

# IFLR

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# PRIVATE EQUITY AND VENTURE CAPITAL REPORT 2014



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**Section 1: PRIVATE EQUITY LANDSCAPE****1.1 How would you describe the current state of private equity activity in your jurisdiction, including the most common forms of private equity transactions?**

Private equity (PE) investments in Turkey have grown immensely over the past decade. Turkey strode through the global economic recession and the 2013 Gezi protests unscathed, which can mostly be put down to a larger macroeconomic process. This included a steady growth of GDP at around 8%, a reasonably lower inflation rate compared to almost triple that 15 years ago. These factors have also helped Turkey's consumer economy to thrive.

Turkey is a sophisticated market for PE transactions. With the rise of angel investors and venture capitals, the Turkish market has further developed in early stage financing. However, corporate acquisitions, joint ventures and minority investments undoubtedly dominate the PE market. Corporate acquisitions in Turkey generally involve PE funds that invest directly in target companies or through joint ventures with local partners, seeking majority interests. Alternatively, minority investments with control over the target by means of shareholders' agreements are very common. In order to drive the investment forward and minimise liabilities, special purpose vehicles (SPVs) are adopted.

**1.2 Are there any factors that make your jurisdiction attractive to private equity investment at this time or that will spur private equity investment in the near term?**

PE sponsors benefit from a range of asset classes and strategies in Turkey. The new Turkish Commercial Code (TCC) offers foreign investors with similar rights as local investors. With the rise of PE transactions, there has been an increase in the availability of alternative debt financing with borrower-friendly terms and a range of feasible exit routes. The recent investor-friendly legal developments have offered both local and foreign investors with a multitude of benefits and practical solutions.

**Section 2 – SIGNIFICANT LEGAL DEVELOPMENTS****2.1 Have there been any recent regulatory developments, including tax developments, in your jurisdiction affecting the raising, formation, governing terms or operation of private equity investment funds or investments made by funds?**

In 2012, the TCC underwent comprehensive legal changes, which overall is welcomed by PE investors. The new law offers a more sophisticated approach and numerous advantages in a broad range of areas, particularly in relation to corporate governance, squeeze-outs, and shareholder agreements.

The TCC has introduced far-reaching corporate governance and transparency requirements for both public and private companies. The code brings about a range of provisions that encourage professional management and the ability to adapt sophisticated shareholder arrangements sought by PE investors. Further, a transfer can be rejected by companies with a share buyback, at a fair value determined by the court.

PE investors can now benefit from two new squeeze-out procedures, merger squeeze-out and squeeze-out for bad faith. The new law enables majority shareholders with voting rights and at least 90% shares to squeeze out minority shareholders who prevent the operation of the company, act in bad faith, and create hardship or act recklessly. Majority shareholders can also apply the squeeze-out method through a merger agreement.

The TCC introduces a prohibition on financial assistance. This provision has been widely criticised, as the company cannot issue a corporate guarantee or surety for acquisition-related loan repayments. The article states that joint stock companies may not advance funds, nor make loans, nor provide security, with a view to the acquisition of its shares by a third party.

**2.2 Have anti-corruption legislation and/or environmental, social and governance principles affected the approach of private equity investors and/or transaction terms?**

In Turkey, there is a general and global trend which gives more emphasis to anti-corruption rules. As this is an increasingly sensitive matter, the principles affect the approach of the investors, especially foreign investors. One of the biggest challenges for PE transactions involve compliance matters, which have become an important component of the due diligence review. Turkey has witnessed a number of unsuccessful transactions due to compliance issues. Thus, in order to avoid such investment challenges, buyers take protective measures with transaction documents against the target's non-compliance with laws.

**2.3 Could a private equity sponsor (and/or its directors, officers or employees) be exposed to liability for a portfolio company's actions or omissions in your jurisdiction and if so, on what legal grounds?**

One of the more significant innovations introduced by the TCC is the concept of 'group of companies'. Here, the law restricts a parent company, in any legal form (such as joint stock or limited liability) from using its controlling power for the disadvantage of one or more of its subsidiaries for the benefit of the others. If the parent company conducts such a transaction, it must equalise the cost to the disadvantaged subsidiary by providing an equivalent opportunity in the same fiscal year, with a specific explanation of how and when this loss will be recovered. Otherwise, the shareholders and the creditors of such subsidiary can file a claim against the parent company and its board of directors.

The TCC provides an additional liability for parent companies in the event that a group has built its reputation in such a way that would lead the public or consumers to trust the group or the group's brands. If a subsidiary uses this reputation with the group's name, logo or in any other way that would give the impression to the public or consumers that the subsidiary's products or services are under the guarantee of the parent, then the parent is liable for the losses incurred by the consumers due to such trust.

**Section 3 – STRUCTURE OF ACQUISITION VEHICLE****3.1 What type of entity is typically used as the acquisition vehicle for private equity investments in your jurisdiction? What are the key factors that determine the choice of entity?**

The typical legal structures in Turkey are joint stock companies and limited liability companies. Non-Turkish tax resident acquisition vehicles are also common for direct investments in Turkey.

The key factors that determine the choice of entity and how many entities will be involved, are tax requirements, and requirements of the finance provider if financing is required. If there is a partnership involved or if the PE is a minority investor, the ability to reflect and enforce the minority rights, corporate governance rules and other shareholders' arrangements could be another key factor.

### **3.2 Does the structure of the acquisition vehicle vary depending on the nature of the investors in the private equity purchaser's fund?**

Depending on the tax requirements, certain investors may prefer non-Turkish tax resident acquisition vehicles.

### **3.3 Describe how the choice of acquisition vehicle affects the nature of the incentive equity compensation that can be offered to management.**

Incentive equity compensation schemes are relatively new in Turkey. Unlike certain other jurisdictions, the corporate structure of Turkish companies is not as suitable to provide this kind of scheme. Nevertheless, incentive equity compensation schemes are becoming more common and they are supported by contractual undertakings by the shareholders, as provision of such schemes usually require action by the shareholders. These schemes are usually contractual or involve the target companies and the choice of acquisition vehicle should not affect the nature of these schemes.

## **Section 4 – ACQUISITION STRUCTURE**

### **4.1 What are the typical structures used by private equity sponsors to acquire portfolio companies in your jurisdiction? What are the major considerations that govern this decision?**

It is typical for PE sponsors to use a holding company that directly, or through another company, holds the target company shares, in which case the PE itself and the sponsors of the target (if any) participate as shareholders. Another common structure is that the PE uses a holding company to hold an acquisition vehicle, which directly participates in the target company.

The major consideration that governs this decision is tax efficiency both on dividends and on exits.

### **4.2 What are the major issues that drive deal timing in your jurisdiction, including disclosure obligations, financing and regulatory approval requirements?**

The major factors that drive deal timing are negotiations between the parties, regulatory consents (antitrust and other sector-specific regulatory approvals) and the due diligence process.

## **Section 5 – GOVERNANCE**

### **5.1 Are there any legal requirements in your jurisdiction that would prevent or otherwise affect the ability of a private equity acquirer to designate members of the board and/or management of its portfolio companies? Are there any legal risks for the private equity acquirer in designating such members?**

Under Article 553 of the TCC, board members may be held liable towards the shareholders and the creditors of the company for their negligent acts. Accordingly, the board members are required to act with the care and diligence expected from a so-called cautious executive and to protect the interests of the company while performing their duties in accordance with the business judgment rule.

### **5.2 Are veto rights over major corporate actions (such as dissolution and winding up, merger or consolidation, significant acquisitions or dispositions, incurrence of material indebtedness, or changing the business of the company) typical rights held by private equity acquirers? Are there any limitations or prohibitions on such rights?**

PE acquirers that are shareholders with at least 10% of the share capital of a joint stock company, generally hold veto rights over major corporate actions. Such rights include: calling the General Assembly to meet; adding a matter to the agenda of the General Assembly; requesting the General Assembly to appoint a special auditor; objecting to the release of founding shareholders, board members and auditors; requesting the termination of the company; and, requesting the postponement of discussions and approval of the company's financial statements.

Any decision that will increase the shareholders' undertakings or obligations, transfer the registered address of the company abroad, or change the scope of activities or purpose of the company, require unanimity of the total share capital of the joint stock companies. There are also other matters such as capital reduction, sale of a substantial asset, termination of the company that require affirmative votes of the 75% of the total share capital. In addition to these, it is also possible to create share groups and allocate certain privileged rights or veto rights to the holders of such privileged share groups. This is the most common method applied by PEs in minority investments or joint ventures.

### **5.3 Do private equity funds or any board members they appoint, have any fiduciary or other duties to minority equity-holders or other stakeholders of a portfolio company? Eg are there any prohibitions against acquisitions of, or investments in, competing or complimentary businesses?**

Board members have the obligation not to compete with the company's business, unless they are permitted to do so. There may also be certain customary contractual undertakings by board members not to acquire or invest in competing businesses.

## **Section 6 – DEAL TERMS**

### **6.1 What pricing structures are typically preferred by private equity sponsors in your jurisdiction?**

The most common mechanism used in PE deals in Turkey is a debt-free cash-free price mechanism. However, the locked-box price mechanism has been preferred in some deals recently, but it is still quite rare.

### **6.2 What is the typical scope of the representations and/or warranties, covenants, undertakings and indemnities provided by a private equity seller and the target company's management team to an acquirer in an acquisition agreement?**

PE sellers usually provide representations and warranties regarding title, capacity and enforceability. Generally, the target company's management will be expected to provide business warranties. Depending on the involvement of the PE in the management of the target company and the negotiations, the PE sellers may also need to provide business warranties.

### **6.3 What are the customary time limits and other limitations on liability applicable to representations and/or warranties given by a private equity seller and the target company's management team?**

Fundamental warranties, such as title capacity, are not usually subject to any limitations. Business warranties are subject to time limitations (usually between 12 to 24 months). There is also a liability cap, which is determined as a certain percentage of the purchase price. The percentage and the amount of the liability cap varies depending on the negotiations. A minimum threshold for bringing claims is also common.

### **6.4 What methods are typically used to fill any 'warranty gap' in your jurisdiction? Is warranty and indemnity insurance commonly used in private equity transactions in your jurisdiction?**

The most common way to bridge any warranty gap is to deduct the purchase price to address a specific potential liability. Warranty and indemnity insurance is not yet common in Turkey.

**6.5 What conditions to a private equity sponsor's obligation to complete an acquisition are typically included in the acquisition agreement? Are these conditions usually substantially aligned with the conditions included in the financing documentation?**

Typical completion conditions are antitrust approvals and other sector specific regulatory approvals. Material adverse change clauses are usually included in acquisition agreements. It usually depends on the amount of the financing to be used in the acquisition for the conditions precedent to be aligned in the financing documents.

**6.6 To what extent are purchaser funds at risk for the equity capital committed to a transaction? Are third-party beneficiary rights or other enforcement rights typically made available to the seller?**

The PE fund usually commits to funding the acquisition vehicle. If all other conditions are satisfied and the PE still fails to perform its commitment, the sellers can enforce this commitment.

The vehicle may be given actual equity, or a contractual arrangement where the shareholders of the target company and the PE undertake to provide the management with a bonus, which is linked to the share purchase price of the target company and a deemed equity vested to them for the time period they work in the target. The management is entitled to a certain number of shares for each year, month or quarter of a year they work for the target. Such percentage depends on the negotiation of the parties.



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**About the author**

Gamze Cigdemtekin has a wide range of transactional expertise covering M&A, corporate, energy, infrastructure, project finance and private equity. She has advised on a vast number of corporate and finance transactions in Turkey, with a particular focus on M&A, private equity and power projects on a project finance basis. Her expertise also extends to competition law. Cigdemtekin has represented major international and Turkish clients in several sectors, including energy, banking and insurance, manufacturing, and cements, as well as chemicals and pharmaceuticals. Leading legal directories recognise Cigdemtekin as a leading M&A lawyer in Turkey, and she was also listed as one of the top lawyers in Forbes Turkey's survey as a result of a number of cases handled before the Competition Authority.