

Company Demergers in Turkey

Introduction

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Reconstructing of companies is a crucial issue in today's rapidly globalizing world especially for those who aim to achieve a strong business development and improvement. Demerger is one of the methods of reshaping a corporate structure by dividing the assets of the relevant company into parts and allowing companies that are to be established or already existent to possess these parts. Although mergers are more frequently applied in practice, demergers are still a very favorable method for companies wishing to adjust their corporate structure based on their needs and business plans.

In Turkish legal practice, the concept and conditions pertaining to demergers were not regulated under the former Turkish Commercial Code No. 6762. Corporate Tax Law No. 5520 ("CTL") sets forth provisions about tax issues of demergers, however these provisions are not sufficient to determine the way or methods of demergers. In 2012, Turkish Commercial Code No. 6102 ("TCL") has come into effect and demerger has been regulated therein. Currently, the definition, types and procedures of demerger are mainly regulated under TCL, Capital Markets Law No. 6362, Communiqué on Merger and Demerger, and CTL. As a matter of fact, despite the legislation attempts that have occurred so far, the existing legislation does not suffice for the needs of the business world; inasmuch as it lacks explicit provisions with regard to the procedures to be applied within a demerger transaction.

In this article, we aim to elucidate the principles and procedures of demerger in respect of TCC provisions.

Definition of Demerger

Demerger may simply be defined as a division of a company's assets and liabilities to be acquired by one or more companies. In a demerger transaction, the company which divides and transfers some or all its assets and liabilities is called "demerged company" or "transferor", and the company which acquires the assets and liabilities of the demerged company is called "acquiring company" or "transferee".

In respect of TCC, commercial companies (joint stock company, limited liability company, commandite company, collective company and cooperatives) may demerge into commercial companies.

Types of Demerger

Demerger may basically be carried out in two ways, i.e. (i) full demerger (also known as "demerger in whole") and (ii) partial demerger. Full demerger is transferring a company's all assets and liabilities (by dividing them into sections/parts) to an existing or newly established company or companies, whereupon the transferor is dissolved and ceases to exist as a legal entity. In this type, the transferor loses its legal personality and the said company is removed from trade registry. Partial demerger is the second type of demerger in which the transferor does not lose its legal personality through the demerger, but instead, it transfers determined parts of its assets and liabilities to existing or newly established companies.

Demerger may also be classified as (i) demerger through acquisition, and (ii) demerger by formation of a new company. Demerger through acquisition takes place if the transferee is an already existing commercial company; and this company acquires shares and/or assets of the transferor within the demerger transaction. In the second option, instead of transferring the assets to an existing company, a new company is established with these assets.

Protection of Shares and Rights of Transferor

Shares and rights of the transferor must be secured through both full and partial demerger. Shareholders of the transferor acquire shareholding rights in the transferee as the transferor's assets and the titles thereof are transferred to the transferee. In case there is more than one transferee, shareholders of the transferor may acquire shareholding rights in some or all transferees. Based on the intention and will of the parties, either the shareholders of the transferor or the transferor itself may acquire shares and shareholding rights in the transferee in exchange for the transferred assets.

General Provisions Related to Demerger

Within the framework of TCC, companies engaging in a demerger transaction shall follow below provisions in case of any necessity:

- » **Capital Decrease:** In case the transferor's capital decreases due to the demerger, provisions specified under TCC related to the procedure of capital decrease shall not be applied. In a full demerger, capital decrease will not come into question as the transferor loses its legal personality through the process.
- » **Capital Increase:** The transferee is under the obligation to increase its capital for the amount sufficient to protect rights of the shareholders of the transferor.
- » **Formation of a New Company:** Provisions of TCC and Cooperatives Law No. 1163, related to the company establishment shall be applied to the formation of a new company through demerger. It is important to note that the specific conditions related to the minimum number of founders and capital in kind shall not be applied for the formation of commercial companies.
- » **Preparation of Interim Balance Sheet:** An interim balance sheet shall be prepared in case (i) there is a period more than six months between the date of balance sheet and signature date of the demerger agreement or preparation date of the demerger plan or (ii) significant changes occur in the assets and liabilities of the companies engaging in the demerger transaction.

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Procedures of Demerger Transaction under TCC

Provisions of TCC provide a road map for the demerger process and procedure to be followed by the companies. Documents to be prepared and procedures to be followed through demerger are listed below in parallel with TCC:

- **Demerger Agreement and Demerger Plan:** In case, the transferor transfers all or some parts of its assets and liabilities to existing companies, a demerger agreement; and if the transferor transfers all or some parts of its assets and liabilities to newly established companies, a demerger plan shall be prepared by managing bodies of companies engaging in the demerger. Both of them must be in writing and must be approved by the general assemblies of these companies. The demerger agreement and the demerger plan must include especially below points:

- Company names, company types, headquarters of the companies engaging in demerger;
- Allocation and division of the assets and liabilities for demerger (i.e. the list including inventories, immovable assets, negotiable instrument and intangible assets allocated for the demerger);
- Exchange rate of shares, if necessary, the equalization amount and explanations regarding rights held by shareholders of the transferor in the transferee;
- Rights granted by the transferee to the privileged shareholders, the holders of non-voting shares, and the holders of dividend shares;
- Exchange method of company shares;
- The date that shares are entitled to the balance sheet profit and all characteristics of this claim;
- The date on which the transactions and actions of the transferor shall be deemed to have been made on the account of the transferee;
- Special benefits granted to the managing bodies, directors and auditors;
- The list related to business relations transferred to the transferee due to demerger.

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Parties are free to add other issues to the demerger agreement or plan in addition to the mandatory issues stated above.

➤ **Demerger Report:** This report aims to provide detailed information regarding the demerger process to the shareholders of the companies. Boards of directors of the companies engaging in demerger shall prepare a demerger report. Mandatory components of this report set out in TCC are as follows:

- The purpose and the results of demerger,
- Demerger agreement or demerger plan,
- Exchange rates of shares, and if determined, the equalization payments; explanations regarding rights held by shareholders of the transferor in the transferee,
- Principles regarding the valuation of shares for determining the exchange rate,
- If required, information regarding additional payment and other personal performance obligations and personal liabilities and unlimited liabilities of the shareholders as a result of demerger,
- In case of a demerger of different types of companies, liabilities to be imposed on shareholders due to the new type of the company,

- Demerger's effects on the employees of the companies engaging in demerger, and, if exists, the content of a social plan,
- Demerger's effects on the creditors of the companies engaging in demerger,

In case the demerger is executed with formation of a new company, articles of association of the new company shall be attached to the demerger report.

In case all shareholders approve, small and medium sized enterprises may decide not to prepare a demerger report.

- **Inspection Right:** Shareholders of the companies engaging in demerger have the inspection right; thence, each company shall present (i) the demerger agreement or the demerger plan, (ii) the demerger report and (iii) year-end financial statements of the last three years, annual activity report, and, if exists, interim financial statements in their headquarters and branches 2 months prior to general assembly meeting.

In case all shareholders approve, small and medium sized enterprises may decide not to exercise the inspection right.

5 General Assembly Meeting for Approval of Demerger

Managing bodies of the companies participating demerger submit the demerger agreement or the demerger plan to the general assemblies. It is important to note that before submitting these documents to general assembly, an assurance for creditors must be provided or allocated.

In joint stock companies, general assembly may approve the demerger with three quarters of existing votes present at general meeting provided that they represent majority of the capital. In limited liability companies, general assembly may approve the demerger with three quarters of the votes of all shareholders provided that they represent at least three quarters of shares representing the capital. In case the percentage of shares are not granted at the same rate in the transferee, the demerger shall be approved with minimum 90% of the shareholders who are entitled to vote in the transferor.

Invitation to Creditors

Parties of demerger must announce to and invite their creditors to apply them regarding their receivables. Invitation to the creditors must be announced in trade registry gazette for three times within the period of seven days. Companies engaging in demerger shall provide assurance to the creditors who apply them within three months starting from announcement for invitation.

Registration and Legal Consequences of Demerger

Once the demerger is approved by the general assembly, the board of directors shall apply to the trade registry for the registration.

Demerger becomes valid upon registration at the trade registry. With registration, all assets and liabilities of the transferor determined under inventory shall be automatically transferred to the transferee. In case of full demerger, the transferor is dissolved upon registration.

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