



I OVERVIEW OF RECENT RESTRUCTURING AND INSOLVENCY ACTIVITY

The world has struggled with the global financial crisis, especially in the second half of 2008 due to the problems of the US financial sector occurring in the first half of 2007. In Turkey the financial sector has continued to grow and the real economy has shrunk dramatically. This indicates that in Turkey the crisis has had completely different effects from those experienced in the rest of the world, owing to the fact that every economy positions itself differently.

The global financial crisis originated in banking, and its effects spread to consumers at first and then the real economy. However, no effects of the crisis were apparent in Turkey's banking sector. Our banks have high profits despite the global crisis. The banking sector grew 9.1 per cent in 2008. As from December 2009, the equity capital profit of the banking sector has increased to 22.8 per cent from 18.74 per cent and returns on assets have increased to 2.61 per cent from 2.05 per cent in comparison with the previous year. The main reason for this is the policy of 'high interest, low currency rate'.

Because of such policy, Turkey is experiencing the crisis in the real and consumer sectors in particular, as an economic crisis rather than a financial crisis. The crisis has had devastating effects in virtually every country marked by the contraction of the global economy. Needless to say, companies across all industries are suffering from this economic downturn in one way or another. Companies that were once successful and stable are filing for bankruptcy or being liquidated. In Turkey, the first wave of the crisis was felt in October 2008 where it affected small to midsized companies. Consequently, the number of companies facing financial difficulty and bankruptcy has risen dramatically.

The Turkish economy was predominantly affected by financial crisis in the first quarter of 2009 and has had slowly started to recover over the final months of 2009, in parallel with the world economy.

Indicating their recovery from the financial crisis of 2007, the liquidity and state of the financial markets had increased considerably in Turkey at the end of 2009. The Istanbul Stock Exchange, taking the pulse of the Turkish capital markets, declared that it funded resources of approximately \$21.5 billion within the past five years for the whole country. With the support of Istanbul Stock Exchange, the market has become available for initial public offerings and 11 important players from different sectors are expected to submit public offerings before the end of 2010. The aim of the Istanbul Stock Exchange in promoting the public offerings is to encourage companies to grow by raising funds from the financial markets. The main reasons given for encouraging public offerings are also: making liquidity and cheap financing available; credibility; transparency; trust; internationalization; and increasing the recognition of Turkish companies domestically and globally.

The Istanbul Stock Exchange is also lobbying for tax incentives for companies that consider initiating public offerings. Ninety per cent of an initial 1,000 large industrial Turkish companies are now traded on the Istanbul Stock Exchange. The Turkish Union of Chambers and Stock Exchanges aims to increase such number within the next 10 years in order to enlarge the Turkish economy.

A lot of companies that have operations in markets in Turkey were affected by the economic crisis. Many companies succeeded in extracting themselves from the chaotic situation, but most were near-bankrupt. There are more than 20 Commercial Courts in Istanbul, and from the court records the picture is clear: from electronics to ready wear, from



chemistry to yarn, from food to household textiles companies, there are many requests for the postponement of bankruptcy.

In Turkey, there are three paths for companies that are near bankruptcy: (1) composition, (2) restructuring and (3) the postponement of bankruptcy. Recently, the most preferred method for large groups in difficulties is the postponement of bankruptcy. The two simple conditions for the postponement of bankruptcy are being in debt and having a plan. Existence of these two conditions is enough to ensure a postponement of bankruptcy decision from the competent court.

Postponement of bankruptcies has increased significantly with the effects of the crisis in the past two years according to lawyers and bankers in Turkey, including postponements undertaken by well-known Turkish companies. One well-known company in Turkey has applied to the court to request postponement of bankruptcy for reasons of intense competition from South-East Asian companies and losses in the European markets. This company requested a postponement of bankruptcy in 2008. It has debts to banks (217 million liras), suppliers (62 million liras) and employees (6.8 million liras). The CEO has declared that the activities of the company are strong enough to pay the debts; the only necessity is time for the company. The court gave the company time through a postponement of bankruptcy decision.

Another company that is involved in debt to banks (80 million liras) and to markets (150 million liras) requested a postponement of bankruptcy from Bakirkoy Commercial Court in August 2008. The request was accepted by the court as the firm's finances were being squeezed after the global financial crisis and money was tight despite its assets.

II GENERAL INTRODUCTION TO THE POSTPONEMENT OF BANKRUPTCY

The Code of Enforcement and Bankruptcy No. 2004 ('the CEB') has been amended by codes Nos. 4,949, 5,092, 5,219, 5,311 and 5,358 since it came into force to meet changing needs and to address the reasons behind the creation and application of the law. In accordance with Code No. 4,949, which amended the CEB, one of the current significant matters is the postponement of bankruptcy. To fully explain and clarify the matter, it is necessary to illustrate in detail the aforesaid amendment, which has significant importance to the postponement of bankruptcy and its implementation.

The period of economic crisis in Turkey between 2000 and 2001 and its aftermath helped to raise awareness of the need for, importance of and concept of restructuring. In other words, the opinion that there was a need for a common law-style legal system for bankruptcy to be implemented in our legal system has been assimilated by the legislators and in line with this, such procedures have been appended to the CEB. In this manner, economists have adopted a decision about the economy as a natural result of globalization and put this into practice, and lawyers have been accorded a supplementary role by operating these procedures.

Together with the implementation of Code No. 4,949 dated 30 July 2003, an amendment of Article 179 of the CEB was made, through which Articles 179a and 179b were incorporated into the CEB. After this amendment, it can be observed that although there have been significant increases in applications for the procedure of postponement of bankruptcy, other procedures that have been implemented in the CEB due to similar necessities by Code No. 4,949 have seen nearly no use.

The postponement of bankruptcy is a procedure whereby bankruptcy can be prevented regarding an indebted corporation or association whose situation can be rectified or where

rectification is likely. The reason behind the postponement of bankruptcy is to prevent the creditors from being affected by the negative economic effects of the bankruptcy and for the corporation or the association to carry out its activities in the economic field. In other words, if the corporations and the associations are able to carry on with their existence in accordance with economic necessities, this will have a positive knock-on effect on the wider economy and as a result of this the indebted company requesting postponement of bankruptcy and other companies involved in transactions with it will be able to continue their activities; furthermore, the employees of the bankrupt companies will not lose their jobs and the state will continue to receive taxes.

In the general reasoning of Code No. 4,949, which amended the CEB, the reasons behind the procedure of postponement of bankruptcy are explained thus:

Due to changes in social and economic factors certain commercial enterprises whose continuation in the economic field is possible are faced with the danger of losing their economic existence by reason of not being able to pay their debts. Such danger affects also the creditors, who are faced with not being able to collect their receivables and employees who are exposed to the risk of losing their jobs as well as the debtors. In the course of such situations it will be beneficial for everyone to take precautions to protect the assets of the establishments with the probability of continuation of economic existence or to provide for their restructuring and to determine the rights and obligations of the creditors and the debtors.

According to Article 324 Section 2 of the Turkish Commercial Code regulating the postponement of bankruptcy and Articles 179, 179a and 179b of the CEB, the directors and representatives of corporations and associations can make a request for the postponement of bankruptcy together with the creditors if there is a possibility for the financial situation to be restored so that the national economy is not affected and so that other companies are not adversely affected, taking into consideration macroeconomics and employment issues. Such a request marks the starting point of the procedure of postponement of bankruptcy as set out in detail *infra*.

The postponement of bankruptcy is a legal matter that may only come into practice during the court examination of a case of bankruptcy or a request for bankruptcy due to indebtedness. Therefore, it is not possible for a corporation to apply to the courts and request postponement of bankruptcy without a notification of indebtedness by a corporation (and as a result a mandatory request for bankruptcy) or an opened bankruptcy case by the creditors for reason of indebtedness.

III RECENT DEVELOPMENTS

In practice, it can be observed that the postponement of bankruptcy is considered and held as a separate case. The phrase of ‘case of postponement of bankruptcy’ is regularly used in Court of Appeal decisions. In accordance with Turkish law, however, such type of case does not exist. Furthermore, in postponement of bankruptcy, a request regarding a proposed subjective right to the counterparty cannot be sufficient, whether the request is being put forward by the corporation or by the creditor. The postponement of bankruptcy should always be thought of as a procedure based on a case of indebtedness or as a part of this case. After the

GÜR

LAW FIRM

amendment of the CEB by Code No. 4,949, three significant legal views have evolved in relation to the subject of postponement of bankruptcy. According to one opinion, the postponement of bankruptcy is an *ex parte* proceeding. Others are of the opinion that the postponement of bankruptcy is a matter in an already active case and the final opinion considers postponement of bankruptcy a form of temporary legal protection.

It seems impossible to agree with the opinion whereby the postponement of bankruptcy is considered as an *ex parte* proceeding, even though the request may seem like an *ex parte* proceeding due to the lack of dispute and lack of a subjective right. Such procedure cannot be regarded as an *ex parte* proceeding as the postponement of bankruptcy cannot be requested as an independent application or case.

Moreover, the postponement of bankruptcy cannot be directly considered as a matter in an bankruptcy case or judgment arising from indebtedness. They are defined, however, as small cases to be able to carry on with running cases and to reach a decision. In general every matter to be resolved in a legal case is an event. The judgment cannot continue before the preliminary matters are resolved and the settlement of these preliminary matters cannot be left to the end.

If the request for postponement of bankruptcy is considered as an event, the court directly considering the request for bankruptcy should make judgments regarding the matters of the events. Although the postponement of bankruptcy is not a matter that needs to be previously resolved regarding the request for bankruptcy due to indebtedness, for a decision of bankruptcy to be upheld the only legal requirement is for a matter of indebtedness to be present. For the postponement of the bankruptcy decision, as a financial condition, indebtedness needs to be determined by the court. The decision to be made regarding the postponement of bankruptcy is not a decision that renders it possible for the requested real judgment to take place.

Apart from the fact that the postponement of bankruptcy is only applicable to corporations and associations and is defined in the Turkish Commercial Code as a matter arising from the bad finances of the company, the fact that this procedure was agreed upon to protect the benefits of the company is a clear indication that it is a procedure unique to corporate law.

If the financial situation of the company is poor, just like other precautions that could be taken, the postponement of bankruptcy is also a matter with characteristics of corporate law. The only connection that the postponement of bankruptcy may have with the CEB is limited by requests for a case of bankruptcy based on indebtedness and the judgment process of this case. However, as the postponement of bankruptcy is not subject to the provisions of the CEB and possesses a limiting effect on the application of the bankruptcy provisions, it should not be considered within the scope of the CEB.

Even though legislators have implemented the postponement of bankruptcy in the CEB, such procedure does not include any aspects of the CEB. Moreover, the intention behind the former implementation is not to establish a new institution within the CEB but to determine the connection and the procedural provisions to be applied to the bankruptcy case or its judgment, the processes of which are already regulated by an established procedure under corporate law.

The temporary legal protection regarding the postponement of bankruptcy can be understood as an obligatory decision to be made the courts, not limited by any time restrictions due to its nature, and only a partial proof being necessary for the preservation of financial status. The decision can be upheld without hearing the creditors if so requested by

GÜR

LAW FIRM

the company, since the decision for postponement is not subject to any fixed financial aspects. The decision can be revoked by the courts upon request, since it is an urgent matter that could have adverse effects upon the legal status of the company regarding its assets and receivables in accordance with the general characteristics of the temporary protection precautions.

Requests for the postponement of bankruptcy are matters that need to be decided urgently just like other temporary legal protection requests. It would otherwise be impossible for such procedures to be beneficial.

The level of proof accepted for the postponement of bankruptcy is sufficient to qualify for temporary legal protection. For a court to make a decision on temporary legal protection, the situation leading to such request does not need to be fully proven. In court, only a high chance for the claim of the event to be correct is sufficient. In reality the partial proof aspect regarding the postponement of bankruptcy derives from the characteristic of 'the possibility of recovering the financial situation' in the postponement condition. When proving that there is such a possibility of recovering the financial situation, it is not possible to request full proof. (However, regarding indebtedness, full proof is required.)

If the debts of the company are higher than the receivables, the company should notify the authorized Commercial Court. Such duty belongs to persons who are authorized to manage and represent the company, namely, the board of directors for corporations and associations, the directors for limited companies and administrators for companies in liquidation.

The board of directors (or a creditor) who notifies the Commercial Court that the debts of a company are higher than the receivables may present (1) an improvement plan for remedying the financial situation and (2) a request for the postponement of bankruptcy. It is also mandatory to present to the courts information and documents showing the seriousness and credibility of the improvement plan. Requests for the postponement of bankruptcy are finalized pre-emptively and instantly. If the court deems it necessary, the persons who are authorized to represent and administer and the creditors may be heard. If the court finds the improvement plan serious and credible (i.e., if the court considers that it is possible to remedy the financial situation of the company), the court will decide to postpone bankruptcy for at least one year.

The court deciding on the postponement of bankruptcy will take all necessary precautions (taking into consideration the improvement plan) to protect the assets of the company. Together with the decision of bankruptcy, the court will decide on the appointment of a Trustee. The court may allocate all authorities of the directing body to the Trustee and furthermore may even decide that the decisions and transactions of the directing body are subject to the approval of the Trustee. All duties and powers of the Trustee are clearly explained in the decision of postponement of bankruptcy. The Trustee will provide regular reports to the court regarding the activities and the status of the establishment whose bankruptcy has been postponed at intervals to be determined by the court. As mentioned *supra*, the period for the postponement of bankruptcy is at least one year. This period can be extended by taking into consideration the reports to be provided by the Trustee; however, the total period for the postponement of bankruptcy cannot exceed four years.

Upon the decision of postponement no further proceedings can be carried out against the debtor company and previous proceedings that have already begun will be stopped (including proceedings undertaken under Code No. 6,183); foreclosure and lapse of time that can be stopped by the end of proceedings will not apply. The legislators have made exceptions for two types of receivables regarding the subject of prohibition of a new procedure and the cessation of procedures. These are pledged receivables and the receivables

GÜR

LAW FIRM

stated in Article 206/1 of the CEB. The exceptions are only limited to enforcement procedures and during the postponement of receivables no bankruptcy procedures can be applied to the debtor company.

As stated *supra*, the courts may decide on postponement of bankruptcy for a minimum of one year. In this postponement period the company will be in a temporary cooling period. During this period, if the financial situation of the company improves (in other words, if the assets of the company are able to cover the debts) then the courts will lift the decision of postponement of bankruptcy and with this the company will go back to its normal status and accordingly the duty of the Trustee will end. A fee to be determined by the courts will be paid to the Trustee for the duration of services.

If the financial situation of the company has not completely improved but there is still possibility for improvement, the courts may extend the postponement period for another year taking into consideration the report provided by the Trustee.

When the financial situation of the company has not improved and there is no chance of improvement the courts will decide on the bankruptcy of the company. If the courts decide thus in accordance with the reports provided by the Trustee, the postponement decision will be lifted and the courts will declare the bankruptcy of the company.

Another important factor regarding the postponement of bankruptcy is the preliminary injunction decision. The legislation provides that the relevant injunctions will be undertaken by the courts for preservation of the assets together with the decision of the postponement of bankruptcy. Looking at the application process, it can be seen that preliminary preservation injunctions are taken. Due to the length of the examination period, such decisions become inevitable. During this long examination period, even though the situation of the debtor company is adequate for the request of the postponement of bankruptcy, without a preliminary injunction, events could lead to the financial situation of the company worsening. If these injunctions are not made, due to the announcement of postponement of bankruptcy, some creditors could end their commercial transactions with the company and even start enforcement proceedings, and it is necessary to intercept such attempts. For this reason, prior to examination of the expert report on the decision of postponement of bankruptcy, the court may grant preliminary injunctions after examining the plan and balance sheet of the debtor company. However, such preliminary injunctions should not be used by debtors in bad faith to benefit from the conveniences that the postponement of bankruptcy entails. During the application of the aforementioned process it is inevitable that debtors in bad faith will be unfairly protected against their creditors by a preliminary injunction, which could be considered a disadvantage of this process.

The court will take into consideration all precautions and the recovery plan for preserving the assets of the cooperation or the association while deciding on the postponement of bankruptcy.

The quality, capacity and duties of the trustees are set out in the relevant law. The Trustee is responsible for the operation of the company and for ensuring the results of the postponement of bankruptcy are in accordance with the improvement plan submitted.

If the request for the postponement of bankruptcy is rejected, since the court that has determined the indebtedness of the company will decide on bankruptcy there is no argument that this decision can be appealed. However, it is controversial whether the decision of the postponement of bankruptcy accorded by the Commercial Court can be appealed.

In accordance with the leading opinions on doctrine and the courts of appeal, a decision on the postponement of bankruptcy can be appealed. When there is no hope that the

GÜR

LAW FIRM

financial situation of the company will improve it is clear that being able to appeal against the postponement of bankruptcy is legally more beneficial for the creditors compared with a decision of immediate bankruptcy where the bankruptcy will occur at the end of the postponement period and it is applicable with the intentions of the legislators that such opportunity is granted for the creditors.

Even though there are no regulations set out in the law regarding appeals against the postponement of bankruptcy, in the Justice Commission Report relating to Code No. 4,949 it states that ‘as every postponement is individually subject to appeal, the activities of the judge are under supervision of the Court of Appeal’ and from this it can be gathered that an appeal for the postponement of bankruptcy is possible; however, it is without doubt that such procedure requires specific legislation.

The postponement of bankruptcy being subject to appeal for the reasons *supra* is undoubtedly beneficial for protecting third parties (who are likely to experience losses as a result of carrying out transactions with the company under postponement) and for the creditors.

When postponement of bankruptcy was regulated only by commercial law, in practice the period for appeals was 15 days from the decision of postponement of bankruptcy. The reason behind this was that the decision of postponement of bankruptcy was held in accordance with Article 324 of the Turkish Commercial Code where the period for appeal was 15 days and not in accordance with the CEB.

As postponement of bankruptcy is now regulated under Code No. 4,949 and subject to the CEB, it is indisputable that the period for appeal is 10 days as in other bankruptcy decisions.

The period of appeal against the postponement of bankruptcy should start from the date of announcement for the creditors and from the date of registration for the company. The appeal against the postponement of bankruptcy shall not affect the results of such decision; even though the decision may be appealed, the postponement period should continue and the preservation precautions held by the court shall continue to be valid.

If the postponement of bankruptcy is requested by the company, the creditors may apply for its appeal, in particular by alleging that the necessary conditions for a postponement of bankruptcy are not satisfied as the financial situation cannot be improved.

If the postponement of bankruptcy is requested by one of the creditors, the governing body and other creditors of the company may appeal by alleging that this will only postpone the bankruptcy of the company and that it is impossible for the company to continue with its activities and that the necessary conditions for the postponement are not fulfilled.

In accordance with Article 366, Section III of the CEB, if the appeal against the decision of the postponement of bankruptcy is accepted by the Court of Appeal, within 10 days the decision should be corrected. The decision of the Court of Appeal upon an appeal against a postponement of bankruptcy is a ‘decision involving legal offices’ as stated in Article 366, Section III of the CEB. The Court of Appeal agrees that decisions upheld upon appeal against a postponement of bankruptcy can be corrected.

Even though there is no legislation regulating the right to appeal in law, as can be surmised from the above, the right of appeal against a decision of the postponement of bankruptcy is agreed upon. It is inevitable, however, that legislation should be passed regarding this issue and it would be appropriate to make this correction together with an appeal procedure.

IV SIGNIFICANT JURISPRUDENCE AND KEY DEVELOPMENTS

In accordance with Turkish law, above all, it should be determined whether or not the company is deeply in debt. If it has been determined through an expert report that the company is deep in debt, the court should evaluate whether or not this can be improved and rectified. Furthermore, a debtor who requests the postponement of the bankruptcy should submit a plan regarding the schedule of rectification. Nevertheless, such condition has been adopted through court decisions. The reason is that Article 324 of Turkish Commercial Code does not regulate the nature of the plan to be submitted to the court.

It should be noted that the CEB has recently been amended through Code No. 4,949 with the effect that a plan for rectification should be submitted. Moreover, if the court decides that such plan is serious and credible, the court may order that bankruptcy can be postponed. Before the amendment of the CEB, the court's decision was only evaluated in line with the expert reports issued by the court-appointed experts. Such application of the courts can be observed through the decision of the Court of Appeal dated 3 June 2004, File No. 2004/1665 and Decision No. 2004/6623.

On the other hand, in accordance with Turkish law, the board of directors should request bankruptcy if the liabilities of a company are more than the assets and on the condition that the company is in bankruptcy. However, in accordance with the CEB, the board of directors is entitled to commence a lawsuit and request that the bankruptcy is postponed. It should be noted that the creditors are also entitled to apply to the court to request the postponement of bankruptcy. Even the board of directors may apply to the court with such request; the request of the board of directors should be supported with a plan for rectification of the present condition. We should emphasize that the time granted by the court for the postponement cannot be more than one year. In one year, if the financial condition of the company has been rectified and the assets exceed liabilities, the decision for the postponement of bankruptcy should be removed. Otherwise, it should be held by the court that the company has become bankrupt.

In a significant case, more than one company jointly applied for the postponement of bankruptcy. The claim petition included the statements that the companies were electronic equipment producers and the marketing was conducted through a sister company, and sub-companies were dealing with the packaging. Subsequent to the global crisis in 1998, such companies under the same group signed and executed a financial restructuring agreement in accordance with the 'Istanbul Approach'. One plan was submitted to the court for all of the companies. In accordance with the decision dated 7 April 2005, the Court of Appeal ordered that more than one company can be evaluated severally and the conditions for the postponement can be determined for each of the applicants and therefore the request for joining of the requests for the postponement can be accepted and such acceptance is lawful in accordance with Turkish Code of Civil Procedure.

V INTERNATIONAL

Regarding how the courts of Turkey may recognize proceedings commenced in another jurisdiction, judgments by foreign courts have legal effect through recognition and enforcement in Turkey only if the reciprocity principle is fulfilled by the other country. Under



Article 54 of the International Private Law of Procedure, there are certain conditions that must be met. The foreign court judgment shall not be given in cases when the Turkish courts have an exclusive competence over the subject; the foreign court judgment shall not be against public policy in Turkey; the opponent party's right to defense shall not be restricted; and there shall be an agreement of reciprocity between the foreign country and Turkey, or there must be a provision of law or any *de facto* application.

VI FUTURE DEVELOPMENTS

In previous years, there have been major changes in Turkish bankruptcy law. These changes brought Turkish bankruptcy procedures closer to the procedures expected by international investors and therefore have benefited both foreign investors and the domestic Turkish economy. These procedures are specifically designated to prevent avoidable bankruptcies and to give relief to Turkish enterprises suffering cash flow or other financial difficulties capable of remedy with a view to an enterprise's long-term recovery. In recent years the use of these procedures was the preferred route for enterprises. It is expected that use of these procedures will decrease in near future in line with the improvement of the banking sector and the growth of the Turkish economy.