



EXECUTION AND BANKRUPTCY PROCEEDINGS IN TURKEY

Creditors may collect their receivables from debtors, who have not paid their debts, through enforcement proceedings. There are two main enforcement methods in Turkey: (i) execution proceedings and (ii) bankruptcy proceedings. In this article, we will provide a general overview of these enforcement methods.

A. EXECUTION PROCEEDINGS

There are three types of execution proceedings in Turkey for collection of debts: (i) proceedings without judgment; (ii) proceedings with judgment; and (iii) foreclosure proceedings. These proceedings are governed by the Enforcement and Bankruptcy Law (the "EBL"). All execution proceedings are carried out by execution offices.

1. PROCEEDING WITHOUT JUDGEMENT

A proceeding without judgment can be (i) an ordinary execution proceeding; (ii) an execution proceeding involving a receivable based on negotiable instruments such as promissory notes, bills of exchange and cheques; or (iii) an execution proceeding for lease receivables.

Creditors can initiate execution proceedings, by submitting an execution request (a standard form) to the competent execution office. Within three days following the submission of the execution request, the execution office must issue a "*payment order*" and serve it on the debtor's place of business or residence. Upon receipt of the payment order, the debtor must act in one of the following three ways, within seven days¹ upon receipt of the payment order: (i) paying the amount requested in the payment order; (ii) objecting to the payment order; (iii) declaring his property.

If the debtor does not object to the payment order, then he must pay the amount requested in the payment order or declare his property (to show that he is not able to pay) within seven days² following the payment order's service. On the other hand, if the debtor objects to the payment order, the execution proceeding will be suspended automatically and it may not proceed until the objection is dismissed.³ In order to dismiss the objection, the creditor may either file a "*lifting of objection lawsuit*" before execution courts within six months or a "*cancellation of objection lawsuit*" before civil courts, within one year following the debtor's objection.

¹ This time limit is five days in execution proceedings involving negotiable instruments.

² This time limit is ten days in bankruptcy proceedings involving negotiable instruments.

³ Contrary to the ordinary type of execution proceedings, if the monetary claim is based on a negotiable instrument, execution proceedings will not be suspended automatically by the debtor's objection. This is generally considered as an advantage of issuing negotiable instruments.

If the debtor has drawn up one of the documents listed under Article 68A of the EBL (e.g. a promissory note, documents issued by or before governmental authorities) or has acknowledged his debt through a notary public, the creditor can file a lawsuit in order to lift the objection before the execution courts. If the creditor cannot prove the existence of the debt pursuant to Article 68A, he must file a cancellation of objection lawsuit before the civil or commercial courts. Lifting of objection is generally decided by the court in a short time, whereas cancellation lawsuits can take one or two years.

If the court (either civil/commercial or the execution) finds that the debt does not exist and also finds that the claimant (i.e. the creditor) was unjustified in commencing execution proceedings, the claimant will be ordered to pay at least 20% of the claimed amount to the defendant (i.e. debtor) as compensation. If the court resolves in favor of the claimant (i.e. the creditor) and cancels or lifts the defendant's objection, the court will order the defendant to pay compensation not less than 20% of the claimed amount. The rationale behind this compensation is to deter claimants from filing execution proceedings in the absence of a receivable, and debtors from filing objections when they are in debt of the claimed amount.

If the court cancels or lifts the objection at the end of the lawsuit, the execution proceeding that had been suspended by the objection will resume, even if the court's decision is appealed by the debtor. Within three days following the service of the court's decision, the debtor must declare his properties. In the event the debtor does not declare his property, he may be sentenced to imprisonment.

The payment order becomes final and binding if: (i) the debtor does not object to the payment order within seven days; (ii) the debtor does not pay the debt within seven days; (iii) the court cancels or lifts the debtor's objection or (iv) the court resolves in favour of the claimant. At this time, the creditor becomes entitled to request attachment of the debtor's assets.

Following their valuation, the attached assets will be sold through public auction upon the creditor's request. In the first public auction, the attached assets can be sold for at least 50% of their value. If, at the end of the first auction, the assets could not be sold, the execution office will arrange a second public auction with the same threshold. If, following the sale, the liquidated assets are not sufficient to cover the creditor's claim, the execution office will prepare a ranking scheme. The creditors' receivables are ranked according to attachment date. If assets belonging to the debtor are found after the ranking scheme is prepared, the creditors in the first rank must be satisfied before the others.

2. PROCEEDING WITH JUDGEMENT

Proceedings with judgment and proceedings without judgment are very similar. The most important difference is that in proceedings with judgment, there must be a prior court decision to start the execution proceedings. In addition, the debtor may object to the payment order within seven days following its service, based on the statute of limitation (the time limit expires after ten years following the final judgment), finalization or suspension. Unlike proceedings without judgment, when the debtor objects to the payment order in due time, the execution proceeding is not automatically suspended. To suspend the execution proceeding, the debtor must submit a letter of guarantee issued by a bank or other security agreed to by the creditor. All other procedures are the same for both types of proceedings.

3. FORECLOSURE PROCEEDINGS

Foreclosure proceedings are also very similar to proceedings without judgment. There are very few differences, however, which are worth noting. A foreclosure proceeding may be a proceeding with or without judgment. Under the EBL, if a debt has been secured by a pledge (e.g. a vehicle pledge), the creditor must particularly request the foreclosure of the pledges, rather than commencing other proceedings.

The debtor may object to the payment order within seven days following its receipt. If the debtor does not object to the payment order, then he must pay the amount requested under the payment order and declare his properties within 15 days following its receipt. If, at the end of the sale, the proceeds are not sufficient to cover the creditor's claim, the execution office will issue a "*deficiency document*". With this document, the creditor would be entitled to commence a standard execution proceeding to which the debtor cannot object.

B. BANKRUPTCY PROCEEDINGS

Another method of collecting monetary debts is commencing bankruptcy proceedings against the debtor. Creditors may prefer commencing bankruptcy proceedings over commencing execution proceedings; as, in bankruptcy, all debts, including the ones that will become due in the future, will become due and all of the debtors' assets will become subject to liquidation for the purpose of satisfying the creditor's receivables. However, as bankruptcy lawsuits generally take more than a year due to the workload of the commercial courts in Turkey, some creditors avoid requesting the debtor's bankruptcy.

Bankruptcy proceedings can only be commenced against merchants. In the presence of a monetary debt, creditors of merchants may either commence execution or bankruptcy proceedings, before execution offices. Creditors may also directly request a debtor's bankruptcy from the competent commercial courts, if: (i) the debtor does not have a permanent address; (ii) the debtor is hiding in order to not pay his debts; (iii) the debtor is involved in or attempts to be involved in fraudulent practices that infringe the creditors' rights; (iv) the debtor hides his assets during execution proceedings; (v) the creditors are explicitly or implicitly informed by the debtor that the due receivables may never be paid; (vi) the proposed concordatum (*konkordato*) is not granted, or the concordatum period is cancelled or terminated; (vii) the debt could not be paid through execution of a court verdict; (viii) indebtedness of capital companies; (ix) termination of restructuring through conciliation or breach of its project.

If a creditor wishes to pursue non-direct bankruptcy proceedings against a debtor, the first step involves requesting payment of the debt through the competent execution office. The execution office will then serve a bankruptcy payment order to the debtor. If the debtor does not pay or objects to this payment order within seven days⁴ following its service, the creditor may file a bankruptcy lawsuit before the commercial court, within the execution office's judicial circuit within one year following the service of the bankruptcy payment order.

If the debtor objects to the bankruptcy payment order, the bankruptcy proceedings will be suspended. In such case, the creditor will be required to file a bankruptcy lawsuit before the commercial court within one year following the service of the bankruptcy payment order. Before examining merits of the bankruptcy request, the court initially examines merits of the

⁴ The objection period is five days if the debt is based on a negotiable instrument.

objection. If the court decides on its cancellation, the bankruptcy proceeding against the debtor becomes definite and the court starts examining the bankruptcy request.

The creditor may withdraw the bankruptcy request during the course of the bankruptcy lawsuit, provided that the debtor's approval is obtained. The bankruptcy decision suspends all execution proceedings commenced against the debtor and, thus, the debtor may want to proceed with the bankruptcy lawsuit. In this case, the creditor may re-file the bankruptcy lawsuit, within one month following the withdrawal.

Commercial courts are entitled to grant measures of protection upon the creditor's request. If the debtor has not objected to the bankruptcy payment order, the commercial court will be required to grant interim measures of protection. These interim measures include, but are not limited to, preparing an inventory of the assets, appointing a trustee, etc.

Within 15 days following the announcement of the court's declaration of bankruptcy in the Trade Registry Gazette, other creditors of the debtor may object to the debtor's bankruptcy. If these objections are found reasonable, the commercial court will grant a depository injunction and order the debtor to make payment (or deposit) of the debts, along with interest and expenses, within seven days following such order. The commercial court will then notify the defendant (debtor) that the court will grant the bankruptcy decision, if such payment is not made. If, within this seven day period, the debt is paid or deposited to the court, the court will reject the bankruptcy request. Otherwise, the court will grant the bankruptcy decision at the first hearing following the order.

Once the decision of bankruptcy is granted by the commercial court, the decision is conveyed to the competent bankruptcy office. The bankruptcy offices are the administrative authorities responsible for carrying out bankruptcy proceedings. The bankruptcy office announces the bankruptcy to creditors and third parties and also notifies related persons and entities (i.e. creditors that previously commenced execution proceedings against the debtor, trade registries, professional organizations, etc.) of the debtor's bankruptcy.

The bankruptcy office's main functions are as follows:

- (i) supervising the bankruptcy administration's activities;
- (ii) executing interim measures of protection;
- (iii) keeping the books of the bankrupt person's or entity's assets;
- (iv) inviting creditors to the "creditors' first meeting"; and carrying out the liquidation process if the first creditors meeting cannot be convened.

All debts of the debtor become due from the moment the bankruptcy decision is rendered by the commercial court. All creditors can benefit from the bankruptcy proceedings (i.e. they can collect their receivables through the same bankruptcy proceeding). If the debtor is a legal entity, once the bankruptcy decision is rendered, the only purpose of the bankrupt entity becomes concluding the liquidation for the purpose of generating proceeds in order to pay the debts. Moreover, the authorities of the bankrupt legal entity's organs are limited to the purpose of liquidation (e.g. proposal of composition of debts) and they are not authorized to dispose the assets, which are considered the "bankruptcy estate".

The "bankruptcy administration" is comprised of three members appointed by the execution court among six nominees nominated at the creditors' first meeting. The bankruptcy administration conducts the liquidation process and takes care of and liquidates the bankruptcy estate. Subsequent to the bankruptcy administration's examination of the receivables claimed by all creditors of the bankrupt person or legal entity that have duly

registered their claims with the bankruptcy estate, the bankruptcy administration will finalize the list of debts and creditors. This list consists of claims of debts, including disputed claims, as well as the bankrupt person's or legal entity's receivables from the third parties. Furthermore, in this list of debts and creditors, the state authorities (e.g. tax offices, the Social Security Institution) that claim public receivables are ranked on top of the list of creditors and pledgee creditors will have a priority over the value of pledged assets.

After the finalization of this list (namely, the ranking scheme), the assets contained in the bankruptcy estate will be sold through a public auction. A certain threshold is set forth under the EBL that must be reached at the public auction for the sale of an asset. This threshold is 50% of the estimated value of the assets. If the threshold determined for the first public auction is not reached, the public auction will be adjourned and a second public auction will take place with the same threshold. As an alternative to the public auction method, the creditors may also decide to sell a portion of the bankruptcy estates through negotiations with buyers. In that case, the bankruptcy administration would ask to the creditors if any of them intends to purchase a particular estate and then decide to sell through negotiations.

During the distribution of the proceeds certain receivables have priority over other claims registered on the list. These are based on employment or family relations or defined as "privileged debts" in specific laws. After these claims are satisfied from the proceeds of the sale of the bankruptcy estate, the remaining amount will be distributed to the creditors. If the remaining amount is not sufficient to satisfy the total amount of other debts, the remaining amount will be distributed to all other creditors in proportion to their receivables.

Finally, a commercial court may also rule for the postponement of bankruptcy, such as in bankruptcy proceedings of capital corporations. In this case, the company's board of directors' (the "**BoD**", for joint-stock corporations) or board of managers' (the "**BoM**", for limited liability partnerships) or any of its creditor's will file the request to postpone bankruptcy. This request must be made along with a reasonable "improvement project" to the commercial court. The period of postponement is a maximum of one year. However, this period may be extended annually by the commercial court up to five years.

In these circumstances, the commercial court will appoint a trustee while granting a decision on the postponement of bankruptcy. This trustee must prepare an inventory of the assets and liabilities and is entrusted with the authority of the BoD or BoM. As an alternative, the BoD or BoM may continue to be active and the commercial court will appoint a trustee with the authority to consider and approve the BoD or BoM resolutions. During this process, the commercial court will also take necessary measures for the protection of the capital corporation's assets, and the trustee must regularly submit activity and financial reports. If at the end of the postponement period, the commercial court decides that the capital corporation cannot improve, it will declare the capital corporation's bankruptcy. The commercial court may also declare bankruptcy before the postponement period is completed if the trustee's reports are sufficient and convincing that improvement is not possible.

This article is only a very general summary of the legal methods available for collection of receivables. These five pages should certainly not be construed as legal advice, but merely as a generic guide on the applicable procedures.

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