The Mergers & Acquisitions Review

Eleventh Edition

Editor
Mark Zerdin

The Law Reviews

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Eleventh Edition

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TURKEY

Emre Akın Sait[1]

I OVERVIEW OF M&A ACTIVITY

The total number of M&A deals in 2016 was 243.[2] This represents a significant decrease compared to the 319 deals in 2015. Out of the 243 deals, there were 101 deals with disclosed values totalling US$4.6 billion. There were no deals exceeding the billion-dollar milestone, and there were only 17 deals over US$100 million in 2016. The total value of the top 10 deals was US$2.9 billion. Out of these 10 deals, three were in the public sector and seven in the private sector. The public sector deals accounted for 28 per cent of the total value of the top 10 deals. These were:

a the transfer of operating rights tender of Menzelet and Kılavuzlu HPPs, awarded to Akfen Holding for US$400.9 million;

b the transfer of operating rights tender of Almus and Köklüce HPPs, awarded to Gül Energy for US$250.2 million; and

c the privatisation tender of TP Petroleum Distribution, awarded to Zülfikarlar Holding for US$159 million.

In the private sector, the major deals that accounted for 72 per cent of the total value of the top 10 deals were the acquisition of Mars Entertainment Group by CJ CGV for US$689.2 million and the acquisition of 23.6 per cent stake in Odeabank by International Finance Corporation, European Bank of Reconstruction and Development and private investors for US$ 265 million.

In 2016, the percentage of the value of top 10 deals to the total value of all transactions decreased to 62 due to fewer number of large deals, whereas in 2015 it accounted for 76 per cent of all transactions.

Turkish investors engaged in more transactions (150) as compared to foreign investors (93). However, the total estimated value of transactions in which Turkish investors participated was US$2.1 billion, while the total estimated value of transactions by foreign investors was US$2.5 billion.

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1 Emre Akın Sait is a consultant at Legal Attorneys & Counselors.

2 Based on E&Y's 'Mergers and Acquisitions Report Turkey 2016'. Please note that the information provided by different sources may vary. For instance, Deloitte's 'Annual Turkish M&A Review 2016' provides 248 as the total number of deals in 2016.

II GENERAL INTRODUCTION TO THE LEGAL FRAMEWORK FOR M&A

M&A activities in Turkey are carried out primarily in four ways: mergers, demergers, share transfers and asset sales. However, the requirements and procedures with regard to M&A transactions in Turkey are not regulated under a single code. The relevant provisions of the new Turkish Commercial Code No. 6102[3] (TCC) apply, for example, to share transfers, mergers and demergers of companies, whereas the provisions of the Turkish Code of Obligations No. 6098[4] (TCO) are applicable to sale and purchase agreements, events of default and available remedies.

Depending on the revenues of the companies involved in a given transaction, a notification to the Turkish Competition Authority (TCA) may be required to obtain pre-closing clearance for qualifying transactions, pursuant to Law No. 4054 on the Protection of Competition[5] (POC).

M&A activity involving a public company is subject to the Turkish Capital Markets Laws No. 6362 and the relevant communiqués, as well as the TCC and TCO, as indicated above.

Based on the industrial sector concerned, there may be additional requirements or approvals to be obtained prior to implementing an M&A transaction, such as the approval required from the Energy Market Regulatory Authority for transactions in the energy sector.

III DEVELOPMENTS IN CORPORATE AND TAKEOVER LAW AND THEIR IMPACT

Mergers and demergers of companies are regulated under the TCC. According to the TCC, companies can merge in two different ways: a merger by acquisition, where the target company is acquired by the acquirer; and a merger through the establishment of a new company, where two companies merge under a new company. Different types of companies can merge; that is to say, companies with share capital (joint-stock companies, limited liability companies) can merge with all types of companies such as cooperatives, unlimited liability companies and limited partnerships, provided that the latter are the acquired party.

Merger agreements, which must be executed in writing pursuant to the TCC, must be signed by the competent company organ (the board of directors for joint-stock companies and the board of managers for limited liability companies) and approved by the general assembly of the company. The necessary content of merger agreements is prescribed by the TCC. Furthermore, a merger report must be drafted by the merging parties' boards of directors. The TCC also specifies the necessary content that must be included in the report.

When merging, the parties to the merger may either offer the shareholders shares and the related shareholders' rights in the target company, or cash payments corresponding to the value of the shares to be received in the target company.

The merger agreements of companies with a share capital must be presented by the board of directors to the shareholders at the general assembly meeting, and the merger agreement

3 The new Turkish Commercial Code entered into force on 1 July 2012.

4 The new Code of Obligations entered into force on 1 July 2012.

5 Law No. 4054 on the Protection of Competition entered into force on 13 December 1994.

must be approved at the general meeting by three-quarters of the members attending. If a partition payment is conducted under the merger agreement, the merger agreement must be approved by 90 per cent of all available votes.

Moreover, 30 days prior to the general assembly meeting, each company that is a party to the merger must present the merger agreement, the merger report, financial tables and activity reports for the previous three years for review by the shareholders, the holders of dividend right certificates, the bearers of securities and any other relevant party.

A merger takes effect and the target company dissolves upon the registration of the decision of the general assembly meeting at the trade registry office.

According to the TCC, companies can demerge completely or partially. In a complete demerger, all assets of the target company are divided and transferred to the acquirer companies. The shareholders of the target company receive the shares and rights of the assignor companies. Upon the registration of the demerger, the target company is dissolved.

In a partial demerger, one or more parts of assets of the target company are transferred to the acquirer companies. The shareholders of the target company receive the shares and rights of the acquirer companies, or the target company forms its own subsidiaries by receiving the shares and rights on the assignor companies against its transferred assets.

The transfer of shares of joint-stock companies and limited liability companies is regulated under the TCC. Registered shares of joint-stock companies can be transferred by assignment or through the endorsement and delivery of the share certificates to the transferee. Moreover, the share transfer must be approved by the board of directors and registered in the share ledger of the company. The shares of a limited liability company can only be transferred by a contract signed before a notary public. Furthermore, the share transfer must be approved by the general assembly and registered in the share ledger of the company.

The sale of assets is subject to the relevant provisions of the TCO regarding organising the 'sales agreements'. It is not mandatory to execute sales agreements in writing, but in practice parties sign a written agreement, according to which a considerable number of provisions focus on the events of default and available remedies.

IV FOREIGN INVOLVEMENT IN M&A TRANSACTIONS

During 2016, foreign investors contributed US$2.5 billion of the US$4.6 billion total transaction value of the 243 deals in Turkey (including those where the value was undisclosed). Similar to 2015, foreign investors outperformed Turkish investors in terms of transaction value. The total estimated value of transactions engaged in by Turkish investors was US$2.1 billion, while the total estimated value of transactions engaged in by foreign investors was US$2.5 billion. However, Turkish investors (150) engaged in more transactions than foreign investors (93), which has been the case over the past seven years where foreign investors engaged in fewer transactions compared to domestic investors. Foreign investors' involvement in 2016 accounted for 54 per cent of the total transaction value, which is a decrease compared to 2015 where foreign investors accounted for 62 per cent of the total transaction value, however still outperforming the Turkish investors.

The average size of investments by foreign investors was approximately US$68 million in 2016, marking a drastic decrease compared to 2015 where the average was approximately US$179 million.

The largest transactions carried out by foreign investors in 2016 were the acquisitions of Mars Entertainment Group and Odeabank, as noted above.

As in previous years, investors from the EU and the United States continued to dominate foreign investor transactions in terms of the number of deals. The EU and the United States were followed by Japan, the UAE, Qatar, Canada and Switzerland. The United States had the highest number of transactions with 20 deals and the highest transaction volume with US$819 million. In terms of number of transactions, UK followed the US with nine deals and Japan with eight deals and, in terms of transaction value, South Korea followed the United States with US$689 million.

V SIGNIFICANT TRANSACTIONS, KEY TRENDS AND HOT INDUSTRIES

As in 2015 and 2014, the energy sector ranked first in terms of transaction value in 2016. However, in terms of the number of transactions, the energy sector (with 30 deals) came second behind the IT sector (which ranked first with 70 deals). The deals in the energy sector constituted three out of the 10 largest transactions in 2016all three of which were privatisations. The transaction value in the energy sector in 2016 decreased by US$2.5 billion compared to 2015, totalling US$1.6 billion.

In 2016, public sector deals constituted 23 per cent of the total transaction value, totalling US$1.1 billion, whereas in 2015 the public deals represented 18 per cent of the total transaction value, with US$ 1.6 million.

With a transaction value of US$689 million for one deal, the entertainment sector ranked second in 2016, unlike 2015 where it did not have a high ranking. The financial services sector accounted for 25 transactions in 2016 with a total transaction value of US$525 million, ranking third.

VI FINANCING OF M&A: MAIN SOURCES AND DEVELOPMENTS

Investors have commonly used their own sources of funds to finance deals. They seem to prefer funding mechanisms that are structured to include both debt and equity. The demand to structure deals as debt financing convertible into shares of the target still continues.

The costs of local financing are high, which makes it tough for parties to obtain financing from local banks and financial institutions. This also causes M&A deals to be structured similar to project finance deals, where the main sources of income are assigned to lenders as security against a loan, and the loan is then converted into equity after a certain period, or after the related conditions precedent have been satisfied.

In M&A transactions, it is very common that the shareholders, the board of directors or the parent and affiliated companies provide financial assistance or guaranties to the target company. The TCC sets forth the principles governing the rights and obligations of related persons and companies as follows:

a shareholders are prohibited from borrowing money from the company unless the shareholder has fully paid his, her or its capital subscription debt to the company, and the company's profit, including the free reserves, is sufficient to cover the losses from the previous years;

b the TCC prohibits companies from providing loans to non-shareholder members of the board of directors and their relatives. The company cannot provide any warranty, security or guarantee to, or undertake any liability on behalf of, the said persons.

Furthermore, the shareholders are not allowed to enter into any transaction with the company without the consent of the general assembly; otherwise, the company may claim that the transaction is invalid; and

c a parent company is prohibited from using its control in a way that will damage an affiliated company. In particular, a parent company cannot force an affiliated company to enter into certain types of transactions, such as:
   - transferring business, assets, funds, personnel, receivables and debt;
   - reducing or transferring its profits;
   - restricting its assets with rights in kind or personal rights;
   - undertaking liabilities, such as providing a guaranty, warranty or surety;
   - making payments; and
   - taking measures to affect the business in a negative way.

VII EMPLOYMENT LAW

There is no specific code within the framework of Turkey's employment laws that regulates M&A activities. In the absence of this, one must refer to Labour Law No. 4857 and the TCC. The main provisions of these two pieces of legislation that apply to M&A transactions are Section 6 (The assignment of the workplace or a part of it) of the Labour Law, and, where share capital companies are involved, Section 178 (Transfer of Labour Relations) of the TCC.

Section 178 of the TCC, which introduced a new provision that did not exist in the previous Turkish Commercial Code, imposed certain specific rules on M&A transactions entered into by companies with share capital (e.g., joint-stock companies and limited liability companies).

Although the aforementioned two provisions of the Labour Law and TCC would apply to an M&A transaction, there is an apparent conflict between the relevant provisions of the Labour Law and the TCC as to which takes precedence in M&A transactions involving share capital companies. There is no case law addressing this matter yet; therefore, it is important to take into account the perspective of the legislature that led the drafting of Section 178 of the TCC to its current format. During the drafting stage of the TCC, the Justice Commission of the Turkish Grand National Assembly reviewed the position, and concluded that Section 178 of the TCC should be applied for M&A transactions involving companies with a share capital because it is more specific and appropriate for these circumstances, whereas Section 6 of the Labour Law should continue to govern all transactions involving the full or partial transfer of workplaces as a more general provision.

Once the case law starts to develop in this regard, there will be a clearer understanding of which of the two pieces of legislation would prevail. In the absence of this, the provisions of Section 178 of the TCC that would apply in a merger or acquisition transaction of companies with share capitals are as follows:

a unless objected to by the employees, all the rights and obligations arising out of the employment contracts signed with the employees, until the day of acquisition, shall be transferred to the new employer on the day of acquisition. In the event of an objection by the employees, the transfer of such rights and obligations shall be deemed to take place at the end of the legal severance period;

b the former and the new employers shall be held jointly and severally liable for all the payables to the employees that would fall due before the acquisition day and until the end of the term of the employment contracts, or until the end of such term that may be applicable should an employee raise an objection; and

c the employees have the right to request security for their receivables that would fall due.

In addition to the above, in an M&A transaction, the new employers will not benefit from the right to terminate employment contracts solely due to the transfer of the business, unless there are grounds that would otherwise provide the right to validly terminate employment contracts (e.g., it is necessary for economic or technical reasons, or there is a change in the business organisation). Should the new employer wish to terminate employment contracts, it would have to comply with the termination notice periods set forth in Section 17 of the Labour Law. Where the number of employees whose employment contracts are to be terminated exceeds the thresholds provided in Section 29[6] of the Labour Law, this would be considered as a collective dismissal, and would therefore require a written notice to be made to the Turkish Labour Authority at least 30 days in advance.

VIII TAX LAW

The current Corporate Tax Law of Turkey was enacted in 2006. The corporate tax rate was reduced to 20 per cent in the same year, and there have been no other changes since then. The Income Tax Law and Corporate Tax Law also stipulate a 15 per cent withholding tax (the amount of this tax is determined by the Cabinet, and the current figure has not been changed since 2009) on dividend distributions, but local corporate shareholders are exempt from such withholding tax. This system effectively creates a 32 per cent tax on distributed corporate earnings (e.g., 1–0.20 Turkish lira (corporate tax) = 0.80 Turkish lira followed by 0.80–0.12 Turkish lira (withholding tax) = 0.68 Turkish lira). Where there is a treaty regarding the prevention of double taxation between the home country of a non-resident shareholder and Turkey, different taxation rates may apply. It must be noted that a new draft law, which will merge the Income Tax Law and Corporate Tax Law into a single law, is being prepared at the time of writing this chapter.

Borrowings from shareholders and related parties in excess of a 3:1 debt-to-equity ratio qualify as thin capitalisation. If the related party is a bank or a financial institution, the applicable ratio is 6:1.

To increase the low national savings rate in Turkey, the Corporate Tax Law was amended last year. Accordingly, capital increases in cash will result in a reduction in the corporate tax payable, equal to an amount of half of the average interest rate applied to commercial loans in Turkey multiplied by the paid capital increase in cash. For example, assuming a company increases its capital by 1,000 Turkish lira in cash and fully pays it, and the company has 500 Turkish lira taxable corporate earnings and the average interest rate on commercial loans is 10 per cent, then the company will be able to reduce 50 Turkish lira from the corporate tax payable (because 1,000 x 0.10 = 100, half of this amount is 50. The resulting 50 Turkish lira can then be reduced from 500 Turkish lira taxable earnings, bringing it down to 450 Turkish lira).

6 For example, in workplaces that have 20 to 100 employees, the termination of 10 employees' contracts would qualify as a collective dismissal.

In 2015, an exemption was included in the Corporate Tax Law that aimed to incentivise research and development (R&D) investments. Accordingly, if a patent or utility model is registered with the Turkish Patent Institute following an invention made through R&D activities that took place in Turkey, 50 per cent of all earnings arising from the lease or sales of this industrial property, from the mass production revenues arising from the implementation of such invention (provided the production takes place in Turkey), or from the use of this invention in production processes or manufacturing of products (provided the production takes place in Turkey, and only on that portion of revenues directly related to the invention) will be exempt from corporate tax.

Another important point to note is the application of stamp duty to companies in Turkey. Different percentages and amounts of stamp duty are imposable on different types of documents. The most important stamp duty within the context of M&A transactions is that imposed on contracts (for 2017, this is 0.948 per cent of the transaction value of the relevant contract). With an amendment that was recently introduced in January 2017, stamp duty will arise only once for each contract regardless of the number of original copies. Before January 2017, every signed original contract was taxed separately; therefore, a 1 million Turkish lira sales contract signed in two originals resulted in a stamp duty of 189,600 Turkish lira (94,800 Turkish lira + 94,800 Turkish lira). With the recent amendment, the same sales contract signed in two originals will result in a stamp duty of 94,800 Turkish lira.

IX COMPETITION LAW

The TCA was established in 1997 pursuant to the POC. The TCA is an independent organisation, and is in charge of the enforcement of the POC. The Competition Board (Board) is the decision-making body of the TCA.

Under the Turkish merger control regime, a prior merger control filing before the TCA is required where the revenues of the parties to the transaction exceed the applicable thresholds. According to Communiqué No. 2010/4 on Mergers and Acquisitions Requiring the Approval of the Board (Communiqué No. 2010/4), the Board sets new thresholds every two years. The current thresholds are as follows: transactions where the parties' total combined revenues in Turkey exceed 100 million Turkish lira, and the revenues of each of at least two of the parties exceed Turkish lira 30 million in Turkey, or where the target asset or activity subject to the transaction generates a revenue in Turkey exceeding 30 million Turkish lira and one other party to the transaction has a global turnover exceeding 500 million Turkish lira. The thresholds were last set in 2013 and maintained for 2016. According to a recent amendment of Communique No. 2010/4, the thresholds shall remain valid unless otherwise resolved by the Board.

Section 7 of Communiqué No. 2010/4 states that the approval of the Board is required for the related M&A transaction to be legally valid and thus trigger the relevant legal consequences. Section 10 of the Communiqué further emphasises that an M&A transaction will have no legal validity unless it is approved by the Board in accordance with the Communiqué.

The notification for approval can be made jointly by the transaction parties, or individually by one party on behalf of all transaction parties. Pursuant to Communiqué No. 2010/4, a transaction is deemed to be carried out on the date when the change in control takes effect.

A failure to notify a qualifying transaction is subject to administrative fines, pursuant to Section 16 of the POC. The fines apply to all transaction parties in mergers, and the acquirer party in acquisitions. The amount of the fine is 0.1 per cent of the related transaction party's annual turnover generated in the financial year preceding the date of the fine. The same amount of fine will also be applicable where a notification is made based on incorrect or misleading information. It should be noted that any such fine imposable until the end of 2016 will not be less than 17,700 Turkish lira, and can be considerably higher.

Pursuant to Section 11 of the POC, where the Board learns, in any manner, about a notifiable M&A transaction that has not been notified, it will launch an *ex officio* assessment of the transaction, and if it is determined that the un-notified transaction is in accordance with the POC, the Board will grant an approval. However, the Board will also impose fines as specified above for failure to notify. If the Board decides that the notifiable (but un-notified) transaction should not be granted an approval pursuant to the POC, it will then unwind the transaction by issuing the necessary order to restore the position existing before closing (e.g., it will stop the relevant M&A transaction, cancel all the actions that have been executed illegally, return all assets to their owners pursuant to the procedures and timing to be decided by the Board). The Board has the right to issue an administrative fine on the concerned transaction parties of up to 10 per cent of their annual turnovers in the financial year preceding the date of the Board's decision.

It should also be noted that the Board has the right to impose personal fines on the managers and employees of the parties to the M&A transaction where the Board believes that such individuals have had an important role in the violation of the provisions of the POC. The amount of fines imposable on individuals in such case would be up to 5 per cent of the fine imposed on the parties to the transaction.

X OUTLOOK

Compared to 2015, M&A activity significantly decreased in terms of transaction volume and transaction number in 2016, and the average deal size was notably low as the majority of the transactions were small and medium sized.

Although an immediate recovery is not expected in 2017, substantial future M&A activity is expected in the energy, healthcare, food and beverage, retail and IT sectors. Taking into account both potential privatisations and private sector deals, the energy sector is again expected to be among the leading sectors in terms of M&A activity.

Privatisations have played a significant role in Turkey's overall M&A activity. The major privatisations that are expected in the public sector in 2017 are the privatisations of Fenerbahçe-Kalamış Marina, Bursa Natural Gas Power Plant and Aliağa Natural Gas Combined Cycle Plant, and the tenders of various electricity generation assets of EÜAŞ. Furthermore, there may be tenders in 2017 for certain ports owned by TCDD and TDİ, and for Turkish sugar factory portfolios.

As for the private sector, small and medium-sized transactions are expected to continue to dominate the market in 2017.

Appendix 1

ABOUT THE AUTHORS

EMRE AKIN SAIT

Legal Attorneys & Counselors

Emre Akın Sait acquired his LLB from the University of Warwick in 1995. In the same year, Mr Sait joined the Honourable Society of the Inner Temple of the UK. Mr Sait further pursued his legal studies at King's College London and earned his Master of Arts in European competition law in 2011. He was called to the Bar of England and Wales in July 2013 after completing his Bar Practice Training Course at the University of West of England.

Mr Sait has acted as the legal manager of Fiat Auto Turkey, and also as the corporate relations director in charge of the legal, media relations, public relations and corporate governance departments, where he was also appointed as a steering committee member for two consecutive years.

Mr Sait has been a consultant at Legal Attorneys & Counselors since 2004. He specialises in M&A, competition law, international labour law, corporate and commercial law.

He served as a lecturer in the Faculty of Law of the Özyeğin University from 2013 to 2014, and is currently a lecturer at the Faculty of Law of the MEF University. Mr Sait also currently serves as a board member of various different companies in the automotive, energy, solid waste and defence sectors.

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