

# GEDİK & ERAKSOY

6 January 2016

## *New Law on Pledges over Movable Assets in Commercial Transactions*

*In an effort to increase the availability of financing for businesses (in particular for small to mid-size businesses) and contribute to the sustainable development of the Turkish economy, the Parliament has passed the Law on Pledges over Movable Assets in Commercial Transactions (Law No. 6750) (the **Movable Pledge Law**), which became effective as of 1 January 2017. The Movable Pledge Law repeals and replaces the Commercial Enterprise Pledge Law No.1447 dated 21 July 1971(the **CEP Law**) which enabled the establishment of pledges over entire commercial enterprises. The Movable Pledge Law gives businesses the ability to offer a more diversified security package whilst seeking financing and provides for efficient and practical procedures in terms of foreclosure mechanics.*

### ➤ **Purpose**

The Movable Pledge Law aims at facilitating access to financing sources by introducing establishment of pledges over movable assets<sup>1</sup> by way of security without any requirement for transfer of possession. To that end, the Movable Pledge Law:

- provides for alternative foreclosure methods;
- contemplates the creation of a public registry called the Movable Pledge Registry (the **Registry**) for the registration of pledges; and
- extends the range of movable assets over which pledges can be established.

Given the small number of commercial enterprise pledges established in the 45 years since the CEP Law was passed (4,297 according to the Movable Pledge Law), the changes introduced by the Movable Pledge Law are intended to allow for much broader use of such pledges.

### ➤ **Parties to a Pledge Agreement**

Under the Movable Pledge Law, a pledge agreement can be entered into between:

- banks and financial institutions regulated by Banking Law No. 5411 or the Financial Leasing, Factoring and Financing Companies Law No. 6361; and/or

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<sup>1</sup> For the purposes of the Moveable Pledge Law, the term “moveable asset” encompasses any intangible assets such as intellectual property rights or debt obligations over which pledge can be established in accordance with the Moveable Pledge Law as further described in the sub-section entitled “Scope of Pledge” below.

- other public or private institutions extending credit or providing surety; and/or
- merchants, artisans, farmers, producer entities and self-employed real or legal persons.

Unlike the CEP Law, the Movable Pledge Law allows merchants and artisans to establish pledges over their trade receivables.

➤ **Requirements as to content**

A pledge agreement must at a minimum include:

- details of the parties, such as commercial title or name and surname, Central Registration System (*MERSİS*) number;
- the nature and amount of the underlying debt;
- the maximum amount secured by the pledge (if the amount of underlying debt is not certain);
- the currency of the maximum pledge amount (as opposed to the CEP Law, the Movable Pledge Law allows pledges to be established with a maximum pledge amount in foreign currencies other than Turkish Lira), and
- a list of pledged movable assets and distinctive features such as serial number, brand name and production year.

Provisions restricting (i) the establishment of sub-pledges or subsequent pledges (negative pledge provisions), or (ii) the pledgor's rights of disposal over the pledged asset (in which event the pledge remains attached to the disposed asset) are deemed to be invalid. In this way, the Movable Pledge Law aims not to suspend the continuity of production in goods and services sectors.

➤ **Requirements as to form**

According to the Movable Pledge Law, a pledge agreement can be entered into in electronic form or in writing. While the former method requires the parties to execute the agreement via secure electronic signature so that the agreement can be registered the Registry, the latter requires that the pledge agreement be signed before a Registry official or that signatures be certified by a Notary Public. In this regard, the Movable Pledge Law constitutes an exception to the provision of the Electronic Signature Law No. 5070 which prohibits the execution of security documents via secured electronic signature.

➤ **Establishment of a Pledge**

A pledge over movable assets becomes effective upon the registration of the pledge agreement with the Registry. The key principles and procedures governing the establishment and organization of the Registry were recently set out in the Regulation on the Moveable Pledge Registry, (the **Registry Regulation**)<sup>2</sup>. The Registry, which was established by the Ministry of Customs and Trade, conducts the registration, release and amendment of pledges and all related transactions through a system called TARES. The Registry is composed of a registry centre and other registry units. It will keep records in both physical and electronic form, and will be public. For movable assets which are subject to registration with other registries (such as the Motor Vehicles Registry, the Turkish Patent Institute or the Trade Registry), registering the pledge over the movable asset with the Registry does not remove the obligation to register with other registries.

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<sup>2</sup>Published in the Official Gazette dated 31 December 2016 and numbered 29935

Nevertheless, even if such pledge is solely registered with the Registry, it will be effective against third parties.

The establishment of a pledge and other formalities carried out before the Registry are exempt from taxes, duties, charges and fees for valuable papers (*değerli kağıt bedeli*).

### ➤ **Scope of Pledge Agreement**

The range of assets that can fall within the scope of a pledge agreement is as follows: (i) receivables; (ii) perennial plants; (iii) intellectual property rights; (iv) livestock; (v) raw materials; (vi) any kind of earnings and revenues; (vii) licenses and permits which do not require registration with other registries and which do not qualify as administrative permits; (viii) rental income; (ix) tenancy rights; (x) any and all commercial equipment, including machinery, tools, vehicles and electronic communication apparatus; (xi) perishable goods; (xii) stocks; (xiii) agricultural products; (xiv) commercial titles and/or trade names; (xv) commercial or artisanal enterprises; (xvi) commercial license plates or commercial transportation lines (e.g. bus services); (xvii) commercially funded projects; (xviii) coaches; and (xix) any combination of the foregoing list of movable assets which are subject to joint ownership or which are used by third parties.

As opposed to the CEP Law, the Movable Pledge Law prohibits the establishment of pledges over an entire commercial enterprise if the value of assets owned by that enterprise is sufficient to secure the underlying debt. The Regulation on the Establishment of Security Interest and Exercise of Post-Default Rights in Commercial Transactions<sup>3</sup> (the **Regulation**), which sets out certain implementation principles and procedures relating to Moveable Pledge Law, provides that the value of the moveable asset that is subject to pledge cannot exceed 120% of the underlying debt. The Movable Pledge Law and the Regulation also enable the establishment of pledges over future assets or their proceeds. Rights over future assets or proceeds must be provided for in the pledge agreement to be effective. Third parties can also establish pledges over their movable assets in favour of debtor of underlying debt.

The Movable Pledge Law does not apply to: (i) deposit pledges; (ii) pledge agreements in relation to financial agreements regarding capital market instruments and derivatives; and (iii) movable assets registered with the Land Registry.

### ➤ **Ranking System and Priority Rights**

The security interests created under a pledge agreement are defined by the degree of the pledge. Under the Regulation, pledgor and pledgee can choose to adopt a fixed degree system or an acceleration system. In an acceleration system, each pledgee moves into a higher ranking position upon release of any pledge established at a higher degree. In a fixed degree system, the release of a higher ranking pledge does not *ipso facto* move lower ranking pledges into higher ranking positions. Unless otherwise stipulated under the pledge agreement or any other related agreement registered with the Registry, the parties shall be deemed to have opted for an acceleration system. Agreements granting the right to step into the degree of the released pledge shall comply with the requirements of the pledge agreement.

Further, if multiple pledges are established over the same movable asset without indicating their degrees, then priority is determined in accordance with their registration dates.

### ➤ **Rights and Obligations of the Parties**

The pledge agreement sets out the rights and obligations of the parties in accordance with the Movable Pledge Law. In terms of the pledgor's obligations, the pledgor must:

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<sup>3</sup> Published in the Official Gazette dated 31 December 2016 and numbered 29935

- take necessary measures for maintaining the value of the pledged movable assets;
- compensate the pledgee if it acts in a way that depreciates the value of the pledged movable assets; and
- register any transfer of pledged movable assets with the Registry.

In terms of the pledgee's rights, the pledgee may request from a court that any acts of the pledgor that are detrimental to the value of the pledged assets be prohibited. In the case of urgency, the pledgee may take appropriate precautions to that effect without a court decision. The pledgee also retains the right to supervise the pledged movable asset.

### ➤ **Valuation**

Parties may have the pledged asset valued either prior to the establishment of the pledge or at any time after processing, commingling or intermingling of the pledged assets or upon event of default, by real or legal persons providing expertise services. The Regulation on the Valuation of Pledged Movable in Commercial Transactions<sup>4</sup> (the **Valuation Regulation**) sets out the relevant principles and procedures with respect to the valuation of pledged assets. Accordingly, while both the pledgor and the pledgee may request a valuation prior to the establishment of a pledge, only the pledgee is given that right after the establishment of that pledge. The expert service provider conducting the valuation needs to be listed amongst the persons or institutions authorized for such valuations by the Regulation on Authorization and Duties of Institutions to Provide Valuation Services to Banks<sup>5</sup>.

If one party raises an objection to the first valuation, a second valuation must be carried out within three days. The second valuation is final and a re-valuation cannot be requested before two years have elapsed.

### ➤ **Remedies after Default**

The Movable Pledge Law introduces the following alternatives to foreclosure:

- Under Turkish Law, as a general principle, terms providing that pledgors are to forfeit ownership of pledged assets in favour of pledgees on the occurrence of an event of default are void. However, the Movable Pledge Law is an exception to this principle: on the occurrence of an event of default, a first degree pledgee may demand the transfer of ownership of a pledged movable from the relevant execution office. The request should be made by the pledgee within 7 days of the occurrence of the event of default. If a request is not made in this period, the right to demand transfer of ownership will pass on to the next ranking pledgee.
- A pledgee may opt to transfer its rights under pledges over receivables to asset management companies regulated by Banking Law No. 5411.
- As a third alternative, a pledgee may exercise rental rights or license rights for assets which are not subject to transfer of possession.
- In the event that a pledgee cannot recover its receivables through the alternatives above, the general provisions of the Turkish Enforcement and Bankruptcy Code (Law No. 2004) will apply.

<sup>4</sup> Published in the Official Gazette dated 31 December 2016 and numbered 29935

<sup>5</sup> Published in the Official Gazette dated 1 November 2006 and numbered 26333

## ➤ Release of Pledge

Within three days of the discharge of the secured debt, the pledgee must release the pledge from the Registry. Otherwise: (i) an administrative fine will be charged at an amount equal to one-tenth of the secured debt; and (ii) the pledgor will be entitled to send the pledgee a demand the release of the pledge, together with documents evidencing the pledgor's payment of the secured debt.

## ➤ Penalties

The Movable Pledge Law also imposes certain penalties for non-compliance with respect to its mandatory provisions. A judicial fine not exceeding 50% of the secured debt will be imposed on the pledgor or any transferee of the pledged movable asset if the security has been impaired by any of the following acts of the pledgor:

- use of pledged movable asset contrary to the Movable Pledge Law;
- failure to transfer the title of the pledged movable in an event of default;
- causing loss and damage to the pledged movable deliberately to the detriment of the pledgee;
- failure to register the transfer of receivables or pledged movables with the Registry; and
- committing fraudulent acts to deceive the Registry.

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