment of an obligation, the English version is available in, http://www.gesetze-im-internet.de/englisch_bgb/englisch_bgb.html#BGBengl_000P181, (last accessed on 2.12.2010)

[444] The GmbH allows contracts between the company and the single-member without any restriction, Jocić, p.216; Çelik, p.195.

[445] *Gesetz für kleine Aktiengesellschaften und zur Deregulierung des Aktienrechts*, BGBl. I Nr.52 vom 9.8.1994, p.1961, Veliye Yanlı, **Anonim Ortaklıklarda Tüzel Kişilik Perdesinin Kaldırılması ve Pay Sahiplerinin Ortaklık Alacaklılarına Karşı Sorumlu Kılınması**, İstanbul: Beta Yayınları, 2000, p. 137; Dornseifer, Germany, p.219.

[446] Frank Wooldridge, "A Simplified Legal Regime for Small and Medium-Sized German Public Companies", **Comp. Law.**, Vol.22, No.1, 2001, p.27.

[447] During the formation it is not requested that the total amount of the share capital as subsequently registered with the commercial register is paid in, 36a sec.1 AktG.

[448] Dornseifer, Germany, p.220.

kind, such as an existing business (AktG 27).[449]

The sole shareholder of an AG is required to give security for the payment of any unpaid cash contribution during the formation (AktG 36(2)). Contributions in kind must be made in full; yet, where the contribution in kind consist of transfer of assets this obligation must be fulfilled within five years of the registration of the company (AktG 36a(2)).[450] Moreover, if a company initially formed as a multi-member company eventually come to have a sole shareholder or if all its shares belong to one person, or to that person and the company, the first name and surname of that person, his occupation and place of residence must be communicated without delay to the commercial register where the company is situated (AktG 42).[451] The AG gains its own legal personality upon registration. Prior to registration the corporation is considered to be a pre incorporated company (*Vor-Aktien-Gesellschaft*).[452] In an AG, each resolution of the GA must be recorded in minutes of the meeting taking the form of a notarial deed, except where the company is an unlisted one (AktG 130(1)).[453]

Art. 181 of the German Civil Code, as in the case of GmbHs, applies to the business transactions between the company and the sole shareholder. Some important business decisions may require the consent of the supervisory board.[454] In order to avoid conflicts of interest, the company when dealing with a member of the BD, is represented by the supervisory board (AktG 112).[455]

2.2.4.3.5.3 Single-Member Limited Partnership with a Limited Liability Company as General Partner

Limited Liability Company&Co. (GmbH&Co. KG), is a German limited partnership, *Kommanditgesellschaft*, ("KG") in which a limited liability company,

[449] Andenas and Wooldridge, p.72.
[450] Andenas and Wooldridge, p.75.
[451] Wooldridge, A Simplified Legal Regime, p.27; Andenas and Wooldridge, p.77; Çelik, p.190.
[452] Dornseifer, Germany, p.221; Despite this, there is a discussion about the nature of a single-member company before registration. Some authors argue that it is an economic entity having partial legal capacity; whilst, others suggest that it is a special property of the sole shareholder subject to the reservation that the pre-incorporation company is suitably organized, Andenas and Wooldridge, p.77.
[453] Andenas and Wooldridge, p.317.
[454] The supervisory board represents the company in its transactions with the BD; this includes entry into employment agreements with its members, Andenas and Wooldridge, p.427.
[455] *See,* for further arguments, Çelik, p.195.

GmbH, participates as the sole personally liable partner and limited partners, &Co, whose liability is restricted to their fixed contributions to the limited partnership, KG.[456] The single-member GmbH&Co. KGs has emerged as a special type in which the sole shareholder of the GmbH, who is the general partner, is the same individual as the limited partner.[457] The sole shareholder may instead be the limited partnership itself.[458] This structure is debatable in theory, when a single-member GmbH is converted into a GmbH&Co. KG because a conversion is allowed only if all of the shareholders of the converting entity prior to the conversion are shareholders of the entity after conversion, the result will be that in case of single-member GmbH the same person will be both the limited and the general partner.[459]

2.2.4.3.6 Austrian Law

An Austrian private limited liability company, GmbH, may be set up by one or more, natural or legal persons. Transactions between the company and the sole shareholder are permitted only if they are recorded in writing. The "declaration of establishment", *Erklarung uber die errichtung der gesellschaft*, of a single-member company, must be executed with the presence of a notary with a notarial deed. Moreover, the formation of a joint-stock company, AG, with one member and the consolidation of all shares of an AG in the hands of a single shareholder is permitted with the law of 2004. In that case, the name of the single shareholder has to be registered with the commercial register.[460]

2.2.4.3.7 Belgian Law

The Belgian private limited liability company, *Société privée à responsabilité limitée* ("SPRL") or *bestolen vennootschap met beperkte aansprakelijkheid*, is examined in detail in Arts 210-349 of the new Belgian Companies Code of May 1999.

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[456] Reimann and Zekoll, p.144.
[457] Orhnial, p.64
[458] Andenas and Wooldridge, p.160
[459] Beretka Katinka, "Concept of Single Member Companies in the Light of EU Harmonization- Comparative Analysis of Serbia, Germany, United Kingdom", (**LL.M. Short Thesis**, Central European University, 2010), p.14; *see* also, Tekinalp, Tek Kişilik Ortaklık, p.43.
[460] Christian Campbell (Editor), **Legal Aspects of Doing Business in Europe [2009] I**, Yorkhill Law Publishing, 2009, www.books.google.com, (last accessed on 15.06.2010), p.AUT-5-7.

According to Belgian law, a SPRL may be formed with a single-member and there is no upper limit to its membership (Belgian Companies Code Art. 220). When an SPRL has only one member who is a natural person, such member is deemed to guarantee the obligations of any other single-member private company which he forms, or of which he subsequently becomes the single-member, unless the shares are transmitted to him by reason of death (Belgian Companies Code Art. 212). This guarantee ends with the entry of a new member or the dissolution of the company. Furthermore, if the founder of a single-member SPRL is a legal person, the latter is jointly and severally liable for the obligations which the SPRL enters into so long as the company has only one member.[461] When an SPRL becomes single-member company after the formation of the company and this situation lasts for a period of one year without the entry of a new member or the dissolution of the company, the single-member is deemed to guarantee all the obligations of the company which come into existence between the time when the legal person became the single-member of the company and the time when the company acquires a new member or consent is given for its dissolution (Belgian Companies Code Art. 213).[462]

2.2.4.3.8 Dutch Law

According to Dutch law, a public limited liability company, *Naamloze Vennootschap*, ("NV") or private limited liability company, *Besloten Vennootschap*, (BV) may have a single shareholder and such shareholder may be a natural or legal person. In addition, such a single-member company is required to file the name and the domicile of the sole shareholder with the commercial register where the company is situated.[463] If all shares in the capital of a company form part of a matrimonial community of property, the company is deemed to be held by a single shareholder (Dutch Civil Code Art. 91a).[464] Shares in the possession of the company itself or a subsidiary are disregarded for this purpose. Resolutions taken at the GA of a BV must

[461] Okan, Tek Üyeli Özel Limited Ortaklıklar, p.522.
[462] Frank Wooldridge, "Some Characteristics of the Belgian SPRL: Comparisons with the SA", **Comp. Law.**, Vol.23, No.5, 2002, p.161; Andenas and Wooldridge, p.124-125.
[463] Setting up a limited company in the Netherlands, Expatax, http://www.expatax.nl/Documents/Brochure%20Setting%20up%20a%20limited%20company%20in%20the%20Netherlands.pdf, p.6, (last accessed on 10.12.2010).
[464] Hans Warendorf, Richard Thomas and Ian Curry-Sumner, **The Civil Code of the Netherlands**, The Netherlands: Kluwer Law International, 2009, p.222.

be recorded in writing. Transactions between the NV/BV and the sole shareholder in his or her private capacity must also be recorded in writing but this does not apply to current commercial transactions of the company under normal conditions.[465]

Such a transaction will be null and void unless the GA explicitly decides that the company can be represented in this transaction by its sole shareholder-director.[466]

2.2.4.3.9 Polish Law

According to Polish Commercial Code ("PCC"), *Kodeks spółek handlowych*,[467] both private limited liability company, *spółka z ograniczona odpowiedzialnością* ("Sp. z o.o.") and joint-stock company, *Spółka akcyjna* ("SA"), may be formed by a single shareholder as far as that sole member is not a single shareholder limited liability company (PCC Arts 151(2) and 301(1)). The application to register a sole shareholder company shall include the name and surname, or the company name and domicile of the sole shareholder as well as the annonotation that he is the sole shareholder.[468] Normally, the resolutions of shareholders are taken at the shareholders meeting. In a single-member company, the sole shareholder exercises all rights provided for the shareholders' meeting. Furthermore, a resolution may be adopted without holding the meeting if all the shareholders agree in writing about a decision about to be made (PCC Art. 227).[469]

The single-member companies were first allowed by the PCC of 1934[470] and there have been many amendments in order to make transactions easier between the company and its sole shareholder. On 23 October 2008, certain changes to the PCC were adopted to come into force on 8 January 2009. Before this amendment, any declaration of intent of the sole shareholder, which was not categorized as a resolution, must be in writing and notarized by a notary and in case the sole shareholder was also the sole manager of the company, transactions between him/her and the company must

[465] Bob Wessels, "Recent Changes in Corporate Law in the Netherlands", **ICCLR**, Vol.6, No.5, 1995, p.182.
[466] Kluiver, p.67.
[467] OJ, 2008/217/1381.
[468] Zdzislaw Brodecki (Editor), **Polish Business Law**, The Netherlands: Kluwer Law International, 2003, p. 102.
[469] Christian Campbell (Editor), **Legal Aspects of Doing Business in Europe [2008] III**, Yorkhill Law Publishing, 2008, www.books.google.com, (last accessed on 15.06.2010), p.III-103.
[470] Journal of Laws 1934/57/502, as amended.

be in the form of a notarial deed and must be notified to the competent court by the public notary making this deed (PCC Art. 173(2),(3) and 303(3),(4)).[471] These provisions are now repealed and in the current situation, a shareholder's declaration of intent may be made in a simple written form in transactions between the single shareholder and the company, without preserving written form with signatures certified by a public notary.[472]

2.2.4.3.10 Portuguese Law

In Portugal, a sole trader normally has unlimited liability; thus, he/she is personally liable for its business' debts. However, by registering as a sole trader with limited liability, *estabelecimento individual de responsabilidade limitada*, ("EIRL"), the sole trader will have the chance to limit its liability with the assets of his/her enterprise itself. On the other hand, in case of bankruptcy of the business, the assets of the sole trader may also be called; if it is proved that the basic principle of separation between the personal and business assets is not respected. A sole trader can form only one EIRL; moreover, with the introduction of single-member limited liability company in Portugal, an EIRL can also be converted into this type of company through a notarial deed.[473]

Portuguese private limited liability companies, *sociedade por quotas*, are as a rule, established by two or more shareholders. Portuguese law also permits the existence of single-shareholder limited liability companies. The name of a limited liability company needs to contain the word "*Limitada*" or the abbreviation "*Lda*" and the words "*sociedade unipessoal*" (single-member) must be included in front of those words, in case of single-shareholder limited liability companies. The minimum number of shareholders for incorporation of a joint-stock company, *Sociedade Anónim,* is five. However, under some circumstances, a joint-stock company may be incorporated with a sole shareholder as long as this shareholder is a legal person.[474]

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[471] Brodecki, p.104.
[472] Legal Alert, December 2008, http://www.dzp.pl/files/Alerty/Legal_alert_corporate_12.2008_3017611.pdf, (last accessed on 10.01.2011.), p.2.
[473] International Corporate Services Group, http://icsg.com/jurisdictions/?lang=en&country=56&id=77, (last accessed on 15.10.2010).
[474] News Lextter, Central and Eastern Europe Desk, January 2010, http://www.szecskay.hu/dynamic/NEWSLETTER_Doing_Business_Portugal_Hungary.pdf,

2.2.4.3.11 Czech and Slovakian Law

The private limited liability company, *společnost s ručením omezeným* ("SRO"), may be founded by one or more natural or legal person and may not have more than fifty shareholders according to Czech and Slovak Commercial Code.[475] However, a single-member SRO cannot be the single founder or shareholder of another SRO and a natural person may not become the sole shareholder of more than three SROs (Commercial Code Section 105 (2)).[476] A joint-stock company, *akciová společnost* ("AS"), may also be founded by a single shareholder, but only if this sole shareholder itself is a legal entity. This limitation only applies to the establishment of a company. If, after the formation of the company all shares are concentrated in the hands of a single shareholder, the company does not need to be liquidated, although the remaining single shareholder is a natural person (Commercial Code Section 162).[477]

No GA is held in case of single-member SROs and ASs, when the sole shareholder decides to exercise the powers of the GA, the decisions of the sole shareholder must be in writing and in certain cases a notarial deed is required. The attendance of the supervisory board is not mandatory when the single shareholder takes such decisions, but the shareholder may ask both the BD and the supervisory board to attend. Decisions of the single shareholder must be in writing and delivered to the BD and the supervisory board. The sole shareholder can act in the company's name if he is entitled to do so. Contracts between the sole shareholder and the company must be in the form of a notarial deed or in writing with authenticated signature (Commercial Code Section 132 and 190). In case a single shareholder AS acquires shares in the company in such an amount that enables the shareholder to control the company, the shareholder is

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(last accessed on 12.01.2011), p.3-4.

[475] Commercial Code No.513/1991 Coll., as amended, for English version *see*, http://www.cnb.cz/en/legislation/leg_capital_market/download/commercial_code.pdf%20, (last accessed on 10.12.2010).

[476] Martin Holler, "Czech Republic", Frank Dornseifer (Editor), in **Corporate Business Forms in Europe: A Compendium of Public and Private Limited Companies in Europe** (11-58), Munchen: European Law Publishers, 2005, p.37; Campbell, Legal Aspects [2009] I, p.CZR-9.

[477] Holler, p.16.

obliged to make an offer to the other shareholders of the company to take over their shares. The shareholder is also obliged to inform the company of such facts.[478]

2.2.4.3.12 Hungarian Law

The primary legislation governing the form and regulation of companies is Act IV of 2006 on Commercial Companies, which comes into effect on 1 July 2006. Both private limited liability company, *korlátolt felelösségü társaság* ("kft."), and joint-stock company (public or private), *nyilvánosan muködo részvénytársaság* or *zártköruen muködo részvénytársaság* ("nyrt." or "zrt."), may be founded by one or more natural or legal persons. The new 2006 Act permits a single-member kft. to become the sole member of another limited liability company.

Regarding the formation of a single-member kft., the contribution in kind of must be paid up in full before the submission of the application for registration. As for the contribution in cash, it is required to pay in only HUF 100.000 if the Arts so provide. When a single-member zrt. is established, the contribution is kind shall be paid up in full and twenty five percent of the cash contribution shall be paid before to the submission of the application for registration.

In case of single-member limited liability companies there is no shareholders' meeting; the single-member decides in writing on all issues falling into the powers of the shareholders' meeting and notify the managers;[479] hence, the sole shareholder of a single-member company can directly give written instructions to the BD. Furthermore, the new 2006 Act no longer prohibits the same person from being an executive officer or a supervisory board member of a single-member company.[480]

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[478] Slavomír Cauder, "Slovak Republic", Frank Dornseifer (Editor), in **Corporate Business Forms in Europe: A Compendium of Public and Private Limited Companies in Europe** (723-771), Munchen: European Law Publishers, 2005, p.734.

[479] Investment in Hungary, January 2010, http://kpmghu.lcc.ch/dbfetch/52616e646f6d495625eac379238878ac0056a83078652ada44eccd618de3d351/investment_in_hungary_2010_web.pdf, (last accessed on 10.12.2010), p.11.

[480] Business Law Alert; What the New Hungarian Companies Act Means to You, June 2006, http://www.ssd.com/publications/detail.aspx?pub=3345, (last accessed on 10.01.2011).

2.2.4.3.13 Greek Law

The Greek Commercial Code[481] provides that a private limited liability company, *Etairia Periorismenis Euthinis* ("EPE"), may be formed by one or natural or legal persons (Law 3190/ 1955 Art. 43a). However, a natural or legal person may not be the sole shareholder of more than one EPE.[482] According to the requirements imposed on single-member EPEs, a single-member company is obligated to state that the company is a single-member company and include the word *Monoprosopi*, which means the sole member, in its trade name. Moreover, the shareholder of a single-member EPE cannot be the sole shareholder of another single-member EPE and the resolutions of the shareholders' meetings must be executed and signed in front of a public notary.[483]

2.3 SOME PROBLEMS REGARDING THE SINGLE-MEMBER COMPANIES

In this part of the study, the problems, which may derive from the functioning of single-member companies in various legal orders, will be discussed and be demonstrated by case-law when it is necessary.

2.3.1 The Use of Straw Men Formations

In jurisdictions which do not legalize the establishment of single-member companies the proliferation of *de facto* single-member companies increases. It is possible to find a limited liability company with more than one shareholder but controlled by one shareholder and the other members are simply nominal shareholders.[484] Such shareholders are called "straw men" or "dummy shareholders".[485]

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[481] Law 3190/ 1955 as amended by Presidential Decree No. 279/1993.
[482] Dornsfier, p.358.
[483] Christian Campbell (Editor), **Legal Aspects of Doing Business in Europe [2008] II**, Yorkhill Law Publishing, 2008, www.books.google.com, (last accessed on 15.06.2010), p. II-121.
[484] Most of the nominal shareholders may be family members of the controlling shareholder.
[485] Paddy Ireland, "Limited Liability, Shareholder Rights and the Problem of Corporate Irresponsibility", *Cambridge Journal of Economics*, 2010, Vol.34, http://cje.oxfordjournals.org/content/34/5/837.full.pdf+html, (last accessed on 10.11.2010), p.847; *see* also, Fahiman Tekil, **Adi, Kollektif ve Komandit Şirketler Hukuku**, İstanbul: Fakülteler Matbaası, 1996, p.21.

Moreover, the controlling shareholder may dominate the company in terms of both the number of shares he holds and the influence in the company.

The use of straw men can be observed in the jurisdictions where two or more members are required while setting up a limited liability company. In order to benefit from limited liability, unincorporated sole traders and small partnerships began to incorporate with straw men just to meet the minimum membership requirements of their national legislations.[486] The legality of this practice is widely questioned however Member States seriously have had to face with such kind of formation as it spreads.

Accordingly, in the middle 1890s, the UK has an experience of dealing with *de facto* single-member companies and the legality of straw men when the famous case of Salomon v. Salomon& Co. Ltd.[487] ("*Salomon Case*") reached to its courts. The facts of the *Salomon Case* were as follows; Mr. Salomon has been a sole trader in London for over 30 years. In 1892, he decided to convert his business into a limited company and he formed *Salomon & Co. Ltd.* with himself, his wife and five of his children as members and Salomon as the managing director. Mr. Salomon then sold his business to the company and received a further 20,000 shares and a £10,000 debenture from the company as the purchase price. As the managing director, Salomon held £20,001 of the £20,007 shares, and each of the remaining shares was held by a member of his family. The company soon ran into financial difficulties, and the holder of the debentures appointed a receiver and the company was eventually wound up. The assets of the company were only enough to pay the debenture holder but not the unsecured creditors who claimed that the company was no more than the agent or alias of Salomon, that the issue of debentures to him was a scheme to defeat the creditors and that, as the company was merely the agent of Salomon, he as principal should be liable to compensate the company against its trading debts. The Court of Appeal held that the whole transaction was contrary to UK the Companies Act and that the company was a mere sham, and an alias or agent for Salomon who remained the real proprietor of the business. Thus, he was liable to the company against its trading debts. However, the House of Lords reversed the decision and ruled that the company had met the legal requirements of

[486] Ireland, p.847-848.
[487] Salomon v. A. Salomon & Co. Ltd. [1897] A.C. 22, H.L.(E.), Westlaw database, (last accessed on 10.04.2011).

seven shareholders and it was not prohibited that six of them could hold at least one share each and decided that the business belongs to the company and not to Salomon, and Salomon was its agent.[488]

Salomon & Co. Ltd. was not, *de iure*, a single-member company, but it was in fact. Thus, it supported the arguments in favor of the legality of this type of company and demonstrated the possibility for a trader to limit the liability with the capital that the trader put into the business. As a result, various legal systems have followed this argument and recognized the validity of setting up *de facto* single-member company with straw men.[489]

For instance, before the legal recognition of single-member companies in the US, in order to comply with the statutory requirements, the owner of the enterprise sometimes has his/her family, employee, secretary or attorney join with him as incorporators and directors.[490] Such incorporators subscribe for shares as a condition to qualification as an incorporator therefore, that incorporators generally subscribe for shares they do not intend to purchase. In that case, the incorporators may assign their pre-incorporation share subscriptions and surrendered them to their real owner after the formal acts of incorporation, and these subscription transfers are presented at the meeting of the BD for the directors' approval. A resolution reflecting the director's approval shall be included in the minutes.[491] Consequently, the ultimate purpose of setting up a single-member company is accomplished in this way.

In Germany, the minimum membership conditions are sometimes circumvented by the use of straw men before the establishment of sanctions by the national legislation regarding the formation of single-member companies. In case of single-member companies, the sole shareholder can be held responsible for the company's obligations where there are abuses of limited liability. In the event of

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[488] For further comments on Salomon, *see*, Mosleh Ahmad At'Tarawneh, "The 'Single-Person' Company in the New Amended Company Law of the State of Qatar", **International Journal of Liability and Scientific Enquiry**, Vol.1, Nos.1/2, 2007, p.182; Simon Bowmer, "To Pierce or not to Pierce the Corporate Veil-Why Substantive Consolidation is not an Issue Under English Law", **Journal of International Banking Law**, 21, 2000, p.194; Davies, p.34.
[489] At'Tarawneh, p.183; Eroğlu, Single-Member, p.6.
[490] These incorporators are generally referred as "dummy incorporators".
[491] John E. Moye, **The Law of Bussiness Organizations**, 6th Ed., United States: Thomson&Delmar Learning, 2005, p.348; Sayın, p.63.

improper contracting with third parties, fraud, abuse of legal privilege and mismanagement, the sole shareholder can be personally liable.[492]

French law differed from German law since it did not recognize the legal personality of single-member companies until 1985. Before that time, a company validly formed by the adequate number of persons loses its corporate existence if the number of its shareholders has been reduced to one and the company will be treated as fictitious. Companies formed by one man with the help of nominal shareholders or straw men are considered as "fictitious companies" and are not validly incorporated. Hence, it is referred that fictitious companies were a threat to the public order as they were expressions of fraud and this approach was followed by the courts and the single-member company was classified as "non- existent".[493]

Consequently, Italy, in its old Commercial Code of 1882, requires companies to be constituted with a multiple membership; thus, it also excludes the formation of *de facto* single-member companies. With the effect of Italian case-law, the Commercial Code of 1942 permits creditors of a single-member companies to levy directly against the sole shareholder, but only in cases of bankruptcy, thus not at all times and in all cases. In addition, the concentration of capital does not lead to the disappearance of the corporate legal entity, but only to the personal liability for the sole remaining shareholder.[494]

It can be concluded that with the enactment of Twelfth Directive, the need for the use of straw men decreased;[495] since, the EU Member States, along with many non-EU states, permit the incorporation of a limited liability company with a single-member.

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[492] Orhnial, p.64-65.
[493] Juan M. Dobson, " "Lifting the Veil" in Four Countries: The Law of Argentina, England, France and the United States," **ICLQ**, Vol.35, No.4, October 1986, p.842; Cohn and Simitis, p.169-170.
[494] Mazzoni, p.500; Çelik, p.170.
[495] One can still choose to incorporate a limited liability company with straw men, even though there is no need to do so.

2.3.2 The Need for Piercing the Corporate Veil in Certain Circumstances

2.3.2.1 Limited Liability and Veil-Piercing

The concept of a company is an entity separate and distinct from its shareholders; hence, the obligations drawn from the operation of the business are those of the corporation itself; therefore, the shareholders are not personally accountable on such obligations of the corporations in which they own shares. Limited liability is regarded as the most significant feature of companies and it has been greeted with praise;[496] however, such wide acceptance has not prevented judiciary from disregarding the corporate entity under certain circumstances.[497] The separate entity status of a company has been commonly disregarded when it is used to defeat public convenience, justify wrong, protect fraud or defend crime.[498] With regard to single-member companies, it is now clear that, the fact that all shares of a corporation are held by one person is not sufficient ground for disregarding corporate personality. Consistently, the distinction between the corporate and the individual property of the sole shareholder is carefully preserved. The same is true for the corporate obligations of each one**.** Corporate creditors cannot obtain satisfaction from the sole shareholder's individual property, as creditors of the sole shareholder cannot obtain satisfaction from the corporate assets.[499]

2.3.2.2 Justifications for Piercing the Corporate Veil

Piercing the corporate veil[500] refers to the situations where the judiciary has decided that the separation of the personality of the company and the member is not to be preserved. The veil of incorporation is thus said to be pierced and personality of the

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[496] *See*, Davies, p.37-40.

[497] Veil piercing is an exception of limited liability principle, for a detailed discussion, *see*, Emrullah Kervankıran, "Sermaye Ortaklıklarında Sınırlı Sorumluluk İlkesine Karşı Önemli Bir İstisna: Tüzel Kişilik Perdesi'nin Kaldırılması", **Erzincan Üniversitesi Hukuk Fakültesi Dergisi**, Cilt XI, Sayı 3-4, Aralık 2007, p.453-471.

[498] There were many other theories with which courts have disregarded the corporate personality; but, in time the inconsistent application of these theories have left the law of piercing the corporate veil in complex situations in many jurisdictions, Patricia A. Carteaux , "Corporations -Shareholder Liability-Louisiana Adopts a Balancing Test for Piercing the Corporate Veil", **Tul. L. Rev.**, Vol.58, 1984, p.1091-1092.

[499] Cataldo, p.475-476.

[500] Various terminologies can be used regarding this concept. It is sometimes called "lifting the veil", "disregarding the corporate entity", or called as "*Durchgriff*" in German and "*non-reconnaissance de la personne morale*" in French, Yanlı, p.13-22; Gülören Tekinalp, Ünal Tekinalp, "Perdeyi Kaldırma Teorisi", **Prof. Dr. Reha Poroy'a Armağan**, İstanbul, 1995, p.389-390.

company and the shareholder is treated as one.[501] Veil-piercing is frequently associated with internal acts of fraudulent, illegal, or other improper conduct which creates an injustice.[502] The veil-piercing situations can be reduced to two broad headings: cases of abusive control of a company, and cases of lack of separation of the assets that give rise to economic units.[503]

There are exceptions to the principle that a company and its shareholders are separate legal entities[504] that have to be seriously distinguished. In this regard, there are cases in which the application of the separation principle will be disadvantageous to the creditors of the company in a way that will be accepted as unjust. This situation might occur in a single-member company; a sole or controlling shareholder who has failed to distinguish between the assets and affairs of the corporation on the one hand and his own private assets and affairs on the other hand and who has taken an advantage from doing so, may be personally liable for the debts of the corporation.[505] It is necessary to protect the interests of shareholders in cases, where shareholders do not sufficiently separate the assets of the company from their personal assets. This problem occurs often, but not exclusively, in single-member companies. Another example for the necessity to disregard the separate legal personality can be seen in cases in which the conduct of the shareholders causes a loss of the companies' assets and thus impairs the chance that the company will be able to satisfy the creditors.[506]

According to German law, the recognition accorded to single shareholder companies means that the corporate veil will only be pierced in exceptional

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[501] İpek Sağlam Atabarut, "İngiliz ve Amerikan Hukukunda Tüzel Kişilik Örtüsünün Aralanması Teorisi ve Uygulama Alanlarından Dava Örnekleri", **Prof. Dr. Nuri Çelik'e Armağan**, Cilt 1, İstanbul: Beta Yayınları, 2001, p.482-483.

[502] Sandra K. Miller, "Piercing the Corporate Veil Among Affiliated Companies in the European Community and in the U.S.: A Comparative Analysis of U.S., German and U.K. Veil- Piercing Approaches", **American Business Law Journal**, Vol. 36, 1998, p.80.

[503] Duncan L. Clore, **Financial Institution Bonds**, 3rd Ed., US: American Bar Association, 2008, p.146.

[504] *Salomon case*, which was cited above, firmly established the primacy of separate corporate personality and limited liability. Limited liability was not established in *Salomon* itself; limited liability was granted to English companies in the Limited Liability Act of 1855. *Salomon case* only affirmed the availability of the separate legal personality of single-member companies, Thomas K. Cheng, "Bridging a Transatlantic Divide: A Comparative Study of the English and the U.S. Corporate Veil Doctrines", Selected Works, January 2011, http://works.bepress.com/thomas_cheng1/5/, (last accessed on 10.02.2011), p.6-7.

[505] Cohn and Simitis, p.190-191.

[506] Dirk Hanisch, "The Liability of Shareholders for Obligations of the Company in Germany and the People's Republic of China", (**Dissertation**, City University of Hong Kong, 2007), http://lbms03.cityu.edu.hk/oaps/slw2007-6537-hd976.pdf, (last accessed on 15.09.2010), p.9.

circumstances. In a Federal Supreme Court decision[507] it is held that, the legal form "will not be lightly disregarded." Furthermore, in another case, it is decided that exceptions where the corporate entity is disregarded involve such cases as the issue of the GmbH as a receptacle for bribes.[508]

Regarding the current developments of veil-lifting in the EU level, in a recent case of the ECJ, Advocate General *Trstenjak* has delivered an opinion[509] which states that, there is not any provision in the Twelfth Directive which instructs the Member States to prescribe in their national legislation that the liability of a public limited company must be limited to the corporate assets, even though many Member States have such kind of provisions in their domestic legislations. For *Trstenjak*, the opposite is the case, especially since in its fifth recital[510] 89/667/EEC (Twelfth) Directive cites the principle of limitation of liability as a necessary 'legal instrument' of a single-member company, but it must be without prejudice to the laws of the Member States 'which, in exceptional circumstances, require that entrepreneur to be liable for the obligations of his undertaking'. As a consequence, according to *Trstenjak*, this suggests that piercing the corporate veil is perfectly lawful under Community law; however, the EU legislature has not regulated this itself.

In the fallowing section I will briefly discuss the situations in which the veil of incorporation will be pierced and apply these situations to single-member companies.

2.3.2.2.1 Liability of the Company as an Alter Ego

The concept of *alter ego* is applied to a person or group of persons who have a kind of control of a corporation; that, the acts of that person or group may be treated as acts of the corporation. This situation often occurs while piercing the corporate veil in order to hold a shareholder personally liable for the corporation's debts. In such a case,

[507] BGH judgment of January 30, 1956, 20 BGHZ 4, 14.
[508] *See*, Henry P. De Vries and Friedrich K. Juenger, "Limited Liability Contract", *Colum. L. Rev.*, May 1964, Vol.64, No.5, p.866-886.
[509] Case C-81/09 Idrima Tipou A.E. v. Ipourgos Tipou Kai Meson Mazikis Enimerosis, Opinion of Advocate General Trstenjak delivered on June 2, 2010, http://curia.europa.eu/, (last accessed on 10.04.2011), p.55.
[510] Fourth recital of 2009/102/EC Directive (revised form).

it should be proved that the *alter ego* completely dominated the corporate entity and abused the corporate structure in order to commit a fraud or wrong.[511]

The consolidation of almost all the shares of a corporation by one or a few individuals is not considered to be a sufficient legal basis for piercing the corporate veil. When acquisition of all shares by a single individual is combined with other factors, which clearly support ignorance of the corporate form on the basis of equity and fairness, courts have experienced little difficulty in applying the *alter ego* theory.[512]

In applying the *alter ego* problem, the responsibility of a sole shareholder for the obligations of his corporation must be distinguished from that where he makes contracts by original obligation for personal liability. No problem arises when the sole shareholder agrees personally and primarily to be responsible; the consequences of such a contract will be binding upon him. In situations where the single-member company is managed in an informal manner an ambiguous situation may occur; thus, the precise party which is intended to be bound by the contract may not seem so evident. This can be seen when the obligation stems from oral conversations. When the sole shareholder makes such kind of contract, which lacks precision of intent, the separation of personal and corporate assets will not apply and the sole shareholder will be held personally liable according to the *alter ego* doctrine.[513]

Another problem might occur where the sole shareholder expressly guarantees or agrees to meet a corporate obligation.[514] It shall be bear in mind that the single-

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[511] *See*, Vural Seven, Can Gürsoy, "Ticaret Şirketlerinde Tüzel Kişilik Perdesinin Kaldırılması", **İBD**, Cilt 80, Sayı 6, 2006, p.2461.

[512] Richard M. Buxbaum, "Commercial Law-Single Shareholder Company", **AJCL**, Vol.38, 1990, p.255.

[513] Warner Fuller, "The Incorporated Individual: A Study of the One-Man Company", *HLR*, 1938, Vol.51, Heinonline Database, (last accessed on 12.01.2011), p.1383.

[514] This can be done by an agreement to answer for the debt, default, or miscarriage of another, such as in the English case of *Macaura v. Northern Assurance* where the House of Lords uphold the separate corporate personality of Mr. Macaura's company and refuse to apply the *alter ego* doctrine, although he has complete control over the company. As a result, it is decided that Mr. Macaura cannot recover from his insurer since he has no insurable interest under the policy he has taken out for the company's property (Macaura v. Northern Assurance Co. [1925] A.C. 619). The property of a company belongs to it not to its member therefore, a shareholder does not have an insurable interests in the property of the company, L. S. Sealy, **Cases and Materials in Company Law**, London: Cambridge University Press, 1971, p.51; Another crucial case of the UK was *Gilford Motor Co. Ltd. v. Horne*, where an action was brought for the breach of a restraint of trade clause. The defendant, Mr. Horne, who was a former managing director of the Gilford Motor agreed to not solicit customers of the company when he left employment. However, he did not comply with the agreement and solicited the Gilford Motor's customers though a private limited company. The Court of Appeal declared that the company *"was formed as a device, a stratagem*" to hide the defendant and made an

member company is a method by which the sole shareholder engages in business. Whether it is regarded as corporate or private, it is eventually his property which will be used to pay the claim. Therefore, the agreements which the shareholder has agreed to be personally liable will defeat the corporate objective of limited liability. In any case, when such a controversy arises, the problem can be solved by answering the question; whether the promise of the sole shareholder was original or collateral. If it is original, he is personally bound by it and if it is collateral, he is not liable. Finally, in order to understand the nature of such promise, it shall be determined whether it benefits the shareholder directly and personally, or indirectly in his status as corporate shareholder.[515]

2.3.2.2.2 Liability Regarding a Subsidiary Company in a Corporate Group

Corporate groups (or groups of companies)[516] are enterprises organized in the form of a parent company (or controlling company) with hundreds of sub-holding, subsidiary, and affiliated companies which conduct a single integrated enterprise under common control.[517] A corporate group is created when a controlling enterprise and one or more controlled enterprises (or subsidiaries) are combined under the centralized management. Many problems regarding corporate groups may arise because of the managerial direction of the group in the interest of the enterprise as a whole.[518] It is generally endorsed that in a corporate group, each corporation is treated as a separate legal entity, and a controlling shareholder is distinguished from its subsidiary.[519]

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emphasis on his improper motive in setting up the company and thus, pierced the corporate veil to find him liable (Gilford Motor Co. Ltd. v. Horne [1933] Ch. 935), Atabarut, p.494-495.

[515] Fuller, p.1384.

[516] In corporate group terminology, the German word "*Konzern*" can be also used in several jurisdictions, such as in the Turkish legal system. *Konzern* also refers to an economic unit consisting of a group of companies, related by ties of control extending into the separate legal entities.

[517] Gül Okutan Nilsson, **Türk Ticaret Kanunu Tasarısı'na Göre Şirketler Topluluğu Hukuku**, İstanbul: On İki Levha, 2009, p.32-33; Andreas Cahn and David C. Donald, **Comparative Company Law**, USA: Cambridge University Press, 2010, www.books.google.com, (last accessed on 15.01.2011), p.677.

[518] Buxbaum, p.256-257.

[519] This approach is clearly observed in *Salomon* when the House of Lords imposed the separation between legal entity and shareholder by stating that, "*on incorporation, a company becomes a separate legal entity distinct and separate from its shareholders and it is not the agent of those shareholders, not even if it is a one-man company with one shareholder controlling all its activities.*" Furthermore, in another crucial case, *Adams v. Cape Industries Plc*. [1991] 1 All E.R. 929, the understanding of group liability is manifested. This case also established that the English law system recognizes the creation of subsidiary companies "*which though in one sense the creatures of their parent companies, will nevertheless under the general law fall to be treated as separate legal entities with all the rights an liabilities which would normally attach to separate legal entities.*" By stating that, the court in *Adams v. Cape* retreats the *Salomon* principle in the group context, underlining the separate identity of each group member and emphasizing

Sometimes, in order to gain maximum profit for the enterprise as a whole, the parent company's managers might attempt to structure the group's credit transactions in a way that will exploit the credit worthiness of its stronger components and the management might attempt to distribute the resources obtained to the most promising investment opportunities within the group.[520] In any case, the result of the distinction of legal personalities must be that the group's debts are distributed separately to each corporation in the group and the directors of each corporation in the group are regarded as owing their fiduciary duties to the separate entity of which they are directors.[521]

The activities of a parent company and its subsidiary should conform to the following standards: First there must be adequate financing of the subsidiary; the subsidiary should be established as a separate unit financed enough to meet its obligations. Secondly, the business transactions of the two units should be kept distinct. Thirdly, the formalities of separate corporate procedures must be distinguished carefully.[522] Lastly, the separation between two units should be emphasized and represented with a strict division to the public.[523] When these requirements are met, a parent and its subsidiary will be treated as separate entities, and the obligations and liabilities of each one will be kept distinct from the other. If there is a failure to fulfill these requirements the court may disregard corporate personality and consider the parent and subsidiary as one.[524] Consequently, liability may be imposed on the parent for contracts and torts of the subsidiary.[525]

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that a subsidiary is not the agent of its controlling shareholder, Alexander Daehnert, "Lifting the Corporate Veil: English and German Perspectives on Group Liability", **ICCLR**, Vol.18, No.11, 2007, p.394.

[520] Buxbaum, p.256.

[521] Michael Gillooly, **The Law Relating to Corporate Groups**, Australia: Federation Press, 1993, p.133-134; Limited liability is a privilege resulting from the separation of the shareholder and company assets being preserved and this must not be abused. Removal of assets, preventing the company from fulfilling obligations, harms the creditors and has to be penalised by lifting the corporate veil, Daehnert, p.401.

[522] The distinction between the two boards of directors shall be respected, even though the directors of both corporations are the same persons.

[523] William O. Douglas and Carrol M. Shanks, "Insulation from Liability through Subsidiary Corporations", **YLJ**, Vol.39, 1929, p.196.

[524] Bernard F. Cataldo, "Limited Liability with One-Man Companies and Subsidiary Corporations", *Law and Contemporary Problems*, 1953, Vol.18, No.4, Jstore Database, (last accessed on 16.10.2010), p.492.

[525] If we take the German system into account, we can observe that the German law governing the parent-subsidiary relationship (*Konzernrecht*), without regard to the corporate structure, protects the minority shareholders and creditors from impairment of the controlled company's capital and profits and require the controlling company to compensate the controlled company for annual net losses. In certain occasions, the law imposes liability upon the controlling entity for losses sustained by the controlled company. Where there is no control agreement, the law protects a controlled company against exploitation of its resources without adequate compensation, and requires

With respect to EU company law harmonization, when corporate groups are taken into account, firstly the level of the creditor protection in the Member State's national systems shall be observed. Then it shall determine whether the national laws protection of creditors is adequate and in conformity under the Twelfth Directive or whether it damages the privilege of limited liability of single-member companies.

Furthermore, there are many commentaries about the liability of the natural or legal person sole shareholder who wants to be the sole member of more than one company.[526] The general view is that the sole shareholder who is a natural person typically makes a controlling investment in only one company; whereas, a legal entity typically makes a controlling investment in several companies.[527] In order to deal with these issues, the Twelfth Directive establishes a creation and membership clause which leaves the Member States with broad discretion in interpretation of this article.[528] In this sense, Art. 2 of the Twelfth Directive is a possible solution regarding this issue but, since the national applications differ widely from each other, the harmonization purposes of this article cannot be fully performed.

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extensive disclosures by the controlling company, Yitzhak Hadari, "The Structure of the Private Multinational Enterprise", **Michigan Law Review**, Vol.71, No.4, March 1973, p.795.

[526] For instance, Germany permits a legal person, as controlling company, to be the sole member of another single-member controlled company. Three kinds of liabilities, under Art. 2(2)(b) of the Twelfth Directive, are suggested in Germany; first, compensation for loss suffered by the subsidiary; second, liability based on lasting mismanagement; third, liability of the parent company for individually damaging measures. One of the basic German cases regarding the application of the liability clauses was *Video* where the BGH held that the sole owner of a limited liability group was liable if those three conditions were satisfied. It can be stated that the *Video* case lead the way to the loss of the privilege of limited liability in all cases where the company had a managing shareholder involved in other business ventures (BGH 23.09.1991, BGHZ 115,187). Since the outcome of this case was contrary to Art. 2(2) of the Twelfth Directive, it is suggested that the German case-law on groups should have been interpreted in conformity with the Twelfth Directive. The second critical case on this subject can be referred as *TBB* (*Thomas*-Baubetreuungsgesellschaft), where the BGH stats the conditions for the liability in the groups, such as; the sole member has to be a company that is set up in the form of a group; there has to be a closeness within the group of this kind of companies; the parent company has to influence the interests of the subsidiary single-member company (BGH 29.03.1993, BGHZ 122, 123), Jocić, p.213-214; In *TBB*, the decision of the BGH was contrary to its earlier *Video* judgement. Finally, another approach was settled in *Bremer Vulkan* case, where the BGH applied neither the provisions on corporate liability within groups nor its previous case-law. Instead, the BGH said that the sole shareholder had a company law responsibility for the maintenance of the share capital of the subsidiary and a liability under tort law and criminal law where the subsidiary could not fulfil its obligations because of breach of this duty (BGH 17.09.2001 – II ZR 178/99, BGHZ 149, 10), Michael Shillig, "The Development of a New Concept of Creditor Protection for German GmbHs", **Comp. Law.**, Vol.27, No.11, 2006, p.348.

[527] Buxbaum, p.264.

[528] For instance, in France if a legal person forms a single-member company subsidiary, the parent company's directors may be held responsible to this subsidiary's creditors; so long as, management faults have led to creditors' losses, Jocić, p. 214.

2.3.2.2.3 Liability in Case of Inadequate Capitalization

Inadequate capitalization (i.e. undercapitalization) means that shareholders have intentionally incorporated a business with insufficient capital although they know that the business might not be able to meet the expected liability. In the most of the piercing cases, inadequate capitalization is important because the company is without or almost without assets.[529] The courts have refused to allow a person to benefit from limited liability unless that person has honestly risked an adequate amount of money. In this regard, liability may be imposed upon a sole stockholder in case of undercapitalization. A sole shareholder must consider bearing the dangers of business and shall not be permitted to shift the burden to his creditors. At the same time, he may be permitted to risk only a part of his personal assets; otherwise, the aspect of limited liability will be meaningless.[530]

Undercapitalization is frequently accepted as a sufficient basis for veil-piercing. The shareholder, who meets the obligations of the corporation by contributing inadequate capital, shifts the risk of business loss onto the creditor while benefiting from profit if the corporation proves successful. Thus, when the adequacy of a corporation's capital is disputed, the main argument asserted by the challenging party is that; it is in equitable for shareholders who have incorporated such a deficient organization to escape from liability.[531]

Most of the inadequate capitalization matters rise from parent subsidiary relationships and those cases are also quite helpful in solving the same problems in the single shareholder companies.[532] These are the situations where the parent seeks to share as a creditor for advances made to the subsidiary. It presents the question whether

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[529] Michala Rudorfer, **Piercing the Corporate Veil: A Sound Concept**, Germany: Grin Verlag, 2006, www.books.google.com, (last accessed on 12.11.2010), p.11.

[530] Jules Silk, "One Man Corporations. Scope and Limitations", **University of Pennsylvania Law Review**, Vol.100, No.6, April 1952, p.861.

[531] Steven G. Marget, "Shareholder Liability", **Journal of Corporation Law**, Vol.3, Fall 1977, p.222.

[532] Fuller, p.1382; Inadequate capitalization in parent and subsidiary relationship can be illustrated from the case of *Erikson v. Minnesota and Ontario Power Co*., where in order to get immunity from damage suits, a parent corporation was to construct a dam, created a subsidiary corporation with negligible capital. The subsidiary constructed the dam with money advanced by the parent corporation, in return for which the parent secured a mortgage on the dam. Whereas, the parent reserved the exclusive right to the use of the water passing over the dam and of the land; therefore, the subsidiary, which had a trivial capitalization, was not able to get any revenue from it. When the dam overflowed and damaged the plaintiff's land, he was permitted to recover against the parent corporation (134 Minn. 209, 158 N.W. 979, 1916), Silk, p.861, footnote 56.

the parent's advances are to be treated as genuine loans, for which the parent may share as a creditor of the subsidiary, or just as contributions to the subsidiary's capital, for which the parent's claim must be depended on the claims of the subsidiary's creditors.[533] Furthermore, in a number of instances liability has been imposed upon a parent corporation for the debts of its subsidiary where the capital of the subsidiary is not adequate for the normal requirements of the business. The implication of undercapitalization rarely finds recognition in decisions; thus, liability is often imposed to the shareholder behind the mask of *alter ego* doctrine. This is because of the difficulty of articulating a satisfactory basis for defining undercapitalization as a liability element; whereas, in some cases capital inadequacy has been an important factor in the imposition of liability upon the parent.[534]

Consequently, when we take a look at the national approaches to the phenomenon of undercapitalization we see that, in order to discourage undercapitalization, Italy introduced new rules; shareholders' financing is now subordinated, in the sense that the financing itself cannot be returned to shareholders before all other creditors are paid (ICC Art. 2467).[535] Moreover, according to German case-law, when the company is formed with insufficient capital such capital, as the company needs, is provided by loans from the sole shareholder. Whenever the operations of the company does not seem sufficient, the company repays the loans to its sole shareholder; as a result, the other creditors are unable to obtain repayment of their debts. However, in order to prevent this, the loans were to be treated as if they were the company's capital. The sole or controlling shareholder who had founded the company in had to be treated as if the loan capital was share-capital thus; he was under an obligation to repay the amount of the loans to the company.[536]

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[533] Cataldo, p.496.

[534] As in the case of *Dixie Coal Mining Co. v. Williams*, where an action was brought against the sole shareholder to recover for the negligent death of plaintiff's decedent. The company for which the decedent was working at the time of his death was bankrupt and declared liability. This company was one of the several companies which the defendant formed to carry on different phases of his business and the assets with which the company commenced business were apparently inadequate. Therefore, the sole shareholder was held personally liable on the ground that his company was just a simulacrum formed for the dual purpose of escaping from liability and of reserving to his own use and benefit the profits gained from the business (221 Ala. 331, 128 So. 799, 1930), Fuller, p.1382-1883.

[535] Montalenti, p.274.

[536] In this case, the German Federal Supreme Court treated a non-quota holder, who incorporated an undercapitalized GmbH through straw men, to be a quota holder with respect to a loan given by him to the company (BGH judgment of December 14, 1959, 31 BGHZ 258), *see* , Cohn and Simitis, p.191-192.

2.3.3 Ultra Vires Acts of the Single-Member Company Which is the Sole Shareholder of Another Single-Member Company

The doctrine of *ultra vires* with respect to private limited liability companies prevents such artificial persons, from committing acts or undertaking relations that are outside their scope of activities as specified in their memorandum and articles of association.[537] Companies are empowered only to the extent necessary to enable them to carry out their objects or purposes; thus, any particular act outside the scope of these aims will be considered as *ultra vires*. According to the doctrine of *ultra vires*, companies can only acquire a very restricted range of rights and liabilities; the underlying principle is that the law requires companies to state their objects on incorporation and so to adopt themselves a restricted capacity.[538]

In case of single-member companies, when the sole shareholder is a legal person the question arises whether the acts of the sole shareholder are beyond its powers (*ultra vires*) or not. It has been suggested that, if it is consistent with the purposes for which a corporation is organized, the company as the sole shareholder can set up a company, join to a corporate group or purchase shares from another limited liability company.[539] As an instance, the problem of the legality of share purchase from another company arises where such purchase is not specifically prohibited by the charter of the purchasing company or by restrictive statutes. Most of the statutes clearly limit the power to purchase shares in other companies to situations in which the exercise of the power is in furtherance of the corporate purpose, and others apparently permits share purchase without limitation.[540]

As a consequence it should be pointed out that, before the Civil War the *ultra vires* doctrine was strictly applied by USA courts; by 1930, it was mostly eroded in practice. With the elimination of the *ultra vires* doctrine, legally valid transactions

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[537] These acts are set forth in the memorandum of association and the articles of association of the company. They are denoted as the objects of the company, limiting the personality of the company to the exclusive sphere of those objects, S. K. Pandey and Abhijit Kumar Pandey, "The Concept of Corporate Personality: A Critical Analysis", **The ICFAI University Journal of Corporate and Securities Law**, Vol.5, No.4, 2008, p.54.

[538] Murray A. Pickering, "The Company as a Separate Legal Entity", *Modern Law Review*, September 1968, Vol.31, No.5, Jstore Database, (last accessed 10.01.2011), p.484.

[539] Cumhur Boyacıoğlu, **Konzern Kavramı**, Ankara: Nobel Yayınevi, 2006, p.155.

[540] "Power of a Corporation to Acquire Stock of Another Corporation", *Colum. L. Rev.*, February 1931, Vol.31, No.2, Heinonline Database, (last accessed on 25.11.2010), p. 282-284.

entered into by artificial persons are fully enforced.[541] In order to protect third parties, the EU took a similar approach with the implementation of the First Council Directive (68/151/EEC), which approved that a company is bound by acts of its organs even if those acts are not within the objects of the company, unless such acts exceed the powers that conferred on those organs. However, the company can escape liability if it proves that the third party knows that the act is outside those objects or can not in view of the circumstances be unaware of it (Art. 9).

2.3.4 Authority of the Sole Shareholder to Bind the Company

After the formation of a single-member company, corporate meetings are rarely held in practice, since the sole shareholder regard himself, as indeed he really is, the owner and manager of the business.[542] The classical procedure of corporate management is left aside, as the entire control of the business is taken over by the sole shareholder. In this sense, the authority of the sole shareholder to act for the company is questioned and it has been concluded that a shareholder-manager may not contract in the corporate name in the absence of authority from the BD. However, from a realistic view, it can be seen that single-member company possesses no proper place for the application of agency principles to the activities of the shareholder-manager. Where a sole shareholder tends to act in behalf of the company, he acts for himself and in his own interest. Thus, the justification of an ordinary company concept for treating the company as a separate entity is missing. According to the US jurisprudence, some cases suggests that the company is bound by contracts of the sole shareholder because it is his *alter ego*; whereas, some others suggests that the authority of the sole shareholder is coextensive with the BD'. Although sole shareholder's powers may be described, they cannot be limited by a requirement, which envisages that contracts shall first be approved by the BD.[543]

As the sole shareholder assumes the management of the business, the question arose whether he/she has the authority to bind the corporation with his acts in

[541] *See*, Stephen J. Leacock, "The Rise and Fall of the Ultra Vires Doctrine in United States, United Kingdom, and Commonwealth Caribbean Corporate Common Law: A Triumph of Experience Over Logic", **Depaul Business and Commercial Law Journal**, Vol.5, Fall 2006, p.67-104.
[542] Fuller, p.1387.
[543] Fuller, p.1388.

company's behalf for corporate purposes.[544] In the early cases it was held that he/she did not;[545] whereas, this approach has gradually changed. In the second half of the 20th century, the US courts embraced the idea that the sole shareholder may bind the corporation by his own acts.[546] It was accepted that a single-member company would be bound by every act done under its name and on its behalf which was within the scope of its powers, if the act was performed or authorized by the sole shareholder-manager.[547] The trend is in the direction of giving the sole shareholder the same authority as is possessed by the BD.

2.3.5 The Problems Regarding the Transactions Between the Single-Member and the Company

2.3.5.1 Misuse of the Company's Property for Private Purposes of the Single-Member

There are several situations in which the sole shareholder uses corporate property for personal purposes.[548] When the corporation appropriates the property for personal use, there will not be any action for recovery; unless, the claims of creditors are involved. If creditors do not exist, it is assumed that there has not been a damaging act of the sole shareholder towards the corporation. On the other hand, if the corporation is insolvent and the claims of other creditors exist, the right of the trustee to recover from the disbursements, which are done before insolvency, will depend on the financial status of the corporation at the time the payment is made. Thus, if the corporation has a surplus at the time of the payment, recovery is denied and if the corporation is insolvent,

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[544] Silk, p.854.

[545] In *English v. Dearborn*, a chattel mortgage was executed in the company name by the sole shareholder and given to his father as security for pre-existing debts of the corporation. In a controversy between the mortgagee and a subsequent purchaser, the mortgage was held invalid because its execution was not authorized by the BD (141 Mass. 590, 6 N.E. 837 1886) and in *Union National Bank v. State National Bank*, the sole stockholder executed a mortgage in the name of the corporation. In a suit between the mortgagee and another creditor, the court found the mortgage invalid (155 Mo. 95, 55 S.W. 989 1900), Fuller, p.1389; Silk, p.854.

[546] Copeland v. Swiss Cleaners, 52 So.2d 223 (Ala. 1951); Muirhead v. Fairlawn Enterprise, Inc., 72 R.I. 163, 48 A.2d 414 (1946); Community Stores Inc. v. Dean, 1 Terry 566, 14 A.2d 633 (1940), Silk, p.854, footnote 7.

[547] This conclusion can be drawn from the cases holding a single-member company bound on contracts signed in the name of the company which are for the personal interest of the sole shareholder; thus, are *ultra vires.* If such contracts are enforceable, it is certain that *intra vires* contracts will be, Fuller, p.1389, footnote 63.

[548] The problems occur only in the event of insolvency or a transfer of all or part of sole shareholder's interest to other persons. The general rule is that directors and officers are liable to the corporation for misuse of assets. However the rule clearly will not apply; if the misuse is authorized by all the shareholders and there is no fraud on creditors, Fuller, p.1390, footnote 66.

recovery is indicated. When the corporation is solvent but the capital impaired the result cannot be determined, some courts require a restoration; whereas, some others validate any payment made at the time the corporation is solvent.[549]

2.3.5.2 Enforceability of a Claim of the Single-Member Against the Company

It is often observed that a sole shareholder advances money to his corporation in the form of a loan. If the company were regarded as his alter ego, it was expected that he would not be permitted to hold the company responsible. By virtue of his ownership of all the corporate shares, he would be unable to prove an enforceable claim against himself; so long as the equity ownership remained the same and the company remained solvent.[550]

The question of enforceability arises where a sole shareholder who has sold his shares to other interests then claims that the corporation is indebted to him, or where upon insolvency of the corporation the sole stockholder seeks to share the distribution of the remaining assets as a creditor. In the first situation, where all of the shares are sold to a single person the question is whether or not the existence of the claim is reflected in the sale price of the shares. Thus, the claim of the former shareholder is enforceable, where it is properly indicated on the corporate books at the time of the sale. On the other hand, the claim will be rejected if the parties have agreed that the sole stockholder is not to recover any debts from the corporation or if the corporate books fail to indicate any corporate obligations to the sole shareholder.[551] In the second situation, as the sole shareholder presents a claim against his own insolvent company, the case will be more complex; thus, it can be divided into two categories. The first category is that, where the sole stockholder adequately capitalizes the corporation and keeps accurate and honest accounts, he/she will be allowed to share in the proceeds; however, where the corporation is inadequately capitalized, his/her claim will be denied.[552] The second category is that, if the sole shareholder keeps the financial identities of the two parties distinct from each other, he/she may lend money to the

[549] Silk, p.856; *see* also, Fuller, p.1390-1394.
[550] Fuller, p.1385.
[551] Silk, p.865; Fuller, p.1385.
[552] Silk, p.865; Fuller, p.1386.

business and share as a creditor upon its insolvency. Otherwise, when the individual and the corporate affairs are merged together, it is impossible to determine if the sole stockholder is really a creditor.[553]

According to EU Law, in these situations, veil piercing is performed in order to overcome the complexity. Whereas, with the implementation of the Twelfth Directive, the obstacles regarding the transactions between the sole member and the company are removed; the Directive envisaged that such contracts between the sole member and the company are required to be recorded in minutes or drawn up in writing;[554] but, this rule is not applied to transactions concluded under normal conditions of the company.

[553] Silk, p.865; Fuller, p. 1386-1387.

[554] According to the laws of the UK and Italy, in order for the contracts between the company and the sole member to be binding on the company's creditors, they must be done in writing or must be recorded in the minutes of the BD. Specifically, British law suggests that, an officer that fails to comply with this requirement will be subjected to a fine. In Spain, such contracts not only have to be recorded in writing but also they must be referenced by the company's annual report; as, in case of insolvency of the company, any contracts which have not been formally recorded will not benefit from limited liability. France also requires such contracts to be acknowledged and recorded in a register, Okutan, p.605.

III CHAPTER 3: REFLECTIONS OF THE CONCEPT OF SINGLE MEMBER COMPANY IN TURKISH LAW

Before examining the reflections of single-member companies in Turkish law, the supporting views and some concerns about the realization of such a company form will be briefly mentioned.

3.1 A GENERAL EVALUATION OF SINGLE-MEMBER COMPANY CONCEPT

3.1.1 Positive Criticisms Regarding Single-Member Companies

The underlying objective for implementation of the Twelfth Directive is ensuring adequate protection for third parties dealing with such business. Moreover, the Directive is implemented with the hope that, the ability to separate the assets of the company from the private assets of the sole member will encourage people to set up their own business in company form.

Another important reason for realization of single-member companies is the extension of limited liability to single-member companies.[555] With the personalization of economic life, proprietors generally prefer to have limited liability and act independently without intervention.[556] When the law admits the advantages of introducing and recognizing a limited liability company, it makes no difference whether a sole trader or a group of companies owns it.[557]

By allowing single-member companies, legal systems can avoid disputes amongst shareholders in SMEs. This makes the life of enterprises longer. Moreover, if such an enterprise is converted to a single-member company; after the death of the sole member, the company can easily be divided into shares among the inheritors.[558]

[555] Yanlı, p.136.
[556] Reşat Atabek, "Tek Şahıslı Şirketler", **İBD**, Cilt 11, Sayı 2, 1937, p.54.
[557] Eroğlu, Single Member, p.7-8.
[558] Yanlı, p.136.

Furthermore the single member company is considered useful particularly to facilitate continuity of the business of a person who is acting as a sole proprietor.[559]

Besides these, *de facto* single-member companies already exist in many countries for a long time, even though commercial law does not allow them. Thus, prohibition of single-member companies is not realistic anymore.[560]

Single-member companies will provide many advantages to the corporate groups in their operations; since, they already have power and capital to operate in group structure. Thus, allowing them to establish single-member companies will allocate them to have wholly-owned subsidiary, which provides many practical benefits, such as operating without considering minority protection, and it will be good for their business efficiency.[561]

In a globalized world, having a well-functioning and competitive commercial law is an important issue for attracting foreign direct investment ("FDI"), as well as encouraging persons to participate in business activities. Therefore, prohibition of single-member companies might force nationals of a state, which do not recognize single-member companies, to use single-member offshore companies to avoid the home state's regulations. On the other hand, it also discourages foreign persons from establishing companies in states, which do not recognize such company form.[562]

Consequently, it is better to face the realities of developing economic life and regulate single-member companies rather than letting people find *de facto* solutions.

3.1.2 Negative Criticisms Regarding Single-Member Companies

There are also negative opinions regarding single-member companies. If related risks can be effectively dealt with, the single-member company can play an important role in promoting investments and economic reforms.

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[559] Roel Nieuwdorp, "Law of Corporations", *International Business Lawyer*, 1989, Vol.17, No.35, Heinonline Database, (last accessed on 04.03.2010), p.36.
[560] Çelik, p.177; Eroğlu, Single-Member, p.8.
[561] Eroğlu, Single-Member, p.8.
[562] Eroğlu, Single-Member, p.8.

It is first argued that a single-member company contradicts with the concept of company. However, this classical theory has been changed in time and according to the new theory, a company is not a union of people with more than one member, but is an operational organization[563] that manufactures and supplies goods and services. Thus, a company is the name given to enterprises that conduct activities in order to realize its purposes. The elements that define a company are generally about its managerial organization to achieve its scope of activity;[564] the number of shareholders is now considered as an indistinctive element.[565]

The doctrine of separate corporate entity is a metaphorical method of describing the fact that the rights and liabilities of the corporation are to be kept separate and distinct from those of the individual shareholders. As the separate personality of the corporation is a statutory privilege, it must be used for legitimate business purposes and must not be perverted.[566] In this regard, the most significant concern about single-member company has always been the risk to the creditors. A person can limit its liability just by establishing a company under which he is sole shareholder as well as director. Such control of the sole shareholders makes it possible that the single-member company may lose its independence.[567] Since the shareholder, as the sole manager, is exclusively in control and subject to no external supervision, it may be questioned whether creditors and third parties will be afforded adequate protection by restricting their claims to corporate assets. The shareholder has opportunity to apply corporate assets to his personal purposes, or to pledge the credit of the corporation for personal debts.[568] According to this interpretation, single-member companies will be open to misuse by their sole shareholders. Thus, there may be mix of assets between the person and the company and the person can defraud creditors or third parties by exploiting the corporate character of the company.

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[563] *See*, Tekinalp, Tek Kişilik Ortaklık, p.8-9.
[564] Tekinalp, Tek Ortaklı Şirketler Sorunsalı, p.592.
[565] PricewaterhouseCoopers, "Draft Turkish Commercial Code-A Blueprint for the Future", (hereinafter "A Blueprint fro the Future"), http://www.turkey-now.org/db/Docs/taxguide2009_pwc.pdf, (last accessed on 23.12.2010), p.6-7.
[566] E. O. E., "Disregarding Corporate Entity: One Man Company", *California Law Review*, 1925, Vol.13, No.3, Heinonline Database, (last accessed on 10.01.2011), p.237-239.
[567] Eroğlu, Single Member, p.9
[568] "Judicial Supervision of the One Man Corporation", *HLR*, 1932, Vol.45, No.6, Heinonline Database, (last accessed on 10.01.2011), p.1086-1087.

Moreover, the problem of using single-member companies in organizing corporate groups shall be taken account well because, in practice, many big enterprises are structured as corporate groups. Thus, allowing the establishment of single-member companies may cause chains of wholly owned subsidiaries, which may be open to misuse. To put it differently, groups of companies may create enterprise pyramids under which creditor protection is difficult.[569] Thus it is referred that provisions that enable national legislation to prevent the creation of inextricable chains of companies are necessary.[570]

Off-shore single-member companies may also create risk for creditors since it will be easy to establish single-member company by foreigners. Legal systems with single-member companies may be open to misuse of corporate form by persons from other jurisdictions.[571]

In short, limited liability companies may create problems for creditors; thus, legal systems have developed some safeguards in order to balance the risk and benefits of limited liability.

3.2 SINGLE-MEMBER COMPANIES IN THE CURRENT TURKISH COMMERCIAL CODE

3.2.1 Legality of Single-Member Companies in Turkish Law

A partnership is defined in Turkish Code of Obligations[572] Art. 520(1) as "*an agreement that two or more people make a commitment to combine their skill and/or capital to achieve a common purpose*".[573] Although, this definition mainly refers simple (ordinary) partnerships, it can be considered as the basis of commercial companies[574]

[569] Eroğlu, Single Member, p.9.
[570] It has been pointed out, however, that in those states where single-member companies are already in existence the problem of inextricable chains has not been a cause of major concern, Tridimas, p.694.
[571] Eroğlu, Single Member, p.9
[572] Turkish Code of Obligations No.818 of 22.04.1926.
[573] This Article is amended in the new Turkish Code of Obligations No.6097 of 11.01.2011. While preserving the similar wording of the ex. Art. 520, the new form of the Article (now Art. 620) specifically defines the ordinary partnership.
[574] *Akın* suggests that, although it is not clearly mentioned in the provisions of TCC, according to the doctrine, there is a simple partnership relation between the members of an AŞ and with the incorporation of the AŞ, this relation ceases to exist, Murat Yusuf Akın, "İsviçre Hukuku Örneğinde Türk Medeni Kanunu Madde 47/II ile Türk Ticaret Kanunu Tasarısı Madde 353 Üzerine Düşünceler, **BATİDER**, Cilt 26, Sayı 1, 2010, p.177-178.

under current Turkish Commercial Code ("TCC").[575] There is not a specific and general definition of the terms "partnership" or "company" in the TCC. Whereas, the types of commercial associations, which have separate legal personalities, are defined in detail in the provisions of TCC.[576]

As long as it is viewed in terms of the functions of the corporate device in a social and economic order, rather than in terms of the essential and eternal nature of the corporations, a sole shareholder does not seem as a conceptual impossibility. [577]

According to the current TCC, a sole trader has unlimited liability. Only in case of ship owners, in circumstances under Arts 948 and 1243 of the TCC, their liability has been limited to the sea assets. The underlying reason is that, ship owners face many risks while performing their work.[578] Turkish law has embraced the principle of the singular and unified character of the financial status of a natural person; thus, gives no permission to natural persons to have two separate properties.[579] However, the only exception of this principle is that; ship owners are assumed to have two separate kinds of properties.

Further, a company is considered as a contract in which two or more persons engaged with a certain capital in order to reach a common purpose. Therefore, it is clear that a company with a single-member contradicts with the current company law theory in Turkey.[580] Although single member companies are not permitted under TCC, there exist many *de facto* single-member companies in practice. In many jurisdictions a multi-member limited liability company can be controlled by one member. Since, *de facto* single-member companies exist in even though Turkish commercial law does not allow

[575] Turkish Commercial Code No. 6762 of 29.06.1956 as last amended by Law No. 5274 of 09.12.2004.
[576] Pulaşlı, p.49-51.
[577] Silk, p.853.
[578] Rayegan Kender, Ergon Çetingil, **Deniz Ticareti Hukuku Temel Bilgiler**, Gözden geçirilmiş 8. Baskı, İstanbul, 2007, p.79.
[579] This theory has been left by NTCC; there has been a reinterpretation of certain components with the realization of single-member companies; *see* also, Tekinalp, Tek Kişilik Ortaklık, p.28.
[580] An exception of this rule can be observed in a specific regulation which governs a single-member limited liability enterprise in Turkish law. Under the Decree law No. 223 State-owned enterprises, *İktisadi Devlet Teşekkülleri*, may be organized as joint-stock companies. In such a case they will be subject to TCC; however, they are not required to have at least five shareholders in order to form a joint-stock company. Consequently, the sole shareholder of such an enterprise will be the legal personality of Turkish government, Gündoğdu, p.231.

them, the prohibition of single-member company is not considered as a logical solution anymore.

This prohibition will be changed with the entry into force of the New Turkish Commercial Code ("NTCC").[581] However until that time, the current regulation is applicable. In the fallowing part, the current provisions of the TCC regarding *de facto* single-member companies will be discussed.

3.2.2 Consolidation of All Shares in the Hands of a Single-Member

Since it is not possible to set up a business association initially with one member; single-member companies either exist with the usage of straw men formations or with consolidation of all shares in the hands of a single-member after being incorporated with minimum members. In this perspective, the most common five different types of business associations, four of which are regulated by TCC, will be examined in this part of the study. Among those five business organizations, simple partnership can be considered as an entity under TCO and the classification of the remaining four can be made as; associations of persons or associations of capital. General and limited partnerships are associations of persons, while private limited liability and joint-stock companies are associations of capital.[582]

3.2.2.1 Simple (Ordinary) Partnership

The simple partnership, *adi şirket*, ("AdŞ"), is a pure private arrangement between the partners that does not possess legal personality separate from the partners. It is simply a contract between the partners which is concluded either in writing or orally. In fact, such a partnership is all about the contract between the partners; thus, according to Turkish law when the number of partners drops to one, the AdŞ ceases to exist.[583]

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[581] Turkish Commercial Code No. 6102 of 13.01.2011.
[582] *See*, Muzaffer Eroğlu, "Limited Liability in Turkish Law", **EBOR**, Vol.9, 2008, p.242-245.
[583] Mahmut Yavaşi, "Unlimited Companies in Turkish Company Law", **Comp. Law.**, Vol.21, No.7, 2000, p.226; According to *Tekinalp*, Art. 199 of the TCC may also be applied to AdŞs by analogy, Tekinalp, Tek Kişilik Ortaklık, p.22.

3.2.2.2 General Partnership

According to TCC Art. 153 (NTTC Art. 221), a general partnership, *kollektif şirket* ("KŞ"), is defined as a partnership whose members are all natural persons and personally liable without limit for the whole of the liabilities of the partnership.[584] There is not an explicit provision in the TCC which requires a minimum number of partners in KŞs; however, as a necessity of partnership contract, there must be at least two partners present in order to form a KŞ.[585] Moreover, the wordings of Art. 153 and 155 can be interpreted as an indication of plurality of partners.[586]

According to Art. 199 of the TCC, if a KŞ comprises only two partners, where justified grounds are present, upon the request of one partner and without dissolving or liquidating the partnership, the court may dismiss the other partner and transfer partnership's all assets and debts to the remaining partner (NTCC Art. 257).[587] Moreover Art. 200 (NTCC Art. 258) envisages that, in such KŞs, if a personal creditor of a partner makes an objection or demands dissolution under Arts 190, 191 and 198; or, if a partner is declared bankrupt, the other partner may exercise its rights under Art. 199 (TCC Art. 200).[588]

According to *Mimaroğlu*,[589] the court, under Art. 199, may not necessarily decide for dismissal of one of the partners. Depending on the circumstances, the court may directly initiate the dissolution and liquidation of the partnership. However *Tekinalp*[590] argues that, the Court cannot initiate a decision for dissolution of the KŞ; since, it is clearly stated in the Art. 199 that the Court will decide on the transfer of all

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[584] *See*, Reha Poroy, Ünal Tekinalp, Ersin Çamoğlu, **Ortaklıklar ve Kooperatif Hukuku**, Güncelleştirilmiş 12. Baskı, İstanbul: Vedat Kitapçılık, 2010, p.127.
[585] Arslan, p.90.
[586] Both articles use the term 'partners'.
[587] Neval Okan, "Türk Hukukunda Ticaret Ortaklıklarında Ortak Sayısının Bire Düşmesi ve Sonuçları", **Eskişehir Osmangazi Üniversitesi Sosyal Bilimler Dergisi**, Cilt 2, No.1, 2001, p.59.
[588] A KŞ may be formed with more than two partners and in time, the number of partners may decrease to two; thus, the Turkish Supreme Court decided that Art. 199 can also be applied in such cases (Yargıtay 11. HD E. 2441 K. 331, 23.01.1975), Gönen Eriş, **Ticari İşletme ve Şirketler Cilt I**, 4. Baskı, Ankara: Seçkin Yayınevi, 2007, p.1402.
[589] Sait Kemal Mimaroğlu, **Ticaret Hukuku Cilt II**, Ankara: BTHAE, 1972, p.239.
[590] Tekinalp, Tek Kişilik Ortaklık, p.19.

assets and activities to the partner who has made the request. The logic underneath such an action is keeping the integrity of the enterprise.[591]

There are two conflicting views about whether the KŞ shall continue to carry out its business with one partner. According to one view, if the KŞ does not take a new partner until the final decision of the court, regarding the application of Art. 199, the legal personality of the KŞ will be terminated because it will not possible for a KŞ to continue existing with one partner.[592] According to another view, since the TCC does not require automatic dissolution of the KŞ when plurality of partners is absent, a conclusion can be drawn that the existence of single partner KŞ is temporarily permitted.[593] It is argued that if the KŞ does not take another member in a reasonable time, the legal personality of the partnership will cease to exist.[594]

All shares of a KŞ may be consolidated in the hands of a single partner as a result of death of a partner or the purchase of all shares. It is debatable in doctrine whether or not KŞ terminates on the death of a partner and whether or not Art. 199 is applicable in this case.[595] However, according to the jurisdiction of Turkish Supreme Court, Art. 199 will not be applicable.[596]

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[591] Okan, Ortak Sayısının Bire Düşmesi, p.59-60; Serkan Aktaş, "Türk Ticaret Kanunu Tasarısında Tek Kişi Ortaklığı", 2007, http://hukukcu.com/modules/smartsection/item.php?itemid=114, (last accessed on 10.05.2010).

[592] According to this view, the KŞ status will terminate however; it will be transferred to the single partner without dissolution and the single partner will continue its business as a sole proprietorship, Eriş, Cilt I, p.1401-1403; The assets of the KŞ will be transferred to the single partner who, as the single owner of the enterprise, will be personally liable from the KŞ's debts, Halil Arslanlı, **Kollektif ve Komandit Şirketler**, 2. Baskı, İstanbul:Fakülteler Matbaası, 1960, p.444; *see* also, Reşat Atabek, "Şirket Paylarının Bir Kişinin Elinde Toplanması", **BATİDER**, Cilt 10, Sayı 3, 1980, p.642-645; However, according to *Tekinalp*, contrary to the situation in Swiss and German laws, KŞ is deemed to have legal personality in Turkish law; thus, it will not be possible for a KŞ to become a sole proprietorship, Tekinalp, Tek Kişilik Ortaklık, p.18.

[593] Since, in case the existence of partnership becomes unbearable, the right to terminate the partnership is regulated in Art. 187. It is clear that the legislator, under Art. 199, does not aim to prevent the temporary existence of single partner KŞs, Okan, Ortak Sayısının Bire Düşmesi, p.60; İsmail Doğanay, **Türk Ticaret Kanunu Şerhi Cilt 1**, 4. Baskı, İstanbul: Beta Yayınları, 2004, p.760; Arslan, p.92.

[594] Okan, Ortak Sayısının Bire Düşmesi, p. 61; Aktaş, 2007.

[595] *Atabek* suggests that the remaining partner may demand the dismissal of dead partner's inheritors according to Art. 199, Atabek, Şirket Payları, 1980, p.642; For the supporters of this view, *see*, Yaşar Karayalçın, **Şirketler Hukuku**, 2. Baskı, Ankara: Sevinç Matbaası, 1973, p.290; Tekinalp, Tek Kişilik Ortaklık, p.20; Ersin Çamoğlu, **Kollektif Ortaklığın Haklı Sebeple Feshi ve Ortağın Haklı Sebeple Çıkarılması**, 2. Baskı, İstanbul: Vedat Kitapçılık, 2008, p.171; Hasan Pulaşlı, **Şirketler Hukuku**, Genişletilmiş ve Güncelleştirilmiş 10. Baskı, Adana: Karahan Kitabevi, 2011, p.135.

[596] Upon the death of a partner of a KŞ, if there is not any inheritor or if there is but the inheritor does not attend to the partnership, KŞ shall be deemed as terminated (Yargıtay 11. HD E.1985/525 K. 1985/2340, 11.02.1985), www.kazanci.com, (last accessed on 10.04.2010); for the supporters of this view, *see*, Tekil, p.124-125; Hayri Domaniç, **Türk Ticaret Kanunu Şerhi Cilt I**, İstanbul: Temel Yayınları, 1988, p.695.

It is also debatable in doctrine what happens when one of the partners, in a two member KŞ, leaves the partnership with the consent of the other partner; and transfers its shares to the remaining one. According to *Arslanlı*,[597] although the transfer of such a partner's assets will be beneficial in practice; there is not any provision in TCC that regulates this situation. On the other hand, *Tekinalp*[598] argues that Art. 199 can be applied in this situation by way of interpretation; as, its application will facilitate the principle of balance between conflicting interests.

However, in any way, it shall not be interpreted that a KŞ with a single partner is permitted in TCC. Such an application can only be viewed as a temporary solution which facilitates the economic integrity and value of the enterprise.[599]

3.2.2.3 Limited Partnership

Accordig to Art. 243 of the TCC, a limited partnership, *komandit şirket*, ("KmŞ"), is characterized by its membership, consisting of two types of partners, namely, the general partners (*komandite*) who has unlimited and individual liability for the whole of the debts of the partnership; and the limited partners (*komanditer*), whose liability for the debts of the partnership is only limited to the amount of their contributions, and who are thus not personally liable to creditors (NTCC Art. 304). Although KmŞ is similar to KŞ, it is rarely used in practice.[600]

According to Art. 267 of the TCC, the provisions on dismissal from the partnership on justified grounds, dissolution or liquidation of a KŞ, will also be applicable in case of a Kmş (NTCC Art. 328).

Legal incapability or death of a limited partner will not affect the existence of the KmŞ.[601] According to Art. 255; the inheritors of the limited partner may take its

[597] Arslanlı, p.442-444.
[598] Tekinalp, Tek Kişilik Ortaklık, p.20
[599] Tekinalp, Tek Kişilik Şirket, p.21; Çamoğlu, p.169.
[600] Yavaşi, p.228.
[601] Pulaşlı, Şirketler, p.177; Tekil, p.170.

place (NTCC Art. 316). In other words, death of a limited partner neither leads to dissolution of the KmŞ, nor results in the creation of a single partner KŞ.[602]

In this regard, some scholars suggests that if a limited partner leaves the partnership, the KmŞ shall be subjected to the provisions regarding AdŞs;[603] some others argue that in that case, provisions regarding KŞs shall be applied.[604] According to Turkish Supreme Court,[605] if there is only one general partner and when that partner leaves, the KmŞ shall be deemed as terminated; since, the main component of the KmŞ is its general partner.

However, this decision is criticized by *Pulaşlı*[606] on the ground that, by applying Art. 199, the KmŞ may refrain from dissolution; thus, continues to exist, if it maintains the plurality of partners, by taking a new general partner in a reasonable time. Consequently, when the dismissal of a partner is in concern or when the number of partners drops to one, the provisions regarding KŞs, including Art. 199, will be applicable to KmŞ.[607]

3.2.2.4 Joint-Stock Company

Arts 269-271 of the Turkish Commercial Code define a public limited company as a company that is endowed with legal personality and equipped with capital divided into shares and which confers limited liability for its members.[608] Art. 277 (NTCC Art. 338(1))[609] requires at least five persons to establish public limited liability

[602] Tekinalp, Tek Kişilik Şirket, p.20; While applying the Articles such as 187,197 or 199, it is important to consider the situation and importance of limited partners in a KmŞ. In evaluating justified grounds of Art. 187, the role of the limited partner in the KmŞ must be taken into account, Okan, Ortak Sayısının Bire Düşmesi, p.62.
[603] Arslanlı, p.601; Hayri Domaniç, **Adi, Kollektif, Komandit Şirketler**, 3. Baskı, İstanbul, 1970, p.217; Poroy/Tekinalp/Çamoğlu, p.192.
[604] Tekil, p.170; Oğuz İmregün, **Kollektif, Komandit ve Sermayesi Paylara Bölünmüş Komandit Ortaklıklar**, Ankara: Yasa Yayıncılık, 1989, p.173; Doğanay, Cilt I, p.844; Gönen Eriş, **Ticari İşletme ve Şirketler Cilt II**, 4. Baskı, Ankara: Seçkin Yayınevi, 2007, p.1507; Pulaşlı, Şirketler, p.165.
[605] When dismissal of a general partner is demanded, without dissolution of the KmŞ, this request will be denied; for the fact that, with the dismissal of a general partner, such a partnership will lose its KmŞ status, (Yargıtay 11. HD E. 1975/2086 K.1975/4647, 03.07.1975), www.kazanci.com, (last accessed on 10.04.2011).
[606] Pulaşlı, Şirketler, p.177.
[607] Atabek, Şirket Payları, 1980, p.642.
[608] Eroğlu, Limited Liability, p.245
[609] This provision was amended in the NTCC and the new version permits the existence of single-member LŞs. The new form of the article (Art. 338) will be examined in detail in the following part of this study.

company. According to Art. 434(4) (NTCC Art. 530),[610] if the legal requirement as to the number of members falls below a specified number, the company shall be dissolved. However it is not that easy to follow the number of members in an AŞ after its formation.[611]

Art. 435 (NTCC Art. 531) states that, after the establishment of the company, if the number of real members falls below five, the court gives definite time to the company if there is an application by shareholders, creditors or the Ministry of Industry demanding completion of the requirement of at least five members. If the company does not act accordingly the court terminates the company. However, if such a claim is not raised, the company may continue to exist.[612] It can be stated that, since the TCC does not tolerate presence of straw men formations, having less than five 'real' shareholders,[613] after the incorporation of the company, is a ground for demanding dissolution of the company.[614]

There have been different approaches about the scope of Arts 434(4) and 435 in Turkish doctrine. According to one view, since the AŞ meets the minimum membership requirement by having five shareholders, this situation is not crucial enough to demand the automatic dissolution of the company. In that case, Art. 453 gives an opportunity to the company to correct the situation in a reasonable time.[615] Contrary to this, some others argue that, since Art. 434(4) initiates automatic dissolution of the company in case the number of members falls below five; the existence of a single-member AŞ, before or after incorporation, is not permitted according to TCC.[616]

According to another view there is a controversy between two Articles; one side, Art. 435 demands a court decree; on the other side Art. 434(4) envisages automatic

[610] According to new version of this article in the NTCC, the consolidation of all shares in the hands of a single member will not lead to dissolution of the company.
[611] Arslan, p.95.
[612] Okan, Ortak Sayısının Bire Düşmesi, p.65-66.
[613] It is hard to determine whether or not the number of real shareholders is below five or the AŞ is incorporated with straw men. However in case of issue of registered shares, the situation can be proved by the minutes of meetings or witness statements, Atabek, Şirket Payları, 1980, p.652; On the contrary, since the remaining single member of an AŞ issues bearer shares, it will not be possible to learn the fact that the AŞ continues to conduct its activities as a single-member company, Arslan, p.100; Okan, Ortak Sayısının Bire Düşmesi, p.66.
[614] Yanlı, p.139.
[615] Poroy/Tekinalp/Çamoğlu, p.729-730; Yanlı, p.139.
[616] Boyacıoğlu, p.152.

dissolution when the number of members falls below five.[617] As a solution to this, Art. 434(4) and 435 shall be evaluated together; since, they both regulate the termination of the AŞ. Therefore, according to this view, dissolution under Art. 434, too, requires a court decree like Art. 435 does.[618] As a result, until the court initiates its decree on dissolution, the company may continue to exist with a single member.[619]

Although, in theory it is not possible to establish single-member AŞ the stated provisions of the TCC reveals that it is possible to have a *de-facto* single-member AŞ in a situation where all shares are consolidated by a single member, and there is no application to courts by shareholders, creditors or the Ministry of Industry.[620] On the other hand, in practice single-member AŞs can occur by dividing shares and giving control of virtually worthless shares to straw-men.[621]

3.2.2.5 Private Limited Liability Company

Art. 503 of the TCC (NTCC Art. 574) describes a private limited liability company, *limited şirket* ("LŞ"), as an incorporated registered business enterprise that confers limited liability for its members.[622] According to Art. 504, a LŞ must have no more than fifty members and a minimum of two members.

According to Art. 504(2) of the TCC,[623] after a company is incorporated by and among multiple shareholders if, subsequently, only one member remains or the company no longer has bodies necessary to enable it to function the court may, at the request of a shareholder or creditor, declare that the company be dissolved; unless, it complies with the legal requirements within a reasonable period. Thus, the acquisition of shares in the hands of a sole shareholder, does not lead to automatic dissolution of the LŞ. The company can only be terminated by a court decree upon the request of a

[617] Tekinalp, Tek Ortaklı Şirketler Sorunsalı, p.582; Tekinalp, Tek Kişilik Ortaklık, p.31; There are many scholars who recognizes the superiority of Art. 435, *see*, Oğuz İmregün, **Kara Ticareti Hukuku Dersleri**, 13. Baskı, İstanbul: Filiz Kitabevi, 2005, p.471-472; Poroy/Tekinalp/Çamoğlu, p.726-727.
[618] Tuğrul Ansay, **Anonim Şirketler Hukuku**, 6. Baskı, Ankara: BTHAE, 1982, p.298.
[619] Tekil, p.22; Yanlı, p.140; Arslan, p.99.
[620] Eroğlu, Single-Member, p.2-3.
[621] Atabek, Şirket Payları, 1980, p.649; Okan, Ortak Sayısının Bire Düşmesi, p.66-67.
[622] Eroğlu, Limited Liability, p.245
[623] This provision was amended in the NTCC and the new version permits the existence of single-member LŞs. The new form of the article (Art. 574) will be examined in detail in the following part of this study.

shareholder[624] or creditor. Until court's decision, the LŞ will continue to exist with a single shareholder.[625]

The situation is debatable where the dismissal or withdrawal of one of the partners in a LŞ, which comprises two shareholders from the incorporation, is in concern. The Turkish Supreme Court had a changing attitude towards this issue. In its previous decisions, the Court suggests that, a shareholder cannot make a decision for dismissal of the other shareholder by itself. However, such a partner may request the dismissal of the other partner from the court.[626]

Whereas, in its latest jurisprudence, the Supreme Court states that, in case of a withdrawal or dismissal of one of the partners in a two-member LŞ, the court will not give time to the remaining partner to correct the situation; thus, Art. 504 will not be applicable.[627] Since it is not possible for the shareholders to dismiss one another, the remaining partner may only request the termination of the company from the court.[628] This issue has also been debated in doctrine. Some scholars argue that, in a two member LŞ, there must be simple majority in order to make the decision on dismissal of one shareholder. Since there are only two shareholders, such a majority cannot be maintained.[629] Some others suggest that the company shall continue to exist and shall be given an adequate time to maintain plurality of its members.[630]

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[624] It will not be realistic to expect the sole shareholder to apply for dissolution of the company. However, the sole shareholder may apply to the court on the ground that the company becomes organless, Arslan, p.102.

[625] Atabek, Şirket Payları, 1980, p.655-656.

[626] Yargıtay 11. HD E. 3904 K. 4490, 08.11.1982, Engin Erdil, **Limited Ortaklıkta Ortaklıktan Çıkarılma**, İstanbul: Vedat Kitapçılık, 2004, p.101.

[627] Yargıtay 11. HD E. 1985/3521 K. 1985/4788, 25. 09.1985,www.kazanci.com, (last accessed on 10.04.2011).

[628] It is not possible for the court to decide the dismissal of one of the partners in a two-member LŞ (Yargıtay 11. HD E. 1991/3056 K.1991/6358, 29.11.1991), www.kazanci.com. (last accessed on 10.04.2010); In a two-member LŞ, the permission of dismissal of one of the partners by the court, may cause the LŞ to continue its existence with a single-member. Thus, it shall be accepted that Art. 551(2) can only be applied in the dismissal of the partners in a LŞ with more than two members (Yargıtay 11. HD E. 2003/13520 K. 2004/7211, 28.06.2004), www.kazanci.com, (last accessed on 10.04.2010); *Pulaşlı* suggested that this view of the Supreme Court was hard to embrace; since, it should not matter how many members the LŞ had before its number of shareholders diminishes to one. The same rule should have been applied in any case, Pulaşlı, Şirketler, p.581.

[629] Since, the TCC requires the plurality of members to be maintained in a reasonable time, it shall be concluded that the legislator does not allow the existence of single-member LŞs, İsmail Doğanay, **Türk Ticaret Kanunu Şerhi Cilt II**, 4. Baskı, İstanbul: Beta Yayınları, 2004, p.1489-1490; Okan, Ortak Sayısının Bire Düşmesi, p.64.

[630] When the number of shareholders drops to one, the LŞ will not automatically dissolve. Unless a request for dissolution has been done to the court, the LŞ will continue to exist. Thus, the legal personality of the company will be maintained, although it has only one shareholder, Poroy/Tekinalp/Çamoğlu, p.808.

3.2.3 The Need for Realization of Single-Member Company in Turkish Law

According to the new company law theory, the company may consist of a single shareholder; whereas, it may also have multi-member BD, various audit committees, several professional commissions and a CEO with regard to the principles of corporate governance.[631] The shareholder is now considered as an important complementary element, not the cornerstone of a company.[632]

Single shareholder companies respond to many needs. It provides the opportunity for an entrepreneur who wishes to convert its sole proprietorship to a new legal type of limited liability company, in order to incorporate its company as a single member company. Thus such an entrepreneur would no longer need to take shareholders as 'straw men' into the company in order for its incorporation.[633] Moreover, in Turkey family companies are very common and most of them are *de facto* single-member companies.[634] Besides, if a company, founded with multiple shareholders, is subsequently restructured as a single shareholder company, such a company becomes able to continue its existence without becoming subject to the risk of dissolution. Thus, there are many management benefits for allowing single-member companies, such as easy decision making process.

The realization of single shareholder company relates to the protection of SMEs. In this way, SMEs with single shareholder shall be discharged from unlimited liability. Moreover, if an AŞ or a LŞ wants to establish a vendor (OEM)[635] related to its own scope of operation, AŞ/LŞ may establish such vendor on its own through a new company.[636]

In practice, when a foundation, association or university wants to incorporate a company, which is related to their operations, they usually take fake shareholders into

[631] Tekinalp, Tek Ortaklı Şirketler Sorunsalı, p.592.
[632] Ünal Tekinalp, "Türk Ticaret Kanunu Tasarısı", **Bankacılar Dergisi**, Sayı 53, 2005, p.116.
[633] A Blueprint for the Future, p.7; Gündoğdu, p.232
[634] Reşat Atabek, Şirket Payları, 1980, p.649-650.
[635] Means; original equipment manufacturer.
[636] For instance, if a company which manufactures refrigerators wants to form a company that produces plastic refrigerator shelves, it would not have take a partner which it does not need, A Blueprint for the Future, p.7.

the company. However, such applications are not often well-suited with these organizations' purposes. With the establishment of this company form, they will have the opportunity to be the single shareholder of such a single-member company.[637]

As a keen market economy and EU candidate country, Turkey wants to keep its economic position stable and improve its attractiveness for FDIs and the competitive status of its domestic business. For this purpose, it is required to adopt the basic economic structure of the EU market economy to have a well-functioning system of private enterprises. Since, a competitive status requires a better structured market economy, and one of the key tools in this regard is commercial and company law, there have been many efforts aimed at modernizing Turkish commercial law.[638]

As single-member companies are very common in European countries, companies that plans to invest in Turkey want to make their investment through a company exclusively belonging to themselves.[639] Urging a foreign investor to accept a partner generally causes legal complications. In order not to lose its competitive advantages in Europe as well in the world, Turkey should follow the trends in comparative commercial laws. In this way an important change has been introduced; foreign investors are granted the opportunity to initiate FDIs in Turkey, through the establishment of a single-member company.[640]

A single shareholder AŞ may easily be converted into a publicly traded company. It will be a formalist approach not to consider an organization with such flexibility as a company, simply because it has a single shareholder or partner.[641]

3.3 SINGLE-MEMBER COMPANIES UNDER NTCC

3.3.1 The New Turkish Commercial Code

The current TCC has been in force since 1957. Although the TCC was substantially responding to the needs of Turkey at the time it was enacted, it no more

[637] *See*, Tekinalp, Tek Kişilik Ortaklık, p. 53-54.
[638] Eroğlu, Limited Liability, p.239.
[639] Tekinalp, Tek Kişilik Ortaklık, p.55.
[640] PricewaterhouseCoopers, New Turkish Commercial Code- 10 Questions 10 Answers, http://www.pwc.com/en_TR/tr/publications/Assets/pwc-commercial-code-eng.pdf, (last accessed on 10.04.2011).
[641] A Blueprint for the Future, p.7.

responded to the current needs of the modern company law theory. It has been little amended since then, even though the commercial life of Turkey has been broadly increased. In the second half of the twentieth century, there have been many commercial law reforms throughout the EU and the world; amendments to commercial codes were made more frequently than in the past. In addition to these, new company law directives and regulations were implemented in terms of EU law. Thus, almost every Member State has introduced reforms in their commercial codes to some extent. During this period, new doctrines were applied regarding specific commercial law issues. All of these modifications affected both the theory and the practice of commercial law.[642] The developments which took place in the EU and the rest of the world made it inevitable that the TCC would need similar changes. Turkey needed to integrate with the EU and transfer EU *acquis communautaire*[643] into Turkish company law.

The TCC has been in use for more than fifty years without a structural change; thus, a radical move has been done and it was decided that a reform code should be prepared. However, the preparation of a new commercial code was a controversial process. The Commission nominated by the Republic of Turkey Ministry of Justice, held its first meeting on February 10, 2000. A total of 631 meetings were held during a period of more than five years. The Draft was publicized in February 2005, and opinions and criticisms from relevant institutions and organizations were taken account and discussed. The Draft has submitted to the Prime Ministry in 2005 and conveyed from there to the Presidency of the Turkish Grand National Assembly. After discussions and minor amendments by the Commission of Justice of the Assembly, the Draft was accepted by Grand National Assembly of Turkey on January 14, 2011.[644]

The NTCC will enter into force on July 1, 2012. Therefore, a transition period has been granted to enterprises and traders in order to comply with the important amendments made to the TCC. The NTCC includes not only amendments to the

[642] Rıza Gümbüşoğlu , "Turkey: Amendments Introduced By the Draft Turkish Commercial Code As Regards the Invalidity of General Assembly Resolutions", 2009, http://www.mondaq.com/article.asp?articleid=83562, (last accessed on 10.03.2011).
[643] The term refers to the body of EU laws, comprising the EC's objectives, policies and, in particular, the primary and secondary legislation and case-law, Craig and De Burca, p.16, 18.
[644] "The New Turkish Commercial Code Has Been Accepted in the New Year", http://erdem-erdem.com/newsletter.php?katid=12110&id=14651&main_kat=14647&yil=2011, (last accessed on 10.03.2011).

existing provisions, but also innovative new provisions. One of those significant innovations is the introduction of single-member company, which satisfies a major need.

3.3.2 Some Characteristics of Single-Member Companies According to the NTCC

In the NTCC, the single-member company has been regulated by means of adapting Twelfth Directive to Turkish law. According to the Directive a private limited liability is allowed to be incorporated by a sole member, which can be a natural or legal person. The Twelfth Directive provides a system with two alternatives; a Member State may either allow the incorporation of single-member private limited liability company or if a Member State is unwilling to allow such incorporation, it may introduce a system of limited liability for activities carried out by sole proprietors. The NTCC has applied the first model with a further step; according to NTCC, either single-member joint-stock or private limited liability company[645] may be incorporated by a natural or legal person. In the alternative, if shareholders of an AŞ or a LŞ incorporated by and among multiple shareholders diminishes to one, the company may legally continue to exist. It depends on the circumstances which type of company supplies the needs of an entrepreneur. Thus, the realization of single-member company form for both companies -AŞ and LŞ- will provide more options and elasticity to those who seek for a business solution.[646]

The single-member AŞ or LŞ is not structurally different from an ordinary AŞ or LŞ, it possesses the same organs. It is not a different type of commercial enterprise. The separation between the personal assets and company's assets must strictly be

[645] According to some scholars, it would be preferable if the NTCC would have envisaged the single-member company form to only one of those two company types. For this view, the realization of single-member LŞ would have been enough to meet the expectations, "Türk Ticaret Kanunu Tasarısı Hakkında Ankara Üniversitesi Hukuk Fakültesi Ticaret Hukuku Anabilim Dalı'nca Hazırlanan Görüş", **BATİDER**, Cilt 23 Sayı 2, 2005, (hereinafter cited as "AÜHF Görüş"), p.224; The availability of formation of single-member AŞs, may result in the misuse of this company form by certain people, who generally sees legal entities as their personal firms, Işıl Ulaş, "Uygulamacı Gözü ile Türk Ticaret Kanunu Tasarısı'na Bakış", **BATİDER**, Cilt 23 Sayı 2, 2005, p.194-195; However, some other scholars disagree and find it convenient to allow the formation of single-member companies for both company forms. Although it is not possible to set up such companies according to the current TCC, in reality and in practice, many single-member companies are present in Turkey. Therefore, the realization of legality of this situation will facilitate the protection of third parties, Korel Açıkgöz, "Türk Ticaret Kanunu Tasarısı'nda Anonim ve Limited Şirketler, **Güncel Hukuk**, Sayı 42, 2007, p.50.

[646] Tekinalp, Tek Kişilik Ortaklık, p.67.

respected.[647] The single-member company status is not a temporary one; it is legally recognized as a class among the limited liability companies. A natural person or legal entity may be the sole member of more than one single-member company.[648] A single-member LŞ does not necessarily be a small sized enterprise. However, a single-member AŞ must be a closed joint-stock company, by nature. A single-member AŞ or LŞ may be converted to another type of company; it may be subjected to merger or division. If there is any inconsistency with the principles and law, governing the single-member companies, this may lead to veil-lifting by a competent court.[649]

3.3.3 Single-Member Companies According to the Provisions of the NTTC

3.3.3.1 Single-Member Joint-Stock Company (AŞ)

In practice single-member AŞ will be subjected to same structural and institutional rules which also governs multi-member AŞs.[650] Only a few provisions are designed in order to assist single-member AŞs in providing the transparency of the company and the separation of its assets thus protect the company from misuse.[651] However, according to *Moroğlu*,[652] some precautions should have been envisaged in order to avoid the risks and abuses of limited liability in specific cases and to remove limited liability of the sole shareholder.

3.3.3.1.1 Incorporation of a Single-Member AŞ

According to the NTCC, natural persons or legal entities may form an AŞ (Art. 337) and an AŞ can be initially incorporated by one or more shareholder founders (Art. 338(1)).[653] Thus, with the entry into force of the NTCC, the relevant provision of the TCC, Art. 277, which requires at least five persons for the incorporation of an AŞ, will no longer apply. Moreover, the NTCC also allows an AŞ, which is founded with

[647] Atabek, Tek Ortaklı Şirket, 1987, p.26.
[648] The Twelfth Directive left it to the Member States' discretion to determine whether the sole member of a single-member company can also be the sole member of another company; thus, Turkish legislation is consistent with the Directive, Çelik, p.203-204
[649] Tekinalp, Tek Kişilik Ortaklık, p.63-67.
[650] Okutan, p.592.
[651] Tekinalp, Tarihi Gelişimi İçinde Tek Ortaklı Şirketler, p.597.
[652] Erdoğan Moroğlu, "Türk Ticaret Kanunu Tasarısı Hakkında Genel Değerlendirme", **Makaleler II**, İstanbul: Arıkan, 2006, p.185.
[653] These provisions of NTCC are also consistent with the Art. 2(2) of the Twelfth Directive.

multiple shareholders, to continue its existence when it subsequently becomes a single-member company. The consolidation of all shares of an AŞ by a single member will not be counted under the heading of reasons for dissolution and liquidation (TCC Art. 434(1)b.4) anymore; since, it will not lead to the dissolution of the company.

Further, the TCC Art. 435 suggests that when an interested party applies to a competent court for dissolution, the court may grant the company an appropriate time to rectify the situation and the failure to correct the situation, will lead to dissolution of the company. This article, which can be interpreted as permitting the *de facto* single-member AŞ to temporarily exist,[654] in respect of NTCC, loses its effect and it is to be considered merely as a way of realization of *de facto* single-member companies.[655]

In the previous draft of the NTCC, when the number of shareholders drops to one, the duty to register the single-member AŞ was given to the BD; if the BD fails to register the company, it will lead to its responsibility. However, this formulation was seriously criticized in doctrine. According to *Moroğlu*,[656] it does not seem satisfactory to hold only the BD responsible; since the BD may not be able to reach to such information about the consolidation of shares without a notification from the single shareholder of the company. It has been argued that a notification shall be done to the BD by the single shareholder as such a shareholder will be the one that knows about the situation. Another criticism is that, although the registration requirement is formulated for the subsequently formed single-member AŞ, the requirement for publicity of such a company is absent in the provision.[657]

As a result, both criticisms have been taken into account and the NTCC Art. 338(2) is defined as follows; if the number of shareholders drops to one, the BD shall be notified about this situation in writing within seven days from the date which such

[654] Okan, p.65.
[655] Gökmen Gündoğdu, "Türk Ticaret Kanunu Tasarısı'nda Tek Kişilik Anonim Ortaklık ve Tek Kişilik Limited Ortaklık", **İstanbul Üniversitesi Hukuk Fakültesi Mecmuası**, Cilt.LXV, Sayı.1, 2007, p.237.
[656] Erdoğan Moroğlu, **Türk Ticaret Kanunu Tasarısı- Değerlendirme ve Öneriler**, İstanbul Barosu Yayınları, 2005, p.81.
[657] Sabih Arkan, "Türk Ticaret Kanunu Tasarısına İlişkin Değerlendirmeler", **Türk Ticaret Kanunu Tasarısı: Konferans, Bildiriler-Tartışmalar**, 13-14 Mayıs 2005, Ankara: BTHAE, p.51; AÜHF Görüş, p.224.

transaction occurs. The BD shall register[658] and announce that the company is a single-member AŞ within seven days from the date of receipt of this notification.[659] Otherwise, the shareholder who fails to make the announcement and the BD that fails to make the registration and the announcement shall be responsible for any damage incurred. It can be observed that it is still not clear who informs the BD about the consolidation of the shares, but in the Preamble of the NTCC, it is stated that both the transferor and the transferee, especially the single shareholder transferee, has been given an obligation to inform the situation to the BD.[660] If this introductory and explanatory announcement[661] as a necessity of the principles of transparency and public disclosure is not made, both the BD and the single member, even, according to one view, the other party to the transaction, may be held responsible for any damage incurred.[662] Yet, this definition of liability is considered as inadequate[663] and subjected to many discussions.[664]

Art. 338(2) also regulates that, in case the company is initially incorporated with a single shareholder or the shares are consolidated in the hand of a single person, name, domicile and nationality of the single shareholder shall be registered and announced. The aim of such a disclosure is the protection of the third parties and

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[658] Another criticism was that, unlike many other provisions which envisaged registration in the commercial registry, it was not explicitly stated which registry was referred in this provision, Çelik, p. 205-206.

[659] The new form of Art. 338 was further criticized by *Moroğlu*, according to him the situation, in which a single-member AŞ was transformed to a multi-member company by gaining new shareholders, should also be registered and announced, Erdoğan Moroğlu, "Türk Ticaret Kanununun Yürürlüğü ve Uygulama Şekli Hakkında Kanun Tasarısı ile Gerekçelerine Dair Değerlendirmeler ve Öneriler", **İBD**, Cilt 80, Sayı 6, 2006, p.2390; However, the opposite view of *Gündoğdu* suggested that, since the registration and publicity requirements in case of a LŞ were mentioned in the Preamble of NTCC, the same conclusion could be drawn for an AŞ by way of interpretation. It would be preferable if such requirements were mentioned explicitly; but, in any case it would not lead to any responsibility, Gündoğdu, p.239, footnote 47; In any case, *Tekinalp* concluded, as it was suggested by Art. 31 of the NTCC that any amendments regarding a registered subject would also have to be registered, any changes in the position of an AŞ should be registered, Tekinalp, Tek Kişilik Ortaklık, p.94.

[660] Turkish Draft Commercial Code and the Report of the Justice Commission, No.96, Preamble to Art. 338, http://www.tbmm.gov.tr/sirasayi/donem23/yil01/ss96.pdf, (hereinafter cited as "Report of the Justice Commission, No.96"), (last accessed on 10.03.2011), p. 487; It was suggested that the transferor would not be able to predict that the AŞ was left with a single-member and the transferee was the one that could have that kind of information, Erdoğan Moroğlu, **Türk Ticaret Kanunu Tasarısı ile Yürürlük ve Uygulama Kanunu Tasarısı Taslağı-Değerlendirme ve Öneriler**, 4. Bası, Ankara, 2006, p.143.

[661] The obligation to make such announcements is consistent with the disclosure requirements of the Art. 3 of the Twelfth Directive.

[662] A Blueprint for the Future, p.6.

[663] Erdoğan Moroğlu, **Türk Ticaret Kanunu ile Yürürlük ve Uygulama Kanunu Tasarıları-Değerlendirme ve Öneriler**, Genişletilmiş 6. Bası, İstanbul: Vedat Kitapçılık, 2009, p.138.

[664] *Tekinalp* tried to clarify and describe the scope of liability as follows; the failure of the BD would lead to its strict liability. The BD could also have non-contractual liability towards third parties in respect of Art. 41 of the Turkish Code of Obligations. In rare circumstances, the BD would also have contractual liability to the company deriving from the relationship between the BD and the company on a services or mandate contract, Tekinalp, Tarihi Gelişimi İçinde Tek Ortaklı Şirketler, p.603; *see* also, Sayın, p.101.

creditors of the company; as, it is important for them to know that the company is left with a single member.[665] Two different kinds of registration and publicity requirement are envisaged in the NTCC. First one is the registration and announcement of the single-member AŞ; the second one is the registration and announcement of the particulars of the single member. Each of them serves a different purpose; the first one is considered as a notification for the third parties and creditors about the situation of the company and the second one is the introduction of the single member to public.[666] Last of all, Art. 338(3) of the NTCC states that the company cannot acquire or have acquired its own share in a way which may result in its being the only member. It is interpreted that, this provision is designed to prohibit an AŞ from existing without any shareholder.[667] According to *Moroğlu*,[668] this part of the provision was considered as contrary to the Art. 379 of the NTCC, which states that a company cannot acquire its own shares in return for consideration, at an amount which exceeds or will exceed as a result of a transaction, one tenth of its capital.

When we consider Art. 338 of the NTCC from the EU perspective, we can see that the Preamble of the Twelfth (2009/102/EC) Directive in its fifth recital sets forth a possibility for Member States to establish restrictions in specific cases on the use of single-member companies or remove the limited liability of the sole shareholders and allows them to set certain rules to avoid the risks that single-member companies presents as a result of having single members. As a demonstration of such restrictive rules; in Spain, if, after six months of becoming a single-member company, that fact has not been publicized in the register, the single member will be fully liable for debts of the company contracted during its single membership. Similarly, in Italy the single member of a joint-stock company will lose its privilege of limited liability, if he/she does not pay

[665] Okutan, p.595.
[666] Tekinalp, Tek Kişilik Ortaklık, p.93-94; Tekinalp, Tarihi Gelişimi İçinde Tek Ortaklı Şirketler, p.603; According to Art. 23 of the new Regulation and Application of Turkish Commercial Code No.6103, the natural or legal person-shareholder of a single-member AŞ, within fifteen days from the entry into force of this Act, is held responsible to inform its name, domicile and nationality to the BD through a public notary and the BD, as the addressees of this notification, within seven days from date receipt of this notification, is obligated to register and announce the matters envisaged in Art. 338, http://www.tbmm.gov.tr/kanunlar/k6103.html, (last accessed on 01.03.2011)
[667] Gündoğdu, p.241.
[668] Moroğlu, Türk Ticaret Kanunu 2009, p.138.

out the capital that has been subscribed and fulfils his/her obligations of disclosure with publicity in the registry.[669]

According to *Tekinalp*,[670] although the subsequent single-member AŞ, which is formed after the number of shareholders drops to one, has been received with sympathy, the initial formation of a single-member AŞ as envisaged in the NTCC is seriously criticized. For the author, such criticisms derive from the term "anonym", which is usually accepted as suggesting plurality. However, in this case, the term does not refer to the plurality of shareholders but it refers to plurality of shares and shareholder rights which arise from the division of capital. Thus, the consolidation of the shares in the hands of a single-member will not cause an impediment to plurality of shares or division of capital.

3.3.3.1.2 The General Assembly

In a single-member AŞ, the GA and BD will consist of the single-member. The single member has the full competence of GA; thus he/she shall adopt all resolutions; however all resolutions adopted in the name of the GA must be specified as GA resolutions and must be in writing (NTCC Art. 408(3)).[671]

Concerning the parties who are authorized to call the GA to a meeting, the provisions on the minority's power to call a meeting (Art. 411(1)), cannot be applied in a single-member AŞ. Since such an AŞ has only one member, the concept of minority will not be present.[672] Even if the duration of the GA is expired, the BD and the liquidation officers, concerning subjects under their authority, may convoke the GA. If

[669] Okutan, p.595.
[670] Tekinalp, Tek Kişilik Ortaklık, p.10; Tekinalp, Tarihi Gelişimi İçinde Tek Ortaklı Şirketler, p.590.
[671] According to *Moroğlu*, a mere written form may lead the company to commit fraud; combined with the fact that, a single-member may take a GA decision anytime, anywhere and under any circumstances, without any public disclosure. Therefore, besides such a written form, there should have been an additional provision which provides for registration in the commercial registry or disclosure requirements, Moroğlu, Türk Ticaret Kanunu 2009, p.137; However, I agree with the view that, since Art. 422(2) provides for the registration of the notarized copies of minutes of the GA; the disclosure of related matters; the publication of the minutes in company's website by the BD, such an additional provision on registration or publicity is not necessary, *see*, Gündoğdu, p.244-245; It is stated in Art. 422(1) of the NTCC that, the minutes of the GA will be considered as invalid unless they are signed by the chairman and the Ministry delegate. In my opinion, this requirement seems inconsistent with the structure of single-member AŞs; as, the only condition for validity of a GA resolution is referred as a 'written form' in Art. 408(3); NTCC Art. 408(3) is also consistent with the Art. 4(2) of the Twelfth Directive.
[672] Gündoğdu, p.243.

the BD is continuously unable to convene or the meeting quorum of the GA is not present, the single member may convoke the GA, upon a permission from the competent court (Art. 410(1),(2)).

The GA of a single-member AŞ may convene in ordinary or extraordinary meetings with full attendance.[673] Since, pursuant to Art. 416 of the NTCC, it is possible to hold a GA meeting without convocation in a single-member AŞ, a single-member may under any circumstances take a GA decision.[674] In cases where single member is the only member in the BD and also the member of the GA, it is not possible to take the decision for the release of the single shareholder from BD.[675]

The provision about the duties of the BD, the delivery of the notarized copies of minutes of the GA to the commercial registry; the registration and disclosure of related matters and the publication of those minutes in the company's website (Art. 422(2)),will also be applicable to single-member AŞs. If the public disclosure of GA resolutions is not made, the BD will be held responsible (Art. 1524).[676]

The non-compliance with the resolutions of the GA will lead to personal liability of members of the BD; thus, each member of the Board and, in necessary circumstances, the Board, itself, may file an action for annulment against the GA (Art. 446). If the single member is also the only director, such an action will be problematic; since, it does not seem feasible for a single-member to file an action against the decisions taken by himself/herself.[677] On the other hand, in cases where the single member is not a member of the BD, both the Board and its members have the right to file an action against GA resolutions (Art. 446(1)c, d).[678]

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[673] Sometimes full attendance may not be maintained, *see*, Tekinalp, Tarihi Gelişimi İçinde Tek Ortaklı Şirketler, p.606.
[674] Gündoğdu, p.243-244; Sayın, p.104.
[675] Tekinalp, p. Tarihi Gelişimi İçinde Tek Ortaklı Şirketler, p.606.
[676] According to Art. 1524 (1) of the NTCC, every capital stock company is obligated to create a website for the transparency of the company. The following and other similar information should be published on the website; all data concerning the company and in which shareholders, minorities, creditors and stakeholders have interest, documents regarding GA meetings, financial statements and merger and division balance sheets, audit reports, valuation reports…etc., A Blueprint for the Future, p.5.
[677] Gündoğdu, p.245.
[678] In practice such an action for annulment will be rarely seen because of the dominance of the single-shareholder in the single-member AŞ, Gündoğdu, p.245.

3.3.3.1.3 The Board of Directors

The relevant provision of the current TCC, Art. 312, requires a minimum of three directors, each of whom shall be a shareholder of the company, for the composition of the BD.[679] With the entry into force of the NTCC, this provision will no longer apply and an AŞ shall now have a BD which consists of one or more persons, assigned by the articles of association or elected by the GA (NTCC Art. 359(1)).[680] In other words, it is now possible for a single shareholder to be a member in the BD.[681] However, it has been criticized that the NTCC preserves the term "Board" for an organ that comprises with only one member in case of single-member AŞs.[682]

At least one member of the BD who is authorized for representation must have his/her domicile in Turkey and must be a Turkish citizen (Art. 359(1)).[683] Therefore, in a single-member AŞ, the single shareholder must meet those requirements in order to be the sole director of the BD.[684] The members of the BD can either be natural persons or legal entities which can be picked outside the shareholders.[685] In case a legal entity is elected as a member of the BD, only one natural person, who is submitted by the legal entity, shall also be registered and announced along with the legal entity. Only this

[679] This necessity has been causing difficulties and resulted in creation of fake shareholding, hence, circumvention of law. In practice, most of the Board members do not exist in real life. Therefore, the benefits of the amendment is that the management will gain professionalism, disputes and abuses arising from the fake shareholdings and circumvention of law will be eliminated, A Blueprint for the Future, p.32.

[680] In companies incorporated by foundations, associations, universities, academies and similar legal entities, it is now possible for these legal entities to be Board members and avoid the participation of third parties in the management, A Blueprint for the Future, p.31.

[681] Arslan, p.152; *Tekinalp* suggests that, all provisions of NTCC concerning the BD are applicable to single-member AŞs and some of them are specifically designed for them. As it is stated in the Art. 359(2) of the Preamble of the NTCC, the BD which consists of only one director, is the best solution for the single-member AŞs that are established for direct foreign investment in Turkey, Tekinalp, Tek Kişilik Ortaklık, p.114.

[682] Ömer Teoman, "Türk Ticaret Kanunu Tasarısı'nın Anonim Ortaklık Yönetim Kuruluna İlişkin Bazı Hükümlerinin Değerlendirilmesi", **BATİDER**, Cilt 26, Sayı 3, 2010, p.6-7; I agree with the author; since, such a term, which refers to plurality, can be misleading.

[683] According to *Çelik*, since the term 'citizen' can only be used when referring to a natural person, it can be stated that, this provision excludes sole shareholder legal entity from becoming the only director in a single-member AŞ. Therefore, the legal entity must be presented by a natural person, who must be a Turkish citizen, in such a company. In other words, in a single-member AŞ, if the single-member is a legal entity, this legal entity cannot be the sole director of the Board, Şehiali Çelik, p.208.

[684] Gündoğdu, p.246.

[685] That means, the management of an AŞ can now be performed by professionals, Tekinalp, Tek Kişili Ortaklık, p.114.

natural person can participate in meetings and vote on behalf of the legal entity (Art. 359(2)).[686]

In the previous drafts of the NTCC, it necessitates at least half of the directors of the Board and the natural person representative and, in a single-member AŞ, the sole director of the Board to have higher education.[687] This expectation has received serious reactions; thus, the provision has been changed.[688] The final version of the provision requires all the members of the BD to be capable to act in full capacity and at least one quarter of the members of the BD to have higher education. It also emphasized that such requirement shall not be applicable in case of a BD which consists of a single member (Art. 359(3)).

A Board member shall not conduct any commercial transaction falling under the scope of activity of the company in his/her or anybody's account without getting permission of the GA and he/she shall not work in a company that performs same kind of commercial activity as a partner with unlimited liability as well (Art. 396(1)).[689]

Furthermore, a Board member shall not conduct any transaction with the company in his/her name without getting permission from the GA. Otherwise, the company shall claim that the transaction conducted is null and void (Art. 395(1)).[690] When single-member AŞs are concerned, in practice, such a prohibition may not be effective for the protection of third parties. Since the GA consists of the single-member and the single-member may also be a director of the Board, it cannot be expected from the single-member to get that permission from himself/herself.[691]

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[686] As the legal entity cannot be physically present in the BD, it will determine the natural person that represents itself.

[687] This is interpreted as a clear indication that NTCC regards widely accepted corporate governance principles, Anlam Altay and Serap Amasya, "Draft of The New Turkish Code of Commerce- New Challenges for Turkish Commercial Law", Deloitte, http://www.deloitte.com/assets/Dcom-Turkey/Local%20Assets/Documents/turkey-en_audit_NewChallengesforTCL_020108.pdf, (last accessed on 12.01, 2011), p.6.

[688] Ulaş, p.195; Açıkgöz, p.48; The criticisms had a common point which was taken into consideration by the Justice Commission. Thus, in the Preamble of the NTCC, the traditional structure and majority of the number of the family enterprises in Anatolia and the fact that the owners of such enterprises do not have higher education, was taken into account. As a result, restraining an entrepreneur from being a director in his/her own company was considered to be an impediment to their constitutional right to enterprise and the draft provision had been amended, *see*, Report of the Justice Commission, No.96, p.489.

[689] *See*, Sayın, p.107.

[690] The same clause is present in the Art. 334 of the current TCC.

[691] Gündoğdu, p.246; Arslan, p.156; *see* also, Sayın, p.107.

The Board member, his/her relatives, the personal companies of which such member and his/her relatives are partners, and capital stock companies in which they have at least twenty percent shares, shall not become indebted to the company. Furthermore, the company shall not provide surety, guarantee or security for these persons or undertake liability (Art. 395(2)).[692] The main purpose of the prohibition to become indebted to the company is the protection of the company's capital and the demonstration of the support for the professionalism of the BD.[693]

3.3.3.1.4 Transactions Between the Single-Member and the AŞ

In a single-member AŞ, regardless of whether or not the company is represented by a single shareholder during the conclusion of a contract, the validity of such contract between this shareholder and the company depends on the condition that the contract is in written form.[694] Whereas, the exception of this provision is that; this requirement shall not apply to contracts regarding daily, insignificant and ordinary transactions under normal conditions of the market (Art. 371(6)).[695]

According to the Twelfth Directive Art. 5(1), contracts between the single member and his company as represented by him, shall either be recorded in minutes or drawn up in writing. When we compare the Directive with NTCC, we can see that in transactions where the single-member does not represent the company, such requirements are not present in the Twelfth Directive.[696] Similarly, in Italy, such contracts, which are concluded during representation of the single member, must be recorded in the book of the BD or drawn up in writing. It can be observed that, there is no restriction on self-dealing[697] in terms of EU and Turkish company laws, but there is a

[692] However, Art. 395(3) of the NTCC suggests that subsidiaries in group of companies may provide surety and guarantee for each other. However, such an exception may lead to misuse of such companies' with the single-member company form, Sayın, p.107, footnote, 508.
[693] Tekinalp, Tek Kişilik Ortaklık, p.160.
[694] If the written form is not complied with, such a contract will be considered as invalid. Whereas, determination of the other factors that affects the validity of such contracts, is left to the jurisdiction of the Turkish Supreme Court, Tekinalp, Tarihi Gelişimi İçinde Tek Ortaklı Şirketler, p.604.
[695] These are accepted as operations that are considered day to day transactions of business life, such as; the purchase of an insignificant tool for the company.
[696] Gündoğdu, p.248; In this regard, the Turkey's provision is one step further than the Directive's, Arslan, p.158.
[697] According to *Tekinalp*, any possible restriction on self-dealing may cause the single-member to circumvent the relevant provision on such a restriction, Tekinalp, Tarihi Gelişimi İçinde Tek Ortaklı Şirketler, p.604; However, *Eroğlu* suggests that the single member, who is managing the single member AŞ as sole director, may not enter into contracts with the AŞ concerning loans, securities, guaranties or collateral, Eroğlu, Single-Member, p.13.

strict requirement of recording the transaction immediately in order to create transparency and prevent defraud.[698]

When we look at the criticisms of this provision; according to *Moroğlu*,[699] without public disclosure of the contracts between the single-member and the company, the written form, by itself, will not provide adequate protection for third parties. It is further argued by *Gündoğdu*[700] that, such a contract should be considered as valid on condition that, the articles of association includes a provision which permits the conclusion of that contract and such a contract is registered in the commercial registry and published in the company's website.

3.3.3.1.5 Liability in a Single-Member AŞ

The NTCC keeps the requirement of the current TCC and requires a minimum capital of fifty thousand Turkish liras as an instrument of creditor protection in AŞs (NTCC Art. 332). However, there is no special capital requirement for single-member companies even though it is generally considered that transactions with single-member companies are riskier than those with other companies.[701] Therefore, for some authors, raising the minimum requirement of registered capital of single-member companies may help providing better protection for creditors.[702]

Capital contributions may either be in cash or in kind. However, in order to accept an immovable property as a contribution in kind, such property shall be appraised by experts and registered at the land registry office, on behalf of the company, directly by the registrar. In addition to that, a movable contribution in kind shall be entrusted to a reliable person, in order to be deemed as a contribution in kind (Art.

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[698] Eroğlu, Single-Member, p.12.
[699] Moroğlu, Türk Ticaret Kanunu 2006, 4.Bası, p.171; *see* also, Okutan, p.606.
[700] Gündoğdu, p.249.
[701] Another concern which is suggested by *Moroğlu* is that; the low capital requirements may cause sole proprietorships to convert their businesses into single-member AŞs to benefit from limited liability. Thus, the author suggests that the minimum capital requirement be five hundred Turkish liras in order to prevent such a tendency, Erdoğan Moroğlu, "Başbakanlığa Sunulan Türk Ticaret Kanunu Tasarısı Hakkında Değerlendirme", **Makaleler II**, İstanbul: Arıkan, 2006, p.196.
[702] Eroğlu, Single-Member, p.10; It can be observe that the Twelfth Directive did not set forth any minimum capital requirement clause for single-member companies; thus, relevant provisions of Member States' legislations, on minimum capital requirements of joint-stock companies, would be applicable in this field. Like the Directive, the NTCC did not provide any specific rule for single-member companies regarding minimum capital, the general provisions for AŞs will be applicable.

128(2)). If the contribution is something other than money, which has an economic value or it if is a movable property, the AŞ will get the possession of such property as soon as it gains legal personality (Art. 128(4)). In order to exercise rights over the ownership of an immovable property or any another real right, which has been brought to the company as a capital contribution, these must be registered at the land registry office (Art. 128(5)).[703]

According to NTCC, at least twenty five percent of the nominal value of the shares subscribed in cash must be paid before registration and the remaining shall be paid within twenty four months following registration (Art. 344 (1)).[704]

The performance of the capital contribution of the shareholders can only be requested by the company (Art. 128(7)). Shareholders are only responsible to the company and their responsibility is limited to the extent of their contributions (Art. 329 (2)). However, the AŞ may request a damage, which is incurred by the company as a result of a delay in performance of the capital contribution, to be compensated by the single member (Art. 128(7)). Since a single-member AŞ consists of one shareholder, such a request, for the fulfillment of capital contribution, may be meaningless.[705] Furthermore, the payment of the share prices may be requested by the BD *via* an announcement (Art. 481)) and the shareholder who fails to perform the capital contributions is obligated to pay a default interest (Art. 482(1)).[706] It is clear that the BD is the unit which will apply the stated sanctions. However, there is not any sanction

[703] Gündoğdu, p.247.
[704] Çelik, p.209; *Eroğlu* suggests that, if, before registration, the single member has not fully paid up the contribution in cash or has not brought in the contribution in kind, he/she must provide sufficient security in this respect, Eroğlu, Single-Member, p.10; In the same way, *Okutan* argues that, there should have been provisions, in the NTCC, regarding the requirement to provide a deposit for the outstanding capital contribution when an AŞ is formed by a single shareholder, Okutan, p.600; I do not agree with both authors' opinion for the fact that such a requirement may decelerate the development of businesses. A similar provision used to be present in GmbHG; however, with the latest 2008 reform, Germany no longer requires a deposit for the outstanding capital contribution. The reasons for the abolition of that requirement may be best described as the attempts of the EU in simplify the rules governing the formation of single member companies. In this regard, according to me, such a provision is not necessary for the NTCC.
[705] Gündoğdu, p.247; In this sense, an action for compensation will probably not be called upon, when the single shareholder is, at the same time, the only director in the Board.
[706] Çelik, p.209.

regarding the non-performance of the capital contributions, in cases where the single-member is also the sole director of the Board.[707]

A single-member has its legal personality and assets separate from its sole shareholder's; thus, such an AŞ is solely responsible with its assets due to its debts (Art. 329(1)). It is not possible to consider a single-member AŞ independent from its sole shareholder, notwithstanding the fact that they are two separate legal personalities. However, the assumption that the privilege of limited liability can easily be abused in this company structure,[708] might affect the functioning of this institution in a negative way.

The structure of single-member AŞ is designed specifically in a form that enables the single entrepreneurs benefit from limited liability. In this sense, there is no provision in the NTCC that leads to unlimited liability of the single member for the non-performance of contribution requirements;[709] since, it will not be consistent with the logic under which the single-member company is established.[710]

On the other hand, the single-member AŞs should be subject to the same conditions and sanctions as the multi-member AŞs. According to *Gündoğdu*[711] it would be too optimistic to think that there could not be any misuse of such a corporate form. Therefore, if the sole member fails to distinguish between the assets and affairs of the company and his private assets and affairs, he/she shall be held responsible. Depending on the circumstances, the liability of the BD may be incurred in case of a detriment of creditors; or, the veil of the corporation may be lifted[712] in order to hold the shareholder

[707] If the obligation of capital contribution were accepted as a provision regarding the incorporation process and if the interests of creditors, shareholders or of public are significantly put under risk or violated as a result of the actions contrary to the provisions regarding the incorporation process of the company; upon the claim of the BD, the Ministry of Industry and Commerce, the creditor or shareholder; the commercial court of first instance, where the company is situated, shall rule for the termination of the company (NTCC Art. 353(1). Such an action must be filed within the three months from the registration of the company (NTCC Art. 353(4)). Since the outstanding cash contributions have been given a period of twenty four months to be paid, if the non-performance occurs after three months from the registration, this provision will not be applicable in practice, further on this discussion, *see*, Çelik, p.210-211.

[708] This was a view embraced by many scholars, *see*, Ulaş, p.194; Moroğlu, Türk Ticaret Kanunu 2006, 4.Baskı, p.142.

[709] Çelik, p.212; Gündoğdu, p.250.

[710] Sayın, p.112.

[711] Gündoğdu, p.250.

[712] The works by Turkish scholars on the topic of piercing the corporate veil, which presented theoretical backgrounds for veil piercing in Turkish law, based on the good faith principles of the Turkish Civil Code. However, these good faith principles could have been interpreted much broader for a developed piercing the corporate veil

personally liable for the debts of the corporation, if he/she purposely undercapitalized the company.

3.3.3.2 Single-Member Private Limited Liability Company (LŞ)

In contrary to the current TCC, in the NTCC, the LŞ has departed from general partnership, and has almost resembled a small size AŞ with the effect of national and international markets. The GA and the manager structure of the LŞ are in a form similar to AŞ, regardless of the number of shareholders it has.[713]

3.3.3.2.1 Incorporation of a Single-Member LŞ

According to Art. 573(1) of the NTCC, a partnership with limited liability shall be incorporated by one or more real persons or legal entities[714] under a trade name and its capital shall be definite and consist of the sum of basic capital shares.[715] Thus, the relevant provision of the TCC, which requires at two persons for the incorporation of a

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theory. Until recently there was no mention of the theory in court decisions; thus, it was hard to state that there is a developed theory of veil lifting in Turkey; In a Supreme Court decision, the Court built its justifications for veil lifting on the foundations of good faith principles, stating that the law would not protect the misuse of limited liability (Yargıtay 19. HD E. 2005/8774 K. 2006/5232, 15.05.2006). Moreover, in another decision, which was accepted as an important application of veil lifting, the Court stated that the fact that a person owned shares in a number of companies was sufficient to classify him as a trader, which would make him eligible to be declared bankrupt (Yargıtay 19. HD E. 2000/5828 K. 2000/7383, 02.10.2000). It might be concluded that, with these decisions, veil lifting in Turkey was applied as a punishment for the misuse of the separate legal personality of companies rather than the establishment of liability of shareholders for the debts of companies, Eroğlu, Limited Liability, p.247-248; *see* also, Seven-Gürsoy, p.2455-2459; Wendy B.E. Davis and Serdar Hızır, "Dance of the Corporate Veils: Shareholder Liability in the United States of America and in the Republic of Turkey", *Ankara Bar Review*, 2008/2, Heinonline Database, (last accessed on 15.05.2010), p.101-102.

[713] A Blueprint for the Future, p.44.

[714] This provision is consistent with the Twelfth Directive, in which it is also envisaged that the single shareholder of the company can be a natural or legal person.

[715] In the previous drafts of this new provision, the minimum membership requirement for LŞ was absent, Hasan Nerad, "Limited Şirketlerin Geleceği-Bir Deneme", **Prof. Dr. İrfan Baştuğ'un Anısına Armağan**, Dokuz Eylül Üniversitesi Hukuk Fakültesi Dergisi, İzmir, 2005, p.224; Since, there was not any indication about the minimum number of members in the draft provision; the incorporation of single-member LŞ was implicitly recognized. However, the draft provision had received negative reactions. The formation of single-member LŞ was explicitly defined not only in the Twelfth Directive but also in Swiss and German legislations; therefore, the implicit recognition of such a company was found inconsistent with law coding technique, Şükrü Yıldız, **Makalelerim 1988-2007**, "Türk Ticaret Kanunu Tasarısının Anonim ve Limited Şirketlere İlişkin Bazı Hükümleri'nin Değerlendirilmesi", Ankara: Yetkin Yayınları, 2008, p.409; Such a requirement is present in the latest version of the provision.

LŞ, will no longer apply. However, the requirement of the current TCC, which envisages maximum of fifty members for LŞs, is preserved (NTCC Art. 574(1)).[716]

It is state in the Preamble to Art. 574(2) that, single-member LŞ does not indicate a different type of company; it belongs to a different class but it is in the same category with the LŞs. Therefore, when the number of shareholders of a multi-member LŞ drops to one, it means that such a LŞ will still belong to the same category and the provisions on conversion of companies will not be applicable. In any case, if there is a change in the class of a LŞ, this fact must be registered and announced; which means that, the situation, in which a single-member AŞ is transformed to a multi-member LŞ by gaining new shareholders, shall also be registered and announced.[717] It is further emphasized that single-member LŞ is considered to have a temporary and different status;[718] as, there may be changes in the number of shareholders.[719] Against this explanation of the Preamble, it is argued that there is not any indication in the provisions of the NTCC that the single-member LŞ has a temporary status. Combined with the fact that, when Arts 593 and 594 are examined, which set forth the possibility of transferral or inheritance of basic capital share, it can be concluded that such a company will have a permanent status.[720]

According to Art. 574(2) of the NTCC, if the number of partners drops to one, the managers shall be notified about this situation in writing[721] within seven days from the date of such transaction.[722] Then, the managers shall register and announce that the

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[716] According to *Yıldız* there should not have been such a limitation. However, since such a limitation is present, the sanctions should have been clearly determined in case the number of shareholders exceeds fifty, Yıldız, Makalelerim, p.409; *see* also, Moroğlu, Türk Ticaret Kanunu 2009, p.327.

[717] Report of the Justice Commission, No.96, p.264-265.

[718] The reason for qualification of the status of the single-member LŞ as 'temporary', can be interpreted with the indication of the fact that single-member LŞ is a form of LŞ, Aktaş, 2007.

[719] There were many debates about that explanation; such a reservation about single-member LŞ did not seem meaning full when the NTCC had already realized the validity of single-member AŞ with all its aspects. Thus, the Preamble of the Art. 574(2) was found inconsistent with the Preamble of Art. 573, which made a reference to the Twelfth Directive, in which the need for the formation of LŞs with one member was emphasized, Yıldız, Makalelerim, p.410; *see* also, AÜHF Görüş, p.234.

[720] Gündoğdu, p.253; *see* also Sayın, p.113.

[721] *Moroğlu* criticizes Art. 574(2) by stating that, according to Art. 595(2), unless provided otherwise in the articles of association, the approval of GA shall be required for a transfer of share to be valid. In this regards, it will not possible for a manager not to know the fact that all shares are transferred to a single member. Therefore, a notification in writing shall only be needed in case of transfers that do not require the approval of GA, Moroğlu, Türk Ticaret Kanunu 2009, p.328.

[722] As in the case of Art. 338(2), it is not clear who informs the managers about the situation. With an interpretation of Art. 574(2), it has been suggested that, the sole shareholder, who acquires all shares of the company, is obligated to inform the situation to the managers, Yıldız, Limited Şirketler, p.72.

company is a single-member LŞ within seven days from the date of receipt of this notification.[723] This notification shall include the name, surname, nationality and domicile of the single member; if the managers fail to make the registration and the announcement, they shall be responsible for any damage incurred.[724] The aim of those disclosure requirements is the introduction of the single member to public; thus, enabling transparency of the company for the protection of third parties.[725] In this way, third parties will be able to know if they are transacting with a company or an individual.[726] The aim of such disclosure is the protection of the third parties and creditors of the company. The managers shall fulfill the same obligation, where the company initially incorporated with a single member; on the contrary to Art. 504 of the TCC currently in force, in such case, an action for dissolution shall not be initiated.[727]

Furthermore, Art. 574(3) states that the company cannot acquire or have acquired its own share in a way which may result in its being the only member. It is interpreted that, this provision is designed to prohibit an LŞ from existing without any shareholder.[728]

3.3.3.2.2 General Assembly

In a single-member LŞ, the GA will consist of the single-member. According to Art. 616(3) of the NTCC, single member has all authorities of GA; however, all resolutions adopted in the name of the GA must be specified as GA resolutions and must be in writing.[729]

Pursuant to Art. 617(1), the GA shall be convoked by the managers. Ordinary GA shall convene annually; however, when necessary, GA shall be called to an

[723] In the previous drafts of the NTCC, the duty to register the single-member LŞ was given only to the managers; if they failed to register the company, it would lead to their responsibility. However, that form of the provision was exposed to the same criticisms that had been attributed to Art. 338. As a result, Art. 574 was, then, modified, Gündoğdu, p.252.
[724] This provision does not impose any responsibility to the sole shareholder who fails to inform the managers. However it should have envisaged liability of the sole shareholder in such a case. Hence, I agree with the view that this may cause the managers to bear all responsibility; even if the non-fulfilment of registration or disclosure requirement derives from the failure of the sole shareholder in notifying the managers, Çelik, 206.
[725] *See*, the Preamble to Art. 574(2).
[726] Tekinalp, Tek Kişilik Ortaklık, p.47.
[727] Gündoğdu, p.252.
[728] Tekinalp, Tarihi Gelişimi İçinde Tek Ortaklı Şirketler, p.607; Çelik, p.204.
[729] Şahirali Çelik, p.207.

extraordinary meeting. The management and decision-making mechanisms of the single-member LŞ is similar to the structure in the single-member AŞ; as an instance, provisions regarding AŞs on convocation, minorities' right to convoke, GA meeting without convocation, minutes and unauthorized attendance excluding those regarding the Ministry delegate; shall be applied to LŞs by analogy (Art. 617(3)). Unless a partner makes a request for an oral deliberation, GA resolutions may be adopted by the written consent of other partners to the proposal of one of the partners regarding an agenda item (Art. 617(4). Hence; if there is more than one manager, the other managers shall request from the single member to take a decision in his/her capacity as GA. However if there is only one manager in a single-member LŞ, the single member may under any circumstances take a GA decision.[730]

There are some non-delegable powers of GA (Art. 616); but, in a single-member LŞ, it is not possible for the GA to exercise some of those powers. Thus, a sole shareholder, in his/her capacity as GA, may appoint himself/herself or a third person as a manager in order to dismiss the other managers or remove them from office (Art. 630 (1)). The sole-shareholder, in his/her capacity as GA, may also terminate the company.[731]

3.3.3.2.3 Managers of a Single-Member LŞ

According to the NTCC Art., 623(1), the management and representation of a LŞ shall be laid down by the articles of association; moreover, it may be delegated to one or more shareholders entitled or to all shareholders or to third parties. Thus, in single-member LŞs, it is mandatory for the single member to be a manager; whereas, the sole shareholder-manager may also appoint other managers besides himself/herself.[732]

Under Art. 623(3), the managers are authorized to adopt resolutions on all management issues which are not reserved solely to the authority of the GA. However, the GA's non-delegable powers, such as the appointment, dismissal or release of the

[730] Gündoğdu, p.254.
[731] Yıldız, Limited Şirketler, p.207; Sayın p.116.
[732] Gündoğdu, p.254; Çelik, p.207.

managers (Art. 616),[733] will not be exercised in practice, as the sole shareholder-manager is also the GA itself.[734] If there is more than one manager, one of them will be determined as chairman of BD by the GA. The chairman manager or if there is only one manager, such manager shall be authorized to convoke and conduct the GA and to make all declarations and announcements (Art. 624).

If one of the managers of the LŞ is a legal entity, it shall appoint a natural person to perform this duty on behalf of itself (Art. 623(2). Besides this, at least one of the managers must be domiciled in Turkey and must be specially authorized to represent the company (Art. 628(1)). Furthermore, name, surname, trade name, domicile of the manager and other parties, who are authorized to represent the company must be registered (Art. 587).

According to Art. 626, managers are responsible to perform their duties with due care, and to safeguard the interest of the company in good faith. Managers shall also be subject to loyalty duty. They also have an obligation no to perform a competitive business activity against the company, unless provided otherwise by the articles of association and all other shareholders have given their written consent. When the structure of a single-member LŞ is taken into account, it is hard to apply such non-competition clause to the sole shareholder.[735] The non competition clause regarding the sole shareholder-manager must be very strict and certain.[736]

3.3.3.2.4 Transactions Between the Single-Member and LŞ

In a single-member LŞ, regardless of whether or not the company is represented by a single shareholder during the signing of a contract, the validity of such contract between this shareholder and the company depends on the condition that the contract is in written form.[737] However, this requirement shall not apply to contracts

[733] In order for this provision to be effective, there must be more than one manager. If there is not any other manager appointed to the company, the sole shareholder will have the authority to manage and represent the company, Çelik, p.207-208.
[734] Gündoğdu, p.254.
[735] Gündoğdu, p.255; *see* also, Sayın, p.118.
[736] Okutan, p.599.
[737] If the written form is not complied with, such a contract will be considered as invalid. Whereas, determination of the other factors that affects the validity of such contracts, is left to the jurisdiction of the Turkish Supreme Court, Tekinalp, Tarihi Gelişimi İçinde Tek Ortaklı Şirketler, p.604.

regarding daily, insignificant and ordinary transactions under normal conditions of the market (Art. 629(2)). Similarly, in Germany, all business conducts[738] between the single-member company, represented by its shareholder-managing director, and its sole shareholder, shall be recorded in a memorandum or minute or any other type of record. This applies even if the shareholder-managing director cannot represent the company acting alone.[739]

Art. 613(1) of the NTCC envisages that, shareholders are responsible not to disclose the secrets of the company. This liability shall not be eliminated by the articles of association or GA resolution. Partners shall not act in a way that impairs the interests of the company. Especially, they shall not carry out transactions that will provide special benefits to them and harms the company. It can also be required by the articles of association that shareholders refrain from transactions and competitive acts against the company (Art. 613(2)). It can be understood that the shareholders do not have a non-compete obligation; combined with the fact that, if all remaining shareholders give written consent, shareholders may engage in activities contrary to loyalty duty and obligation not to compete (Art. 613(4)).[740]

3.3.3.2.5 Liability in a Single-Member LŞ

The NTCC requires a minimum basic capital of twenty thousand Turkish Liras for LŞs (Art. 580(1)). Compared to the current legal regime, the minimum standard specified in the NTCC is quite high. However, the purpose of this regulation is to facilitate the warranty functions of the share capital for the creditors of the company.[741] There is no special capital requirement for single-member companies.

As in the case of AŞs, capital contributions may either be in-cash or in-kind may and performance of the capital contribution of the shareholders can only be requested by the company (Art. 128(7)). However, in a single-member LŞ, this provision may be considered as inadequate for the enforcement of capital

[738] The requirement was not restricted only to contracts.
[739] Eroğlu, Single-Member, p.12.
[740] Gündoğdu, p.255; *see* also, Sayın, p.120.
[741] Altay and Amasya, p.10.

contributions.[742] On the other hand, as a positive development for the protection of third party's interests, Art. 585 (1) requires the shareholders to subscribe the whole capital unconditionally and pay the amount to be contributed in cash fully and immediately, in order for the company to be incorporated.[743] If the contribution is an immovable property, it must be registered at the land registry on behalf of the LŞ (Art. 128(5)).[744]

A single-member LŞ has its legal personality and assets separate from its sole shareholder's; thus, such a LŞ is solely responsible with its assets due to its debts. According to Art. 573(2), shareholders shall only be responsible for paying the basic capital shares they subscribed; for fulfilling their obligations to make additional payments and for secondary performances set forth in the articles of association. It must be emphasized that the contributions of the shareholders takes crucial part in case of LŞs. It is clear that the NTCC enforces a detailed regime for accessory obligations and obligation of additional payment.[745] Accessory obligations are obligations, which may arise when regulated in the articles of association. On the other hand, obligation of additional payment may arise when the assets of the company are not adequate to cover the obligations of the company. These are considered as two exceptions of the limited liability; by regulating these, the NTCC demonstrates its intentions on formulating a secure legal regime for the shareholders.[746]

According to the Preamble of the NTCC, when obligation for additional payment is compared to personal liability, the common point of two institutions is that; non-performance of both of the obligations invokes the shareholder's liability. The disparity between two institutions is that, personal liability is towards the company's

[742] It was argued that by *Arslan* that, while all European countries are trying to facilitate the simplification of their legislations regarding single-member companies, the heavy formation and capital contribution requirements of the NTCC contradicts with this innovative movement, Arslan, p.184; In my view, the author's point is understandable; since, such heavy requirements will lead to complexity of the formation of single-member LŞs. Furthermore, it is important to emphasize the fact that even Germany has left such requirements, with the establishment of its latest company law reform.
[743] Çelik, p.210.
[744] Gündoğdu, p.247; Çelik, p.209; A Blueprint for the Future, p.45.
[745] According to Art. 603(1), shareholders may be held responsible for additional payment other than the basic capital contributions if it is stated in articles of association. Such additional payments can only be requested; where, the total of capital and statutory reserves do not cover the company's losses; it is impossible for the company to continue its business without such additional instruments; a situation, which is defined in the articles of association, arises for a need for equity.
[746] Altay and Amasya, p.11.

creditors; whereas, liability on obligations for additional payment is towards the company itself.[747]

[747] Preamble to Art. 603, Report of the Justice Commission, p.269; *see* also, Sayın, p.121.

CONCLUSIONS

The crucial function of the harmonization of European company laws is to eliminate the disparities in national laws, which prevent the economic intercourse between the Member States. In order to avoid such obstacles, many harmonization tools that are part of EU legislation are used, such as Treaty provisions, regulations, directives or the jurisprudence of the ECJ. Furthermore, EU company legislation has to be interpreted in line with the provisions of the TFEU on the right of establishment.

It should not be forgotten that, the harmonization of European company laws has been supported by the case-law of the ECJ, which set aside the national provisions that constituted obstacles to freedom of establishment. In the absence of harmonization measures, private international law dealt with the question of which legal system governed a company incorporated in one country that has some foreign contact that gives rise to conflict-of-laws. In this regard, the ECJ cases were mostly about the divergence between the two private international theories, namely, the real seat and the incorporation theory. As an instance, in previous rulings of the ECJ, such as *Centros, Überseering* and *Inspire Art,* the Court did not give attention for the compatibility of Member State's private international law systems adopting the real seat theory; thus, it has required that Member States should abandon this theory. Paradoxically, in its latest *Cartesio* case, the Court fallowed the logic under one of its earliest judgements *Daily Mail* and tried to save the remains of the real seat theory. In other words, the Court avoided burying the real seat theory and replacing it with the incorporation theory.

Since, the jurisprudence of the ECJ has important impacts on national company laws of Member States, many of them fallow the Court's previous rulings and tend to abandon the real seat theory. However, when the changing attitude of the ECJ is considered, it can be concluded that, instead of eliminating the real seat theory completely, a compromise between the real seat theory and the incorporation theory can be a better solution in order to maintain the competition between the Member States.

The right of establishment is considered to be one of the core elements of EU company law; as, various directives are enacted under Art. 50(2) TFEU, which facilitate

the harmonization. Directives are often used because of their easy adaptation to national systems of Member States. One of the attempts, in the harmonization process of European company laws, is the realization of single-member companies with the Twelfth Directive. The main task of the Twelfth Directive is creating a legal instrument, which allows the individual entrepreneur to benefit from the privilege of limited liability in all Member States, in the same way. Thus, the Directive presents two models to achieve this aim, which are 'limited liability sole proprietorship' and 'single-member private limited liability company'. Most of the Member States have made their choice in favor of private limited liability company model; except Portuguese, who has embraced the sole proprietorship. It can be stated that the sole proprietorship formula has been rarely used; since, there is much confusion about the actual form of the sole proprietorship; whether it shall be considered as a company or a legal person.

At first glance, setting up a company with only one member is criticized as being inconsistent with the traditional company law theory, which requires plurality of members as an essential element; and a contract, in which all parties agree to work together in order to reach a common purpose. However, in time, this theory has changed and a company is now regarded as an organizational structure, which can be instituted by the act of will of a single person, rather than a contract. The single-member company shall be regarded as an important instrument, which facilitates the development of this theory.

Having a competitive company law system is an important issue for attracting FDIs and encouraging persons to participate in commercial activities. In order to achieve this, the Directive allows both natural and legal persons to be the sole shareholder in a single-member company. With granting limited liability to the sole shareholder, another criticism is attributed to the single-member company, which is the difficulty of separation between the private assets of the shareholder and the assets of the company. The main concern is that, a probable mix of assets of the company and the single-member may harm the creditors and third parties.

The Directive cites the principle of limited liability as a necessary instrument of a single-member company, but it must be without prejudice to the laws of the

Member States which, in exceptional circumstances, require the sole shareholder to be liable for the obligations of its undertaking. Thus, although it is not explicitly stated in the Directive, piercing the corporate veil can be used as a safeguard which is perfectly legal under EU law. The veil of incorporation can be pierced and the single-member can be held liable in situations; where there is exploitation in parent-subsidiary relationships; where alter ego problems occur and the acts of the single shareholder are treated as acts of the corporation or where inadequate capitalization of a company is in question.

The provisions of the Twelfth Directive envisage just a framework for Member States. Since the Directive does not contain detailed provisions which sets forth strict regulations for single-member companies, each Member State, acting consistent with the framework of the Directive, may use its discretion in implementation of the Directive. However, this has led to disparities in the application of the Directive in domestic laws of Member States. Although Member States, in general, have been very enthusiastic about the harmonization of company laws, it is doubtful whether harmonization can easily be maintained when such a broad discretion is given to Member States. It is inevitable to give Member States the discretion to put forward certain restrictions on the use of single-member companies or abolish the limits on the liability of single member in specific cases; since, the Directive did not provide for any other safeguard. However, this discretion can be criticized as being too much; when the ultimate aim of full harmonization is taken into account.

In the Directive, there was no direct prevention of a single-member company to be the sole shareholder of another single-member company. Since, such prevention would have been too restrictive for groups of companies, the Directive left it to the initiative of the Member States. Such regulation of the Directive was appropriate; since, the parent company in a corporate group might need to establish more than one subsidiary to conduct a high scale enterprise. Thus, if a restriction had been applied, many problems might have occurred.

The Directive did not have any provision regarding a minimum capital requirement for the formation of single-member companies. This view should be

considered consistent with the aims of the establishment of single-member company form; since, an additional capital requirement might lose the attractiveness and competitiveness of this enterprise form. In addition to this, Member States were set free to put forward rules to overcome the risks that single-member companies might constitute as a consequence of having single-members, especially to ensure that subscribed capital was paid.

According to the Directive, in a single-member company, the single member has the full competence of the GA; thus, may adopt all resolutions in the name of the GA, so long as they are in writing. It is a general principle of most company laws that, at least one shareholders meeting has to be called every year to adopt the annual report. Unfortunately, in practice, such a formal requirement may be overlooked by the single shareholder in a single-member company. However, those formal handicaps may easily be abolished, if it is accepted that all GA resolutions may be taken outside formal meetings. This solution may also receive recognition from the supporters of the view that the GA of a single-member company shall be no more regarded as a "meeting"; since all GA resolutions may be adopted solely by the single shareholder. However, the written form requirement may be strengthened by requiring a more detailed and formal record of GA resolutions.

When the reflections of single-member company concept in Turkish law is analyzed, it can be observed that; although the current TCC envisages the dissolution of the company when the plurality of shareholders is absent, *de facto* singe-member companies are already present in practice. Thus, the introduction of single-member companies in Turkish law shall be considered as a chance to legitimize the existing situation.

The current TCC, which has been in force since 1957, no more responds to the needs of the modern company law theories; as, there have been many commercial law reforms throughout the EU and the world. In order to cope with the modifications in theory and practice, the TCC inevitably needed changes thus this situation has led to the construction of a new commercial law reform.

The NTCC, which will enter into force on July 1, 2012, includes provisions with significant innovations; such as, the introduction of single-member company. It can be stated that the NTCC mostly fallowed the German company law model in its reforms. With the entry into force of those provisions, a company will be able to be formed with a single-member or to continue to exist although, after formation, its number of shareholders drops to one. Although there are not many provisions in the NTCC that are specifically regulated for single-member companies, they are all in line with the Twelfth Directive. Only a few provisions are introduced exclusively for single-member companies. Therefore, in the absence of special regulations, single-member companies will be subjected to same structural and institutional rules which also govern multi-member limited liability companies. Only a few provisions are designed in order to assist single-member companies in providing the transparency of the company and the separation of its assets to protect the company from misuse. Moreover, the minimum capital requirement of a single-member company is the same with an ordinary limited liability company. This application is consistent with the latest company law trends of EU member states, which abandon the minimum capital requirements for single-member companies.

According to the Twelfth Directive, contracts between the single member and his company as represented by him, shall either be recorded in minutes or drawn up in writing. Whereas, according to the NTCC, such transactions in which the single-member does not represent the company, too, must be in writing. Such a requirement is not present in the Twelfth Directive. It is appropriate that there is no restriction on self-dealing in terms of EU and Turkish company laws, but there is a strict requirement of recording the transaction in writing immediately.

In a single-member company, all GA resolutions may be adopted solely by the single-member and these resolutions must be recorded in writing. This provision of the NTCC is similar with the relevant provision of the Directive. In addition to this, the NTCC envisages that, all related matters of the company, including GA resolutions, must be disclosed in its website. Thus, when the written form requirement is combined

with such a disclosure requiremet, it presents even a more advanced protection for third parties.

Despite all positive developments, there may naturally be handicaps regarding the application of provisions regarding multi-member AŞs and LŞs in case of single-member companies in the future. However these obstacles can be overcame with the jurisprudence of Turkish courts.

A reasonable criticism regarding single-member companies is about the preservation of the term "Board" in case of BD. The criticism is mainly on the use of such a term in cases where the BD is only comprises with a single-member. This view can be embraced since, such a term refers to plurality and it may be misleading to use the term "Board" for an organ with a single-member.

A major concern about the single-member company is that, this innovative instrument can be used to the detriment of creditors and third parties; since, in case of a claim on the misuse of this company structure, there is not many sanctions available to apply. There is not any specific rule that allows Turkish courts to pierce the corporate veil other than the general principles of TCC and Turkish Civil Code. If there is a breach of good faith rules, Turkish courts may remove the corporate veil and hold the sole shareholder liable. In such a case, the court will examine whether the conditions on separating corporate personality and limited liability are used in a way that breach good faith. In this regard, it is necessary for Turkey to have a developed theory and practice on veil-piercing cases in order to apply accurately in single-member companies.

Another argument regarding the provisions on single-member companies is that, some precautions should have been envisaged in order to avoid the risks and abuses of limited liability in specific cases and to remove the limited liability of the sole shareholder. However, there is no provision in the NTCC that leads to unlimited liability of the single member even for the non-performance of capital contribution requirements. The main reason is that, the realization of single-member company concept is based on granting limited liability to the sole entrepreneurs. Thus, regulating heavy sanctions which envisages single-member's unlimited liability will not have been

consistent with the logic under which the single-member company is established. Thus, it can be stated that the conflicts, which may rise regarding the functioning of this company form, are left to the Turkish doctrine and jurisprudence to be solved.

Consequently, if Turkey would have insisted on the prohibition of the formation of single-member companies, this would force the sole entrepreneurs to continue using straw men formations, when setting up AŞs and LŞs, in order to circumvent law. On the other hand, it would also continue to discourage foreigners from establishing companies in Turkey because of heavy statutory requirements.

However, Turkey by recognizing single-member company concept, accepted an economic reality which will facilitate the functioning of the SMEs and increase the competitiveness of the Turkish market. In short, supporting the formation of single-member companies with efficient regulations, will be very beneficial for Turkey's economy.

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