The Beginning of a New Legislative Area – A General Overview of the Law of Corporate Groups in Turkey

by Fatma Bilim

The commercial world is dominated both nationally and internationally by complex groups of companies. Although the Turkish economy is still predominantly comprised of small and medium-sized enterprises, the organized structure of national and international group companies[1] and holding companies[2] has always been extremely common. Notwithstanding that these institutions were in commercial usage, they were not standardized in the current Turkish Commercial Law no. 6762 (hereinafter referred to as "TCC") until 60 years ago. Before the change, the institution of group companies was only occasionally and indirectly described in a few paragraphs in Capital Market Law, the Corporation Tax Act, the Banking Law, the Competition Law, the Labor Law and the Current Turkish Commercial Law.

Due to several economic and commercial needs related to the standardization of group companies, the Turkish Legislator recently established a New Turkish Commercial Law numbered 6102 (hereinafter referred to as "NTCC;" unless expressly stated otherwise, Articles mentioned in this article refer to those in the NTCC), which will take effect beginning on July 1, 2012. It is important to note that the new Turkish Commercial Code has been largely influenced by the German Commercial Code.

The NTCC contains a uniform set of rules regulating the relationship between companies in general and group companies in particular. This legislation also places many various, new legal obligations on companies and management boards.

The New Legal Concept of Dominant and Dependent Companies

For the first time in the legal history of Turkey, the regulation on groups and inter-company relationships is provided under the title "Şirketler Topluluğu" in Articles 195 – 209 under the general concept of dominant and dependent companies ("hakim ve bağlı şirketler").

The current system of Turkish Company law is based on the classical legal model of an autonomous company. Although in former practice, a company was submissive to the control of a dominant company; current Turkish legislation views a company as an independent entity that includes all negative consequences for minority shareholders and creditors. The current model proceeds upon the assumption that a company is an independent, economic and legal entity for which equity capital is spread by several individual shareholders who are interested in the best overall return on their investment and whose management is committed to a body of independent managers. As a matter of fact, a shareholder who is

1 A group company means at least one parent company or an individual that is a merchant, and a minimum of one subsidiary company, which are collectively referred to as the "group" company.

2 A holding company is one that controls other companies through stock ownership but that usually does not engage directly in their productive operations.

economically or entrepreneurially active outside the company might use his/her controlling power to pursue their own business interests ("self-interest") at the cost of the controlled company.This self-interest causes fear that the controlled[3] company may not be able to run an independent business because it may be made a subservient business to the controlling shareholder company.

General Quintessence of the New Turkish Commercial Law

The general issues targeted in the new Turkish Commercial Law aim to protect the controlled company, its minority shareholders, and the creditors. As it is the goal of a company to protect its best interest, it is clear that at the same time and in the structure of group companies, the controlled company becomes a dependent unit whose affairs are directly or indirectly managed by another company. This occurs through the dominating influence or uniform management by a mother[4] company, and is an instrument of the business interest of a parent or group company.

Legitimizing of the Dominating Influence

The first regulatory task of the NTCC was to provide a legitimate basis for the (otherwise unlawful) exercise of power or control and prioritizing group interest over the interest of the individual company. As the controlling[5] company might be, according to Article 195 Paragraph ("Par.") 6, a partnership or capital or limited companies, it also might be a private person or Merchant. The establishment of a group structure is important from a judicial view, because group connections are important from an organizational view. In particular, this concept might also be efficient for tax optimization and for business specialization effects. One entity of the group might be subject to a lower tax and another entity might be subject to a higher tax. Each participating undertaking/company is a present member of the group, but by acquisition, spin-offs, splitting-up, merger, new formation, or demerger, the future structure of the group might adapt to the needs of the group. In this context, it shall already be mentioned, that in case of an unjustified transformation, the shareholder has, pursuant to Article 202 Par.2, the right of a claim.

The Protection of the Dependent Company, the Minority Shareholders and the Creditors

Another regulatory need was to establish a protective mechanism for subsidiary companies to have against their controlling company, their minority shareholders, and their creditors. Moreover, a regulation was needed to standardize an adequate compensatory scheme for seeking redress from a controlled company and to implement obligations over it as well. The new Turkish Commercial Law acknowledges the domination of the mother company by imposing on the mother company several duties, such as compensation for annual losses of the controlled company (Article 202 NTCC).

Numerous Clauses of Dominating Influence and Affiliation Relationships

A detailed analysis of domination[6] types of relationships shall be made below.

The law does not provide for a general definition of "controlling," but it describes the concrete types of affiliation relationships between companies.

There are mainly five types of direct relationships– the relationship of domination by the majority of the voting rights as simple participation; by a privileged voting right according to the Articles of Association to nominate the majority of the members of the management board; by an electoral agreement which gives the company alone or jointly with another shareholder(s) by a voting agreement with the majority of votes; by a special control agreement (for example, a domination agreement) (Article 195 Par. 1); and by having the majority of share capital by holding a certain amount of shares, which entitles a company to manage and to lead a controlled company (Article 195 Par. 2). In the latter case, the relationship of domination is presumed by law, which means that if necessary, the opposite must be proven by the "controlling" company.

This legal numerous clauses of inter-company relationships does not cover all possible economic forms or types of controlling. The controlling and controlled company shall be deemed to exist when fitting within

3 A controlled company is also known as a subsidiary.

4 A mother company can also be referred to as a parent company, which means a corporation or other business enterprise that owns controlling interests in one or more subsidiary companies (distinguishable from a holding company).

5 A controlling company can also be referred to as a parent or mother company.

6 Domination is another way of describing the system for controlling another company.

the framework of one of those groups identified by the aforementioned regulations.

Furthermore, in Article 195 Par. 3, an indirect domination is established whenever a company exercises the management control of another company through an intermediate third company and then is subsumed as a controlling company.

According to Article 197, bilateral[7] relationships of affiliation are legally relevant if the companies each own a quarter of the shares. However, if one of them is controlling the other company, this company is legally the controlling one and the other one is the controlled one.

If the affiliation of companies cannot be subsumed under the heading "dominating influence" within the several systems mentioned above, then one must determine if more than one company is under the uniform management of another company. For example, this can be seen through cash-pool or financial management situations.

Dominating Influence by Corporate Management

Controlling means the right to issue instructions to the management of one's controlled company, even if following the instructions would be a disadvantage to them. For example, such instructions may serve the economic interest of another company or the interest of the group as a whole.[8]

Dominating Influence by Voting Power

Under Article 195 Par. (1), a controlling company is defined as being a company which has voting power arising from various legal grounds. According to Article 195 Par. (1)(a)(1), a company which owns (directly or indirectly) the majority of the voting power of another company (by holding a certain percentage of equity capital), is subsumed under the term "dominant" company. From a legal point of view, it represents a fundamental type of affiliation since it holds a logical priority over the other types. It is unlikely that finalization of a share purchase agreement will be a determining factor, but rather the binding act of the acquisition of shares will determine the relationship of domination.

Article 196 standardized the calculation of the dominant majority of the share capital and the shares ratio.

In Article 195 Par. (1)(2), the domination is based on the Articles of Association, and can be exercised positively. However, it can sometimes negatively prevent certain key decisions to be taken, as may be the case in blocking minorities or in the event of special general meeting resolutions requiring a qualified voting majority.

Dominating Influence by Specific Corporate Agreements

Furthermore, the type of agreement which is considered by Article 195 Par. (1)(b) is not clearly specified. This agreement might be an affiliation agreement or subordination agreement (similar to the German "Beherrschungsvertrag"), or another agreement type that represents sufficient control of a (controlled) company.

Legal Form of the Dominant and the Dependent Companies

The legal form of controlling or controlled companies might be a stock corporation, a limited liability company, a partnership limited by shares, or a partnership. For controlling entities, private merchants are also added to this list.

Nationality of the Dominant and Dependent Company

The nationality of the companies involved is an important matter. In contrast to the legislation of many other countries, the Turkish Legislature has chosen to apply this law: when one company's central headquarters, regardless of whether it is the controlling or the controlled company, is located in Turkey, then the regulations mentioned in this article apply. In case of international group companies, this application of the law seems problematic. To ensure coherence between this regulation, the International Private Law will become important

Obligations of the Dominant and Dependent Company

In Article 198, the affiliation relationship creates a

7 A bilateral relationship is when two companies each hold a minimum of a quarter of shares belonging to the other.

8 In Germany, the controlling company may enter into a profit transfer agreement with the controlled company, according to which the controlled company is compelled to convey a part or even all of its annual profits to the controlling company or at the request of the controlling company to another group company.

duty of communication and registering applications as soon as a company or merchant buys or sells the shares of another company, in the amount determined by the law (5, 10, 20, 25, 33, 50, 67 and 100 %), it must inform the other company and the competent authority in writing within ten days. The information shall be provided to the commercial register and published. At that time, if the company has failed to fulfill its obligation under this Article, certain rights (i.e. voting rights) will be frozen.

Pursuant to Article 199, the controlling and the controlled companies shall report on relations within the group regarding every transaction and that service in the legal transactions reported was not inappropriately high. Furthermore, deficits[9] as a result of a legal act or omission or assumption of deficits, shall be reported.

Liability of the Management Board of the Dominant Company

It is important to note that the management board of a controlling company has, according to Article 202 and the general regulations of liability, a duty of care and diligence towards each controlled company regarding their instructions.

Protection of the Dependent Company, its Minority Shareholders and its Creditors

Furthermore, the law contains a system of protection for the controlled company, its outside or minority shareholders, and its creditors, by giving them the right to claim compensation. Additionally, the shareholders have the right to sell their shares to the controlling company. Another shareholder right is access to information in Article 200, regarding the financial performance, or the relationship between the controlling and controlled company, the instructions from the controlling company, and the relationship between affiliates.

In Article 202 Par.1, the controlling company is obligated to pay or give the equivalent of the annual deficit of the controlled company. If the conditions from this paragraph are met, then the controlling company has to compensate the deficit.

In Article 202 Par. 2, the shareholder is entitled to seek compensation from the controlling company at a quoted market price or in absence of such market price, the value of the shares are determined by a recognized valuation method. Article 202 also indicates that the value is to be determined close to the date of the court's decision, but because of fluctuating market values, this calculation system runs the risk of not being accurate.

Creditor rights are standardized in Article 206. If the controlled company suffers a deficit as mentioned in Article 203, the creditor may claim damages against the controlling company and against any board member that is liable for damages.

In Article 208, the "Squeeze-Out"[10] and transfer of the shares of minority shareholders is established when at least 90% of the share capital and voting power of the controlled company belongs to the controlling company. In order to be transferred, it must also be proven that the minority shareholder has met the conditions set forth in Article 208.[11] The compensation to be paid is determined by reference to Article 202. However for example, German jurisdiction determines compensation by reference to the circumstances existing when the transfer of shares by the general meeting is passed, and the weighted average domestic stock exchange price of shares during the last three months prior to publication of the decision to let the general meeting is resolved on a Squeeze-Out. This calculation method has been chosen by German Jurisdiction to ensure fairness.

Article 209 governs the liability of the controlling company as mentioned in the relevant decision "Swiss Air", according to which the controlling company is obliged to pay damages. This is because the good-will and reputation of the controlling/parent company has instilled trust in the controlled/subsidiary company and has been a deciding factor in the decision to invest there in the first place. Thus, if the controlled company defaults in any way, the controlling company must step in as a pseudo-guarantor and take responsibility for losses.

9 An Group Law, a deficit occurs when a controlled or subsidiary company sustains any kind of loss or disadvantage during the operation of a business due to following instructions from the controlling company.

10 "squeeze-out" is a term referring to the compulsory acquisition of the stakes of a small group of shareholders from a joint stock company by means of cash compensation.

11 There are four conditions mentioned, the first one being if the minority shareholder disturbs the business.

Conclusion

The Turkish Legislature based its new regulations on the concept of "dominating influence," which is largely equivalent to the notion of "Beherrschender Einfluss" in German Corporation law. It shall be mentioned that the concept of dominating influence is an elusive one, as elusive as the reality it describes. The Law governs the framework of the dominating influence from a judicial mechanism (majority voting power); contractual mechanism (agreement of domination, management agreement); and organizational mechanism (Articles of Association). Turkish jurisdiction will develop this meaning further, such as, in factual mechanisms (personal linkages or strategic market positions). A dominating influence can assume a wide variety of forms and degrees of intensity in its exercise. Furthermore, the influence can be exercised directly, indirectly, positively (when the controlling company determines the business policy and management) or negatively (by preventing certain key decisions to be taken), exclusively or in association with third parties. It can also correspond to the entire range of company affairs or be exercised only over one specific business sector.

As aforementioned, the dominating influence is based on a wide range of facts. The regulations also set forth various legal duties and consequences for the controlling company and their management board.

The companies and management boards that are organized in groups should by now be up-to-date regarding these new regulations. It is important to seek legal advice from counsel that is most knowledgeable on relevant changes to the new Turkish Commercial Code.

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