

THE NEW CODE'S APPROACH TO PRIVILEGED SHARES

The concept of "privileged shares" is commonly used under the current Turkish law. Shareholders, especially founders and financial investors, usually desire to have some privileges in comparison to other shareholders as they usually invest more and wish to have extra rights to secure their investments. Therefore, creating privileged shares with superior rights becomes an important need in corporate life.

The new Turkish Commercial Code No: 6102 (the "New Code"), which will be effective as of 1 July 2012, does not abolish the "privileged rights" concept as such fundamental change would create a gap, given the fact that it is applicable under the current Turkish Commercial Code No: 6762



(the "Code") for long years. In order to prevent such undesired situation, during the preparation of the New Code, other countries' regulations, especially those related to restrictions regarding "privileged shares", have been carefully analyzed by the lawmaker. Additionally, the New Code sets up several measures to monitor misuse of "privileged shares".

This article aims to generally highlight the significant amendments introduced by the New Code and provide information on the new arrangements regarding the privileged shares and shareholders' rights under the New Code.

Definition of Privileged Shares

Despite the fact that there is no definition regarding the privileged shares under the Code, through the New Code, the term of "privilege" is defined as follows; "A privilege is either a superior right granted to a share concerning dividend entitlements, liquidation proceeds entitlements, pre-emptive or voting rights, or any other new shareholder's right not defined in the legislation."

As per Article 478 of the New Code, privileges shall be granted through provisions stipulated in the articles of association of companies. Accordingly, (i) companies may issue privileged shares; (ii) privileges may only be granted through articles of association of companies; and (iii) privileges may be granted to the shares and not to the shareholders.

Significant Amendments Introduced by the New Code

Representation of Share Groups at Board Level

The right to nominate candidates to the Board of Directors is not explicitly regulated under Article 401 of the Code concerning the privileged shares. However, it is generally accepted that a privilege to that effect may be granted under the Code. On the other hand, as per Article 360 of the New Code, provided that there is a relevant provision in the articles of association (i) certain share groups; (ii) shareholders that constitute a certain group due to their qualifications; and (iii) minorities may be represented in the Board of Directors.

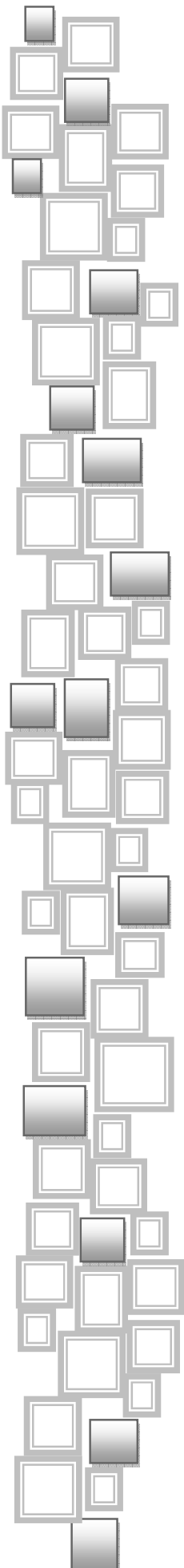
The main difference between the privileges granted to certain share groups and the privileges granted to shares is that while the latter may be exercised individually, the group privileges have to be exercised as a group. That is to say, a privilege may be granted to a group, however for exercising such privilege, the group shall act together. This act does not require unanimous decision of members of such group; however it necessitates the gathering of all the members of such group and taking the decision with the majority in order to exercise the privilege.

Even though as a general principle it may be considered that the privileges shall be granted to the shares, the Court of Appeals accepts in its judicial opinions that group privileges can be granted to certain share groups. Accordingly, the New Code explicitly specified the group privileges within the scope of privileges. In this regard, it is an exception for the general rule, which sets forth that the privileges can only be granted to the shares.

Privileged Voting Rights

The New Code codifies the voting rights differently from the Code. The general rule regulated under the Code according to which "every share has at least one voting right", has been replaced by the rule stating that "voting rights shall be exercised in the general assembly in proportion with the nominal value of the shares".

Under the current system, privileges in voting rights are granted through two different methods. Privileges may be established by granting different voting rights to shares with equal nominal values or alternatively, equal voting rights may be granted to shares with unequal nominal



values. However, the New Code clearly rejects the second method in order to prevent any hidden privileges. As lawmaker does not approve the hidden privileges, some restrictions have been provided for the privileges in voting rights as follows:

- maximum number of voting rights that may be granted to one share shall not exceed 15; and
- privileged voting right cannot be exercised with regard to the following decisions:
 - (i) amendments to the articles of association,
 - (ii) election of process auditors (*işlem denetçisi*),
 - (iii) releasing and initiating actions regarding responsibilities of directors.

The maximum limit of 15 voting rights can be increased by a court decision provided that one of the following conditions is present:

- increase of the limit should be necessary for the corporate governance of the company; or
- there should be a just cause for such increase ;

Additionally, a corporate governance report supporting and explaining the reasons of increase request has to be submitted to the court.

Unlike the Code, the New Code sets forth a different system regarding privileged voting rights; and therefore the Code on Effectiveness and Enforcement of the Turkish Commercial Code Numbered 6103 (the “**Enforcement Code**”) accepts a comprehensive provision for the transition period. Articles of association that are incompatible with Article 479/1 of the New Code must be amended so as to be in line with the New Code within 3 years as of the publication of the New Code, i.e. on 14 January 2014. Therefore, the companies adopting the method of giving same number of voting right for shares with different nominal values, rather than giving different number of voting right for shares with equal nominal values, should quit this method in order to comply with Article 479/1 of the New Code.

On the other hand, according to Article 479/2 of the New Code, the provisions of the articles of association setting forth exorbitant privileged voting rights should also be amended within 3 years. Accordingly, it is essential to decrease the voting rights which are more than 15 or take a court decision in line with Article 479/2 of the New Code for increasing the voting rights.

Eventually, the Enforcement Code resolves that if the amendments to the articles of association regarding the voting rights are not realized within 3 years, these provisions of the articles of association shall be automatically deemed null and void.

Privileged Shareholders’ General Assembly

Privileged shareholders meeting is regulated under the New Code similar with the Code. According to the New Code, general assembly resolutions related to (i) any amendments to the company’s articles of association; (ii) any increase of the company’s share capital; or (iii) any authorization of the Board of Directors regarding the increase of the company’s share capital which may diminish privileges of the privileged shareholders shall be approved at the privileged shareholders meeting to be separately held by the privileged shareholders. Otherwise, such resolutions cannot be executed. Lack of such meeting and approval of the privileged shareholders are not one of the cancellation reasons and does not result in the cancellation of the general assembly resolution by itself; instead it annuls the execution of the transaction subject to the amendment.

Unlike the Code, the New Code provides a provision regarding the process to convene privileged shareholders meetings. Thus, with the New Code, the loophole that existed in the Code has diminished. According to the New Code, in case the privileged shareholders or their representatives with the required quorum as specified below attend the general assembly held to approve any of the above matters and cast their votes, it is not necessary to separately convene a privileged shareholders meeting. The New Code sets forth that the privileged shareholders meeting shall be held with the attendance of 60% of the shareholders that represent the privileged shares and the decision shall be taken with the affirmative vote of the majority of participants.

I just think the most difficult thing to displace is privilege.

- Sean Connery

Conclusion

In a nutshell, with the New Code, a privilege right is defined as a superior right granted to share or share groups. Privileges in voting rights are restricted in order to prevent their misuses. However, exceptions of the restrictions are specifically enumerated provided that necessary court process is completed. Thus, privileged shares can no longer have the effect of blocking the system and become subject to a justifiable process.

Representation right in the Board of Directors is regulated in a separate Article as a privilege granted to certain share groups and the minorities, therefore, it has been aligned with the concept accepted by doctrine and adjudications.

Finally, the provisions with regard to the privileged shareholders meetings are detailed, the controversial issues are clarified.

With all these changes, privileged shares which are essential for practice are regulated comprehensively. Troubles experienced in practice have been eliminated and controversial issues have been regulated.

The aim of this 10th-dailies is to give an executive summary on certain legal matters. This has been prepared for information purposes only and does not constitute any legal advice. Thus, one should not rely on it for specific advice. For further information or advice please contact Taboglu&Demirhan, a full-service law firm based in Istanbul.