Overview of restructuring transactions under Turkish law

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THIS HAS BEEN A YEAR of adaptation and reaction. The world is trying to grasp the "new normal" emerging out of the COVID-19 pandemic. The new normal has brought numerous challenges to almost all sectors, which has caused fluctuations, stagnant markets and ambiguity. In order to adapt, some businesses have been required to take drastic measures, such as downsizing or moving to online stores, while others are seeking relief in structural changes. In this article, we will review the go-to options for restructuring under Turkish law, namely, mergers and demergers.

A merger is a process in which two companies come together under one entity, where one company transfers its assets and liabilities to the other and is liquidated. The Turkish Commercial Code provides three merger options: standard merger, rescue merger and short-form merger. In a standard merger, various steps must be taken to protect creditors' and the minority shareholders' rights (e.g., preparing a merger report and obtaining the general assembly's approval), which take considerable time. Given the urgency of actions to be taken in this hectic period, in this article, we will only focus on the rescue merger and short-form merger options.

A rescue merger is only available to companies that are in financial distress, in other words, those that are in "technical bankruptcy" or "financial indebtedness." Normally, if certain percentages of the share capital and legal reserves of a company have eroded, it is required to take various measures, depending on the severity. That being said, in a rescue merger, it is possible to rescue a company that is in financial distress from bankruptcy or liquidation by merging it with another, financially stable company that has sufficient disposable equity to recover the distressed company's losses.

This method is often preferred by group companies to save the affiliates that are going through a distressed period to protect the group's credibility, or by strategic investors who acquire a financially distressed company with valuable assets or portfolio by merging it with their other investments. Although there are many upsides to this, the status of the financially stable company's creditors may become a point of concern, as that company will lose a portion of its equity during the merger.

Another merger method is a "short-form merger." If merging companies are non-public and affiliated, they may proceed with a short-form merger, which is faster and more cost-efficient when compared to a regular merger. If one company owns all of the shares of the other company, or they are fully controlled by the same entity (sister companies), they may skip some of the steps foreseen in a standard merger (e.g., capital increase, preparing a merger report). If one company owns 90% of the other's shares, they may still proceed with a short-form merger, but need to fulfill some additional procedures, and may be required to pay a squeeze out fee to the minority shareholders.

The final restructuring method that we will review is called a demerger in which all, or a portion, of a company's assets are transferred to other another company or companies in exchange for shareholding rights. A demerger may be made in full, by dividing a company into at least two companies by liquidating the demerging company, or as a partial demerger, by dividing a portion of a company's assets among other companies, whereby the demerging company continues its business activities. For example, a distressed business line may be removed from the main business by conducting a partial demerger to ensure that the main business does not suffer from the distressed business line.

It is possible to configure the demerger structure in various ways: the demerging company or its shareholders can acquire the shareholding rights in the other companies. With this flexibility and tax-related advantages, a demerger is always a popular option in restructurings. However, this is a rather long process, and can be particularly cumbersome and costly due to the requirement to provide securities to the creditors.

In some cases, if the distressed company is a member of a group, the short-form merger may be preferred as a faster solution, or the rescue merger may be a better option if there are financially stable companies in the group. For other cases where the goal is to divide the assets and liabilities, or to construct a more flexible structure, a demerger may be the most feasible option. In any event, participation of all of the shareholders, the creditors' status, as well as tax-related aspects carry great importance while determining a restructuring method. Each method has unique strengths, requirements, and consequences, and a company must consider all aspects when choosing the most suitable method to achieve a successful restructuring.