

# The Stargate of Foreign Investors: M&A Transactions in Turkey

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## 1. Introduction

The title of my presentation is inspired from the famous movie and TV series: STARGATE... In this movie as well as in the series, a group of scientists and soldiers travels between universes via a gate called "STARGATE". Passing through that mysterious door, a different universe with a totally different climate, population and dangers lies before the visitors.

In this regard each M&A transaction is a "Stargate" for foreign investors. Once a transaction has started, the investor enters a new commercial world and a new legal system.

Having explained the metaphor in my title, I would also like to point out that both Turkey and China are appealing destinations for investors.

Turkey is shown as "one bright spot in an otherwise bleak landscape" where the M&A business has not been particularly badly affected by the global downturn<sup>1</sup>. For foreign investors Turkey is an emerging market with its growing economy and young population.

When a foreign investor plans to invest in a new country, he has many different choices:

As for Turkey, these options are to set up a new company, branch or liaison office or to conclude an M&A transaction. Amongst these options the entrance of the foreign investor to a country generally starts with an M&A transaction. Since the foreign investor prefers to start its journey with a local companion and profit from its experience and connections.

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<sup>1</sup> <http://www.corporatefinanceineurope.eu/countries/about-ma-turkey.htm>;  
<http://www.kpmg.com/TR/tr/Issues-And-Insights/ArticlesPublications/Documents/Turkiye-Sirket-Birlesme-ve-Satin-Alma-Raporu-2011.pdf>

Every transaction attempt has the chance to create either a long-term successful co-operation or a disaster. The type of the transaction and the period that follows must be structured wisely in order to prevent the disaster scenario.

In this presentation, the practice of M&A transactions in Turkey will be summarized while the FAQ of the investors are highlighted. Also basic knowledge for managing a company in Turkey will be given within the terms of the new Turkish Commercial Code (TCC) and related legislation.

## 2. Terminology

First of all, a terminological explication must be made in order to avoid any misunderstanding. Whenever the terms “merger and acquisition” is used in classic Turkish legal doctrine, it shall include the models set forth by TCC where the total subrogation principal is applied<sup>2</sup>.

However we see that in global practice the term “M&A” is widely used to cover all kinds of transactions resulting the taking over of a company or enterprise, including even a patrimony. These models include the asset deals and share deals as well as the classic merger and acquisition definition.

## 3. M&A Transaction Models

Turkish law provides and allows different types of M&A transaction models.

### 3.1. M&A Models Under the New TCC

The new TCC stipulates two transaction models for M&A projects; takeover of a company and fusion of companies<sup>3</sup>. In the takeover of a company by another company, the company -which has been taken over- terminates. As for the second option both companies participating the fusion

<sup>2</sup> However the terms “Merger” and “Acquisition” are defined extensively by article 7 of “The Act On The Protection Of Competition numbered 4054” as “*Merger by one or more undertakings, or acquisition by any undertaking or person from another undertaking – except by way of inheritance – of its assets or all or a part of its partnership shares, or of means which confer thereon the power to hold a managerial right,(...)*”; For “Mergers and Acquisitions” from a competition law perspective please see, **ERDEM Ercüment**, Türk ve AT Rekabet Hukuku’nda Birleşme ve Devralmalar, İstanbul 2003.

<sup>3</sup> For detailed information on mergers under TCC please see, **PULAŞLI Hasan**, Türk Ticaret Kanunu Tasarısına göre Birleşmenin Temel Nitelikleri, Prof. Dr. Hüseyin Hatemi’ye Armağan, Cilt II, İstanbul 2009, s.1329-1349; **YASAMAN Hamdi**, Anonim Ortaklıkların Birleşmesi, Ankara 1987; **TÜRK Hikmet Sami**, Ticaret Ortaklıklarının Birleşmesi, Ankara 1986.

terminate in the favor of the new one. In addition to these classic structures, new TCC also stipulates the takeover of an enterprise by a company.

The main principles applicable to the merger types set forth by the TCC are<sup>4</sup>:

1. Total subrogation; transferor company shall automatically (per se) undertake the rights and obligations of the transferred company
2. Continuity; the legal relations of the transferred company will not be affected by the transaction
3. Ongoing rights of shareholding; The shareholders of the transferred company will be the shareholders of the transferor company (with a percentage of their shareholding to be determined taking in consideration the value of both companies' assets); and
4. Termination without liquidation; the transferred company will cease to exist, but will not enter into liquidation.

The provisions provided in the new TCC regarding the merger and acquisition of companies are adopted from the Swiss law "Loi fédérale sur la fusion, la scission, la transformation, et le transfert de patrimoine" ("The federal law on the fusion, scission transformation and transfer of the patrimony").

By adopting the Swiss law on fusions, harmonization with European Union legislation is also provided; since the Swiss law on fusion is in line with,

1. The 3rd Council Directive (EEC) 78/855 of 9 October 1978 based on Article 54(3)(g) of the Treaty concerning mergers of public limited liability companies, [1977] OJ L 295/36;
2. The 6th Council Directive (EEC) 82/891 of 17 December 1982 based on Article 54(3)(g) of the Treaty concerning the division of public limited liability companies, [1982] OJ L 378/47;
3. The 2nd Council Directive (EEC) 77/91 of 13 December 1976 on coordination of safeguards, which for the protection of the interests of members and others, are required by Member States of companies within the meaning of the second paragraph of Article 58 of the Treaty, in respect of the formation of public limited liability companies and the maintenance and alteration of their capital, with a view

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<sup>4</sup> **PULAŞLI Hasan**, 6102 Sayılı Türk Ticaret Kanununa Göre Şirketler Hukuku Şerhi, C.I, s.111 vd., Ankara 2011.

to making such safeguards equivalent throughout the Community,  
[1977] OJ L 26/1

### 3.2. Other M&A Structures

Other than these two merger options, as qualified by Turkish law it is also possible to realize an M&A transaction as a share or an asset deal.

The “*share deal*” means the transfer of a part or all of the shares in a company. The company subject to the share deal is often a joint stock or a limited liability company<sup>5</sup>. The transaction in the share deal is structured in compliance with the formalities set forth by law and articles of association for share transfer in each company type. In a share deal, the legal entity of the company is not affected by the transaction; the shareholding structure changes.

On the other hand, in the “*asset deal*” the buyer does not acquire a part or all of the shares. Instead the subject of the deal is the assets of the company, i.e. machines, goods, stock, contracts, IP rights etc.

### 4. The Steps of an M&A Transaction

Regardless of the type of the transaction the steps to be followed are more or less identical and similar to other legal systems;

#### 1. Negotiation

#### 2. Signing of memorandum of understanding (MoU)/letter of intent (LoI)<sup>6</sup>

Under Turkish law neither MoU (where the basic understandings of parties are outlined) nor LoI (where the intention of one party regarding the transaction is expressed) are provided for by law. However both are commonly used by parties. Due to absence law on this subject both documents can be and actually are designed according to parties’ requirements. They can be binding or non-binding but generally include two important clauses, the exclusivity and confidentiality clauses.

With the exclusivity clause, parties aim to prevent the other party from entering into a M&A transaction with a third party.

A confidentiality clause assures that the information disclosed during the negotiations, especially during the due diligence period, is kept confi-

<sup>5</sup> <http://www.tobb.org.tr/BilgiErisimMudurlugu/Sayfalar/KurulanKapananSirketistatistikleri.aspx>

<sup>6</sup> For LoI under Turkish law, please see, DİNAR Cem R., Niyet Mektubunun Hukuki Niteliği ve Bağlayıcılığı, İstanbul 2008.

dential. This provision's importance becomes much more significant as the trade secrets of the parties are revealed;

### 3. Due Diligence

During due diligence the purchaser/transferor party evaluates the target company or business by getting information about the financial, legal, and other material (important) issues<sup>7</sup>.

The main problem for Turkish companies hosting a due diligence is the lack of corporate structure.

Most Turkish companies work as either family businesses or one-person operations. The shareholders behave as if they own the company and unfortunately this fact stands between the Turkish companies and a corporate structure. Frequently, the data rooms for these types of companies contain very few and out of date documents. Several of the common data room problems include;

- No/few written contracts,
- No/late general assembly/ shareholders' meetings,
- Insufficient book keeping,
- Shareholder debts instead of profit distribution.

The new commercial code aims to resolve these problems with an effective audit system and corporate rules such as prohibition on shareholder debt and application of international accounting standards.

After the due diligence period naturally another negotiation period follows whilst the contracts are drafted.

### 4. Signing of main contracts or following the merger procedure set by TCC

There are certain contracts to be drafted between the parties depending on the type of the merger; such as share purchase agreement<sup>8</sup>, asset transfer agreement, merger agreement etc.

Also a shareholders' agreement<sup>9</sup> and its reflections on the Articles of the Association must be reconciled. Since these two documents will be the guidebook of the partners to be.

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<sup>7</sup> **PULAŞLI Hasan**, Şirket Satın Alma ve Birleşmelerinde İşletme Değerlemesi ve Due Diligence, BATİDER C.XXIV,S.2,s.203 vd.

<sup>8</sup> For share transfer in joint stock companies please see, **SEVİ Ali Murat**, Anonim Ortaklıkta Payın Devri, Ankara 2012.

<sup>9</sup> For shareholders' agreements please see, **OKUTAN NILSSON Gül**, Anonim Ortaklıklarda Paysahipleri Sözleşmeleri, İstanbul 2003.

## 5. Closing

In the fifth step “The Closing” the transaction shall be concluded and a new era shall commence. However even after the closing the investor who has entered a new legal system will have to deal with the requirements of that legal system as well as the new business at the same time.

## 5. FAQ

I’d like to summarize the answers to some frequently asked questions by the foreign investors:

- How will the “foreign investment” effect the company’s position under Turkish law?

The principles of (i) freedom to invest and (ii) national treatment of foreign investors are stated in the Foreign Direct Investment Law. Thus, the use of/M&A transactions regarding by foreign investors to enter Turkey will be accomplished in exactly the same way as by companies with local capital. Companies with foreign capital established in Turkey are considered Turkish companies. Therefore, these companies enjoy the same rights and obligations as Turkish companies including the rights and obligations of Turkish Companies under the new TCC and other legislation.

- Which company type is advisable for investors?

Unlike under Chinese law the foreign investor is not obliged to function using a particular company type. Under Turkish law, we have 5 types of companies amongst which only two are utilized in and subject to M&A transactions; limited liability company and joint stock company.

When we look at the last statistics of March 2012<sup>10</sup>, we don’t see any company type other than limited liability company and joint stock company.

Also the capital invested is strikingly high in joint stock companies.

The reason for this choice is that joint stock companies are more suitable to a professional corporate structure and also more flexible.

Hopefully as of 1 July, both joint stock companies and limited companies can be a “single shareholder company”. When compared to Chinese Company Law which also allows a single shareholder company, the new TCC does not provide strict restriction for the single shareholder company.

Please note that with the new TCC limited liability companies are also structured similarly to joint stock companies. But the rule regarding the

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<sup>10</sup> <http://www.tobb.org.tr/BilgiErisimMudurlugu/Sayfalar/KurulanKapananSirketistatistikleri.aspx>

liability of Limited company shareholder for public debts has not been amended. This responsibility does not exist for joint stock company shareholders and this fact is a plus value for joint stock companies.

- Can an investor void the past responsibilities of the target company by an asset deal?

No, cherry picking is not allowed. Turkish Code of Obligations art. 202 does not allow the transfer of "*just*" the actives of an enterprise. The actives are the guaranties of the passives and they must be transferred together. However the transfer of some assets shall always be possible unless the volume of the transferred assets is qualified an enterprise.

- Is there a tax friendly M&A structure?

In a share deal when the shareholder holds the share certificates for more than two years, no tax is due from the parties except for the stamp duty to be paid upon the biggest amount reflected in the contract (if any is signed).

## 6. Conclusion

Similar to our new TCC, China has adopted a New Company law in 2006 that reflects shareholder protection needs, transparency as well as a flexible and a professional corporate structure. In the dawn of a new era with the new TCC, Turkey is preparing to welcome foreign investors. During this period we would be glad to share the knowledge and experience of our Chinese colleagues. I'd like to thank you for your presence and also your patience.