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Deadlock in Limited Liability Companies

Introduction

A deadlock arises in companies whenever there is a split decision where the parties have equal standing on either side. Accordingly, a deadlock situation in a Limited Liability Company ("LLC") usually occurs in situations where required quorums cannot be achieved by neither side at shareholder level, who are represented in the General Assembly ("GA"). A deadlock can render a company impotent, unable to take decisive action, and leave the company vulnerable to internal and external risks. A deadlock can also have a destructive effect on the professional relationship between the shareholders. Circumstances that cause the deadlock in the functioning of the LLCs and deadlock breaking mechanisms are not covered in the Turkish Commercial Code ("TCC", Law No. 6102). In this article, the decision quorums of GA, circumstances causing the deadlock and the potential deadlock breaking mechanisms will be explained briefly.

Directors

Unless otherwise provided in the Articles of Association ("AoA"), directors make decisions with simple majority. If the company has more than one director, one of them is appointed as the chairman by the GA regardless of whether he/she is shareholder of the company. The chairman of directors' vote has superiority over the rest of the directors (Art. 624/3 of TCC). In other words, the chairman has the power to break the tie votes. Therefore, the lawmaker has avoided deadlock situations concerning decision-making processes among the directors.

General Assembly

Unless otherwise provided by law or in the AoA, all GA resolutions, including resolutions regarding election, shall be taken with the simple majority of votes represented in the meetings. However, different quorums are regulated under TCC.

GA resolutions that must be taken with at least two-thirds of represented votes together with the absolute majority of the total of basic capital shares with voting right are as follows:

a. To alter the company's scope of activity,
b. To introduce basic capital shares with privileged voting rights,
c. To restrict, prohibit or facilitate the transfer of basic capital shares,
d. To increase the basic capital,
e. To restrict or cancel pre-emptive rights,
f. To alter the headquarters' location,
g. To approve the directors and shareholders acts against the duty of loyalty and prohibition of competition,
h. To start the legal proceedings for dismissal of a shareholder for just cause and to dismiss a shareholder for a reason set forth in the AoA,
i. To terminate the company.

However, in contrast to the chairman's vote among directors, TCC does not provide a deadlock breaking mechanism on the resolutions of GA.

Occurrence of Deadlocks

Deadlocks in an LLC typically arise out of several circumstances such as:

a. The failure to reach majority vote required by law or the AoA;
b. The failure to reach unanimous consent where unanimity is required by the AoA, or

c. The failure to reach an agreement between equal shareholders.

An increasingly common deadlock circumstances occur in companies where there are two shareholders, each having 50% of shares. Without any deadlock-breaking mechanisms, these companies face a number of avoidable problems in terms of time, money and productivity.

Deadlock-Breaking Mechanisms

Judicial dissolution is the most common option for an LLC that did not adapt deadlock-breaking mechanisms into its AoA. In case of a deadlock in an LLC, a solution can be requested from the court by the shareholders. In addition, according to TCC, if one of the legally required bodies of the company has not been present for a substantial time or if GA meeting cannot be held, the company may be dissolved by a court order upon request of one of the shareholders or creditors of the company.

Another common and effective method of dealing with a deadlock is drawing up a Shareholders Agreement ("SHA"). The SHA is concluded between the shareholders in relation to the matters that cannot be regulated by the company's AoA or for the subjects that the law does not allow or limit to be drawn up by the AoA. This agreement only binds its parties and cannot be claimed against the company or third parties. If a shareholder who is also a party to the SHA acts against the agreement and causes loss for the company, other parties can claim compensation in accordance with the SHA, and within the framework of the Turkish Code of Obligations (Law No. 6098). Therefore, it is frequently recommended to include penal clauses in this agreement.

Use of tiebreakers, which can be either external or internal, can be considered as an alternative as well. In case of a tied vote, the decision can be given to a tiebreaker which might be a group of people, a professional advisor, a mediator, or an industry expert.

However, in such a case, the decision is taken by people who may not be familiar with the company or who have a lack of insight in order to have a proper decision.

Conclusion

Deadlocks may ruin the relationship between shareholders and as a result, company may suffer a loss in the number of its customers as well as a loss in profits, time, and reputation. Until a way of solution is regulated under TCC, the above-mentioned breaking mechanisms can be implemented in order to prevent the company from falling into pieces.

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