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Project Finance

Turkey
Levent Lezgin Kılınç, Seray Özsoy, Duygu Doğan Şahiner
and Bartu Metin
Kılınç Law & Consulting

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Contributed by:
Levent Lezgin Kılınç, Seray Özsoy, Duygu Doğan Şahiner and Bartu Metin
Kılınç Law & Consulting** **see p.14

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1. Project Finance Panorama

1.1 Recent Trends and Developments

Within the last year in Turkey, important financing projects have been completed in the energy, automotive, agriculture, heavy industry, textiles, defence industry, aerospace, technology and real estate sectors.

Projects with national and international partnerships and state banks financing are generally realised as investments from scratch. In recent years, consortium models have become prominent in major projects. In addition, the incentives injected directly into the economy, along with the government's incentive policy, played a critical role for economic development in terms of helping their effects to emerge in a short time. In line with the financial support given to SMEs and small businesses, products such as raw materials, spare parts, etc, that need to be produced by intermediate staff and intermediate units have increased profitability and ensured that investments are built on solid foundations.

It was decided to gradually reduce loan and deposit rates as of the second half of 2019. In addition, the Central Bank reduced the policy interest rate to 12% with the decision published by the Monetary Policies Board on 12 December 2019. Loan interest rates, which were 24% in the first half of 2019, decreased to 1% on a monthly basis at the end of the year. With this decision, the terms of loans used with high interest rates were extended during the year and costs were reduced.

The Central Bank of Turkey announced in a press release dated 31 March 2020 that in order to limit the adverse effects of the COVID-19 outbreak, rediscount credits will be available for Turkish lira-denominated export and foreign exchange earning services for up to TRY60 billion. In the previous period, it has been observed that the loan requirement for working capital was effectively met by the banking system. For this reason, it was decided that TRY20 billion of the facility allocated for Turkish lira rediscount credits would be extended more efficiently as an investment-committed advance loan in order to support investments in selective sectors, which are deemed critical to the country.

Of the remaining TRY40 billion limit for Turkish lira rediscount credits, TRY20 billion is being used by Turkish Eximbank, TRY10 billion by public banks, and TRY10 billion by other banks. Moreover, when examining the projects implemented in recent years in Turkey, it shall be seen that there are also numerous projects that are jointly financed by both local and foreign lenders.

1.2 Sponsors and Lenders

In Turkey, sponsors typically vary from local companies to multinational sector leaders, based on the size and length of the undertaken projects.

Lenders in the Turkish market are typically the institutions that are licensed by the Banking Regulation and Supervision Agency (BRSA) which are public, private or investment banks that lend funds to the sponsors for the financing of the projects.

However, many other actors in the sector – including multinational lending agencies and international finance institutions such as the European Bank for Reconstruction and Development (EBRD), International Finance Corporation (IFC) and European Investment Bank (EIB) – can act as lenders.

1.3 Public-Private Partnership Transactions

In Turkey, there are four main public private partnerships (PPP) models: build-operate-transfer (BOT); build-operate (BOO); build–lease-transfer (BLT); and transfer of operating rights (TOOR). The sectoral scope of the BOT and TOOR models is quite wide – currently, highway, airport, port, marina and tourism facility, customs facility and customs gate, urban infrastructure and energy facility projects are carried out with these models.

The major legislation regarding the PPP structure in Turkey is as follows:

- Law No 3996 on Making Certain Investments and Services within the Framework of Build-Operate-Transfer Model;
- Law No 3096 on the Assignment of Incorporations other than Turkish Electricity Authority for the Generation, Distribution and Trade of Electricity;
- Law No 3465 on the Assignment of Establishments other than the General Directorate of Highways for Construction, Maintenance and Operation of Highways with Access Control;
- Article 23 of Law No 652 on Institutions Providing Private Accommodation Services and Some Regulations;
- Article 20 of the Higher Education Credit and Hostels Institution Law No 351;
- Law No 4283 on the Establishment and Operation of Electrical Energy Production Facilities with the Build-Operate Model;
- Law No 4046 on Privatization Applications; and
- Article 33 of Law No 5335 (Transfer of Airport Operating Right).

1.4 Structuring the Deal

First of all, in a traditional project, a special purpose vehicle (SPV) according to the desired company form is required to

be incorporated. The SPV can be incorporated as a company – either a limited liability company or a joint stock company. If it is decided that the project company is to be formed as a company, and therefore a legal person, a joint stock company is preferred, due to the limitation of liabilities and the structure of capital.

In these cases, if there are multiple sponsors in the project, there are two agreements that are traditionally signed for the co-operation of the sponsors, as well as to determine their rights and obligations. In Turkish law, the content and the limitations in drafting an article of association (AoA) is regulated strictly in the Turkish Commercial Code and the AoA is registered to the Trade Registry and announced in the Turkish *Trade Registry Gazette*. Therefore, parties cannot regulate every issue in their internal relationship within the AoA due to the limitations imposed by law and the usually confidential nature of the internal relationship. Internally, a shareholder's agreement (SHA) is signed between the parties; this remain confidential unless a dispute arises. If there is a conflict between the AoA and SHA then AoA shall prevail according to legal regulations. In order to ensure the relationship between sponsors are protected as much as possible, AoA tends to be kept short and concise, regulating only what is required by law.

There are also other methods that can be used in project financing, such as consortiums and joint ventures. However, since the use of joint ventures and consortiums require direct liability of the sponsors, if the project does not specifically define the structure (which may occasionally happen, especially in tenders and PPP projects when the public authorities so require), the incorporation of a company is advised.

However, in cross-border transactions that include foreign lenders, creditors or security providers, the SPV may be shaped according to the different requirements and precautions of the various parties.

Therefore, in order to correctly assess the project financing structure to be formed and the legal nature of the SPV, a unique evaluation is required to be completed for every unique project.

2. Guarantees and Security

2.1 Assets Available as Collateral to Lenders

Lending institutions can use real estate and all kinds of immovable mortgages, liens on movables and stocks, letters of guarantee, any receivable that is allowed to be assigned, equipment, bonds and repo as loan collateral.

As per the formalities:

- in order to register immovable properties as collateral, a registration before land registry is required;
- commercial enterprises can be registered as collateral and the related transaction is required to be completed before the notary public;
- when shares are subject to lien, shares are endorsed and registered in the company's share ledger;
- assignment of receivables can only be valid and binding if agreed in writing between the assigner and the transferee; and
- for the loans where commitments and/or receivables on agreements are subject to lien, the agreement is required to be written and it is strongly advised to notarise the agreement as a possible prevention of disputes.

2.2 Charges or Interest over All Present and Future Assets of a Company

Turkish law does not permit a floating charge or other security interest over present and future assets. In Turkish law, the subject of the security is required to be definite.

2.3 Registering Collateral Security Interests

Credit-users are required to pay different charges for different types of security formalities described above. It is required to pay the notary fee for registration of commercial enterprises as securities and commitments on contract receivables and, depending on the contract, the fee for depository services. Moreover, notary and Land Registry expenses are required to be paid in order to register immovables as security; the fees and taxes that are required to be paid are determined according to the CPI rate at the beginning of every year.

2.4 Granting a Valid Security Interest

Regardless of the type of collateral to be registered as a security in Turkish law, the specific items are required to be mentioned according to the type of collateral agreement made. A general description of the scope of the determined coverage is not sufficient and, as previously mentioned, the subject of the security is required to be definite in every security transaction.

2.5 Restrictions on the Grant of Security or Guarantees

In line with the provisions on preservation of capital, companies are restricted from purchasing and/or accepting their own shares as security or guarantee. Moreover, there may be extra restrictions imposed depending on the nature of security or guarantees and depending on the request of the lender.

2.6 Absence of Other Liens

Commercial enterprise liens must be made through a notary public. If a lien has been established on a commercial enterprise, it appears on the notary system if a secondary lien has been registered on the item. In immovable liens, the lien must be recorded in the Land Registry records. If a new lien is to be established, it is stated in the Land Registry system that there is already a lien for the subject property.

Although this does not stop the lien from being recorded, it makes the registered lien secondary to the previous lien in payments.

2.7 Releasing Forms of Security

Securities given against a loan or an agreement are released after the payment of the current loan debt or the fulfilment of the contractual obligations. After the parties release each other from the contractual obligations, the lien release procedures are initiated and the lien on the subjected property is removed. Land Registry fees or notary fees must be paid in order to complete this operation according to the type of lien.

3. Enforcement

3.1 Enforcement of Collateral by Secured Lender

As per the provisions of the Turkish Code of Obligations No 6098, a secured lender can enforce its collateral provided that the claim is unpaid and has become due. The basic instrument to put the claim in default is to instigate a warning to a debtor and to give a specific time, unless there was already an agreed specific time in the agreement.

According to the Turkish Enforcement and Bankruptcy Law No 2004, collateral enforcement methods depend on the collateral's quality. The basic and most preferred method is to claim to sell the assets which were registered as collateral, through enforcement offices. When collaterals are valuable immovable and/or movable assets other than cash collateral, bank letter, or cheques, the lender may make an application before the enforcement offices in order to put up the collateral for sale. In project finance, these collaterals are mostly the right of a mortgage on immovable assets such as facilities or debtor's properties or stock certificates of a debtor or guarantor's company. Following the lender's application, the selling procedure is organised by the enforcement office and collateral is sold by auction unless the related collateral does not have a market value.

On the other hand, the lender may accept the bank letter or bank cheque as collateral. In this situation, once the debtor became overdue, the lender may collect the collateral from the guarantor bank without applying to any enforcement offices.

3.2 Foreign Law

Pursuant to Article 24 of the International Private and Civil Procedure Law of Turkey No 5718 (MOHUK), in case there is a foreign element in an agreement, the parties may decide on the application of foreign law. Should the parties choose foreign law, the dispute in the agreement shall be resolved by the foreign law before the foreign judicial authorities. In order to be able to take action before Turkish courts with a foreign court decision, the recognition and enforcement process of the decision must be completed.

After the recognition and enforcement process is completed, all kinds of demands, acquired before foreign courts or arbitral tribunals, may be executed within Turkish courts and enforcement offices.

3.3 Judgments of Foreign Courts

A judgment ruled by a foreign court or an arbitral award may be enforceable within the Turkish jurisdiction. Since Turkey is as a contracting state to the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards, arbitral awards which are given by one of contracting states shall be recognised and be enforced according to provisions of the New York Convention, without a retrial.

In case that the arbitral award is given by a country other than New York Convention's contracting states, or a judgment which is given by any foreign country's court is in question, then recognition and enforcement procedures shall be subjected to MOHUK. According to the MOHUK, a valid and definite foreign country court's judgment or arbitral award (given by non-member states of the Convention) shall be enforceable exactly like a judgment or award procured in Turkey with a recognition decision given by the Turkish Civil Court of First Instance.

3.4 A Foreign Lender's Ability to Enforce

Under Turkish law, foreign lenders generally have the same rights as Turkish citizens to apply to courts and enforcement offices regarding their rights arising from loan or security agreements. However, according to the Code of Civil Procedure No 6100 and MOHUK, Turkish citizens with no habitual residence and foreigners should provide a cash or guarantee letter as collateral in order to initiate a lawsuit and execution proceeding or participate physically to lawsuits before the Turkish courts and enforcement offices, unless their country is not a party to the Convention of 1 March 1954 on Civil Procedure.

4. Foreign Investment

4.1 Restrictions on Foreign Lenders Granting Loans

Loans in foreign currency and indexed to foreign currency from Turkish or foreign banks are regulated under the Decree No 32 and its secondary legislation. Pursuant to such decree, persons residing in Turkey cannot take out foreign currency loans in Turkey or from foreign countries.

Foreign exchange matters are mainly regulated by:

- the Law on Protection of the Value of the Turkish Currency No 1567 of 20 February 1930;
- Decree No 32 Concerning the Protection of the Value of Turkish Currency (Decree No 32);
- Circular of the Central Bank of the Republic of Turkey (CBRT) on Capital Movements No 2002/YB-1 of 2 January 2002.

The rules regarding Turkish residents obtaining loans from abroad are set out in Article 17 of Decree No 32 and, in relation to this, certain restrictions on obtaining foreign currency loans have recently been introduced. Turkish resident legal entities may freely receive loans in Turkish liras from abroad if they utilise such loans through banks in Turkey. Turkish resident legal entities may also receive loans in foreign currency from abroad, if they abide by the principles and restrictions set out under Decree No 32 and they utilise such loans through banks in Turkey. Generally, Turkish resident legal entities with no foreign currency income must not receive loans in foreign currency from abroad. However, this condition will not be required for the following categories.

- Public entities, banks, financial leasing, factoring and financing companies.
- Legal entities with a loan balance of USD15 million or more at the time of the use of the new loan.
- Loans obtained based on investment incentive certificates.
- Loans used for the financing of equipment listed under line 17 of the Annex-I to the Council of Ministers Decree No 2007/13033 on the Determination of the Value Added Tax Ratios to be Applied to Goods and Services.
- Legal entities that are awarded with internationally announced domestic tenders or a defence project approved by the Undersecretaries of the Defence Industry.
- Legal entities appointed to conduct public-private partnership projects.
- Legal entities performing foreign currency generating transactions through export, transit trade and other sales and deliveries that qualify as exporting activities, if these entities certify that they:
  (a) have not generated foreign currency income within the three previous financial years; and
  (b) can potentially generate foreign currency income no less than the amount of the foreign currency loan amount.

In addition to the above, the Council of Ministers is authorised to determine further exemptions.

4.2 Restrictions on the Granting of Security or Guarantees to Foreign Lenders

There are no restrictions against providing security or guarantees to foreign lenders and the procedure is usually completed through a letter of guarantee issued by one of the Turkish banks on behalf of the project company. Also, counter-guarantees are widely accepted by the Turkish banks which results in a facilitated regime for the provision of security or guarantees for projects in Turkey.

4.3 Foreign Investment Regime

The national policy applicable to foreign direct investments in Turkey has been liberalised following the amendments to the Foreign Direct Investment Law No 4875 (FDI Law) in 2003.

In principle, foreign direct investments can enter into the Turkish business landscape freely without any need for permission. Legal entities incorporated under Turkish law with foreign capital, irrespective of the shareholding percentage of the foreign investors, are treated as domestic companies. Foreign investors and their investments are accorded the same level of treatment as domestic investors and their investments.

Investors are only required to notify the Treasury and the Ministry of Finance, through an online platform (Electronic Incentive Application and Foreign Investment Information System, E-TUYS), of the investment type (whether share transfer, greenfield, etc), capital investment amount and the shareholding structure. They must inform the Ministry about their investment activities on a yearly basis on any capital increases or share transfers, and any payments related to such increases or transfers, through E-TUYS. The information is provided by filling in the standard forms available in the system.

The FDI Law also introduced some other principles which are vital for fostering a successful foreign investment environment such as the freedom to invest, valuation of non-cash capital and the employment of foreign personnel. Foreign investors can freely establish an entity, open a branch and/or acquire shares of an existing company and conclude know-how technical assistance agreements with domestic companies.

Under the FDI Law, companies with foreign shareholding which are established in line with the Turkish Commercial Code are treated equally to companies with local shareholding. In line with this principle, foreign investors may establish a company with 100% foreign shareholding or acquire all of the shares of an existing Turkish company. However, exceptions to this equal treatment principle exist, including for acquisitions by companies with foreign shareholding of real property in Turkey. There are also restrictions on investment in certain strategic sectors such as TV broadcasting, maritime and civil aviation by companies with foreign shareholding.

In principle, Turkey has a liberal foreign exchange regime. Recently, certain foreign exchange restrictions related to foreign exchange outflows from Turkish residents have been imposed. Important exemptions to such restrictions exist, amongst others, for transactions entered into by branches, offices, or representation and liaison offices of foreign legal entities in Turkey, such as concerning sale and lease of immovables, employment and services contracts. Payments under independent contractors' agreements that include costs in foreign currency can be denominated in foreign currency. These exemptions minimise the effect of the foreign exchange restrictions on foreign investments.

Transfer of profits are guaranteed under the bilateral and multilateral investment protection treaties that the Republic of Turkey has ratified, as well as domestic laws.

Turkish resident companies are free to borrow from abroad in Turkish currency or in foreign currency, but foreign currency loans from abroad are subject to certain restrictions. Turkish legal entities without any income in foreign abroad currency are not allowed to borrow from abroad in foreign currency. Important exemptions exist such as loans to be granted to financial institutions as well as to legal entities whose loan balances are above USD15 million at the time of the drawdown. Furthermore, companies that are resident in Turkey may obtain intercompany loans in foreign currency from their parent companies, provided that such parent companies directly or indirectly own 100% of their shares.

4.4 Restrictions on Payments Abroad or Repatriation of Capital

There are no restrictions on the expatriation of dividends or investments abroad. According to the FDI Law mentioned in **4.3 Foreign Investment Regime**, the regulations accept a foreign investor in the same way as a local shareholder and provide no restrictions in regard to the payment of dividends or repatriation of capital to the investors state.

4.5 Offshore Foreign Currency Accounts

Since the major projects are usually subject to tenders, one of the prerequisites of the project would be for the SPV to have a bank account in Turkey. Also, Turkish banks may decide to set a prerequisite for the project company to have an account in Turkish banks.

However, there are cases where the project company is operated through offshore foreign currency accounts. Here, particular attention should be paid to the issues of dividend transfer and double taxation according to the concrete event and the country of the investor.

5. Structuring and Documentation Considerations

5.1 Registering or Filing Financing of Project Agreements

First of all, it should be noted that private law subjects do not have any registration or filing obligations within the scope of the projects (financing or project agreements) they undertake in Turkey. However, there are exceptions to this general rule.

Public or public-private partnership projects that are subject to the tender procedure are required to be registered by the relevant tender institution. In addition, the application to tenders by private law persons is also subject to special forms determined by law. Moreover, publicly held companies have certain notification and permission obligations that are subject to the Capital Markets Board (CMB). It is obligatory to apply to the CMB for transactions such as issuance and public offering of capital instruments, mergers, acquisitions and divisions. There are also certain obligations that public companies are subject to under the Banking Regulation and Supervision Agency.

For these reasons, although the projects and/or financial agreements are generally not subject to any notification or registration obligation, there are certain obligations that may be imposed if the company is publicly held and if the project is realised within the scope of a tender, or if the project is subject to special regulatory institutions such as the CMB, BRSA and EMRA. Accordingly, the authorities and legislation to which the relevant financial or project agreement is subject to should be considered separately for every project. In this way, specific obligations to be complied with and registration obligations specific to project-based works shall be determined.

5.2 Licence Requirements

In Turkey, the companies that want to operate in underground and natural resources fields must acquire a licence from the institutions that regulate the relevant areas to be able to engage

in these activities. Mining, petroleum works, water resources and fields of activity within the scope of EMRA are the primary areas that require a licence for companies to operate. Especially within the scope of EMRA, production, storage, transmission, distribution and similar activities in the fields of electricity, natural gas, petroleum and LPG require a licence to be given by the relevant institution.

In accordance with Article 5 of the Electricity Market Licensing Regulation, the legal person who wants to operate in the market (except for the companies that are exempted from the obligation under the Regulation) is required to obtain a separate licence for each activity and, if the said activities are to be carried out in more than one facility, obtain a separate licence for each facility. According to the physical condition of the connection point and the facility, the Board may evaluate the units subject to more than one project under a single pre-licence or licence. In this context, the person who wants to carry out production, transmission, distribution, wholesale, retail sale, import, export and market operation activities in the field of electricity must first be a legal person, and must obtain a separate licence for each of the above-mentioned fields of activity.

There is no obstacle against foreign companies operating in the electricity sector in Turkey, but every company that shall operate in the sector is required to be a limited liability company or a joint stock company incorporated according to the regulations of the Turkish Commercial Code. In addition, there are separate regulations within the scope of each resource/energy element, and there may be articles, minimum capital requirements, periodic audit/reporting processes that must be included in the company's articles of association in order for a company to acquire a licence.

5.3 Agent and Trust Concepts

In order for legal transactions to be valid according to Turkish law, the parties must reflect their will in the legal process and ensure the fulfilment of the debts that will be charged to them as a result of this legal transaction. In accordance with the principle of proportionality of agreements, an agreement only binds the parties of that agreement and can only impose rights and debts on the parties of that agreement. For example, by establishing a consortium, it is not possible to follow up the work that is the subject of the consortium and to leave the authority and responsibility in this context to a single party or a third party. Within the scope of a project, those who are shareholders of the project jointly have the responsibility and cannot assign the responsibility to a single shareholder.

Even if there is no "guarantee representative" specifically defined under Turkish laws, in practice, there is almost no transaction without a guarantee in multilateral and complex business partnership, SPV, shareholding, etc, structures. Among the collaterals, instruments such as lien, mortgage, third-party surety, guarantorship, performance bond obtained from the bank, and bonds are frequently used. In addition, in commercial relations where both parties are merchants, the limits of liability and penal clauses are applied for possible disputes.

For this reason, although the concept of "trust" is not valid in Turkish law, the legal transaction and relationship are carried out in accordance with the contractual decisions taken by the parties of the legal transaction.

5.4 Competing Security Interests

The rules governing the priority of competing security interests may vary on the type of security. Priority in collateral and security aspects is the order of date. Mortgage order and lien order is also important, in terms of prioritisation. The parties are free to agree on a different ranking in any case. Within the scope of the Law on the Procedure for the Collection of Public Receivables, public receivables may be prioritised in some cases.

The ranking of contractual security depends on the date of the creation of the security, or it may be stated in the contract which of the guarantees will be applied first and which will be applied later. Here, joint/several collection or sequential application can be envisaged. An example of this is joint or ordinary securities.

5.5 Local Law Requirements

Within the scope of projects and financial agreements, capital and individual companies can be established within the scope of the Turkish Commercial Code; projects and financial agreements can also be conducted through the establishment of a partnership or consortium. For example, it is obligatory to be subject to the CMB and to operate as a joint stock company in order to go public. Further, in order to operate within the scope of EMRA, the legal person must be a joint stock company or a limited company. In addition, the partnership structure, management structure, and responsibility structure of partners and managers for each type of company are different. The liability of the partners for the debts of the company is much heavier in a collective company and commandite company compared to the limited company and joint stock company.

Determining the legal form of a project company depends on several factors such as the field of activity of the project company, the legislation which it will be subject to, the permits and licensing regulations to which it is bound, the degree of influence the shareholders want to use on the management, the balance of responsibility and rights and obligations, risk-taking, tax processes, etc.

6. Bankruptcy and Insolvency

6.1 Company Reorganisation Procedures

Various legal remedies are foreseen in Turkish law in order to ensure restructuring other than bankruptcy. These can be summarised as concordat, restructuring by means of reconciliation and restructuring between the parties with external agreements without being brought before the court.

Concordat is not technically a procedure that allows the debtor's debts to be collected partially or completely, such as execution or bankruptcy proceedings. Concordat is a procedure that aims to prevent the debtor from bankruptcy by delaying and restructuring the debts of the debtor who wants to pay their debt but cannot pay do so due to economic developments and market conditions.

Concordat can be classified as either bankruptcy concordat and non-bankruptcy (ordinary) concordat, according to the time it is made. While an ordinary concordat has the feature of preventing the debtor's bankruptcy, the bankruptcy concordat is a method applied for a company which has decided to go bankrupt in order to remove the bankruptcy decision.

The non-bankruptcy concordat process begins when the debtor or one of the creditors who may request the bankruptcy of the debtor apply to the commercial court of first instance and submit a concordat project and specify when and how the debts will be paid. In the presence of the necessary conditions, the court gives temporary respite to the debtor and appoints a temporary concordat commissioner. The court must decide whether the debtor will be given a definite deadline within the temporary deadline. Within the scope of the concordat process, creditor meetings will be held and the concordat project will be voted on. With the approval of the concordat, concordat provisions become obligatory for all creditors.

In the abandonment of assets method, which is a type of concordat, the creditors are authorised to make savings on the debtor's assets or to transfer all or part of these assets to third parties. In this type of concordat, there is a liquidation stage similar to that in bankruptcy.

Restructuring by means of reconciliation is a method foreseen for capital companies and co-operatives, allowing these companies to continue their activities by reconciling with their creditors and changing their debts and, if necessary, their structural organisations.

Restructuring through reconciliation enables a capital firm or a co-operative to escape bankruptcy by agreeing with its creditors within the framework of a restructuring project. Restructuring through settlement involves not only the restructuring of debts, but also the financial restructuring of the company or the co-operative. In reconciliation, the borrower company or the co-operative prepares a restructuring project and this project must be negotiated and voted on with the creditors. The debtor can apply to the court for the approval of the project, together with the project, which has the required quorums and has been accepted as a result of the voting.

6.2 Impact of Insolvency Process

Various arrangements have been made in the relevant articles of the Execution and Bankruptcy Law No 2004 regarding the status of the receivables existing at the time of bankruptcy. In line with the adjudication of bankruptcy proceedings, it is regulated that the receivables that are not yet due will become due and demandable with the bankruptcy decision of the court. The exception to the rule is: the receivables guaranteed by a lien on an immovable property of the debtor. In regard to these types of receivables, the maturity date of pledged receivables shall be delayed and the debt shall not become due with the court decision.

In addition, with the decision of bankruptcy, processing of interest on interest-bearing debts does not stop. In line with the opening of the bankruptcy proceedings, interest continues to be charged for the receivables that can be registered to the bankruptcy estate. It is important to emphasise that, in accordance with the principle of equality between creditors adopted in Turkish bankruptcy law, even if monetary or non-monetary receivables can be registered to the bankruptcy estate, these receivables will be paid in cash. However, the bankruptcy administration may choose to pay off the debt by specific performance for non-monetary receivables, if it is in the best interest of the bankruptcy estate. In this case, the bankruptcy administration will be obliged to give a guarantee upon the request of the creditor.

Creditors who are bound with a delaying condition or an uncertain term, can also register their receivables at the bankruptcy estate. However, at the end of the liquidation phase, the share allocated for these receivables will be payable only if the condition is met or the uncertain maturity is reached.

6.3 Priority of Creditors

In case of bankruptcy, the payment to be made to the creditors is made in the following order: first of all, the receivables that are secured with liens are paid. Afterwards, the tax receivables arising from the goods or immovables, the costs of keeping and selling the pledged goods, and the rights of the ship's creditor, if any, are paid.

The amount remaining with bankruptcy costs and bankruptcy estate's debts being paid with this money. The remaining amount is distributed according to the order specified in Article 206 of the Execution and Bankruptcy Law No 2004, as detailed below.

First Rank
The first rank for payment is (in the following order):

- the receivables of the workers, including the notice and severance payments accrued within one year prior to the opening of the bankruptcy, based on the employment relationship, and the notice and severance payments they deserve upon the termination of the employment relationship due to bankruptcy;
- debts of employers to facilities have gained legal personality or associations that were incorporated for the purpose of establishing or maintaining aid funds or other aid organisations for employees;
- all kinds of alimony arising from family law that is required to be paid in cash which have accrued in the last year before the opening of the bankruptcy.

Second Rank
The second rank is all receivables of those whose properties are left to the administration of the debtor due to guardianship and tutelage. However, if these receivables are opened within the period following the termination of bankruptcy, guardianship or custody or in the year following their expiration, they will be considered as privileged receivables and priority will be given.

Third Rank
The third rank is receivables specified as privileged in their special regulations.

Fourth Rank
Lastly, the fourth rank is all other non-privileged receivables.

6.4 Risk Areas for Lenders

As a rule, the creditor cannot claim from the surety bond unless they request payment from the debtor first. However, the exemption of this situation is stated in Article 585 of the Turkish Code of Obligations (TCO), No 6098. In the event that the debtor's bankruptcy is decided pursuant to this article, the creditor may make a request directly from the guarantor/security provider without applying to the debtor. Therefore, this situation is an advantage for lenders.

If the receivable is also secured with a lien in ordinary guarantee, before or during the guarantee, the guarantor/security provider may request that the receivable is to be taken from the pledged property first, whereas if the burrower has become insolvent the guarantor/security provider will not be able to request the debt to be set off from the lien first. Therefore, this situation constitutes an issue in favour of the creditor and, in case of bankruptcy of the debtor, the guarantor/security provider is obliged to pay the debt directly and without resorting to the lien.

Additionally, according to Article 202 of the Enforcement and Bankruptcy Law, No 2004, if the guarantor goes bankrupt before the actual debt is due, the creditor will be able to register the receivable in the bankruptcy estate of the guarantor. In this case, after the actual debt is due – when the conditions for applying to the guarantor specified in Article 585 of the TCO in case of ordinary guarantee and in Article 586 of the TBK in the case of joint guarantee – the creditor will be able to receive the money corresponding to their receivable from the bankruptcy estate in the amount that the guarantor would be responsible for.

In accordance with all these issues, alternatives have been created within the legal system in order for the debtor, security provider or guarantor to claim their receivables in case of bankruptcy, and the risk for creditors are minimised.

6.5 Entities Excluded from Bankruptcy Proceedings

Persons subject to bankruptcy in Turkish law are indicated in Article 43 of the Execution and Bankruptcy Law, and persons subject to bankruptcy in accordance with the aforementioned article are those who are subject to the provisions of the Turkish Commercial Code and the real or legal persons who are declared to be subject to bankruptcy, although they are not merchants according to their special laws.

In order to determine the persons who are not subject to bankruptcy, it is useful to determine who are the real and legal persons who are in fact subject to bankruptcy, namely: commercial companies; foundations; associations that operate a commercial enterprise in order to achieve their purpose; institutions and organisations established by the state; special provincial administrations, municipalities and villages and other public legal entities to be managed or commercially operated in accordance with the provisions of private law in accordance with their own founding laws (and thereby considered merchants). In addition, those who act as if they have opened a commercial enterprise and associations of shipowners are also subject to bankruptcy. Traders who abandon the trade will be subject to bankruptcy for another year after the announcement of their abandonment.

However, the state, special provincial administrations, municipalities and villages and other public legal entities and public benefit associations, and foundations that spend more than half of their income on public duties are not considered merchants and are not subject to bankruptcy.

In addition, the foreclosure and bankruptcy provisions of the Execution and Bankruptcy Law cannot be applied to the Social Security Institution. Although it may be possible to initiate enforcement proceedings by means of foreclosure for the sake of collecting these receivables, it does not seem possible to get results from the enforcement proceedings initiated, especially against public legal entities, since it has been stated in Article 82 of the Enforcement and Bankruptcy Law that state property and other properties specified in other laws cannot be seized.

7. Insurances

7.1 Restrictions, Controls, Fees and/or Taxes on Insurance Policies

In accordance with Article 33 of Expenditure Tax Law No 6802, a 5% tax is applied to insurance transactions. The Bank Insurance Transaction Tax (BITT) rate was determined as 5% with the decision dated 12 August 1991, No 91/2072, published in the *Official Gazette* on 16 August 1991, No 20962. Although the liability of the tax is the insurance companies themselves; this is a subsidised liability, just like VAT, and the tax burden is reflected towards the end user who benefits from the services as a result.

However, there are some exceptions according to Article 29 of the same law. For example, the following are exempt from all kinds of taxes, duties and charges: the money received for insurance against nuclear risks, mortgage finance institutions, housing finance institutions, and housing finance funds received in favour of all transactions within the scope of housing finance as defined in the first paragraph of Article 38/A of the Capital Market Law No 2499, and compulsory earthquake insurance (DASK) premiums.

However, for each insurance policy, there are "general conditions" published by the Turkish Association of Insurance (eg, based on policy type, responsibility or varying according to the property insurance); pursuant to these general conditions, there are certain exemptions for insurance coverage that are jointly present in every policy due to the standardised coverage by the general conditions. For example, in accordance with the General Conditions of Personal Accident Insurance, participating in strikes, locked-out labour movements, popular movements and fights are within the scope of the exemption.

7.2 Foreign Creditors

Mostly, risks in a project finance transaction are reinsured abroad, at a percentage determined depending on the types of transaction. Both original insurances and reinsurance are transferable and can also be paid to the foreign creditor.

Reinsurance of a certain part or all of the insured risk is called "reinsurance insurance". Insurance companies take out repeated insurance in order not to have difficulties in paying the damage, in case of the risk of large damages coming at the same time. Reinsurance allows insurance companies to spread out risks that are not financially possible to bear on their own. On the basis of certain financial measures, the risk is then transferred to reinsurance companies through reinsurance agreements for parts exceeding the risk that the insurance company can undertake.

In reinsurance transactions, the company that takes over the risk in this way is called a "ceding company" and the company that issues the reinsurance policy is called a "reinsurer". The ceding company reflects a certain part of the premiums collected from the insured and the damages paid to the insured to the reinsurance company through reinsurance agreements made according to different techniques. Big tax assessment risks undertaken by insurance companies in Turkey are usually reinsured with foreign insurance companies.

8. Tax

8.1 Withholding Tax

The relevant articles of the Income Tax Law and the Corporate Tax Law list the items that will be subject to tax withholding. The major items are self-employment payments, employee payments, rent payments, and dividends.

Article 30/8-b of the Corporate Tax Law regulates the tax cuts that will be made from the credits used from abroad. According to said article, no tax deduction is made over principal, interest and dividend payments, insurance, and reinsurance payments regarding loans obtained from foreign financial institutions.

Furthermore, the consumer loans used from domestic banks and finance companies, credits used from abroad by residents of Turkey, and futures import transactions are subject to Resource Utilisation Support Fund (RUSF) deductions. Thus, the credits in foreign currency and gold used by residents of Turkey, except the banks and finance companies, will be subject to RUSF cuts in varying rates according to the maturity of the loans. The said RUSF cuts are determined into brackets and are as follows;

- 3% for those with an average maturity of up to one year;
- 1% for those with an average maturity between one year (including one year) and two years;
- 0.5% for those with an average maturity between two years (including two years) and three years;
- 0% for those with an average maturity of three years (including three years) or more.

8.2 Other Taxes, Duties, Charges

In addition to the deductions stated in the above article, creditors have been evaluated separately in terms of Banking and Insurance Transactions Tax (BITT).

Pursuant to paragraph 2 of Article 28 of the Expense Taxes Law No 6802 ("The Law"), the money received by bankers in cash or on account for their own benefit due to their bank transactions and services (buying and selling securities on their own or on the account of others, commissions, fees on the income and benefits of those who are constantly in the business of collecting money in order to give deposit interest or to provide interest and similar benefits, with the money remaining in favour of those who make commitment to pay debts in return for the securities they buy and sell, money received under names such as service provision) are also subject to bank transactions tax.

In the event that the group firm residing abroad and providing credit is not a bank and financial institution or is an institution that provides financing only to group companies, a corporate tax withholding at a rate of 10% over the gross amount of the interest amounts to be paid must be calculated and declared.

8.3 Limits to the Amount of Interest Charged

In Turkish law, the Law on Legal Interest and Default Interest (Code No 3095) regulates the percentage of interest to be applied in cases where the parties do not determine the contractual interest and default interest rates. Code No 3095 also regulates the percentage of capital interest and default interest to be applied in commercial transactions.

Furthermore, the Turkish Code of Obligations No 6098 limits the contractual interest rates to be determined between the parties. It is crucial to mention that the Turkish Commercial Code No 6102 clearly states, in Article 8/1, that the interest rates may be determined freely in commercial transactions. As a result, the interest rates can be determined freely in commercial transactions, as well as project finance processes – otherwise the amounts indicated in Code No 3095 will apply.

9. Applicable Law

9.1 Project Agreements

As detailed in **9.3 Domestic Laws**, if the agreement does not have a foreign element then, as a rule, Turkish law will be applied to the agreement. However, if one of the parties is a foreigner, it can be decided that foreign country law will be applied in project agreements.

9.2 Financing Agreements

As detailed in **9.3 Domestic Laws**, if the agreement does not have a foreign element, as a rule, Turkish Law will be applied to the agreement. However, if one of the parties is a foreigner, it can be decided that foreign country law will be applied in project agreements.

9.3 Domestic Laws

As a rule, if the parties to the agreement are Turkish then Turkish law shall be applied.

The Law on International Private Law and Procedural Law (IPLPL) entered into force after being published in the *Official Gazette* dated 12 December 2007, No 26728, and regulates the law to be applied in transactions and relations related to private law with foreign elements, recognition of foreign decisions with the international authority of Turkish courts and rules on enforcement of decisions.

The "foreign element" mentioned here means that a legal act or transaction is related to or relevant to more than one legal system.

The foreign element is evaluated in terms of person or place. The element of foreignness in terms of the person is the case when at least one of the parties is a foreign citizen, is resident or has their habitual residence in a foreign country. Whereas the foreign element in terms of the place would be when the place of signature of an agreement or the place of fulfilment sought is in a foreign country.

In this respect, if an agreement has an element of foreignness, in order to determine the applicable law, Article 24 of IPLPL will find the application area. According to the aforementioned article, the parties are free to choose the law to be applied to the agreement, and the choice of law, which can be understood from the provisions of the agreement or the conditions of the case, is also considered valid. The parties to the agreement can decide that the chosen law will be applied to all or part of the agreement. The parties can always change the law they choose, and the choice of law after the establishment of the agreement will be effective retroactively, without prejudice to the rights of third parties.

Again, in accordance with Article 24 of IPLPL, if the parties of the agreement have not made a choice of law, the law most closely related to that agreement is applied. In this case, the following shall apply to the agreements: (i) the law of the habitual residence of the characteristic performance debtor during the establishment of the agreement, (ii) the law of the place of business of the characteristic performance debtor in agreements established for commercial or professional activities. However,

in cases where these two options cannot be determined, (i) residence law or (ii) if the characteristic performance debtor has more than one workplace, the workplace law, which is the most closely related to the agreement in question, shall apply to the agreement.

If there is no foreign element in the agreement, Turkish law will be applied to the agreement. However, even in this case, if there are transactions regarding real rights on immovables in another country, pursuant to paragraph 4 of Article 21, the law of the country in which these properties are located will be applied to legal transactions regarding real rights on immovables.

However, it should be emphasised that, although there is no foreign element in the agreement, in practice, the parties can refer to foreign law rules and even agree that a foreign law will be applied to the agreement. In this case, we are of the opinion that it cannot be said that the parties made a choice of law within the framework of Article 24 of the IPLPL mentioned above – on the contrary, the parties would incorporate the relevant provisions of the agreed law into the text of the agreement. (Please note: the opinion stated is the dominant view in the doctrine and there are also opinions arguing that the parties can choose foreign law, even if they are in the minority, although there is no foreign element.) In order for the IPLPL to find a field of application, the contract must objectively have a foreign element. In conclusion, we would like to state that it is of great importance to determine whether there is an element of foreignness in the contract.

Kılınç Law & Consulting is an Istanbul-based full-service law firm with offices in Izmir, London and Qatar. The firm operates with 22 different departments, with associates specialised in their respective departments providing services to many different clients in various sectors, including energy, retail, construction, aviation and foreign direct investments. The firm has a particularly strong and well-established project finance practice – especially on operations in the energy sector – aiding its clients with their contractual relationships with the sponsors, lenders and other actors in their transactions. The firm's goal is to offer preventative precautions and to generate solutions to the legal issues its clients face. The team of Kılınç Law & Consulting comprises experienced partners, associates, and paralegals who are fluent in English, German, Arabic, Russian and Azerbaijani.

Authors

Levent Lezgin Kılınç is the founding and managing partner of Kılınç Law & Consulting. He advises clients in their project financing requirements and assists them in their transactions and also advises in relation to dispute resolution matters, both internationally and in Turkey. Levent's practice focuses on corporate governance, mergers and acquisitions, investigations and dispute resolution. He advises clients extensively on matters involving cross-border acquisitions, joint ventures, private equity investments, strategic investments, investigations and litigation across a wide range of sectors, including financial services, retail, transportation, energy, and logistics and manufacturing.

Seray Özsoy is a partner/counsel at Kılınç Law & Consulting and heads the firm's M&A, capital markets, competition law and projects departments. Seray Özsoy has gained experience in the fields of commercial and corporate law, capital markets and project finance, as well as an extensive experience in national and international projects in the fields of mergers and acquisitions and competition law. She provides legal consultancy services in the fields of capital markets, competition and contracts law, as well as mergers and acquisitions; she specialises in sectoral investments in national and international areas, project finance, aviation and sports law, predominantly for local and foreign natural and legal persons and private equity funds and holding companies operating and investing in more various sectors.

Duygu Doğan Şahiner is one of the partners at Kılınç Law & Consulting and currently heads the firm's dispute resolution, maritime, innovation and fintech departments. Duygu Doğan Şahiner has gained experience in the fields of maritime law and dispute resolution as well as the follow-up and strategic planning of civil and penalty cases and enforcement proceedings throughout her career; she is specialised in providing consultancy services, drafting, examining and negotiating commercial contracts, litigation, and follow-up of transactions within the scope of maritime law, and has expertise in the fields of fintech and start-up law, e-sport, e-commerce, and artificial intelligence (AI).

Bartu Metin is an associate at Kılınç Law & Consulting and currently works at the firm's corporate law, mergers and acquisitions, intellectual property law and projects departments. Bartu has completed his legal internship at Kılınç Law & Consulting and over the course of his career has gained experience in the fields of corporate and commercial law, the completion of procedures associated with mergers and acquisitions, and intellectual property law; he is specialised in the drafting of commercial contracts, the follow-up and finalisation of commercial transactions subject to corporate law, drafting and negotiating SPA and SHAs, and overseeing operations on project financing.

Kılınç Law & Consulting

Levent Lezgin Kılınç
Seray Özsoy
Duygu Doğan Şahiner
Bartu Metin
Turkey

Tel: +90 212 217 12 55
Email: info@kilinclaw.com.tr
Web: www.kilinclaw.com.tr