Turkish Corporate Debt Restructurings: Navigating a Changing Landscape

By **SERA SOMAY** *and* **SONER DAĞLI**

This article aims to give a brief summary of recent developments in the Turkish financial markets relating to corporate restructurings and legal changes made as a result of such developments.

Overview of the Turkish Financial Markets

The second half of 2018 has been a difficult period for Turkey and its financial markets. Turkey has faced rating downgrades, the depreciation and volatility of the Turkish Lira, an increasing inflation rate and rising distress in the private sector.

In July 2018, Fitch lowered the sovereign rating of Turkey to BB from BB+. In August 2018, Moody's lowered the sovereign rating of Turkey to Ba3 from Ba2, three notches below investment grade, and Standard & Poor's decreased the rate to B from BB-. These downgrades took place shortly after the U.S. imposed sanctions against two Turkish government officials as a result of the detention of Pastor Andrew Brunson, who was held in prison by Turkey due to his alleged involvement in the failed coup of July 2016. After the release of Pastor Andrew Brunson on October 12, 2018, the U.S. lifted sanctions against two Turkish government officials in November 2018.

In September 2018, the Central Bank of Turkey raised its benchmark rate by 625 basis points to 24%. This steep rise in interest rates and an amelioration of the relations with the U.S. stabilized the Turkish Lira, which, as at August, had lost 36% of its value against the Dollar since the start of the year.

In October, Fitch downgraded the long-term foreign currency issuer default ratings of 20 banks and the viability rating of 12 banks. Although the Turkish banking sector has a strong track record and a moderate level of non-performing loans, these downgrades were based on the assumption that the sector could face challenging conditions in 2019 due to weaker economic growth, higher interest rates and an expected rise in non-performing loans. Furthermore, the Turkish banking sector is expected to roll over its loans at a higher cost.

Consumer prices were 24.52% higher in September 2018 and 21.6% higher in November 2018 compared to the same months in 2017, according to official statistics released by the Turkish statistics office (TUIK).[1]

Recent Legal Measures to Support Stability in the Turkish Financial Markets

Following the Turkish Lira's dramatic fall against the U.S. Dollar in recent months, the Turkish government has taken a number of measures to support the financial markets and stabilize the Turkish Lira, as discussed further below. One such measure is a new foreign exchange enabling Turkish residents to utilize foreign currency loans. The market appears to have welcomed the amendments.

Restrictions on FX Borrowings
On January 3, 2018, the Council of Ministries amended the Decree numbered 32 on the Protection of the Turkish Lira ("**Decree No. 32**") to restrict any foreign currency borrowings by Turkish corporates with no foreign currency revenues, except in limited cases, with effect from May 2, 2018. Turkish corporates are no longer authorized to borrow in foreign currency from Turkey or from abroad unless they have foreign currency revenues, an outstanding cash loan balance of at least USD 15 million or they benefit from other exemptions listed in Decree No. 32, namely:

— Foreign currency borrowings of public institutions, banks, financial leasing companies and financing companies;

— Foreign currency borrowings of legal entities with an investment incentive certificate allowing them to borrow in foreign currency;

— Foreign currency borrowings utilized by the legal entities for the financing of machinery or equipment with HS Codes as referred to under the relevant legislation;

— Foreign currency borrowings of legal entities that are the winners of national public tenders announced internationally, or foreign currency borrowings of the legal entities that will carry out defense industry related projects that are approved by the Undersecretariat of Defense;

— Foreign currency loans to be used by Turkish legal entities for the financing of renewable energy investments within the scope of a government purchase guarantee pursuant to the Law on Utilization of Renewable Energy Sources for the Purpose of Generating Electrical Energy numbered 5346 and dated May 10, 2005;

— Foreign currency loans to be used by Turkish legal entities who win tenders within the scope of the Law on Privatization Implementation numbered 4046 and dated November 24, 1994, or tenders in which the price is determined in foreign currencies;

— Foreign currency loans to be used by Turkish special purpose companies which are established for the sole purpose of acquiring the shares of a new company and which do not have any operations other than the realization of this purpose; or

— Foreign currency loans to be used by wholly owned (directly or indirectly) Turkish subsidiaries of foreign companies from such foreign companies and their wholly owned affiliates.

Furthermore, those Turkish corporates that do have foreign currency revenue or benefit from other exemptions listed above cannot borrow in foreign currency from abroad or from Turkish banks.

The banking sector could face challenging conditions in 2019 due to weaker economic growth, higher interest rates and an expected rise in non-performing loans.

Restrictions on FX Transactions
Pursuant to an amendment to Decree No. 32 that came into effect in September 2018, pricing and other payment obligations specified in certain types of agreements executed between persons residing in Turkey must be denominated in Turkish Lira. Accordingly, monetary obligations stipulated in sales and lease agreements for real estate property and vehicles, agreements to commission work that does not involve costs in foreign currency, service agreements (including consultancy, transportation and brokerage agreements) and employment agreements can no longer be determined in foreign currency or indexed to foreign currency but need to be set in Turkish Lira.

A number of exemptions were issued in October 2018 and updated in November 2018 with the Communiqué No. 2018-32/52, relaxing the restrictions and providing calculation methods for the conversion of existing foreign currency agreements into Turkish Lira. Amongst others, the exemptions are as follows:

REAL ESTATE SALE AND LEASE AGREEMENTS

The following real estate sale and lease agreements executed between Turkish residents are exempt from the Turkish Lira denomination requirement:

— Sale and lease agreements for real estate property located in free zones;[2]

— Real estate lease agreements executed for the purpose of operating accommodation facilities certified by the Ministry of Culture and Tourism;

— Lease agreements in relation to the lease of duty-free stores;

— Real estate property sale and lease agreements to which non-Turkish nationals residing in Turkey are party as *purchaser* or *tenant;* and

— Real estate property sale and lease agreements to which (x) the branches, representative offices or liaison offices of persons who are not residents in Turkey ("**non-residents**"), (y) Turkish companies in which non-residents directly or indirectly hold 50% or more of the share capital or which are under the control or joint control of non-residents or (z) companies based in free zones, are party as *purchaser* or *tenant*.

MOVABLE SALES AND LEASE AGREEMENTS

Agreements for the sale or lease of movable assets (commodities) other than vehicles (including heavy construction equipment) are exempt from the restriction. While the Turkish Lira denomination requirement applies to sale and lease agreements for vehicles, an exemption has been granted for the sale and lease of heavy construction equipment; these agreements can thus be denominated in foreign currency. Also, lease agreements executed before the restrictions entered into force for vehicles and sale agreements for passenger-carrying commercial vehicles can remain in foreign currency.

WORK COMMISSION AGREEMENTS

All agreements to commission a work that incorporate costs in foreign currency can be denominated in foreign currency.

EMPLOYMENT AGREEMENTS

The following employment agreements can be denominated in foreign currency:

— Agreements made as part of residents' activities to be performed abroad;

— Agreements to which non-Turkish nationals are party;

— Agreements to which seamen are party; and

— Agreements executed by (x) the branches, representative offices or liaison offices of non-residents, (y) Turkish companies in which non-residents directly or indirectly hold 50% or more of the share capital or which are under the control or joint control of non-residents or (z) companies located in free zones, where such entities are party to the employment agreement as *employer*.

SERVICE AGREEMENTS

The following service agreements can be denominated in foreign currency:

— Agreements to which non-Turkish nationals are party;

— Agreements that are made as part of export transit trade, sales and deliveries that may be deemed as export and exchange saving services and activities;

— Agreements made as part of Turkish residents' activities to be performed abroad;

— Service agreements that are initiated outside of Turkey and end within Turkey or vice versa, and service agreements that initiate and end outside of Turkey; and

— Service agreements executed by (x) the branches, representative offices or liaison offices of non-residents, (y) companies in which non-residents directly or indirectly hold 50% or more of the share capital or which are under the control or joint control of non-residents or (z) companies located in free zones, where such entities are party as *service recipient*.

Service agreements in relation to transportation activities can be indexed to oil prices.

SOFTWARE AGREEMENTS

IT agreements for the sale of software developed outside of Turkey, as well as license and service agreements for hardware and software, are exempt from the restriction.

Other Restrictions

The Banking Regulation and Supervision Agency (“**BRSA**”) capped Turkish banks’ cross currency swap, spot and forward transactions to 25% of a given bank’s regulatory capital. New transactions will not be executed or renewed until the current excess has been reduced to 25%, calculated on a daily basis. Transactions conducted by banks between their foreign credit institutions or financial institutions and which are within the scope of the same consolidated group are exempt from this restriction. Separately, when calculating the transactions falling within the scope of the 25% threshold, local banks should consider transactions having a maturity of (i) 90 to 360 days as 75% and (ii) no less than 360 days as 50%.

Furthermore, as of September 2018, Turkish exporters are now required to bring at least 80% of their foreign currency export revenues into Turkey within 180 days following the date of exportation and sale of such foreign currency proceeds to Turkish banks.

Recent Key Restructurings

The current restructuring environment is shaped by contractual arrangements amending the existing loan facilities and extending their maturity.

In May 2018, Yıldız Holding, the holding company of Godiva and McVitie’s, refinanced its short-term loan portfolio of approximately USD 6 billion. This refinancing is one of the largest such transactions undertaken by Turkish banks to date.

The closed restructuring of the USD 4.75 billion loan provided to Oger Telecom (“**OTAS**”) by a syndicate of Turkish and international banks is one of Turkey’s largest restructurings. OTAS is the special purpose vehicle holding the shares of Turkish Telecom—a listed company and a strategic asset for Turkey. As a result, the shares owned by OTAS in Turkish Telecom have been delivered to a special purpose company established by OTAS’s lenders. The financing being restructured dates from May 2013; OTAS began to fail making repayments in September 2016.

Dogus Holding, a conglomerate active in the automotive, construction, media, food and entertainment industries, disclosed that it is in talks with banks for the restructuring of loans valuing up to EUR 2.3 billion. This restructuring was completed very recently, just eight months following Dogus Holdings’ initial public announcement thereof.

We are also aware of a number of construction and energy companies currently working on restructurings. The energy sector, which has significant foreign currency exposure, has been affected particularly severely by the devaluation of the Turkish Lira along with rising natural gas and oil prices. The energy sector is also affected by the lack of realization of projected growth, which was projected by the IMF to be around 5% for both 2018 and 2019 but has been updated as 3.5% for 2018 and 0.4% for 2019. On the construction side, companies face pressure from decreasing real estate prices due to excessive supply and the rise in interest rates and construction costs.

As part of this ongoing restructuring, we expect to see various asset disposals by distressed companies.

Current Legal Framework on Restructuring on a Comparative Basis

There are three formal restructuring mechanisms provided for by Turkish legislation: (i) the concordat (*konkordato*), (ii) restructuring by way of framework agreement and (iii) restructuring upon settlement.

The concordat and restructuring upon settlement are formal restructuring options provided under the Enforcement and Bankruptcy Code No. 2004 (“**EBC**”). Restructuring by way of framework agreement is a form of restructuring based on (i) a restructuring regulation issued by the BRSA and (ii) a framework agreement issued by the Turkish Bankers’ Association and accepted by most Turkish banks by the execution of such framework agreement. Foreign financial institutions can choose to join the restructuring and become a member of the consortium creditors of a borrower by signing the framework agreement, without requiring the approval of other consortium creditors.

We provide below a comparative table reflecting the major steps under the concordat and a restructuring by a framework agreement. The table does not include restructuring upon settlement since this is not commonly used in the Turkish market. ■

1. http://www.turkstat.gov.tr/PreTablo.do?alt_id=1014
2. Free zones have been established in Turkey with the entry into force of Free Zones Law No. 3218. Free zones are special sites deemed outside the customs area, although they are physically located within the political borders of the country. Legal and administrative regulations in the commercial, financial and economic domains that are applicable within the customs area are either not implemented or partially implemented in free zones.

<table>
<tr><th>RESTRUCTURING BY A FRAMEWORK AGREEMENT</th><th>CONCORDAT</th></tr>
<tr><td colspan="2">WHO CAN APPLY?</td></tr>
<tr><td>Debtors (i) with a minimum credit balance of TL 100 million and (ii) against whom no enforcement proceedings have been initiated.</td><td>Individual and corporate debtors who are unable to pay their debts or who are not likely to pay their debts when due. Financial status and initial concordat project approved by an independent auditor should be submitted to the court.</td></tr>
<tr><td colspan="2">COURT APPROVAL</td></tr>
<tr><td>No court approval is required.</td><td>The court grants an initial concordat term up to three months (which can be extended to five months) and appoints a trustee to prepare an initial report reviewing whether the restructuring can be achieved. With the initial concordat, the standstill period commences.

At the end of the initial concordat term, the court may decide to reject the concordat claim or to grant a definitive concordat term for one year, which can be extended to one and a half years. If the court rejects the concordat application, it declares the debtor bankrupt.

Upon creditor approval (explained below), the restructuring needs to be approved by the court to be binding on all creditors.</td></tr>
<tr><td colspan="2">CREDITOR APPROVAL</td></tr>
<tr><td>The restructuring plan proposed by the debtor is required to be accepted by the Consortium Creditors holding at least two-thirds of the total indebtedness.

“Consortium Creditors” are financial creditors that signed the Framework Agreement. Other financial creditors that would like to be members of the consortium should sign the Framework Agreement and be approved by at least 30% in number of existing Consortium Creditors and by those Consortium Creditors holding at least 75% of the total indebtedness.

Foreign financial institutions can choose to become members of the consortium without the approval of Consortium Creditors.</td><td>During the definitive concordat term, the restructuring plan proposed by the debtor is required to be accepted by:

— the majority of the Creditors and the majority of the receivables; or

— one-fourth of the Creditors and two-thirds of the receivables.

For these purposes, the term “Creditors” includes all creditors of the debtor except (i) secured creditors, unless security is not sufficient to cover the secured debt, and (ii) employees, since payments to employees are not stopped as a result of the concordat.</td></tr>
<tr><td colspan="2">STANDSTILL PERIOD</td></tr>
<tr><td>The standstill period starts upon application by the debtor for the restructuring and continues until the expiration of the restructuring period.

The standstill period is a minimum of 90 days and can be extended to 150 days unless agreed otherwise by the Consortium Creditors.

During the standstill period, all enforcement actions by the Consortium Creditors are suspended and no new enforcement action can be initiated by the Consortium Creditors.

During the standstill period, the debtor undertakes to treat all creditors equally, not to take new loans, not to make any asset disposals, including any disposals of tangible rights, not to make any settlement of debt and to share information and documents with creditors.</td><td>The standstill period starts with the court’s approval of the initial concordat term and continues until (i) the court’s rejection of the concordat or (ii) the court’s approval of the definitive concordat period.

The initial standstill period is 90 days and can be extended to 150 days with court approval. If the court accepts the concordat, the definitive concordat period lasts a minimum of one year and can be extended to one and a half years.

During the standstill period, all enforcement actions by creditors (excluding the proceedings initiated for the debts secured with a pledge or mortgage and the proceedings initiated by the employees) are suspended and no new enforcement action (excluding proceedings initiated for the debts secured with a pledge or mortgage and proceedings initiated by the employees) can be initiated by the creditors.

There are no specific restrictions on the debtor.</td></tr>
<tr><td colspan="2">AMENDMENT, HAIRCUT, EXTENSION OF NEW LINES</td></tr>
<tr><td>A new credit line should be extended by all Consortium Creditors if such extension is approved by more than one Consortium Creditor holding at least 90% of the total indebtedness. If this majority is not reached, Consortium Creditors can still extend a new credit line with the approval of 30% in number of Consortium Creditors and those holding at least 75% of the total indebtedness.

Any haircut or payment in kind is possible if approved by 100% of Consortium Creditors. Any reduction or cancellation of debt will be distributed among Consortium Creditors on a pro rata basis.

The restructuring agreement can be amended if approved by at least 30% in number of Consortium Creditors and those holding at least 75% of the total indebtedness.</td><td>No higher voting quorum applies to any haircut or extension of new lines.

The restructuring agreement cannot be amended without court approval.</td></tr>
<tr><td colspan="2">END RESULT FOR CREDITORS</td></tr>
<tr><td>Following execution of the restructuring agreement and as long as the obligations under such agreement are performed, no further enforcement action can be initiated by the Consortium Creditors.

This is not binding on creditors other than Consortium Creditors.</td><td>Once the restructuring is approved by the court, the restructuring agreement binds all creditors.</td></tr>
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Sera Somay is a partner at Paksoy with experience in multiple practice areas including finance, restructuring, Islamic finance and capital markets. She has previously advised investors in the restructuring of a high-yield bond issued by a Turkish construction company. Currently, she is advising international financial institutions and domestic commercial banks on an ongoing restructuring of a Turkish energy company. She received an LL.M. from New York University School of Law and a law degree from Istanbul University.

Soner Dağli is an associate at Paksoy. His practice areas include finance, restructuring and capital markets. He has advised a consortium of Turkish banks in their restructuring of loans provided to a Turkish steel company, and is currently advising international financial institutions on a restructuring. He received a law degree from Galatasaray University School of Law.