

## **An Indispensable Tool in Business Life: Promissory Note**

Thousands of commercial agreements are executed every day, most of the times with at least one party having a payment obligation. Although the said party may have the option to fulfil this obligation by paying cash on the due date, other means of payment such as negotiable instruments are also frequently used. From a Turkish law perspective, this is because negotiable instruments are not just payment tools. Their ease of transferability and most importantly their independence from the underlying contractual relationship between the parties of the relevant transaction make them the preferred choice for a number of other reasons.

This article is intended to provide its readers with general information on the validity and enforceability of promissory notes (or bonds) under Turkish Law, which are among the three types of negotiable instruments<sup>1</sup> (*kambiyo senedi*) stipulated in the Turkish Commercial Code (the **TCC**). A concise explanation on the special execution proceeding, specified in the Turkish Execution and Bankruptcy Law No.2004 (the **EBL**) with regard to the negotiable instruments, is also provided.

One should bear in mind that what is said in this article on the validity and enforceability of the promissory notes may be subject to the review of further documents including the up-to-date Articles of Association and the signature circular of the drawer, in case it is an entity. Accordingly, no specific conclusions should be inferred from this article as each case should be separately analyzed.

### **1 Mandatory contents**

According to the TCC, a promissory note, in order to be valid and binding as a negotiable instrument, must fulfil the following conditions;

- (i) The expression "promissory note" must be included in the text (in case the promissory note is produced in a language other than Turkish then the equivalent of the same expression in that language must be included),
- (ii) There must be an unconditional undertaking to pay a specified amount of money,
- (iii) The date of maturity must be stated on the promissory note,
- (iv) The place of payment must be stated on the promissory note,
- (v) The title/name of the entity/person to which the payment shall be made (i.e. the beneficiary) must be stated on the promissory note,
- (vi) The date and place where the promissory note is issued must be stated on the promissory note,
- (vii) The signature of the drawer must appear on the promissory note.

A promissory note not fulfilling all of the conditions above would be invalid, except for the following cases:

- In the event that the date of maturity is not stated, the promissory note shall be paid "when seen" meaning that the payment shall be made when the beneficiary submits the promissory note to the drawer for payment.

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<sup>1</sup> The negotiable instruments provided for under the TCC are (i) bill of exchange (*poliçe*), (ii) promissory note/bond (*emre muharrer senet/bono*) and (iii) cheque (*çek*). They are stipulated on an exhaustive basis. No other type of negotiable instrument can be produced by the parties of a certain legal transaction.

- In the event that the place of issue is not stated, the promissory note shall be deemed issued at the place mentioned next to the drawer's title/name. In addition, in case the place of payment is not stated, the place of issue shall be deemed to be the place of payment.

In practice, where more than one promissory note are issued with different dates of maturity, a clause, providing that all promissory notes shall automatically become due at once in the event of the non-payment of any due promissory note, is inserted in each.

## **2 Independence from the underlying contractual relationship**

There is always an underlying relationship between the drawer and the beneficiary of a certain promissory note. In accordance with Turkish law, a promissory note is a negotiable instrument issued, in principal, independently from the underlying relationship between the drawer and the beneficiary. To illustrate this principle by way of an example: Let us assume that Company A sells goods to Company B and Company B issues a promissory note to the order of Company A for the payment of the goods. In case Company A fails to fulfil its obligation under this sales agreement (e.g. delivers defective goods or is in default) Company B can not refrain from paying the amount specified on the promissory note on its date of maturity, alleging that Company A breached the sales contract.

In the above example, if the drawer (i.e. Company B) opines that its debt, which is subject to the promissory note, does not have any valid ground, it can initiate a lawsuit (*Menfi Tespit Davası*) where the request would be the determination of the non-existence of the debt in question. On the other hand, if such debt is already paid then it can claim its re-collection from the creditor based on the unjust enrichment provisions. However, this claim can only be the subject matter of a separate lawsuit to be initiated by the debtor against the creditor, with the debtor bearing the burden of proof.

## **3 Avalisation**

In accordance with the TCC, avalisation (*aval*) is the name of a legal transaction providing a third-party guarantee in favour of the beneficiary of a promissory note with respect to the due payment of the same. The person providing such guarantee to the beneficiary is called the "avalist". In order to be valid, any avalisation must be indicated on the front side of the promissory note. The usual practice is that the avalist handwrites a very short phrase such as "For avalisation" and puts his signature below it. Ideally, his name should also be indicated underneath.

The TCC states that the liability of an avalist arising out of a promissory note is the same as the drawer's. Consequently, the drawer and the avalist are jointly and severally liable for the payment of the sum specified on the promissory note. The submission of a promissory note to its drawer and its subsequent non-payment is not a prerequisite for submission of the same to its avalist for payment. In other words, when the date of maturity comes, the beneficiary would have the option to submit the promissory note and request payment from either the drawer or the avalist. In practice, avalisation is preferred when personal guarantees of the shareholders of a company are required. Namely, the company issues a promissory note as the drawer and its shareholders become the avalists of the said promissory note. This enables the beneficiary of such promissory note to demand its payment from either the company itself or its shareholders and to initiate execution proceedings against any or all of them.

## **4 Stamp duty and costs**

Although not the case until very recently, negotiable instruments are no more subject to stamp duty. On the other hand, the main agreement, which constitutes the base for the underlying contractual relationship between the drawer and the beneficiary, may be subject to stamp duty. Accordingly, a tax advisor's opinion would ideally be required for each specific case.

## **5 Execution proceedings**

The EBL provides for two main types of execution proceedings regarding the collection of monetary debts from the debtors. There are (i) ordinary execution proceeding (applicable for all kind of debts) and (ii) execution proceeding for negotiable instruments, which is only applicable in respect of the debts arising out of a negotiable instrument. The execution proceeding for negotiable instruments is preferable to the ordinary execution proceeding because it facilitates the creditor's (the beneficiary of the promissory note) collection of his receivables within a shorter period of time and, more importantly, because the debtor's (the drawer of the promissory note) objection to the execution proceeding does not automatically suspend the proceeding as in the ordinary execution proceeding. A negotiable instrument also enables a creditor to obtain a preliminary attachment order from a commercial court, making him able to seize the debtor's assets much more easily and thus preventing the creditor from engaging in fraudulent conveyance.

Below are the particulars of the execution proceeding for negotiable instruments.

## **6 Execution proceeding for negotiable instruments (EPNI)**

### **Commencement**

An EPNI is initiated by the creditor's application to the competent execution office and presentation of the negotiable instrument he holds. At this stage, the creditor will be required to pay execution office charges amounting to 0.5% of the disputed amount, subject to reimbursement from the debtor provided that the execution proceeding results in the creditor's favour.

Once an EPNI is initiated, the director of the relevant execution office is obliged to inspect the negotiable instrument and check its validity. Once the director verifies its validity, a payment order shall be served on the debtor and/or on the avalist (if applicable) ordering them to pay the debt (normally the amount specified on the negotiable instrument), together with interest and the relevant charges to the execution office within 10 (ten) days from the order's delivery date.

### **Debtor's objection**

Contrary to the ordinary execution proceeding where a debtor's objection is made directly to the execution office, an objection to an EPNI must be brought before the competent execution court. The debtor must submit his objection petition to the execution court in 5 (five) days starting from the delivery date of the payment order. In his objection, the debtor may allege that the debt does not exist or has been paid, that the signature on the negotiable instrument is not his or raise any other kind of opposition. Such objection does not automatically suspend the EPNI. However, the judge (of the execution court) may decide the temporary suspension of the EPNI as a precautionary measure.

### **Proceedings before the execution court**

These proceedings slightly differ depending on the nature of the debtor's objection;

(i) In case of objection to the signature, a hearing shall be held and the signature on the negotiable instrument shall be examined by the execution court in accordance with the general provisions of the EBL.

If the execution court decides that the signature does not belong to the debtor then it accepts the debtor's objection, which has the effect of suspending the EPNI (if it has not already been suspended by the execution court as explained above). In such case, the creditor has the right to file a separate lawsuit before the commercial court to claim his receivables based on other documents and arguments. Besides, if the execution court opines that the creditor acted in bad faith or in gross negligence when initiating the EPNI, it may impose on the creditor an indemnity amounting to at least 20% of the disputed amount and a penalty amounting to 10% of the disputed amount. In case the creditor files a separate lawsuit before the commercial court, the collection of such indemnity and penalty shall be postponed until the end of such lawsuit.

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If the execution court decides that the signature on the negotiable instrument belongs to the debtor, the debtor's objection is then dismissed and if the EPNI has been suspended before, it will resume. In such case, the debtor runs the risk of being penalised an indemnity amounting to at least 40% of the disputed amount and a penalty amounting to 10% of the disputed amount. However, the debtor has the right to file a separate lawsuit before the competent commercial court, which would postpone the collection of such indemnity and penalty until the end of the lawsuit.

(ii) In case of objection to the debt, the proceedings are quite similar to the ones applicable in case of objection to the signature. The aforementioned indemnities/penalties and the parties' right to file separate lawsuits before commercial courts are applicable with regards the objection to debt as well.

*This article has been written for general information purposes only. Nothing in it should be relied upon when involved in legal matter/conflict. Specific advice should be sought depending on the particulars of each case.*