

A lively market

Despite stormy conditions worldwide, Turkish M&A continues to experience smooth sailing. Zeynep Ergun Özeren and Oya Ugur of YükselKarkınKüçük look to the future

In recent years, Turkey has undergone a series of serious social, economic, and institutional transformations with the clear political objective of EU membership. The definitive prospect of EU membership should make Turkey attractive for foreign direct investment (FDI), because among its other strengths it has a highly skilled and adaptable labour force, a large domestic market, and geographic proximity both to Europe and to the Middle East, northern Africa, and Central Asia markets. Despite negative conditions such as the crises in the global financial market in the second half of 2007, the Turkish economy proved that it is now more resilient to internal and external shockwaves. The January 2008 report published by Deloitte Turkey points to another busy year. In 2007 the total volume of M&A activity reached \$20 billion through 162 deals.

According to that report, since mid-2007 the political arena in Turkey has settled down following the renewal of the government's mandate in the general elections and the appointment of the new president. On the other hand the US sub-prime mortgage crisis and credit crunch

have adversely affected the global financial markets. Thanks to its high growth potential, Turkey withstood the effects of the global financial turbulence in the second half of 2007 and remained a hot spot for investment. Out of 162 transactions in 2007 121 had a disclosed deal value, amounting to \$19.3 billion. Considering the anticipated value of deals with undisclosed values, the total M&A volume exceeded \$20 billion in 2007.

In brief

The legislation applicable to the M&A deals comprises different codes and different fields of law. Basically, the Turkish Commercial Code (TCC) and Turkish Code of Obligations cover the rules applicable to companies. However practitioners should also look to the legislation on tax law, competition law, capital markets law, bank law and foreign direct investments law, where necessary.

M&A deals are more commonly structured through the acquisition of a significant portion or all of the operational assets of a company, the acquisition of a significant portion or all shares of a company, or subscription for shares to be issued as a result of capital increase. M&A deals usually take between three and 12 months with the pre-negotiation, negotiation and closing stages.

Mergers

According to the general provisions of the TCC, merger is only possible between companies of the same kind. For completion of a merger, companies need to resolve the contemplated merger in line with the procedures and provisions for amendment of their Articles of Association. Under Turkish law mergers are based on the principle of general succession (subrogation) in which the assets and liabilities of the predecessor are assumed by the successor in its entirety. Therefore, the acquiring company assumes all the assets, rights, obligations and liabilities of the target company upon completion of merger

procedures.

Mergers may occur in two ways under Turkish law.

- By way of acquisition (an acquiring company takeover a target company).
- By way of establishment of a new company (two or more companies merge to form a new company). It is noted that most cross-border M&A transactions in Turkey are being formed as acquisitions rather than mergers.

Acquisitions

Acquisitions in Turkey are mostly structured through contractual means – acquisition agreements for share, business and asset transfers or tender offers. In contract law practice, representations and warranties in share or asset-purchase agreements are among the most critical and highly negotiated sections.

It is also widespread practice for foreign investors in Turkey to buy controlling shareholdings of entities jointly with a local partner. The aim of such joint acquisitions could be investigation of the business environment before entering into bigger investments or receiving support from a local partner. In either case, the joint venture agreement provisions need to be negotiated carefully, including conditions for termination options, joint approval matters, share transfer restrictions, deadlock and penalty provisions. The key step after joint venture agreements is incorporating the provisions into the target company's Articles of Association as far as is legally possible.

As to the asset transfers, investors may assume that asset-transfer transactions mean acquisitions of assets merely, as a whole or in part, but not liabilities of a target company. It is necessary to state that pursuant to the Turkish Code of Obligations, a legal person who acquires assets of a target company will be liable for debts of the transferred assets jointly with the transferor. The transferor's liability in that case is for a term of two years following the announcement of the asset transfer. Following this two-year term, the liability of the transferee will continue during the statute of limitations; the transferor will not bear liabilities after two years. In addition, if debtors transfer all or substantial portions of their assets with the aim of harming their creditors, it is considered that the transferees know the purpose of this transfer. Therefore such transactions may be cancelled provided that the conditions stipulated by the Code of Execution and Bankruptcy are realised.

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The practice of M&A

By working together with international lawyers in large M&A deals, Turkish lawyers have gained considerable experience. Turkish lawyers advise on every stage of M&A deals.

First stage: due diligence

In the first phase, the parties set out their intentions with respect to the transaction in the form of a letter of intent or a memorandum of understanding. These documents do not oblige the parties to conclude an agreement in future. However the parties may bear obligations. Therefore the parties must diligently observe all clauses of the letter of intent or memorandum of understanding. In practice, the documents must observe and stipulate confidentiality issues, duration, governing law and jurisdiction clauses.

Upon the signing of the memorandum of understanding, the party wishing to acquire the assets or shares of the other party conducts legal, financial and operational due diligence to find out and assess the actual and potential risks of the target company, as far as is possible. The legal due diligence comprises an examination of the corporate structure of the company, its licences and permits, material contracts, credit and facility agreements, properties and employees. The limit and extent of the examination depends on the company's scope of activity. The due diligence reports play significant role in conclusion of the share purchase agreement and in determination of the representations and warranties of the parties.

Recently electronic data rooms that ease access to information on a timely and organised basis where there is more than one prospective purchaser have gained acceptance in Turkish M&A auctions. Electronic due diligence is particularly useful when vast amounts of information are available on different platforms and in different locations.

Second stage: negotiations

The transfer of shares that gives the authority to control the target company is effectuated by a share purchase agreement. Conditions precedent are commonly foreseen in such agreements. The parties may freely determine conditions precedent. Transfer of shares and payment of the purchase price obligations are due if the parties fulfil the conditions precedent. Upon the satisfaction of the conditions, the parties perform their respective obligations arising from the contract at the closing date.

Representations and warranties of the transferor should be drafted with diligence

Author biographies



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Zeynep Ergun Özeren is a partner in YükselKarkinKüçük Law Firm. She has extensive experience in the areas of mergers and acquisitions and competition law matters in a leading law firm. She has also worked as in-house counsel at a leading cement company and as a specialist in EU affairs and competition law at Sabancı Holding.

Özeren received her LLM degree in EU law from the Université Libre de Bruxelles Institute d'Etudes Européennes in 1996 and a Law Diploma from Ankara University School of Law in 1993. She is a recipient of the Jean Monnet Scholarship and was a trainee at the Directorate General of Taxation and Customs Union of EU. She speaks fluent English and French.



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as they define the target company and the transferor's liabilities. Therefore all representations and warranties should be accurate and reasonable. In share purchase agreements the parties may agree on a contractual penalty, which is the payment of a certain amount of money if the transferor breaches its representations and warranties or fails to fulfil (or inadequately fulfil) its obligations. In some cases, call or put options are stipulated in the share purchase agreements. Such options also aim to compensate for damage to the transferee due to a transferor's breach of its obligations.

Beside the share purchase agreement, the shareholders conclude a shareholders' agreement to define their obligations vis-à-vis each other. The shareholders' agreement is binding only on the shareholders. In practice, the shareholders' agreement

comprises parallel provisions with the company's Articles of Association. The Articles of Association is the constitutional document of a company governing the company's activities and the shareholders' obligations towards it. It is binding on the shareholders and on the company. Moreover, the Articles of Association is a public document, which is published at the trade registry gazette. Therefore it would not be possible to insert the parties' trade secrets into the Articles of Association. Nevertheless, it is advisable that the parties stipulate the same provisions in the Articles of Association as in the shareholders' agreement to the extent possible, such as deadlock, share transfer restrictions, and put and call options. We observe that increasingly the parties insert such clauses into the Articles of Association. Furthermore the parties may agree that a

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shareholders' agreement with a foreign element is governed by the laws of a foreign state, or that disputes arising from such an agreement are settled by arbitration instead of courts, whereas the Articles of Association of a company are governed by Turkish law. Commonly Turkish commercial courts have the jurisdiction to hear the cases in relation to the articles of association. Therefore inclusion of certain clauses such as governing law and jurisdiction should be diligently observed.

Teamwork

Exchange of ideas and close collaboration among the legal, financial and technical teams of a project provide benefits in evaluation of critical issues in the earlier stages of a due diligence exercise. In most cases, the acquiring company and/or its consultants organise the conveyance of information between all the parties in the preliminary meeting. Following this initial meeting, which integrates and motivates the teams, weekly process meetings assist team members in their specific aims, and help avoid wasting time on insignificant matters. It is possible to state that success in M&A comes from the method and execution of integrated planning. Communication is critical throughout the process in achieving an optimal level of due diligence.

Last stage: closing

After the fulfilment of the conditions precedent determined in the share purchase agreement, the seller transfers the shares or assets to the transferee in consideration of the purchase price of the shares or assets. Regarding joint stock companies, the shares certificates or temporary share certificates (if any) should be physically transferred to the transferee. Therefore it is recommended that the share certificates or the temporary share certificates be issued before the closing date. If the company has not issued such certificates, the share transfer deed should be executed separately from the share purchase agreement. Furthermore, the transferee should determine the nominee shareholders in order to fulfil the minimum number of shareholder required by the Turkish Commercial Code. Determination of nominee shareholders is an important issue and should be diligently assessed by foreign investors because of tax saving possibilities. The new Board of Directors representing the new shareholders and the new auditors will also be appointed on the closing date. It should also be noted that stamp tax is accrued for each signed version of the agreement. The stamp tax applicable to the transactions is 0.75% of the amount stated in the contract. Nevertheless, it is possible to foresee tax minimising provisions in the contract.

Turkey and the EU

M&A transactions cannot be legally valid until obtaining the permission of the Competition Board if the parties' turnover in a relevant product market exceeds TL25 million (\$19 million) or, even if this threshold is not exceeded, the total market share of the parties in a relevant product market exceeds 25% of the market share.

Under the current competition legislation, the Board needs to be notified preferably one month before the closing of M&A deal, as the Board must to issue an opinion within one month. However, it should be noted that the one-month review period may be disrupted by the Board's request of additional information or documents regarding the parties or the transaction, as stopping the clock is at the sole discretion of the Board. Only a fully completed and attentively drafted notification form should be submitted to the Board since a short form notification does not find an application under Turkish law, in contrast with EU law.

2007 M&A

The banking and finance sector was the most active sector in 2007, with 32 transactions having an approximate total volume of \$6.5 billion. The largest acquisition of 2007 was ING's acquisition of Oyakbank's 100% shares for a value of

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“We will see an increasing number of deals in the energy sector in coming years”

\$2.673 billion. Another noteworthy transaction was the sale of 60% shares of Türkiye Finans Katılım Bankası to National Commercial Bank of Saudi Arabia for \$1.08 billion.

In media, Turkuaz, fully-owned by unlisted energy-to-finance conglomerate Çalık Group, purchased ATV-Sabah, Turkey's second largest media company, for the minimum of \$1.1 billion after the other bidders dropped out of the auction process.

In energy, remarkable acquisitions occurred, such as the acquisition of 50% of shares of Enerjisa by Verbund, the acquisition of Birle_ik Oksijen Sanayi by Linde Group, and the sale of 39.9% shares of Bursagaz to the German EWE. Moreover, there were a significant number of deals involving target companies that have electricity and natural gas distribution licences. We will see an increasing number of deals in the energy sector in coming years.

In logistics and transportation, Limak Group made the highest bid of €1.932 billion (\$3.075 billion) for the operation of Istanbul Sabiha Gökçen Airport for a 20-year period. Furthermore, Kohlberg Kravis Roberts purchased 97.6% shares of UN Ro-Ro for \$1.251 billion. The acquisition of UN Ro-Ro in 2007 represented the

largest ever private equity deal in Turkey. In the early weeks of 2008, BC Partners have agreed to acquire 50.8% of Turkish supermarket chain Migros from Koç Group, the largest company in Turkey, for TL21.85 (\$16) a share, representing a market capitalisation of about \$3.25 billion.

As for privatisations, in petrochemicals, a consortium comprising Azerbaijani oil company Socar, Turkey's Turcas Enerji and Saudi-based Injaz Projects made the second highest bid of \$2.04 billion for a 51% stake in Petkim, Turkey's largest petrochemical company and only cracker operator. The consortium acquired the required approvals from the relevant authorities. However the courts have suspended the transaction. The case is still pending. In infrastructure, the Global-Hutchison-EIB consortium made a bid of \$1.275 in the privatisation of Izmir Alsancak port.

In 2007, Turkish investors were also party to considerable deals in the global markets. Çalık Group acquired 76% of shares in Altelecom, the state-owned fixed-line communication company of Albania, for €120 million (\$191 million). In the last days of 2007, Ülker Group, the largest consumer goods company, agreed to the acquisition of 100% shares of Godiva

Chocolates for \$850 million. The acquisition of Godiva represented the largest transaction ever of a Turkish company worldwide.

Cross-border M&A

Even in the early phases of cross-border transactions, legal prerequisites must be discussed with a local firm to identify issues and plan the timing of each legal step in line with the overall timing of the transaction. Another major concern may be extension of certain local laws into other jurisdictions and conflicting legal requirements. In such circumstances, close contact with local regulatory authorities and government agencies, and assisting them in understanding other jurisdictions' point of view, is imperative for successful closing of a transaction.

Expectations

The activity seen in the M&A market in 2007 will probably continue in 2008. Energy, food, healthcare, insurance, real estate, retail and services will continue to be the areas that attract the interest of foreign investors. We expect that privatisation projects, such as electricity distribution, highways and bridges, the privatisation of the National Lottery, Halkbank, and Ba_kent Do_algaz, the natural gas distribution company in Ankara, will gain speed in 2008.

Turkey scores better than its competitors when it comes to foreign direct investments. A huge and growing domestic market, a skilled and cost-effective labour force, strong local companies, and access to other expanding markets are all strengths of Turkey. Furthermore Turkey has had a liberal legal framework for foreign direct investments and a convertible currency for almost 15 years – far longer than its competitors.