DEMERGERS AND PRIVATIZATIONS

A.Berke CANBERK
Associate/GSI Meridian

1. Development of Demergers in Turkish Law

Demerger of the capital stock companies is a model of restructuring of the companies. Despite of being an important part of the Commercial Law, Demergers were not regulated under Turkish Commercial Code. First legislation enacted regarding the demergers is the Decree Law on State Economic Enterprises numbered 233 dated June 18, 1984. Following this Decree Law, demerging of the companies is enabled with the Decree of the Council of Ministers. For instance, a significant legislation on demergers is the Decree of the Council of Ministers on Restructuring of the "*Turkish Electricity Corporation*" by demerging into "Turkish Electricity Generation and Transmission Company" and "Turkish Electricity Distribution Company" in 1994.

The above-mentioned Decree Law and the Decree of the Council Ministers, which allows the demerging of the companies have a common point that they both have been enacted for demerging of specific public enterprises. Therefore, the private-owned companies were not subject to demergers up until 2001. In 2001, the Law Amending Some Laws and Decree Laws, numbered 4684 dated June 20, 2001 amended the Turkish Corporate Tax Law numbered 5422 (hereinafter referred to as "Law numbered 5422") and allowed private Turkish companies to demerge for the first time. Article 38 of the Law numbered 5422 enables the partial demergers of the companies. However, the procedures of the demergers have not been stated in the Article. Instead, the Article gives competence to the Ministry of Finance to set the rules and publish a regulation regarding the procedures of demergers. Hence, Ministry of Finance and Ministry of Industry and Commerce jointly enacted the Communiqué on the Procedures and Principles regarding the Demerger of the Joint Stock and Limited Liability Companies (hereinafter referred to as the "Communiqué") in September 16, 2003. In 2006, the new Corporate Tax Law numbered 5520 (hereinafter referred to as the "Corporate Tax Law") which annuls the Law numbered 5422 was enacted. Corporate Tax Law regulates the partial demergers and full demergers under Article 19 and 20. The reason lies beneath the regulation of demergers under Corporate Tax Law is to allow the capital stock companies to demerge without any taxation if it is transacted under the specified terms and conditions of the Corporate Tax Law.

2. Basics of Demergers in Turkish Law

2.1. Types of Demergers

The text of the Article 19 of the Corporate Tax Law envisages two different types of demergers; full demergers and partial demergers. However, definitions of full and partial demergers were not provided under this article, instead, which transactions to be considered as full and partial demergers were stated.

2.1.1. Full Demergers

If a company is dissolved without liquidation and its assets and liabilities are transferred to two new or existing companies, it shall be considered as full demerger. The shareholders of the demerging company shall own the shares of the new transferee companies.

2.1.2. Partial Demergers

If (i) immovable properties, production facilities, service establishments and rights related to such facilities and establishments which belong to the demerging company are transferred to a newly established or an existing company, and (ii) the shares proportional to the value of such assets are transferred to the demerging company or to the shareholders of the demerging company, these activities are considered as partial demerger according to the Article 19 of the Corporate Tax Law.

2.2. Main Principles of Partial Demergers

Article 19 states the assets that can be transferred to the transferee company/companies in partial demergers, which are namely, immovable properties, production facilities, service establishments and the rights related to them(hereinafter referred to as "Transferred Assets").

Transferred assets may only be invested as capital in kind to the transferee company/companies. Until 2009, as a principle, Turkish Commercial Code, without having any exceptions, prohibited shares issued in consideration for the invested capital in kind to be transferred for a period of two years following the investment. Initially, this prohibition has been removed by the Commercial Tax Law which states clearly that the relevant article which prohibits the transfer of the shares issued in consideration for the invested capital in kind for two years will not apply to the demergers realized as per the provisions of the Commercial Tax LawIn 2009, Turkish Commercial Law has amended. According to the amendment, the rule shall not be applied to the transactions realized pursuant to the Article 19 of the Commercial Tax Law.

The value of the Transferred Assets shall be their registered value in the registry books of the Company. The shares transferred shall be equal to the registered value or equal to an amount calculated pursuant to exchange ratio unit. The exchange ratio unit may be determined in accordance with the actual value of the shares of the demerging and the transferee companies. However, such determination must protect the rights of the shareholders of the demerging company.

The demerger shall be completed in conformity with the integrity of the establishment principle, as the company can only be demerged by investing capital in kind which constitutes the assets of the demerging company. According to the integrity of the establishment principle, the company shall not demerge into parts that would not able be to operate by itself, since it is prohibited by the Commercial Tax Law.

In the event that the shares of the transferee company are acquired by the shareholders of the demerging company, there will be a decrease in the capital of the demerging company. Therefore, the shareholders of the demerging company may decide on a capital decrease to meet the loss of the paid capital.

2.3. Procedures of the Partial Demergers

2.3.1. Drafting and Submission of the Demerging Report

The board of directors of the demerging company shall initially prepare a demerger report including the expected benefits from the demerger, the purpose of the demerger , the economical needs that require demerger and information on the assets to be transferred. This report shall be submitted to the

general assembly of the demerging company. Additionally, the budget of the demerging company shall be prepared before the holding of the general assembly meeting. This budget shall accurately indicate the assets and the debts of the company. If the time period between the date of the annual budget and the budget which shall be taken as a basis for the demerging transactions is more than 6 months, a new mid-budget shall be drafted.

Following the discussions in the general assembly, if the shareholders agree on the demerger, the general assembly shall grant the authority to the board of directors in order to start and follow up the demerger procedure.

2.3.2. Expert Report

Since the main transaction in the demerging is to invest capital in kind to the transferee company, the board of directors shall apply to the competent court to appoint experts for the appraisal of the current value of the assets to be invested as capital in kind. The experts shall prepare another expert report regarding the demerging report.

2.3.3. Demerging Plan

If the Transferred Assets shall be transferred to an existing company, a Demerging Agreement, if the Transferred Assets is going to be transferred to a newly established company, a Demerging Plan shall be drafted. The Demerging Agreement or the Demerging Plan is a roadmap to the demerger. Therefore, it shall include all the details and procedures of the demerger. Pursuant to the Commercial Tax Law and the Communiqué, the Demerging Agreement or Plan shall be in writing.

In case the Transferred Assets shall be transferred to a newly established company, the articles of association of the newly established company shall be prepared simultaneously with the Demerging Plan. The Articles of Association shall be signed and notarized in accordance with the company establishment procedures stated under the Turkish Commercial Code.

2.3.4. The Partial Demerging Decision

The general assembly of the demerging company shall discuss and vote on the Demerging Agreement or Plan drafted by the board of directors. The meeting quorum is the half of the shares of the company and the decision quorum for the approval of the demerging decision is simple majority of those present at the general assembly meeting.

2.3.5. Registry

Following the approval of the Demerging Plan and the making of the decision regarding partial demerger by the general assembly, the establishment of the new company (if any), the capital decrease (if any) and the demerging shall be registered in the Trade Registry Gazette. Once the demerger is registered, the assets of the demerging company shall be transferred to the newly established company within a period of three months.

2.4. Protection of the Claimants

According to Turkish Commercial Law, the companies' assets are designated as an assurance for the claimants to whom the companies have debits and credits. By demerging, some assets which assure the debts are transferred to the transferee. For this reason, all the assets shall be transferred in

accordance with the complete succession principle. Therefore, the assets shall be transferred with all its related debts in order to protect the claimants.

Article 387 of the Turkish Commercial Code regulates the protection of the claimants. Pursuant to this article, the demerging company shall announce and send a registered mail to the claimants in order to obtain their consent or demands for the assurance of their claims. Unless the demerging company fails to prove that all due obligations are paid or the consent of the claimants regarding the demerger, the trade registry will refrain from register the demerger.

3. Demerger of the Companies under Privatization

The rules governing privatization is set forth by the Law on the Applications of Privatizations numbered 4046 dated November 24, 1994 (hereinafter referred to as the "Privatization Law"). Article 20 of the Privatization Law stipulates some special privatization procedures for the joint stock companies owned by the administration which is competent to privatize (hereinafter referred to as "Administration") . The said Article allows the joint stock companies to demerge by investing capital in kind to newly established companies. It should be noted that, the Administration shall demerge the joint stock company as a part of the privatization. If the demerge is omitted from the privatization process, then the exemptions stipulated by Article 20 shall not be applied to the demerge.

In such a demerge, the demerging decision shall be made by the Administration which owns the demerging company. The decisions of the Administration shall be considered as the decisions of the General Assembly of the company. Therefore, there is no need to hold a general assembly meeting to decide upon the demerge.

Article 20 states that the Administration shall approve the articles of the association of the demerging company. In the system of the Turkish Commercial Law, the articles of the association shall be signed by each shareholder before being notarized. However, in such a demerge, the Administration shall decide on the establishment of the new company and approve the articles of association of the said company.

Moreover, Article 20 of the Privatization Law explicitly indicates that, in such transactions the relevant articles of the Turkish Commercial Code shall not apply. In practice, there are not any demergers being performed under the terms of Article 20 of the Privatization Law. However, other transactions like mergers and acquisitions which also have been stated under Article 20 of the Privatization Law have been applied. In these privatizations, the competent administration to privatize is the Privatization Administration and the articles regarding the court or approval of claimants in mergers and acquisitions are not applied.

4. Conclusion

The demerging process has not been regulated under the system of Turkish Commercial Code, but the system of the Commercial Tax Law. Since a transaction which is directly related with the commercial law is regulated under another branch of law, Tax Law, difficulties have been arisen in the practice. Procedures to avoid problems, are set forth by the Communiqué which is jointly published by the Ministry of Finance and Ministry of Industry and Commerce. However, such an effort is not sufficient to fill the loophole.

Overall, the demerging process is a long and detailed process. Article 20 of the Privatization Law may facilitate and expedite the privatizations. In practice, the Privatization Administration takes the advantage of the Article 20 by construing the Article up to the widest extent. However, it should be noted that up until today, there are not any demergers that has been performed under the terms and conditions of Article 20.