Turkey

Negotiated M&A Guide 2022

Corporate and M&A Law Committee

Contacts

Nihan Bacanak
Paksoy, *Istanbul*
nbacanak@paksoy.av.tr

Melisa Sevinç
Paksoy, *Istanbul*
msevinc@paksoy.av.tr

1. INTRODUCTION

This guide aims to provide a framework in respect of private M&A transactions in Turkey. The typical course of an M&A transaction as well as the main legislation governing Turkish M&A transactions are explained. Further, most common transaction structures, stages and related documentation are touched upon.

2. RECENT DEVELOPMENTS AND LEGAL FRAMEWORK

The Turkish M&A sector had an outstanding year in 2021 in line with global trends. M&A transactions closed in 2021 grew significantly in terms of volume and quantity compared to the previous years. The impact of Covid-19 on M&A transactions has been an increase in deals involving target companies engaged in e-commerce, information technology and healthcare.

M&A transactions are mainly governed under two pieces of legislation: the Turkish Commercial Code No. 6102 (TCC), and the Turkish Code of Obligations No. 6098 (TCO). The applicable provisions of the TCO in respect of M&A transactions are mainly those relating to sale contracts and obligations of the parties, especially in relation to potential claims of the purchaser regarding the defects on the shares or assets subject to sale, and the warranties of the seller. The provisions of the TCC, on the other hand, comes into play within the context of an M&A transaction typically in respect of share transfer or merger procedures, restrictions on the transfer of shares of the target company, rights and obligations of the parties post-closing in cases where a joint venture will be formed, and transactions to be carried out following closing.

Other applicable legislation includes the Capital Markets Law No. 6362 and its respective secondary legislation, if the transaction involves acquisition of a target with publicly traded shares. Likewise, in transactions concerning a target operating in a regulated sector such as energy, banking or telecommunication, the relevant legislation regulating such specific area may also be applicable. If the transaction involves an asset deal, depending on the particular asset to be transferred, relevant legislation such as the Industrial Property Law No. 6769, the Title Deed Law No. 2644 and the Labour Law No. 4857 may apply.

Depending on the characteristics, the structure and the parties of the relevant transaction, the Corporate Tax Law No. 5520, the Income Tax Law No. 193, the Value Added Tax Law No. 3065 and the Stamp Duty Law No. 488 may also be applicable in Turkish M&A transactions.

Transactions where certain thresholds relating to the transaction parties' turnovers are exceeded must be cleared by the Turkish Competition Authority under the Law No. 4054 on the Protection of Competition and the respective secondary legislation, especially the Communiqué on Mergers and Acquisitions Requiring Permission from the Competition Board (Serial No: 2010/4).

3. TYPE OF TRANSACTION STRUCTURES ADOPTED IN PRIVATE M&A TRANSACTIONS

Private M&A transactions in Turkey are mostly built on two main structures: share deals and asset deals. While mergers where more than one entity merge under a new entity or one of the merging entities survives whereas the others cease also take place, this is a rather less common structure amongst Turkish M&A transactions.

Share deals are more commonly preferred than asset deals in Turkey. The main reasons for this are tax-related advantages and simplified closing procedures available for share deals under

Turkish law. In the case of a share deal, the transaction may be closed, in principle, solely by way of transfer of shares, while an asset deal mostly requires each asset within the scope of the transaction to be separately transferred as per the transfer procedure envisaged for such asset.

A share deal may be carried out through the transfer of existing shares belonging to a shareholder of the target, or acquisition by the purchaser of new shares issued by the target through a capital increase. An asset deal can be structured as a transfer of specific assets of the target, a commercial enterprise transfer along with all assets and liabilities, or a partial spin-off of certain assets. Within the context of an M&A transaction, the former is the most common asset transfer structure, whereas partial spin-off is mostly invoked as part of a pre-closing reorganisation during the transaction. As to the commercial enterprise transfer, practical difficulties may be encountered before the trade registry when registering the transfer: hence, this is a rather less commonly preferred structure type.

In an asset deal, in principle, procedures envisaged for each asset to be transferred are required to be completed separately. This complicates closing mechanics, particularly in respect of assets for which transfer is subject to a form requirement, such as real estate. Moreover, it may not be practically possible to complete the respective actions simultaneously, and sometimes even within the same day. Nevertheless, where an asset deal is structured in the form of a commercial enterprise transfer or partial spin-off, closing mechanics may be facilitated to a certain extent.

Closing procedures vary significantly depending on the transaction structure, A further material difference between an asset deal and a share deal pertains to the liability of the purchaser in respect of the target or the assets. Under Turkish law, as a rule, shareholders of equity companies are not liable for the company's undertakings. Therefore, setting up the transaction as a share sale enables the purchaser to allocate the risks related to the target; in other words, the probability of the liabilities of the target to be reflected to the purchaser directly is quite remote as in principle, the shareholders' liability is essentially limited to the amount of the capital committed. However, in case of an asset sale, liabilities attributed to the owner of the sale assets would pass on to the purchaser upon consummation of the transaction.

Notwithstanding the above, with regard to the ultimate risk assumption, asset sale transactions may generally be considered as more favourable for the purchaser as they would be able to cherry-pick the assets of the target to be acquired and would assume the risks attached with such assets. On the other hand, in a share sale, the purchaser assumes the ultimate and overall risk relating to the target's liabilities. Therefore, unlike the case in a share sale, the risk pertaining to the assumed liabilities would be relatively limited in an asset sale, setting aside the possibility of the asset deal being considered as a business transfer, as a result of which all assets and liabilities would be transferred due to the universal succession principle applicable to business transfers. Accordingly, the transferee becomes liable for all debts associated with the transferred business, and the transferor continues to be jointly liable with the transferee for such debts (including contractual and possibly tax liabilities) for a period of two years after the transfer is formally notified to the creditors and/or publicly announced.

Although the parties can validly agree on the allocation of liabilities by contract, such agreement is not enforceable against third parties. There is very little guidance under Turkish law as to when an asset sale would qualify as a business transfer under Turkish law. Court precedents in which an asset transfer has been characterised as a business transfer mostly relate to instances where the transaction was structured in bad faith, and therefore focus on the fraudulent behaviour of the parties. As for a commercial enterprise transfer within the scope of an asset deal, the purchaser only assumes the liability pertaining to commercial enterprise, not all the liabilities of the target.

Aside from the closing mechanics, share deal may also be considered as more favourable from tax perspective. Share purchase agreements (SPA) are exempt from stamp tax while, in an asset deal, the parties may encounter stamp tax exposure for each asset to be transferred. In addition, given the tax exemptions available for share sales, this transaction structure may be more advantageous in terms of income tax and corporate tax burden.

As transfer of registered shares of a joint stock company can be considered as the most common type among Turkish M&A transactions, this scenario will be focused on in this guide.

4. MAIN STEPS

A non-auction process share deal (only one potential purchaser *vis-à-vis* the seller) typically consists of the following main steps:

a) signing a non-disclosure agreement (NDA);
b) submission of a non-binding offer letter to the seller by the purchaser;
c) negotiation and execution of a preliminary document such as a memorandum of understanding or term sheet;
d) conducting legal, financial, tax and technical due diligence processes;
e) drafting and negotiation of transaction agreements;
f) signing;
g) performance of pre-closing actions;
h) closing; and
i) performance of post-closing actions.

5. PRE-AGREEMENT DOCUMENTATION

There are a number of commonly used documents that are executed before entering into definitive transaction agreements in an M&A transaction. The seller typically requires that the purchaser shall execute a NDA or undertaking whereby the purchaser (or both parties in case of an agreement) undertakes not to disclose the confidential information that will be received during the course of the M&A process with the respect to the transaction, the target and the parties, as applicable.

Upon execution of an NDA, the purchaser is provided with the information as may be needed by the purchaser to make a valuation on the target company. Based on such valuation, the purchaser would submit the seller a non-binding offer, which will typically be subject to a number of conditions – including absence of any material due diligence findings that may affect the purchaser's decision regarding the transaction or valuation on the target.

While this is also not the case in all Turkish M&A transactions, it is common for the parties to enter into some sort of non-binding preliminary document such as a memorandum of understanding, letter of intent or term sheet before execution of the definitive agreements and even before commencement of the due diligence.

Although most of the provisions of such a document would not be binding on the parties, execution of the same is still useful to set forth that the parties have a common understanding on the major aspects of the subject matter. In fact, the content of such preliminary documentation is commonly referred to during the course of negotiation of the definitive agreements, and thus the parties take the time and effort to negotiate such preliminary document in the very beginning of the process. It is worth noting in this context that damages can be claimed under Turkish law even prior to execution of binding agreements in the event that the negotiations are terminated in bad faith. Therefore, even if the preliminary documentation is not binding in principle, it may serve as a proof that negotiations have taken place between the parties.

The preliminary document mostly includes an exclusivity period, within which the seller is obliged not to enter into discussions with any other potential purchaser in relation to the same or similar type of transaction involving the target. This enables the purchaser to have a certain level of certainty during the course of due diligence and negotiation of the transaction agreements, and to minimise the risk of misuse of its resources. The preliminary document also includes a confidentiality obligation, which is repeated if an NDA was previously executed, as mentioned above. Confidentiality and exclusivity provisions are crucial under the preliminary document for the seller and the purchaser, respectively. These provisions are thus mostly among the binding provisions of the preliminary document.

Some other typical provisions of a preliminary document would include those relating to the structure of the transaction, purchase price and payment mechanics, the next steps, how transaction costs and expenses of the parties will be borne, and the governing law and jurisdiction, the latter also being usually binding on the parties.

6. DUE DILIGENCE

Conducting a due diligence review on the target by the purchaser before proceeding with the execution of the definitive agreements is common practice in Turkish M&A transactions. The scope of the due diligence varies from one transaction to another, but it would be fair to say that legal, financial and tax due diligence are the most typical due diligence workstreams. Some other due diligence review topics that a potential purchaser would prefer to investigate include, amongst others, insurance, human resources, real estate and environmental matters.

Upon execution of the aforementioned preliminary documentation, the seller provides the purchaser with access to a virtual data room where the purchaser can expect to find a significant amount of information regarding the target and the business that it intends to acquire. The due diligence process can be different in every transaction, but it is common to have management meetings, Q&A sessions and site visits as part of the due diligence process for the purchaser's better understanding of the target and the business. In this context, gun-jumping principles must be observed as applicable, and clean team arrangements should be put in place as needed. The period for the due diligence process may also vary from one transaction to another, but it would generally take around one to two months assuming that sufficient amount of data is provided in a data room in an organised manner.

Typical key aspects that are looked into within the course of legal due diligence include:

a) due ownership of the shares of the target;
b) restrictions on share transfers;
c) absence of any encumbrance over the shares or material properties of the target;
d) consent requirements or penalty clauses that may be triggered by a change of control clause under the agreements to which the target is party;
e) compliance with regulatory permits and licences;
f) absence of insolvency or bankruptcy on the part of the target;
g) absence of major lawsuits;
h) ownership of intellectual property rights;
i) terms of transactions with related parties;

j) compliance with data protection laws; and
k) absence of any investigation related to compliance matters.

7. DEFINITIVE AGREEMENTS

The process of drafting and negotiating the definitive agreements (mainly the SPA as well as the shareholders' agreement (SHA) or the joint venture agreement (JVA) if it is not a 100 per cent share sale) usually starts upon completion of the due diligence reviews or immediately before completion of these. That is mainly because the purchaser would normally like to address the due diligence findings under the definitive agreements as it deems fit (eg, under the conditions precedent to closing (CP), specific indemnities, etc.) and these would be expected to be among the negotiation topics during the course of discussions between the parties over the definitive agreements.

Given the principle of freedom of contract applicable under Turkish law and in line with the global practices, SPAs include detailed provisions regarding the transaction. SPAs are subject to the TCO, but the TCO does not specifically regulate the transfer of shares as a subject matter. Therefore, provisions regarding the sale of movables under the TCO shall be applicable in this context.

One matter that the TCO provisions come into picture and widely discussed within the context of an M&A transaction is the seller's representations and warranties (R&W). In this context, since the subject of the sale under the SPA is the shares of the target company, rather than the target itself, the warranties available under the TCO only provide protection for defects related to the shares being sold. However, the purchaser's main objective in an M&A transaction is acquiring control of the target, the level of which would vary depending on the specifics of the transaction. This is the reason why SPAs contain a broad catalogue of R&Ws not only relating to the sale shares but also, in connection with, amongst others, aspects such as:

a) capacity and title of the seller;
b) share status;
c) corporate standing of the target;
d) affiliates;
e) compliance;
f) financial matters including borrowings, encumbrances, guarantees and working capital;
g) material contracts to which the target is party;
h) compliance and litigation;
i) data protection;
j) property;
k) intellectual property;
l) employees and pensions;
m) environment; and
n) tax.

It is also commonly stated under SPAs that the purchaser relies on each of the R&Ws in the agreement when entering into the transaction. This aims for the purchaser to enjoy protection, not only from the R&Ws available under the law, but also from the R&Ws explicitly provided under the SPA.

Concerning the impact of due diligence on the liability of the seller in connection with the R&Ws, as a matter of Turkish law, it may be claimed that the purchaser has an obligation to investigate the target for any clear defects prior to the acquisition. In case any issues have been identified during the due diligence process that may be considered as a defect within the meaning of the TCO, the purchaser would be deemed to be aware of the defect at the time of acquisition. Accordingly, the seller would not be liable *vis-à-vis* the purchaser for any clear defects, unless the seller made a specific representation to the contrary.

On the other hand, the purchaser has an obligation to investigate the target upon the acquisition and inform the seller immediately of any latent defects or non-compliance with the seller's R&Ws. If there are any hidden defects which existed prior to the execution of the definitive agreements and/or closing of the transaction, the seller will be liable against the purchaser by law. It may be worth noting in this context that an obvious defect may be identified without need for an investigation (ie, due diligence in this case) or if the purchaser could have discovered such defect by conducting due diligence.

Unless otherwise provided under the transaction agreements, as per the R&Ws available under Turkish law, it would not be possible for the purchaser to claim indemnification if the purchaser had knowledge (or was able to obtain this information) before executing the definitive agreements or and/closing, as applicable. Nevertheless, if the seller has made a specific representation under the agreement, it would be liable against the purchaser for such representation being inaccurate. The fact that the seller would not be liable for defects known to the purchaser under the law leads to discussions between the seller and the purchaser over the impact of disclosures of the seller against the R&Ws. While the seller would obviously be inclined to avoid any liability *vis-à-vis* the purchaser to the extent possible including by way of disclosing any defects pertaining to the target, the purchaser's motivation would be in favour of minimising the possible elimination or limitation of liability of the seller in this regard.

If the seller and the purchaser are either corporate entities or individuals, who somehow operate a business, both the seller and the purchaser may be deemed as merchants under the TCC. Being considered as merchant and thus as a prudent businessperson under Turkish law, the purchaser would be expected to investigate the target for any defects, which would correspond to an extensive due diligence on the target and its business within the context of an M&A transaction.

Another matter that is widely discussed during the course of definitive agreement negotiations, which is also linked with the R&Ws, is the limitation of the seller's liability under the SPA. In this context, amongst others, basket clauses whereby the purchaser may only bring claims upon reaching certain thresholds and *de minimis* clauses setting forth that the seller is obligated to indemnify only in case of exceeding the *de minimis* amount are common instruments used for purposes of limiting the seller's liability under the agreement. The overall liability of the seller that may arise under the SPA may also be capped.

As to time limitations, liability arising in connection with the R&Ws relating to tax and social security (and environment in some instances) are typically subject to the statutory limitation period (in some transactions, along with an additional six months), whereas the liability relating to the other R&Ws are usually subject to one to three years' limitation period.

8. PURCHASE PRICE

As for the purchase price, both closing accounts and locked box mechanics are preferred in line with global practices. The SPA addresses the details of the designated mechanics (eg, definitions such as 'cash' and 'debt', the scope of and the exceptions to the same in case of closing accounts, and 'leakage' and 'permitted leakage' in case of locked box) extensively, which can be hardly negotiated between the parties. If closing accounts is preferred, adjustment would take place usually within three months following closing. It is common for an audit firm to be involved in the process to do the calculations as would be provided under the SPA. Separately, holdback and escrow mechanisms can be put in place under the SPA to be applicable in connection with the payments to be made within the scope of adjustments and/or the liability of the seller arising from the agreement.

Interim period covenants that will be applicable during the period between signing and closing is also an important section of an SPA. The purchaser would wish to have some sort of say over the company's operations at this period, while the seller would prefer the interim covenants to be limited considering the risk of violating the R&Ws due to mismanagement of the purchaser and the risk of the transaction not being closed. Gun-jumping considerations should also be kept in mind in this context, particularly where the parties to the transaction are competitors, to ensure that the purchaser's intervention in the target during the interim period should not reach a level of control.

Another topic that may be crucial under the definitive agreements would be the seller's non-compete and non-solicitation obligations. These obligations would particularly be relevant in transactions concerning a target, the business of which is based on know-how and customer portfolio, whereas these may not be priority for a purchaser acquiring a target active in an asset-intensive sector. The matter would typically be addressed under the SPA if a 100 per cent share sale is concerned, whereas the SHA or the JVA would be expected to address the matter if a share sale less than 100 per cent is on the table. There are certain limitations to these obligations under competition law principles from territory and time perspectives, which should be taken into account when negotiating the relevant provisions.

As for the governing law and jurisdiction clauses of the definitive agreements, as a general rule, parties are free to choose Turkish law or other law to govern the transaction agreements. However, certain Turkish law provisions (eg, provisions relating to share transfers, shareholder rights and corporate governance principles, which are mostly provided under the SHA or the JVA, as applicable) will in any case need to be observed – as the failure of which would lead to invalidation of the respective contractual provision. In practice, Turkish law – as well as foreign law such as English law or Swiss law – is commonly agreed upon as the governing law of the transaction agreements. Regarding jurisdiction, local and international arbitration such as the Istanbul Arbitration Centre (ISTAC), the International Chamber of Commerce (ICC) and the London Court of International Arbitration (LCIA) are frequently preferred. In light of some recent court decisions invalidating arbitration provisions under the SHAs, the arbitration clauses of the definitive agreements should be carefully drafted with a view to minimising such invalidation risk.

9. PRE-CLOSING ACTIONS

Once negotiations on the transaction agreements are finalised and upon execution of the SPA, parties proceed with the actions that need to be taken prior to closing.

CPs set forth under the SPA mostly relate to the actions that the purchaser requires the seller to take or procure that the target shall take prior to closing based on the due diligence findings. Failure to satisfy a CP would entitle the purchaser to walk away from the transaction, which would conceptually overshadow deal certainty; thus, the seller is usually inclined to keep the CP list as limited as possible. The CPs required by the purchaser from the seller are therefore one of the toughest negotiation items in an M&A transaction. Other than the CPs incorporated in the agreement based on a due diligence finding, such as obtaining of a licence that the target should but does not hold, obtaining mandatory regulatory approvals such as merger control clearance from the Turkish Competition Authority (if the thresholds set forth under the relevant legislation is exceeded), and absence of a material adverse change are common examples of CPs under the SPA in a Turkish M&A transaction.

Parties can spend a lot of time on discussions regarding the definition of a material adverse change and any carve-outs from such definition. Other than those, obtaining third-party approvals as per change of control clauses or similar arrangements incorporated under the agreements to which the target is party is also a typical CP to be addressed by the seller prior to closing.

10. CLOSING ACTIONS

Closing of an M&A transaction structured as a share deal requires payment of purchase price by the purchaser and taking of actions necessary to effect the transfer of shares, depending on the specifics of the case.

In principle, transfer of existing shares of a joint stock company does not require execution of a contract under Turkish law. For effectuation of transfer of registered shares of a joint stock company, share certificates representing the sale shares (assuming these have been issued) should be endorsed and possession of the same should be delivered to the purchaser, and the share transfer should be registered in the share ledger of the target. If no share certificate representing the sale shares has been issued, a written agreement on transfer would be required. However, due to tax exemptions granted to share sales represented by share certificates, it is common to issue share certificates shortly after incorporation and each capital increase. In any event, the parties (and mostly the purchaser) would prefer to effect the share transfer over the share certificates representing the sale shares at closing, and thus if not issued to date, in practice, issuance of the share certificates representing the sale shares prior to closing of the transaction is commonly arranged.

In case sale shares are issued to the bearer, transfer of possession of the share certificates representing the shares to the purchaser should suffice for effectuation of the transfer. In such case, notification to the central securities depository on the transfer should also be made, failure of which would prevent the exercise of shareholding rights attached to the sale shares by the purchaser.

Transfer of shares of a joint stock company is in principle not subject to the target's approval. There may be exceptions to this depending on the type of the company, whether the shares have been paid up, or if the articles of association provide otherwise, in which case additional procedures may be required for the transfer of ownership. For instance, in the case where the target's articles of association lawfully set forth that the transfer of shares shall be subject to the approval of the board of directors or if the capital undertaking pertaining to the sale shares is not fully paid, the said approval would be required to effectuate the transfer of ownership.

Regardless of whether the relevant share transfer requires the approval of the target, in practice a board resolution to the effect that the share transfer shall be approved and registered in the share ledger is commonly taken as part of closing actions in an M&A transaction involving transfer of registered shares of a joint stock company. The new shareholder must be registered in the share ledger as the owner of the sale shares for exercising its rights associated with the shares *vis-à-vis* the target company.

If the transaction involves transfer of shares of a limited liability company, execution of a share transfer deed before Turkish notary public followed by a general assembly resolution approving the transfer and registration of the same with the relevant trade registry would be required.

In the event that the transaction concerns shares to be issued to the purchaser via increase of share capital of the target, the ownership over the shares to be issued would be acquired upon registration of the capital increase that requires the target's general assembly meeting to adopt a decision on the capital increase with the approval of the existing shareholders. In such case, the shares would be issued for the purchaser by restricting existing shareholders' pre-emptive rights over such shares. The corresponding amount would need to be paid to the company rather than to the seller, unless a different arrangement is agreed upon between the parties.

In M&A transactions where the seller remains as a shareholder in the target, an SHA (or a JVA) is signed either along with the execution of the SPA to become effective at closing or at closing. It is typical for the general assembly meeting to be held at closing to approve amendments to the articles of association of the target based on the relevant provisions of the SHA to the extent permissible under the law. Further, at that general assembly meeting, election of new board members representing the purchaser is commonly approved. Another typical closing action is the approval of changes in the signatories and signature authorities of the company in order for the purchaser to gain control over the target.

11. POST-CLOSING

While application to the trade registry with which the target company is registered for the registration of the relevant closing actions is sometimes planned as a closing action, usually the application can realistically be made in the days following the closing date. Other than registration with the trade registry of the changes in the articles of association, the board of directors, the signatories and the signature authorities mentioned above, a direct and indirect change in the shareholding structure ranging from 5 per cent to 100 per cent should be notified to and registered with the trade registry. Additionally, if the purchaser becomes the sole shareholder of the target as a result of the transaction, the sole ownership should also be registered with the trade registry.

As per Foreign Direct Investment Law No. 4875, Turkish companies with direct or indirect foreign capital are required to notify the General Directorate of Incentive Implementation and Foreign Investment of transactions resulting in a change of the shareholding structure. This notification should therefore be in principle included in the agenda post-closing of a Turkish M&A transaction.

Depending on the target's scope of activity, certain statutory procedures might need to be completed under the respective legislation, such as notification to the relevant authority, the supervision of which the target is subject, based on its field of activity.

12. CONCLUSION

Generally speaking, private M&A transactions are governed by the principle of freedom of contract within the applicable legislative framework under Turkish law. Parties are mostly free to determine and agree on the specifics of the transaction under contract. To avoid any disputes during or after an M&A process is completed, it is advisable for parties to clearly address material items under the respective agreements.

This guide includes a high-level overview of topics that are commonly discussed within the context of an private M&A transaction in Turkey. Due to the extensive content of the subject matter, all the related matters may not have been touched upon at all or in full herein. There may be circumstances different from what is explained above depending on the facts and specifics of the case at hand. This guide aims to supply foreign lawyers familiar with private M&A transactions general practical information regarding the legislation and practices in Turkey and should not be construed in any way as an advice on a particular matter, an academic writing or otherwise.