

Introduction of an In-Court Restructuring Mechanism: The Turkish Concordato Scheme

By MELTEM AKOL



Coinciding with the general downturn in the Turkish economy, concordato, re-introduced in 2018, is currently the only in-court reorganization proceeding available for Turkish companies, which may be initiated by either the debtor company or a creditor.

The re-introduction followed the repeal of the postponement of a bankruptcy mechanism, which, though not designed as a restructuring tool, was being used opportunistically as one. Lessons learned have been and are still being incorporated into the concordato scheme. Since its re-introduction, there have been a number of cases even though its use has been limited

to (in practice, but not in law) small to mid-size enterprises. The restructuring of large size companies has so far still been done on an out-of-court basis, led by refinancing of financial indebtedness and combined with asset disposals and equity injections.

Nonetheless, financial lenders and corporates dealing with suppliers and customers that may be impacted by counterparty concordato proceedings have been analyzing the new concordato rules to update their loan underwriting standards and to build in trade protections.

Concordato is aimed at being a preventative, pre-insolvency tool. It is not available to companies with an unsustainable debt burden. To take advantage of the concordato scheme, the applicant must show the court that the debtor is unable to, or may become unable to, pay its debts as they become due, but, would be able to pay its debts or avoid bankruptcy if granted a maturity extension or a discount on principal and debt.

Concordato Proceedings

At the initiation of the concordato proceedings, in addition to a creditors list and financial statements, the applicant must present to the competent court: (i) a preliminary restructuring plan detailing the proposed payment plan, which may include proposed haircut, plans for asset disposals, equity injection and procurement of new financing; (ii) a comparison of the liquidation proceeds that creditors would receive upon a bankruptcy process versus the expected recovery amounts that would become available following the proposed concordato plan; and (iii) an audit report from an accredited independent audit firm giving reasonable assurance that the preliminary restructuring plan can be realized.

Protection Available to the Debtor Pending Concordato Proceedings

Upon a duly made application, which could be made by a debtor or creditor, the competent court shall, without having to assess the merits in detail, grant a temporary protection term to the debtor for up to five months and appoint a temporary concordato officer(s) to assess the viability of the restructuring plan. The grant of the temporary protection term is notified to government institutions and is announced to the public. The announcement further invites creditors to file their claims and objections.

As such public announcement is made at the outset, before commencement of the final concordato proceeding, this potentially puts a strain on the continuous relationship of the debtor with its creditors, suppliers and employees (even though certain protections against termination of the contracts are offered in the concordato institution – more on this below).

The court will eventually decide whether to grant a final protection term by reviewing the claims of the debtor, the objections of the creditors and the temporary concordato officer's report. The final protection term is granted for one year, which may be extended twice, each such extension being for a period of 6 months. Such extensions may be

requested to enable potentially lengthy divestment required to implement the restructuring, lengthy negotiations between creditors and investors, or due to conditionality attached to new financing. The court may terminate the final protection term if the financial status of the debtor ameliorates or the opening of bankruptcy due to certain reasons including the deterioration of the financial status of the debtor.

The most important protections extended to the debtor during the protection term (which are the same for the temporary and final period) include the following:

- No collection proceedings may be initiated or continued against the debtor, including for tax and other receivables of the state.
- As a major exception, secured creditors may initiate and continue foreclosure proceedings up to the point of sale of the pledged asset.
- Sale of pledged assets or return of property subject to financial lease to the lessor may, however, be postponed up to one year following the concordato order of the court, if the pledged or leased asset is crucial to the operational viability of the debtor.
- Interest ceases to accrue on any unsecured debt, unless the approved concordato plan proposes otherwise.
- Any transfer by the debtor of contingent receivables that crystallizes during the protection term is deemed invalid.
- Creditors that have non-monetary claims must calculate and submit the cash value of their claims, unless the debtor elects to continue with specific performance. Such valuations may not always reflect the true value of the claims. If the debtor objects to the quantum of the creditor's claim, the court shall re-evaluate the creditor's valuation.
- Contractual terms stating that a concordato filing constitutes an event of default, a ground for termination or acceleration of debt (the so-called ipso facto clauses) are not enforceable in the case of contracts that are material to the overall viability of the business of the debtor.
- Debtor may terminate, with the consent of the concordato officer and the court, contracts (except employment contracts) that impose continuous performance obligations on the debtor and hinder the chances of success of the concordato. Any compensation that may result from such termination shall be subject to the concordato terms *pari passu* with other unsecured creditors.

Control of the Debtor's Business

The control of the business remains with the debtor in principle, subject to the supervision of the concordato officer. The court may require certain actions and transactions be approved by the concordato officer or, alternatively, the court may at its discretion, transfer management control to the concordato officer altogether at any time during the concordato proceeding. The authority of the debtor to encumber or dispose of property such as machinery, equipment, real estate, vehicles required for the operation of the business or provide sureties during the protection periods is restricted. Violation of these restrictions or instructions of the concordato officer may result in removal of management control or even declaration of bankruptcy.

Concordato Officer

Amongst the concordato officer's duties are to compile an inventory of the debtor's assets and conduct a valuation, invite creditors to submit their claims for recognition, hear the objections of the debtor to creditors' claims, examine the debtors' books and records, make conclusions in his report to the creditors and invite the creditors to negotiate the debt restructuring plan.

Given the breadth of the concordato officer's duties and further in view of the potential shift of the management of the debtor as described above, concerns have been voiced in the market that candidates for concordato officer roles lack the necessary skills and capabilities to fulfill these duties.

Role of Creditors and the Approval of the Concordato Plan

Creditors are represented during the process by a creditors' board comprising of up to seven creditors, selected by the court representing diversified kinds of debt. The creditors' board role is to supervise the concordato officer and make recommendations to the court. In determining whether to terminate the protection term for the debtor due to amelioration or deterioration of the financial situation of the debtor or to invalidate any encumbrance or disposal of property conducted by the debtor during the protection term, the court must consult with the creditors' board.

All recognized creditors are invited to meet with the concordato officer, in the attendance of the debtor, to negotiate and vote on the proposed concordato plan. The concordato plan remains available for review and execution for seven days following the meeting.

Quorum for acceptance of the concordato plan is more than 1/2 of the recognized creditors in number and the aggregate amount of the recognized debts, or 1/4 of the recognized creditors in number and 2/3 of the aggregate amount of the recognized debts. Disregarded in the voting are claims of employees (the terms of which may not be amended by the concordato terms) and secured debt, subject to the below. The court has discretion as to whether to grant voting rights to holders of contingent or disputed claims.

Creditors may not formally propose an alternative plan. Shareholders typically play an indirect role in formulating the concordato plan through existing management.

The court or the creditors may not force the substantive consolidation of the debt and receivables of group companies where a concordato plan is submitted for a single member of a corporate group. Concordato provides no specific treatment for intercompany loans.

Secured Creditors

If the debtor has requested a restructuring of its secured debt as part of the concordato, separate negotiations will need to be held with the secured creditors. Secured debt continues to accrue interest at the rates set in their original contracts, as from the date of the concordato request.

Any agreement for a haircut on principal and interest amounts and any debt rescheduling is binding on dissenting secured creditors only if approved by secured creditors holding more than 2/3 in aggregate principal amount of the secured debt, provided that the concordato plan is also approved by the required majority of the unsecured creditors.

Dissenting secured creditors are deemed to have accepted the longest of the rescheduled maturity terms approved by the requisite majority of the secured creditors.

Default of the debtor vis-à-vis even a single secured creditor of the terms of the concordato plan entitles such creditor to revoke its consent to the concordato plan. If secured creditors holding 2/3 or more of the secured debt revoke their consents, the concordato plan is no longer binding on the remaining secured creditors.

Concordato Order by the Court and its Effects

The court will approve the final terms of the concordato plan that has been accepted by the creditors, if it determines that: (i) the projected recovery amount under the proposed plan is more favourable than the recovery that bankruptcy liquidation proceeds would yield; (ii) the projected recovery amounts are proportionate to the resources available to the debtor (and the court has discretion in considering the extent to which expected future income of the debtor should be taken into account); (iii) meeting requirements (quora and approval levels) were duly met; (iv) employee claims can be paid in full; (v) sufficient reserves are set aside to perform obligations undertaken with the consent of the concordato officer during the protection period; and (vi) concordato proceeding costs are covered. The court order sets forth the haircut ratio and the maturities rescheduling.

Following approval of the concordato plan, the court may appoint an administrator to oversee and manage the implementation of the concordato terms and provide update reports to the court as to the ongoing ability of the debtor to service its debt. Such reports remain available to creditors for review but are not otherwise made publicly available.

The concordato order may require provisions for debts in dispute. Creditors with claims that were not recognized during the concordato proceedings may bring their challenges within one month following the court order for concordato. Concordato orders may also be appealed against by the debtor or any objecting creditor. An appeal would not halt implementation of the concordato, unless provided otherwise in the approved concordato plan.

The concordato plan approved by the court order is binding on all creditors, except the following which are excluded from the scope of the concordato coverage:

- employee receivables,
- secured creditors' receivables to the extent covered by the security,
- receivables of the state, such as tax,
- obligations which the debtor undertakes during the concordato proceedings with the consent of the concordato officer; and
- receivables of the counterparties under the continuously performed contracts which were approved by the concordato officer.

Attachments on property of the debtor given effect prior to the commencement of concordato proceedings will cease to be effective, except for those relating to claims excluded from the concordato plan. Any commitment of the debtor to any other creditor, beyond the approved concordato plan is invalid.

Debtor default vis-a-vis an unsecured creditor entitles such creditor to revoke concordato as it applies to it, upon application to the court.

Actions of bad faith that aim the concordato to be accepted by any creditor or the debtor may result in the concordato being revoked in its entirety. As an example, if the debtor makes or promises a secret additional payment (which is not covered by the terms of the concordato project) to a creditor in exchange for that creditor's vote in favour of the concordato project, that may be deemed as bad faith. Additionally, if the debtor presents fictional debts to be included in the concordato, then the relevant concordato project may be revoked.




Concordato documentation and financing provided during proceedings benefit from certain tax incentives.

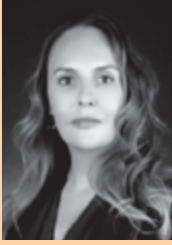
Rejection of the Concordato

If the plan is not accepted, the court may convert concordato proceedings into bankruptcy proceedings, where the criteria for direct bankruptcy exists, such as suspension of payments by the debtor.

The court may also switch to bankruptcy proceedings during the protection term: (i) upon failure by the debtor to comply with the terms of the approved concordato plan or instructions of the court; (ii) upon the court becoming aware that the concordato is unlikely to be successful; or (iii) the debtor withdraws from the concordato proceedings where the proceedings were initiated by the debtor. ■

Comparison with Proceedings in Other European Jurisdictions

	 Turkish law <i>Concordato</i>	 English law		 Italian law <i>Judicial composition with creditors (concordato)</i>
		<i>Administration</i>	<i>Scheme of arrangement</i>	
Debtor's right to initiate the proceedings	Yes – by formal application made to court	Yes – by formal application made to court (the <i>court route</i>) or filing of documents at court (the <i>out-of-court route</i>)	Yes – by filing application in court for an order summoning meetings to vote on the scheme	Yes – by formal application made to court.
Creditors' rights to initiate the proceedings and throughout the process	Yes – by formal application made to court or following the public announcement, by filing documents to concordato officer	Yes – by the <i>court route</i> or, if the creditors are qualifying floating charge holders, by the <i>out-of-court route</i>	Yes – by filing application in court for an order summoning meetings to vote on the scheme	No, only debtor is entitled to initiate the proceedings. If the plan does not provide for repayment of at least 40% of unsecured claims in cash (or 30%, in case the plan does not envisage a liquidation), holders of at least 10% of debt may propose competing plans.
Court's role	Hearing of application; granting temporary term and final protection term to debtor or dismissing application	Hearing of application; making administration order or dismissing application	Deciding whether a meeting on the scheme should be called; holding court hearing and court meeting; sanction the scheme if seen fit	Hearing of application, authorizing transaction outside of the ordinary course (including new financings), ruling on creditors' challenges, ratifying the plan, or dismissing the application.
Class composition / approval requirements	Quorum for acceptance of the concordato plan is more than 1/2 of the recognized creditors in number and the aggregate amount of the recognized debts, or 1/4 of the recognized creditors in number and 2/3 of the aggregate amount of the recognized debts	Generally by deemed consent procedure: decision deemed approved within 14 days of notification unless objected by $\geq 10\%$ in value of creditors, following which decision is voted on by majority.	For each relevant class of creditors, majority in number, representing $\geq 75\%$ in value.	Plan to be approved by unsecured creditors (and secured creditors to the extent of any collateral deficiency) holding a majority of claims by value entitled to vote. If classes of creditors are formed, the plan must also be approved by majority of claims in a majority of classes.
Secured creditors' status	Secured receivables are not affected by the concordato in principle, unless the debtor requests the restructuring of the secured debts and the agreements are approved by more than 2/3 of such receivables in value. Secured debt continues to accrue interest.	Generally protected, main risk to security is if granted during hardening period	Creditors are only bound by the scheme from the date of filing of the sanctioned scheme with the Companies House	Generally protected (assuming hardening). The plan must provide that secured creditors be paid in full for the value of their claims.
Moratorium	Statutory moratorium when application is submitted to court	Statutory moratorium when company enters into administration' Interim moratorium may be imposed pending entry into administration	No moratorium; under limited circumstances court may stay claims of dissenting creditors; a contractual moratorium is quite often implemented prior to the scheme	Automatic stay on creditors enforcement actions for pre-petition claims.
Timing	Creditors' meeting should be convened at least 15 days later following the public announcement of the court and within temporary protection term	Creditors' decision on the administrator's proposal should be made within 10 weeks upon the company entering into administration (subject to possible extension)	Approximately two months from announcement of the proceedings to the scheme becoming effective	Court typically ratifies the plan within nine months from the filing of the application.



▼ **Meltem Akol** graduated from Istanbul University, Faculty of Law in 1991 after completing her education at Robert College Istanbul. She received her master's degree from Harvard University School of Law.

Her legal career started at White & Case LLP in 1991. By 2007, she was appointed as Partner which was followed by her role as the Managing Partner of the Istanbul Office from 2009 until the end of 2015. Since 2016, she has been continuing her career as the Founding Partner of Akol Namlı & Partners Law Firm.

Meltem's experience of over 25 years mainly concentrates on cross-border mergers and acquisitions, capital markets, private equity transactions, joint ventures, bank financing, structured finance and PPPs.

Meltem assisted many leading multinational strategic investors, private equity funds, financial institutions and funds in connection with their investments in various sectors including retail, infrastructure, financial institutions, healthcare, automotive, industrial and manufacturing, energy, ports, construction and real estate in Turkey. She has been involved in numerous major large-size international M&A, capital markets and finance transactions across a wide range of sectors, including "first of their kind" and "most complex of their kind" transactions. Her career was shaped within the investment environment of Turkey with a unique insight to the perspectives of foreign investors.

Meltem has been recognized as one of the best and most experienced lawyers by international ratings agencies, widely accepted in the international arena and described as one of the undoubted leading M&A and Capital Markets lawyers of Turkey, her success being ranked as Tier 1 by all well-known legal directories and bringing her various awards given to selected women leaders and best lawyers around the world.

