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Acquisition Finance

Turkey
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Law and Practice

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1. MARKET

1.1 Major Lender-Side Players

The Turkish economy is undergoing continuing progress following the economic reforms that took place back in 2001 after the economic depression in Turkey. The structural reforms and remarkable steps taken to reinforce the regulatory and supervisory institutions under Basel criteria had a swift and positive effect on the banking system in Turkey, particularly on the financial stability and capital adequacy of local banks. Lending activities have gained great momentum, and loans provided to the private sector have significantly increased.

In the first instance, M&A deals were mainly funded with syndicated structures consisting of both local and foreign banks, including international financial institutions. Local banks (both private and public banks) then started to take the lead in domestic financing, thanks to their strong capital adequacy and sufficient liquidity.

However, the rapid growth in both cross-border and domestic financing deals lost its momentum over the last three years but has continued at a certain level. Following the Turkish Ministry of Treasury and Finance's introduction of limitations on foreign currency loans obtained from abroad in early 2018, there has been a significant decrease in cross-border financing; both local and international banks seem to be reluctant to provide financing until the application of the new legislation is tested and the currency crisis is settled. Considering tax-related challenges and the expensive pricing offered by local banks, corporates often turn to international banks in acquisition finance deals, so the limitations to foreign currency loans will continue to create an adverse environment in terms of leveraged financing.

1.2 Corporates and LBOs

In past years, the Turkish government focused on establishing an investment-friendly environment and restoring the stability of financial markets. A series of laws – particularly the Turkish Commercial Code and the Turkish Code of Obligations – were enacted in 2012 to harmonise the real sector with international standards and to create a transparent and sustainable commercial environment for both local and international investors. These reforms paved the way for the establishment of permanent balance in the market, and led to an increase in M&A transactions. However, Turkey has recently struggled with political issues in neighbouring countries and economic uncertainties, such as high inflation rates and volatility in currency interest rate balance. The Central Bank's policy on interest rates and arguments regarding its foreign currency reserves have caused major currency fluctuation and a significant increase in the country's credit default swap premium.

In 2020 the M&A market encountered a temporary setback due to the unexpected outbreak of the global COVID-19 pandemic. The number of transactions with a large deal size decreased, while small to mid-sized investments increased. The total transaction volume has not exceeded USD10 billion due to a lack of huge transactions such as privatisations or acquisitions in the banking or energy sectors. Due to some intensive development in the start-up environment, investments in growth-oriented companies have dramatically increased, and this investment model has reduced the total transaction volume in recent years. The total deal volume in 2020 was USD9 billion, with 304 deals. Given that the total deal volume in 2019 in Turkey was around USD5.3 billion through 233 transactions, a significant increase was observed. It is also worth noting that foreign investors' share in the total deal volume was less than that of local investors, for the first time in five years.

Please see **5.4 Restrictions on Upstream Security**, **5.5 Financial Assistance** and **6.2 Restrictions** for details on leveraged buyouts and related restrictions.

1.3 COVID-19 Considerations

The COVID-19 pandemic has had a disruptive effect on the Turkish economy, particularly those sectors related to tourism, accommodation, entertainment and transportation. The uncertainty in the market brought about by the measures and restrictions adopted by the government also caused some postponements and cancellations in acquisition and leveraged finance deals in the first half of 2020. Nevertheless, the second half started with a promising recovery in M&A deals and the financing of such transactions, thanks to the advantageous nature and developing character of the Turkish M&A market. Even though the impact of COVID-19 is likely to continue and to cause ongoing uncertainties in both the global and Turkish economies over the next year, investors are expected to seek opportunities in several sectors that are likely to show notable improvement in a pandemic environment, such as technology, remote access-oriented products and logistics.

The impact of COVID-19 and the measures and practices implemented by the government and official authorities have adversely affected borrowers, making it increasingly difficult for them to fully and timely meet their obligations under financing transactions. The parties have amended the provisions related to conditions precedent and conditions subsequent, and made several adjustments to the deadlines of certain transactions, particularly those conducted before the official authorities. The definition of "material adverse effect" has become one of the most negotiated points between the parties in order to avoid triggering default provisions. Furthermore, borrowers have found some room for negotiation on financial undertakings. In that sense, the parties have focused more on the calculation method adjustment, particularly those related to cash flow, net profit and EBIDTA. These changes and amendments in the financing agreements have generally been envisaged in a manner that will be effective throughout the pandemic.

2. DOCUMENTATION

2.1 Governing Law

Turkish lenders tend to designate Turkish law as the governing law under the loan documentation in domestic financing transactions; in cross -border financing featuring foreign lenders, the loan documentation is mainly governed by English law. In particular, the international financial institutions strictly request English law as the governing law due to their internal policies. However, even if the parties choose a foreign law to govern the loan documentation, Turkish law must govern security arrangements related to assets located in Turkey, in order to avoid any conflict of law issues (ie, to facilitate the enforcement process against the security provider).

The International Private and Procedural Law (IPPL) regulates the principles regarding the governing law of transaction documents, and applies if there is a foreign element in the respective transaction. A "foreign element" is not defined in the IPPL but, according to Turkish law doctrine, may exist where either party is non-Turkish or not resident in Turkey, where the transaction includes a cross-border service and sale of goods or international capital movement, or where the transaction falls within the scope of international commerce.

As a general rule, pursuant to the IPPL, the governing law is the law explicitly chosen by the parties. If a governing law is not explicitly stipulated, the implicit choice of governing law may be applied so long as such implicit choice can be understood from the provisions of the underlying agreement or the conditions of the transaction.

Having said this, the IPPL has the following two limitations to the application of foreign law.

- If the application of a provision of the applicable foreign law would clearly violate Turkish public order, then the relevant provision of the foreign law will not apply; if necessary, Turkish law will apply instead. It is worth noting that an intervention on the grounds of "Turkish public order" is of an exceptional nature and requires a case-by-case analysis.
- "Over-riding" mandatory provisions of Turkish law (eg, capital controls, customs and tax legislation, import and export regulations, zoning regulations, occupational health and safety regulations and environment regulations) are applicable to any situation falling within their scope, regardless of the foreign governing law.

There is no exhaustive list of the over-riding mandatory provisions of Turkish law and "over-riding mandatory provisions" are not defined by law. According to Turkish doctrine, these provisions may be defined as "provisions the respect for which is regarded as crucial by a country for safeguarding its public interests, such as its political, social or economic organisation." Over-riding mandatory provisions are only identifiable through the subject and purpose of the relevant provision.

2.2 Use of LMAs or Other Standard Loans

Until the early 2000s, the Turkish banking sector preferred to use general loan agreements for both corporate and consumer loans, regardless of the nature of the transaction, which mostly led to lender-friendly clauses compared to the LMA standards. With the intensive participation of foreign lenders in the Turkish loan market, parties started to use LMA standard loan documentation in Turkey, mainly in cross-border financing transactions. Even though Turkish lenders still use general loan agreements for various corporate loans provided to Turkish borrowers, they now mostly prefer LMA standards for domestic financing that requires complex financial mechanics and provisions, such as privatisations or acquisition finance deals.

It is worth noting that the LMA standard loan documentation used in the Turkish market differs from its original form as Turkish lenders tend to insert as many lender-friendly provisions as possible in the first drafts. Furthermore, in recent years, the Turkish local counsel have included Turkish law-oriented provisions in LMA standard loan agreements in an attempt to integrate English law concepts such as parallel debt or security agent mechanisms into Turkish legal practice. However, as this approach is very likely to disrupt the legal framework of the LMA standard and its mechanics, it is strongly advisable for parties to insert these kinds of provisions in a way that does not prejudice the Turkish law principles in order to avoid any possible claims regarding the invalidity of such before the Turkish courts.

2.3 Language

Turkish language requirements are regulated under Law No 805 on the Mandatory Use of Turkish in Commercial Enterprises (Law No 805). According to Article 1 of Law No 805, all Turkish enterprises are obliged to use the Turkish language in all their business transactions, agreements, correspondences, accounts and books that are executed in Turkey. Furthermore, Article 2 of Law No 805 provides that this obligation shall apply to foreign legal entities in transactions and communications made with Turkish individuals and legal entities in Turkey.

There are conflicting arguments in Turkish doctrine in terms of the interpretation and application of Article 1 to foreign legal entities. The main rationale behind this conflict is based on the wording of "agreement", which is indicated in Article 1 but not in Article 2. There is also a dispute among Turkish scholars regarding the impact on transactions of non-compliance with Law No 805 (ie, whether or not any failure to comply with Law No 805 results in the invalidity of the respective agreement). It is worth noting that there are also controversial decisions rendered by the Cassation Court on the application of Law No 805, and this prevents the uniform practice of this law on transactions between foreign and Turkish parties.

Despite the uncertainties regarding the application of Law No 805, in financing transactions with foreign entities whereby the foreign jurisdiction or foreign arbitration is chosen, even if the loan documentation would be executed in a foreign language, it is strongly advisable for the parties to execute the clause related to the submission to a jurisdiction/arbitration in the Turkish language and to ensure that the Turkish language for such clause is determined as prevailing language.

In addition, in order for the parties to submit the loan documentation to the Turkish courts as evidence, any documentation executed in a foreign language must be translated into Turkish and certified by a notary public or a General Consulate of Turkey.

2.4 Opinions

As a market practice, the lender-side counsel provides a legal opinion regarding the enforceability of the transaction documents and the capacity of the borrower (which may also include security providers) to execute the same, whereas the legal counsel representing the borrower is mainly required to issue a legal opinion only regarding the capacity of the respective parties. If there is a foreign element in the financing transaction (eg, a foreign sponsor or foreign law security), the lenders generally tend to obtain a legal opinion from outside counsel qualified in the jurisdiction where the sponsor is incorporated or where the asset subject to the security arrangement is located. Such legal opinions should specifically cover the enforceability aspects of the clauses related to submission to jurisdiction and governing law.

Apart from the general context of opinions, Turkish law opinions include the assumptions and qualifications that are generally standardised and agreed in global market practice. However, the Turkish law opinions may have several qualifications in connection with the concepts adopted from common law practice, such as parallel debt or one-sided provisions contrary to the general principles of Turkish law. As for the acquisition finance transactions, depending on the deal structure and type of security, Turkish law opinions may contain qualifications regarding the prohibition on financial assistance and the upstream security restrictions stipulated under the Turkish Commercial Code (please see **5.4 Restrictions on Upstream Security** and **5.5 Financial Assistance** for detailed explanations).

3. STRUCTURES

3.1 Senior Loans

Acquisition finance deals in Turkey contain various senior loan structures. Lenders typically provide a senior loan to the buyer for the financing of the respective acquisition. In many cases, the target company can also be a party to the same loan documentation as the borrower, whereby the lender extends a working capital loan to the target company, which is utilised on a revolving basis. Furthermore, the lending structure under the acquisition finance may be comprised of restructuring of target company's existing debts. The senior loan structure generally includes a loan-to-value ratio, which should be satisfied as of the date when the loan is utilised. In that sense, simultaneously with the utilisation, the buyer is required to inject the sufficient equity into the account designated by and pledged in favour of the lender.

3.2 Mezzanine/PIK Loans

It is not common in Turkey to finance M&A deals under a payment-in-kind (PIK) loan structure.

In recent years, financing transactions have rarely been structured with mezzanine loans. The mezzanine loan is generally bundled with senior loans and ranked as junior to the senior loans with respect to the payment distributions among lenders and the enforcement of securities. The terms and conditions of mezzanine loans, particularly the clauses related to prepayment events and events of default, typically comply with those envisaged under the senior loan.

3.3 Bridge Loans

Bridge loans have been structured to satisfy various requirements stipulated under M&A deals. The bridge loan may be provided for the refinancing of the target company's existing debts or for dividend distributions to shareholders before the closing. Lenders may also extend bridge loans in acquisition finance deals where the debt pushdown mechanism is set up.

3.4 Bonds/High-Yield Bonds

Please see **4.2 Bank/Bond Deals**.

3.5 Private Placements/Loan Notes

Please see **4.2 Bank/Bond Deals**.

3.6 Asset-Based Financing

Asset-based financing structures are commonly used in acquisition finance deals, and are mostly set up so the target company's assets are pledged in favour of the lenders (please see **5.4 Restrictions on Upstream Security**, **5.5 Financial Assistance** and **6.2 Restrictions** regarding LBO restrictions). In this structure, the borrowers are under an obligation to maintain the loan-to-value ratio determined by the lenders and to satisfy the financial obligations related to that ratio.

4. INTERCREDITOR AGREEMENTS

4.1 Typical Elements

In syndicated loans, it is very common for the intercreditor arrangements to be drafted in the loan agreement itself rather than as separate intercreditor agreements. The syndicated loan documentation mainly stipulates the role of lenders acting as agent in terms of administrative actions or security-related matters, and the rules for the appointment of such agents. The various mechanisms that regulate the decision-taking process, voting rules among the lenders and the distribution of proceeds are also included in the loan documentation. Turkish law comes into play for intercreditor arrangements related to loan acceleration and security enforcement. It is market standard that the acceleration and enforcement rights are linked to the majority lender decision; however, this arrangement would not go beyond the contractual claim. In other words, from a Turkish bankruptcy and enforcement law perspective, a lender will have a right to individually accelerate its participation and initiate enforcement proceedings against the borrower to foreclose the respective securities.

Intercreditor agreements in financing transactions also include subordination provisions that aim to prioritise the monies from the borrower to the lenders (please see **7.1 Equitable Subordination Rules**). Such subordination principles may also be applicable to the proceeds generated through the enforcement of securities. Under

Turkish law, the parties can determine the priority between the creditors under the several types of securities.

4.2 Bank/Bond Deals

It is not common in Turkey to finance acquisition deals with bond issuances; companies mainly resort to bond issuances in order to meet their general corporate expenditures.

4.3 Role of Hedge Counterparties

As a market practice, banking services agreements are envisaged as one of the finance documents under which the lenders may act as hedge counterparties and mostly have a right to offer hedging products to the borrowers accordingly. As the banking services agreements have a framework nature, Turkish lenders usually prefer to use separate ISDA master agreements to determine the specific terms and conditions of the respective hedging products. In cases where the lenders provide the hedging products to the borrower, the loan documentation is drafted in a way that such hedging arrangements are a part of the secured obligations and benefit from the security agreements accordingly. In that sense, the hedge counterparties' claims arising from the hedge products are pari passu to the claims of the lenders arising from the loan.

5. SECURITY

5.1 Types of Security Commonly Used

In Turkey, the following types of security are commonly used in acquisition financing:

- pledge over movables (including the commercial enterprise pledge);
- pledge over receivables (including account pledge);
- pledge over company shares;
- assignment of receivables;
- pledge over trade marks and licences; and
- mortgage.

In Turkish practice, the lenders may commercially require the borrower to provide a security package depending on the borrower's field of activity and asset portfolio, which may include all or some of the above-mentioned securities.

5.2 Form Requirements

A pledge over movables in accordance with the Movable Pledge Law (see **5.3 Registration Process**) and a pledge over a limited liability company's shares both require a notarised written pledge agreement.

In addition, to establish a pledge over trade marks, a notarised written pledge agreement is required to be executed and registered with the Trademark Registry.

To establish a mortgage over real properties, a written mortgage agreement is required to be executed before the Land Registry, which must also register the mortgage with the relevant title deed registry.

5.3 Registration Process

Pledge over Movables

In principle, according to the Turkish Civil Code, in order to create a pledge over a movable, physical possession of such movable must be transferred to the pledgee, unless otherwise stipulated by law. That said, the Law on Pledge over Movable Assets in Commercial Transactions (the Movable Pledge Law) introduces an exception to such principle for commercial transactions, and thus enables the pledgor to establish a pledge over its movable without transferring possession thereof.

The Movable Pledge Law aims to popularise the use of the movable pledge as collateral, to extend the scope of movables that may be pledged, to ensure public accessibility and transparency in movable pledges, and to facilitate easy access to financing by way of new alternatives in foreclosure of the pledged property. Contrary to the Law on Commercial Enterprise Pledge, the pledge may be established over one or more movable assets instead of the entire commercial enterprise.

Under the Movable Pledge Law, various movables may be pledged over the online system, including:

- receivables;
- intellectual and industrial property rights;
- raw materials;
- animals;
- any income and revenues;
- any licences or permits for which registration is not required;
- rental incomes;
- tenancy rights;
- trade names or business names; and
- other movables to be determined by the lawmaker authority.

Pursuant to the Movable Pledge Law, the Movable Pledge Registry was established as a new registry for the registration of the pledge agreement to establish a pledge over movables. Movable Pledge Registry transactions are made via an online system and registered by the notary public. If the pledged movable is also monitored through another public registry (eg, the traffic registry for vehicles), the Movable Pledge Registry will notify the establishment of the pledge to the relevant registries.

Pledge over Receivables

Under Article 954 of the Civil Code, a pledge can be established over assignable receivables subject to the agreement of the parties by entering into a written pledge agreement between a pledgor and a pledgee. The pledge over the deposit accounts is the most typical example, and the banks generally use such type of security to monitor the cash flow of the borrowers.

Pledge over Company Shares

The establishment of a pledge over a company's shares is different for limited liability partnerships and joint stock corporations, with the distinction deriving from the different nature of shares. In joint stock corporations, share certificates are qualified as negotiable instruments; in limited liability partnerships, share certificates (representing the initial share capital) are ordinary bills.

A pledge over the shares of a limited liability partnership must be established by a written agreement, and the parties' signatures must be notarised. In addition, the approval of the general assembly of partners must be obtained in a meeting of the general assembly of partners, if required by the articles of association of a limited liability partnership. Partners of a limited liability partnership can separately consent to the pledge without holding a meeting of general assembly of partners. The general assembly of partners cannot reject the pledge unless there is a just cause for doing so. If the general assembly of partners does not reject the application of the pledge's establishment within three months of the application, the pledge establishment will be deemed approved by the general assembly of partners. Although not legally required, it is advisable for the pledge to be registered with the shareholders' registry for evidentiary purposes.

Shares certificates of a joint stock corporation are negotiable instruments, and a written agreement is not required for the establishment of a pledge over negotiable instruments. Accordingly, a pledge over a joint stock corporation's shares can be established with the delivery of the share certificates to the pledgee if the share certificates are bearer share certificates, or with the endorsement of the share certificates to the pledgee and the delivery of the share certificates to the pledgee if the share certificates are registered share certificates. However, if the relevant company has not issued any share certificates to represent the shares, a written agreement will be required.

According to the majority opinion, the registration of a pledge over shares with the relevant shareholders' registry (the share ledger) is not a validity condition, but it is important to register such pledge with the relevant shareholders' registry (the share ledger) for evidentiary purposes. Registration of such pledge with the relevant shareholders' registry (the share ledger) will prevent third parties (including the company itself) claiming good faith in conducting any transaction regarding the pledged shares.

Assignment of Receivables

In accordance with Article 183 of the Turkish Code of Obligations, unless otherwise stipulated by law or agreed in written form, a creditor can assign its existing or future receivables to a third party without the debtor's consent, pursuant to a written agreement between the creditor (assignor) and the assignee.

The agreement for such assignment of receivables does not need to be registered or filed with any governmental authority as a perfection requirement. However, it is advisable for the assignment to be notified to the debtor, as otherwise the debtor paying the receivable to the assignor in good faith will be released from its payment obligation and the assignee will not be able to request payment.

Pledge over Trade Marks

In accordance with Article 148 of the Industrial Property Right Law, a registered trade mark can be pledged under the Movable Pledge Law. A pledge over a trade mark is registered with the Trademark Registry and publicly announced upon registration to the Movable Pledge Registry.

In the case of a pledge establishment according to the Movable Pledge Law, the Movable Pledge Registry shall inform the Trademark Registry ipso facto of the relevant pledge transaction.

Mortgage

Under Turkish law, a mortgage can be created over real estate property as security for any kind of receivable, whether present or future. The perfection of a mortgage requires a mortgage agreement to be entered into by and between the mortgagor and mortgagee before the Land Registry where the real estate property subject to the mortgage is located. The Land Registry must also register the mortgage itself, in the relevant title deed registry.

If additional construction is made after registration of the mortgage, the subsequently constructed buildings will become subject to the mortgage, automatically and without any amendment to the mortgage agreement or re-registration with the Land Registry. However, movable assets in the real estate property – other than those registered with the annotation column in the records of the Land Registry as an accessory – will not fall within the scope of the mortgage.

5.4 Restrictions on Upstream Security

The Turkish Commercial Code includes rules and principles regarding intra-group transactions, which are designed to prevent group companies from using their dominant position over other group companies. These provisions are mainly applicable to scenarios where a subsidiary provides an upstream security to its parent company or its affiliate company (eg, cross-guarantee/security).

Under Article 202 of the Turkish Commercial Code, the parent company cannot use its dominant position in a manner that would cause damages to the affiliated company. Accordingly, the affiliated company cannot be forced or directed to assume liabilities or debts, such as taking over a business or assets, a debt transfer, a transfer or reduction of profits, the creation of an encumbrance over its assets, the provision of surety and a guarantee or aval (guarantee of bills), unless the resulting loss is equalised and compensated within the relevant financial year or unless a right of claim in an equivalent value is granted to the affiliated company by the end of that operating year with a statement on when and how the loss will be equalised. Otherwise, the affiliated company's shareholders can claim compensation for the resulting damages and losses from the parent company and the members of the parent company's board of directors who caused the damages and losses. Furthermore, the affiliated company's creditors can request the affiliated company's damages and losses to be compensated.

Please see **5.5 Financial Assistance** regarding restrictions in terms of leveraged buyout transactions.

5.5 Financial Assistance

The financial assistance prohibition was introduced into EU law in 1976 in Article 23 of the Second Council Directive 77/91/EEC. In 2006, the European Commission amended the directive, loosening the tight financial assistance restriction on public companies. Under the amended Directive, public companies are now allowed to provide financial assistance, as long as it does not decimate the distributable reserves and as long as the transaction concerned fulfils certain pre-defined shareholder and creditor protection measures. Although the Commercial Code was actually discussed by sub-commissions of the Turkish Parliament and finalised after the Second Council Directive 77/91/EEC was amended, it unfortunately does not reflect the latest provisions and, instead, adopts the directive's provisions as they were prior to the amendment.

Article 23 is very similar to Article 380 of the Turkish Commercial Code, which prohibits financial assistance in buyout transactions. Article 380 prohibits a joint stock corporation from granting any advance payment, monetary loan or security to a third party for the purpose of that third party acquiring the company's shares, unless the transaction falls within the scope of activity of credit and financial institutions, or unless the advance payment, monetary loan or security is granted to the employees of the company or the employees of the company's affiliates, for the purpose of facilitating the acquisition of company shares by said employees.

Although there is a financial assistance prohibition under the Turkish Commercial Code, the Turkish banking sector is familiar with the concept of the leveraged buyout concept and has pursued this trend for a while. In other words, the prohibition – even if it is absolute – does not necessarily prevent parties from structuring a transaction as a leveraged buyout. Therefore, investors and lenders are prompted to establish new models that are designed to avoid any obstacles arising from such prohibition on financial assistance. In that sense, as the restrictions are only applicable to joint stock companies, the parties may use the conversion method to convert the target company to a limited liability company or to establish the target company as a limited liability company. However, this method may involve a time-consuming process due to the administrative burden of share transfer rules, and may cause additional tax liability. Alternatively, the parties often resort to an upstream-merger model to mitigate the risk arising from the prohibition. In this model, the target company is merged with its holding company following the respective acquisition, but this may also bring possible claims as to whether a post-acquisition merger would be invalid due to evasion of law.

5.6 Other Restrictions

Treasury Notification

Under Decree No 32 on Protection of the Value of Turkish Currency, companies and/or individuals that are resident in Turkey must notify the Ministry of Treasury and Finance regarding the guarantees and/or sureties that will be granted in favour of foreign beneficiaries within 30 days of the execution date of such guarantee and/or surety. Although this requirement may not be considered a restriction under Turkish Law, it is worth noting that there is still a notification burden regarding such securities, which are commonly used in acquisition finance deals for statistical purposes.

Material Transactions of Public Companies

The Capital Markets Law classifies a variety of transactions of public companies as "material transactions" and provides additional rules to govern their mechanics, which are further elaborated on by the Communiqué on Common Provisions relating to Material Transactions and Exit Rights (II.23.3). Among others, mergers, demergers, conversions, transfers of all or a material portion of assets, granting privileges, amending the scope of existing privileges and delisting are considered as "material transactions" for public companies. The pledges and/or mortgages can be an example of such privileges in the first place.

In a material transaction, the board of a public company must resolve on such material transaction and the general assembly of shareholders must also approve such resolution. Shareholders dissenting from the general assembly resolution pertaining to the material transaction have an exit right by selling their shares to the company itself. Furthermore, upon the occurrence of certain material transactions detailed under the respective communiqué, the board resolution would suffice without the approval of the general assembly of shareholders. For instance, if the company obtains financial benefits in return for granting security (eg, mortgage or pledge), such material transaction can be realised with the consent of the Capital Markets Board (CMB) without the need of the general assembly resolution.

5.7 General Principles of Enforcement

Judicial Enforcement

Foreclosure of security interests can be implemented through a judicial enforcement procedure in accordance with the Execution and Bankruptcy Law. The general enforcement procedure is initiated by a written request of the secured party to the relevant execution office. With this written request, the relevant enforcement officer serves a payment order to the obligor. The secured party can request the sale of such security through public auction if the obligor does not object to such payment order within the period prescribed under the Execution and Bankruptcy Law. Otherwise, the secured party can file a lawsuit against the objecting party before the competent court; if the judgment is in favour of the secured party, said party will be able to proceed with the sale of the security through a public auction.

The similar procedure steps are followed by the secured party regarding the receivables based on negotiable instruments such as promissory notes, bills of exchange and cheques. The only difference would be that the periods prescribed under the Execution and Bankruptcy Law regarding such enforcement procedure are shorter than the ordinary enforcement procedures detailed above.

Private Foreclosure

Although it is not stipulated in Turkish law, according to Turkish scholars, the pledgee and pledgor can agree on the private sale of pledged movable assets by the pledgee. The enforcement of a mortgage over real estate property can only be accomplished via a public auction; no private sale arrangements can apply. According to scholars, the pledgee must be given authority to enforce the pledge via a private sale only after the debt becomes due.

The advantage of a private sale is that it may provide a quicker and simpler means of enforcing the pledge than a public sale. There are no procedures/steps envisaged under Turkish law (ie, the appointment of a receiver, etc) in relation to the mechanics of a private sale process. As such, the terms and conditions of the private sale process should be agreed upon between the parties.

In addition, it is widely accepted that the pledgee must use this right in good faith. Accordingly, the pledgee must:

- enter into a commercially reasonable transaction;
- sell the asset as soon as possible, particularly if the asset's value may be decreasing; and
- sell the asset at a fair market value.

If the pledgee does not act in good faith, it may be required to compensate the owner's damages arising from the private sale.

Some scholars opine that, in a private sale, the pledged asset must be sold to third parties. The requirement to sell the movables to a third party arises from the principle of lex commissaria. Under Article 949 of the Civil Code, any agreement between the pledgor and the pledgee allowing the pledgee to become the owner of the pledged asset is null and void. An undertaking by the pledgor to transfer the movables to the pledgee via a private sale or an out-of-court settlement will be caught by the principle of lex commissaria and therefore be null and void. Similarly, if, in the event of the pledgor's default, the pledgee exercises its right to a private sale and purchases the movables itself rather than selling them to a third party, this sale will also be caught by the lex commissaria principle and be null and void. However, if the opinion that "the pledgee must be given the authority to enforce the pledge via private sale only after the debt becomes due" is accepted and the pledgee will be given the right to enforce the pledge via private sale after the debt becomes due, the principal of lex commissaria will not apply and the pledgee will not be required to sell the pledged asset to third parties.

6. GUARANTEES

6.1 Types of Guarantees

Guarantee agreements are not specifically governed under Turkish law. Turkish scholars often interpret the guarantee agreement within the scope of "guarantee of performance by third party" under the Turkish Code of Obligations. A third party can personally guarantee the obligations of a debtor as a surety/guarantor or secure the obligations of a debtor by granting collateral. Turkish law provides for the following two types of guarantee obligations.

- Surety – unless otherwise agreed, the obligation of a surety is secondary to the underlying obligation. Accordingly, the beneficiary must exhaust its remedies against the principal debtor before pursuing the surety. If, however, the surety agrees to be "jointly and severally" liable with the debtor, the beneficiary can pursue such surety before pursuing the principal debtor, provided that the debtor is in default in the performance of its obligations

and disregards the creditor's warning for the performance, or is clearly insolvent.
- Guarantee – on the other hand, a guarantee is a separate and independent obligation from the underlying obligation. The beneficiary can pursue the guarantor to pay the debt as soon as the underlying obligation becomes due. In addition, the receivables arising from the guarantee agreement, similar to the bank letter of guarantee, must be paid upon the lender's first request, without the need for any further review.

Lenders tend to request a guarantee as security instead of a surety, as a guarantee agreement imposes a primary obligation on the guarantor independent from the validity of the underlying obligation and a surety can raise its own defences against the lender, such as lack of a qualified form requirement, or the invalidity of the underlying agreement or statute of limitations related to the underlying agreement. The guarantee agreement provides stronger protection to lenders.

6.2 Restrictions

Please see **5.4 Restrictions on Upstream Security** and **5.5 Financial Assistance**.

6.3 Requirement for Guarantee Fees

As the guarantee agreements are not explicitly governed by Turkish law (see **6.1 Types of Guarantees**), there is no requirement regarding guarantee fees. In addition, as it is not customary or common practice to pay a guarantee fee to a guarantor in Turkey, the guarantee agreements do not include such provision.

On a separate note, banks or financial institutions may charge commissions/fees for the issuance of letters of guarantee within the scope of non-cash loans.

7. LENDER LIABILITY

7.1 Equitable Subordination Rules

General Rules on Priority of Claims

Under Turkish law, the general rule is that creditors secured with pledges over the debtor's assets have priority in the distribution of proceeds to be generated through the sale of those pledged assets. First, the secured creditors are satisfied, then the unsecured creditors are satisfied, after the public receivables including the taxes and the sale costs regarding the pledged assets are paid. The unsecured creditors' claims are ranked as follows:

- employment receivables;
- receivables related to family law;
- privileged creditors' receivables governed under the relevant laws (eg, receivables of the Central Bank of the Republic of Turkey and receivables of the Social Security Institution of the Republic of Turkey); and
- other unsecured creditors' receivables.

Ranking System

As for pledges over immovables, the ranking system adopted under Turkish law provides a priority ranking to mortgagees holding a mortgage with a preceding degree over other mortgagees in subsequent rankings. The degrees of mortgages on real property separately secure the obligations for which they are created up to the mortgage amount in each degree. The degree determines the order of distribution of the foreclosure proceeds.

In this respect, the first-degree mortgagee will have priority to receive the proceeds of the mortgaged real estate property in an amount equal to the security amount registered under such degree for that particular mortgagee. If there is a remaining surplus, mortgagees that have established mortgages in the following degrees will be entitled to a payment in accordance with the ranking of their degrees. Therefore, mortgages registered in different degrees will not be treated as pari passu.

A mortgagor and a mortgagee may execute agreements whereby the mortgagee may move up to prior ranking degrees if they become vacant. This is called the "Free Degree System". Agreements granting the mortgagee the right to benefit from the Free Degree System do not confer rights in rem upon the mortgagees unless they are annotated to the Real Estate Registry.

As for pledges over movables, the priority regime was changed by the Law on Pledges over Movable Assets in Commercial Transactions, which has been effective since 1 January 2017. Previously, creditors' rights were ranked in accordance with the date they established the pledge. Now, the security provided by the pledge will be limited to the amount and the pledge's degree as registered with the relevant registry. The date of establishment is considered by determining the priority only if the parties did not agree on the pledge's degree.

Please also see **5.7 General Principles of Enforcement**.

Subordination Agreements
Subordination agreements are commonly used in Turkish practice. However, apart from the exceptions stipulated under additional Tier 1 and Tier 2 regulations in banking regulations and specific scenarios in bankruptcy proceedings, Turkish law does not govern contractual subordination in principle. Contractual arrangements that are agreed by the respective parties before the initiation of an execution or bankruptcy proceeding against the debtor may not be enforceable against the public authorities. Under Turkish law, the priority of claims is determined by the Execution and Bankruptcy Law without taking any subordination agreement into consideration. Therefore, a subordination agreement only creates a contractual obligation and is binding on the creditors that are party to the agreement.

In addition, the Turkish Commercial Code stipulates contractual subordination principles to be exercised during the bankruptcy proceeding against the debtor. Pursuant to Article 376/3 of the Turkish Commercial Code, in a bankruptcy proceeding the competent court may recognise the subordination agreement between the creditor(s) and the debtor whereby the respective creditor(s) accept in writing to sort their receivables in the order after all other creditors.

7.2 Claw-Back Risk
Under the Execution and Bankruptcy Law, during and after the debt collection and liquidation processes, any transactions completed by the bankrupt prior to its bankruptcy (particularly those within the hardening period) can be challenged through a lawsuit for the "cancellation of disposition".

Each creditor that could not collect its receivable(s) from the debtor's assets may file a cancellation of disposition lawsuit, under which an asset or right subject to disposition cannot be transferred back to the debtor's assets, and the creditor will be authorised to collect its receivable(s) by way of initiating an execution proceeding over such asset or right.

Three types of transactions can be cancelled:

- transactions made at undervalue;
- inappropriate transactions; and
- transactions that constitute intentional creditor defraud.

Undervalue Transactions
Transactions under which consideration is materially less than the relevant market price may be cancelled by a court if they were entered into

within two years prior to the commencement of the bankruptcy.

Inappropriate Transactions

The following transactions are considered inappropriate and may thus be cancelled if they were entered into within one year prior to bankruptcy:

- the provision of security by the debtor for previously secured debts;
- any benefits granted by the debtor other than those granted in cash or other usual means of payment;
- any repayment of debt that is not yet due; and
- transfers and registrations in relation to the title deed register strengthening the other party's contractual position.

However, transactions where the party benefiting from the transaction is able to prove that it acted in good faith regarding the debtor's financial condition when entering into the transaction may not be subject to the cancellation of disposition.

Creditor Defraud

Transfers made by the debtor intentionally against the creditors' interests may also be subject to cancellation if they are made within five years before the bankruptcy request was filed. To have such transfers cancelled by a court, the claimant must prove that the transferee knew or should have known the debtor's financial condition when entering into the transaction, and also knew or should have known that the debtor acted in violation of the principle of good faith.

According to the above, pledge agreements/mortgages and the assignment of receivables agreements that are considered as disposal transactions by nature may face a claw-back claim. In cases where the above-mentioned conditions are met, the creditors would have the right to initiate a lawsuit for the cancellation of disposition against the respective security arrangements.

8. TAX ISSUES

8.1 Stamp Taxes

Under the Stamp Tax Law (the STL), any agreements, undertakings and assignment-related documents with a monetary commitment will be subject to stamp tax at 0.948% of the amount indicated under such agreement. However, Table 2/IV/23 of the STL regulates an exception to this rule, wherein "any documentation regarding the facility by banks, foreign lending institutions and international institutions of loans, the securities related to the same and any documents related to the repayment of such loans, documents related to the assignment of credit receivables and records to be inserted on such documents (excluding utilisations)" will benefit from the stamp tax exemption.

Under this exemption, no stamp tax will apply to documents in connection with the facility, security, extension or repayment, provided that the loan is facilitated by a bank, a foreign lending institution or an international institution. Any loans facilitated by another person or an entity will still be subject to stamp tax at the above rate over the higher amount mentioned in the relevant document.

In addition, the amount of stamp tax that can be accrued per document is capped at TRY3,534,679.90 for 2021.

8.2 Withholding Tax/Qualifying Lender Concepts

In Turkey, resident companies (ie, a company whose legal seat or place of management is in Turkey) are subject to corporate tax on their worldwide income, while non-resident companies are subject to corporate tax on their Turkey-based income.

Under Article 30 of the Corporate Tax Law, certain payments (including interest payments deriving from receivables and earnings from bonds) to be made to a foreign company that is established in a country listed by the President are subject to withholding tax, amounting to 30%. The President is entitled to reduce such tax rate to zero and/or increase it up to 30%. However, as the President has not yet published such country list, there is uncertainty regarding this matter.

Withholding tax is not applicable to interest payments on loans obtained from banks, international institutions and financial corporations, but is applicable at a rate of 10% to interest payments on loans obtained from non-financial corporations.

8.3 Thin-Capitalisation Rules

Thin-capitalisation rules are only applicable to related party transactions. If the debt financing obtained from shareholders or related parties of the shareholders (ie, a corporation in which the shareholder owns, directly or indirectly, more than 10% of the shares, voting rights or rights to receive dividends, or a corporation or individual that owns, directly or indirectly, at least 10% of the capital, voting rights or rights to receive dividends of the shareholder or an affiliated corporation of a shareholder) exceeds three times the shareholders' equity in the borrower company, the relevant debt will be considered as thin capital, and the following thin-capitalisation rules will apply:

- financing expenses such as interest accruals and foreign exchange costs corresponding to the exceeding portion of the acquisition financing cannot be deducted for corporate tax purposes; and
- interest paid or accrued on the thin capital will be deemed dividends received by the lender and will be subject to withholding tax.

9. TAKEOVER FINANCE

9.1 Regulated Targets

M&A transactions in regulated sectors (eg, banking, insurance, energy and telecommunications) are subject to the regulations and supervision of independent regulatory authorities. Any changes in the shareholding structure (generally limited to the shareholding percentage specified in the relevant regulation) or change of control in the company requires the prior approval of the relevant regulatory authority.

As for the financing of banks, the Banking Law of Turkey envisages contains provisions regarding credit limits and defines the types of risk groups (eg, risk group of executives, state-owned banks or public organisations). According to the Banking Law of Turkey, the total loan amount to be provided by banks to any person or specific risk group will not exceed 25% of the bank's total shareholder equity.

9.2 Listed Targets

The Turkish capital markets law contains specific rules and requirements for the acquisition of listed company shares. The respective communiqué states that if a person or group of persons acting in concert, directly or indirectly, acquires shares granting management control over a public company, such person or persons must make a tender offer to the other shareholders for the target company's remaining shares under the terms and conditions approved by the CMB.

In that sense, a mandatory tender offer is triggered by the "acquisition of management control", which is defined as the acquisition (whether single-handedly – directly or indirectly – or together with another person acting in concert) of shares corresponding to at least 50% of the voting rights or, irrespective of share percentage, the acquisition of privileged shares enabling the holder to appoint or nominate the majority of the board of directors. Furthermore, the CMB may hold a bank exempt from making a mandatory tender offer for shares that have been previously pledged to said bank as a security.

In addition to mandatory tender offers, the same communiqué also regulates the voluntary tender offer process. A voluntary tender offer can be conducted for the acquisition of all or part of a public company's shares. However, if a partial voluntary tender offer results in the acquisition of "management control" over the target, the offeror must make a mandatory tender offer for the target's remaining shares.

In public companies, the respective communiqué also regulates the squeeze-out of minority shareholders by the majority shareholder, as well as the minority shareholders' exit right by selling their shares to the majority shareholder. If the total voting percentage of a shareholder or group of shareholders acting jointly reaches or exceeds 98%, such shareholder or group of shareholders is considered the "controlling shareholder". The controlling shareholder can reach the threshold by way of different methods, such as a tender offer, merger, capital increase or otherwise. When the controlling shareholder reaches this threshold, minority shareholders can exercise their exit right and force the controlling shareholder to purchase their shares. The minority shareholders must apply to the company within three months of the public disclosure stating that the controlling shareholder has reached or exceeded the mentioned threshold. If the minority shareholders fail to apply to the company within such period, their exit right is terminated, and the controlling shareholder can exercise the squeeze-out right and force minority shareholders to exit the company by applying to the company within three business days after the end of the three-month period.

10. JURISDICTION-SPECIFIC FEATURES

10.1 Other Acquisition Finance Issues

The Turkish capital movement regulations stipulate several restrictions for the utilisation of loans denominated in currency other than Turkish lira. Turkish individuals are prohibited from obtaining foreign currency loans or loans indexed to foreign currency from banks and financial institutions, while Turkish legal entities that generate foreign currency income can freely borrow foreign currency loans from banks and financial institutions. However, these entities are also required to have a loan balance of at least USD15 million on the date of utilisation; if not, the entire loan to be utilised and the outstanding loan balance cannot exceed the borrower's foreign currency income of the past three years.

As a general principle, Turkish legal entities that do not generate foreign currency income are prohibited from borrowing foreign currency loans from banks and financial institutions. This prohibition will not be applicable in certain cases – for example, if the borrower is a bank, a public authority or a financial institution, or if the borrower has the loan balance of at least USD15 million on the date of utilisation, or, most notably, if the borrower is a Turkish special purpose vehicle that is incorporated solely to purchase the shares of a company. The form of the special purpose vehicles (ie, whether these companies should be incorporated as holding companies) is yet to be clarified.

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Kolcuoğlu Demirkan Koçaklı Attorneys at Law is a full-service law firm offering a wide range of legal services to local and international companies, institutions and individuals in various sectors. It has approximately 60 fee earners in Istanbul and Izmir, and advises clients in connection with all Turkish law matters. KDK offers expert legal services on banking and finance transactions. The highly experienced team has played a vital role in a significant number of finance transactions, ranging from cross-border secured lending and portfolio restructuring to regulatory compliance. The KDK team provides legal advice on facility and security agreements, project finance and Islamic finance transactions, foreign exchange issues, LMA standards and ECA-backed loans. In numerous financial transactions involving major financial institutions, KDK has advised both local and foreign investors, borrowers and lenders, as well as fintech companies operating in banking, e-money and payment services, regarding critical aspects of Turkish law.

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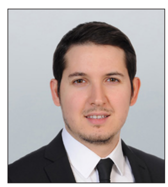

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