

Limitations on Dividend Distribution & What Actions May Be Taken by Board Members?

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Dividend distribution, a form of cash flow to the shareholder, is a matter of utmost importance, as it is not only a principal shareholder right but also a constitutional right deemed as a property right that reflects the strongest bond between company and shareholder. In fact, equity companies, the lifeblood of current system, have been established with the aim of profiting and distributing dividends to their shareholders. A great deal of provisions regarding dividend distribution are thus included in the Turkish Commercial Code [“TCC”] constituting the legal framework of the latter.

Notwithstanding the pivotal significance, dividend distribution also had a share from the Covid-19 Pandemic amongst many other legal subjects. In light of the pandemic’s financial consequences upon companies, Turkey introduced limitations on dividend distribution, the aim of which is said to be protecting the capital of equity companies. The limitation was first announced with the advisory information note of Turkish Union of Chambers and Commodity Exchanges dated 01.04.2020, referring to the letter of the Ministry of Trade dated 31.03.2020. This announcement was subsequently legalized through the addition of a Provisional Article 13 to the TCC on 17.04.2020 and a Communiqué on the Procedures and Principles Regarding Implementation dated 17.05.2020 followed it.

Pursuant to the above-mentioned regulations applicable as of 17.04.2020, equity company’s general assembly [“GA”] who has an exclusive and non-delegable authority on the subject, cannot (i) distribute dividends exceeding 25% of company’s net profit for 2019; (ii) distribute retained earnings and free reserve funds; (iii) authorize its board of directors [“BoD”] to distribute advance dividends and (iv) even if GA adopted such a resolution before the effective date of the Provisional Article 13, yet the payment was not made or partially made, the payment shall be postponed until 30.12.2020.

Looking at the situation prior to recent regulations, GA had no limitations on these matters if the legal conditions were met and within this respect, and had the right to distribute dividends between 5%-100% from the annual net profit for such period, solely from voluntary reserves allotted for this purpose, although the minimal mandatory amount of 5% is controversial in Turkish doctrine.

As might be expected, these limitations would also have an impact on BoD, handling all sorts of matters pertaining to management and representation of the company. Accordingly, there are various scenarios concerning company BoD’s possible actions in the face of the outcomes related to the limitations. Firstly, as a valid and common approach, unless it did not already make a call, BoD may choose not to call the ordinary GA meeting in 2020 and hold the last years’ (unheld) meetings combined in 2021, since there is no imperative provision that stipulates an ordinary GA meeting to be held each year. Limitations introduced on dividend distribution are effective until 30.12.2020, which means that the companies will be entitled to decide dividend distribution freely as of 31.12.2020, provided that further limitations are not introduced by Turkish Lawmaker.

As an alternative approach, BoD may arbitrarily choose to call GA for ordinary GA meeting in 2020. In such a case, there would be two different potential outcomes. If the agenda of the ordinary GA meeting is complying with Provisional Article 13 and GA adopts a compatible resolution, there shall be no inconvenience considering GA is already the exclusive authority on the matter. However, despite the agenda issued by BoD that is completely in compliance with the Provisional Article 13, GA might prefer to adopt a non-conforming resolution *e.g.* distributing 50% of company’s net profit for 2019. In this case, GA’s decision on dividend distribution could be deemed as contrary to law.

BoD members are obliged to perform their duties with diligence and to protect the interests of the company within the framework of the principal of good faith, as well as in accordance with the business judgement rule. Therefore, in the event of a decision sought to distribute dividends that exceeds 25% company’s annual net profit for the year 2019 and/or any other contradiction that falls within the realm of Provisional Article 13, BoD ought to consider filing a cancellation lawsuit against GA’s such resolution. On the other hand, BoD acting in compliance with the business judgment rule, should consider not to distribute the dividends more than 25% despite the GA’s decision. Otherwise, it may result in a liability lawsuit filed against them, an outcome almost every BoD member would like to avoid.

In a nutshell, it seems that BoD has varied options vis-à-vis the limitations on dividend distribution imposed on Turkish companies. Taking into account every company's distinctive particularities and internal balances, we are of the opinion the best option could be determined by their BoD members, people who are acting diligently and meticulously in line with the business judgment rule.

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