Employee Stock Option Plans in Turkiye: Legal Framework and Implementation

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1. Introduction

This article explains legal nature and market practice of employee stock option plans ("**ESOP**") with a particular focus on their implementation in Turkiye. ESOPs regulate the conditions under which certain key employees to become shareholders in a company they serve for a certain period of time. Employee ownership schemes gradually become a common incentive tool especially among start-ups, early and growth-stage technology companies as well as multinational group companies. Although there is no ESOP specific legislation under Turkish laws, general provisions of law of obligations, corporate law, employment law and local tax rules apply.

It is also significant to note that there are two common company types in Turkiye: (i) joint-stock companies ("**JSC**") and (ii) limited liability companies ("**LLC**"). JSCs are more suitable for ESOP implementation due to fewer procedural obstacles and relatively easier share transfer mechanisms. In this regard, referrals to Turkish law in this article only cover non-public JSCs, not LLCs.

2. ESOP Structures in General Terms

An ESOP generally follows a specific timeline that transforms potential efforts of employees into actual share ownership in a company as a kind of benefit and reward. Under Turkish laws, an ESOP is freely designed as a contract to be entered into by and between the employees, company (and existing shareholders) within the scope of freedom of contract principle.

ESOP process begins with grant. At this stage, the employees do not immediately acquire the shares and become shareholders to the company. Instead, the company in question or some shareholders grant(s) employees option rights to acquire certain shares issued by the company, as being subject to certain time limits and/or specific performance conditions. Having said that such options do not bear any obligatory nature or undertaking for the employees. This is to say under ESOPs, employees are indeed free to acquire the shares at their own discretion.

ESOPs also specify an exercise price or calculation method. Exercise price is the price the employees to pay per the option to be exercised. It can be a fixed amount and may be set at (i) fair market value or (ii) nominal value of the shares. The purpose of setting an exercise price is to allow the employee to buy shares at a lower price if the company's value grows. Difference between the exercise price and the actual price of the stock on the exercise date constitutes the employee's incentive. In some exceptional cases, founder or majority shareholders may also undertake to pay value of the shares and grant them to employees on a free of charge. Tax implications should be also considered when setting the exercise price.

Employees may exercise their options by sending an exercise notice to the company and shareholders. Following this stage, each employee is generally required to become a party to the shareholders' agreement ("**SHA**") executed by and between the existing shareholders to regulate the internal relationship of the shareholders. In practice, employees sign a basic deed of adherence or any similar participation document acknowledging to be bound by the rights and obligations of the SHA, as being new shareholders.

ESOP structure may also regulate employees' departure conditions from the company to the extent that they are not contrary to general ownership related rules and provisions of Turkish laws. Leaver provisions generally govern these scenarios in a detailed and structured manner. These provisions may be also included in the SHA.

3. Implementation of ESOPs Under Turkish Legislation

Since Turkiye does not have a specific regime or regulations specified for ESOPs, general mechanisms of Turkish Commercial Code No. 6102 (**"TCC"**) apply to put an ESOP into practice for acquisition of the shares by employees. From Turkish corporate law perspective, share ownership may be obtained primarily through (i) standard share capital increase, (ii) conditional share capital increase and (iii) share transfer. In this context, the contemplated share acquisition under an ESOP may be realized through any of the foregoing methods, as the case may be.

In order to follow standard share capital increase process for issuance of new shares and acquisition of such shares by relevant employees, the existing shareholders may voluntarily waive from their pre-emptive rights. Alternatively, the pre-emptive rights can be restricted with affirmative votes of the shareholders representing at least 60% of the share capital based on the ground of employee participation which constitutes a just cause. In this method, depending on the case at hand, other requirements of share capital increase process must be also duly satisfied for registration of the share capital increase with the trade registry. For instance, the company's previous total share capital must be fully paid and at least 25% of cash share capital increase amount must be paid before the registration, while the remaining 75% may be paid within 24 (twenty-four) months following registration.

Conditional share capital increase is another method under the TCC which can be used to grant option rights to employees by the general assembly and restrict the pre-emptive rights of existing shareholders so that the employees can acquire shares of the company on contingent basis. Accordingly, when an employee, as an option holder, exercises their option once the condition is met, the share capital of the company increases automatically to the extent of the exercised options. However, in any case, share capital article of the articles of association shall be amended and registered with the trade registry by the board of directors. This method also requires certain restrictions. For instance, the total nominal value of the shares subject to conditional capital increase cannot exceed half of the company's total share capital amount. On the other hand, compared to the standard share capital increase, it can be inferred that conditional share capital increase offers a more direct and automatic process in terms of the employees.

As a third alternative, existing shares of a JSC already owned by certain shareholders or the company itself (in certain exceptional circumstances) may be transferred to employees without issuing new shares and pursuing standard or conditional share capital increase process. In this case, share transfer method and requirements would depend on type of the shares to be transferred and existence of issued share certificates.

If an ESOP stipulates employees to acquire the shares through a share transfer at the time of exercise, it might be also necessary to secure the specific performance in favour of the employees. For instance, establishment of a pledge or escrow mechanism over the share certificates representing the sale shares to be transferred might be a practical solution.

All in all, while preparing an ESOP, its provisions should be constituted in line with Turkish corporate law practice. Depending on the scope and content of the ESOP, it might be also necessary to reflect its relevant provisions to the articles of association of the company to the extent permissible from corporate law point of view. In addition, it would be required to structure the right share acquisition method and take relevant actions to secure the process.

4. Conclusion

ESOP is a popular method of employee incentive and retention worldwide for many companies. As Turkiye does not have a specific or statutory ESOP regime, scope of ESOPs may freely be determined within the framework of freedom of contract principle. In order for relevant employees to acquire the promised shares upon fulfilment of all necessary conditions stated in an ESOP, applicable mechanisms of Turkish corporate law come into play and provide complementary roles. ESOPs should be also evaluated from employment law and tax perspectives.

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