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Draft Law on Pledge of Movable Assets in Commercial Transactions

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The Draft Law, which will abolish Commercial Enterprise Pledge Law No. 1447 and bring major reforms to the pledge over movable assets, including the ability to establish pledges without delivery of the pledged assets, was submitted to the Parliament on August 9, 2016.

The Draft Law aims to facilitate the access of commercial enterprises to financing by allowing them to pledge their movable assets without a delivery requirement. The draft regulation broadly defines the movable assets that can be the subject of such a pledge and introduces a new registry for the pledged movable assets that will be the medium for perfection, monitoring and public disclosure of pledges. The Draft Law also introduces substantial changes to the foreclosure procedure of pledges.

While substantial amendments are expected to be made to the initial version of the Draft Law before being adopted by the Parliament it is still expected that the Draft Law when enacted will introduce important reforms and this Client Alert elaborates on some of those changes and the legal challenges they present.

Scope of the Draft Law

Commercial enterprise pledges established under Commercial Enterprise Pledge Law No. 1447 cover the trade name, enterprise name, intellectual property rights and machinery, tools, equipment and motor vehicles allocated to the commercial activities of the enterprise; whereas the Draft Law aims to allow enterprises to pledge other movable assets without a delivery requirement enabling the relevant enterprise to continue its business without interruption.

In this context, in addition to the assets that can be pledged under the current Commercial Enterprise Pledge Law No.1447, the Draft Law allows the pledge of receivables, perennial trees bearing fruit, stock, live stock, revenue and income, licenses and permits that are not required to be registered with other registries, rental income, tenancy rights, consumable materials, raw material, agricultural products, wagons and those movable assets, rights and jointly owned properties in possession of third parties without delivery of such assets.

It is not clear however as to how “identifiability” will be achieved for movable assets including raw materials, agricultural products and stock which are fungible goods, such as grains and fuel oil, under the Draft Law. The Draft Law further provides that movable assets that by nature commingle and mix with other assets can be subject to pledge and the pledge will continue on the commingled/mixed movable assets in accordance with provisions of the Draft Law. On the other hand, the Draft Law is not clear on how the mandatory

requirement of a pledge agreement as set out in the Draft Law: “stating distinctive features of the pledged assets in the pledge agreement”, will be satisfied for mixed and commingled assets.

Also worth mentioning is the unusual inclusion of assets such as “trees” and “tenancy rights” in the definition of movable assets under the Draft Law. It is unclear what is meant by “tenancy rights” and how the pledge rights will be exercised on these assets.

The Draft Law will not apply to pledge agreements related to financial agreements on capital market instruments, derivatives and account pledges. Any movable asset registered with the title deed registry is also excluded from the scope of the Draft Law.

Scope of Pledge

Except for the regulated exceptions, under the Commercial Enterprise Pledge Law No. 1447, all machinery and equipment allocated to the commercial activities of the commercial enterprise are subject to pledge as a whole. The Draft Law on the other hand, allows the establishment of pledges on any and all of the movable assets set out in the Draft Law. It further provides that where the value of the assets that can be subject to pledge individually are sufficient to satisfy the secured debt a pledge on the entire enterprise cannot be established. We see this as an important impediment in using the type of pledge envisaged under the Draft Law as it would be burdensome to first satisfy the valuation of the assets that can be subject to pledge and even then financial institutions may prefer to require as collateral all of the assets of the commercial enterprises to maintain intact the collateral value of the enterprise if and when an enforcement action is taken.

Movable Asset Registry and Ranking System in Movable Pledges

The Draft Law establishes a registry for pledged movable assets to be maintained by the Ministry of Customs and Trade for the perfection, monitoring and public disclosure of the pledged assets, determining priority among the pledgees and registering disposals on the pledged movable assets. Secondary legislation regarding the principles and procedures of the incorporation and operation of the Registry is also expected to be issued by the Ministry.

Another significant change brought by the Draft Law is the introduction of the degree system in ranking to determine priority among pledgees in a manner similar to the mortgage provisions applicable to immovable properties. This change is an important diversion from the provisions of the Civil Law pursuant to which priority amongst pledgees is determined according to timing of perfection. The degree system in the Draft Law allows parties to benefit from a statutory escalation right and creates a system where a pledge automatically escalates to the next degree upon release of the prior ranking pledge.

The Draft Law is not clear on the issue of whether a pledge over movable assets can be established through a definite amount or maximum amount security. However, as “the maximum amount of pledge” is listed as a mandatory provision of a pledge agreement under the Draft Law, it can be interpreted on the face of the current draft that a maximum amount pledge is the form intended to be regulated by the Draft Law.

It should also be noted that, the Draft Law introduces several alternative perfection procedures in the registration of pledges, such as signing before a notary or the registrar, or signing by electronic signature.

Denomination of the Pledge

The Draft Law lists the following items as mandatory provisions to be stated in the pledge agreement: (i) the amount of debt/the amount of secured obligations; (ii) the currency of secured obligations; and (iii) the maximum amount of pledge. Commercial Enterprise Pledge Law No.1447 stipulates that the debt shall be indicated in Turkish Lira whereas such requirement is not regulated under the Draft Law. The Draft Law does not explicitly regulate the establishment of a commercial enterprise pledge denominated in a foreign currency. This issue should be addressed in the further revisions of the Draft Law.

Rights and Remedies Following a Default

Under the Draft Law in case the debts secured by a pledge are not performed when due, the pledgees are entitled to take various actions prior to resorting to general legal means available under the Execution and Bankruptcy Law. According to the relevant provisions of the Draft Law, a pledgee may request, (i) the transfer

of the ownership of pledged movable asset from the execution office, if the pledgee is a first degree pledgee; (ii) the transfer of its receivables to an asset management company which operates in accordance with the Law No. 5411; or (iii) the exercise of lease and license rights for the assets which are not a subject to the transfer of possession. If the secured debt cannot be recovered through the abovementioned procedures, the pledgee will still have the right to resort to the proceedings within the framework of the general provisions of the Execution and Bankruptcy Law.

The provisions of the Draft Law regarding the transfer of ownership should be further clarified and refined particularly in the light of the “lex commissoria” prohibition, one of the main principles of Turkish law. The rights and authority of execution offices in these proceedings and the relevant procedures need to be regulated in more detail.

Monetary Fines

In somewhat an unusual manner, the Draft Law provides that, in case of failure by the pledgee to release the pledge within three business days following the fulfilment of the secured obligations, the pledgee will be subject to an administrative monetary fine equal to one tenth amount of the secured debt.

Certain actions of the pledgor listed under the Draft Law such as destroying or damaging the pledged asset with the purpose of harming the pledgee or omitting to transfer the ownership of the pledged asset in case of non-payment of debt, will also be subject to judicial monetary fine not exceeding half of the secured debt amount upon request of the pledgee that is unable to partially or fully collect its receivables.

Taxes and Other Exemptions

Pursuant to the Draft Law, execution of the pledge agreement and transactions carried out before the Pledged Movable Asset Registry shall be exempt from taxes, charges, fees and other expenses.

Effectiveness

It is expected that the Draft Law will enter into effect on January 1, 2017 after being passed by the Grand National Assembly and the approval of the President of the Republic. Upon being adopted the Draft Law will abolish the Commercial Enterprise Pledge Law No 1447. The commercial enterprise pledges established before the effective date will still be subject to the provisions of the abolished regulation. Although the transition provisions in this respect are regulated under the Draft Law, the regime regarding the additional pledge undertakings under the current commercial enterprise pledge agreements need further elaboration.

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