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**RESEARCH ARTICLE**

# Executive Remuneration of Company Directors under EU Law and Turkish Law

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**Abstract**

The criteria to determine the material scope of executive pay has always been a controversial aspect of corporate law and corporate governance. The controversy stems from the fact that the board of directors generally tends to determine a suitable executive remuneration for its members, not considering the interests of other stakeholders. In some cases, an independent compensation/remuneration committee is appointed by the board of directors and determines the amount of executive pay. Depending on the legislation, this may require additional approval at the annual general meeting by the shareholders.

European legislators have differing approaches with regards to regulating this very area of corporate pay. The revised Shareholders Rights Directive requires an enhanced approach for the shareholders' role by determining the remuneration policy of the company. These amendments can be identified as the promotion of the say on pay, on the remuneration policy, and remuneration report. Furthermore, the previous recommendations have also set the criteria to determine the amount of remuneration. The Directive contains provisions for setting up a clear and transparent corporate remuneration policy and shareholders' binding vote with temporary derogations.

The corporate remuneration system of Turkish law is legislated under Art. 394 TCC (Turkish Commercial Code Nr. 6102), which only requires that board members can be paid an honorarium, salary, bonus, premium, and a portion of the annual profit, provided that this amount is determined by the articles of association, or by way of a general meeting resolution. Art. 408 TCC also stipulates a binding general meeting approval of the remuneration policy, whereas Art. 513 TCC requires the framework with regard to bankruptcy procedures.

**Keywords**

Remuneration Of Company Directors, Say on Pay, Shareholders Right Directive, Shareholders' Oversight, Corporate Governance

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## I. Introduction: The Rationale Behind Executive Pay Systems

The design of executive pay systems concerning corporate managers has reflections on a wider scale, especially with regard to previous economic crises where unsupervised corporate compensation schemes played a crucial role[1].

The subject of how to determine executive pay is closely related with the "principal-agent" conflict[2]; however, agency theory has come under significant criticism lately in literature on the basis that it is insufficient to explain the legal grounds for the shareholder-manager relationship[3].

Executive pay systems are of crucial importance to a company, as companies are managed by their board of directors.

There are five globally accepted characteristics of business corporations: *(i)* legal personality, *(ii)* limited liability, *(iii)* transferable shares, *(iv)* investor ownership and *(v)* delegated management with a board structure[4]. Other than partnerships[5], corporations are managed by a board of directors, which is elected by the general meeting of shareholders, i.e. there is a statutory organ responsible for the management of the corporation. Being a shareholder does not result in managing the corporation; as opposed to the partners in a partnership. The members of the board of directors are called managers or directors[6]. According to the system of any given country, the board can be structured as either a one-tier or two-tier board system. A two-tier board system requires a supervisory board and a managerial board, with executive members[7]. In one-tiered board systems, e.g. Turkey, commercial codes mostly enable the delegation of management. (Art. 367 TCC) Delegation of management is the separation of day-to-day business of the firm from strategic management. Corporate officers who run the operational day-to-day business of the corporation are called executive managers, as they are in fact managing the commercial affairs of the

1 Guido Ferrarini, Niamh Moloney and Maria Cristina Ungureanu, 'Understanding Directors' Pay in Europe: A Comparative and Empirical Analysis' (2009) SSRN ECGI - Law Working Paper 126/2009, 5 <https://ssrn.com/abstract=1418463> accessed 10 April 2023; John Armour, Luca Enriques, et. al.: *The Anatomy of Corporate Law, A Comparative and Functional Approach*, (third edn, Oxford University Press 2017) 155. Huriye Kubilay, 'Anonim Ortaklıkta Yönetim Kurulu Üyelerinin Ücretlerinin Belirlenmesi' in *Ticaret Hukuku ve Yargıtay Kararları Sempozyumu XXIV* (2010) BTHAE 11.

2 Mathias Habersack, 'Vorstands- und Aufsichtsratsvergütung – Grundsatz- und Anwendungsfragen im Lichte der Aktionärsrechterichtlinie' (2018) (127) NZG 129.

3 Jean-Philippe Robé, 'The Shareholders Rights Directive II' in *ERA Forum 17* (2016) 45-55, 51.

4 Armour and Enriques (n 5) 5.

5 Partnerships are also commercial companies, where the identities of partners are important, other than the investment they bring in to the company. With regard to the management of partnerships, all of the partners are vested with managerial duties and responsibilities, unless the partnership agreement stipulates otherwise. In other words, all of the partners are managers. The feature of partnerships is also linked with the rule that limited liability is not applicable to partnerships, i.e. partners are liable for the debts of the company.

6 Within this paper the terms "*directors*" and "*managers*" will be used interchangeably. In specific legal systems there might be technical differences between these two terms, however in this paper both of the terms will be referred to within their general meaning.

7 Armour and Enriques (n 5) 50.

corporation. These executive directors may also be professionals appointed outside of the members of the board of directors. The non-executive directors are the members of the board of directors who are not vested with the managerial power to run the daily management of the corporation and are responsible for the supervision of these executive directors. The function and powers of non-executive directors are reduced to the strategic management and oversight of the executive directors[8].

The obligation to run a company is burdensome. The members of the board of directors[9] are bound with fiduciary duties. Generally, these duties may be classified as the duty of loyalty and the duty of care. In this sense acting as a director bears high risks, as directors can personally be exposed to claims from shareholders[10], the company itself, and from the creditors of the company on the grounds of mismanagement[11]. A generally used benchmark for the determination of fiduciary duties is the "business judgement rule"[12]. This rule foresees that the decisions taken by the board shall be made with business discretion. This refers to the procedure of commercial decision-taking. In the event that the members of the board of directors or the managerial board are making informed decisions on a certain topic, even if the decision will result in the loss of the corporation, the managers will not be held liable as the decision was taken in due process[13].

Despite this duty being incumbent with a high-risk potential, another important aspect to be considered is that it is easy to abuse the power to determine the amount of corporate remuneration. In other words, depending on the national system, the system can be abused by way of tunneling corporate assets for the personal needs of the directors. The national system of remuneration policy must be designed in a way to abolish these risks.

8 Marco Ventoruzzo, Pierre-Henri Conac and et. al., *Comparative Corporate Law* (West Academic Publishing 2015) 250.

9 A technically more accurate determination would be that all the persons involved in the management of the corporation are bound with fiduciary duties based on the general principle stipulated in Art. 754 OR.

10 The claims of the shareholders are called derivative actions, as these derive from the right of the company to bring claims. In some jurisdictions, shareholders and creditors of the company are vested to substantiate their claims on the employment agreement between the company and the director, such as the Art. 553 TCC.

11 Mismanagement of course is not the only ground for the responsibility claims to be initiated, here it is referenced as a general reason for the claims. According to Art. 553, Turkish Commercial Code (TCC), directors are held liable for the damages the company sustains when they fail to fulfil their obligations originating from the TCC and the articles of association (AoA).

12 Art. 369 TCC prescribing the duty of care and the duty of loyalty of the board of directors, stipulates that "*Board of Directors and third parties in charge of management shall be held liable for prudent performance and protection of the company's interests*.". Also, in the preamble of this very provision, the legislator stipulates that the threshold for the duty of care is set as the "business judgement rule" which requires a diligent decision mechanism to be initiated on an informed judgement.

13 Ventoruzzo and Conac (n 12) 297.

### A. Theories Approaching the Concept: Principal-Agent Conflict

As agency theory suggests, the discrepancy of the management of a company by the managers for the shareholders can be eliminated by way of aligning the interests of shareholders with those of the managers. In other words, performance-based remuneration contracts are an effective tool for keeping the managers motivated to consider shareholders' interests[14]. However, keeping these interests aligned with each other can lead to excessive risk taking, which is also considered to be the main reason behind the 2007-2009 financial crisis[15].

The underlying fact of agency problems lies in the phenomenon of delegated management. As stated above, the modern corporation is managed by a professional board consisting of managers, whereas in a partnership all the partners are vested with managerial powers. As they are managing their own investment and acting on their own behalf, there is no agency problem in partnerships. However, the modern corporation is embedded with this very problem, i.e. the management board of a corporation is an elected body of professionals, they are running others' investments, not their own. This is the structure of agency problems and as a result of this fact, the board of directors are vested with fiduciary duties, i.e. duty of care and duty of loyalty[16].

The "Agency Problem" or the "Principal-Agent Conflict" arises, when the interests of the principal must be considered by the "agent", whose actions result to affect the financial situation of the principal. The main problem, and the grounds for a substantial conflict of interest, is that the agent has to abstain from acting in its own interests and has to follow those of the principal[17].

As the agent is the one who is closer to the "transaction" at issue, the principal has to monitor the agent, in order to be sure that the agent is acting in good faith and in line with the interests of the principal. It is claimed that there are three main agency conflicts with regard to corporate law[18]: The first one is between the "firm's owners"[19] and its managers. The other agency problems are claimed to occur between the majority and minority shareholders of a company and a third appearance comes between the company and third parties[20]. As mentioned above, the costs for observing the agent are costly in the sense that there are different ways and approaches designed to reduce these costs, one of which is the "trusteeship and rewards strategy".

14 Ferrarini, Moloney and Ungureanu (n 5) 3.

15 Ferrarini, Moloney and Ungureanu (n 5) 6.

16 Ventoruzzo and Conac (n 12) 561.

17 Armour and Enriques (n 5) 29.

18 Armour and Enriques (n 5) 30.

19 With regard to "firm owners" the term refers to the shareholders of the company, however the fact whether the shareholders are the "owners" or even the "economical owners" of the firm is controversial according to new approaches with regards to corporate law. For a recent point of view and a critical approach towards the Agency Theory see: Robé (n 7) 47.

20 Armour and Enriques (n 5) 30.

*Trusteeship strategy* mostly refers to "independent directors". It is believed that in the event that there is a lack of high monetary gains, or even the lack of interest towards those, the "agents" will be closely bound with the incentives of honesty, impartiality and prudency. Now, many jurisdictions rely on the impartiality of the independent directors in order to monitor the executive directors and, in a general sense, the board of directors[21].

Furthermore, the reward strategy aims to reward the agents for successfully fulfilling their duties, and serving for the interests of the principal. Considering this, the crucial link of agency theory is that the statutory rules with regards to corporate remuneration find their roots in this very reward mechanism[22]. In a more general sense, and in line with this "reward strategy", legislators do not opt for high returns with regard to corporate remuneration. The main problem here is to be considered as taking excessive risks[23].

As all the directors -"agents"- are not equal in many aspects, there is no reason to pay the same amount of remuneration to every director; the benefit/reward packages, namely the contracts granting these rights can only be designed on an individual basis. However, this procedure of determining individual pay regimes can result in controversy, as the preparation of such a contract will not be supervised by any third party. Again, the core part aims to examine this very sophisticated structure of shareholders' control on remuneration. However even this "shareholder supervision", namely the concept of "say on pay" is not sufficient to solve the agency costs problem, as in most jurisdictions only the remuneration policy, but not the individual remuneration agreements are subject to shareholders' approval.

Within this scope, the remuneration of the "agent" must be determined in a way that does not exceed a certain threshold, so that the agent is dissuaded from taking excessive risks. However, remuneration must be in line with the heavy burden of employment, and at the same time it must be enough of a deterrent to dissuade agents from participating in fraudulent activities[24].

However, agency theory is criticized on the basis that the shareholders are not the owners of a company, and that the managers are not the agents of the shareholders, but agents of the company[25]. *Robé* further argues that aligning the interests of shareholders with those of the company will not result in the affirmative. As discussed further in

21 According to Art. 4.3.4 Turkish Corporate Governance Principles, at least one third of the members of the board of directors of a listed company must consist of independent board members. The number of independent board members shall not be less than two.

22 Although highly criticized and sort of outdated, Agency Theory still is one of the main approaches construing the management of a corporation.

23 Armour and Enriques (n 5) 36. ,

24 Armour and Enriques (n 5) 36.

25 Robé (n 7) 51.

the paper, *Robé* argues that giving more incentives to shareholders with regard to supervisory powers will not change their behaviour. In other words, he argues that based on factual data, passive shareholders are not going to become active and take part in decision making processes[26].

## B. Objectives of the Pendulum

As stated above, the issue with the determination of corporate remuneration policies is that the factors to be considered are very broadly defined. In other words, one end of the pendulum aims to not leave enough room for the directors to commit fraud and serve their own personal interests, while the other threshold must be defined in a manner that allows the allocation of sufficient funds to the directors.

Determining remuneration either as too high or too low can result in fraudulent activities. If it is too low, then the directors might resort to seeking out alternative sources of income; while if it is too high, with regard to alignment of the interests of the shareholders, it might result in excessive risk taking. In this sense, the aforementioned[27] "trusteeship and reward strategy" may serve to prevent deceitful activities. As reward strategy basically means aligning the interests of the shareholders with those of the directors, remuneration must be assessed proportionally if it is to be an effective solution[28].

However, Commission's Proposal for the amendment in the Shareholders Right Directive 2007/36[29] stated that shareholder control over remuneration policies will stop directors to act only in their own interests and reward them personally, instead of serving the best interests of the company. As a result, the amendment included a solution for this problem by way of inserting new rules with regards to better shareholder oversight of directors' remuneration, which is believed to strengthen the link between the pay and performance of directors.

As stated by *Gordon*, it is still unknown what level of remuneration will be sufficient to prevent an executive from engaging in fraudulent activities. Excessive risk taking and deceitful behaviour are the two extreme points of the pendulum, which cannot be easily solved by way of aligning the interests of the shareholders and the directors[30].

26 Robé (n 7) 52.

27 Please see above under the heading: "A.Theories Approaching the Concept: Principal-Agent Conflict".

28 Guido Ferrarini and Maria Cristina Ungureanu, in J. Gordon and G. Ringe (eds) 'Executive Remuneration. A Comparative Overview' (2014) *Oxford Handbook of Corporate Law and Governance* (Oxford University Press, European Corporate Governance Institute (ECGI) - Law Working Paper 268/2014) 5 < https://ssrn.com/abstract=2509968 >, accessed 10 April 2023.

29 Proposal for a DIRECTIVE OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL amending Directive 2007/36/EC as regards the encouragement of long-term shareholder engagement and Directive 2013/34/EU as regards certain elements of the corporate governance statement, Brussels, 9.4.2014 COM (2014) 213 final., https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52014PC0213.

30 Jeffrey Gordon, 'What Enron Means for the Management and Control of the Modern Business Commission's Proposal

Besides the legal restraints to achieve a legal and honest management of the company, the main duty of the directors of a company is to serve the corporate interest by way of diligently making corporate decisions[31]. However, the issue of the determination of corporate pay is an important factor for directors honouring their employment contracts. As was revealed in the Enron scandal[32], and in the latest financial crisis, the alignment of the interests alone did not work out, as it led to excessive risk taking on the part of the directors, when the long-term interests of the company are not taken into consideration.

With regard to this consideration, The Commission introduces the notion of enhanced shareholder oversight as a solution to undercut the tendency of short-termism. Furthermore, this approach of focusing on the long-term interests and sustainability of the company introduces itself as the natural outcome of current corporate circumstances. It has become all too apparent that the alignment of the interests of the company with those of the managers does not suffice to regulate executive remuneration, and nor does it serve the objective to prevent corporate fraud.

## II. EU Legal Framework of Executive Compensation

### A. The Regime After the Company Law Plan 2003

After the Enron incident, the Commission came up with the 2003 Company Law Plan on "*Modernizing Company Law and Enhancing Corporate Governance in the EU*", which describes a more solid role for the shareholders[33] and where the first steps to regulate this area of corporate pay were taken[34]. The plan states that the Commission is considering the regulation of corporate remuneration as an urgent initiative. Following the Action Plan, the Commission adopted three different Directives with regards to this very area of corporate remuneration:

#### 1. Commission Recommendation 2004/913/EC[35]

The 2004 Recommendation requires that the shareholders must be sufficiently informed about the remuneration policy at a general meeting. In particular it details a disclosure regime for the company's remuneration policy and individual

Corporation: Some Initial Reflections' (2002) 69 University of Chicago Law Review 1233-1250, 1246.

31 Armour and Enriques (n 5) 74.

32 Gordon (n 34) 1247.

33 For a detailed analysis of the shareholders' position in European company law, see: Pavlos E. Masouros 'Is the EU Taking Shareholder Rights Seriously? An Essay on the Impotence of Shareholdership in Corporate Europe' (2010) 7(5) European Company Law 196.

34 < http://europa.eu/rapid/press-release_IP-03-716_en.htm?locale=en > accessed 10 April 2023.

35 COMMISSION RECOMMENDATION of 14 December 2004 fostering an appropriate regime for the remuneration of directors of listed companies (2004/913/EC) [2004] OJ 2 385/01.

pay arrangements. The disclosure of the company's policies can either be realized through the annual remuneration report, or a separate report as stated in Art. 3.1 of the Recommendation. The remuneration policy of the company is called the "Remuneration Statement" and according to Art. 3.3, it should at minimum contain an explanation of the director's remuneration components, sufficient information on the performance criteria, a link between performance and pay, information on the main parameters for the annual bonus scheme, and supplementary pension schemes.

Art. 4.1 dictates that this statement must be an explicit item on the agenda of the annual general meeting and pursuant to Art. 4.2, the statement should be submitted for shareholders' vote at the general meeting. The vote can be binding or of an advisory nature.

Art. 5.1 stipulates that "*The total remuneration and other benefits granted to individual directors over the relevant financial year should be disclosed in detail in the annual accounts or in the notes to the annual accounts, or where applicable, in the remuneration report*.".

And pursuant to Art. 6.1, share-based remuneration schemes need the prior approval of shareholders by way of a resolution at the annual general meeting prior to their adoption, in order to be implemented.

However according to the Commission's 2007 Remuneration Report[36], only 60 % of member states implemented the recommendation with regard to remuneration policy disclosure. Only about a third of the Member States have legislated shareholders vote on the policies. Moreover, the recommendation related to the disclosure of individual board members' remuneration has been adopted by more than two thirds of member states and prior shareholder approval of share-based remuneration schemes has been adopted by more than the majority of the member states.

## 2. Commission Recommendation 2005/162/EC

The Commission's 2005 Recommendation[37] stipulates board governance with two main tools: the endorsement of independent directors and board committees in listed companies. With regard to remuneration, the 2005 Recommendation stipulates an independent remuneration committee to be set up in order to decide in an area of corporate law, where particular conflicts of interest are present.

36 Report from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions Report on the application by Member States of the EU of the Commission 2009/385/EC Recommendation (2009 Recommendation on directors´ remuneration) complementing Recommendations 2004/913/EC and 2005/162/EC as regards the regime for the remuneration of directors of listed companies {COM(2010) 284 final} {COM(2010) 286 final} {SEC(2010) 670}.

37 COMMISSION RECOMMENDATION of 15 February 2005 on the role of non-executive or supervisory directors of listed companies and on the committees of the (supervisory) board (2005/162/EC) [2005] OJ 2 52/01.

In the preamble (para. 10) of the Recommendation it is stated that the audit, nomination, and remuneration committees should make recommendations to the board of directors in order to prepare for the decisions to be taken by them. Paragraph 13 of the preamble explains the situation of the Remuneration Committee in more detail[38].

Art. 4 of the Recommendation states that an independent director must be appointed to the board of directors or to the supervisory boards of companies. Art. 13.1 states: "*A director should be considered to be independent only if he is free of any business, family or other relationship, with the company, its controlling shareholder or the management of either, that creates a conflict of interest such as to impair his judgement*."[39].

However, the Recommendation does not set a definitive number or ratio to the number of independent directors to be elected as board members. It only stipulates that a sufficient number of independent or non-executive directors must be elected to the supervisory board. As discussed earlier, the management of a company can be designed in different ways. As to national regulation, it can come forward in a one or two-tier model. In a one-tier board system the management of the company can be delegated to executive directors, whereas in a two-tier system, the board of directors are placed as the supervisory board.

In this sense, Art. 5 stipulates that independent directors are to be placed in sufficient number in board committees to prevent these conflicts of interest. The key areas for a potential conflict of interest are defined as audit, nomination, and remuneration. Therefore, to avoid such conflicts, the recommendation requires the constitution of committees.

As stated in the "Objective" of the "Report on the application by the Member States of the EU of the Commission Recommendation on the role of non-executive or supervisory directors of listed companies, and on the committees of the (supervisory) board,[40] "*Member States were invited to take the necessary measures to promote the application of the Commission Recommendation by 30 June 2006, either through legislation or through best practice rules based on the "comply or explain" principle*."

In other words, compliance with the recommendations was not binding on member states. They were free to decide whether or not to legislate certain areas of law. They

38 The remuneration committee should consist of only non-executive and independent members, according to Annex I Art. 3.1 subparagraph 2: "*The remuneration committee should be composed exclusively of non-executive or supervisory directors. At least a majority of its members should be independent*."

39 The criteria for being independent are described in much further detail in Art. 13.

40 European Commission, Report on the Application by the Member States of the EU of the Commission Recommendation on the Role of Non-executive or Supervisory Directors of Listed Companies and on the Committees of the (Supervisory) Board (COM SEC (2007) 1021) (2007).

were also free to choose the type of legislation[41] in the event they decided to legislate this very area. However, if they choose not to apply these principles at all, then they have to explain the reasons thereof.

## 2. Commission Recommendation 2009/385/EC

The Commission's 2009 Recommendation[42] is, as stated in the literature, mostly focused on the design of executive remuneration[43]. In the preamble of the Recommendation, it is stated that in the previous Commission Recommendations, namely 2005/162/EC and 2004/913/EC, the focus was on the introduction of a disclosure regime and transparency of remuneration practices, by way of regulating shareholders' say on pay, or by the appointment of independent directors in listed companies. The preamble continues to explain that the focus of the 2009 Recommendation is on the regulation method of remuneration legislation[44].

In other words, the Commission suggests that the remuneration criteria need to be precise and based on performance. In particular it is also stipulated that the remuneration should consist of variable and non-variable components[45]. The non-variable components of the remuneration must be determined on measurable criteria.

In Paragraph 7, the Commission suggests limiting "golden parachutes"[46], the compensation packages to be paid to directors, in the event of early termination of their employment contracts[47]. However, these compensation packages are mostly subject to abuse. It is clearly stated that these payments must not be designed in a way that they result in "a *reward for failure*", but that they only constitute a "*safety net*" for the directors. In addition to this, termination payments should not exceed a fixed amount, and should not be higher than the sum of the two years of non-

41 Member states choose to regulate this area through legislation or, in the most frequently used method, through soft law, and generally provisions prescribed in national Corporate Governance Codes.

42 COMMISSION RECOMMENDATION of 30 April 2009 complementing Recommendations 2004/913/EC and 2005/162/EC as regards the regime for the remuneration of directors of listed companies (2009/385/EC) [2009] OJ 2 120/01.

43 Ferrarini, Moloney and Ungureanu (n 5) 28.

44 Paragraph 6 of the Preamble states that: "*The structure of directors' remuneration should promote the long-term sustainability of the company and ensure that remuneration is based on performance. Variable components of remuneration should therefore be linked to predetermined and measurable performance criteria, including criteria of a non-financial nature. Limits should be set on the variable components of remuneration. Significant variable components of remuneration should be deferred for a certain period, for example, three to five years, subject to performance conditions. Furthermore, companies should be able to reclaim variable components of remuneration that were paid on the basis of data, which proved to be manifestly misstated."*

45 According to Article 2.1 of the 2009 Recommendation: "*Variable components of remuneration' means components of directors' remuneration entitlement which are awarded on the basis of performance criteria, including bonuses*."

46 Golden parachutes are contractual clauses designed to get effective in the event of an early termination of directors' employment contracts. However, in most of the cases, where contractual golden parachutes are invoked, big amounts of money are payable, therefore the Commission felt the need to limit the amount of such payments. For a detailed information on golden parachutes with regards to *Mannesmann* Case: Armour and Enriques (n 5) 221; Ventoruzzo and Conac (n 12) 524.

47 2009 Recommendation entails a definition of *golden parachutes* in Article 2.2: "Termination payments' means any payment linked to early termination of contracts for executive or managing directors, including payments related to the duration of a notice period or a non-competition clause included in the contract."

variable components of remuneration. Share remuneration schemes must be better linked to performance and consider the long-term interests of the company by way of introducing a vesting period, a minimum of three years, for these shares[48].

The Recommendation also suggests that at least one member of the remuneration committee be an expert on remuneration practices. Art. 9.3 stipulates that the remuneration committee *should ensure that the remuneration of individual executive or managing directors is proportionate to the remuneration of other executive or managing directors and other staff members of the company*. This suggestion is criticized in the literature on the grounds that it constitutes an unjust intervention to corporate autonomy[49].

Section II of the 2009 Recommendation entails recommendations with regard to the remuneration policy: Article 3 puts down the rules with regard to the structure of the remuneration policy. According to that, the remuneration policy includes variable components of remuneration and companies should set limits on the variable component(s). The non-variable component of remuneration should be sufficient to allow the company to withhold variable components of remuneration when performance criteria are not met. Award of variable components of remuneration should be subject to predetermined and measurable performance criteria. Performance criteria should promote the long-term sustainability of the company and include non-financial criteria that are relevant to the company's long-term value creation, such as compliance with applicable rules and procedures.

The Commission also recommends including claw-back provisions under Article 3.4 which states that, "*contractual arrangements with executive or managing directors should include provisions that permit the company to reclaim variable components of remuneration that were awarded on the basis of data which subsequently proved to be manifestly misstated*."

Under Article 3.5 the regime is designed with regards to golden parachutes: "*Termination payments should not exceed a fixed amount or fixed number of years of annual remuneration, which should, in general, not be higher than two years of the non-variable component of remuneration or the equivalent thereof. Termination payments should not be paid if the termination is due to inadequate performance".*

Section II of the 2009 Recommendation also covers issues with regard to the disclosure of the policy on directors' remuneration under Article 5. Shareholders' votes are also covered, according to Article 6 "*Shareholders, in particular institutional shareholders, should be encouraged to attend general meetings where appropriate*

48 This system is criticized to be intrusive: Ferrarini and Ungureanu (n 32) 23.

49 Ferrarini and Ungureanu (n 32) 23.

*and make considered use of their votes regarding directors' remuneration, while taking into account the principles included in this Recommendation, Recommendation 2004/913/EC and Recommendation 2005/162/EC."*

Section III is about the creation, operation and role of the remuneration committee. With regard to the creation of the committee, it is important to point out that at least one member is recommended to have knowledge and experience with regard to remuneration policy. According to Article 9.3 *the remuneration committee should ensure that the remuneration of individual executive or managing directors is proportionate to the remuneration of other executive or managing directors and other staff members of the company*. Article 9.4. foresees the remuneration committee to report on the exercise of its functions to the shareholders and be present at the annual general meeting.

### B. The Regime under the Directive (EU) 2017/828 and the General Framework (New Shareholders Rights Directive)

In 2014 the European Commission proposed a revision of the Shareholder Rights Directive[50], focused on five main goals[51]:*"1) Increase the level and quality of engagement of asset owners and asset managers with their investee companies; 2) Create a better link between pay and performance of company directors; 3) Enhance transparency and shareholder oversight on related party transactions; 4) Ensure reliability and quality of advice of proxy advisors; 5) Facilitate transmission of cross-border information (including voting) across the investment chain in particular through shareholder identification."*

The Commission's 2014 proposal was also in line with its previous recommendations of 2004, 2005 and 2009[52]. On 14 March 2017**[53]**, the European Parliament voted on the proposed alteration of the Shareholders Right Directive and the Council adopted the amended Directive on 22 March 2017. Within this regard, Article 1 of Directive 2007/36/EC is amended to emphasize the long-term approach of the new Directive[54].

50 Proposal for a DIRECTIVE OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL amending Directive 2007/36/EC as regards the encouragement of long-term shareholder engagement and Directive 2013/34/EU as regards certain elements of the corporate governance statement Brussels, 9.4.2014, 2014/0121 (COD) COM (2014) 213 final.

51 The Shareholders Directive 2007/36/EC before the current amendment did not entail any provisions with regards to corporate remuneration.

52 See also: Mathias Habersack 'Vorstands und Aufsichtsratsvergütung – Grundsatz und Anwendungsfragen im Lichte der Aktionärsrechterichtlinie' (2018) 127 NZG 132.

53 DIRECTIVE (EU) 2017/828 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 17 May 2017 amending Directive 2007/36/EC as regards the encouragement of long-term shareholder engagement [2017] OJ 2 132/01.

54 J. Nijland and T.C.A. Dijkhuizen 'Say on Pay and Focus on Sustainability of Companies: A Revised Shareholders' Rights Directive' (2017) 14 (5) European Company Law Journal 188–189, 188.

The aim of the Directive 2007/36/EC was to promote the attendance of shareholders in general assembly meetings in order to eliminate shareholder apathy[55] in order to contribute to shareholder democracy in European public corporations. The 2017 amendment contributed in terms of establishing a long terminist approach of the shareholders towards the corporation by way of considering the external stakeholders.

The highlight of the 2017 amendment is the right granted to shareholders with regard to the approval of remuneration policy in the general meeting, i.e. say on pay. Chapter II of the revised Directive is dedicated to shareholder rights in general meetings. Article 9a specifically regulates the right of shareholders to vote on remuneration policies.

The explanatory memorandum of the proposal states that the recent deficiencies in the area of European Corporate Governance are due to *insufficient shareholder engagement* and the *lack of adequate transparency*. Within this regard, the Commission's 2014 Proposal aims to solve these problems by way of amending the Shareholders Rights Directive[56] and promoting transparency and engagement of the shareholders. The proposal states that the overarching aim thereof is to contribute to the long-term sustainability of EU companies.

According to paragraph 29 of the preamble, "*In order to ensure that shareholders have an effective say on remuneration policy, they should be granted the right to hold a binding or advisory vote on the remuneration policy, on the basis of a clear, understandable and comprehensive overview of the company's remuneration policy. The remuneration policy should contribute to the business strategy, long-term interests and sustainability of the company and should not be linked entirely or mainly to short-term objectives. Directors' performance should be assessed using both financial and non-financial performance criteria, including, where appropriate, environmental, social and governance factors. The remuneration policy should describe the different components of directors' pay and the range of their relative proportions. It can be designed as a frame within which the pay of directors is to be held. The remuneration policy should be publicly disclosed, without delay, after the vote by the shareholders at the general meeting*".

It is further mentioned that the rules of the proposal are only aimed at addressing listed companies and aim to increase transparency and promote shareholders say on

55 For a detailed explanation of the concept of *shareholder apathy* see: Ventoruzzo and Conac (n 5) 520.

56 An amendment of the Shareholders Rights Directive was also required under the 2012 European Company Law and Corporate Governance Action Plan of the Commission (Action Plan: European company law and corporate governance - a modern legal framework for more engaged shareholders and sustainable companies). COMMUNICATION FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT, THE COUNCIL, THE EUROPEAN ECONOMIC AND SOCIAL COMMITTEE AND THE COMMITTEE OF THE REGIONS Action Plan: European company law and corporate governance - a modern legal framework for more engaged shareholders and sustainable companies Strasbourg, 12.12.2012 COM (2012) 740 final.

pay, namely by way of the granting of voting rights[57] at the general meeting with regard to remuneration policy and remuneration report[58]. It is argued that the new directive introduces a minimum standard for the participation, access to information and voting rights of shareholders at the European level[59].

## 1. Remuneration Policy

### a. Insights and Characteristics of the Policy

With regard to remuneration, Art 9a "Right to Vote on the Remuneration Policy" and Article 9b "Information to be Provided in and Right to Vote on the Remuneration Report" were added to the Shareholders Rights Directive. With regard to the remuneration policy, Article 9a sets forth detailed provisions in subparagraphs 6[60] and 7.

According to these rules, the remuneration policy shall contribute to the company's business strategy and long-term interests and sustainability. It must be clear and understandable. When remuneration is based on different factors such as a fixed part and a variable part, it must define all parts of the remuneration and their ratio to the whole remuneration amount. Variable components of the remuneration are parts of the executive compensation amount which are not fixed, such as salary, but fluctuate depending on several different factors such as performance, or any other criteria thereof. Furthermore, the reasons for the company to claim the remuneration back (Claw-back provision) must be indicated. The aim here is to enhance the transparency

57 It is argued that this enhanced position of shareholders is weakened by a possible derogation of these rules, as Member States may opt out from a binding shareholders' vote. See: Nijland and Dijkhuizen (n 58) 189.

58 Commission's Proposal, p.3. This approach of the Commission with regards to granting shareholders a binding vote on the remuneration policy is considered to be a reaction to the executive pay arrangements not related to the performance of the individual directors: Ferrarini and Ungureanu (n 32) 28.

59 Miroslav Georgiev and Marko Kolev 'Die überarbeitete Aktionärsrechterichtlinie (RL 2017/828/EU): Mehr Rechte und erhöhte Transparenz für die Aktionäre' (2018) GWR 107.

60 "*6. The remuneration policy shall contribute to the company's business strategy and long-term interests and sustainability and shall explain how it does so. It shall be clear and understandable and describe the different components of fixed and variable remuneration, including all bonuses and other benefits in whatever form, which can be awarded to directors and indicate their relative proportion. The remuneration policy shall explain how the pay and employment conditions of employees of the company were taken into account when establishing the remuneration policy. Where a company awards variable remuneration, the remuneration policy shall set clear, comprehensive and varied criteria for the award of the variable remuneration. It shall indicate the financial and non-financial performance criteria, including, where appropriate, criteria relating to corporate social responsibility, and explain how they contribute to the objectives set out in the first subparagraph, and the methods to be applied to determine to which extent the performance criteria have been fulfilled. It shall specify information on any deferral periods and on the possibility for the company to reclaim variable remuneration. Where the company awards share-based remuneration, the policy shall specify vesting periods and where applicable retention of shares after vesting and explain how the share based remuneration contributes to the objectives set out in the first subparagraph. The remuneration policy shall indicate the duration of the contracts or arrangements with directors and the applicable notice periods, the main characteristics of supplementary pension or early retirement schemes and the terms of the termination and payments linked to termination. The remuneration policy shall explain the decision-making process followed for its determination, review and implementation, including, measures to avoid or manage conflicts of interests and, where applicable, the role of the remuneration committee or other committees concerned. Where the policy is revised, it shall describe and explain all significant changes and how it takes into account the votes and views of shareholders on the policy and reports since the most recent vote on the remuneration policy by the general meeting of shareholders."*

of the remuneration. As the variable parts of executive compensation are those most open to being misused, it is stipulated that the criteria to determine the variable parts is to be clear and precise, as it is not a fixed amount, and the entitlement is subject to discretion.

Furthermore, in line with the proposal's focus point, in the event that the remuneration policy is share-based, Article 9a requires a vesting period of such shares to be legally obtained by the directors. Similarly, the provisions aim to keep the shares for a set period of time.

The remuneration policy must also entail explanations with regard to the managerial decision processes, its revision and implementation. It must also contain information with regard to the committee and its approach towards the shareholders' vote. In the event that the policy is subject to amendment, all important changes need to be addressed following the last vote of the shareholders at the general meeting.

Moreover, according to subparagraph 7, the remuneration policy must be made public and stay available on the website of the company as long as it is applicable.

### b. Shareholders' Approval

Article 9a also details provisions with regard to the shareholders' supervision of the remuneration. Within this regard, subparagraphs 1 to 5 target the shareholders' vote and its effects. According to the provisions, shareholders must have binding votes with regard to the remuneration policy. In other words, in the event shareholders do not approve a certain remuneration policy at the general meeting, the company has to continue to apply the previous policy, until the revised policy is submitted to the annual general meeting, having obtained the shareholders' approval. However, Member States are not bound by the Directive, as to their discretion, they can decide on an advisory vote of the shareholders. This option of the Directive is interpreted as undermining the position of the shareholders[61]. Even in the case of an advisory vote, companies still cannot implement a remuneration policy not voted for by their shareholders. Also, all substantial changes to the remuneration policy must be submitted to a shareholders' vote, according to subparagraph 5.

According to 4. Subparagraph of Art 9a, a temporary derogation from the remuneration policy is possible under exceptional circumstances. These circumstances need to serve the long-term interests and sustainability of the company, in order to justify a temporary derogation.

61 Nijland and Dijkhuizen (n 58) 188.

The policy must also be subject to a shareholders' vote after every material change, and every four years[62].

## 2. Remuneration Report

### a. Features of the Report

Besides the remuneration policy, a clear and understandable remuneration report is also mandatory for listed companies to be drafted, according to Art. 9b "Information to be provided and right to vote on the remuneration report". This report shall entail a detailed analysis of the remuneration with all benefits. The report must also contain information about the last year's amounts, as well as that of due payments, including all managerial remuneration. The report must be drafted in line with the remuneration policy.

Article 9b also clearly stipulates the information required to be present in each of the individual director's remuneration reports. The first subparagraph of the provision stipulates these components for each remuneration report:

The report must show the total remuneration amount divided into components. As discussed previously, remuneration can consist of fixed and variable components. The report must also indicate its compliance with the remuneration policy, by way of proving its contribution to the long-term performance of the company. The report shall also contain explanations with regards to the performance criteria and its application.

In addition, the report also must provide information with regard to the annual change of remuneration and *of average remuneration on a full- time equivalent basis of employees of the company other than directors over at least the five most recent financial years, presented together in a manner which permits comparison.* This provision is very forward-looking and serves the transparency goals of the new Directive.

Furthermore, with regard to groups of companies, any remuneration within the same group must be indicated in the report.

In the event a share option plan is required, as or part of remuneration, the number of shares and the conditions attached must be explained in detail.

The report must also entail information with regard to an existing claw-back provision and its use and conditions. For a temporary derogation from the remuneration policy, the exceptional circumstances must be defined[63].

62 Christoph Van der Elst 'Shareholders: Holding the Reins of Remuneration: The European Say on Pay' (2017) 14 (3) European Company Law Journal 118.

63 According to Article 9.4. "*... Exceptional circumstances... shall cover only situations in which the derogation from the*

The directive also requires the protection of the data to be disclosed in order to meet transparency requirements.

Although not binding, according to subparagraph 4, member states shall include the shareholder vote in the remuneration report. This vote, however, is by its very nature advisory. The company must also provide an explanation in the following year's report and describe how it made use of the last year's advisory vote. According to the same subparagraph, in the event that the company is a small or medium-sized company, as defined in Articles 3(2) and (3) of Directive 2013/34/EU, the advisory vote of the shareholders at the annual meeting can be substituted with a discussion about the report in the annual general meeting. In such cases, the company must explain in the next year's report how it made use of such negotiations at the annual general meeting.

Pursuant to subparagraph 5, after the general meeting, companies must make the remuneration report publicly available on their website, free of charge, for a period of 10 years, and may choose to keep it available for a longer period provided it no longer contains the personal data of the directors.

The drafting of the remuneration report is one of the duties of the board of directors. In the event they fail to draft it, it will result in their collective responsibility. In order to comply with the provisions of the directive, member states have to enforce a responsibility regime for non-compliance with the provisions of drafting the remuneration report.

### b. Shareholders' Role

As discussed, and explained above in more detail, the Directive vests the shareholders with supervision rights. Both the remuneration policy and the remuneration report need to be submitted for shareholders' vote at the annual general meeting. The shareholders' vote can be either binding or advisory and serves to fulfil both the transparency aim of the provisions and to enhance the clarity of the whole remuneration system. Even in the case of an advisory vote scheme, the company must explain how the advisory vote was taken into consideration.

A binding vote, on the other hand, vests real power to shareholders to supervise remuneration policies.

### c. Related Party Transactions

According to Article 9c *Transparency and approval of related party transactions,* each member state has to define material transactions between a listed company and

*remuneration policy is necessary to serve the long-term interests and sustainability of the company as a whole or to assure its viability*."

its related third parties. Following that, there is a regime foreseen for every undergone transaction with related parties. According to that, *(i)*the transaction must be publicly announced; *(ii)*an independent report may have to be published assessing whether the transaction is fair and reasonable from the company's perspective and for the other shareholders (optional for member states); *(iii)* the transaction must be approved by shareholders or the board. Member states may require additional shareholder approval in case of approval by the board.

According to Art. 9c/6/c, Directive remuneration payments are excluded from the related party transactions regime, if these were realized in line with Art. 9a, as previously discussed. Within this structure of the directive, it can be argued that the shareholders are dually protected. In other words, the breach of remuneration policy regime will result in the remuneration payment falling under the related party transaction control regime[64].

## III. Turkish Executive Compensation System

### A. Introduction and Characteristics of the TCC system

According to Article 394 TCC, board members can be paid an attendance fee, honorarium, salary, bonus, a premium, and a portion of the annual profit provided that respected amounts are stipulated in the articles of association or determined by a general assembly resolution As it is easily understandable from the wording, there is, however no specific provision which prescribes the obligation of the company to pay remuneration to its directors; Art. 394 TCC only requires that these components are payable to the directors[65]. In other words, the wording of the provision is clear: there is no statutory obligation vested in the company to make payments to board members[66]. However; on the basis of the current standpoint of economies and the corporate world, companies do pay considerable amounts to their board members and directors. As a result, we might argue that in the modern world, paying executive compensation to board members has evolved into a (commercial) usage and became another tool to balance the interests of all stakeholders[67]. However, according to the corporate governance principles, remuneration must be paid to the independent directors in a listed company in order to assure their independence[68].

64 For a detailed analysis of the Directive's provisions with regards to related party transactions: Andreas Tarde 'Die verschleierte Konzernrichtlinie, zu den neuen EU-Vorgaben für related party transactions und ihren Auswirkungen auf das deutsche Recht' (2017) 46 (3) Zeitschrift für Unternehmens- und Gesellschaftsrecht 371.

65 Veliye Yanlı 'Yönetim Kurulu Üyelerinin Kazanç Payı ile İlgili Bazı Sorunlar' (2019) 8 (32) Banka ve Finans Hukuku Dergisi 1155-1176, 1158.

66 *Birsel* argues that an articles of association provision stipulating that no remuneration shall be paid to board members, can only be considered as a theoretical assumption. For a detailed examination on the grounds of the former TCC please see: Mahmut T. Birsel, *Anonim Şirketler Hukukunda Kâr Kavramı Cilt1* (Ege Üniversitesi Matbaası 1973) 89.

67 Damla Songur, in Kemal Şenocak (eds) *Şirketler Hukuku Şerhi C.II*, (Seçkin Yayıncılık, 2023) Art. 394, 2131.

68 For a detailed analysis please see below: "H.Regulations with regards to Public Companies".

### *B. Numerus Clausus* or Enumeration; the Nature of Art. 394 TCC

Items mentioned in Article 394 TCC, with regard to the pecuniary rights of the board of directors, can be paid separately or by way of an aggregate order to the director[69]. The preamble of Article 394 states that these components of a directors' remuneration are of a *numerus clausus* nature. However, on the basis of the wording of Article 516/2 stipulating the minimum content of annual activity report and of the Article 394, it is argued that payments under other names and indeed, by other means can be disbursed to board members, i.e. the provision is not of *numerus clausus* nature[70]. However, this interpretation shall only be valid in the event that the overarching principle of corporate asset protection is considered[71]. Explanations made in the preamble of Art. 516/2/c concerning the annual report of the directors states that benefits provided to the directors, other than those mentioned in Article 394 TCC, must also be covered in the annual activity report. Benefits provided to board members on the grounds of Article 394 TCC are mandatory content of the annual activity report[72]. However, the wording and preamble of Article 516/2 TCC provide that there might be other instruments with regard to corporate remuneration, in the event they are present, they also have to be mentioned in the annual activity report[73].

### C. Scope of Application with Regard to Persons: Are Directors Also Awarded Pecuniary Rights Stipulated under Art. 394 TCC?

In the event that the management of the company is delegated to executive members of the BoD, or to third persons pursuant to Art. 367 TCC, these third persons are thus executive officers, while the board members are executive members. As it is obvious that executive officers are not part of the BoD, they are still, under Art. 553 ff. TCC, liable to the company, to its shareholders and creditors. Although these executive officers are treated as BoD members with regard to the responsibility regime, they are not deemed to be entitled to attendance fees and shares from the profits, as these are specifically designed for the members[74]. In other words, attendance fees and shares in profit may not be granted to directors who are not part of the board of directors (BoD), namely to the executive officers of the company.

69 Işık Özer, *Anonim Şirket Yöneticilerinin Mali Hakları*, (Yetkin Yayınları 2013) 219.

70 Hasan Pulaşlı, *Şirketler Hukuku Şerhi, C.II*, (4th edn, Adalet Yayınevi 2022) 1512 N.47.

71 Çağlar Manavgat, İsmail Kırca and F. H. Şehirali Çelik, *Anonim Şirketler Hukuku, C. 1*, (BTHAE 2013) 731, Özer (n 73) 221; Yanlı (n 69) 44, Songur (n 71) 2137.

72 Güven Sayılgan and Kemal Şenocak, in Kemal Şenocak (eds) *Şirketler Hukuku Şerhi C.III*, (Seçkin Yayıncılık 2023) Art.516, 3406. With regards to minimum content of joint stock companies annual reports, please the Regulation: <https://www.mevzuat.gov.tr/File/GeneratePdf?mevzuatNo=16547 &mevzuatTur=KurumVeKurulusYonetmeligi&mevzuatTertip=5.> accessed 10 April 2023. Also in the wording of Article 9/1/a, pecuniary rights of board members are enumarated, they are not of a numerus clausus nature.

73 Özer (n 73) 271; Songur (n 71) 2137.

74 Özer (n 73) 220.

On the other hand, *Manavgat* states that directors also might be entitled to shares from profits on the basis of Article 339/2/f TCC. This article foresees that pecuniary rights granted to members of the board of directors and executive officers as shares in profit shall be stipulated in the articles of association of the company. As a result, pecuniary rights excluding shares from profit to be granted to executive officers other than the members of the board of directors can be regulated in a separate agreement between the company and executive officers[75].

Executive officers and the members of the board of directors shall be subject to the same executive payment opportunities on the grounds of the overarching principle of equality in corporate law. As they are subject to the same responsibility regime on the basis of Article 553 TCC, they shall have access to similar financial benefits. Besides these fundamental rules with regard to the legal position of board members and executive officers, the origin of their pecuniary rights is common. *Manavgat* states that their rights to executive payment stems from the agreement they have with the company. The author further explains that although the regimes have mutual legal ground, the method of allocation of rights is different[76].

## D. Types of Pecuniary Rights enumerated in Art. 394 TCC

### 1. Attendance Fee

An attendance fee is the fee to be paid to directors, for the reason they attend the board of directors 'meetings. This type of remuneration payment is not based on performance. The mere reason for the payment is the effort of being present and the mental effort they are putting in. It also has a role to encourage the attendance of board members at meetings[77].

However, in the event that the meeting is held via correspondence as enabled on the grounds of Art. 390/4 TCC, i.e. without convening a meeting, unless one of the board members requests so. In this method the board of directors meeting resolutions can be taken on a proposal regarding a certain matter proposed by one of the members by obtaining the written approval of the majority of all members. In such cases, an attendance fee must still be paid to the board members, as the payment is the remuneration for their mental work, the same interpretation shall also be valid with regard to online-held board meetings[78].

75 Manavgat Kırca and Şehirali Çelik (n 75) 742.

76 Manavgat, Kırca and Şehirali Çelik (n 75) 727.

77 Pulaşlı, (n 74) 1513 N. 51; Manavgat Kırca and Şehirali Çelik, (n 75) 731; Özer (n 73) 249.

78 For a detailed analysis of the subject matter please see: Özer (n 73) 250.

## 2. Salary

Salary is one of the pecuniary rights stipulated under Article 394 TCC. It is a periodical payment made in remuneration for the labour of managing the corporation. The periods can be determined as one, three or six months long. Again salary is not a performance-based corporate remuneration like an attendance fee[79].

## 3. Premium

Premium is an extra payment on top of other pecuniary rights of board members[80]. Premiums are not necessarily determined on the basis of success; they are merely an additional payment to be made in certain periods[81]. However, premiums can also be designed as performance-based instruments[82]. A similar payment type to premiums might be bonuses. A bonus is a performance-based payment which can be determined upon the number of annual sales, new customers, provided services etc, any factor other than annual profit. There is not a clear distinction between these two instruments, however, they might be differentiated based on the components subject to evaluation[83].

## 4. Shares from Profit Payments

If the remuneration entails a share in profits, pursuant to Art. 511 TCC, this share may only be deducted from the net earnings of the company and only after the legal reserves are allocated, and after the minimum amount of dividend payments are made to the shareholders.

However, according to Art. 523 TCC on the relation between shares from profit and reserves, shares from profit can only be distributed to shareholders provided that statutory and legal reserves are allocated.

As the provision of Article 511 TCC stipulates that shares from profit payment have to be realized before the remuneration payments, there is discrepancy with regards to the Articles 511 and 523 on the basis of statutory reserves, i.e. reserves that were generated on the basis of the articles of association. In doctrine, there are different approaches towards that contradiction. The majority of authors are in favour of the interpretation on the grounds of Art. 523 TCC, i.e. that also statutory reserves have to be allocated before the remuneration payments, as the legislator prioritizes shareholders before board members, with regard to shares from profit payments[84].

79 Manavgat Kırca and Şehirali Çelik (n 75) 730, Pulaşlı, , (n 74) 1516, N.53.

80 Pulaşlı (n 74) 1523 N.70.

81 Manavgat, Kırca and Şehirali Çelik (n 75) 730.

82 Özer (n 73) 354.

83 Manavgat Kırca and Şehirali Çelik (n 75) 731.

84 Halil Arslanlı, *Anonim Şirketler C.II-III*, (Fakülteler Matbaası 1960) 164; Birsel (n 70) 93, Zehra Badak, *Türk Ticaret Kanunu'na Göre Anonim Şirkette Pay Sahibinin Kar Payı Hakkı*, (On İki Levha 2018) 233, Özer (n 73) 238; Sinan

The dissenting opinion stipulates that the allocation of statutory reserves is not mandatory for the share from profit payments of board members[85].

This article is designed with regard to the capital maintenance principle governing Turkish companies' law. The reasoning behind this ruling is to prevent the misuse of corporate assets, by way of granting unjust shares in profits to the directors of the company.

However, unlike other remuneration instruments as stipulated in Article 394, directors are only entitled to shares in profits, in the event they are stipulated in the articles of association of the company according to Art. 339/2/f TCC[86]. In other words, it is not possible to pay a share in profits to directors based only on a general meeting decision[87]. The general meeting decision can only decide to initiate the payment and designate the payable amount of the share in profits. With regard to the voting of this agenda item, the directors are deprived of their voting rights[88].

## F. Determination Methods of Executive Remuneration

The amount payable as executive remuneration must be determined by the articles of association or by an annual general meeting resolution. The amount of salary can be determined in the articles of association of the company or via a general meeting resolution. However, there is no criteria set for the determination of the amount of the salary in TCC. In Turkish law, only the corporate governance principles require a criterion for the remuneration amount of the independent directors; the criteria only prescribes that the amount of the remuneration shall be set in a manner that does not affect the independence of the said director.

## G. Claw-Back Provisions

Article 512 TCC foresees a claw-back provision, provided that the board of directors will receive the share in profits in bad faith. As the article only mentions payment with regard to shares in profit, it does not regulate the claw-back of other payment types which may be part of the remuneration[89]. Shares in profits are considered to be received in bad faith if they were granted based on misleading financial statements, where a fictional profit is indicated.

Sarıkaya, in Kemal Şenpolat (eds) *Şirketler Hukuku Şerhi C.III* (Seçkin Yayıncılık 2023) Art.511, 3308. With regards to the meaning of "allocation of statutory reserves" please see: Ünal Tekinalp, *Anonim Ortaklığın Bilançosu ve Yedek Akçeleri*, (Fakülteler Matbaası 1979) 313.

85 Hayri Domaniç, *Anonim Şirketler* (Eğitim Yayınları 1978) 472.

86 Oğuz İmregün, *Kara Ticareti Hukuku Dersleri*, (Filiz Kitabevi1996) 350; Pulaşlı (n 74) 1518 N.56; Abuzer Kendigelen, *Yeni Türk Ticaret Kanunu, Değişiklikler Yenilikler ve İlk Tespitler*, (3rd edn., On İki Levha 2016) 282; Badak (n 88) 231; Sarıkaya (n 88) 3305.

87 Ünal Tekinalp, Reha Poroy and Ersin, Çamoğlu, *Ortaklıklar Hukuku- C.I* (15th edn, Vedat Kitapçılık 2021) N. 561; Badak (n 88) 232; Arslanlı (n 88).162; Özer (n 73) 230; Pulaşlı (n 74) 1518 N.56.

88 Yanlı (n 69) 51.

89 Manavgat, Kırca and Şehirali Çelik (n 75) 746; Özer (n 73) 391.

The initiated payment can also be interpreted as a "shares in profits" payment if the balance sheet was not taken into consideration[90] and as a result this payment can be subject to clawback provisions. *Manavgat* argues that according to Art. 555 TCC, remuneration granted on the basis of performance criteria can be reclaimed in the event that the performance-based assessment criteria were misleading[91].

Article 513 TCC stipulates the conditions under a bankruptcy regime. According to the provision, the board of directors are obliged to return any remuneration payments, exceeding a reasonable amount, which were received under any name within the last three years prior to the company becoming bankrupt. While directors must return the payments to the creditors of the company[92], payments exceeding a reasonable amount are different than shares in profit received in bad faith[93].

Article 408 TCC stipulates powers and obligations of the general meeting which cannot be delegated to any other body of the company. According to subparagraph b of the first paragraph, it is within these non-delegable powers of the general meeting to decide on the remuneration of the board of directors.

However, according to Article 394 TCC, the type and amount of remuneration can be decided in the articles of association of the company. If the incorporators of the company have opted to regulate this concern in the articles of association (AoA), it will result in the by-passing of the annual general meeting's approval of this policy. In other words, the shareholders' supervision will be alienated. However, the TCC system is open to such regulation. However, it is still viable to amend the articles of association according to Article 421 TCC, which requires shareholders representing at least 50% of the company's capital to be present as a quorum[94]. This decision will be taken with the majority of the votes present at the meeting. As a result, it is not likely that a decision regarding the remuneration policy to be rendered against the wishes of the majority of the company. As in most of the cases, where the management represents the interests of the majority in the company, an oversight of the remuneration decision will not be realized through shareholder voting.

Article 516/2/c TCC further stipulates that the annual report of the board of directors must entail the payments made to the board of directors as part of their executive remuneration.

90 Tekinalp, Poroy and Çamoğlu (n 91) N. 918.

91 Manavgat, Kırca and Şehirali Çelik (n 75) 746.

92 However as a bankruptcy proceeding is initiated, the bankrupt's assets are managed by a trustee; in this event the payment has to be reached to this authorithy. Also the authorithy to manage bankrupt's assets has the right to sue the directors for the reimbursement of the payments exceeding a reasonable amount. For a detailed analysis please see: Özer (n 73) 399.

93 Manavgat, Kırca and Şehirali Çelik (n 75) 747.

94 This requirement of a 50% majority will decline to the majority of shares representing at least 1/3 of share capital in the second meeting, in the event that the quorum was not summoned in the first meeting.

## H. Regulations with regards to Public Companies

Besides the provisions set forth in TCC, there are also provisions in the Turkish Capital Markets Law (CML) with regard to directors' remuneration payments.

Article 19 CML stipulates the conditions under which directors can receive a portion of the annual profit as or part of their remuneration. A distribution decision with regard to directors' profit shares cannot be taken unless the statutory reserves are allocated, and dividend payments to the shareholders are substantiated. Unless there are dividends paid to the shareholders, directors cannot receive any shares from the profit.

There are also provisions with regard to the remuneration policy, board committees, and independent directors in the Corporate Governance Principles, which are annexed to the CMB's Communique Series: II, Number:17.1.

According to Art. 4.5.1 of the Corporate Governance Principles, listed companies must have board committees, of which the remuneration committee is mandatory. All of the committees must consist of non-executive members and must be chaired by an independent director. In accordance with Art. 4.5.4. the CEO or the chairman of the executive board cannot participate in these committees.

Article 4.5.13 regulates the formation and rules of conduct of the Remuneration Committee. Within this regard, it shall, in line with the long-term goals of the company, determine the principles and criteria for the remuneration of the executive managers and the board of directors. The committee shall also observe compliance with these rules. Another responsibility of the committee, having considered the degree of compliance with the aforementioned criteria, is to share its recommendations with regard to the remuneration policy of the executive managers and the board of directors.

The remuneration provided to the executive managers and the board of directors is regulated under Art. 4.6 of the principles. Art.4.6.1 stipulates that the board of directors is responsible for the attainment of the operational and financial goals of the company, which were previously determined and disclosed to the public. The assessment thereof shall be included in the annual report. The board of directors shall also assess and evaluate the performance of the board as a whole, as well as the performance of the executive managers and the board of directors. The board of directors and executive managers are to be either rewarded or dismissed based on these assessments. According to the principles the amount of remuneration shall be determined in line with three factors: transparency, impartiality and performance-based evaluation[95].

95 Manavgat, Kırca and Şehirali Çelik (n 75) 740.

According to Article 4.6.2 Remuneration principles of the executive managers and the board of directors shall be put in writing to comply with the transparency principle, and must be included in the agenda of the annual general meeting as a separate agenda topic, and submitted to the shareholders for their evaluation and comments. To serve this purpose the remuneration policy must be placed on the official web-site of the company.

Article 4.6.3 prohibits share profits, share options and performance-based remuneration principles to be adopted for the remuneration of the independent directors. The Article also sets forth the remuneration of the independent directors to be above a certain threshold in order to serve to maintain their independent character.

According to Article 4.6.5, remuneration, and all the other benefits provided to the executive managers and the board of directors are to be disclosed by way of an annual activity report, and the disclosure is to be performed on a personal basis.

With regard to share options, while there are not any explicit provisions, Art 4.6 of the corporate governance principles does contain the explanation that share options can be a part of a director's remuneration[96]. In the event that a share option is allocated as a remuneration payment for directors, it constitutes "inside information" and must be disclosed according to Art. 14 of Serial II, Number: 15.1a Communique of the CMB.

Turkish law does not entail any provisions with regard to "golden-parachutes". Art. 364 TCC necessitates that compensation be paid to the directors in the event of unlawful termination of their employment contracts, however, this provision cannot be interpreted in a way to contain a golden-parachute payment[97]. The system in general does not forbid such payments, but directors can only be entitled to them if there is a general meeting decision with regard to their grant.

Turkish law entails provisions regarding directors' liability insurance. In accordance with Art. 361 TCC, a listed company must disclose its liability insurance if its directors are insured against damages resulting from breach of their fiduciary duties for an amount exceeding 25% of the company's capital. Although there is no clarity with regard to the debtor of such insurance premiums, it is assumed that the company must pay the premiums[98]. Furthermore, as it covers an amount which otherwise will be paid by the directors themselves, liability insurance is also to be considered part of the remuneration package allocated to directors[99].

96 For further details concerning the application of the share-options in Turkish law see, Özer (n 73) 278 ff.

97 Ünal Tekinalp, *Sermaye Ortaklıklarının Yeni Hukuku* (5th edn., Vedat Kitapçılık 2020) N.12-113.

98 Özer (n 73) 289.

99 Özer (n 73) 290.

Although the CML does not require an explicit claw-back provision, Art. 21 CML may be construed as an implicit claw-back provision. If the remuneration paid to the directors exceeds the reasonable amount "value of equal", it can violate the transfer pricing prohibition as stipulated in Art. 21 CML. According to Art. 21/4 CML, the company may reclaim the transferred amount with interest, and the party benefiting from this transfer shall return the payments. The Capital Markets Board is entitled to determine the amount and the decision to reclaim. Additionally, in accordance with Art.94/1 CML, the CMB is also entitled to file a suit concerning the transferred amount to be paid back to the company. The CMB is even entitled to file an annulment suit with regard to the transfer pricing transaction pursuant to Art. 94/2 CML.

## IV. Evaluation of the Turkish System and Setbacks to be Addressed

For closed companies, i.e. companies subject only to TCC provisions, Art. 394 TCC designs the main structure of the remuneration system. As mentioned previously, the remuneration payments can be made based on a provision of the articles of association of the company, or on a general meeting decision. A general meeting decision in this regard is binding. To initiate payments based on a remuneration schedule, this schedule must be approved, or a decision must be taken at the general meeting to ratify it. Pursuant to Art. 418 TCC, the quorum for this decision is a simple majority. Besides Art. 394 TCC, TCC also contains other provisions with regard to companies' accounts, and the procedure for a profit share to be allocated as part of remuneration.

Article 394 TCC enumerates the types of executive remuneration payments; although there is a discussion in the literature, the majority of authors interpret it as not of a *numerus clausus* nature. Moreover, besides these types of remuneration, directors might also sign an employment contract with the company. In other words, the members of the board of directors can also have a permanent employment contract with the company as a regular worker. In this case the power to enter into a contract is vested to the board of directors itself. Article 374 TCC stipulates that the board of directors vests the power to manage the company to achieve its aims of operation within the subjects and powers not vested to the general meeting[100]. Within this scope, the board of directors' power to decide on the individual remuneration packages is not supervised by any other authority or by the shareholders[101].

This can result in the tunnelling of assets of a particular company. In the event that this power is misused and, eventually, the company sustains damage, the board of

100 According to this Article, if the competence to decide in a particular corporate issue is in question, unless it is not within the powers of the general assembly according to Art. 408, the competence is of the board of directors. In other words, the floating competence belongs to the board of directors.

101 It is argued that the board of directors shall not sign up any contracts incumbent with provisions of high remuneration payments which are not in line with the remuneration policy. Özer (n 73) 215-217.

directors can be exposed to personal responsibility claims. Under Art. 21 CML, the tunneling of assets in listed companies constitutes transfer pricing.

Remneration payments can be initiated based on a general meeting decision. Remuneration packages exceeding a reasonable threshold can be subject to annulment suits pursuant to Art. 445 TCC, on the grounds that they are not in line with the principle of good faith.

Furthermore, it is criticized that disclosure via the annual activity report serves only the purpose of aggregate disclosure. Unlike Art. 4.6.5 Corporate Governance Principles, TCC does not contain a provision that the disclosure shall be made on a personal basis.

## Conclusion

While the TCC system does not contain any detailed provisions with regard to a remuneration policy or report, remuneration can only be paid to board members on the grounds of a general meeting decision or by articles of association provision.

However, the system for the listed companies stipulated in CML and Corporate Governance Principles entails parallel provisions with regards to the Shareholders Rights Directive and the Commission's Recommendations.

Each system requires both transparency and shareholder supervision in different degrees. As stipulated in Corporate Governance Principles, the amount of remuneration shall be determined by way of considering the long-term financial interests of the company.

The Turkish system requires a binding shareholder vote in order for remuneration to be payable to the board members unless there is an article of association provision already drafted with regards to remuneration. This indicates that the legislator did not aim to vest any powers to the BoD with regard to the determination of the remuneration policy. As a result, the BoD is not entitled to implement any remuneration policies which have not been approved by the shareholders. According to Art. 375 TCC, the BoD is entitled to, and indeed obligated to enforce the annual general meeting decisions, exactly as they were taken[102].

Within this regard, as stated above, drafting of the rules or principles related to the remuneration in the first articles of association of the company may result in the circumvention of the shareholder oversight.

102 Özer (n 73) 216.

Furthermore, the problem with Turkish practice is that individual employment agreements are not supervised by third parties. As *Özer* argues, the individual employment agreements of directors should not be in breach of general meeting decisions regulating this issue or against the related provisions set forth in the AoA of the company. As a result, individual employment agreements cannot be used as a tool for the circumvention of the company's remuneration policy.

EU legislation only recommends a binding shareholder vote on the remuneration policy and report; however, member states are free to choose between a binding or advisory vote of the shareholders. The provisions require that in the event that the Member State did not opt in for a binding shareholder vote, as it is designed to be voluntary, the company has to report in what way it made use of the shareholders voting results. The Commission designed the new directive in a voluntary approach by not prescribing to a binding shareholders' vote. In this design of the new directive, a company cannot entirely ignore shareholders' response to remuneration discussions.

With regard to transparency, Turkish capital market legislation contains detailed provisions, stipulating disclosure on personal basis. As mentioned previously however, TCC provisions require disclosure only by means of the annual activity report, which happens to be an aggregate disclosure, not serving the very principle of transparency.

EU rules contain provisions that data protection, that of information related to directors and their remuneration schemes, will be disclosed and the information will be present on the company's web-site for a certain period of time.

Despite having come a long way since the EU Commission's first recommendations, directors' remuneration is still a controversial area of corporate law. It is, however, also a dynamic area of law.

The remuneration system itself evolved from a perspective focusing on the alignment of corporate interest with that of shareholders, and promoting shareholders' oversight of the remuneration policy. The natural state of the debate resulted in the suggestion that contributing to a company's business strategy, long-term interests and sustainability contributes to the best interests of all stakeholders. It came out however, that remuneration legislation cannot be designed by only aligning the interests of managers with those of the company, and in order to avoid short-termism, and better ensure the sustainability of the company, shareholder oversight proved its need to be mandatory.

However, individual remuneration agreements are the soft underbelly of the current system. As discussed previously, another method of supervision must be constituted in order to deal with this issue in both systems.

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