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NEWSLETTER

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Law on Pledges over Movable Property in Commercial Transactions

Law on Pledges over Movable Property in Commercial Transactions (“**New Law**”) numbered 6750 has been published in the Official Gazette dated 28 October 2016 and numbered 29871 abolishing the Commercial Enterprise Pledges Law no:1447 (“**Current Law**”). The New Law will enter into force on 1 January 2017.

The New Law does not apply to litigation which were initiated before the effective date and also the Current Law continues to apply to pledges which were established over commercial enterprises before the effective date.

Purpose

The main purposes of the New Law are; facilitating the access to sources of financing for the Small Medium Enterprise’s (“**SME**”), increasing the use of pledge on movable properties and thus, contributing to the economic development of Turkey. With the New Law, a pledge could be established over a movable property in the commercial transactions through a registration system without the transfer of possession of the pledged assets.

Implementation of the New Law will be regulated by secondary legislation enacted by the Ministry of Customs and Trade, which has not been done yet.

The most important differences between the New Law and the Current Law can be listed as follows:

- ✓ introducing an exception to *lex commissoria* principle which prohibits the pledgee to obtain ownership of the pledged property in case of an event of default,
- ✓ introducing a degree system through establishment of a Movables Pledged Registry (“**Registry**”),
- ✓ expanding the scope of movable pledge that may be established without the transfer of possession,
- ✓ removal of the principle of establishment of the pledge on the entire commercial enterprise instead, establishment of a pledge over sufficient movable properties to secure the debt .

Scope of the Pledge

New Law is an exception to the movable pledge system under the Turkish Civil Code (“**TCC**”). The parties that are falling into the scope of the New Law may choose whether the provisions of TCC or the New Law shall apply to the movable pledges that they establish. Furthermore, in case of lack of any provisions in the New Law, provisions of TCC shall apply also to the pledges established under the New Law as appropriate.

In comparison to the Current Law, scope of the movable properties which can be pledged under the New Law is considerably extensive. Under the Current Law, the pledge can be established over:

- ✓ commercial title and/or trade name,
- ✓ machinery, vehicles, tools and motor transportation vehicles, which are present at the time of registration of the pledge and which are allocated to the activity of the operating activities of the enterprise, and
- ✓ intellectual property rights.

In addition to the above properties, under the New Law, the Pledge can also be established over:

- ✓ receivables,
- ✓ trees yielding perennial products,
- ✓ earnings and revenues,
- ✓ licences and permits which are not required to be registered with another registries or are not administrative permit,
- ✓ raw materials,
- ✓ animals,
- ✓ rental incomes,
- ✓ rental right,
- ✓ stock
- ✓ consumable material,
- ✓ agricultural product,
- ✓ commercial enterprises in their entirety,
- ✓ commercial plates or commercial lines,
- ✓ commercial project,
- ✓ waggons,
- ✓ among those mentioned above; movable properties, rights and joint ownership rights which are under the third party’s possession.

It is also possible to establish a pledge on future movable properties. The pledge on future movable properties was not expressly regulated under the Current Law but it was deemed to be valid for future receivables in practice. On the other hand, the New Law regulated pledge on future movable properties explicitly. However, the New Law does not clarify how the future movable properties will be pledged and the application of this is expected to be clarified under secondary legislation. Similar to future movable property, establishment of pledge over receivables, tenancy rights, rental incomes, commercial lines, commercial projects are also regulated under the New Law and thus clarification is also expected to be made under the secondary legislation as well.

Under the Current Law, as a general rule, pledge must be established over the whole commercial enterprise, with a few exceptions (licenses, models, trademarks and similar industrial property rights). The New Law deviates from this principle and sets forth that if establishing pledge over certain items provides enough security to satisfy the secured obligations, the entire commercial enterprise shall not be pledged as a whole.

The New Law does not apply to account pledge agreements and pledge agreements that cover financial contracts regarding capital market instruments and derivatives. Also, the movable properties which are registered to a land register for any reason are out of the scope of the New Law.

Pledge Agreement and Parties

The pledge agreement within the context of the New Law may be executed: (i) between financial institutions and merchants, artisans, farmers, producer organizations, self-employed real and legal persons; or (ii) among merchants and/or artisans.

Under the Current Law, the pledge agreement could be executed only before notary. Under the New Law, the pledge agreement can be executed in two ways:

- (i) electronically (should be approved by a secure electronic signature for registration before the Registry); or
- (ii) in written form (in which case signatures of the parties should be approved by the notary or should be signed before the Registry.)

The following matters must be included in the pledge agreement:

- (i) parties to the agreement,

- (ii) the movable subject to pledge and its serial number, brand, year of production, chassis no, document serial number identifying their distinctive features,
- (iii) subject of the debt and its amount, (if the amount of the debt is not certain, the amount of secured obligations), the maximum amount of the pledge coverage and the respective currency.

Under the Current Law, the maximum amount of the pledge coverage or the amount of the debt must be determined in Turkish Lira but the New Law does not include such a restriction in terms of currency. Thus the amount of pledge can be determined in other currencies. We expect that this matter will be expressly covered under the secondary legislation and further clarified.

Any transactions before the Registry and perfection of the pledge and execution of the pledge agreement will be exempt from taxes, duties and charges, fee or other expenses.

Establishment of Pledge

The pledge will be established by registration of the pledge agreement to the Registry. For the properties that should be registered to other registries, the registration to the Registry will not establish the pledge. To exemplify; there are separate registries for livestock and motor vehicles. Accordingly, the pledge of livestock or pledge of motor vehicles is deemed to have been established only after registration with their respective registries. Registration of such pledge to the Registry will not be sufficient for establishment of any such pledge.

In addition, the Registry provides publicity and the pledge on movable properties will also be effective towards third parties upon the registration of the pledge agreement with the Registry.

Rights and Obligations of the Parties

The pledgor shall be obliged to take necessary measures to protect the value of the pledged properties. In case of a failure of such, the pledgee may ask the court to prohibit the pledgor from taking such actions or ask for other remedies. The Current Law includes provisions for compensating damages or granting additional collateral in case the value of the pledged property decreases, where the New Law does not include such a provision.

If the pledgor transfers the property of the pledged asset or assigns the receivable, it shall register such with the Registry as well.

Power of Disposition

The power of disposition of the pledgor over the pledged movable properties continues. However, under the Current Law the owner of the commercial enterprise was required to obtain consent of the pledgee;

- ✓ to transfer,
- ✓ to assign to a third party,
- ✓ to transfer to another place, or;
- ✓ to exchange

the commercial enterprise or any of the assets that constitutes part of the pledge.

Under the New Law, the pledgor's disposal rights on pledged movable property is protected in order not to interrupt the production of goods and services and thus expanded.

According to the New Law, provisions relating to the restriction of the power of disposition of the pledgor on the pledged movable assets in the pledge agreement are invalid. As seen, the New Law liberalizes the existing procedures for disposal of the pledged movable properties and also paves the way for establishment of more than one pledge over the same movable property through the ranking system.

Degree System and Priority Right

The assurance provided by the movable pledge shall be limited to the amount and degree of the pledge stated in the registration. Subsequent, the pledges may be established at the second or following degrees. However, in such a case, the amount of liability under the preceding pledge shall be expressly stated at the Registry. In this case, provisions of Articles 871 to 876 of the TCC regarding the pledges over immovable property and the degree system which are not contrary to the New Law will be applied by analogy.

Under the pledge agreement, pledgee may be granted with the right to accelerate to the free degrees.

If the subsequent pledgees are granted with the right to accelerate to the free degrees; the subsequent pledgees shall not receive any payments unless the first ranking pledgee is satisfied in full. In case more than one pledge is established on the same movable property without stating the degree, the priority of the pledgees shall be determined according to the time of establishment of the pledge. If degree is specified, such specified degree will be taken into account.

Intermingle and Commingle

A pledge may be established on assets which may intermingle or commingle with other assets.

In case a movable property intermingles or commingles with another property as its integral part, the pledge shall be deemed to have been established on the entire movable property. The pledge over the intermingling or commingling movable properties shall have the same priority as before intermingle or commingle. If they have the same degree, the time of registration will be taken into consideration; which may give rise to certain difficulties in practice.

The pledge on an intermingled or commingled movable property continues over the ratio of the value of each intermingled or commingled movable property (at the time of intermingling and commingling) to the value of the new product. If the movable properties are intermingled or commingled with each other; pledgees shall have a joint pledge in proportion to their movable properties' over the value at the time of intermingle or commingle.

The status of a party having a pledge (by way of a pledge on future asset or stock or raw material) over the new product and the pledgee's priority rights against to the other parties are not regulated under the New Law. Even though the New Law enables to have pledge over stock or raw materials, it seems that application of it may be problematic and cause difficulties in practice and thus we think these issues should be clarified under the secondary legislation.

Valuation

The valuation mechanism is envisaged in various situations within the scope of the New Law; some of which are mandatory and some of which are discretionary. The parties may request a valuation before the establishment of the pledge. The parties shall request a valuation:

- ✓ in the event of intermingle or commingle of a pledged asset, and
- ✓ in the exercise of the rights after an event of default.

The value of movable properties shall be determined within three days by an expert appointed by civil court of peace. In the event an objection is raised to this valuation, a new valuation shall be made within three days. The valuation made upon objection will be deemed to be final and a revaluation cannot be requested until the expiry of two years.

Rights After Event of Default

In the event of non-performance of payment obligations, three alternatives as to the foreclosure are set out as follows under the New Law:

- ✓ First degree pledgees can demand the transfer of the title of the pledged movable property from execution offices, (with this regulation, the legislator has introduced a new

exception to the *lex commisorio* principle under Turkish law and collateral system). In such cases, if the value of the pledged property is higher than the pledge amount of the first degree pledgee, the pledgee shall be jointly liable with the pledger towards the subsequent ranking pledgees for the amount of difference between the value of the pledged property and the pledge amount.

- ✓ the pledgee can transfer its receivable to the asset management companies operating under the Banking Law No.5411 in which case the relevant asset management company shall have the same pledge degree over the pledged property,
- ✓ the pledgee can use the tenancy or licensing rights over assets which are not subject to the transfer of possession.

If the receivable cannot be collected by these means, execution proceeding is carried out within the framework of general provisions.

Sanctions

If a pledgee does not apply to the Registry for release of a pledge within 3 business days upon discharge of the secured obligations, it shall be subject to an administrative fine equal to 10% of the amount of the secured obligations. If a pledgee fails to apply for the release of the pledge, the pledgor may also request release of the pledge by evidencing fulfilment of its obligations.

The pledgor or transferee of a pledged movable property shall be penalized with a judicial fine in an amount not exceeding half of the amount of the secured obligations upon complaint by pledgee in the following cases:

- ✓ using the pledged property contrary to the New Law,
- ✓ not transferring the title of the pledged property in case of non- payment of debt,
- ✓ damaging or destroying the pledged property with the intention of causing damage to the pledgee,
- ✓ not notifying the Registry about transferring the pledged property and transferring of the receivable,
- ✓ acting to mislead the Registry.

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Yours faithfully,
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