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International legal practice

Joint Ventures in Turkey

Joint ventures with the participation of foreign shareholders became very popular in Turkey, especially after the late 1980s. The major reasons behind this popularity were the necessity to attract foreign investment, and the significant improvement in the Turkish economy.

The major change and progress regarding foreign investment is the enactment of Law No. 4875 which provided fundamental changes in all phases of proceedings in relation to foreign investments.

Subsequent to the enactment of Law No. 4875, foreign investment in Turkey is no longer subject to the approval of the General Directorate of Foreign Investment of the Undersecretariat of the Treasury of the Prime Ministry of Turkey (the "FIGD"). The basic purpose of Law No. 4875 is to encourage direct foreign investment and to change, in general, the investment process from the authorization and approval system to the information system. No approvals and/or authorizations are required to be obtained by foreign investor other than those required of local companies in establishing a company or participating in an existing one in Turkey.

Under Article 4 of Law No. 4875 foreign investors must notify the FIGD of the statistical information on their respective investments in Turkey, in accordance with the procedures and principles to be set out in the regulation to be prepared by the Undersecretariat. Such information is required only for statistical purposes, and may not be employed as a means of evidence.

In addition, two new concepts are included in the definition of "foreign investment" in Law No. 4875:

• not only citizens of foreign countries but also Turkish citizens resident in foreign countries will be regarded as foreign investors, and • the acquisition of shares of a minimum 10% or an equal proportion of voting rights through stock exchanges, or participation in an already existing company or establishment of a branch office is also defined in the scope of a foreign investment.

Under Turkish law, generally joint ventures are deemed to be ordinary partnerships and are subject to the Turkish Obligations Code numbered 6098 (“TOC”). Article 620 and subsequent articles of the TOC relevant to the ordinary partnerships are also applicable to joint ventures. However, under Turkish Law, while joint ventures can be established as ordinary partnerships they can also be established by incorporating a commercial entity or by participating in an already established commercial entity.

By the admission of the Foreign Direct Investment Law No. 4875 ("Law No. 4875"); foreign investors may incorporate or participate in all kinds of companies, which are open to local investors in Turkey in line with the “equal treatment” principle.

On the other hand, to incorporate an ordinary partnership or a general partnership, joint stock company type (anonim şirket) (“AS”) is particularly preferred where shareholders with potentially conflicting interests come together for joint ventures since it is possible to establish classes on the shares of an AS. Furthermore, under the Turkish Commercial Code no. 6102 (“TCC”), provisions relating to limited liability company (limited şirket) (“LS”) governance are less thorough and clear than those relating to AS governance. As well as those reasons, AS is preferred by foreign investors because LS shareholders, unlike AS shareholders, may be liable for amounts owed by the LS to government authorities for taxes, duties and charges if the company cannot make the required payments. The liability of the shareholders of LS in this respect is not limited to their respective capital contribution in the joint venture company.

An ordinary partnership (adi şirket) does not hold a legal entity status. Ordinary partnerships can be established by two or more persons, with or without a written partnership agreement. Among all the entities, ordinary

partnership is the only entity which does not require a written agreement for its establishment. A partnership's assets are jointly owned by its partners. Similarly, partners of an ordinary partnership are jointly, severally and unlimitedly liable against the creditors of the partnership. Therefore, an ordinary partnership can neither sue nor be sued because it does not have the capacity to act as a legal entity.

There is no particular Turkish legislation which overall govern the joint venture contracts. Articles 620 and subsequent articles of the TOC apply to a joint venture, should it be incorporated in the form of an ordinary partnership. Furthermore, joint ventures may be established in the form of ordinary partnerships or by incorporating a commercial entity or by participating in a commercial entity already established.

Furthermore, provisions of the TCC will be applicable to joint venture contracts, and the relevant provisions of Law No. 4875 will also be applicable to such joint ventures should there be any foreign component.

The Structure of the Joint Venture

The issues which are mutually agreed on by the parties in the joint venture agreements should also be incorporated in the Articles of Association of the company (the "AoA"). Otherwise, it is likely for the parties to encounter the problem of whether the joint venture agreement prevails over the AoA or vice versa should there exist conflicting provisions among those in a joint venture agreement to the AoA.

There are two types of companies which are mostly preferred by foreign investors when forming a joint venture in Turkey, namely an AS and an LS. The LS is a simpler structure which takes the same amount of time as an AS to incorporate but may in the long run be easier to administer. While an AS is by far the more common choice, an LS may be preferable when the sole objective is to establish a fully owned subsidiary with minimum capitalization and administration requirements.

Certain attributes of a joint stock company incorporated in Turkey are

summarized below:

• Shareholders and Capital

• There is a no requirement with regards to number of the shareholders for a joint stock company, single shareholder is sufficient, • The minimum capital required under the TCC for a joint stock company is TL 50,000.- (approximately €21,630.- EUR as of October 1, 2012). • 25% of the subscribed capital has to be prior to the registration of the company before the relevant trade registry.

• Corporate Documents

The AoA is the only corporate document required for a joint stock company. Issues which are not addressed in the AoA of the company are governed by the provisions of the TCC. The shareholders may establish various classes of shares and allocate special voting, dividend and liquidation privileges to such classes. Usufruct certificates and founders' shares for participation in profits are also possible. The AoA of a joint stock company is registered in the trade registry and is therefore a matter of public record.

• Shareholder Rights

• to participate in the shareholders meetings,

• to cast one vote per share,

• to review the annual report and financial statements,

• to bring legal action against shareholders' decisions,

• to participate pro rata in the shareholder's existing shareholding in each capital increase except as may be restricted by the AoA,

• to transfer its shares in the company except as may be restricted by the AoA,

• to receive a pro rata share of dividends except as may be restricted by the AoA,

• to receive a pro rata share of any proceeds arising from liquidation of the

company except as may be restricted by the AoA.

• Shareholder Obligation

The primary obligation of a shareholder is to pay the outstanding portion of his capital subscription as and when called by the board of directors, or by the shareholders where such power is reserved to the shareholders in the AoA of the company. In the event that a shareholder is in default on the payment of his capital commitment, the board of directors of the company may revoke all rights of shareholder and expel such shareholder from the company. Furthermore, shareholders have the obligation to maintain the confidentiality of commercial secrets of the company and this obligation remains binding even after neither of them is a shareholder in the company.

• Decision-making Process:

In the AoA of a company, issues regarding to the decision-making process may be provided. A simple majority shareholding is sufficient to control a joint stock company for most purposes. The TCC contains a very limited number of super majority requirements for shareholders' meetings and decisions. It is possible for the shareholders to add to the list of super majority decisions or to provide for higher (but not lower) quorum and voting requirements than those stated in the TCC.

A shareholder holding more than 50% of the shares will be able to control all decisions in all the categories described above except for the first category, provided he is represented at all shareholders meetings.

Notwithstanding the foregoing, where there are different classes of shares, any decision which adversely affects the rights of shareholders holding a specific class of shares will also need to be approved by a special assembly of such shareholders. The quorum and voting requirements for such a meeting are the same as those required for the third category of decisions discussed above.

• The Board of Directors' and Officers' Liabilities:

Directors of a joint stock company may be jointly or severally liable for their actions. To the extent that authority is delegated by the board to officers (i.e.

managerial employees with signature authority granted by the board) such officers may also be liable in the same manner as the directors.

Generally, directors and officers are not personally liable for agreements and transactions executed on behalf of the company. However, directors and (to the extent of their delegated authority) officers are jointly liable towards the company, the shareholders and the company's creditors where they negligently or intentionally fail to perform their duties as provided for in law or in the AoA.

The standard of care expected from a director or an officer is that of a prudent businessman and to the extent that such a standard of care is demonstrated, the relevant director or officer will be relieved from liability. In particular, a director will not share the liability caused by a damaging action or a decision of the board if, with respect to such action or decision, he casts a negative vote, registers his objection in the minutes of the meeting and promptly notifies the auditors of his doubts concerning such action or decision. A director will also not be liable if he is absent with cause from the meeting in which such damaging action or decision was discussed and resolved.

The board may delegate all or part of its authority to an officer of the company. Within the scope of duties so delegated by the board, liability on the basis of negligence will fall solely upon the relevant officer and not on any director.

The ongoing liability of a present or former director or officer will terminate either by explicit release by shareholders' decision or through shareholder approval of the company's annual report and financial statements.

There are a number of other circumstances, such as misrepresentations concerning the company, failure to disclose conflicts of interest or competition with the company, which can result in directors or officers becoming liable for their actions. • Deadlock in Joint Ventures

In Turkey, as elsewhere, deadlock in management and operation is the most common legal issue of joint ventures, and it is a long-standing issue. The put/call option is probably the best way to resolve issues in instances of

deadlock. The provisions of the put/call option are very commonly used in 50%-50% joint ventures in Turkey. The option and the procedures to be followed should be included both in the AoA and also the Joint Venture Agreement of the company in order to prevent potential disputes between the parties. There are no specific provisions in the TCC in connection with deadlocks except for one provision providing that in the event that a deadlock occurs at the Board of Directors' level in connection with a decision; the issue is discussed in the following meeting and should the deadlock continue in the second meeting as well, the issue will bee deemed to be dismissed.

Joint venture shareholding structure including more than one class of shares is rather preferred by the investors. By dividing the shares into classes, nominating directors, deadlock procedures, the transfer of shares is more easily assessed. Negative control rights may be granted to certain groups of shares under the AoA of the joint venture company.

• **Preemption right.** This is more commonly used with share transfer restrictions in the joint venture agreement and/or the AoA for the purposes of avoiding the transfer of shares of the joint venture to an outside before offering them to the existing joint venture partner.

• **Termination.** Adequate documentation should exist in order to provide clearly the cases of termination of the joint venture.

• **Minority Rights.** The laws may not be satisfactory to protect the rights of the minority shareholders, therefore adequate written agreement should exist between the parties listing out both the positive minority rights and the negative control rights by means of veto rights and blocking powers.

• **Purpose.** The main purpose of the joint venture and the way it will operate, authorizations, including any limitations, must clearly be agreed between the joint venture parties at the outset.

• **Competition Laws.** Competition issues are also important in Turkey for joint ventures. Pursuant to item (c) of Article 5 of Communiqué no. 2010/4 on the Mergers and Acquisitions Subject to Permission of the Competition Board ("Communiqué No. 2010/4"), joint ventures which emerge as an autonomous

economic entity possessing assets and labour to achieve their objectives, and which do not have any aims or effects restricting the competition among the parties, or between the parties and the joint venture are deemed to be mergers and acquisitions between undertakings under Article 7 of Law no. 4054 on the Protection of Competition ("Law No. 4054"). In accordance with Article 5 of Communiqué no. 2010/4, in order for a merger or acquisition to be legally effective, approval of the Competition Board, either explicit or implied, must be obtained. There are specific conditions which must be met in order to render the notification compulsory: these are the "notification necessity thresholds" set forth under Article 5 of the Communiqué no. 2010/4. Therefore, any transaction which falls under the scope of the definition of a merger or acquisition and which exceeds the thresholds should be notified to the Board.

Communiqué No. 2010/4 provides for a threshold which is based on the relevant market share, or alternatively, the sum turnover of the enterprises in the relevant markets.

Should the Competition Board determine that a joint venture has not been constituted as defined in Article 5 of Communiqué no. 2010/4, the joint venture will not be subject to Communiqué no. 2010/4, in which case, it will fall under the scope of Article 4 of Law No. 4054, which states the unlawful and prohibited agreements under Law No. 4054. Parties to an agreement, which may be deemed to infringe Article 4 of Law No. 4054, can apply to the Board in order to obtain an individual exemption if the agreement in question cannot benefit from any block exemption.

Matters regarding the Joint Ventures

General problems, which joint ventures in Turkey get into trouble with, may be grouped under the following headings:

• **Financing:** the party who is expected to provide financing to the joint venture does not or cannot provide the expected financing for the joint venture;

• **Expertise:** the party who claims to have the required expertise for the operation of the joint venture does not have such expertise;

• **Inequality:** although the parties believe at the outset is that each party has the same level of expertise and thus may produce new products, services, etc. But later find out that the expected equal level of expertise does not exist in the counterpart;

• **Distraction:** although the parties agree at the outset is that each party will concentrate primarily investing in the joint venture; either of the parties does not comply with such undertaking and divest its financing resources to other business;

• **Non-compliance with laws:** one of the joint venture parties may not give enough importance in complying certain laws of the country such as environmental laws, licensing requirements, etc. and enhance the legal operation of the joint venture;

• **Uneven risk assumption.** Either of the parties in the joint venture may refrain to take the risks proportionately, but may be willing to share the rewards.

• **Accounting.** There is no special legislation for joint ventures in Turkey. In the Turkish Corporate Tax Law No. 5422 (the "CTL"), joint ventures are categorized as "partnerships" and it has been stated that joint ventures comply with the articles of the CTL. But this is binding only for the tax liability of joint ventures because joint ventures are deemed partnerships under Turkish legislation. This is a special exception because according to Turkish tax legislation only the incorporations, which have legal entity status, are governed by the CTL. Ordinary partnerships do not have legal entity status and therefore are not governed by the CTL as a general rule. But under the provisions of the CTL it has been stated that joint ventures are governed by the provisions of the CTL despite the fact that they are incorporated as ordinary partnerships with no legal entity status.

Joint ventures in Turkey with foreign investment most often take the form of a joint stock company since the partners of partnerships or general partnerships are personally liable for the obligations of the partnership. But it is possible for a joint venture to be incorporated as an ordinary partnership as well.

In the event that a joint venture is incorporated in the form of a partnership, it is impossible for such a partnership to obtain loans from a bank on behalf of the partnership under Turkish Banking Law, since no legal entity status has been attributed to the partnerships under the Turkish legal system. Only the partners of the joint venture are able to obtain such loans on their behalf from the banks.

Also, accounting standards and auditing present problems for joint ventures. There are no precise, generally accepted accounting principles for joint ventures in Turkey. All the shareholders of a joint venture, which has been incorporated as a partnership, have the right to audit the financial records of the joint venture. For the joint ventures, which have been incorporated as a joint stock or limited liability company, only the authorized shareholders have the right to audit the financial records of the joint venture.

The most crucial measure to terminate the legal problems of joint ventures in Turkey is to enact legislation for joint ventures, which should be composed of at least the following titles: preamble and general provisions, parties to joint venture, management and representation of joint ventures, operation of joint ventures, taxation of joint ventures, supervision of joint ventures and duration and liquidation of joint ventures.

Legal Proceedings

It should be noted that lawyers have a major role in connection with the incorporation of a joint venture in Turkey. Drafting and/or negotiating letters of intent, confidentiality agreements, joint venture agreements, the AoA of the joint venture company and competition issues are the major documents about which the recommendations of lawyers are sought in order to ensure the successful completion of the business plan.

Furthermore, with the assistance of lawyers, the joint venture parties may enter into joint venture agreements governing matters which they do no not wish to make part of the AoA and thus a public record. Joint venture agreements are not registered to any public registry and are enforceable only between the signatories and not vis-à-vis third parties. Such agreements are common in joint ventures in Turkey. On the other hand, lawyers are not subject to any special obligations or rights with respect to joint ventures in

Turkey different from the lawyers in other countries.

Joint venture structure carries on both ownership and management rights. Therefore, parties to a joint venture agreement may disagree with regard to actions or decisions to be taken. There are no specific provisions in the TCC or in the TOC regarding a dispute resolution mechanism. Therefore the parties forming a joint venture company may wish to provide in their joint venture agreement that one or more dispute resolution mechanisms will be employed prior to recourse to arbitration or to more effective measures such as termination of joint venture.

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