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Minority Private Equity and Venture Capital Investments in Start-up to Growth (Expansion) Capital Stages under the Turkish Merger Control Regime

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Merger control issues have substantial repercussions for deal timelines in M&A transactions. Failing to consider merger control implications when planning the deal timeline could cause a major hold-up for closing the transaction while it waits to receive a decision from the relevant authority. This is particularly so in jurisdictions with a suspension requirement in their merger control regime.

Modern competition law regimes call for ex ante analysis of the potential impacts of a certain transaction with regard to the competitive structure of the relevant markets. Thus, transactions that exceed certain thresholds are not considered valid until a clearance decision is obtained from the relevant authority. Such a decision may be either a straightforward clearance decision, or a decision conditioned on fulfilment of certain undertakings.

Notifiability concerns easily find their way to the equation when structuring the deal timeline for private equity investments. Particularly so for transactions which are at or beyond growth (expansion) capital stage, where the transaction involves acquisition of sole control, and the target has a significant local presence. That said, assessing the potential merger control implications of the transaction could easily be overlooked in most private equity and venture capital transactions performed at start-up to growth (expansion) capital stages. Particularly where the deal is structured as a minority investment and certain veto rights are granted to the investor or to multiple co-investors. Given that the target in the latter type of transactions generally does not have a significant local presence makes the decision process more difficult.

This article provides a general overview of the merger control notification requirements under the Turkish merger control regime, specifically focusing on private equity and venture capital transactions ranging from start-up to growth (expansion) capital stages. The transactions contemplated in this article involve one or more investors with veto rights, as well as a target which does not have significant Turkish activities.

Mergers and Acquisitions under Law No. 4054 on Protection of Competition

Control of mergers and acquisitions1 in Turkey is regulated by Article 7 of the Law No. 4054 on Protection of Competition ("***Law No. 4054***"). Turkish law deems mergers or acquisitions illegal if through creating or strengthening a dominant position, the transaction will result in significant lessening of competition in a market for goods or services within the whole or a part of Turkey.

Identifying which transactions require clearance from the Turkish Competition Board (the "***Board***") is a policy decision which is decided by the Board itself (Article 7 of the Law No. 4054). Accordingly, the Board issued Communiqué No. 2010/4 on Mergers and Acquisitions Requiring the Approval of the Competition Board ("***Communiqué No. 2010/4***"). Article 5 of the Communiqué No. 2010/4 regulates the types of transactions that would fall within the scope of Communiqué No. 2010/4 and thus the Law No. 4054.

Accordingly, a transaction must obtain the Board's approval if it would result in a change of control on a lasting basis and involves either:

1. The merger of two or more undertakings, or
2. One or more people/undertakings (who currently controls at least one undertaking) acquiring direct or indirect control over all or part of one or more other undertakings.

However, Article 5 requires the transactions outlined above to be executed through (a) the purchase of assets or shares, (b) an agreement, or (c) some other instrument. Joint venture transactions are also included to the extent that they permanently meet all functions of an independent economic entity (Article 5(3) of Law No. 4054).

If a transaction would lead to a change of control on a lasting basis as described above, determining the transaction's notifiability is a matter of calculating the turnover of the transaction parties to assess whether the thresholds under the Article 7 of the Communiqué No. 2010/4 have been exceeded.

Change of Control

Control is defined under Article 5 of Communiqué No. 2010/4. Accordingly, control is defined as the rights, agreements, or any other means which confer the possibility of exercising decisive influence on an undertaking. Decisive influence is conferred in particular by granting:

- Ownership of an undertaking's assets,
- The right to use all or part of the undertaking's assets, or
- The rights or agreements which confer decisive influence on the composition or decisions making of the bodies of an undertaking.

Control can be acquired solely or jointly either de facto (through common interests among shareholders) or de jure (through a legally binding agreement).

The role change of control plays in assessing the transaction's notifiability is directly related with whether the change of control is on a lasting basis or not. Competition law and merger controls concern permanent changes in market structures. The Turkish merger control regime only deals with changes to control that would be on lasting basis.

Transactions involving co-investors with veto rights are prone to joint control issues. The remainder of this article focuses on the potential issues related to joint control which are decisive in assessing notifiability.

Joint Control

Joint control exists where two or more undertakings, or persons, are capable of exercising decisive influence over another undertaking. Decisive influence is inferred where one party has the power to block actions which determine an undertaking's strategic commercial behavior. Therefore, one of the defining characteristics of joint control is the potential for deadlock in strategic commercial decisions resulting from the veto power of two or more parent companies. If a deadlock occurs, the interdependence of the shareholders in deciding on the joint venture's commercial policy is evident.

Joint control can be acquired in three ways:

1. **Decision making bodies with equal voting rights, or appointments;** the most common examples of joint control are transactions where the decision making bodies contain an equal number of members from each parent, or an equal split of voting rights among the parents.
2. **Veto rights;** joint control is still possible even if decision making bodies do not have equality in voting rights, or appointments. In a transaction which concerns veto rights on decisions regarding the joint venture's strategic commercial behavior, the nature of the veto rights may mean that the minority shareholder(s) might still be deemed to have joint control over the target. In this regard, veto rights that confer control must provide broader rights than the typical veto rights granted to minority shareholders. Relevant veto rights could be on issues such as the budget, business plan, major investments or appointment of senior management. Apart from these, there might be market specific issues (i.e. market specific strategic business decisions) whereby veto rights granted to minority shareholders would mean joint control would be deemed to have been conferred.
3. **Joint exercise of voting rights;** even without any veto rights, minority shareholders may be deemed to have joint control if they hold the majority of the voting rights. This is provided that there is a de facto or de jure basis for them to act together in exercising these voting rights.

In a deal with co-investors, if one of the investors has been provided with the above mentioned rights, the transaction would lead to a change in the quality of control regardless of the shareholding percentages of the shareholders. Identifying a change of control from sole control to joint control is generally straightforward. However, changes among the shareholders of an already jointly controlled undertaking make identifying changes in control more difficult.

Changes in the Quality of Control

Transactions that involve change of control fall within the scope of the Turkish merger control regime. A change from sole to joint control is a form of change in control. Another form of change of control occurs in a joint control scenario where the controlling shareholders increase in number, or a change in identity. Such a change could occur as a result of:

- A change from sole to joint control, or
- The entry of an additional shareholder, or
- A replacement of an existing shareholder, in an already jointly controlled undertaking.

Mere changes in the shareholdings which do not lead to a change in the powers granted to parents do not constitute a change in the quality of control and therefore are not notifiable. Similarly, reductions in the number of controlling shareholders that do not lead to a change from joint to sole control do not constitute a change in the quality of control.

The first step in assessing the notifiability of a transaction which involves co-investors with veto rights, is determining whether the transaction involves a change of control. Once it is clear that the transaction would lead to a change of control, parties must then determine whether the jurisdictional notifiablitiy thresholds have been met.

Joint Control for the Purposes of Calculating the Relevant Turnover

Notifiability thresholds under Turkish merger control regime have two alternative prongs:

1. Considering only Turkish turnover information: The total turnover of the parties to a transaction in Turkey exceeds TRY 100 million and the respective Turkish turnovers of at least two of the parties to a transaction individually exceed TRY 30 million, or
2. Considering both global and Turkish turnover information:
    1. For acquisitions, the Turkish turnover of the transferred assets or businesses in the transaction exceeds TRY 30 million and the worldwide turnover of at least one of the other parties to the transaction exceeds TRY 500 million, or
    2. For mergers, the Turkish turnover of any of the parties in the transaction exceeds TRY 30 million and the worldwide turnover of at least one of the other parties to the transaction exceeds TRY 500 million.

The punchline for turnover calculation is whose turnover needs to be taken into account. This seems to be a straightforward question for most deals. However, depending on the corporate structure involved, a series of follow-up questions might need to be asked and answered before calculating the turnover of the transaction parties.

Most private equity and venture capital funds are managed by management companies, which are usually separate legal entities, distinct and independent from the fund itself. A given management company could well be managing a number of funds, independent from each other. Therefore, for the purposes of calculating turnover, it is a reasonable to ask whether it is the turnover of the fund directly involved in the merger or acquisition is the most relevant, or the turnovers of all of the funds managed by the management company.

For tax or corporate governance purposes, private equity and venture capital funds prefer mostly to set up special purpose vehicles ("***SPV***") in different jurisdictions. The funds invest indirectly through the SPVs, which have been established solely for the sake of realizing the deal. In this regard, a derivative of the above question could be, whether having separate and distinct investments structured under different SPVs would have an impact on turnover calculation.

The answers to these questions hinge on the concept of "parties to the transaction" under the Turkish merger control regime. Article 8 of Communiqué No. 2010/4 makes it clear that the turnover of the economic unity (including both upstream and downstream entities in the control structure) that the undertaking signing the transactional documents belongs to must be taken into account. Therefore, the turnovers of all of the undertakings that are being controlled (solely or jointly) by the ultimate parent of the transactional party are relevant to the turnover calculation. In this regard, in a deal involving a fund with a management company which manages a number of funds independent from each other, the relevant turnover would be the aggregate turnover of the all funds being managed by the managing company. Similarly, an SPV's involvement in a deal does not change the landscape for turnover calculation purposes. Thus, the turnover of the ultimate parent is still the relevant figure to consider when making the turnover calculation.

A relevant question arises about whether the Turkish activities of the buyers (but not the target) can trigger a notification requirement. Such a question falls under the first prong of the notifiability thresholds outlined above. "Parties to the transaction" noted under this prong refers to the entire economic unit which the undertaking signing the transactional documents belongs to.

Therefore, in transactions that involve co-investors (that have a significant local presence) with veto rights on the strategic commercial decisions, and a target which does not have significant Turkish activities, generally the Turkish activities of the parents will be considered for the turnover calculation. This is despite the target having no significant Turkish activities itself.

While the parents have the potential to trigger a merger control notification under the first prong of the notifiability thresholds, the same is not true for the second prong. The second prong of the jurisdictional notifiability thresholds focuses on the Turkish turnover of the transferred assets or businesses. Accordingly, the Turkish turnovers of the parents are not relevant. Thus, if the transaction involves a target which does not have significant Turkish activities, it would likely be a non-notifiable transaction in Turkey.

Conclusion

Merger control notifications have a significant impact on the deal timings. These are relevant to deals involving targets that have significant local presence and also to private equity and venture capital transactions performed at start-up to growth (expansion) capital stages. Both of these types of transaction could require merger control notifications to the Turkish Competition Authority.

Accordingly, regardless of the size of the transaction, conducting a notifiability analysis before finalizing the deal timeline is a prudent step and will avoid any unnecessary and unexpected delays in deal timings.

1. Unlike the EU Competition Law regime, Turkish legislator have preferred to use the phrase "Mergers and Acquisitions" when referring to transactions. That said, a draft law which is pending before a subcommittee of the Grand National Assembly proposes to amend the Law No. 4054, instead referring to transactions as "concentrations".
2. Notifiability thresholds under Turkish merger control regime will be discussed further below.

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