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NEWSLETTER

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Considering Becoming A Board Member? Read This First.

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Good corporate governance requires fully informed board members who are aware of their duties and the potential legal implications of their actions.

Under the Turkish Commercial Code ("**TCC**"), the board of directors ("**Board**") is broadly responsible for the management and representation of a joint stock company ("**JSC**"). Board members (or "**Directors**") are required to either undertake or refrain from undertaking certain actions (separately, "**Duties**" **and Restrictions**"). While all Duties and Restrictions are equally important, the following most commonly give rise to issues within JSCs and become the subject of disputes:

- **Treat shareholders equally** – Failure to do so may result in Directors' liability for damages incurred by the JSC arising from potential claims raised by shareholders suffering from mistreatment.
- **JSC's interests first** – Prioritize the interests of the JSC in all transactions undertaken on its behalf. This duty of loyalty may continue to apply after expiry of a Director's term with respect to certain circumstances (e.g., a Director must continue to keep company secrets confidential).
- **Act as a director would** – Directors must perform duties using the standard of care of a "director" (*tedbirli yönetici*) and protect the interests of the JSC in good faith. This standard, introduced under the new TCC, created more limited and strict liability for Directors, as they are now held liable for their actions (or failure to act) in connection with matters which are or which would be expected to be at their discretion, determined on a case-by-case basis by taking into consideration "the actions expected of a director faced with a similar situation".
- **Be careful with "related party" transactions** – Directors are prohibited from entering into commercial transactions with the JSC absent the explicit consent of the general assembly. In addition, (a) Directors who are not shareholders in the company; or (b) their (i) ascendants; (ii) descendants; (iii) spouses; and (iv) blood relatives up to the third degree (including third degree relatives) who are not shareholders in the company are prohibited from borrowing from the company either in cash or in kind. Furthermore, companies are restricted from entering into any transactions with such individuals, including granting security or collateral, assuming any liabilities or acting as surety.

- **Remember you are subject to a non-compete obligation!** – A Director cannot (a) enter into a commercial transaction on behalf of himself or a third person which falls within the scope of activities of the JSC; or (b) become a shareholder with unlimited liability in entities such as ordinary partnerships (*adi ortaklık*) or unlimited liability companies (kollektif şirket) which engage in the same activities as the JSC in the absence of general assembly approval.
- **Take action in the event of loss of capital** – In the event that there is a loss of at least half of the share capital of the JSC, the Board must call a general assembly meeting and propose measures to rectify the situation. If it is clear from the balance sheet that the assets of the JSC are insufficient to cover its debts, the Board must apply to the court for a bankruptcy decision.

What is the standard for acting in due care?

Directors must perform their duties with the standard of care of a "precautious director" and protect the interests of the JSC in good faith pursuant to the "**business judgment rule**" set forth under the TCC.

The standard of care is determined by taking into consideration the requirements of the relevant business and sector. The level of care expected from Directors is construed with attention to both the qualifications required by the business and the level of ability and knowledge of Directors. However, Directors may not be held liable for damages resulting from breach of laws or articles of association or other failures to comply that are beyond their control.

Although the outline for the standard of due care is provided under the TCC, keep in mind that interpretation of this provision and formulation of the boundaries of the duty of due care largely depends on court precedents and is determined on a case-by-case basis.

What is the general liability regime under the TCC?

Directors will be held jointly and severally liable to the company, its shareholders and creditors for damages suffered due to their actions or failures to take action. However, unlike the previous TCC, under the new TCC, even if all Directors have been sued jointly, each Director will be held liable only if damages are attributable to him or her personally. If damage is caused to the JSC by more than one Director, each will be held jointly liable to compensate for damages, *pro rata* to their level of fault based on the specifics of the case.

What if Duties are delegated?

In case of delegation of Duties among Directors, delegating Directors may not be held liable for damages incurred by the JSC due to the breach of such Duties by other Directors, unless the delegating Directors failed to fulfil their general "duty of care and diligence" in designation of their authorities. However, Directors will remain liable if they fail to monitor and supervise the acts of appointed representatives.

Are Directors ever held severally liable?

In principle, Directors are not held liable for agreements and transactions executed on behalf of the company and do not have personal liability for company debts. However, if:

(a) the company lends cash to or provides security for Directors that are not shareholders (or Directors' relatives up to the third degree) and a creditor of the company suffers a loss due to such transaction, the creditor may raise a claim directly against such individuals for the amount at stake in the transaction; and

(b) a Director breaches his or her non-compete obligation, the company may (i) claim all profits to which such Director would be entitled under such transaction as if the company were party to the transaction; or (ii) claim damages from the relevant Director.

Is there a difference between individual Directors and corporate Directors (legal entity directors) in terms of civil liability?

No distinction is made between individual and corporate Directors in terms of civil liability. Both would be held liable for damages suffered by the company, its shareholders and creditors that are attributable to the relevant Director.

What about representatives of corporate Directors?

In principle, a representative should not be held liable to the company or its shareholders to the extent that he or she complies with the corporate Director's instructions. However, in circumstances such as misrepresentation, any representative that wilfully provides misstatements in connection with company documents may be held liable for damages along with the corporate Director.

Who can file a lawsuit against Directors?

Any shareholder or creditor suffering a direct loss is entitled to file a lawsuit against a Director (e.g., if a creditor extends credit to the company based on misleading information or if a shareholder is prevented from exercising its pre-emptive right to participate in a share capital increase). In such case, the shareholder or creditor suffering proven loss would be directly compensated.

In the event the JSC suffers a loss due to the Directors' failure to comply with obligations set forth under the law or articles of association of the company, the JSC may file suit against such Directors. As a direct loss by the JSC results in an indirect loss to shareholders, the TCC also allows shareholders to file this lawsuit; however, ultimately only the JSC would be compensated.

Sellers: How Long Are You On The Hook?

Author: **Emre Özşar**

Provided below is a brief synopsis of the key issues in connection with statutes of limitations generally applicable to M&A transactions in Turkey.

A statute of limitation is the period of time prescribed by law within which one must raise a claim in order to enforce his or her rights or receivables. Failure to raise a claim within the time period set forth under the law results in loss of the "right to enforce".

What is the general principle?

In general, pursuant to the Turkish Code of Obligations (the "**TCO**"), unless a shorter period of time is set forth by law (e.g., the statute of limitations applicable to payment of rent is specifically set at five years), the statute of limitation for exercising a right or initiating a claim arising from a contractual relationship is 10 years. This 10 year period commences on the date the right to claim payment arises. However, time limits applicable to commercial transactions are specifically regulated by the Turkish Commercial Code (the "**TCC**") where both parties are deemed "commercial persons" (*tacir*).

Statutes of Limitations in M&A Transactions: Be prepared for a claim; but for how long?

Statutes of limitations applicable to M&A transactions vary based on the nature of the claim. The following are of particular importance:

(A) Warranties for the Sale of Shares

The TCC provides a two year statute of limitation period for warranty claims where both parties are deemed "commercial persons". However, the TCO allows this period to be extended contractually by the parties.

(B) Employment Related Claims

Pursuant to the Labor Law, employees' salary receivables and all other monetary salary related receivables (e.g. overtime payments, bonuses, etc.) are subject to a five year statute of limitation commencing when the relevant receivable becomes due. However, as there is no specific statute of limitation applicable to severance notice indemnities, unused vacation time payments and compensation for breach of the principle of equality under the Labor Law, the general 10 year statute would apply, commencing upon termination of the relevant employment contract.

(C) Tax Claims

Under the Turkish tax system, two main statutes of limitations apply:

Statute of Limitations on Tax Assessment: The Turkish tax system is based on self-assessment; i.e. tax authorities have the right to conduct tax inspections on tax returns filed by Turkish companies until expiry of the statute of limitations pursuant to the provisions of the Turkish Tax Procedural Law. The limitation period for a tax assessment is five years commencing on the first day of the year after the related tax debt is incurred.

Statute of Limitations on Collection of Tax Receivables: Pursuant to the Law on the Collection Procedure for Public Receivables, following a tax assessment carried out by administrative authorities, tax receivables, which are deemed public receivables, must be collected within five years commencing on the first day of the year after the tax payment is due.

Tax Incentive On Cash Injections to Capital

Author: Hakan Eraslan

A new tax incentive to support capital injections was introduced for corporate tax payer companies last year. This new regulation enables corporations to take advantage of a notional interest deduction, calculated over cash injections to capital, from their corporate tax base. The Turkish tax system has historically favored debt financing as no regulations restricting the deduction of financial expenses from the corporate tax base currently apply.

The notional interest deduction is a regime which supports financing by way of capital injections and will aid in increasing liquidity and the financial robustness of corporations and also in equalizing the tax treatment of capital and debt financing. The Council of Ministers issued a Decree in 2015 determining notional interest deduction rates and the Ministry of Finance issued a general communique on March 4, 2016 setting forth procedures for implementation of the notional interest deduction.

Set forth below is a brief overview of the application and calculation of the notional interest deduction, a discussion of entities and cases where the deduction does not apply and an evaluation of thin capital and the notional interest deduction.

Application and Calculation

The notional interest deduction applies to corporations (*Anonim Şirket*), limited liability companies (*Limited Şirket*) and other corporations subject to Turkish Corporate Tax Law.

Calculation of the notional interest deduction is quite simple and is equal to 50% of the amount of notional interest calculated. Notional interest is calculated by multiplying the amount of the cash injection by the weighted annual average interest rate applied to commercial loans in TL currency, extended by banks as disclosed by the Central Bank of Turkey, within the relevant accounting period.

Companies may benefit from this deduction in the accounting period in which the capital increase or articles of association (if capital is being injected at incorporation) is registered and in each subsequent accounting period. If a capital decrease is undertaken in any subsequent period, the reduced amount of capital should not be taken into account in calculating the deduction. The notional interest amount calculated will be deducted from the annual corporate tax base and in the absence of taxable profit will be carried forward for years without limitation in time.

The 50% deduction rate is increased to 75% for listed companies where publicly owned shares make up 50% or less of total share capital and is 100% for listed companies where publicly owned shares make up more than 50% of total share capital. The deduction rate is increased 25 points if the cash capital increase is allocated to investments in production and industrial facilities, machinery and equipment for such facilities or land for the construction of such facilities within the scope of an investment incentive certificate. Therefore the notional interest deduction rate may hypothetically be up to 125% in the event that a capital increase in cash is allocated to an investment in the context of an investment incentive certificate by a company listed on BIST where publicly owned shares make up more than 50% of total share capital.

For example, if a 1 million TL capital increase is undertaken in January to finance investments under an incentive certificate by a listed company where publicly owned shares make up more than 50% of total share capital, a 187,500 TL deduction from the annual corporate tax base would apply, assuming the weighted annual average interest rate applied to commercial loans is 15%. This would result in net tax savings of 37,500 TL annually at a 20% corporate tax rate.

Exceptions

Companies operating in the finance, banking and insurance sectors and public economic enterprises cannot benefit from the notional interest deduction. Furthermore, the deduction rate is 0% in the following cases:

(i) companies where at least 25% of income is “passive” (derived from interest, dividends, rent, license fees and capital gains obtained from the sale of securities);

(ii) companies where 50% or more of total assets consists of securities, affiliates and subsidiaries;

(iii) capital increase amounts injected as capital to other companies or extended as loans to other companies;

(iv) for companies that invest in land, capital injections for land investments; and

(v) capital increases arising from merger, transfer and split off transactions, or addition of equity items set out in the balance sheet to the share capital or utilization of loan or borrowing of debt by shareholders or persons related to shareholders, including those arising from the transfer of assets other than cash to companies, shall not be taken into account in the calculation of deduction.

Capital increases undertaken by transferring from other accounts into capital in order to benefit from the interest deduction is not permitted; therefore, treatment of additions to the capital account from the shareholders’ current account is not clear under the existing legislation.

Thin Capital and Notional Interest Deduction

While no regulations restricting financial expenses currently apply to external financing, a “thin capital” regulation restricts financial expenses incurred over thin capital, the situation arising when shareholders’ and related party loans exceed three times the equity at the beginning of an accounting period. Interest, foreign exchange differences and other financial expenses incurred over the amount of thin capital are not tax deductible and other negative tax consequences of thin capital exist (e.g., withholding tax over deemed dividend distribution, deductibility of VAT incurred over interest payments to related parties). Companies were generally advised to maintain at least 1/4 of their net working capital as a capital injection to avoid the negative consequences of thin capital under tax regulations. Now tax incentives on cash injections must also be taken into consideration by tax and finance experts to achieve the most favorable capital/debt financing compositions in investments and M&A transactions.

Information Exchange Between Competitors – A Competition Law Perspective

Author: **Sezin Elçin-Cengiz**

There is no doubt that "information" is a valuable asset in today's economy and companies must be "well informed" in order to remain competitive. The exchange of information between companies is therefore a commercial reality and a common feature of competitive markets.

It is also widely accepted by both economists and competition law practitioners that information exchanges may have positive effects on competition through the generation of certain gains in efficiency, with a direct benefit to consumers. On the other hand, sharing too much information may lead to restrictive effects on competition and therefore create exposure to the risk of significant penalties through breaches of competition law. It is therefore essential for companies to understand the fine line between pro-competitive and anticompetitive exchanges of information.

This article aims to provide a brief overview of information exchange from a competition law perspective and guidance for companies in managing competition law related risks arising from external communications.

There are various ways for companies to exchange information: they may choose to communicate directly or they may exchange information indirectly through third parties such as professional associations and market research institutions, through a common distributor or supplier, or through public disclosures. Regardless of how information is exchanged, a competition law risk is consistently present if through information received or delivered companies possess knowledge regarding competitors' market strategies, as this may lead to coordination and collusive behavior.

Responding to a seemingly innocent information request from an industry association; a newspaper article involving a statement by a company executive regarding expected price increases in the market; a benchmarking exercise by a market research company involving detailed, individualized and up-to-date market data or information shared by a common distributor regarding a competitor's future price increases may create competition law risks for a company. Accordingly, any information inflow to and outflow from companies should be managed with utmost care.

The Turkish Competition Board (the "**Board**") published the "Guidelines on Horizontal Cooperation Agreements" in 2013 (the "**Guidelines**"), which is very similar in content to the European Commission's Guidelines on the same topic. Paragraphs 40 to 90 of the Guidelines specifically cover the competitive assessment of information exchange among competitors.

What is your Intent?

The Guidelines make clear that any information exchange with the objective of restricting competition in the market will be considered a restriction of competition, regardless of its actual effect on the market. Accordingly, if the aim of the exchange of information is to fix prices, quantities or other terms of trade, it would be considered and treated as cartel activity regardless of whether such information exchange has an actual effect on the market. In other words, once the Board establishes that the exchange of information is a restriction of competition by object, it is no longer required to analyze the effect of such exchange. The exchange of strategic information such as future prices or sales amounts generally fall under this category and would typically be treated as cartel activity.

How is the competition affected?

Exchanges of information may also lead to infringement of competition laws where the objective is not to restrict competition. In this case, the actual and potential effects on competition of such exchange must be analyzed on a case-by-case basis. As a first step, the characteristics of the market as well as the nature of the information exchanged must be assessed. Secondly, it is necessary to analyze whether the pro-competitive benefits of the information exchange (if any) outweigh the anti-competitive effects.

Assessing Your Risks - What Type of Market Are You Operating In?

The Guidelines list five main market characteristics that increase the likelihood of information exchanges resulting in a collusive outcome:

Transparent	Information exchanges may have an impact to increase market transparency. The more transparent the market in terms of prices, costs, volume, demand, output, etc., the more likely that exchanges of information may result in the restriction of competition.
Concentrated	The fewer the number of competitors in a market, the more likely that information exchanges will have restrictive effects.
Stable	Information exchanges may decrease volatility in a market. It is easier to collude in a stable market in terms of demand, supply, market share, number of competitors, etc. Therefore, the more stable the market, the more likely that information exchanges will restrict competition.
Symmetric	Companies with similar cost structures, market shares, product range, capacities, etc. are more likely to end up with a collusive outcome through the exchange of information.
Non-Complex	It is harder to restrict competition through information exchanges in complex markets covering a number of differentiated products.

Assessing Your Risk – What Type of Information Are You Exchanging?

The Guidelines lists the following factors that affect the assessment of whether information exchanged is likely to raise competition law concerns:

Commercially Sensitive (Strategic) Information	Future sales prices, costs, profit margins, promotions, terms of sale, business plans, customers, territories, capacities, production, output, quantities, turnovers and any information that is likely to reduce market uncertainty is considered particularly sensitive and risky to exchange with competitors.
Market Coverage	Information exchanges covering a substantial portion of the market are more likely to raise competition law concerns.
Aggregated/ Individualized	The exchange of genuinely aggregated data which would make identification of the individual data of a particular company difficult is not likely to have restrictive effects.
Age of Data	The older the data, the less likely it is to have restrictive effects. Exchange of historic data is unlikely to be problematic; however, there is no threshold to determine how dated the data must be in order to be considered historic. This would require case-by-case analysis. On the other hand, the exchange of current and especially future data is generally considered problematic.
Frequency of Exchange	Frequent exchanges of information are more likely to lead to concerns compared to infrequent exchanges; however, it should be noted that even one single exchange of information may be considered restrictive.
Public / Non-public Information	The exchange of genuinely public information, described in the Guidelines as information that is equally accessible to all competitors and customers in terms of cost of access, is unlikely to restrict competition. A distinction should be made between genuinely public information and publicly available information, the exchange of which may give rise to a collusive outcome. The cost of collecting such data is an important factor and should be assessed on a case-by-case basis.

In cases where it has been established that the exchange of information is likely to have restrictive effects due to market characteristics and the nature of information exchanged, the next step would be to determine whether there are any pro-competitive effects of the exchange and, if so, whether such pro-competitive effects outweigh the restrictive effects of the exchange. In order to do so, based on Article 5 of the Law on the Protection of Competition No. 4054, companies must show: (i) gains in efficiency, (ii) consumer benefits arising from such efficiencies, (iii) that competition is not eliminated in a significant part of the market and (iv) that competition is not restricted more than necessary to achieve such efficiencies and consumer benefits.

Although detailed explanations are provided in the Guidelines as to how the Board would make its assessment, it is also made very clear that there is no definitive list of information that can or cannot be exchanged and that the restrictive effects of any information exchange require a case-by-case analysis, much of which depends on the specific economic and factual context.

Conclusion

Information exchange is a rather grey area within the competition sphere. Despite the fact that specific Guidelines have been issued by the Board, the boundaries in this area are still vague, leaving significant room for discretion. Companies must therefore be extremely cautious in the exchange of information with competitors, particularly with information regarding future prices and quantities. Any information that reduces strategic uncertainty in the market and that is likely to affect the future market conduct of participating companies is problematic from a competition law perspective and may lead to significant fines issued by the Board.

Employee Issues in Demergers under Turkish Law

Author: Rozita Nigrin-Borden

Not As Easy As It Looks

For law makers a positive change in law represents progress; however, for legal practitioners unclear provisions lead to long hours of discussions resulting in diverse opinions. Employee issues resulting from demergers is an example of a subject created out of a change in law that has recently been subject to debate.

This topic arose after enactment of the new Turkish Commercial Code numbered 6102 ("**TCC**") and the introduction of new Article 178, based on the Swiss Code of Obligations, regulating employee issues in demergers. The core incentive for this change in law was to protect the interests of employees; yet the absence of certain important details and conflicts of laws between the Labor Law numbered 4857 ("**Labor Law**") and the TCC has caused undesired complexity in this area.

Similar employment related issues are regulated under both Article 178 of the TCC and Article 6 of the Labor law - through different rules and methods of application - and the question of which one governs has become an issue.

Article 6 of the Labor Law regulates the general framework of a workplace transfer and the effects of a workplace transfer on employment contracts, whereas Article 178 of the TCC specifically regulates the transfer of business relations and employee issues in case of demerger.

Why Do Companies Undertake Demergers?

Demergers promote a focus on the core business of a company and enable shareholders to separate the parts of a less recognized investment out of the main business to exploit the benefits of core competencies and to utilize cash in a productive way. Companies often undertake demergers with the strategic goal of growing earnings and creating value for shareholders. Often potential investors lead the push for a demerger.

Are Demergers Common in the Turkish Market?

Demergers are on the rise globally and have also become increasingly common in the Turkish market. Foreign investor interest in a specific part of the business of target companies causes shareholders to undertake demergers prior to completion of transactions. Following introduction of the TCC, employee considerations have started to play a significant role in demerger structures, especially in employee driven businesses. Due to the personnel costs and liabilities involved, investors keep a close eye on these issues, therefore employee matters in demergers cannot be underestimated.

Why Do Employees Matter in Demergers?

Demergers bring a special focus on human resources because as a result of a demerger existing employees are transferred to a new entity along with all accrued rights and liabilities arising from their employment contracts up until the transfer date. This requires specific review of all existing employment contracts, rights and liabilities of the employees subject to transfer.

What Are the Similarities and Differences between Article 178 and Article 6?

Both Articles govern employee issues in business transfers but with certain similarities and differences.

The similarities between the two Articles are as follows:

- Pursuant to both provisions, employees are transferred to the transferee automatically along with all accrued rights and liabilities arising from their employment contracts up until the transfer date. The transferee acquiring the business or workplace is not entitled to refrain from acquiring existing employees.

- In both provisions, the transferor and the transferee are jointly liable for employees' receivables arising from their employment contracts existing on the transfer date.

However, the main issue arises due to the following differences and conflicts:

- Pursuant to Article 178 of the TCC, employees may object to their transfer without having to indicate grounds for objection. However, Article 6 of the Labor Law does not grant employees the right to object to transfer.
- Objection by an employee leads to termination of the employment contract and entitles the employee to all accrued legal and contractual rights under Article 178 of the TCC. However, pursuant to Article 6 of the Labor Law, a business transfer does not provide transferred employees the right to terminate. If an employee subject to transfer wishes to terminate his or her employment agreement, such termination would be considered a resignation.
- Under Article 6 the period for joint liability is limited to 2 years, whereas Article 178 does not prescribe a time limitation.
- According to Article 178, employees may seek specific guarantees for their employee receivables, whereas Article 6 does not grant any such option to employees.

These differences and conflicts between these two Articles may create a number of issues affecting the phase and structure of business transfer and demerger transactions.

Which of these laws takes priority would in principal be subject to the hierarchy of norms. However, from the hierarchy point of view both laws are equal thus hierarchical priority principals are not applicable. The reasoning of Article 178 of the TCC implies that the law maker has intentionally regulated Article 178 to constitute a special provision compared to Article 6 of Labor Law. A majority of legal scholars are of the opinion that Article 6 of the Labor Law should still be applied when there is any legal gap but priority should be given to a newer and special provision in case of any conflict.

If a potential transaction involves a demerger, employee issues should primarily be considered from the perspective of Article 178. Issues surrounding whether and when to inform employees of a demerger are not regulated by Article 178. When and how the employee’s right of objection will be exercised is also not regulated under Article 178. The parties will have extended joint liability vis a vis the employees of the transferor.

In conclusion, this issue carries several legal gaps and complexities which have not been settled in practice and should be considered and thoroughly planned in advance in order to prevent impediments in potential transactions. Better to know them now than later!

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