



Movable Pledge in Commercial Transactions

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In commercial agreements made by commercial enterprises, some legal opportunities have been provided to guarantee the claims that may arise under Turkish Law. Among these legal opportunities, options such as a movable pledge and bailment contract are the first ones that come to mind. Although each type of legal opportunity has its specific problems, it does not seem possible or sustainable to use the movable pledge regulated in the Turkish Civil Code by commercial enterprises in practice. Because under normal conditions, in case of providing collateral with the movable pledge, the Pledger is obliged to transfer the possession of the pledged thing to the Pledgee. However, if commercial enterprises transfer the possession of their machinery, vehicles, equipment, tools, raw materials, or stocks to the Pledgee, they will not be able to generate commercial income and therefore cannot pay their debts to the Pledgee, and the other creditors. However, commercial enterprises can pledge their movables without delivering them whereby the "Movable Pledge in Commercial Transactions". In this legal brief, we will answer some of the questions that may arise over "Movable Pledge in Commercial Transactions".

What is Movable Pledge in Commercial Transactions and Why Is It Required?

Movable Pledge in Commercial Transactions Code No. 6750 dated 20.10.2016, was adopted to facilitate access to finance and entered into force on 1 January 2017. Consequently, a new type of **pledge of movables that does not require the transfer of possession but rather requires registration** has been regulated by Law. Accordingly, the right of the Pledge will be established through the registration of the pledge contract to the Registry. It is possible to draft the contract of pledge electronically or in written form. Transactions established in the Registry with the arrangement of the pledge contract are exempt from taxes, duties, fees, and valuable paper costs. In addition, with the publication of the pledge contract at the Registry, it is aimed that the pledge will be enforceable against the third parties.

On Which Assets and by Whom Can the Pledge Be Established?

Persons who can benefit from the Code No.6750 are regulated quite broadly in the Law. According to the Law, the movable pledge in commercial transactions can be established between *financial institutions and merchants, artisans, farmers, producer organizations, self-employed real and legal persons or among merchants and/or artisans*. The subject of the pledge is also regulated quite broadly in the Law. Accordingly, *it is possible to establish a pledge on all kinds of movable assets and rights, including raw materials, licenses, trade names, and business names* within the scope of the Law. Furthermore, movable assets that are not yet owned by the owner but will be owned in the future may also be the subject of the pledge contract.

If the amount of debt is pre-determined, pledges can only be established on the assets, *up to a maximum of one-fifth, in addition to the entire debt amount*. Another issue regulated in Regulation¹ is related to **"add-ons and integral parts"**. According to the Law, the right of pledge on the movable asset also includes the integral parts of that asset. If there are distinctive features of an integral part, these should also be specified in the pledge contract. In terms of add-ons, unless otherwise agreed, neither the add-ons in the movable asset when the contract of the pledge is concluded nor the add-ons added after the conclusion of the contract are within the scope of the contract of pledge.

In terms of the pledge on receivables, it is accepted that existing receivables or future receivables arising from any type of contract can be pledged. However, it should be noted that, according to Article 16 of the Regulation, "Contracts of pledge stating that all future receivables are pledged without being limited to a specific business or subject are invalid."

What is the Scope of Pledge?

Per the later added clause *"All kinds of similar movable assets and rights"*, the assets and rights that can be pledged in the Law are not *numerus clausus*. The fact that assets that can be processed, such as raw materials, can also be pledged according to the Law raises the question of what is the scope of the pledge if these assets are processed.

According to Article 7 of Code No. 6750, *all kinds of future legal returns of the pledged movable asset, such as interest and insurance, will be the subject of the pledge contract directly. If a production process is pledged together with the movable assets used in the production process, the pledge shall be deemed to have been established automatically in the same ratio and order on the receivable that will emerge during and as a result of the production process.*

Whereby this pledge system, on the one hand, the receivables of the creditor will be secured with raw materials and stocks, and on the other hand, the pledger will be able to continue its production activities by using those raw materials.

How Are the Risks That May Occur in the Non-Delivery Pledge System Prevented?

The non-delivery pledge system is quite profitable for both parties. Since the Pledgor continues to make a profit from pledged assets without delivering them, the Pledgor has a higher profit. Therefore, some concerns may arise for the Pledgee who accepts to make a pledge contract without having possession of pledged assets. However, at this point, various measures have been taken in the Law. First of all, the registration system ensures the authenticity of the Movable Pledge in Commercial Transactions.

The establishment of the movable pledge in commercial transactions contains **four stages** according to the Regulation. First, there must be an existing or future debt that can be secured by a pledge, secondly the will of contracting parties must be formed to establish a limited real right on the movable asset in order to secure the payment or fulfilment of an existing or future debt, without the need to transfer of possession. In the third stage, the pledge contract should be prepared and signed, and finally, in the fourth stage, the pledge contract should be

¹ Regulation on Establishment of Pledges in Commercial Transactions and Exercising the Rights in the event of Default, Official Gazette 29935 (31 December 2016)

registered to the Registry. Consequently, it will be possible for the pledge agreement to take effect against third parties by registering and declaring it to the Movable Pledge Registry for Commercial Transactions (TARES).

It is possible to draw up the Pledge Contract electronically or in writing. The Pledge Contract that is drawn up electronically must be signed with a secure electronic signature in order to be registered. If the Pledge Contract is drawn up in a written form for registration to the Registry, it must be signed before the Registrar, or the signatures of the parties must be notarized. The conditions of a pledge contract can be found in Article 9 of the Regulation.

Another important point about the pledge registry system is, the right of a pledge can be established with a progression system based on the moment of registration or a fixed rank system based on the rank and order of the pledge. Thus, the Pledgor can establish the pledge on the same property in favour of more than one creditor, and the parties of the pledge agreement will be able to determine which of these creditors will have priority.

What are the Pre-Default Rights and Obligations of the Contracting Parties?

Even if the debtor goes bankrupt, declares bankruptcy or pledged goods are distrained later, the Pledgee can use established pledge rights, in other words, the Pledgee can claim the right of a pledge against the bankrupt's estate and to the creditors who had the right to distrain after the pledge has been established. The Pledgee also has the right to inspect pledged movables that are held by the Pledgor and third parties. At this point, it should be noted that, in any case, the Pledgor is obliged to take measures to protect the value of the pledged movables. Otherwise, the right of the Pledgee to demand the prohibition of such behaviour from the court is reserved. Therefore, within the framework of transactions that reduce the value of pledged goods, the Pledgee has the right to demand compensation for the damages.

What are the Post-Default Rights and Obligations of the Parties?

Apart from pursuing under general provisions on the default of the debtor, the additional choices provided to the creditor are noteworthy. In the event of non-performance of payment obligations, three alternatives are set out under the Law. Firstly, a First-degree Pledgee can demand the transfer of the title of the pledged movable property from execution offices. Secondly, the Pledgee can transfer its receivable to the asset management companies operating under Banking Law No. 5411. Lastly, the Pledgee can use the tenancy or licensing rights over assets that are not subject to the transfer of possession. Furthermore, the Pledgee can initiate enforcement proceedings or file a lawsuit through general provisions. Detailed information is available in the Regulation regarding the exercise of post-default rights.

In this context, lastly, it is necessary to briefly mention the sanctions that the Pledgor may face in case of a violation of the Law. If the Pledgor uses the pledged goods contrary to the applicable law, resists the transfer of ownership of the pledged good in compulsory cases, damages the pledged goods intending to harm the Pledgee, avoid registration before the Registry, or commits acts to mislead the Registry; upon the complaint of the Pledgee, the Pledgor may be subject to a judicial fine not exceeding half of the debt amount.



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