

New Law on Pledges Over Movable Assets in Commercial Transactions

On 27 October 2016, the Law on Pledges over Movable Assets in Commercial Transactions (Law No. 6750) (the "**New Law**") was published in the Official Gazette abolishing the Commercial Enterprise Pledge Law (Law No. 1447) (the "**CEP Law**"). The New Law will enable a pledge to be established over movable assets in commercial transactions through a registration system without the transfer of possession.

Purpose

As a result of the impracticalities associated with the perfection conditions for pledges over movable assets requiring the transfer of possession (ie physical delivery (*zilyetliğin devri*)) of pledged assets to the pledgee, this type of security was not commonly used in commercial transactions. Instead, parties typically opted for a commercial enterprise pledge, which (whilst not requiring the transfer of possession) required the pledge to cover all of the movable enterprise assets used in the operation of such commercial enterprise, subject to certain exceptions. The New Law, however, aims to make pledges over movable assets more flexible and easier to use by: (i) eliminating the transfer of possession requirement for pledges of movable assets listed under the New Law; (ii) allowing for the creation of a pledge over only certain movable assets rather than all of the movable enterprise assets; and (iii) proposing alternative routes to foreclosure.

Establishment of Pledge

The New Law contemplates that a pledged movable asset registry (the "**Registry**") will be set up by the Ministry of Customs and Trade (the "**Ministry**"), the records of which will be publicly available. A pledge over movable assets will be effective against third parties upon the registration of the pledge agreement with the Registry. If all or part of the pledged assets are recorded at other registries and pledges over those assets need to be registered with such registries (such as vehicles and intellectual property rights), the pledge would still need to be notified to those other registries (ie a pledge over such assets cannot be established merely by registration at the Registry). The

principles and procedures for such notification will be specified under a regulation to be published by the Ministry.

Pledge Agreement

Under the CEP Law, pledge agreements were required to be drawn by and signed before a notary. The New Law allows pledge agreements to be signed either:

- electronically (with secure electronic signature); or
- in written form (before the Registry or by having the signatures of parties approved by a notary).

Pledge agreements can be executed between:

- (i) banks and financial institutions operating under the Banking Law (Law No. 5411) and Financial Leasing, Factoring and Financing Companies Law (Law No. 6361) or public or private institutions authorised to lend and give sureties, and (ii) merchants, craftsmen, farmers, producer organisations, self-employed real and legal persons; or
- merchants and/or craftsmen.

A pledgor granting a pledge does not need to be the debtor and hold the underlying debt, instead it can be a third party providing the pledge for the debt of another debtor.

In order to be effective, a pledge agreement must include the following:

- a list of the pledged assets identifying their distinctive features;
- the subject matter and the amount of the underlying debt;

- if the amount of the underlying debt is not certain, the amount of the secured obligations;
- the currency of the secured obligations; and
- the maximum amount of the pledge.

The CEP Law required that the maximum amount of a pledge needed to be determined in Turkish Lira, however, as the New Law refers to the "currency" of secured obligations, this may be construed so as to allow the pledge to be established in a foreign currency. We expect this issue to be more expressly covered in secondary legislation.

The New Law exempts the execution of pledge agreements and transactions carried out before the Registry from taxes, charges, fees and other expenses.

Scope of Pledge

In comparison to the CEP Law, the scope of movable assets that can be pledged under the New Law is considerably more extensive. Under the CEP Law, a pledge could create security over:

- a trade name and commercial title;
- machinery, equipment, tools and transportation vehicles used in the operation of a commercial enterprise; and
- intellectual property rights of a commercial enterprise.

In addition to the above, the New Law allows creation of security over, amongst others:

- receivables;
- raw materials;
- animals;
- licences and permits which are not required to be registered with other registries or are not administrative;
- rental income;
- consumable materials;
- stocks;
- agricultural products; and
- commercial plates.

It is also possible to pledge future assets, although it is not clear how such a pledge would be registered at the Registry (assuming such assets are ascertainable) or even whether it would be possible to do so. If future assets cannot be registered, we would expect additional transactions to be completed in order to ensure that such

assets are covered by the pledge and to minimise risks during any foreclosure process.

It should also be noted that some of the listed movables, such as receivables, do not seem in fact to be "movable assets" at all; some of them seem to introduce a pledge over rights, such as tenancy rights and commercial lines; and some of them are simply unclear, such as commercial projects. It is also not clear how fungible assets can be specifically identified in pledge agreements and the Registry.

The New Law also includes provisions regarding the status of the pledge if the pledged assets are intermingled or mixed with other movables and provides for pledges to cover end-products up to the same value of the pledged assets prior to the production of such end-product. The value of the new end-product and the pledged assets would be determined in accordance with the valuation procedure set forth under the New Law and explained in more detail below.

It is still possible to establish a pledge over all of the assets of a commercial enterprise, however as opposed to under the CEP Law, under the New Law, it is not a requirement. In fact, the New Law prohibits creation of a pledge over the whole enterprise if the value of the movable assets that are pledged are sufficient to satisfy the secured obligations. This may necessitate valuation of the pledged assets before execution of the pledge agreement.

The New Law is not applicable to pledges over deposits and pledge agreements regarding financial agreements in relation to capital market instruments and derivatives. Any movable registered to the title deed registry is also excluded from the scope of the New Law.

Degree System

The New Law allows for the creation of more than one pledge over a movable asset. One of the significant changes introduced by the New Law is the ranking system to determine the priority amongst pledges over movable assets and the ability to benefit from the free degree system if set out in the pledge agreement similar to mortgages over immovable assets. The priority of a pledge over movable assets is principally determined by its degree, unless there is no indication of the degree (in which case the time of registration of the pledge is the determining factor).

Rights and Obligations

The undertakings of the pledgor and rights of the pledgee

under the New Law are more in line with the provisions relating to mortgages under the Turkish Civil Code (Law No. 4721) than the CEP Law. Briefly, the New Law requires the pledgor to take necessary precautions to maintain the value of pledged assets and provides remedies to the pledgee in case such precautions are not taken.

Under the New Law, negative pledge provisions and provisions restricting the pledgor's disposal rights over the pledged assets are deemed to be void. However, the pledgor has to notify the Registry of the transfer of the title of the pledged assets and/or the underlying debt and the relevant assets would be transferred together with the pledge.

Valuation

The parties can request a valuation of the amount of the pledged assets before registration of the pledge in accordance with the procedure set out under the New Law. Otherwise, the valuation would need to be made following the occurrence of an event of default. There is no exception to this valuation requirement for monetary assets such as receivables, although this point may be clarified in future secondary legislation. Valuations will be carried out by experts appointed by the courts within 3 days following the application of the pledgee. If one of the parties objects to the valuation, the court will request a new valuation and the new valuation will be final and binding for 2 years. The regulation to be published by the Ministry will regulate the qualifications required for such experts.

Remedies

The New Law sets out the following alternatives to foreclosure:

- First degree pledgees may demand the transfer of title of the pledged assets from execution offices. This option is an exception to the *lex commissoria* principle under Turkish law (ie the prohibition on entitling the security holder to become the owner of the secured asset upon the occurrence of an event of default). In such cases, if the value of the pledged asset is higher than the pledge amount of the first degree pledgee, the pledgee would be jointly liable with the pledgor against the subsequent ranking pledgees for the surplus amount.
- Pledgees may assign their receivables to asset management companies in which case such companies will have the same ranking as the transferring pledgees.

- Pledgees are entitled to use the tenancy or licensing rights covered by the pledge but it is not certain how these rights will be exactly used as this seems to be a new type of security under Turkish law and the secondary legislation may offer more clarity on this issue.
- If pledgees cannot recover their receivables using the above methods, the general provisions of the Turkish execution and enforcement laws would then be applicable.

Penalties

If a pledgee does not apply to the Registry for de-registration of a pledge within 3 business days following satisfaction of the secured obligations, it will be subject to an administrative monetary fine payable to the Ministry equal to 10% of the amount of the secured obligations. If a pledgee does not make this application, the pledgor may request de-registration by evidencing repayment/fulfillment of its obligations.

A pledgor or a transferee of a pledged asset may also be subject to judicial monetary fines in an amount not exceeding half of the secured obligations if the pledgor:

- uses the pledged assets contrary to the provisions of the New Law;
- does not transfer the title of the pledged assets upon foreclosure;
- damages or destroys the pledged assets with the intention to harm the creditor;
- fails to notify the Registry of the transfer of the title of the pledged assets and/or the underlying debt; and
- performs acts to deceive the Registry.

Effectiveness

The New Law will enter into force on **1 January 2017**. Whilst it will abolish the CEP Law, it will not be applicable to existing lawsuits and execution proceedings as well as any commercial enterprise pledges established prior to 1 January 2017.

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