Restrictions on Use of Foreign Currencies in Certain Agreements between Turkish Residents

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The Presidential Decree dated September 12, 2018, on the Amendment of Decree No. 32 on the Protection of the Value of the Turkish Lira ("***New Decree***"), introduced significant restrictions on the use of foreign currencies in certain agreements between Turkish residents. Below, we explain the scope of the New Decree and discuss possible issues and problems that may arise in relation to the implementation of the New Decree. We also assess the potential effects of the Communiqué (2018/32-51) on the Amendment of the Communiqué on Decree No. 32 on the Protection of the Value of the Turkish Lira (2008/32-34) ("***Communiqué***"), which was published in the Official Gazette on October 6, 2018, and lists the exceptions to the restrictions imposed by the New Decree.

1. What Does the New Decree Bring?

With the New Decree, the following paragraph was added to Article 4 of Decree No. 32 on the Protection of the Value of the Turkish Lira ("***Decree No. 32***"), which regulates foreign currency transactions in Turkey:

"*Except under certain circumstances to be specified by the Ministry [of Treasury and Finance], contract prices and other payment obligations in sales agreements for movables and immovables, lease agreements for movables and immovables, including vehicle leases and financial leasing agreements, leasing agreements, employment agreements, service agreements, and contracts for work between Turkish residents cannot be determined in a foreign currency or indexed to a foreign currency.*"

Moreover, the following provisional article (Article 8) has been added to the Decree No. 32 with the New Decree:

"*Except under certain circumstances to be specified by the Ministry [of Treasury and Finance], contract prices that were denominated in a foreign currency in agreements that were executed prior to this Decree and that are subject to Article 4(g) of this Decree shall be re-determined by*

the parties in Turkish currency within thirty days as of the date on which Article 4(g) of this Decree comes into force."

Therefore, the New Decree has not only imposed significant restrictions on the use of foreign currencies in certain agreements to be executed between Turkish residents in the future, but it has also imposed an obligation to revise contract prices and re-determine them in Turkish Liras for certain agreements that had already been executed before the announcement of the New Decree.

2. Agreements Falling into the Scope of the New Decree and the Communiqué

As the New Decree imposes significant restrictions on the use of foreign currencies in certain agreements, it is of paramount importance to first determine which agreements fall within its scope. The New Decree only provides a general list of several types of agreements that are covered by the new rules and authorizes the Ministry of Treasury and Finance ("***Ministry***") to specify exemptions to the New Decree. Accordingly, the Communiqué published on October 6, 2018, which provides detailed provisions on this front, must also be taken into consideration while examining the scope of the New Decree.

2.1. Turkish Residency Requirement

The first and most fundamental precondition for an agreement to be covered by the New Decree is that both parties to the agreement must be "resident in Turkey." Therefore, an agreement may only fall within the scope of the New Decree if it is executed between real and/or legal persons resident in Turkey.

As per Article 2(b) of the Decree No. 32, "*persons resident in Turkey*" means real or legal persons who have legal residency in Turkey, including Turkish citizens that are working abroad as employees, self-employed persons or private business owners who maintain a legal residence in Turkey. Pursuant to this definition, Turkish citizens and foreigners who are legally resident in Turkey and companies that are established in Turkey are deemed as "persons resident in Turkey" for the purposes of the New Decree.

Pursuant to the Communiqué, foreign branches, representatives, offices, and liaison offices of persons resident in Turkey, funds established abroad that are operated or managed by persons resident in Turkey, and companies established abroad whose majority shares (50% or more) are owned by persons resident in Turkey, and foreign companies that are directly or indirectly owned by persons resident in Turkey are also considered and treated as "resident in Turkey" in terms of the New Decree and the Communiqué.

The Communiqué provides a number of exceptions in terms of the residency requirement for certain individuals, institutions, and types of agreements. For instance, there are specific exclusions for public institutions and companies belonging to Turkish Armed Forces Foundation. Moreover, the Communiqué provides certain exemptions for contractors who carry out work related to the performance of agreements executed by public institutions in foreign currencies. Another significant exception is provided for banks with regard to the agreements that they have concluded in relation to the Law No. 4749 on Public Finance and Debt Management. Commercial airlines, companies providing technical maintenance services to airplanes or for their motors and other components, as well as companies delivering ground services at airports and their affiliates are also allowed to conclude and carry out certain agreements in foreign currencies.

Other particular circumstances, in which certain real or legal persons are exempted from the currency restrictions provided in the New Decree and the Communiqué, are discussed under the relevant sections below.

Pursuant to the Communiqué, if parties who are exempted from the scope of the New Decree nevertheless mutually agree to conclude an agreement in Turkish currency or to re-determine a contract price for an agreement that was previously concluded in a foreign currency (despite being entitled to continue using foreign currencies in their agreements according to the Communiqué), such contract prices must still be re-determined and converted into Turkish currency.

Therefore, all existing agreements must be carefully examined in terms of the residency status of the contracting parties, in order to determine whether they are covered by and subject to the New Decree.

2.2. Types of Agreements Specified by the New Decree and the Communiqué

As indicated above, *(i)* sales agreements for movables and immovables, *(ii)* rental agreements for movables and immovables, including vehicle rents and financial leasing agreements, *(iii)* leasing agreements, *(iv)* employment agreements, *(v)* service agreements, and *(vi)* contracts for work all fall within the scope of the New Decree. That being said, the Communiqué provides a number of exemptions and exceptions for certain agreement types and puts these kinds of agreements out of the purview of the New Decree. We will further elaborate on these exemptions below.

2.2.1. Sales Agreements for Movable and Immovable Properties

The New Decree covers sales agreements for movable and immovable properties. However, the Communiqué makes a critical distinction between the sale of movables and immovables. Accordingly, contract prices and other payment obligations arising from sales agreements for immovables located in Turkey including free zones (including residences and roofed workplaces) executed between Turkish residents cannot be determined in a foreign currency or be indexed to a foreign currency. On the other hand, contract prices and other payment obligations arising from sales agreements between Turkish residents for movables other than vehicles (including construction equipment and work machinery) are allowed to be determined in a foreign currency or indexed to a foreign currency.

At this point, it would be beneficial to elaborate on what is considered as "movable" and "immovable" property in Turkey. Under Turkish law, land, independent and continuous rights that can be registered in a land registry, and real estate that can be recorded on an applicable land registry are categorized as "immovable." As a rule, all types of property that fall outside the scope of the "immovable" category are considered as "movable" property. For instance, anything that can be moved from one place to another, as well as natural resources such as electricity and natural gas, receivables, industrial property rights, agreements regarding economic rights, and all vessels (regardless of whether or not they are registered) are considered as "movables" under Turkish law. Furthermore, these definitions and classifications are also applicable to other types of agreements, as will be explained below.

Therefore, we note that, as a general rule, the New Decree prohibits the use of foreign currencies with respect to the sales of immovable properties, while it is permitted for the sales of movables, except for vehicles (including construction equipment and work machinery).

2.2.2. Rental Agreements and Leasing Agreements

As explained above, rental agreements for movables and immovables, including vehicle rents and financial leasing contracts, and leasing agreements are covered by and subject to the New Decree. The Communiqué sets forth rules in more detail regarding such lease and rent agreements.

Just like in sales agreements, the Communiqué makes a crucial distinction between rental agreements for movables and immovables. Although contract prices and other payment obligations in rental agreements for immovables located in Turkey including free zones (including residences and roofed workplaces) executed between Turkish residents cannot be

determined in foreign currencies or be indexed to foreign currencies, this restriction does not apply to rental agreements for movables, except for vehicles (including construction equipment and work machinery).

There are other exemptions and exclusions stipulated in the Communiqué with respect to leasing and financial leasing agreements for vessels, as well as for financial leasing agreements that fall under the scope of Articles 17 and 17(A) of the Decree No. 32. These agreements generally concern loans obtained from domestic and foreign sources. Accordingly, foreign currencies can continue to be used in such agreements under the New Decree.

2.2.3. Employment Agreements

As a general rule, employment agreements fall within the scope of the New Decree and are subject to its restrictions with respect to the use of foreign currencies. However, there are certain exceptions provided by the Communiqué with regard to employment agreements.

Firstly, contract prices and other payment obligations arising from employment agreements between Turkish residents cannot be denominated in a foreign currency or be indexed to a foreign currency. However, this rule does not apply if the work subject to the employment agreement will be performed outside of Turkey.

Secondly, employment agreements that are concluded by individuals who are not Turkish citizens, but who are Turkish residents, are also deemed to fall outside the scope of the New Decree. Therefore, contract prices and other payment obligations in such employment agreements executed with Turkish non-citizen residents can be determined in a foreign currency or be indexed to a foreign currency.

Thirdly, contract prices and other payment obligations arising from employment agreements executed by branches, representatives, offices, and liaison offices of those parties residing abroad, by companies whose majority shares (50% or more) are owned by persons residing abroad, and by companies operating in free trade zones, can be determined in a foreign currency or be indexed to a foreign currency. In light of this exemption, we conclude that it will be possible to continue to use foreign currencies in employment agreements that are carried out between employees and subsidiaries, branches, offices or liaison offices of foreign companies.

2.2.4. Service Agreements

In accordance with the New Decree, the Communiqué prohibits the use of foreign currencies in service agreements, including consultancy, brokerage, and transportation and carriage agreements. However, there are four important exclusions provided by the Communiqué, stipulating the circumstances in which contract prices and other payment obligations can be determined in a foreign currency or be indexed to a foreign currency: *(i)* service agreements to be executed by persons who are not Turkish citizens, *(ii)* service agreements that are concluded for exports, transit trades, sales and deliveries that are deemed as exports, and services and activities that bring foreign currencies into Turkey, *(iii)* service agreements concluded with Turkish residents regarding activities to be conducted abroad, and *(iv)* service agreements between Turkish residents for electronic communications starting from Turkey and ending abroad or starting abroad and ending in Turkey.

Moreover, the final exemption provided for employment agreements is also deemed to be applicable to service agreements by the Communiqué. Accordingly, contract prices and other payment obligations in service agreements that are concluded by branches, representatives, offices, and liaison offices of parties residing abroad, by companies whose majority shares (50% or more) are owned by persons residing abroad, and by companies operating in free trade zones, can be determined in a foreign currency or be indexed to a foreign currency.

2.2.5. Contracts for Work

Pursuant to the Communiqué, agreements to produce a piece of work (*i.e.*, contracts for work) are also covered by the New Decree, with only one exception. This exception pertains to agreements to build vessels (which are legally deemed as contracts for work) as well their repair and maintenance, and asserts that such agreements will be excluded from the scope of the New Decree. Therefore, contract prices and other payment obligations arising from such vessel construction agreements can be determined in a foreign currency or be indexed to a foreign currency.

2.2.6. Other Exceptions

In addition to the exceptions provided above, the Communiqué also provides that foreign currency can be used in agreements related to sales, licensing and service agreements for software and hardware produced abroad as part of information technology.

Moreover, provided that the relevant provisions of Decree No. 32 are reserved, use of foreign currency in issuance, sales, and other transactions related to capital market instruments (including foreign capital market instruments, depositary receipts, and shares of foreign investment funds) based on Capital Markets Law No. 6362 and other related legislation is possible.

3. What is the Scope of "Indexing to a Foreign Currency"?

The New Decree introduces a prohibition against determining contract prices and other payment obligations arising from certain agreements in a foreign currency or indexing them to a foreign currency. As per the Communiqué, this means that negotiable instruments that are issued in relation to an agreement that is covered by the New Decree and the Communiqué cannot be drawn in a foreign currency or be indexed to a foreign currency either.

Furthermore, pursuant to the Communiqué, agreements indexed to the prices of precious metals or commodities, whose prices are determined in a foreign currency in the international markets and/or indirectly indexed to a foreign currency, are also considered as agreements in which prices are "indexed to a foreign currency." Therefore, the Communiqué expands the meaning of "indexing to a foreign currency" by specifically including the practice of indexing contract prices to the prices of precious metals or commodities in its scope.

4. Effects of the New Decree and the Communiqué on Existing Agreements

It is important to note that the New Decree and the Communiqué do not only impose restrictions on the use of foreign currencies in agreements to be concluded after the New Decree enters into force, but also require the amendment of existing agreements whose contract prices or other payment obligations were previously concluded in foreign currencies or indexed to foreign currencies. Accordingly, prices that were established in foreign currencies in certain existing agreements (as specified above) must also be re-determined by the parties in Turkish currency within thirty (30) days as of the date on which the New Decree enters into force, (*i.e.*, September 13, 2018). Therefore, such price re-determinations must be completed by October 13, 2018.

Agreements falling into the scope of the exclusions provided by the Communiqué, and which were concluded before the New Decree entered into force on September 13, 2018, are also exempt from the obligation to re-determine contract prices and other payment obligations in Turkish currency. Therefore, such agreements can continue to be executed *as is*, without having to re-determine contract prices and other payment obligations in Turkish currency.

However, it should be noted that there is one crucial exception to this rule. Although rental agreements for vehicles (including construction equipment and work machinery) are covered by the New Decree and should be subject to the rule regarding price re-determination in Turkish currency, the Communiqué indicates that rental agreements for vehicles (including construction equipment and work machinery) that were concluded before the New Decree entered into force are excluded from the price re-determination requirement. Therefore, rental agreements for vehicles (including construction equipment and work machinery) that were concluded before the New Decree entered into force can continue to be executed in a foreign currency, while rental agreements for vehicles (including construction equipment and work machinery) that are executed after the New Decree entered into force must use Turkish currency to determine contract prices and other payment obligations. The Communiqué is silent on the issue of whether it is possible to continue with the foreign currency after renewal of a rental agreement for vehicles (including construction equipment and work machinery) that were concluded before the New Decree entered into force. Considering that it is merely a time extension, not conclusion of a new agreement, it can be concluded that foreign currency can be used after the renewal too.

4.1. What Does "Re-Determination" Mean?

As indicated above, the New Decree and the Communiqué require the "*re-determination*" of contract prices and other payment liabilities in Turkish currency for certain agreements.

It is important to note that both the New Decree and the Communiqué refer to a process in which the "re-determination" is carried out by the parties to an agreement, without providing any further guidance or direction as to how such re-determinations should be carried out. Although, at first glance, one might reasonably assume that such re-determinations can/should be carried out by using the applicable exchange rates to convert prices, it would actually be a mistake to jump to this conclusion, as the New Decree and the Communiqué both refrain from using the term "conversion," possibly on purpose.

Therefore, it is possible to conclude that "re-determination by the parties" actually refers to the process of determining the contract price and other payment obligations in Turkish currency, which would presumably be undertaken by the parties as if they were concluding the agreement *for the first time*. This would surely involve a significant amount of re-negotiation between the parties and would require the mutual consent of both sides to the re-determined prices. At this point, the most vital question for practitioners is: What happens if the parties cannot agree on the re-determination of the contract price and other payment obligations in Turkish currency?

4.2. What Happens if the Parties to a Contract Cannot Agree on Price Re-Determination?

Unfortunately, the New Decree fails to provide any definitive answers with respect to the question of what happens if the parties to an existing contract cannot come to an agreement on re-determining the contract price and other payment obligations in Turkish currency.

The New Decree's silence on this crucial issue has raised serious concerns among scholars, legal practitioners, and in judicial and business circles, as this omission has caused a significant amount of legal and commercial uncertainty. However, the Communiqué has provided some clarity on this point by establishing a reference date for the currency exchange rates that must be used in cases of disagreement on price re-determination.

Accordingly, if the parties to an existing contract cannot come to an agreement on re-determining the contract price and other payment obligations in Turkish currency, then the Turkish Central Bank's effective foreign currency exchange rates for January 2, 2018 (1 USD = 3.7776 TL and 1 EUR = 4.5525 TL) must be used for agreements in re-determination of the contract price and other payment obligations in Turkish currency. But the monthly consumer price index rate (as determined by the Turkish Statistical Institute) from January 2, 2018, until the date of re-determining, must be applied to the amount calculated by using the relevant exchange rate in order to calculate the final amount.

In terms of rental agreements for residences and roofed workplaces, the Communiqué provides that the re-determination must be carried out for two (2) years. In case of dispute regarding the contract price for the next rental term, the consumer price index rate (as determined by the Turkish Statistical Institute) must be applied to the last amount that was determined in Turkish currency, and the increase will be as such the end of the two-year period. Consequently, this means that the re-determined Turkish currency contract price shall remain for two years as of re-determination and after that period, the agreement can revert back to foreign currency. But this is the case only for rental agreement for residences and roofed workplaces concluded before the New Decree.

On a last note, it is important to highlight that the obligation for re-determination does not apply to receivables already collected or receivables that are due but not collected.

4.3. Is Termination of an Existing Agreement an Option for the Parties?

If one of the parties to an existing agreement covered by the New Decree does not wish to continue with the agreement due to the requirement of re-determining the contract price and

other payment obligations in Turkish currency, does that party have the right to terminate the agreement without being exposed to any potential legal consequences? Regrettably, neither the New Decree nor the Communiqué provides a clear answer to this critical question.

The party who would prefer not to continue with the agreement in light of the price re-determination requirement should theoretically be allowed to argue that an obligation to amend the contract price arose after the agreement was executed and that it would be unfair to oblige the party to continue honoring such an agreement. This party could reasonably contend that an essential element of the agreement was changed without its consent after the agreement was concluded, since contract price is a fundamental and objective component of any agreement. On the other hand, the counterparty may also easily claim that the party wishing to terminate the agreement is using the New Decree as an excuse to wriggle out of the contract and avoid its obligations thereunder, which would basically constitute an "abuse of right" claim. Therefore, we can expect that commercial and legal disputes will arise with respect to this issue, and such claims and counterclaims will be brought before the courts in these types of contract termination cases.

As both the New Decree and the Communiqué are silent on whether parties to an existing agreement are entitled to terminate such agreements due to the newly introduced obligation of price re-determination in Turkish currency, the legal uncertainty on this front continues.

5. Possible Sanctions in Case of Non-Compliance with the New Decree and the Communiqué

The New Decree was promulgated by the President as per Article 1 of the Law No. 1567 on the Protection of the Value of the Turkish Lira ("***Law No. 1567***"), with the declared aim of protecting the value of Turkish currency. As per Article 3 of the Law No. 1567, parties who fail to comply with the obligations set forth in Presidential decrees as per the Law No. 1567 will be sanctioned with an administrative monetary fine ranging from TL 3,000 to TL 25,000. If such non-compliance is perpetrated for the benefit of a legal person, the same administrative monetary fines shall be imposed on that legal person as well. The law also states that the sanctions will be doubled if there is a repeat violation. These sanctions are imposed by the public prosecutors.

Hence, we conclude that such administrative monetary fines may be imposed on parties who determine the contract price or other payment obligations in an agreement covered by the New Decree and the Communiqué in a foreign currency or by indexing to a foreign currency. Furthermore, these fines will be applicable to those parties who fail to re-determine contract prices and other payment obligations in Turkish currency by the applicable deadline (*i.e.*,

October 13, 2018) for agreements that were concluded before September 13, 2018, and that fall under the scope of the New Decree and the Communiqué.

It is also important to note that each non-compliance or breach of the New Decree entails a separate legal sanction. In other words, for each agreement that fails to comply with the requirements of the New Decree and the Communiqué, there will be a separate administrative monetary fine imposed on the liable parties.

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