

# Security Over Movable Property – New Perspectives for Borrowers and Creditors



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Long-awaited Law on Security over Movable Property has been finally adopted. So why it was adopted and how your business may benefit from it either as a borrower or a creditor? Businesses operating in Azerbaijan often encounter issues in attracting funds for financing their projects. In particular, not always businesses are able to satisfy requirements of their creditors, which prefer solid and liquid security instruments to reduce their risks associated with lending. Borrowers may be more interested to offer their immovable property or movable property, including equipment or other goods they possess or intend to purchase with the borrowed funds as collateral for their borrowings. However, in the absence of the registry of security interests over movable property, lenders may not be eager to accept movable property as a security due to higher transactional risks associated with the lack of the efficient mechanism for tracking pledged movable property and enforcement of their security interest over movable property. With the introduction of this new Law, legislators establish a new set of rules on creation and perfection of a security interest over movable property, state registration of a security interest over movable property and procedures for enforcement of security interest over movable property under Azerbaijani legislation. By thoroughly regulating the rules with respect to a security interest over movable property, the Law is quite important in terms of interests of borrowers, security providers and creditors.

The Law is expected to encourage businesses to use movable property more actively as a security for attracting and providing funds. To put it another way, creditors should be satisfied with minimizing the level of their financial risks by perfection of their security interest over movable property. Furthermore,

creditors will have more visibility and transparency in respect of liens and other interests imposed on movable property of borrowers and security providers. This eventually should lead to more favorable terms and conditions (e.g. lower interest rates) for borrowers and create more reliable business environment in general.

## Objects of Security Interest

A security interest over (i) movable property, including movable property to be owned by a borrower in the future and (ii) rights and claims fall under the scope of the Law. Having said that, the rules established by the Law do not apply to a security interest over movable property (e.g. vehicle, vessel, aircraft, etc.) and securities (e.g. participatory interest, share, bond, etc.) which are subject to the state registration.

The following types of a security interest over movable property are available:

- (i) State and Municipal – for example, issuance of an order to a bank by a tax authority for transfer or freezing of funds from a taxpayer's bank account or seizure of taxpayer's property to ensure payment of tax debts, an accrued interest and financial sanctions; receipt of security by customs officers for both an existing and future customs debt; imposition of temporary restrictive measures on movable property by courts; and
- (ii) Private – for example, a contractual pledge and a usufruct over movable property; lease of movable property; lessor and lessee's right of pledge.

## Perfect Your Security Interest

Principally, the Law can be characterized with the mechanism for perfection of a security interest over movable property. Perfection of a security interest evidences registration of a security interest with the appropriate state authority and thus, the perfected security interest becomes protected from and effective against third-party claims. Such perfection shall be realized through the State Registry of a Security Interest over Movable Property (hereinafter the "State Registry") managed by the Chamber of Control over Financial Markets. The



State Registry will not serve only for perfection of a security interest over movable property, but also for registration of amendments to a security interest, objection to a security interest and termination of a security interest. The rules on registration of a security interest are yet to be prepared and introduced by the Cabinet of Ministers of Azerbaijan.

Under the new Law creditors are provided with an opportunity to advance their rights in the order of priority for payment of claims by disclosing the security interest over movable property to third parties either by registering such security interest in the State Registry, or by acquiring right of possession or obtaining control over the subject of a security interest. Disclosure of the state and municipal categories of a security interest is mandatory. Hence, private businesses should be able to inquire whether movable property (e.g. equipment, tools) owned by their current or potential business partners or borrowers are subject to any state lien or whether any court injunction is ordered in their respect.

Notably, creditors that hold a security interest over movable property created prior to the effective date of the Law will also enjoy the right of perfection of such security interest. They are entitled to register their security interest created prior to the effective date of this Law with the State Registry within 9 (nine) months from the date once the State Registry becomes operative in order to claim priority from the original date of creation of the security interest. Such creditors are not to be required to obtain a prior consent of security providers and the notification of security providers will be sufficient for registration purposes.

## Prioritize Your Claim

The Law also establishes the order of priority for payment of creditors' claims if a movable property is subject to several security interests. Creditors could prioritize their claims against the claims of other creditors by disclosing their security interest through one of the above described methods. Correspondingly, the claim of creditor who has first disclosed the relevant security interest shall be paid first.<sup>1</sup> Such disclosure opportunity is prerequisite for creditors to have priority over the claims of other creditors.

However, irrespective of whether the above disclosure has been made or not, the Law privileges certain categories of creditors. For example, when subject of security interest is acquired with the proceeds of creditor's funds, a claim of such creditor shall prevail over the claims of other creditors, subject to certain requirements to be complied with under the Law.

## Publicity of Security Interest

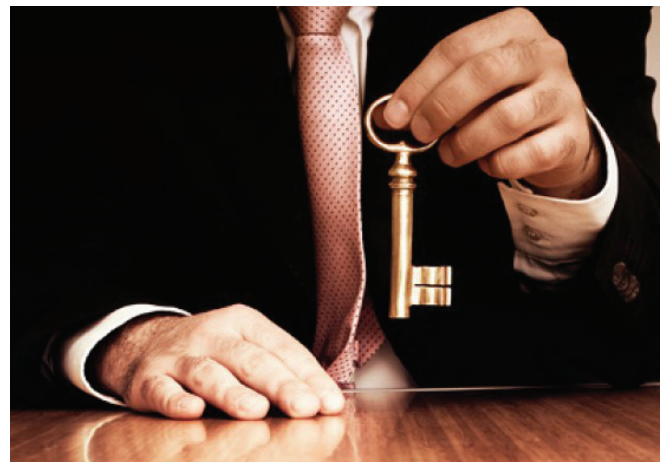
The State Registry will provide public search engine, which will enable creditors to determine whether the particular property is already subject to a security interest. Information contained in the State Registry can be accessed both in electronic and paper-based forms. This feature will enable the State Registry to become an effective risk management tool for businesses.

1. Notwithstanding the above, when subject of security interest is funds from the bank account, the order of priority for payment of creditors' claims shall be paid as envisaged by Article 965 of the Civil Code.

## Cautions and Recommendations

Despite benefits and opportunities the Law provides, certain provisions of the Law should be carefully considered by borrowers, security providers and creditors. For example, it is not clear from the Law whether creditors should obtain security provider's consent prior to entering into intercreditor's agreement for the change of the order of priority for payment of claims. Such provision constitutes a risk in terms of security providers' interests and may lead to the objection of security providers, especially when security providers are not borrowers. To avoid such risk creditors may consider obtaining the security provider's consent (i.e. by making the security provider a party to the relevant agreement) for such change.

The rules on the registration of security interest notices have not been introduced and the State Registry has not become operational yet. Therefore, practical aspects of the registration process are unpredictable. Furthermore, it is not clear yet, whether additional requirements will be imposed with respect to execution of pledge agreements or upload of additional paperwork will be required for the said registration.



### Authors' biography

**Mr. Kamil Valiyev** is a partner with MGB Law Offices. His practice primarily focuses on energy and infrastructure projects and he extensively advises local and international clientele on project development and financing. He holds the Master of Laws degree from the University of New Hampshire School of Law and the Bachelor of Law degree from the Baku State University.

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