

## Overhauled Concordat Regime Opens A New Chapter for Turkish Bankruptcy Law

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Bankruptcy postponement under the Turkish Bankruptcy Law was heavily criticised on the basis that it was open to manipulation. Critics also claimed the protections offered in this scope went beyond the legislators' intentions due to systematic errors which had emerged in the process.

Bankruptcy postponement was introduced to give debtors a final chance before being forced into bankruptcy, allowing them to put their business back on track without the pressure of collection proceedings. Statistically though, its success proved low as a majority of companies which postponed bankruptcy ultimately went bankrupt regardless, failing to successfully emerge from these circumstances.

These circumstances frustrated creditors because their likelihood and proportion of collection were negatively affected by this relief. Also, the mechanism was not helpful for restructuring debts given that creditors piled up, operational income diminished, assets were relatively dissipated, and this hopeless process took years. Therefore, there was a consensus that reform was needed.

The proposed solution is to overhaul the concordat mechanism, modernising this forgotten relief. Accordingly, Turkey has amended the concordat system, keeping in mind the problems which arose for bankruptcy postponement. The new concordat mechanism's success is yet to be tested. However, concerns already exist that the new concordat system is no different to the repealed bankruptcy postponement system in terms of the problems which creditors may face.

Turkey suspended the bankruptcy postponement mechanism during the recent state of emergency (as per Decree Law No. 669, dated 21 July 2016).

More recently though, Law No. 7101 entirely repealed the postponement of bankruptcy mechanism and amended the concordat provisions outlined in the Execution and Bankruptcy Law No. 2004 ("**EBL**"). These were published in the Official Gazette on 15 March 2018.

Turkey introduced fundamental changes for concordat procedures and principles. Concordat is a special kind of agreement which becomes binding with court approval. Both creditors or debtors can initiate the procedures. It allows debtors to pay their debts by giving them extra time to repay debts, making discounts from amounts owed, or preventing the debtor's possible bankruptcy.

The mechanism existed in Turkish law before March 2018. However, it had largely been ignored in practice for commercial reasons and due to its procedural complexity.

The concordat process has five stages:

1. Application to concordat

2. Temporary relief
3. Definitive relief
4. Creditors meeting
5. Court's examination and approval on concordat

Since bankruptcy postponement was suspended during the state of emergency, debtors were waiting for a tool which would allow them to stop their creditors. As a result, when the new concordat system was introduced, companies which could not pay their debts lined up before the courts seeking concordat relief.

## Who Can Apply For Concordat?

A debtor does not need to be deep in debt to apply for concordat. Rather, debtors can apply for concordat if they are (Article 285 of the EBL):

- Unable to pay their debts at the due date.
- In danger of failing to pay in due time.

Unlike bankruptcy postponement, debtors are not required to be insolvent to apply for concordat. Rather, debtors which have sufficient assets to meet their debts can apply for concordat if their debt discharging organisation is severely impaired.

The EBL does not impose any restriction for concordat in terms of qualifying the debtor. As a result, debtors who are not subject to bankruptcy may also request concordat. For instance, natural or legal persons who are not deemed to be "tradesmen" under the Turkish Commercial Code.

The lowered admissibility test for concordat carries the risk that the new regime could be manipulated by companies facing financial difficulties of any sort, whereby they use the concordat mechanism to freeze liabilities for up to nine months. This concerns many in business circles, who worry the new regime could cause further problems, rather than addressing those caused by bankruptcy postponement.

Further, a creditor who can file for bankruptcy of its debtors can also apply for concordat for its debtors.

## Competent Court

Concordat applications should be made to the commercial court of first instance. Before the amendments, enforcement courts would review concordat applications. However, since March 2018, commercial courts of first instance have become the courts responsible for reviewing concordat applications.

Enforcement courts would previously conduct short and quick trials. Regardless, it is considered that appointing the first instance commercial courts would be more pertinent for such procedures, which require a detailed examination and involve many creditors. In general, commercial courts have more technical expertise regarding corporate bodies and bankruptcy procedures. Further, commercial courts consist of three judges, while enforcement courts consist of only one judge.

## Application Documents

Debtors must include the following documents in their concordat request (Article 286 of the EBL).

1. **Preliminary project:** A project demonstrating how to carry out the concordat, how to liquidate the debts, as well as the necessary financial resources and methods.
2. **Documents showing the status of assets:** All assets and liabilities, revenues, cash flow, interim balance sheets, information about the commercial books, receivable and debt status lists, all the information and documents describing the debtor's financial status.
3. **Documents showing creditors and credit status:** A list of creditors, receivable amounts and concession status.
4. **Table showing the concordat's projected success:** A table demonstrating the likelihood that creditors would collect more from their receivable than if the debtor went bankrupt. It should include comparison with the result which would occur under the preliminary project's proposal. This document should reflect a prospective projection of creditors' probable conditions if the project is successful.
5. **Financial analysis reports** and their sources, prepared by an independent audit firm authorised by the Capital Markets Board or the Public Oversight Accounting and Auditing Standards Authority. The reports should show that the preliminary project's proposal is highly likely to occur. This requirement does not apply to small businesses employing less than 50 employees per year and whose annual sales revenue or financial balance is less than 8 million Turkish Liras. The debtor should prepare all of these documents, except for the financial analysis reports (prepared by independent auditors).

Financial statements must be prepared no more than 45 days before the concordat's application date.

There is no liability or penalty specifically for those who prepare the application documents, which the court bases its concordat decision on. As a result, concerns exist about the accuracy of information which may be provided to the courts.

If a creditor applies for concordat, the court grants debtors a reasonable time to submit the necessary documents (Article 287/2 of the EBL). In this case, the creditor bears the costs of preparing the documents. If the debtor fails to submit these documents in full within the given period, the court will reject the application.

Courts also request the following documents and evidence:

1. Tax certificates.
2. Articles of Incorporation and trade registry records.
3. SSI notifications.
4. Balance sheet based on the continuity of the entity and the probable sales price of assets.
5. Lists of tangible and intangible assets, including their book values.
6. The last five-year tax return and interim tax declaration.
7. A decision by the board of directors, including the decision and authorisation to request concordat.
8. Whether immovable property is registered in the debtor's name.

The cost of concordat expenses should be paid to the court when applying for concordat, amounting to circa 50,000 Turkish Liras (Communiqué on Expense Advance Tariff of Composition of the Creditors, published in Official Gazette No. 30439 on 2 June 2018). The exact amount of expenses will be calculated depending to a number of factors. For instance, the total number of creditors, total number of experts to be appointed by court etc. If this is not deposited, the concordat request will be rejected.

## Temporary Relief

If the court determines the application documents are complete, it will immediately render a decision allowing three months of temporary relief (Article 287 of the EBL). This period can be extended by up to two months at the debtor or concordat trustee's request.

The EBL stresses that the temporary relief decision must be rendered "immediately". Therefore, it is considered that examination of the application documents will be procedural. The court examines concordat applications via an expedited procedure, rendering a decision within 48 hours. This causes significant concerns about applicants trying to manipulate the concordat mechanism to obtain five months' relief, even when this is underserved.

During the temporary relief period, creditors cannot initiate execution proceedings or continue execution proceedings that have already been initiated. Further, the court must take all necessary measures to protect the debtor's assets, although the EBL does not prescribe any limits on those measures.

The court will appoint a temporary trustee, who will determine whether the conditions to approve the concordat exist and determine the likely success of concordat proceedings.

The temporary relief will be announced in the Commercial Registry Gazette and on the official advertisement portal of the Press-Advertisement Agency, as well as notified to the relevant institutions and organisations.

Creditors can file their objections to the relief within seven days of the announcement.

## Definitive Relief

If the court understood from the trustee's evaluations and judge's review that concordat could be successful, it will grant definite relief to the debtor for one year, which can be extended for a further six months.

While definitive relief applies:

- No proceedings can be carried out against the debtor.
- Execution proceedings which have already been initiated against the debtor must stop immediately.
- Provisional seizures cannot be executed against the debtor (including public debts such as Social Security Institution receivables and tax debts).
- Preliminary injunction cannot be executed against the debtor (including public debts such as Social Security Institution receivables and tax debts).
- Collection proceedings based on liens can be initiated (or continue), but seizures or auctions cannot be conducted.

However, attachments can be placed based on alimony and employees' receivables.

Interests will cease running for all types of receivables from the date definitive relief is granted, except for receivables secured by pledges. However, execution proceedings, seizures and official sales can be carried out for receivables arising from transactions made with the concordat trustee's permission during the definitive relief period.

Contracts which the debtor is party to and which are instrumental for the debtor's operations cannot be terminated by the counterparty on the basis that the debtor has been declared concordat (Article 296 of the EBL). This provision protects debtors against contract terminations which could otherwise cause their financial and operational collapse.

The debtor should continue to work under the concordat trustee's supervision during the definitive relief period. In principle, this should occur without any limitations on the debtor's operations (Article 297 of the EBL). This is a development on the strict trustee limitations which existed under the bankruptcy postponement mechanism.

However, in some instances the court can impose limitations or remove the debtor's operational authority. In such case, the court can declare the debtor bankrupt if the debtor fails to comply with the trustee's warnings or instructions.

Debtors must obtain the court's permission to establish a pledge, transfer immovables, become surety, or make gratuitous disposals during the definitive relief period. Otherwise, such transactions will be deemed null and void.

## Concordat Trustee's Role

The concordat trustee's primary tasks are to:

- Contribute to completing the concordat project.
- Oversee the debtor's activities.
- Hold a ledger of the debtor's presence.
- Make a valuation of the debtor's existing assets.

The concordat trustee must monitor the debtor's activities on a regular basis and intervene in transactions which are contrary to the interests of creditors. Therefore, the concordat trustee should be equipped with the capabilities and capacity of a general manager.

Creditors can file complaints to the court about decisions by the concordat trustee.

## Committee Of Creditors

The court forms a committee of creditors (Article 289/4 of the EBL). The committee must be constituted so that creditors with different types of receivables are fairly represented. For instance, in terms of legal qualifications and creditors with pledges, if any. The committee must comprise an uneven number of creditors, maximum seven.

The EBL does not recognise the committee of creditors having authority to make binding decisions. Therefore, the necessity of this institution is open to debate. The committee can only provide its views to the concordat trustee and court, to help raise the voice and interests of creditors.

Only the committee of creditors can ask the court to replace the concordat trustee.

## Creditors Meeting

Creditors will be invited to notify their receivables within fifteen days of an announcement made by the concordat trustee. If a creditor fails to notify within this period, they will not be able to participate in the negotiations, nor vote in the concordat project.

The concordat trustee chairs the creditors meeting and prepares a report on the debtor's status after listening to the debtor and creditors.

The concordat project is deemed to have been accepted if it is signed by either:

- Half of the registered creditors whose receivables exceed half of the total debt, or
- One-quarter of the registered creditors whose receivables exceed two-thirds of the total debt.

## Approval Of Concordat

Once the concordat project is approved at the creditors' meeting, the concordat trustee submits the project and the report to the court.

The relevant commercial court of first instance will hear any objections to the report.

The court will certify the concordat project if the following conditions are met:

1. The amount proposed under the concordat is greater than the amount possible to be held by the creditors if the debtor goes bankrupt.
2. The proportion of the proposed amount is proportionate to the debtor's resources (in this context, the court also takes into account whether the debtor's expected rights are to be considered and if so, how much).
3. The prescribed majority of creditors have accepted the concordat project.
4. Debts owed to privileged creditors and debts entered with the concordat trustee's permission have been collateralised (unless the creditor expressly agrees otherwise).

The court decides on a payment plan to determine the extent to which creditors waive their receivables and pay the debtor's debts within the framework of the calendar outlined in the concordat decision.

If the debtor fails to fulfil its obligations under the concordat project, each creditor can apply to the court to invalidate the concordat, while maintaining its status recognised in the concordat decision. If a creditor invalidates the concordat for its receivables, it can initiate new enforcement proceedings to collect these receivables.

The court will review the concordat project and creditor objections. It can refuse the concordat request, demanding amendments on the concordat project, or even bankruptcy, if it finds that the application does not meet the relevant conditions.

## Conclusion

The reintroduced concordat mechanism is the result of frustrations about bankruptcy postponement and the need for a better performing system. Bankruptcy postponement was causing unfair consequences and was open to manipulation, which caused much uncertainty in Turkey.

The new concordat regime is faster, with a shorter evaluation process. It provides more limited protection compared to bankruptcy postponement. However, the current concordat regime has its own flaws.

Concordat applications have created a domino effect. SMEs are negatively affected when big players seek concordat protection, thus avoiding their payment liabilities. Disputes lawyers are now working on temporary

relief requirements with accounting experts on both sides of the table, as case files have yet to arrive to the stage of definitive relief in practice.

The courts' approach is not yet fully established. The fact that there is no substantive review in granting temporary relief for up to five months is a real concern. Further, the lack of transparency and accountability in respect of reports and balance sheet provided to courts give rise to reliability issues.

Certain courts are quite conservative in issuing temporary relief, while others issue it without making any analysis over the requirements, particularly the accuracy of the concordat project and balance sheets.

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