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TURKEY'S MANDATORY TENDER OFFER RULES: ENOUGH PROTECTION FOR MINORITY SHAREHOLDERS?

GÜNİZ GÖKÇE AND TULU HARSA

The Turkish capital markets legislation includes a number of provisions that aim to protect the interests of minority shareholders in the context of takeover bids and changes of control. The foremost of these measures is arguably the mandatory tender offer requirement. This article offers an analysis of the mandatory tender offer rules, with a focus on the adequacy of the level of protection provided to minority shareholders. This article draws examples from the capital markets legislation, the decisions of the Turkish regulatory authority (the Capital Markets Board) in charge of enforcing the capital markets legislation and case law.



Legal framework

The Capital Markets Law No. 2499 of 1981 (CML)¹ Article 16(A), gives the Capital Markets Board (CMB) the authority to enact secondary legislation governing the acquisition of shares in listed companies by way of tender offers, for the protection of minority shareholder rights and to ensure transparency. Communiqué Serial IV No. 8 on the Principles of Proxy Voting, Proxy Solicitation and Tender Offers (the Communiqué)² issued by the CMB sets out these rules.

Conditions

A mandatory tender offer is required to be launched under the Communiqué when a person acting alone or in concert with others, directly or indirectly, in a single transaction or through a series of transactions, or by any other means:

- acquires 25 per cent or more of the share capital and voting rights of a listed company

- acquires shares allowing it to control a listed company, regardless of the number of shares it holds or
- increases its shareholding by 10 per cent or more within any 12-month period in a listed company in which it otherwise already holds 25 to 50 per cent of the share capital and voting rights.

Main steps of a mandatory tender offer

Once the requirement of a mandatory tender offer is triggered, the parties involved must make a public announcement regarding the underlying acquisition through the Istanbul Stock Exchange (ISE), where the shares are listed.

The purchaser of the shares is then required to make an application to the CMB for the approval of the tender offer. Alternatively, the purchaser may seek an exemption from the CMB in respect of the mandatory tender offer requirement, as discussed below.



Although the legislation governing mandatory tender offer rules is straightforward, it does not regulate in detail various issues that rest at the core of a mandatory tender offer, such as the offer price.

Following the approval by the CMB, the tender offer needs to be announced in the newspapers and thereafter launched via an intermediary financial institution. The shareholders of the listed company are entitled to sell their shares in the company to the purchaser during the time period set out in the announcement at the offer price approved by the CMB.

Lastly, the intermediary financial institution acting for the purchaser in the tender offer is required to notify the CMB and the ISE of the tender offer results.

A timeline of a mandatory tender offer process may be reflected as shown in Chart 1.

Exemptions

At the request of the purchaser, the CMB may, at its discretion, grant an exemption from the mandatory tender offer requirement based on the following grounds:

- the acquisition aims at strengthening the financial soundness of the target
- the acquisition is approved by a qualified majority of the shareholders of the target company
- the control of the target company would not change as a result of the acquisition
- the acquisition results from a legal requirement or
- the acquisition is realised through a privatisation process.

The grounds set out in the second and third bullets are the most commonly seen bases for a CMB exemption.

Issues for follow-up

Although the legislation governing mandatory tender offer rules is straightforward, it does not regulate in detail various issues that rest at the core of a mandatory tender offer, such as the offer price.

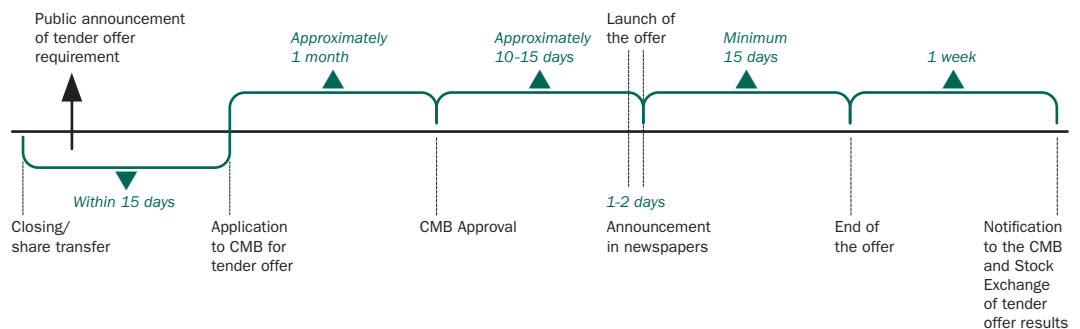
So far, the approach of the CMB has been to exercise discretion on these issues through its decisions on a case-by-case basis.

This gives the CMB greater flexibility in protecting the interests of the parties involved in accordance with the specifics of the transaction at hand. While this approach aims to achieve a result which is tailored to the specific transaction, it may, on the other hand, potentially lessen the level of comfort among investors, shareholders and even practitioners, due to the resulting lack of certainty and relatively limited transparency.

This is mainly because, despite the consistency in the CMB decisions, it is not always possible to have a clear understanding of the guiding principles and reasoning behind them. In most cases, only the operative sections of the CMB decisions are published in the CMB bulletins and there is no, or limited, access to the detailed facts of an application reviewed by the CMB.

In addition, the decisions of the CMB are not frequently challenged and therefore rarely tested before the Turkish courts. This, in turn, means that there is a lack of settled case law reflecting the position of the judiciary on the practice adopted by the CMB in respect of these issues.

Chart 1
The mandatory tender offer process



Source: Article authors.



There is no explicit regulation on how a foreign currency-denominated purchase price should be converted into Turkish lira in the context of calculating the offer price.

Due to their importance, we have briefly analysed the practice of the CMB on the questions of (i) the calculation of the offer price; (ii) the calculation of the offer price in acquisitions where the purchase price is denominated in a foreign currency; (iii) the calculation of the offer price in indirect acquisitions; and (iv) the accrual of interest on the offer price.

Offer price

The Communiqué states that the offer price must not be less than an amount equal to:

- the highest price per share paid by the purchaser in an acquisition (in a single transaction or a series of transactions) by way of a block sale or a voluntary tender offer
- the highest price paid per share by the purchaser in the three-month period preceding the date the tender offer requirement was triggered, by way of any other type of acquisition.

The offer price is paid in the local currency, in cash.

Offer price in foreign currency-denominated acquisitions

As mentioned above, the offer price in a mandatory tender offer is to be paid in Turkish lira.

There is no explicit regulation on how a foreign currency-denominated purchase price should be converted into Turkish lira in the context of calculating the offer price. Where the purchase price in an acquisition is in a foreign currency, the exchange rate to be used in the calculation of the Turkish lira tender offer price will be determined in consultation with the CMB. The CMB often requests changes in the exchange rate proposed by purchasers to protect the interests of minority shareholders.

The settled practice of the CMB is to require that the conversion be made by taking into account the higher of the Turkish Central Bank's foreign exchange purchase rate at 15.30 (EET):

- on the date of the transaction and
- on the first business day preceding the date on which the tender offer is launched.

Offer price in indirect acquisitions

It is common in acquisitions of listed companies for the target to have listed subsidiaries. In these circumstances the purchaser of the target would be required to launch a tender offer not only in respect of the target, but also for each of the listed subsidiaries.

Indirect acquisitions are not expressly regulated under the Communiqué. However, the CMB has adopted a practice in indirect acquisitions of calculating the offer price based on the weighted-average exchange trading price of the shares of the listed subsidiary for the three-month period before the date of the acquisition triggering the tender offer.

The CMB also takes into consideration factors such as (i) the existence of a valuation on the shares acquired in the listed subsidiary; and (ii) the purchase of shares by the purchaser in the listed subsidiary during the three-month period before the date of the acquisition, in the calculation of the offer price in indirect acquisitions.

The takeover of Yapı Kredi Bank by Koçbank³ is a recent example of this CMB practice. Koçbank indirectly acquired a number of listed Yapı Kredi subsidiaries including Yapı Kredi Insurance as a result of the acquisition and was required to launch a tender offer in respect of each of these subsidiaries. The CMB in its decision on the tender offer application of Koçbank required the offer price for Yapı Kredi Insurance to be increased to the weighted-average exchange trading price for the three-month period before the date of the acquisition. Accordingly, Koçbank increased its offer price for Yapı Kredi Insurance shares from 1.91 Turkish lira to 2.45 Turkish lira per share, translating approximately to a substantial 28 per cent increase on the proposed offer price.

Significantly, it is worth pointing out that an offer price based on the weighted-average exchange trading price can be lower than the trading price of the listed subsidiary. This issue was the subject of litigation recently in relation to the acquisition of Finansbank by the National Bank of Greece⁴ where the shareholders of the listed financial lease company of Finansbank, Finans Finansal Kiralama A.S., challenged the decision of the CMB claiming that the offer price should not be less than the trading price of the shares.



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The Administrative Court reviewing the matter ruled for the claimant shareholders, cancelling the CMB decision approving the tender offer with immediate effect. The CMB initially appealed the ruling of the Administrative Court and thereafter adopted a second decision requiring the purchaser, National Bank of Greece, to apply to the CMB for a second tender offer and provide with this application the valuation on the shares of the listed subsidiary. The purchaser, National Bank of Greece, provided the valuation for the shares, but challenged the CMB decision requiring a second tender offer to be launched by filing an administrative lawsuit on the grounds, among others, that the tender offer was already completed.

The above clearly shows that until investors start litigation, the settled practice of the CMB can be sufficient in addressing the unregulated issues relating to tender offers. But once the Pandora's box is opened and the CMB practice is challenged, things can get complicated.

It is highly likely that these developments will lead to a change in the CMB practice or prompt new regulation to be enacted by the CMB on the matter of tender offer pricing in indirect acquisitions.⁵

Accrual of interest on the offer price

The duration of a tender offer process can significantly vary depending on the specifics of an acquisition transaction. It is quite common for acquisitions to incorporate an adjustment component in respect of the purchase price in circumstances where the acquisition process is lengthy.

In acquisition transactions, particularly where the purchase price is denominated in Turkish lira, the CMB closely monitors the timing involved in the tender offer process and if, in its view, this term is longer than that of what may be considered a typical tender offer, interest is accrued in the calculation of and applied to the offer price by the CMB.

The applicable rate of interest is determined by the CMB on a case-by-case basis with an aim of "making whole" the minority shareholders for any financial loss that they may suffer due to the delay in the payment of the offer price.

Some recent examples are the acquisition of Finansbank by the National Bank of Greece, where the CMB applied interest on the purchase price for the 95-day adjustment period at a rate of 5.47 per cent yearly, and the acquisition of Migros by Moonlight Capital where the CMB applied interest for a period of 45 days due to the unjustified delay that occurred in the completion of the application file.

Sanctions for a breach of mandatory tender offer requirements

The Communiqué sets out the conditions of a mandatory tender offer process, but what happens when a purchaser does not comply with these requirements?

Neither the CML nor the Communiqué includes provisions imposing specific sanctions on the violation of mandatory tender offer rules. Therefore, the general sanctions applicable to the violation of capital markets legislation as set out in the CML will also apply to the violation of mandatory tender offer rules.

Accordingly, under Article 47(A) of the CML, the CMB may impose a fine for the violation of a mandatory tender offer requirement of an amount of 15,000 Turkish lira to 100,000 Turkish lira (approximately, €7,128 to €47,517).⁶ Significantly, the CMB refrains from imposing repeated fines where a purchaser's failure to comply with the mandatory tender offer requirement continues.

It is clear that these sanctions are not severe enough to have a dissuasive effect on the market participants. There are very few examples of violations of mandatory tender offer requirements in the Turkish market, but this fact does not change the potential legal risk as perceived by the investors and minority shareholders in relation to violations of the mandatory tender offer rules.

Remedies available to minority shareholders

In the event of a violation of the mandatory tender offer requirements, any of the minority shareholders may initiate litigation proceedings against the purchaser that failed to comply with such requirements.



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Case law, although very limited on the matter, suggests that Turkish courts view tender offer requirements as minority rights that must equally benefit all shareholders. In lawsuits where the minority shareholder petitioned the court to rule for the purchaser that violated the tender offer requirements to purchase its shares, it was ruled that the court may not decide in favour of shares of solely the shareholder initiating the lawsuit, but must order the purchaser to launch a mandatory tender offer to all shareholders as per the requirements of the capital markets legislation.

If the purchaser fails to comply with the judgment of the court, that is, fails to launch a mandatory tender offer, the shareholder that initiated the lawsuit would be entitled to compensation. However, a claim for compensation necessarily means additional litigation costs and a further delay in recovery of losses to the detriment of the minority shareholders.

Arguably, the litigation path is a long and burdensome one for the minority shareholders with no guaranteed time frame and outcome.

An additional point of interest worth noting is that case law and scholars' views suggest that courts should take into consideration the actions of minority shareholders following the date of the acquisition. In this context, it is argued that if a minority shareholder continues to trade in the shares of the target, that is, sells and buys-back or buys additional shares in the target after the date of the acquisition, then this can be construed as consent to the change of control by the relevant shareholder, relinquishing its rights to the mandatory tender offer. In the practice of mandatory tender offers, no distinction is made between shareholders that have acquired shares before or after the date of the acquisition.

Towards a more efficient minority protection

With many shortfalls in the legislation and limited dissuasive measures as sanctions, it is important to tighten the regulatory framework governing mandatory tender offer rules under Turkish law in order to better protect the interests of minority shareholders and foster a more investor-friendly legal environment.

In this context, the issues that have been addressed through the CMB practices should be regulated under the Communiqué. We understand that the draft Communiqué that was prepared by the CMB in 2003 aimed at achieving this purpose, but for now it remains pending.

Specific sanctions should be introduced to allow the CMB to impose tougher sanctions on violations of mandatory tender offer requirements. These could include sanctions authorising the CMB to suspend the exercise of all ownership-related rights of the purchaser (other than dividend rights) in respect of acquired shares pending a corrective action on the violation of the mandatory tender offer requirement. Similar sanctions exist in banking legislation and have been important tools in ensuring compliance with the mandatory provisions of this legislation.

It is time for Turkey to revisit and improve the protection of minority shareholders' rights in the context of mandatory tender offer rules. In so doing, Turkey should also align its laws with that of its European counterparts, and particularly the European Directives on Takeover Bids, in line with its commitment to adopt the European Union's *acquis communautaire*.

Notes and authors

- ¹ Published in the Official Gazette numbered 17416 and dated 30.07.81.
- ² Published in the Official Gazette numbered 21872 and dated 09.03.94.
- ³ Under a share purchase agreement dated 8 May 2005 by and between various Çukurova Group companies, Mehmet Emin Karamahmet, Koç Finansal Hizmetler and Koçbank Nederland, Koçbank acquired 57.4 per cent shares in Yapı Kredi Bankası.
- ⁴ Under a share purchase agreement dated 3 April 2004 by and between Fiba Holding, Fina Holding, Fiba Faktoring Hizmetleri, Girişim Factoring and National Bank of Greece, National Bank of Greece acquired 46 per cent of the ordinary shares in Finansbank and 100 per cent of the founders' (privileged) shares.
- ⁵ In fact a draft communiqué was prepared by the CMB in 2003 regulating various issues including pricing for tender offers in indirect acquisitions. However, the draft communiqué is still pending as of the date of this article.
- ⁶ The applicable amounts are subject to revision on an annual basis. The above figures relate to 2008. The currency rates were converted on 30 January 2009 at a rate of one Turkish lira to 0.475496 euros.



1 Güniz Gökçe
Partner, Gide Loyrette Nouel, Istanbul
Tel: +90 212 385 04 15
Fax: +90 212 325 35 87
Email : gokce@gide.com



2 Tulu Harsa
Associate, Gide Loyrette Nouel, Istanbul
Tel: +90 212 385 04 15
Fax: +90 212 325 35 87

Gide Loyrette Nouel
Buyukdere Caddesi Yapı Kredi Plaza
C Blok Kat 3 Levent 34330 Istanbul Turkey