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In This Issue...

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Recent Changes in Legislation

Board Resolutions and Announcements of the Energy Market Regulatory Authority

The Turkish Energy Market Regulatory Authority ("**EMRA**") has recently issued the following resolutions[1] and announcement[2] regarding the electricity market:

- EMRA increased the amount of electricity that a generation license holder is allowed to purchase annually from the market (i.e., through bilateral agreements, from the day-ahead market, intra-day market and balancing power market) in order to secure its supply obligations. Such limit is increased to 100% of a generation license holder's annual licensed output whereas, under the repealed EMRA resolution dated November 2013, the threshold was 40% of the same.
- EMRA resolved that a generation license holder cannot simultaneously hold a supply license.
- EMRA announced the details of how generation license holders are required to evidence the fulfillment of their pre-construction obligations to EMRA pursuant to Temporary Article 15(1) of the Electricity Market Licensing Regulation. In particular, the announcement addresses the ambiguity among generation license holders on how to fulfill the requirement to obtain usage rights for different types of land (e.g., forest, pasture, Treasury land etc.). The announcement also makes it clear that generation license holders must take action without waiting for a notification from EMRA in this regard.

Ministry of Forestry and Water Affair's Circular on Forestry Permits

The Ministry of Forestry and Water Affairs issued a circular No. 2014/1 on 3 March 2014 (the "**Circular**") which restricts the grant of forestry permits to energy and mining projects in certain areas of Turkey. The material issues under this Circular are as follows:[3]

- Depending on the location of the project, preparation of a new "scientific report" will be required for energy and mining projects that are not subject to environmental impact assessment requirements;
- Forestry permit applications for wind and solar projects in certain regions of Turkey will no longer be accepted. Such regions include, among others, certain parts of the cities of İstanbul, Kocaeli, Çanakkale, Tekirdağ, Hatay and Artvin. The Circular specifies that such restriction also applies to licensed wind projects;
- Forestry permit applications for some mining activities in certain regions (such as protected areas etc.), depending on the categories ascribed to them under the mining legislation, will no longer be accepted; and
- Forestry permit applications for license exempt electricity generation activities will no longer be accepted.

The Circular may potentially affect many energy and mining projects going forward. An annulment lawsuit may be filed in the administrative courts for those projects that are adversely affected by the Circular, or any individual administrative action of the administration pursuant to the Circular.

Electricity Market Consumer Services Regulation

The Electricity Market Consumer Services Regulation ("**New Regulation**"), which repeals the Electricity Market Eligible Consumer Regulation and the Electricity Market Customer Services Regulation, entered into force on 8 May 2014.

The New Regulation brings, inter alia, the following novelties:

- Consumers can now opt for making utility payments by credit card; and no commission can be imposed on the customers during the collection of the utility bills, regardless of the payment method they choose.
- Retail sale contracts will be executed for an indefinite term, unless the connection is established for temporary purposes. Also, within 3 business days of a subscriber's request to terminate the retail sale contract, supplier companies are required to finalize the procedures pertaining to such request.
- Existing customers whose consumption amounts in the previous years did not exceed the "eligible customer limit" will no longer be able to be considered as an "eligible consumer" by means of giving an undertaking to the relevant retail company that they will exceed the relevant eligible customer limit.

Implementation Regulations related to Forestry Permit Fees

On 18 April 2014, two new regulations (i.e., the Implementation Regulation of Article 16 of the Forestry Law and the Implementation Regulation of Articles 17/3 and 18 of the Forestry Law), regarding the forestry permits required for mining and energy operations and other infrastructure projects, came into force. One of the major changes brought by these regulations is that the coefficients taken into consideration for calculation of the annual fees have been changed, and different rates have been introduced with respect to forestry lands in different regions of Turkey. Additionally, the new regulations require calculation of annual fee increases in accordance with the revaluation rate under the Tax Procedural Law rather than the previously applied deflator of the Ministry of Development.

1 For the full texts of the resolutions, see: http://www.epdk.gov.tr/index.php/elektrik-piyasasi/mevzuat?id=38

2 For the full text of the announcement, see: http://www.epdk.gov.tr/index.php/tum-duyurular/elektrik-duyurular-tumu

3 For the full text of the Circular, see: http://www.ormansu.gov.tr/osb/osb/mevzuat1/genelge/2014-1sayili_genelge.aspx?sflang=tr

Regulation on Debt Assumption by Treasury

The Regulation on Assumption of Debts by the Undersecreteriat of Treasury (the "**Regulation**") entered into force on 19 April 2014.

The Regulation mainly sets forth the rules and principles envisaged under Article 8/A of Law No. 4749, which governs the Undersecreteriat of Treasury's (the "**Treasury**") debt assumption with respect to foreign financed projects carried out as per the (i) "build-operate-transfer" model under Law No. 3996 having a minimum investment amount of TRY 1 billion; as well as (ii) "build-lease-transfer" model under the health and education PPP legislation having a minimum investment amount of TRY 500 million.

Additionally, in order to be able to benefit from this debt assumption, investors falling within the above mentioned scope must ensure that the relevant project agreements include a provision envisaging the administration's take-over of the relevant facility in the event of early termination.

Apart from the details of the general framework drawn by Law No. 4749, the Regulation sets forth provisions in relation to the below listed issues:

- The limit of the debt assumed by the Treasury will not exceed 85% of the principal debt amount if the implementation agreement is terminated due to the project company's fault; whereas the Treasury will assume the entire debt if no such fault is attributable to the project company;
- The Treasury may also assume the financial costs arising out of the termination of any derivative transactions that are concluded in connection with the loan facility agreement. The Treasury is authorized to determine the limit of such assumption amount to the extent of 10% of the principal debt amount.
- The debt assumption agreement cannot contain any reference to how the Treasury will make the payments (i.e., either in installment, as envisaged under the relevant loan facility or on lump sum basis).

Electricity Import and Export Regulation

On 17 May 2014, EMRA issued the new Electricity Market Import and Export Regulation (the "**New Regulation**") for the purposes of implementing the Electricity Market Law No. 6446. The New Regulation repeals and replaces all provisions of the 2011 Electricity Market Import and Export Regulation (the "**Repealed Regulation**").

- Under the Repealed Regulation, Türkiye Elektrik Ticaret ve Taahhüt Anonim Şirketi ("**TETAŞ**") and private sector wholesale companies were allowed to import and/or export electricity, whereas retail sale companies and distribution companies holding a retail license were only entitled to import electricity with a voltage level of 36kv or less.
- In the New Regulation however, all supply companies, which cover wholesale and retail sale companies, together with TETAŞ are entitled to carry out both import and export activities in the electricity market without being subject to any voltage limit.
- The New Regulation, as also permitted under the Electricity Market Law and the Licensing Regulation, provides that generation companies are entitled to conduct export activities.
- Companies can carry out import or export activities only if such provision is included in their licenses.
- The New Regulation specifies that TETAŞ is entitled to sign import/export agreements that are within the scope of intergovernmental agreements.

Secondary Legislation on Energy Markets Operation Joint Stock Company (*Enerji Piyasaları İletme Anonim Şirketi*)

On 1 July 2014, the Turkish Energy Market Regulatory Authority ("**EMRA**") published the long-awaited articles of association for the Energy Markets Operation Joint Stock Company ("**EPİAŞ**") and the Regulation on the Organization and Working Principles of EPİAŞ[4].

According to the articles of association, market participants will have 40% shareholding in EPİAŞ whereas TEİAŞ, the national transmission company, and Borsa İstanbul, the İstanbul stock exchange, will each have 30% of the shares. Half of the shares owned by TEİAŞ will be transferred to the national natural gas transmission company following the unbundling BOTAŞ, the national natural gas transmission and sales company. Among the market participants, the following are eligible for becoming a shareholder in EPİAŞ:

- Electricity supply license holders and electricity generation license holders (provided that the generation facilities have started commercial operations); and
- Natural gas wholesale, retail sale, import and export license holders.

A single license holder's share in EPİAŞ cannot exceed 4% (including its controlling relations).

License holders that wish to become shareholders in EPİAŞ are required to submit an application to EMRA by 29 August 2014. EPİAŞ will be incorporated and registered with the trade registry following the payment of the corresponding capital contribution and signing of the articles of association by the shareholders.

4 Under the Electricity Market Law, EPİAŞ was required to be incorporated by 30 September 2013.

Draft Legislation

Draft Mining Law

- A draft amendment to the Mining Law has been ready for submission to the Turkish Parliament for enactment. The draft had been planned to be submitted in mid-May; however, it has been withdrawn from the Parliament's agenda upon the recent developments and tragic events in mining sector, for further consideration especially with special attention to the work place health and security regulations in this sector. The major changes proposed by the draft can be summarized as follows:

- **Financial Obligations and Royalty Payments:** The draft introduces a new license fee that is to be calculated based on the relevant license groups and sizes instead of the previously used fixed annual fees. A considerable increase is also planned for the State Royalty rates; e.g. the rate of State Royalty to be collected from operation of gold, silver and platinum mines is proposed to be increased to from the current 4% to 14%. Apart from the rates, the procedure for determining the precedent over the pit-head sale price for each mine will also be amended.

- **Forfeiture of Deposited License Securities:** This sanction is being abolished entirely as a concept; instead, administrative fines are being envisaged for license holders breaching their obligations under the Mining Law.

- **Completion of Necessary Permits within Three Years:** The disputed cancellation sanction envisaged for operation license holders who cannot complete, within three years, the environmental permits and surface rights necessary for issuance of an operation permit and conducting mining operation activities (such as EIA affirmative approval, work place opening and operation permit and surface rights) is contemplated to be abolished. Instead of cancellation, the license fee of operation license holders, who cannot fulfil their obligations in time, shall be doubled until the necessary permits are obtained and the respective operation permit is issued, which is likely to be observed as a significant development for investors whose operations are delayed due to governmental formalities. Additionally, the draft sets forth that public interest decisions adopted by the Ministry of Energy and Natural Resources shall be deemed to satisfy the surface rights completion requirements in terms of agricultural lands and lands subject to private property.

- **The Temporary Article for Cancelled Operation Licenses:** A temporary article enables operation license holders, whose licenses have been cancelled or have become subject to cancellation as of 25 June 2011, to recover their licenses provided that they can obtain the missing permits and surface rights within one year starting from the effective date of the amendment.

- **Operation License Terms:** The draft proposes to change the upper threshold for operation license separately for different mining groups. The term extensions of Group I and II licenses beyond the upper thresholds will be subject to the approval of the Minister of Energy and Natural Resources and term extensions of other groups of licenses will be subject to the approval of the Council of Ministers.

- **Transfer of Licenses:** The draft subjects transfer of licenses, which are currently within the authority of the General Directorate of Mining Affairs, to the approval of the Minister of Energy and Natural Resources. The license transfer fee is contemplated to be increased as well.

- **Merger of Licenses:** Under the current Mining Law, in case of merger of licenses, an exemption can be obtained if the visible reserves on the relevant licenses form integrity. The draft introduces two additional conditions for receiving this exemption: (i) the relevant license areas must be operated together and (ii) production on the merged license must be made for the purposes of feeding the integrated facility. However, the same amendment also offers a new opportunity; in case there is not enough proper and sufficient space for the establishment of mandatory production and infrastructure facilities on a license area, the relevant license holder will be able to merge its license with adjacent licenses for the establishment of such facilities, regardless of the area limitations or the current phase of the relevant licenses.

Draft Nuclear Energy Law

The Draft Nuclear Energy Law (the "**Draft Law**"), which has recently been prepared by the Ministry of Energy and Natural Resources, is aimed at the regulation of nuclear energy related facilities and operations. Main features of the Draft Law can be summarized as follows:

- **A New Regulatory Body:** The Draft Law envisages the establishment of the Nuclear Regulatory Authority ("**NRA**"). Under the Draft Law, NRA is designed to take over substantial authorities of the current regulator (i.e., the Turkish Atomic Energy Authority) with respect to licensing, permitting and supervision of nuclear activities. NRA would not be subject to the Public Procurement Law No. 4734, State Tender Law No. 2886, Public Finance Management and Supervision Law No. 5018 or the Court of Accounts Law No. 6085.

- **Licensing Requirements:** Pursuant to the Draft Law, potential actors are required to obtain license(s) from NRA in order to perform nuclear energy related activities. The Draft Law further requires permit(s) to be granted by NRA for, among others, construction, decommissioning and dismantling of nuclear and radioactive facilities as well as import/export and transportation of the nuclear material. The Draft Law is silent on eligibility criteria of the applicants and application procedures, and states that these matters will be governed by secondary legislation.

- **Liability:** The Draft Law sets forth various obligations on license and permit holders for the purposes of nuclear safety and security (e.g., establishment of a quality management system, providing required training to the personnel). Under the Draft Law, liability that may arise out of these matters is envisaged to rest entirely with the license and permit holders. The Draft Law further stipulates that the "producer of the waste" will be responsible for the safe management of radioactive waste.

Draft Amendments to the Natural Gas Market Legislation

The draft law amending the Natural Gas Market Law No. 4646 (the "**Draft Law**") is still under the review of the Prime Ministry and is awaiting submission to the Turkish Parliament for enactment.

The Draft Law envisages that Boru Hatları ile Petrol Taşıma Anonim Şirketi ("**BOTAŞ**"), the state-owned gas trade and transmission company, will continue to operate in its current vertically integrated form for one more year as of the enactment of the draft. At the end of this 1 year period, BOTAŞ's activities pertaining to (i) transmission; (ii) operation and storage of liquid natural gas; and (iii) other operations, will be unbundled under the umbrella of three separate legal entities.

The Draft Law introduces higher administrative fines in cases of noncompliance with the natural gas market legislation, which amounts to an increase in the neighborhood of 30% when compared with the currently applicable fines.

Further, three members of the Turkish Parliament proposed an additional amendment to the Natural Gas Market Law on 27 May 2014. This additional amendment aims to enable joint stock companies, established by the municipalities, to carry out natural gas distribution activities in the relevant region, on the condition that no application has been filed for that region in the last 3 tenders conducted to transfer the distribution rights in that region.

While the amendments to the Law are still being discussed, EMRA announced certain proposed amendments to its Natural Gas Market Licensing Regulation on 30 May 2014. License holders were invited to provide feedback on the proposed amendments until 13 June 2014. These amendments do not bring any material changes to the current Regulation, and mainly provides clarifications as to the documents to be submitted during the licensing procedures before EMRA.

Draft Amendments to the Electricity Market Law and the Law on the Renovation of Olive Cultivation and Vaccination of the Wilds

Draft Amendments to the "Electricity Market Law" and the "Law on the Renovation of Olive Cultivation and Vaccination of the Wilds" was submitted to the Turkish Parliament on 16 June 2016 for enactment. The changes proposed by the draft can be summarized as follows:

- **Extension Period:** The draft grants a 1 year extension of time (in addition to the remaining construction term, if any) to legal entities that were not able to fulfil their obligations by 30 March 2013 related to the commencement of construction of the production plant within the pre-construction term granted in their licenses. When necessary, the construction term and completion time for the production plant granted in a legal entity's license may be amended to ensure completion of construction accordingly.

- **Unapproved Investment Expenditures:** A temporary article enables distribution companies' unapproved investment expenditures from 2006-2010 to be taken into consideration by EMRA during tariff calculations for the third implementation term, which will commence on 1 January 2016. However, there will be no adjustment due to inflation or interest.

Articles

Cumulative Impact Assessments in the Environmental Impact Assessment Process

Av. Dr. Cem Çağatay Orak

Introduction

The Environmental Impact Assessment Regulation[5] (the "**2013 Regulation**") introduced a new concept, namely the cumulative impact assessment (the "**CIA**"), which is required to be taken into account during the environmental impact assessment (the "**EIA**") process.

The CIA basically requires that not only the environmental impact of a single project but also the environmental impacts of several projects, which are under either development or operation and located in the same region, should be examined by the project owners and the Ministry of Environment and Urbanization. In other words, the CIA aims at identifying whether or not interface risks exist.

Prior to the 2013 Regulation, Turkish environmental legislation included no provision concerning the CIA. In fact, the CIA concept was, to our knowledge, first introduced by administrative court decisions released before the 2013 Regulation, as explained below.

I. Court Decisions Favouring the CIA

Certain non-governmental organizations and environmental activists filed challenges before the Turkish High Administrative Court (Danıştay) regarding several electricity generation licenses issued by the Energy Market Regulatory Authority ("**EMRA**") to investors who intend to construct thermal power plants in the East Mediterranean region of Turkey. The claimants' main argument was that EMRA and the Ministry failed to examine multiple negative impacts of those planned thermal power plants during the EIA process. The 13th Chamber of the High Administrative Court (the "**13th Chamber**") rejected the claimants' injunction relief request, and the claimants then challenged this rejection before the Grand Chamber of Administrative Litigation of Turkish High Administrative Court (the "**Grand Chamber**").

The Grand Chamber overruled the rejection decision of the 13th Chamber[6] and implied that the CIA must have been taken into account by EMRA and the Ministry. As can be seen, the Grand Chamber's decision favouring the CIA was released long before the 2013 Regulation which expressly governs the CIA issue for the first time. To be more precise, notwithstanding the lack of an express legal obligation requiring the CIA in the EIA process, the Grand Chamber rather made a catch-all interpretation based on general provisions governing the protection of the environment.

In practice, we have then observed that local administrative courts started to follow such principle established by the Grand Chamber and to suspend, in particular, energy, mining and infrastructure projects due to lack of the CIA no matter the legislation is silent on this concept prior to the 2013 Regulation.[7]

II. Evaluation of the Court Decisions

Under Turkish administrative law, each administrative act can only be reviewed in accordance with the rules and legislation that are in force and applicable at the time of the issuance of the said administrative act. Further, review by an administrative court is limited to a legal review. As per Article 125 of the Constitution of the Republic of Turkey and Article 2(2) of the Law No. 2577 on Administrative Trial Procedure Administrative courts cannot question or direct a policy of the administrative authorities.

At the time when the challenged administrative acts (i.e., EIA decisions of the Ministry and electricity generation licenses) referred to above were executed, Turkish environmental law included no provision requiring a CIA. Therefore, the Ministry was not expected to conduct a specific CIA, and failure to do so could not normally be considered an omission of the decision makers. However, we understand that administrative courts rather preferred to make a broad interpretation during the judicial review.

Although we believe that the court decisions requiring the CIA, even for those EIA decisions released before the 2013 Regulation, are contrary to law under the well-established principles of Turkish administrative law, the EIA reports that will be prepared by investors subsequent to the 2013 Regulation must now include the CIA, and the Ministry must supervise the adequacy of the CIA before furnishing its permission.

III. The Position of CIA Under the Current Legislation

The 2013 Regulation only makes a reference to the CIA; however, the definition and scope of this concept has not been elaborated. Moreover, how such concept would be implemented both by investors and the Ministry is still a question mark.

The CIA needs detailed efforts, works and surveys by project owners, investors and the Ministry as the decision maker. In order to discover the cumulative impacts of the projects in the same region or basin, project owners must reasonably ask for the technicalities and statistical details of other projects and so forth. During this process, the sharing of information in a transparent manner is of material importance but commercial secrets must also be protected.

5 Published in the Official Gazette No.28784, dated 3 October 2013.

6 Grand Chamber, Decision No. 2012/222, dated 21 January 2013.

7 Injunction decision of the Çanakkale Administrative Court No. 2012/718 dated 20 November 2013 and cancellation decision of the Çanakkale Administrative Court No. 2014/267 dated 18 March 2014 (unpublished).

Given the above, without clarifying the mechanics of the CIA, we do not think that a mere reference to the CIA, as it is now, will serve the expected purpose. Additionally, investors may still encounter different troubles after receipt of the EIA decisions as it is very likely that those decisions would again be challenged, and the inadequacy of the CIA would eventually be raised this time.

Therefore, the Ministry should soon prepare a comprehensive regulation regarding the CIA that would give comfort not only to the investors but also to judicial authorities and society as a whole. The Ministry can benefit from international experience and practices of the European Union and other relevant organizations[8] to achieve a satisfactory result.

Otherwise, the realization of many energy, mining and infrastructure projects may be delayed or hindered due to these uncertainties. Considering the development model that is being followed by Turkey, delays or failures in such kind of projects may adversely affect the economical dynamics of our country.

Conclusion

It is fair to mention that environmental reflex of Turkish society has started soaring in recent years. Consequently, such reflex triggers new regulations and protectionist judicial precedents. To the extent principles of sustainable development and sustainable environment are observed in line with international standards, we do believe that those new regulations and judicial precedents may serve a public benefit. Nevertheless, it is also obvious that Turkey has a well-defined civil and administrative law system, and administrative courts are not empowered to conduct a review of expediency while hearing court cases.

Therefore, we believe that administrative court decisions favouring the CIA before the 2013 Regulation are not in line with the law. However, now that the CIA is now settled by the 2013 Regulation, project owners and the Ministry must indeed take into account the CIA during the EIA process that would be conducted after the 2013 Regulation. In any case, we recommend that a new detailed regulation governing the CIA process should be issued by the Ministry to avoid different troubles and interpretation problems in practice, as the current language of the 2013 Regulation seems to be quite insufficient.

Taking this opportunity, it would also be fair to regulate the position of energy, mining and infrastructure projects which are now stopped as a result of court decisions merely based on the lack of a CIA even in the EIA reports prepared long before the issuance of the 2013 Regulation. This is because those investors are imposed extra-legal burden in an unfair manner that they could never foresee at the very beginning of their ventures. We believe that such a new regulation, which may somehow remit those projects, is a requirement of the rule of law and confidence in the government. In fact, those projects will ultimately be required to obtain other regulatory permits and licenses in order to operate notwithstanding the resolution of the EIA issue.

Capital Loss and Financial Distress under the Turkish Commercial Code

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Introduction

The Turkish Commercial Code No. 6102[9] (the "**TCC**") gives particular importance to the protection of capital in joint stock companies and identifies compulsory measures to be taken by the organs of a joint stock company (the "**Company**") in the event of capital loss. Article 376 of the TCC distinguishes between three different levels of capital inadequacy and regulates the corporate remedies specific for each level. The first level involves a 50% loss of the sum of capital and legal reserves. The second level is defined as the loss of the sum of capital and legal reserves by two-thirds (technical bankruptcy). The final level is financial distress.

More recently, due to the implementation of the Tax Amnesty Law No. 6111[10] (the "**Tax Amnesty Law**"), a considerable number of undertakings, including project companies in various sectors, have reported capital losses reaching the level of technical bankruptcy, and have faced serious credibility losses. Obviously, the implications of Article 376 of the TCC can be accurately analyzed only if considered in connection with other legislations since it may have specific consequences under various regulations relating to energy, healthcare or financial services. Our analysis will mainly focus on its commercial law related consequences.

I. Capital Loss in Joint Stock Companies

Pursuant to Article 376(1) and (2) of the TCC, the board of directors (the "**Board**") should regularly check whether any of the following financial situations, which trigger the duty of the Board to take counter measures, is evident in the most recent annual balance sheet of the Company: (i) **half of the sum of its capital and legal reserves** has remained uncovered due to deficit; or (ii) **two thirds of the sum of its capital and legal reserves** have remained uncovered **due to deficit**. Both of these situations indicate that the financial stability of the Company is deteriorating or under risk.

8 e.g., International Finance Corporation (IFC), Good Practice Handbook on Cumulative Impact Assessment and Management: Guidance for the Private Sector in Emerging Markets, August 2013. http://www.ifc.org/wps/wcm/connect/3aebf50041c11f8383ba8700caa2aa08/IFC_GoodPracticeHandbook_CumulativeImpactAssessment.pdf?MOD=AJPERES

9 Published in the Official Gazette No. 27846 dated 14 February 2011.

10 Published in the Official Gazette No. 27857 (Repeated) dated 25 February 2011.

Examination of the Annual Balance Sheet of the Company

For this financial check-up, the Board is required to take into consideration the most recent annual balance sheet of the Company. If the company is subject to independent auditing and thus to Turkish Accounting Standards requirement, it is not clear as to whether these financial statements must be prepared in accordance with Turkish Accounting Standards (the "**TAS**") or the Tax Procedural Law. The more dominant view is that it should be prepared based on the Turkish Accounting Standards in order to comply with the requirements of the TCC.

In parallel with this, publicly-held companies are required to carry out their financial check-up based on financial statements prepared in accordance with the standards set forth by the Capital Market Board ("**CMB**") pursuant to CMB legislation. Therefore, there seems to be no ambiguity for publicly-held companies.

Nevertheless, in the case where different legislations, applicable to a Company, impose varying accounting rules for the preparation of the balance sheet (i.e. principles set out in the Tax Procedure Law No. 213[11] and Turkish Accounting Standards), it is not clear which balance sheet should prevail in the consideration of capital loss in the event of contradicting results. Although the legislation is silent on this issue, the safer approach would be taking compulsory measures in the event that the capital loss thresholds are exceeded according to any of the financial statements.

Calculating the Uncovered Amount

In order to detect to what extent the loss of capital drained equity, the Board must compare (i) the shareholders' equity in the Company with (ii) the sum of capital and legal reserves of the Company. If the ratio between the shareholders' equity and capital+legal reserves is equal to or less than 1/2, the Company would not be deemed as under technical bankruptcy but would need to take necessary measures, as explained in below.

However, if the ratio is equal to or falls below 1/3, the financial instability of the Company reaches the level of "technical bankruptcy", as it is called in corporate practice. Although the term "technical bankruptcy" is widely used for ease of reference, it is prone to misunderstanding as "technical bankruptcy" has actually nothing in common with legal bankruptcy but refers only to the following adverse financial situation.

To illustrate a technical bankruptcy situation, imagine "Company X" with a statutory capital of YTL 50,000 and legal reserves of YTL 10,000. Based on the most recent annual balance sheet of Company X, its assets account for YTL 150,000 while its liabilities amount to YTL 135,000 and Company X has a shareholders' equity of YTL 15,000 (i.e. 150.000-135.000). Given that its shareholders' equity (YTL 15,000) is less than 1/3 of the sum of its capital and legal reserves, YTL 20,000 (i.e. 60,000/3), Company X would be considered in technical bankruptcy.

By defining the uncovered amount as a "*deficit*", in the larger sense, the TCC neglects the factual and financial reasons that give rise to the decrease in equity (i.e. the uncovered amount of the capital due to deficit). The Company may, therefore, experience a technical bankruptcy situation, even at the end of a financially successful fiscal year mainly due to the previous year's deficit.

For instance, as is widely known, the Amnesty Law allows adjustment of the balance sheet by placement of the lacking cash balance under non-deductible expenses in exchange for a 3% tax levied on the adjustment amount. In this context, the paid tax amounts are recorded as a deficit for the previous year and may unexpectedly give rise to a technical bankruptcy situation despite a decent level of earning.

Compulsory Remedies for Capital Loss

If the "shareholders' equity/capital+legal reserves" ratio is between 1/2 and 1/3, the Board must immediately notify its shareholders and convene a general assembly (the "**GA**") meeting whereby the Board must report the financial situation of the Company to the GA by explaining its reasons and suggest remedies. The proposed remedies may vary from capital increase, cost reduction policy, suspension of investments to the sale of assets, depending on the circumstances.

If the ratio is less than 1/3, the Board must immediately notify its shareholders and convene a GA meeting in order to discuss the financial situation of the Company and adopt one of the following remedies:

In the first option, the GA may decide to run the Company with the remaining shareholders' equity and thus decrease the Company's capital to an amount equal to 1/3 of its statutory capital (provided that the minimum capital requirements under the TCC and any other applicable legislation, as the case may be, are satisfied).

Alternatively, the GA may replenish the equity to its pre-loss amount either (i) by means of a capital decrease followed by a capital increase that takes affect simultaneously since both transactions are resolved in the same GA meeting and registered at the same time in the Trade Registry; or (ii) by creating a loss compensation fund into which the shareholders contribute additional funds or receivables of shareholders are converted. Loss compensation fund payments cannot be classified as capital or a loan and should not be paid back to the shareholders.

11 Published in the Official Gazette No. 10703-10705 dated 10 January 1961.

II. Financial Distress

Article 376(3) of the TCC regulates "financial distress" as follows:

"*(3) In the case where there are signs which create the impression that the company is in financial distress; the Board should prepare an interim balance sheets based on the fair market value of the assets and also taking the principle of continuity of the operations as the basis. If, pursuant to such reports, it is seen that the assets are not sufficient enough to cover the debts, then the Board shall notify this situation to the Commercial Court of First Instance located where the headquarters of the company is situated and request declaration of the bankruptcy of the company unless the creditors of the debts, with an amount covering the company deficit and remedying the financial distress, accept in writing prior to the bankruptcy decision that their debts may be deferred after all other creditors are satisfied; and the accuracy and validity of such statement is verified by the experts appointed by the court to which the bankruptcy request will be made. Otherwise, the application filed to the court for expert review shall be accepted as a bankruptcy notice.*"

Internal Determination of the Financial Distress

As understood from the above mentioned Article, if the assets of the company do not cover its liabilities; the financial situation of the company is no longer a capital loss or technical bankruptcy but falls under financial distress. In such a case the Board is required to ensure preparation of interim balance sheets as envisaged in the TCC to evaluate the financial situation of the Company. One of those interim balance sheets should be prepared based on the fair market value of the assets; and the other one should take the principle of continuity of the operations, as the basis.

However, in practice, the existence of two separate balance sheets may lead to some uncertainties in case those two interim balance sheets reach two different results. We hope that at least the doctrine and/or court precedents answer this question in the near future.

Application to the Court for Declaration/Adjournment of the Bankruptcy

Board is required to apply to the competent court to notify the financial situation of the company; however, it does not envisage any a specific time period for such action. Nonetheless, taking into consideration the reference to "promptly" under the relevant provision in the Repealed TCC, it can be concluded that the safest approach would be to make such notification as soon as possible to avoid any possible claims by creditors, as any of them who cannot collect its receivable may take action against the board members and/or the Company.

III. Legal Remedies

As mentioned above, the remedies to be taken by the joint stock companies that are in financial distress are both regulated under TCC and Code of Execution and Bankruptcy No. 2004[12] (the "**Bankruptcy Law**").[13] In the event of financial distress, the Board is obligated to notify this situation to the Commercial Court of First Instance located where the headquarters of the company is situated and request either (i) declaration of the bankruptcy or (ii) bankruptcy adjournment.

However it should be noted that the Board or any of the creditors may request bankruptcy adjournment by submitting a recovery plan to the court stating the objective, real resources and measures that can be taken to the overcome bankruptcy situation. Bankruptcy Law requires that such recovery plan be serious and credible. The aim is to prevent the usage of the option of requesting bankruptcy adjournment as a way to delay making payments to the creditors of the Company.

Once the court resolves to take adjournment measures, the expert appointed by the court should analyze whether (i) the company is in financial distress and (ii) the recovery plan submitted to the court is serious and credible. If these two conditions exist, the court will rule to the continuation of the adjournment measures and adjournment of the bankruptcy. If it is determined that the company is in financial distress but the recovery plan is not serious and credible, the court will issue a ruling for the bankruptcy of the company.

In addition to the bankruptcy adjournment mechanism, the Company may seek to exercise any of the following methods to avoid the declaration of bankruptcy:

Requesting for Written Acceptance of the Creditors

A new remedy has been introduced with the effectiveness of the TCC. Accordingly, the creditors of the debts with an amount covering the company deficit and remedying the financial distress may prevent the declaration of bankruptcy. In order to do so they should accept in writing prior to the bankruptcy decision that their receivables may be deferred after all the other creditors, provided that the accuracy and validity of such statement is verified by the experts appointed by the court to which the bankruptcy request will be made. Otherwise, the application filed to the court for expert review will be accepted as a bankruptcy notice.

In case of bankruptcy, the receivables of the creditors of the company will be paid as per the order of precedence stated in the Bankruptcy Law. However, if the creditors accept in writing that the priority of the payment of their receivables remedying the financial distress may be deferred; the court cannot issue a ruling of bankruptcy. In such case, a written agreement must be entered into between the company and each creditor and the legitimacy, merits and validity of such agreement must be verified by the experts appointed by the court.

12 Published in the Official Gazette No. 2128 dated 19 July 1932.

13 As per Article 179 of the Bankruptcy Law, financial distress is a reason for bankruptcy for corporations.

Merger

Article 139 (1) of the TCC provides that a company in financial distress may merge with a company that has enough equity to cover the financial distress. Thus, the Company may merge with a company in good financial standing as a recovery plan.

Conclusion

The main purpose of Article 376 of the TCC is to maintain the financial stability of companies and to ensure continuity of their operations. By distinguishing between three different levels of capital inadequacy, it provides an escalated protection structure and guides the Board and the GA about the corresponding remedies. Nevertheless, early detection and the mitigation of financial risks raised in Article 376 of the TCC may be achievable only if this structure is supported by mechanisms such as the independent audit requirement. Contrary to the companies subject to independent audit requirement general audit rules applicable to most companies remain unregulated since the secondary regulation has not been issued by the Ministry of Customs and Commerce. Finally, we believe that the entry into force of the pending audit regulation will reinforce the applicability of Article 376 of the TCC for all joint stock companies and may clear up the ambiguities in practice.

Other Recent Developments

The Turkish Constitutional Court's ruling on the Electricity Market Law

The Turkish Constitutional Court recently annulled certain provisions of the Electricity Market Law No. 6446 (the "Law"), which was enacted on 14 March 2013.

Although the Court's ruling was announced on its website on 22 May 2014, the reasoned decision has not been published in the Official Gazette yet. Therefore, the reasoning behind the Court's judgment remains to be seen.

The Court annulled the following provisions of the Law:

- The Court annulled Temporary Article 8 of the Law, which introduced a grace period for compliance with environmental requirements by state-owned power plants, including the power plants to be privatized. Pursuant to this clause, state-owned power plants were granted a grace period until 31 December 2018 to comply with the environmental laws. This grace period was aimed at facilitating the generation sector privatizations, as it provides a temporary exemption for state-owned power plants that usually require substantial investments to comply with environmental requirements. The Court's annulment decision will enter into effect 6 months after publication of the decision in the Official Gazette.

- The Court also declared Temporary Article 14 of the Law unconstitutional. This Article enabled those projects, whose licenses were cancelled at the construction stage (other than hydropower projects), to submit an application to the Turkish Energy Market Regulatory Authority ("**EMRA**") for a new license, provided that the Ministry of Energy and Natural Resources (the "**Ministry**") determines that construction had reached an irreversible stage and that the project was in the benefit of the public. The Court's annulment decision on this subject will enter into effect on the date of its publication in the Official Gazette.

The Court rejected the unconstitutionality claims against the following provisions of the Law:

- The Court ruled that the provisions of the Law empowering EMRA to regulate the following issues through secondary legislation are not unconstitutional:

  - Procurement of services (outsourcing) by license holders (Article 22, last sentence): Pursuant to the Labor Law, while auxiliary works can be freely subcontracted, works that fall under the scope of the core business of a company can only be outsourced due to the required expertise for the work, the specific requirements of the workplace, and for technological reasons. All these requirements are sought as a justification of outsourcing of the core business activities to subcontractors. Otherwise, subcontracts may be challenged based on claims of hidden labor. The Law includes a provision stating that license holders may outsource their operation and repair and maintenance works required for the activities performed within the scope of its license. The same provision states that EMRA is

authorized to determine the list of activities that can be outsourced. Accordingly, EMRA provided a list of activities that can be outsourced by license holders under the Licensing Regulation. The Constitutional Court ruled that the provision of the Law permitting EMRA to provide such a list of permissible service procurements is not contrary to the Constitution. This decision provides additional comfort, especially for distribution and authorized retail sale companies, whose outsourcing activities were found contrary to law in several labor court decisions prior to the effectiveness of the Law.

- Mandatory provisions that must be included in the articles of association of license holder companies (Article 4(3), last sentence).
- Out-of-market activities that can be carried out by distribution companies to increase efficiency (Article 9(1), 5th sentence).
- Import and export of electricity by supply companies (Article 10(3), last sentence).
- Organizational structure of EPİAŞ (Article 11(3), first sentence).
- Procurement of services by EMRA (Article 16(6)).

- The Court rejected the unconstitutionality claims against the following provisions of the Law as well:
  - Ownership of meters by the distribution companies (Article 9(7), 2nd sentence and Article 9(9)).
  - EMRA's authority to impose sanctions on the authorized supply companies and distribution companies for their failure to comply with the requirements of legal and decision-making unbundling (Article 10(7), last sentence).
  - Service procurement by the Ministry, State Water Affairs (DSİ) and EMRA for audit services provided that the inspections carried out and reports prepared by the service providers will not be binding or will not impose sanctions (Article 15(3)).

Under the Turkish Constitution, a provision of law that has been declared constitutional by the Court cannot be brought before the Court again for a period of ten years. Therefore, the recent decision of the Court confirms the constitutionality of the above-stated provisions of the Law and removes the risk of their annulment by the Court for at least ten years.

Upcoming Conferences & Events

- 16 – 17 September 2014, İstanbul: **6th Annual Turkey Energy Congress & Exhibition** organized by E.E.L. Events.
- 24 – 25 September 2014, Istanbul: **All Energy Turkey 2014** organized by Istanbul Restate.
- 18 – 19 November 2014, Ankara: **7th International Energy Congress and Fair/EIF 2014** organized by Global Energy Association and with the support of the Ministry of Energy and Natural Resources.
- 26 – 27 November 2014, Ankara: **3rd Annual PPP in Turkey Forum** organized by E.E.L. Events.

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