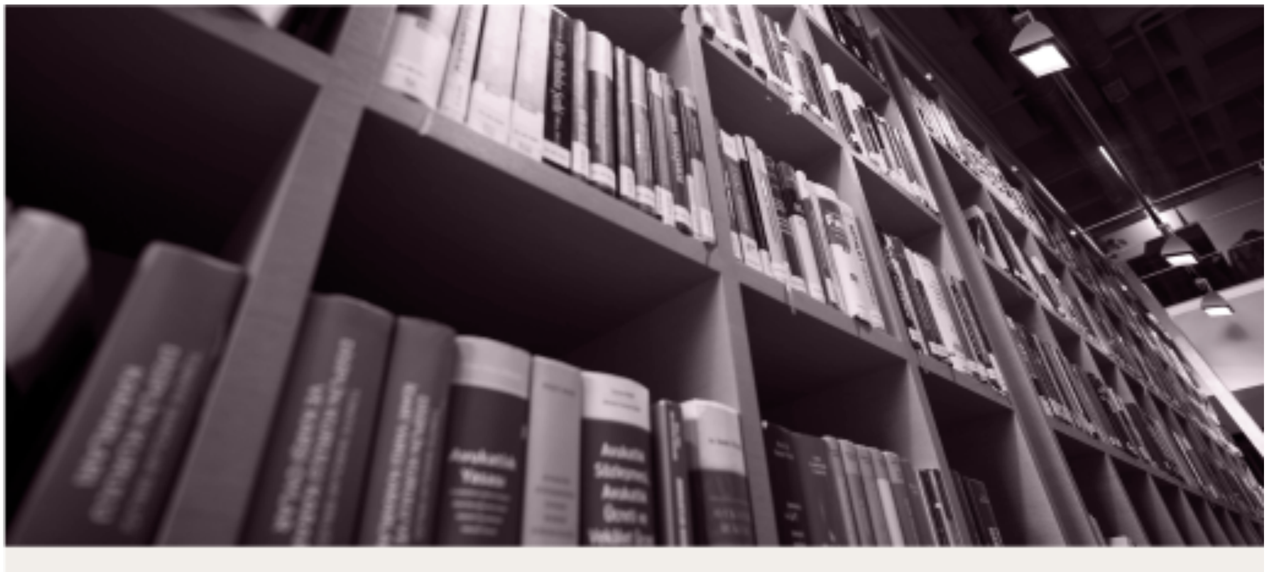

Employee Stock Option Plans under Turkish Law

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Over the last decade, granting employees stock option rights for acquiring shares in the employer company has become a growing trend among companies operating in the technology sector, particularly in start-up companies. In this respect, companies favour "Employee Stock Option Plans" enabling employees to acquire a certain amount of shares in the company and conclude "Stock Option Agreements" with the employees for this purpose. In this article, the concept of stock options and various stock option plans will be discussed along with their implementation under Turkish law and in other jurisdictions.

I. Stock Options and Their Implementation in Turkey

There are many types of benefits companies grant to their employees as a part of their compensation. Nowadays, companies, wishing to provide various financial benefits to their employees beyond salary increases are offering employee stock option plans, an increasingly popular type of benefit, to their employees.

Stock option plans allow employees to acquire company shares or other benefits tied to company shares upon the fulfillment of certain conditions. While these plans were mainly popularized in the US, they are now increasingly being adopted by Turkish companies as well.

Companies prefer to establish stock option plans in order to award productive employees while also creating a connection between the interests of the company and the interests of its employees. Primary benefits of employee stock option plans include improved relationship between the company and the employees, bridging the gap between the company's commercial interests and the employees' interests and creating a common identity.

Stock option plans are currently not widely adopted in Turkey unlike other jurisdictions, due to the lack of a clear legislation on the matter. Having said that, stock option plans which have become relatively viable after the enactment of Turkish Commercial Code No. 6102 ["TCC"] in 2012, are mostly preferred by technology and start-up companies.

II. Stock Option Plans in Turkey

1. Direct Shareholding of Employees

In this type of plans, company shares are granted directly to the employee and the employee becomes a shareholder of the company. Therefore, employees enjoy the shareholding rights provided by the TCC, like any other shareholder of the company.

The direct employee shareholding plans generally consist of the following three phases:

i. **Granting:** In this phase, company grants an option to the employee(s) to acquire a certain amount of company shares provided that they fulfill the conditions set by the company and/or continue to work for the company for a certain period of time.
ii. **Vesting:** In the vesting period, employees become entitled to share option upon the fulfillment of the conditions set forth in the stock option agreement concluded between the company and the employee [e.g., after the expiration of the 3-year period specified as an exercise date in the stock option agreement].
iii. **Exercising:** In the exercising phase, employees that are included in the plan acquire company shares by exercising their options provided that conditions stated in the stock option agreement have been fulfilled. It is worth noting that in the foregoing phases, employees have not yet acquired the actual shares.

In this context, to the extent permitted by Turkish legislation, direct employee shareholding plans can be executed in three alternative ways:

a. **Conditional share capital increase and issuance of new shares:** In this method, in the exercising stage where the employee becomes a shareholder, new shares are issued in a conditional share capital increase, and the employee becomes the owner of the newly issued shares.

   For a conditional share capital increase, the articles of association of the company must contain specific rules. Therefore, in order to grant shares to employees through a conditional share capital increase, the articles of association of the company will have to be amended in the granting phase by the shareholders via a general assembly resolution. Moreover, existing shareholders will typically have the pre-emptive right during a capital increase. As such, they have the right to purchase newly issued shares on a pro-rata basis to their shareholding. Hence, in order for the employees' participation in the company to be deemed as a justifiable reason to restrict the pre-emptive rights of existing shareholders, the articles of association should specifically contain a provision addressing this matter. Accordingly, the pre-emptive rights of the existing shareholders can be restricted for the conditional share capital increase, provided that the other conditions set by the TCC have also been met.

   This method, although rarely used, is generally preferred by corporations in which registered share capital system is adopted or by publicly held companies [1]. It is also worth noting that conditional share capital increase in public companies with the registered capital system is subject to the rules of the Capital Markets Board's Communiqué on Shares no. VII-128.1.

b. **Existing shareholders' commitment to transfer shares to the employee:** In this method, all or some of the existing shareholders commit to transfer a portion of their shares to the employee in accordance with the share option plan. Therefore, the capital increase procedures are mitigated, and current shareholders waive a part of their shares and transfer those shares to the employee. Where a corporation opts for this method, the promissing shareholders transfer their committed shares to the employee upon fulfillment of the agreed conditions. In any case, this plan would merely constitute a contractual relationship between the shareholders and the employee and may not be binding on the shareholder in terms of corporate law.

c. **Share transfer by the company:** Under Turkish law, companies are entitled to acquire their own shares up to 10% of its share capital. Those shares owned by the company can be offered to the employees as stock options in the future.

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Given that direct employee shareholding stock option plans are not explicitly regulated under Turkish law and considering the employers' concerns in granting shareholding rights to the employees, companies in Turkey are inclined to prefer phantom stock option plans described below.

2. Phantom Stock Option Plans

In simple terms, employees do not directly own shares in these plans. However, they have financial rights attached to these shares such as receiving dividends or certain benefits in various scenarioes, such as in case of exit. In this method, which is frequently known as the "Phantom Stock Option Plan" or synthetic equity, employees receive the respective benefits depending on the ratio or amount of shares on the date of commitment.

In practice, especially in phantom stock option agreements concluded between the founding shareholder and the employee, the shareholders promise to pay a part of the dividend they receive from the company to the employee. That is to say, such undertaking establishes a purely contractual relationship between the employer-shareholder and the employee and may not be binding in terms of corporate law.

This method is frequently preferred in Turkey [2]. On the other hand, some companies choose to merge both methods and offer stock options allowing employee to be a direct shareholder to their high-ranking senior managers and phantom stock options to other employees. The type of options to be offerred by the company should be evaluated for each employee according to the company dynamics.

III. Stock Option Plans in Other Jurisdictions

There are various alternative mechanisms to the above stock option plans. While these alternative mechanisms are yet to be widely used in Turkey since they are not directly regulated, they are preffered in many parts of the world. Some of these methods are as follows:

i. **Plans to Acquire Shares in an Associated Company:** In this method where some procedures applicable in direct employee shareholding are mitigated, employees are granted shares not in the main company, but in another company related to the main company [e.g., a different legal entity with the same founders]. Accordingly, some rights and receivables are transferred to the associated company by the main company. In this method, while the employee becomes a shareholder in the associated company; the shareholding structure of the main company is preserved in its current form.

ii. **Stock Bonuses:** Stock bonuses are performance rewards granted to the employees depending on the fulfilment of performance objectives for a time period determined by the employer. In these stock plans, incentives/bonus payments can be granted as company stocks as well as in cash.

iii. **Employee Stock Ownership Plan:** This plan provides the employees with the opppurtunity to directly own company shares by purchase. However, to allow employees to buy the shares, it is necessary to set up a trust fund within the company consisting of issued shares of stock reserved specially for the employees.

iv. **Stock Appreciation Rights ["SAR"]:** Employees will be entitled the cash equivalent of a stock's appreciation over the period between the grant date and the vesting date without acquiring the ownership of the company shares. In this case, the employee does not need to purchase the stock beforehand. Although SAR is similar to phantom stock option plans in that regard, the latter is are designed to pay employees in cash over the market price of the shares at the exercise date while SARs are designed for the employees to receive the sum of the increase in the stock value.

[1] For instance, Osmanli Yatirim Menkul Degerler Anonim Sirketi issued 98,500 Class B shares in the conditional share capital increase transaction dated 24.09.2020 to the employees as part of the Stock Option Plans Program (See https://www.kap.org.tr/tr/Bildirim/876443).

[2] Turkish Airlines, for example, reached an agreement with Hava-İş Union in 2016 and announced that employees would be entitled to receive a portion of the dividend distributed in the repective financial year. (See https://www.kap.org.tr/tr/Bildirim/770440,2019 senesi kar dağıtım tablosu/).

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