Turkey's New Financial Leasing Law and Industry

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This Article is based on an address given by Unal Tekinalp on March 26, 1992, as part of the Fordham University School of Law Graduate Colloquium 1991-1992, Transnational Financial Services in the 1990s.
In this Article, Professor Tekinalp describes Turkey's new and rapidly growing financial leasing industry. One of the reasons for this rapid growth is the newly enacted Law Concerning Financial Leasing ("LCFL"). Enacted before a financial leasing industry existed, the LCFL is unique in its heavy regulation of this industry. As a drafter of the LCFL, Professor Tekinalp offers insight into the operation and goals of the statute and provides fertile ground for comparison with other developments in international financial regulation.

INTRODUCTION

FINANCIAL leasing operations and transactions were introduced to Turkey in 1985 by the Law Concerning Financial Leasing ("LCFL"). Prior to the LCFL's promulgation, sporadic instances of equipment leasing and other types of leasing activity took place in Turkey but generally did not attract the attention of academic and industrial circles. The best known of these early examples—the forerunners of cross-border operations—involves the leasing out by foreign concerns of sophisticated computers and electronic equipment. Because academic texts at the time did not attach much importance to these early leasing contracts, their validity as precedent was minimized. The dearth of leasing activity similarly limited the interest in studies conducted by investment banks indicating a need for leasing and improved leasing techniques. Moreover, the traditional Turkish notion that banks are the exclusive financial institutions also partly accounts for this early lack of interest in financial leasing operations and transactions. Consequently, given the overall limited interest in this area, the promulgation of the LCFL to regulate financial leasing operations was not expected.

Since its enactment, the number of leasing operations and transactions in Turkey has skyrocketed. As a drafter of the LCFL, I did not foresee such a rapid development in Turkish leasing transactions. Similarly, at various symposiums, seminars, and panel discussions, and during the introduction of the subject to commercial and financial circles, few partici-
pants predicted that financial leasing operations would become so popular and that financial leasing companies would provide an alternative to banks in so short a time. Yet, in retrospect, the rapid increase in the number of leasing operations in Turkey is partly explained by financial leasing's favorable comparison to bank practices of financing loans to large industry with exorbitant interest rates and excessive demands for collateral.

Many countries that initially developed leasing systems within their industrial infrastructures solidified and promoted those systems, and passed laws to regulate them. Yet, Turkey’s LCFL differs from other countries' laws in three ways. First, the LCFL regulates financial leasing activity exclusively; second, it was enacted before leasing transactions became popular; and lastly, the LCFL is unique because of the unusually rapid development of leasing activities it spawned.

This Article examines Turkey's new Law Concerning Financial Leasing and its financial leasing industry. Part I introduces the LCFL, Part II describes various types of finance leases recognized under the LCFL, and Part III analyzes the LCFL by looking at its unique features, its restrictions on financial leasing, and the incentives it provides to encourage financial leasing. Part IV then discusses the four types of financial leasing organizations allowed to conduct business in Turkey. Finally, Part V explains how a finance lease operates.

I. TURKEY'S NEW LAW CONCERNING FINANCIAL LEASING

The LCFL is Turkey's principal law regulating financial leasing. It

2. See Surtees, Turkish Leasing Law in an International Context in Leasing Digest, supra note 1, at 1.

3. See Regulation Governing the Period and Limitations of Financial Lease (Rental) Agreements, Decree No. 85/9866, Turkish Official Gazette No. 18882 (Sept. 28, 1985), amended by Amendment to Regulation Governing the Period and Limitations of Financial Rental Agreement, Decree No. 87/11758, Turkish Official Gazette No. 19473 (May 28, 1987), Decree No. 88/13469, Turkish Official Gazette No. 20028 (Dec. 23, 1988), Decree No. 91/1653, Turkish Official Gazette No. 20916 (July 1, 1991) [hereinafter Limitations Regulations]; Regulation Governing the Establishment and Control of Financial Leasing Companies and Branches of Foreign Companies, Ministry of State and Deputy Prime Ministry, Sept. 11, 1985, Turkish Official Gazette No. 18882 (Sept. 28, 1985), amended by Amendment to Regulation Governing the Establishment and Control of Financial Leasing Companies and Branches of Foreign Companies, Ministry of State and Deputy Prime Ministry, Turkish Official Gazette No. 19451 (May 5, 1985) [hereinafter Establishment Regulations]; Regulation Governing the Guaranty Requirements for Customs Duties for Cross Border Transactions, Ministry of Finance and Customs, Sept. 11, 1985, Turkish Official Gazette No. 18882 (Sept. 28, 1985) [hereinafter Customs Regulations]; Income Tax General Communique No. 146 Ministry of Finance and Customs, Sept. 11, 1985, Turkish Official Gazette No. 18882 (Sept. 28, 1985), amended by Income Tax General Communique No. 150, Ministry of Finance and Customs, Turkish Official Gazette No. 19130 (June 7, 1986) [hereinafter Tax Regulation]; Stamp Duty General Communique No. 13, Ministry of Finance and Customs, Turkish Official Gazette No. 19130 (June 7, 1986); Annual Communiques on the Encouragement and Orientation of Investment, No. 92/2805, Turkish Official Gazette No. 21185 (Mar. 28, 1992) [hereinafter Encouragement Regulation].
regulates the organization, nature, and structure of Turkish financial leasing companies and of Turkish branches of foreign financial leasing companies. The statute contains various provisions relating to finance leases and provides several incentives to promote this type of leasing activity. The LCFL does not address operating leases, which are regulated by the Turkish Code of Obligations (“TCO”). Generally, the Turkish government has a policy against promoting operating leases.

Two distinctive characteristics of the LCFL are found in its treatment and definition of owners of lease property. Under the statute, the lessee is not the owner of the property that is the subject of the finance lease; rather, the lessor retains legal title. Second, while the lessor has legal title, he is unlike a traditional owner because he cannot transfer the ownership of the goods and has no responsibility for their delivery. Instead, the lessor acts like a financial institution because his only role in the financial leasing transaction is to provide funding for the goods. Despite the provisions concerning legal ownership, the lessee, in practice, still resembles an owner of the lease property because the LCFL imposes on him the cost and responsibility of the goods and provides him with security as if he were an owner.

II. FINANCE LEASES

A. Types of Finance Leases

Finance leases are classified as either domestic or cross-border leases. While cross-border leases are mentioned in the LCFL, the statute contains no formal definitions of a domestic or cross-border lease. Common practices and academic texts, however, define a domestic lease as one between a lessor and lessee within the same country, while in a cross-border lease, the lessor and lessee are situated in different countries. Thus, for example, a contract made between a domestic lessee and a Turkish branch office of a foreign corporation is deemed a domestic lease. Whether the goods constituting the subject of the finance lease have been procured from domestic sources or from abroad is immaterial in designating a lease as domestic or cross-border.

4. See LCFL, supra note 1, art. 10.
5. See id. arts. 28-29.
6. Other types of leasing activity have emerged in Turkey in the past seven years. These include: sale and lease-back transactions, capital leases, first-hand leases, second-hand leases, revolving leases, and leveraged leases. In the absence of a specific provision in the LCFL, these lease contracts are governed by the general provisions of the Turkish Code of Obligations, Law No. 818, Turkish Official Gazette No. 366 (May 8, 1926) [hereinafter TCO].
7. See LCFL, supra note 1, art. 17.
8. See id. arts. 9 & 18.
9. See id. arts. 16 & 17.
10. See id. arts. 13, 17, 18.
11. See id. art. 6 (LCFL mentions types of leases but does not define them).
12. See id. arts. 6, 11 & 8, 11.
The two types of leases also can be distinguished by the way the LCFL regulates their prices and registration. The LCFL requires cross-border contracts to set annual rent at a minimum of 25,000 United States dollars and to be registered with the Ministry responsible for the Under-Secretariat for the Treasury and Foreign Trade ("Ministry").

Cross-border leasing—commonly referred to as international leasing—is more complex than domestic leasing. The difficulties one would expect with such international transactions, however—such as determining the applicable law, the currency risks, and the exchange control rate—are almost non-existent because Turkey has enacted several laws that simplify matters for cross-border leasing operations, as well as for other foreign transactions. Such laws include Decree No. 32, which concerns the protection of the value of the Turkish currency; Law No. 6224, which encourages infusion of foreign capital; and Law No. 2675 ("Law of Conflicts"), which deals with international private law and procedural law.

B. Nature of the Finance Lease

The finance lease has two independent functions: it provides financing for goods and leaves the use of these goods to the lessee. The lessor both provides the financing for the goods and, despite having legal title over the goods, leaves their use to the lessee. This separation of use and ownership for financing purposes is an essential feature of the finance lease. These functions are linked in the LCFL to complement each other. The result is that, under the LCFL, the amount which the lessee repays to the lessor within the course of the agreement term is enough to meet the cost of the goods, the broader amount of financing costs, and the profit margin of the lessor.

Treatment of lessors as financiers confers on financial leasing transactions the characteristics of a "standard" financial transaction, as do two

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13. See id. arts. 6 & 8.
14. See id. art. 6, ¶ 2.
15. See id. art. 8, ¶ 2.
16. See Decree No. 32, Turkish Official Gazette No. 20249 (Aug. 11, 1989) [hereinafter Decree 32].
20. See LCFL, supra note 1, arts. 9 & 18.
21. See id. arts. 4 & 13, ¶ 1.
other principles of the finance lease: the full pay-out lease and the net lease.

III. AN IN-DEPTH LOOK AT THE LCFL

A. Unique Features

Turkish leasing law is unique because financial leasing is not an ordinary type of leasing transaction. There are six features of the LCFL, in particular, that distinguish it from similar laws in other countries:

- Tripartiteness
- Lessor's diminished liability
- Lessor's retention of title
- Insulation of lease property from creditors
- Required four-year lease period
- Transfer of ownership of lease property not fatal

The first unique feature of the LCFL is its tripartiteness—the rule that the lessor may not be a producer or supplier of goods in a single leasing transaction. Each leasing transaction must contain three parties: a producer or supplier, a lessor, and a lessee. The statute treats the lessor like a financial institution, requiring him to either buy the goods from a third party or to become the owner of the goods by recovering them after the termination of a separate lease agreement to which he was a party. If the goods are leased again under a new contract, a second line of leasing is transacted. The second unique feature of the LCFL is that the lessor generally cannot be held liable to the lessee for loss of or damage to the goods. Under the statute, the lessor's responsibilities end once he has paid for the goods and signed the contract. The lessor is not liable for the supplier's failure to deliver or for late delivery of the goods to the lessee.

Third, the title of the goods remains with the lessor even though the lessee uses them as if he is the owner. The lessee is liable for repairs and maintenance and must pay the insurance premiums on the goods. The consequences of any loss or damage to the goods during the term of the lease are the lessee's responsibility. However, this liability is limited to that portion of the damage not covered by insurance.

Fourth, the lessor's creditors may not seize the goods during the term
This characteristic leaves the lease unaffected by the lessor's bankruptcy and retains the validity of the lease until its normal expiration date.34

Fifth, the LCFL requires the term of a finance lease to be at least four years,35 except in unusual cases.36 Accordingly, the LCFL prohibits termination of the lease before the expiration of the four-year period.37 This minimum term is not merely a characteristic of the finance lease, it is a part of the LCFL's very definition of a finance lease.38

The final unique characteristic of the LCFL is that transfer of ownership of the lease property is not necessarily fatal. While the lessor generally may not transfer ownership of the goods to another party,39 if the lessor has explicitly reserved the right of transfer in the lease, the goods may be transferred to another financial leasing organization. Contrary to the principle enunciated in Article 254 of the TCO that a "rent contract is terminated in case the goods are sold," under the LCFL a finance lease is not terminated by a transfer in its operations. Instead, the lease remains valid and the lessor to whom transfer has been made becomes a contracting party with the consent of the transferee.40 Under this feature of the LCFL, the transfer becomes valid with respect to the lessee from the moment he receives notice of the transaction.41

B. Restrictions and Incentives

The LCFL imposes two restrictions on financial leasing. First, financial leasing companies in Turkey may only engage in activities directly related to financial leasing.41 They are not yet allowed to conduct receivables-discounting operations or to issue securitizations. Fortunately, a new law entitled the Draft Law for Amendment of the Capital Market Act allows this kind of discounting operation. This new law should benefit financial leasing institutions and increase the number of financial leasing transactions in Turkey.

Second, both domestic financial leasing companies and branches of foreign financial leasing companies must obtain approval from the Ministry to set up and conduct leasing operations.42 The Ministry gives its permission if the requesting company "has sufficient capital and experi-

33. See id. art. 20.
34. See id. art. 20.
35. See id. art. 7. But see Limitations Regulations, supra note 3, art. 1 (under certain conditions, the rental contract period may be less than four years).
36. See, e.g., id. art. 23 (exceptions for non-payment of rent and material breach); id. art. 22 (exception for death).
37. See id. art. 7.
38. See id. art. 4.
39. See id. art. 18, ¶ 1.
40. See id. art. 18, ¶ 2.
41. See Establishment Regulations, supra note 3, art. 20, ¶ 1. However, the Ministry is authorized to exempt development and investment banks. See id. art. 20, ¶ 2.
42. See id. arts. 3-8; LCFL, supra, note 1, arts. 8, ¶ 2.
ence" in financial leasing, if it is "creditworthy," and if it agrees to comply with Turkish law regarding its structure.\textsuperscript{43} Upon obtaining the Ministry's permission, a financial leasing organization must set up and begin operations within one year; otherwise, the Ministry may cancel its authorization.\textsuperscript{44} If this happens, the organization must reapply to the Ministry for permission.

There are heavy penalties for conducting financial leasing operations without permission. Individuals who commit this crime are punishable by a fine of 500,000 to 5,000,000 Turkish Liras and imprisonment for a period of three months to one year.\textsuperscript{45} If the offender is a corporate body, the penalties are applied to the individuals who were responsible for the decision to operate without the necessary permission and to those who participated in the illegal activities.\textsuperscript{46}

The LCFL's restrictions on financial leasing are balanced by incentives contained in the statute. The LCFL provides generally that investments realized wholly or in part through financial leasing may benefit from incentives, provided that an incentive certificate is issued.\textsuperscript{47} The various incentives include the investment incentive allowance,\textsuperscript{48} the custom duty exemption,\textsuperscript{49} the Resource Utilization Support Fund Credit, and the premium for domestically produced machinery and equipment. Moreover, the finance leases may be exempted from all types of taxes, duties, and charges.\textsuperscript{50} The LCFL authorizes the Council of Ministers to decrease or increase the withholding tax rates applied to the earnings and wages of foreign companies that do not have branch offices in Turkey.\textsuperscript{51}

IV. FINANCIAL LEASING INSTITUTIONS

Institutions permitted to conduct financial leasing transactions in Turkey include investment and development banks ("I&D Banks"), private financing establishments ("PFEs"), Turkish branches of foreign companies ("Branches"), and financial leasing companies ("FLCs").

A. Investment & Development Banks

I&D Banks are regulated by the Establishment Regulations promulgated under the LCFL.\textsuperscript{52} These banks do not receive deposits, but perform credit and investment bank operations with funds they collect from domestic and foreign markets. They may conduct financial leasing trans-

\begin{itemize}
  \item \textsuperscript{43} Establishment Regulations, \textit{supra}, note 3, art. 5.
  \item \textsuperscript{44} See id. art. 8.
  \item \textsuperscript{45} See LCFL, \textit{supra} note 1, art. 10, ¶ 4.
  \item \textsuperscript{46} See id.
  \item \textsuperscript{47} See id. arts. 28-30.
  \item \textsuperscript{48} See Encouragement Regulation, \textit{supra} note 3; Tax Regulation, \textit{supra} note 3.
  \item \textsuperscript{49} See LCFL, \textit{supra} note 1, art. 29.
  \item \textsuperscript{50} See id. art. 30, ¶ 1; Tax Regulation, \textit{supra} note 3.
  \item \textsuperscript{51} See LCFL, \textit{supra} note 1, art. 30, ¶ 2; Yetkin, \textit{Taxation Issues Relating to Financial Leasing}, in Leasing Digest, \textit{supra} note 1, at 11.
  \item \textsuperscript{52} See Establishment Regulations, \textit{supra} note 3, art. 20, ¶ 2.
\end{itemize}
actions without creating a separate company or setting up an independent department.

B. Private Financial Establishments

PFEs, regulated by a separate decree, are unique financial institutions that purchase products chosen by a customer and resell them to that customer at prices determined by the length of the repayment term, the financing cost, and the profit margin. PFEs also make joint investments with clients, operating on a profit-sharing basis. They provide financing not in cash, but in the form of goods chosen by the client. The PFE sells these goods to the client on a "profit-and-loss" basis, not on an interest-collecting basis. In this respect, PFEs differ from deposit-taker banks and more closely resemble FLCs. As such, they are more suited to financial leasing operations than are traditional investment banks. PFEs also differ from the other financial leasing organizations in two accounts that they may open, profit- and loss-sharing accounts and current accounts. Profit- and loss-sharing accounts are used when goods are procured and resold to the client. The holder of the account shares the profit or loss derived from the investment for which the funds were used. Current accounts are analogous to the deposit accounts of commercial banks.

C. Branches

Branches are opened, operated, and audited according to the provisions of the LCFL and may only conduct financial leasing operations. The LCFL requires Branches to have a minimum paid-in capital of the Turkish Lira equivalent of 2,000,000 United States dollars. Unlike I&D Banks and PFEs, Branches may only conduct financial leasing transactions. Further, they may only conduct leasing activities if they receive two forms of government approval. First, Branches must obtain permission to set up and operate. This preliminary permission from the Ministry to establish a Branch is unique to Turkish financial leasing law. In addition, Branches must apply for permission from the Ministry of Industry and Commerce.

D. Financial Leasing Companies

Like Branches, FLCs are opened, operated, and audited according to the provisions of the LCFL and may only conduct financial leasing operations. An FLC is a financial institution as understood in the provisions

54. See LCFL, supra note 1, art. 10, ¶ 1; Establishment Regulations, supra note 3, art. 20, ¶ 1.
55. See LCFL, supra note 1, art. 11, ¶ 2.
56. See Establishment Regulations, supra note 3, art. 20, ¶ 1.
57. See id. art. 5.
58. See Provisional Act (Turk. 1914).
of Article 96.2 of the Banking Act and must be established in the form of a joint-stock company. The paid-in capital of an FLC may not be less than 1,000,000,000 Turkish Lira.59

1. Set-up

Because an FLC is necessarily a joint-stock company, it is also governed by the provisions of the Turkish Commercial Code (“TCC”) relating to joint-stock companies. Following receipt of preliminary permission from the Ministry, an FLC/joint-stock company is set up in four stages. First, the founders of the FLC/joint-stock company sign its Articles of Association. These signatures must be certified by a notary public.60 Second, the Ministry of Industry and Commerce approves the Articles of Association of the joint-stock company in accordance with Article 280 of the TCC. Third, the court located where the FLC/joint-stock company is situated approves its establishment.61 Finally, the FLC must register its Articles of Association with the Commercial Registry within the locale of the central offices of the joint-stock company.62 With this registration, the FLC acquires the status of a joint-stock corporation in accordance with Article 301 of the TCO.

Foreigners may set up an FLC or may become shareholders after the FLC is created.63 The LCFL does not contain provisions regarding qualifications for founders of FLCs; however, the Establishment Regulations require that anyone who has been bankrupt or convicted of a crime of infamy may not be a founder of an FLC or own more than ten percent of the share of capital of an FLC.64 While the provisions of the TCC on minority shareholders are applicable to an FLC, the Establishment Regulations’ restrictions on founders are also relevant to minority shareholders.65

2. Structure

An FLC is divided into and run by three “organs:” the general assembly, the board of directors, and the auditors. This tripartite system has been sanctioned by the LCFL and is based on the system by which joint-stock companies in general are established and run under the TCC. Unlike the TCC provisions, which set the minimum number of directors at three,66 the Establishment Regulations set the minimum number of di-

59. See LCFL, supra note 1, arts. 10-11.
60. See Turkish Commercial Code, Law No. 6762, Turkish Official Gazette No. 9353 (June 9, 1956) at art. 279 [hereinafter TCC].
61. See TCC, supra note 60, art. 299.
62. See id. art. 300.
63. See LCFL, supra note 1, art. 10, ¶ 2; Law 6224, supra note 17; Framework Decree, supra note 17; Comm. 1, supra note 17.
64. See Establishment Regulations, supra note 3, art. 3.
66. See TCC, supra note 60, art. 312.
rectors at five. The General Manager, or in his absence, the Assistant General Manager, is an ex-officio member of the board of directors.

There are some qualifications which the General Manager and his Assistant must satisfy. Both must possess a higher education in law, business management, engineering, finance, or banking, and must be well-versed and experienced in their respective fields. The General Managers and the Deputy General Managers of Branches must meet the same requirements. In addition to the presence of the General Manager, the Establishment Regulations state that a representative of the Ministry must be present at each general assembly meeting of the FLC and must sign the minutes of the meeting. Similarly, according to the TCC, a representative of the Ministry of Industry and Commerce must also be present at these meetings and must sign the minutes.

The Establishment Regulations require that FLCs elect at least two internal auditors. These auditors must have a university degree and knowledge and experience in economics, law, or finance. As an organ of the company, these auditors must evaluate company activities in accordance with the LCFL and the TCC, and must give reports at the general assembly meetings. These reports then must be submitted to the Ministry with the minutes of the meeting. In addition, the Establishment Regulations authorize certified bank auditors and their deputies to analyze the financial structure of the FLC and to investigate its compliance with the LCFL, the TCC, and other relevant regulations.

Under the terms of the Establishment Regulations, FLCs are obliged to prepare their accounts, annual balance sheets, and profit-and-loss accounts in accordance with standards prepared by the Ministry. These standards require the FLC to submit to the Ministry, Ministry of Industry and Commerce, and Central Bank copies of its balance sheets and profit-and-loss accounts, as approved by auditors, accompanied by reports from those auditors and from the board of directors. FLCs have one month following their general assembly meetings to submit these materials to the various government agencies.

In addition, an FLC must report to the Under-Secretariat for the Treasury and Foreign Trade ("Treasury") regularly. For example,
each FLC must report, within twenty days after preparation, the following documents: quarterly statements of accounts prepared as of the end of each March, June, September, and December, with a form provided by the Ministry; tables prepared at the end of each March, June, September, and December showing rentals to the lessor's subsidiaries, officers, shareholders, and subsidiaries of shareholders; a reporting form for each finance lease; documents showing payments with respect to cross-border operations; and any other documents or information requested by the Treasury.81

3. Loan Payment Limits

Because the character of an FLC resembles a financial institution, the Limitations Regulations promulgated under the LCFL place several restrictions on leasing activities. These limitations, directed toward the institution's equity, are similar to those in Article 38 of the Banking Law. Under these regulations, the lessor's equity must consist of the total paid-in capital or total capital allocated to the Turkish branch office plus reserves minus the lessor's loss.82 In addition, the Limitation Regulations prohibit lessors from incurring a debt more than fifteen times its equity.83 Finally, the regulations prescribe the maximum amount of rental due under the lease.84

V. FINANCIAL LEASE CONTRACTS

Generally, a financial lease contract ("Contract") is a contract in which a financial leasing institution finances the procurement of goods and leaves the utilization and full exploitation of the goods to the lessee.85 Any property may be the subject of a Contract except "intellectual property or industrial rights such as patents."86 The lessor's investment plus interest is returned to him in the form of rent. A Contract is only valid if it is notarized.87

A Contract has a minimum term of four years and may not be terminated during that term by either party.88 There are, however, exceptions to this no-termination rule. For example, the LCFL allows termination where the lessee defaults on payment of the rent or where one party violates the agreement and as a consequence the other no longer wishes to maintain the contractual obligation.89 In addition, the Limitations Regulations allow a term shorter than four years in cases involving goods

81. See id.
82. See Limitations Regulations, supra note 3, art. 2, ¶ 2.
83. See id. art. 2, ¶ 1.
84. See id. art. 4, ¶ 1.
85. See LCFL, supra note 1, arts. 4 & 13, ¶ 1.
86. Id. art. 5.
87. See id. art. 8.
88. See id. art. 7.
89. See id. art. 23.
with a useful life of less than four years due to their technical characteristics, goods which are the subject of a new Contract that is the sequel to a previous Contract, and goods lost due to reasons such as war, fire, or an act of God.90

The LCFL contains a general provision relating to the distribution of rent payments during the Contract term.91 Generally, distribution of rent depends on the character of the business and the payment capacity of the lessee. In practice, large rents are collected in the first two or three years and smaller rents are left to the final years. The Ministry applies international standards when ascertaining the amount of rent and distribution of the rent for goods such as aircrafts.

A purchasing option may be granted to the lessee, but this is not an essential feature of the Contract.92 In order for the lessee to have the option of purchasing the goods at the end of the term, it is a practice in Turkey to require the non-cancelable period of a cross-border lease to be four years and, in some cases, the present value of the minimum lease payment to be more than or equal to ninety percent of the fair market value of the lease equipment. It is also a practice of the Ministry to require the inclusion of a purchasing option in a contract for cross-border operations involving goods such as aircrafts, ships, or large computers. The purchase price depends on the total amount of the rent or the total number of rentals.

The LCFL contains various registration requirements for financial lease contracts. Contracts relating to real property must be registered in the Land Registry; those relating to ships must be registered in the Ship Registry; and those concerning movable property must be registered in a notarized log at the lessee’s place of domicile.93 The registration requirements aim to prevent any claims of good faith by the third parties and to protect the public interest.94

A. Obligations of the Lessor

It is the lessor’s obligation to procure the goods that are the subject of the finance lease.95 This obligation involves providing financing, concluding an agreement with the supplier or producer, and effecting the payment in compliance with the Contract.96 The lessor completes these

90. See Limitations Regulations, supra note 3, art. 1.
91. See LCFL, supra note 1, art. 6.
92. See id. art. 9.
93. See id. art. 8, ¶ 1.
95. See LCFL, supra note 1, art. 4.
96. See id. art. 16.
obligations so that the supplier or producer can punctually deliver the goods to the lessee in accordance with the Contract. Unlike the laws of many countries, Turkish law has taken into consideration the fact that the lessor is involved in the leasing transaction solely to finance the investment, and has protected him accordingly. It does not hold the lessor liable for any delay or failure in delivery for reasons attributable to the supplier or producer. Instead of requiring the lessor to deliver goods to the lessee after the lessor receives them from the supplier or producer, the supplier or producer delivers the goods directly to the lessee. Upon delivery, if the Contract does not already confer the lessee with authority, the lessee acts as the representative of the lessor to receive the goods directly.

Once he has possession, unless the Contract contains a provision to the contrary, the lessor may not transfer the goods to third parties. If the Contract grants a right of transfer to the lessor, the goods may only be transferred to another financial leasing institution. If transfer rules are violated, the third party may not claim any right against the lessee, and the lessor must indemnify the lessee for any loss suffered because of the illegal transfer.

Under the LCFL, the lessor is obliged to insure the goods for the term of the Contract. Premiums, however, are paid by the lessee. If the lessor fails to obtain insurance coverage for the goods, the indemnity that would have been received had there been insurance will be deducted from the loss incurred. The lessee remains liable only for the difference. The parties may agree to place on the lessee the responsibility of obtaining insurance. Nevertheless, the lessee is strictly liable for any loss of or damage to the goods. Thus, the lessee has an incentive to secure a separate insurance policy if the lessor has obtained insurance that is insufficient to meet perceived risks.

While either the lessor or the lessee may be the beneficiary of the insurance policy, the practice of the international leasing industry is to name the lessee as the beneficiary. In either case, unless the Contract contains a provision to the contrary, any indemnity received must be spent for repair or renewal because the damage and loss do not terminate the Contract. On the contrary, the LCFL explicitly provides that the Contract continues to be valid until the goods are repaired or renewed.

Since the lessee is responsible for making the repairs, it is more appropriate to have him as the beneficiary. The obligation to obtain insurance for the goods and the ability to use the goods as collateral both provide

97. See id.
98. See id. art. 18, ¶ 1.
99. See id. art. 18, ¶ 2.
100. See id. arts. 14 & 17.
101. See id. art. 17.
102. See id. art. 14.
103. See Altop, supra note 94, at 177.
104. See LCFL, supra note 1, art. 14.
protection for the lessor in case the lessee is financially incapable of repairing the damage.

B. Obligations of the Lessee

The lessee's primary obligation is to pay rent on the dates and at the location designated in the Contract. In the absence of a specific clause in the Contract, rent is to be paid at the lessee's domicile. This payment obligation is subject to a statute of limitations of ten years. Failure to perform this obligation gives the lessor the right to terminate the Contract. Frequently, Contracts provide that if the elements factored into calculation of the rent undergo change during the term of the Contract, any adverse effects will be borne by the lessee. Such clauses are valid, and they protect the lessor from currency fluctuations and from increases in refinancing costs, taxes, and charges.

The lessee also is obliged to use the goods with care. This obligation means that the goods may not be used other than for their intended purpose, that their needs for repair and maintenance must not be disregarded, that alterations to the goods may not remain after the expiration of the Contract, that only original-manufacturer spare parts may be used on the goods, and that additions should not be made to the goods.

The LCFL provides generally that, unless otherwise stipulated in the Contract, the lessee is responsible for maintaining and protecting the goods and must bear the cost of any kind of maintenance and repair. If the goods are damaged because of the lessee's fault, the lessor may demand compensation and may be able to terminate the Contract if the damage is so severe that the lessor should no longer be expected to uphold the Contract.

Holding the lessee liable in cash for loss or damage in the absence of fault is an exception to Article 117.2 of the TCO, but this exception is proper because it protects the lessor, who provided the financing. This heavy burden imposed on the lessee also is mitigated by the lessor's obligation to obtain insurance, by the LCFL's principle of limited liability, and by the fact that the LCFL gives priority to the repair or renewal of the goods and to centimation of the fulfillment of the contract.

105. See id. arts. 4 & 6.
106. See TCO, supra note 6, art. 127.
107. See LCFL, supra note 1, art. 23.
108. See id. art. 13, ¶ 2.
109. See id.
110. See id.
111. See id. art. 23, ¶ 3.
112. See id. art. 14.
113. See id.
C. Consequences of Bankruptcy and Attachment Procedures

There are provisions in the LCFL protecting the lessor if the lessee becomes bankrupt or the lessee’s creditors attach the goods. The lessee is similarly protected from the lessor’s creditors and insolvency. Turkish and foreign academic texts point out that these provisions, which are unique to the Turkish legislation, will contribute to the development of the leasing industry in Turkey.

Generally, when a corporation or a merchant in Turkey is bankrupt, the creditors of that corporation form a committee called a Board of Bankruptcy (“Board”) to manage and distribute the assets of the corporation and to decide whether the goods should be exempt for the bankruptcy estate. Instead of putting in a claim with the Board and waiting approximately seven months to gain possession of the lease property, the lessor is allowed to petition the Executive Officer for a segregation. By petitioning the Executive Officer, the lessor can quickly regain possession of the lease goods to which he has legal title.

Third parties may object to the Executive Officer’s segregation of the lease goods, but must do so within seven days of the decision. The Bailiff’s Court subsequently must issue a decision on such an objection within one month. These provisions of the LCFL are a significant protection of lessors and are unique to Turkish leasing law.

Lessors are similarly protected in attachment procedures. In an attachment procedure, a lien is applied to the lessee’s property and the Contract is presented to an Executive Officer who decides whether the goods should be exempt from attachment. Third parties and parties to the Contract may object to the Executive Officer’s decision within one week after the decision is made. Like an objection in a bankruptcy context, the Bailiff’s Court must rule on the objection within one month of its assertion.

D. Termination and Rescission of Contract

1. Reasons for and Causes of Termination

A Contract may come to an end by automatic termination, by termination by lessor for non-payment of rent, by termination for material breach by one of the parties, by mutual consent, by specific methods listed in the Contract, by miscellaneous prescribed reasons, or by rescission. Parties injured by the first six types of termination receive, in

114. See id. art. 19.
115. See id. art. 20.
116. See id. art. 19.
117. See LCFL, supra note 1, art. 19, ¶ 1.
118. See id. art. 19, ¶ 3.
119. See id. arts. 19 & 20.
120. See id. art. 19.
121. See id. arts. 21-23.
principle, expectation interest, while the party injured by rescission of the Contract only receives reliance interest.

The Contract ends automatically at the completion of the agreed term. Generally, silence of the parties at the end of the lease term does not renew or extend the Contract even if the parties continue to behave as if the Contract was still in force. However, the parties may agree that silence will extend or renew a Contract by an express provision in the Contract that describes the consequences of renewal or extension. If the Contract does not contain an explicit provision renewing or extending its term, the parties may agree to amend existing provisions in the Contract to effectuate an extension or renewal of the Contract. In any case, requests to extend the Contract term must be made three months before the Contract is due to terminate.

Silence by the receiver of a request to extend the Contract for the suggested term with suggested provisions extends the Contract pursuant to the request. Because the new Contract does not contain an element of financing, it is no longer a finance lease—rather, it is considered a hire contract.

Lessors have the right to terminate the Contract for nonpayment of rent, but may waive this right or attach certain restrictions to this right by inserting provisions into the Contract. If the lessee defaults on the rent payment, the lessor need not prove that there has been a material breach of the Contract because rent is a material obligation under the LCFL. In addition, if the lessee fails to pay promptly, he has defaulted according to the TCO. Lessees are permitted a thirty-day grace period after the rent is due to meet their rent obligations. If the lessee has a purchase option, he should be given sixty days. Since the consequences of failing to pay rent during this period are extremely serious, the law provides that the period commences after the initial default. If the Contract provides for a purchasing option, the lessor may

122. See id. art. 21.
123. See id.
124. See id.
125. See id.
126. See TCO, supra note 6, arts. 248-69; Kuntalp, supra note 94, at 91.
127. See LCFL, supra note 1, art. 23.
129. Article 107 of the TCO does not require notice of a time limit for subsequent performance if the agreement evinced the parties' intention to effectuate performance punctually on a fixed date or within a certain period. Otherwise, the lessor would be obliged to serve a notice of default each time payment was overdue. Under the TCC, final notice of default should be served according to the prescribed manner. Notice between merchants for purpose of terminating the contract must be served either by the notary or by registered letter with acknowledgment of receipt or by cable in order to be valid. See TCC, supra note 60, art. 20, ¶ 3.
130. See LCFL, supra note 1, art. 23, ¶ 1.
131. See id. art. 23, ¶ 2.
132. See TCC, supra note 60, art. 407. But see Altop, supra note 94, at 269; Yavuz, supra note 94, at 349-50.
not terminate the Contract until sixty days after the rent fell due.\textsuperscript{133}

Although the LCFL enables the lessor to terminate the contract in the event that the lessee defaults for nonpayment of rent, it has not overruled Article 107 of the TCO. This Article provides that if the lessee defaults within the specified time limit, the creditor has the option of suing for specific performance and damages for delay, or foregoing subsequent performance. If he chooses the latter, the creditor must provide immediate notice of his intent to do so. Then he may either claim damages for nonperformance or withdraw from the Contract.

The LCFL also recognizes the right to terminate the Contract for a material breach.\textsuperscript{134} A material breach is one that creates a situation so intolerable that the innocent party cannot be expected to continue performing the Contract.\textsuperscript{135} The parties may agree to include a \textit{clausula rebus sic stantibus}, but even if this is not done, where a change in existing circumstances would result in the economic collapse of a party, that party may terminate the Contract. The rationale for this rule is that the foundation of the Contract has collapsed.

Parties may terminate a contract by mutual consent. In this instance, the party who benefits from incentives will bear penalties that accrue due to the early termination. Similarly, parties may list in the Contract certain events which will terminate it. The realization of any one of these events will cause the Contract to end.

The LCFL contains a catch-all provision, listing miscellaneous ways a Contract may be terminated. Some of these miscellaneous reasons for termination include dissolution of a corporate lessor or lessee, bankruptcy of the lessee, winding up of a corporate lessee, ineffective levy of an execution process against the lessee's property, death of the lessee, or the lessee's loss of capacity to do business.\textsuperscript{136}

These reasons for terminating the contract have special characteristics.\textsuperscript{137} For example, where either the lessor or the lessee is a business, a contractual provision may be inserted to the effect that the Contract will not terminate immediately upon dissolution of the corporate body. However, once dissolution is completed and the financial leasing organization's title is removed from the Commercial Register, the Contract is terminated because one of the parties no longer exists. Similarly, while bankruptcy of a company usually terminates a Contract,\textsuperscript{138} the LCFL treats the parties as individual persons in its provisions addressing bankruptcy as a reason for termination. Nevertheless, the Contract may state that bankruptcy of one of the parties does not terminate the Contract.

Finally, Article 106 of TCO enables the lessee to rescind the Contract

\begin{itemize}
\item \textsuperscript{133} See Altop, \textit{supra} note 94, at 269.
\item \textsuperscript{134} See LCFL, \textit{supra} note 1, art. 23, \textit{f} 2.
\item \textsuperscript{135} See \textit{id}.
\item \textsuperscript{136} See \textit{id} art. 22.
\item \textsuperscript{137} See Altop, \textit{supra} note 94, at 263-70; Kuntalp, \textit{supra} note 94, at 91-92.
\item \textsuperscript{138} See TCC, \textit{supra} note 60, arts. 185, 267, 434.8, 476, 549, \textit{f} 3.
\end{itemize}
if the lessor does not, for reasons attributable to him, fulfill the transaction with the lessee’s chosen producer or supplier as provided for in the Contract. The lessee also may rescind if the lessor fails to make payments required by the Contract or if the goods are not delivered to the lessee.

2. Consequences of Termination

All terminations require the lease goods to be returned to the lessor, unless the lessee exercises the option to repurchase the goods or automatically obtain ownership of the goods at the expiration of the term. In the event that the lessee fails to return the goods, the lessor is left without a remedy. Neither the LCFL nor the Law on Execution and Bankruptcy No. 2004 contains provisions for recovering the goods through the Bailiff’s Court. This problem, which becomes particularly important when the Contract comes to an end through premature termination, merits a solution.

Upon termination of the Contract, the lessee also is obliged to pay the rents which have not yet become due and to cover the lessor’s loss in excess of this amount. After recovering the goods, the lessor may either sell them or use them to conclude another financial leasing agreement. When a Contract is terminated in accordance with Article 22 of the LCFL, the LCFL does not address the question of whether the breaching party must indemnify the other party’s loss. If the fault of one of the parties caused the termination of the Contract, however, the other party may demand compensation for any loss he suffered as a result. Otherwise, the innocent party will bear the loss.

CONCLUSION

Turkey’s financial leasing industry, regulated primarily by the LCFL, is still quite new. Yet, despite several kinks in the law that must be addressed to advance the goals of the statute, the industry’s rapid growth since the LCFL’s enactment indicates that the statute is off to a very successful start.

139. See LCFL, supra note 1, art. 16.
140. See id. art. 24.
141. See id. art. 25; Kuntalp, supra note 94, at 98-99. Some academics, however, state that the parties may provide for other obligations in the contract. See Altop, supra note 94, at 276; Köteli, Leasing Sözleşmeleri [Financial Lease Contracts] 190 (1986).