

Dividend Distribution Restrictions Imposed on Equity Companies in Scope of COVID-19 Measures

Within the scope of the fight against the spread of Covid-19, provisional article 13 was added to the Turkish Commercial Code (“TCC”) with the Law numbered 7244 adopted on 16 April 2020. The said provisional article brought certain restrictions on dividend distribution rights of the equity companies until 30 September 2020 and it was further regulated that the companies exempt from these restrictions and the procedures and principles regarding the application thereof would be specified in a communiqué to be adopted by the Ministry of Trade (the “Ministry”). In this respect, the Communiqué Regarding the Procedure and Principles on the Application of Provisional Article 13 of the Turkish Commercial Code (“Communiqué”) entered into force with the announcement of the same in the Official Gazette on 17 May 2020.

Additions of the Communiqué as to the Provisional Article 13

The Communiqué clarifies the provisions brought forward in the provisional article 13 of the TCC regarding the distribution of dividend and advance dividend.

For instance, the provisional article 13 stipulated that companies are restricted to distribute more than 25% of their net profits generated in 2019 financial year until 30 September 2020 and retained earnings and free reserve funds cannot be distributed as dividend. As per article 4 of the Communiqué, this restriction shall be applied for the dividend distribution “in cash” and the capital increase through internal resources as per article 462 of the TCC would be exempt from the restriction. With this provision, it was made clear that the capital increase through internal resources complies with the regulations where the main purpose is to preserve the companies’ capital structures.

Furthermore, as per the provisional article 13, if a dividend distribution resolution regarding the payment of profits related to 2019 financial year had been adopted before the enforcement of this article but no payment was made to the shareholder(s) or a partial payment was made, then the payments exceeding 25% of the net profit for 2019 financial year should be postponed until 30 September 2020. In addition to this, the Communiqué stipulates that if the company had adopted a resolution for the distribution of free reserve funds although the company made loss in 2019 financial year, the payment corresponding to the unpaid part of that amount should also be postponed until 30 September 2020 and no interest should be accrued for this postponement.

Finally, while the provisional article 13 prohibits the board of directors’ authority to distribute advance dividend, the Communiqué postpones the payment of such advance dividends until 30 September 2020 even if the board of directors was previously authorized regarding the distribution of the same.

Companies that are Exempt from the Restrictions

The companies exempt from the restrictions set forth in the provisional article 13 of the TCC and in the Communiqué are determined in article 5 of the Communiqué.

In principle, article 5/1/a of the Communiqué allows companies to distribute dividend including and up to TRY 120,000 in order to protect the shareholders for whom the dividend constitutes an important income item. However, two following categories of companies cannot benefit from this exemption: 1) companies which employ employees receiving the short-time employment allowance and/or employees who are on unpaid leave and receive monetary financial aid as per the Law on Unemployment Insurance numbered 4447, 2) companies which make use of the Treasury supported credit surety and still have outstanding balance in credit debt as per the Law on Public Financing and

the Regulation on Debt Management numbered 4749 and related legislation. With the first exemption, the interest of preserving the company's capital structure has taken precedence of the shareholders' interest in terms of receiving dividend if the company's commercial operations have already suffered from significant disruptions and accordingly its employees are benefitting from the short-time employment allowance or monetary financial aid. The second exemption aims to protect assets of a company which makes use of credits with the public guarantee and which has outstanding debts, by preventing the decrease in its assets through dividend distribution which may compromise public resources.

As per article 5/1/b of the Communiqué, dividend distribution resolution may be adopted if more than half of the dividend to be distributed will be used for performing the capital commitments in another equity company. This exemption clarifies that using the dividend for forming or increasing the capital of another company will not contradict with the purpose of the restrictions.

Finally, a company is allowed to distribute dividend if the dividend will be used to perform the debts of shareholders which have arisen from credit or project finance agreements and which are due by 30 September 2020. However, the payment of the dividend amount of which exceeds the debts of the shareholders shall be postponed until 30 September 2020. This exemption prevents the risk of shareholder's going into default due to the credit and project finance debts and consequently the risk of downgrading their credit ratings.

The Steps that should be Taken

As for the companies who benefit from the exceptions mentioned above, it is mandatory to obtain the approval of the Ministry before the discussion of dividend distribution in the general assembly meetings. In order to obtain this approval, the following documents should be submitted to the General Directorate of Internal Trade ("General Directorate"):

- The notarized copy of the managing body resolution regarding the general assembly meeting to be convened,
- Company's financial statement and profit/loss statement for the financial year prepared in accordance with the standards determined in the TCC and the relevant legislation,
- The documents proving that one of the exemptions mentioned above is applicable for the company.

Since the Communiqué has recently entered into force, it is yet to be seen how much detailed the General Directorate's examination will be and how long it will take.

Consequences of the General Assembly Resolutions Contrary to the new regulations

Taking into consideration the prohibitive expression and the direct relation between these provisions and the capital preservation principle which is one of the most important principles of the equity companies, the mandatory nature of these provisions should be noted. Therefore, invalidity of the general assembly resolutions contrary to the dividend distribution restrictions may be claimed.

It is important to determine whether the invalidity will be claimed through a cancellation action which can be filed by a limited number of people and within a definite period of time or through an action for determination of nullity which can be filed by any related party without any time limitation.

Since article 445 of the TCC which lists the legal reasons for cancellation action stipulates that the general assembly resolutions contrary to the provisions of law may be cancelled, it may be put forward

that a cancellation action should be filed against the general assembly resolutions contrary to dividend distribution restrictions. However, as per article 447 of the TCC, general assembly resolutions “contrary to the provisions relating to capital preservation” shall be null and void. As it is expressly stated in the preamble of the provisional article 13, this provision came into force in order to preserve the equity of the company and to prevent the decrease in financial resources thereof. Therefore, it would be more appropriate to state that these general assembly resolutions shall be null and void.

Neither provisional article 13 of the TCC nor the Communiqué does have a response to the question of whether the dividend distribution resolution contrary to the restrictions shall wholly or partially -the part exceeding 25% limitation- be null and void. Scholars put forward that article 1530/1 of the TCC - which states that if an agreement contains a provision exceeding the limit set forth by the legislation, this agreement shall be considered valid up to the maximum amount provided in that legislation, may be applicable by analogy in this case.¹ Therefore, as for the general assembly resolution distributing more than 25% of the total profit, the part exceeding 25% may be considered null and void.

Liability of Shareholders and Board of Director Members

Article 512 of the TCC has specifically regulated the dividend distribution contrary to the restrictions mentioned above. As per this article, a shareholder who received dividend unjustly and in bad faith should return it back to the company. In this respect, it is clear that receiving dividend contrary to the express prohibition of law (provisional article 13 of the TCC) and provisions of the Communiqué, constitutes an unjust act and accordingly the shareholder cannot be considered acting in good faith.

Moreover, article 553 of the TCC states that the members of the board of directors and managers shall be liable for damages occurred to the company, shareholders and/or to the creditors of the company because of the wrongful violation of their duties arisen from the provisions of law. Consequently, as per this article the board of directors’ members who determine the dividend distribution proposal and accordingly cause general assembly resolution to be taken contrary to law may be held liable due to breaching their duties wrongfully. The company itself, shareholders and/or the creditors of the company may claim their damages related to the unlawful dividend distribution from the board of directors.

The Alternative Methods to the Dividend Distribution

As mentioned above, restriction imposed with the provisional article 13 and the Communiqué prohibits the distribution of dividend and advance dividend. However, the financial rights of shareholders on the company are not limited to these options.

As per article 358 and 644 of the TCC, in joint stock companies and limited liability companies, if the company’s profits along with the reserve funds exceed previous years’ loss, the shareholders who fulfill their due debts arisen from capital share commitments may take loan from the company. Looking at the provisions mentioned above, in principle, taking loan from the company is not prohibited for shareholders.

In theory, it is also possible to make a transfer in cash to the shareholders through capital decrease. Nonetheless, as there are detailed and long procedures specified in articles 473-475 of the TCC that

¹ Dr. H. Ali Dural, Restrictions Imposed Regarding Profit Distribution in Equity Companies by the Provisional Article 13 Added to the Turkish Commercial Code with the Law numbered 7244 due to the Outbreak of COVID-19. For Turkish version of the article please see: <https://blog.lexpera.com.tr/covid-19-salgini-ndeniyle-turk-ticaret-kanununa-eklenen-gecici-13-madde-ile-sermaye-sirketlerinde-kar-dagitimina-getirilen-sinirlamalar/>

should be followed in order to decrease capital of a company, this would not be considered as a practical solution during the outbreak.

Despite the fact that the prohibitions mentioned above only cover the distribution of dividend and advance dividend, taking into consideration that the purpose of the regulations is to preserve the equity of the companies, the transactions contradict with this purpose may cause the liability of the board of directors. Therefore, it is critical to duly consider the alternative methods to the dividend distribution and not to make cash transfer in the amount that would invalidate the prohibitions by acting in compliance with the provisions of the Communiqué.