Restructuring in Turkey: A new paradigm?

As more Turkish companies begin to report liquidity issues and economic pressures begin to bite, successful financial restructurings are likely to become increasingly critical to the prosperity of the Turkish economy

Restructuring in Turkey: A new paradigm?

Distressed investors are increasingly turning their attention to Turkey, but there is little history of international restructurings. The Turkish government has recently updated the legal regime, but how will the new climate impact on major restructurings and the position for investors looking for new opportunities? Partners **Ian Wallace**, **Güniz Gökçe** and **Ateş Turnaoğlu** of global law firm White & Case explore this issue.

Turkey's geopolitical significance as a bridge between Europe and Asia is common knowledge in the West. What is perhaps less well known is that Turkey's economy is the 13th largest in the world, and the 6th largest in Europe. However, in recent years that economy has had to face up to significant political and financial headwinds as regional stresses and economic challenges escalate.

These pressures, combined with the lira's continued depreciation (losing around 40% of its value in 2018), has started to trigger announcements by companies about cash flow payments and missed debt payments. Inevitably, investors in Turkey are starting to focus on how best to restructure debt, while those not yet invested in Turkish debt are watching closely for potential distressed investments.

Historically, there have been few formal restructurings in Turkey. The processes that existed were not particularly effective or often used, and restructurings have tended to be implemented on a consensual and 'behind closed doors' basis between debtors and their Turkish lenders. The last period of significant restructurings in Turkey was in the early 2000s, when the Turkish banks, following the so-called "Istanbul approach", were able to work with other creditors outside of formal processes to implement debt amendments. However, those same large Turkish banks are now under pressure themselves because of their reliance on external financing and the effect of the lira crisis, combined with high levels of exposure to stressed sectors such as energy and real estate. As a consequence, most large Turkish banks have now created separate work-out teams to deal with distressed borrowers.

The number of large highly-levered businesses facing distress suggests potential opportunities for distressed investors, and recent legislative changes mean that there are now several formal restructuring processes that are available to debtors and their creditors in the Turkish market. These processes are mostly untested however, and it remains to be seen how widely adopted and they will

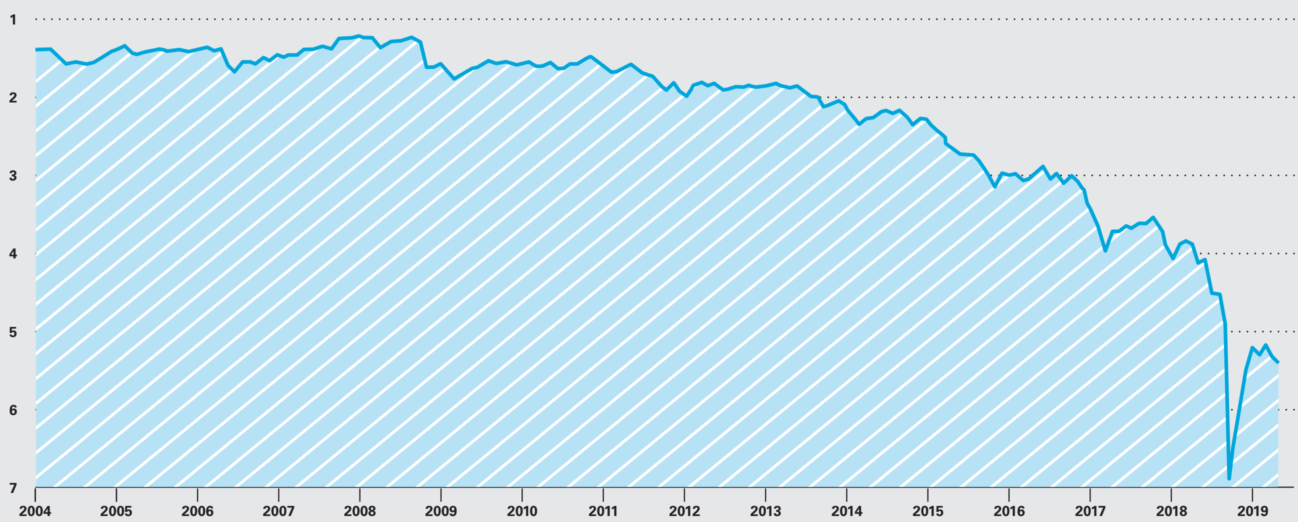
US$146bn

External debt maturing in the year to July 2019 held by the private sector in Turkey

Source: *Reuters*

Turkish lira

Against the $ (lira per $)



Source: Thomson Reuters Datastream

be, and/or whether further statutory amendments may be made. In particular, questions remain as to the level of involvement for international lenders or non-bank creditors, and whether the newly-introduced "framework agreement" will cater to them adequately. Only time will tell whether local processes will provide a suitable toolkit for large-scale corporate restructurings, or whether other international restructuring processes may also have a role to play.

Current Turkish restructuring procedures

In August 2018, the Turkish legislature sought to address some of the uncertainty surrounding the Turkish restructuring process by enacting the Regulation on the Restructuring of Debts in the Financial Sector (Regulation). The Regulation introduced the concept of a Framework Agreement ('*Finansal Yeniden Yapılandırma Çerçeve Anlaşması*' or '*Çerçeve Anlaşma*' in short) to act as the template intercreditor agreement through which debtors and their creditors can negotiate an agreement to restructure outstanding indebtedness.

US$16bn

Major Turkish companies, financial institutions and the government have at least US$16 billion in bonds denominated in foreign currency due by the end of 2019

Source: Bloomberg

The new framework echoes the 'Istanbul approach' launched in 2002 with a similar intention of facilitating restructurings led by the major Turkish banks and key industry players. The Istanbul approach (named after its Western European predecessor, the 'London approach') was considered successful, resulting in the restructuring of more than 300 companies during its three-year lifespan.

The Framework Agreement, which has been recently amended and posted on the website of the Banks Association of Turkey, is signed up to by the main credit institutions and banks in Turkey (referred to as 'Creditor Institutions') and forms the 'constitution' of restructurings to be entered into pursuant to the Regulation. Although as currently formulated, the Framework Agreement as the main intercreditor platform for Turkish financial institutions is only capable of being signed by Turkish financial institutions (and not international lenders), it sets out the contractual framework for terms of individual debtor-specific financial restructuring agreements (FRAs), while allowing flexibility in the terms of the underlying restructurings.

International lenders may sign the Framework Agreement, if they choose to, and join a specific restructuring without the approval of the other creditors.

Some of the key features of the Framework Agreement include:

- A standstill on actions by any Creditor Institution immediately upon application by a debtor to commence a restructuring
- The formation of a consortium of the debtor's Creditor Institutions (CCI), led by a 'leader bank' typically holding the largest exposure
- The ability to restructure multiple debtors in the same corporate group as part of a single process
- A cram-down mechanism where dissenting Creditor Institutions can be forced into a restructuring if two-thirds of a debtor's CCI (by value) enters into an FRA (subject to certain higher thresholds for specific restructuring measures)
- The imposition of a fixed 90-day timeline to negotiate and agree the FRA (extendable to 150 days by the CCI)
- The ability to implement a wide range of restructuring measures, including term extensions, advancement of new money and debt-for-equity swaps

However, the Regulation has remained silent on a number of important points, including, crucially,

Some recent restructurings in Turkey

Company	Details of restructuring
Yıldız Holding	Food manufacturing conglomerate Yıldız Holding underwent a restructuring in 2018 to restructure US$5.5 billion in loans with a maturity of eight years. This has been the country's biggest loan restructuring to date.
Yeni Elektrik Üretim A.Ş.	Turkish electricity generator Yeni Elektrik restructuring ongoing in respect of a 14-year loan of US$700 million which was secured in 2010.
Doğuş Holding	Doğuş Holding has restructured approx. US$2.5 billion worth of debt with its Turkish lenders.
Bereket Enerji	Bereket second phase restructuring ongoing with all group lenders to refinance US$4 billion worth of debt.
Arkas Holding	Izmir-based conglomerate with ship operations, port operations, logistics services began restructuring negotiations with bank creditors relating to its short-term liabilities, has around US$850 million equivalent in debt owed to local banks which is to be restructured.
Boyabat Elektrik Üretim ve Tic. A.Ş.	One of the largest privately owned HEPP (Hydroelectric Power Plant) in Turkey, the 513MW Boyabat Dam, was negotiating with its creditors to restructure its US$ 750 million 2020-maturing loan. Boyabat Dam and HEPP is owned by subsidiaries of Doğuş Holding (34%), Unit Investment (33%) and Doğan Enerji (33%).

"Only time will tell whether local processes will provide a suitable toolkit for large-scale corporate restructurings, or whether other international restructurings processes may also have a role to play

Summary of Framework Agreement process

	Regime	Description	Application
☐ The Regulation sets out the foundational principles and lays the groundwork for the Framework Agreement ☐ Original plans proposed an additional new law, which, once in force, would provide certain additional provisions complementary to the Framework Agreement, but at present this is not expected to be enacted ☐ Forms part of Turkish law and therefore generally binding in Turkey	Regulation	Legislation	Binding effect on all creditors in Turkey
☐ The Framework Agreement has been entered into by certain Creditor Institutions pursuant to the Regulation (and approved by the Banking Regulation and Supervision Agency) ☐ It provides the constitutional framework for Framework Restructurings ☐ Binds all original signatories and acceding creditors to the Framework Agreement	Framework Agreement	Contract (backed by legislation)	Binding on (i) Creditor Institutions who have signed onto the Framework Agreement (all major Turkish financial institutions), (ii) any other creditors (including trade creditors or international lenders) who accede in each case, and (iii) the applicant debtors (and certain required related parties)
☐ The Framework Agreement provides that debtors, Creditor Institutions and other creditors can enter into an FRA ☐ The FRA will contain the deal-specific terms which implement the restructuring ☐ Binding on all signatories and also on all relevant Creditor Institutions if approved by 2/3 of relevant Creditor Institutions by value (subject to certain additional thresholds) ☐ Leaves existing security interests unaffected	Financial Restructuring Agreement	Contract (deal-specific)	Binding on (i) all Creditor Institutions that are lenders to the debtors in question and any other creditors that have elected to sign the FRA for such debtors and (ii) the applicant debtors (and potentially guarantors or other related parties who accede to the FRA)

Source: White & Case/GKC Partners

how dissenting creditors that have not signed up to the Framework Agreement can be bound. While the application of the Framework Agreement structure to debtors with exclusively Turkish creditors is relatively clear, it is more difficult to interpret how the Framework Agreement process could be made to apply to debtors with a mixture of Turkish and overseas creditors. The most recent amendments to the Regulation permit the participation of international lenders in Turkish restructurings, but explicitly confirm that international lenders are not bound by the creditor voting matters under the Framework Agreement (unless they have explicitly elected to 'opt in' to the Framework Agreement for these purposes). Accordingly, in the absence of direct consensual agreement with each international lender, it is not easy to see how the cram-down and other mechanics in the Framework Agreement will be able to provide a full solution for Turkish borrowers with a combination of local and international bank creditors.

For many large Turkish corporates, particularly those in the infrastructure, construction and energy sectors, international debt constitutes a large part of their balance sheet, and so the lack of certainty as to how the Framework Agreement structure will apply to such creditors is a major limiting factor on the potential effectiveness of the new regime.

Also various sponsor-related requirements of the Framework Agreement, such as the requirement to declare personal assets and concerns relating to additional collateral requirements from financial institutions on personal assets, have so far limited the number of actual restructurings under the Framework Agreement.

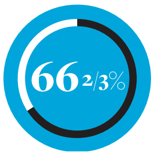
75%

Under an English scheme of arrangement, a company's creditors can approve a scheme with a majority in number and 75% by value of each affected creditor class

Konkordato

Konkordato, the principal Turkish restructurings regime prior to the implementation of the new Framework Agreement structure (and which remains in effect notwithstanding the new regime), is a court-led process governed by the Turkish Enforcement and Bankruptcy Code. The aim of Konkordato is to restructure a company's indebtedness via a restructuring plan (the 'Konkordato Plan') that proposes amendments, extensions and/or haircuts to creditors, so that the company can avoid bankruptcy. Either the debtor company or a creditor can apply to the Court to put a company into Konkordato.

Because the Konkordato process is only available to restructure obligations of a single legal entity, it is not suitable for many large-scale corporate group restructurings. In addition, although the required approval level is relatively low (either (i) 50% in value and number or (ii) 2/3 in value and 1/4 in number), the Konkordato process carries two substantial downsides. The first is the degree of involvement of the Court (and Court-appointed comissar) and potential level of oversight on the debtor. The second is that if the debtor fails to agree or implement a Konkordato Plan, the Court has no option but to file it for bankruptcy.



Under the Turkish Restructuring Settlement, the plan must be approved by creditors affected by the plan representing at least 66 2/3% of the value of the debt

> **Tried and tested insolvency procedures that have been successful in other jurisdictions may provide an effective solution to debtors and creditors in the Turkish market**

Restructuring Settlement

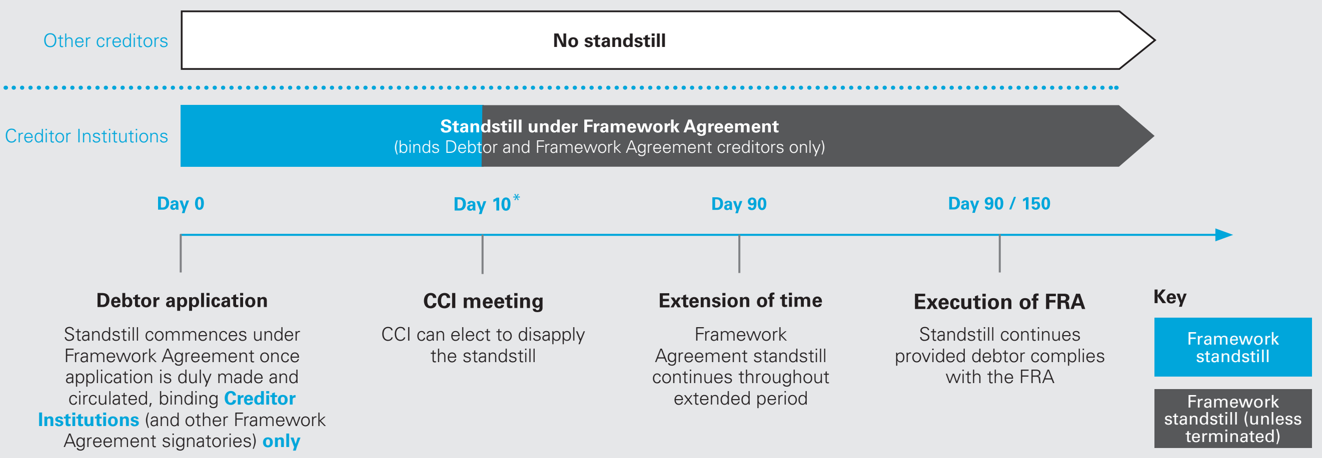
Restructuring Settlement is a rarely used process regulated under the Execution Code. Under this process, a company can apply to the Court for a Restructuring Settlement and request a reorganisation of its debts via a restructuring plan. The plan must be approved by creditors affected by the plan representing at least 66 2/3% of the value of the debt before being presented to the Court. Following an application for a Restructuring Settlement, the Court is required to have a hearing within 30 days to decide on the proposed plan.

As with Konkordato, if the creditors do not approve the Restructuring Settlement, or it cannot be successfully implemented, the Court is required to place the company into bankruptcy

Comparison of restructuring best practice

	Turkey (old regime - still in effect)	Turkey (new regime)	UK / Western Europe
Standstill on lender action	□ Moratorium available as part of *konkordato* proceedings □ No standalone standstill unless agreed contractually	□ Standstill on Framework Agreement signatories and acceding creditors on commencement of restructuring	Contractual – by way of a standstill agreement between debtor and lenders
Equalisation between lenders	No automatic equalisation / loss-sharing and deals often agreed bilaterally	Treatment of all lenders equalised	Positions equalised and losses shared as between lenders on a contractual basis
Information sharing	Information sharing on an ad-hoc basis only	Information shared with Turkish lenders (and international lenders as required) pursuant to letter of undertaking as part of Framework Agreement. Debtor undertakes to share all relevant information with lenders.	Information shared with all participating (i.e. "private") lenders simultaneously
Treatments of local vs international lenders	Foreign creditors can participate in restructurings but usually on a bilateral basis	□ Turkish lenders subject to Framework Agreement □ International lenders outside of process unless willing to participate and accede to Framework Agreement	No difference in treatment as between local and international lenders
Documentation	No standardised restructuring documentation and form of documents dependent upon implementation	Financial restructuring agreement (may be under Turkish law or governing law of debt documents)	□ English law restructuring / lock-up agreement □ LMA finance documentation
Restructuring implementation tools	*Konkordato* and restructuring settlements allow for cram-down but may lead to compulsory bankruptcy if they fail	Framework Agreement cram-down with 66 2/3% Turkish lender consent	Scheme of arrangement (with 75% creditor consent) and/or pre-packaged English administration
Willingness to impair / equitise debt	Possible through consent or restructuring processes but not widely applied or accepted by lenders	Possible under Framework Agreement (with support of all Framework Agreement creditors)	Lenders increasingly prepared to write down debt in return for improved pricing, equity stakes, ability to inject new money on favourable terms etc.
	The current Banking Law is a barrier for impairment by Turkish banks as legislation may pose criminal liability for banks that agree to contractual impairment. Draft legislation is being prepared with the intent to amend this and allow banks to write off debt.		

Framework Agreement: Structure of standstill periods



*****Indicative. The timing for the first CCI meeting is not prescribed by the Framework Agreement

Source: White & Case

upon application of the creditors.

Given the tight timeframes applicable to this process, the lack of an automatic moratorium and the threat of bankruptcy should it not be successful, the Restructuring Settlement has not been widely used. The mechanism is more likely to be useful in implementing a consensual restructuring agreed to by a debtor and a sufficient proportion of its creditors.

Restructuring tools outside Turkey

Given the challenges posed by local Turkish restructuring tools—particularly when international creditors are involved—more sophisticated Turkish debtors may look to alternative options that have become familiar in recent international restructurings.

Two obvious candidates are the English scheme of arrangement and the the US chapter 11 process, both of which are tried and tested and do not require the centre of main interest of the debtor company to be in that jurisdiction in order to take advantage of the process.

Schemes of arrangement

An English scheme of arrangement is a well-established route for companies to restructure their debt. If a debtor's existing finance documents were not already governed by English law, a change of governing law by the majority lenders would open up the scheme of arrangement as a possibility.

A scheme of arrangement is a very flexible mechanism which can be used to effect a compromise or arrangement between a company and its creditors. As it can bind secured creditors, and only affected creditors need to be consulted, a scheme of arrangement can be used in a discrete fashion to restructure finance debt without affecting the vital trade creditors of a debtor. Because it is not an insolvency process, a scheme of arrangement also avoids some of the stigma that has hitherto limited the utility of the Turkish restructuring regime.

A company's creditors can approve a scheme with a majority in number and 75% by value of each affected creditor class. Court sanction is also required for the scheme to become effective, but in the absence of some impropriety or unfair treatment of creditors, the English Court will usually be inclined to sanction a scheme approved by the requisite majorities.

While there is no moratorium applicable to a scheme of arrangement because it is not an 'insolvency' process (being contained in the UK Companies Act 2006), there is not the stigma attached to insolvency, nor would a standard insolvency cross-default clause (as would commonly be found in commercial contracts, as opposed to finance documents) be triggered by the scheme. Another strong advantage to a scheme of arrangement is that it is confined to the restructuring of the financial debt of the distressed company, leaving trading operations and creditors intact.

Although no successful scheme has yet been implemented for a Turkish company, we expect that English schemes would be effective and recognised under Turkish law.

It remains to be seen whether Turkish debtors will have the appetite to use a scheme of arrangement for these purposes, but for those debtors with material international creditors, a scheme may be a viable option.

> **"The new regime will potentially provide additional certainty and transparency to Turkish restructurings, and may go some way to unlocking Turkey as an attractive opportunity for international investors**

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English schemes of arrangement provide a very flexible mechanism which can be used to effect a compromise between a company and its creditors

Chapter 11

When it is either not possible to perform an English scheme of arrangement or the ‘extra-territorial’ effect of a US chapter 11 is a desired outcome, chapter 11 is another viable option for a Turkish debtor. The US Bankruptcy Court can take jurisdiction if the Turkish debtor has money in a bank account in the US (which can be achieved by putting a retainer in a law firm’s US client account), even if there are no other links between the debtor and the US.

While the chapter 11 process is longer and more heavily court-based than an English scheme, it can provide a more holistic solution to a company’s financial distress. The cross-class cram-down available in chapter 11 is useful if there are impaired classes of creditors that need to be bound into the process.

Chapter 11 provides a moratorium upon the bankruptcy filing, and in the event that the Turkish debtor was in need of rescue finance to maintain its operations during the chapter 11 process, debtor-in-possession (DIP) financing and its primacy can be secured.

Opportunities for investors

Given the current distress in Turkey and the impending maturity walls in this and subsequent years, Turkey looks likely to be an intriguing jurisdiction for international debt investors. The depreciation of the lira and the large amounts of debt outstanding in foreign currencies may well give rise to opportunities for investors prepared to invest in distressed assets.

Some of the uncertainties—such as how restructurings negotiated under the Framework Agreement will be made effective where there are non-consenting international lenders—may be become clearer over time and as the first wave of debtors make use of the new regime. However, Turkey has no track record of international restructurings. Although the Istanbul Approach was comparatively successful in the 2000s, the lenders then were Turkish banks, not international lenders. Upcoming restructuring discussions will therefore have a very different tenor from those that took place some 15 years ago.

That uncertainty has the potential to create opportunities for distressed investors looking for new markets. If the pricing reaches levels that are sufficiently attractive, investors may well be prepared to accept the geopolitical risks and reap their rewards through Turkish restructurings.

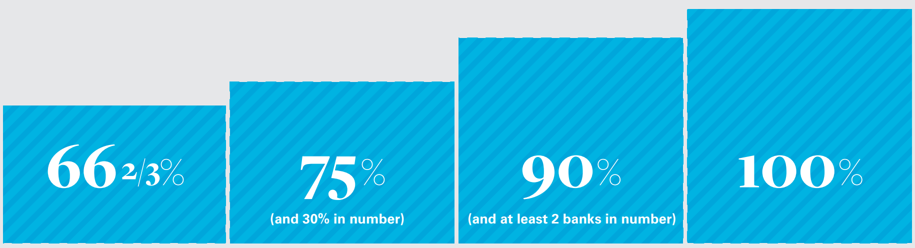
Turkish restructurings: Watch this space

Turkey remains a challenging jurisdiction, and some investors may be hesitant to take on the risks associated with investing in the debt of Turkish companies. However, the Regulation provides welcome evidence that the Turkish government is seeking to address the effect of the refinancing wall and lira depreciation on the Turkish economy and its borrowers. Corporate restructurings are clearly needed, and both government and banks are more aware of this than ever, but it is also clear that more needs to be done.

The ability to utilise the new regime (perhaps in parallel with a recognised international tool such as a scheme of arrangement) may potentially provide additional certainty and transparency to Turkish restructurings, and may go some way to unlocking Turkey as an attractive opportunity for international investors.

One thing seems inevitable: Turkish restructurings are likely only to increase in the coming months and years as Turkish banks face up to the need to work out their distressed loan books. As a consequence, Turkey will become a jurisdiction of ever-increasing interest to distressed investors. Whether or not the market in Turkey will open up to large-scale international distressed debt investment in the manner of other European countries remains to be seen. It is likely to depend on whether developments such as the new legislative regime can provide the stability and certainty that investors require. The next 12 months, and the first few major restructurings featuring institutional creditors, will be hugely instructive. Watch this space.

Framework Agreement: CCI voting thresholds (by value)



66 2/3%
- Cram-down of dissenting CCI members into restructuring
- Measures other than those with higher thresholds*

75% (and 30% in number)
- Revision of key deal terms at FRA negotiation stage and extension of 90-day period
- Consensual provision of new money by CCI members or other parties
- Entry by Turkish non-Creditor Institution creditor into CCI
- Appointment of alternative Creditor Institution as leader bank

90% (and at least 2 banks in number)
- Provision of super-senior new money by entirety of CCI (pro rata to exposure)

100%
- Write-downs to debts owed to CCI creditors (pro rata to exposure), including debt-to-equity swaps

*The assumption is that the 2/3 threshold will apply, but the Framework Agreement is not specific as regards actions that do not directly apply to the FRA (e.g. disapplication of the Framework Agreement standstill)

Source: White & Case

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