

CLIENT ALERT

BANKING & FINANCE | TURKEY |

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DEALING WITH F/X PHOBIA IN TURKISH CONTRACTS: EXCEPTIONS TO "CONVERSION INTO TRY" ANNOUNCED

Decree no. 32 on the Protection of the Value of the Turkish Currency (the "**Decree**") was amended on 13 September 2018 in order to restrict f/x and f/x-indexed payments for certain Turkish resident-to-resident transactions as follows: contract prices and other payment obligations arising from contracts for (i) the sale of movable/immovable property, (ii) the lease (including financial leasing) of movable (including vehicles) and immovable property, (iii) employment, (iv) service and (v) construction, cannot be denominated in or indexed to a foreign currency, except for cases to be determined by the Ministry of Treasury and Finance (the "**Ministry**").

In accordance with the amendments made in Decree no. 32, all prices denominated in a foreign currency under contracts already executed (falling within the scope of the restrictions above) must be re-determined in Turkish Lira within 30 days following the introduction of the said amendment (*i.e.* 13 October 2018), except for cases to be determined by the Ministry. These amendments to Decree no. 32 were followed by further amendments indicated in Communiqué no. 2008-32/34, Communiqué no. 2018-32/51, which amended Communiqué no. 2008-32/34 regarding Decree no. 32 (the "**Communiqué**") which entered into force on 6 October 2018, reiterated this restriction and provided a number of exceptional cases. This Client Alert aims to briefly summarise restrictions and exceptions provided under the Communiqué.

WHAT ARE THE RESTRICTIONS?

In line with the amendments made in the Decree, in principle, the contract price and other payment obligations arising from the following types of contracts concluded between Turkish residents cannot be determined in or indexed to foreign currency:

- Sale, purchase and lease agreements regarding immovable property;
- Employment agreements other than those to be performed abroad;
- Construction/building agreements, except those relating to the building, repair and maintenance of ships defined in Turkish International Ship Registry Law and Decree no. 491 regarding the establishment of the Undersecretariat for Maritime Affairs;
- Service agreements including counselling and brokering services, save for the following exceptions: (i) service agreements concluded with foreign persons (individuals who do not have Turkish citizenship); (ii) service agreements concluded within the context of export, transit trade, sales and deliveries deemed as export, and foreign-currency-earning services and activities; (iii) service agreements concluded for activities to be performed abroad; (iv) and service agreements related to electronic communications that start in Turkey towards foreign countries, and vice-versa.

As regards the implementation of the above-mentioned restrictions, the Communiqué also provides three important rules for interpretation:

- Branches, representative offices, liaison offices, bureaus that belong to Turkish residents and funds that are managed by Turkish residents abroad; and non-resident companies of which Turkish residents hold 50% or more of the share capital directly or indirectly will be considered as resident in Turkey, and the agreements that are made by and between these institutions and Turkish residents will be subject to the above-mentioned restrictions.
- Moreover, amounts/values included in negotiable instruments (cheques or promissory notes) to be issued within the scope of the agreements specified above, shall be neither denominated in nor indexed to a foreign currency.
- Agreements indexed to precious metals, the value/price of which is determined on the basis of foreign currency, and agreements whose contract prices are indirectly indexed to foreign currency, shall be deemed/interpreted as foreign-currency-indexed agreements.

WHAT ARE THE EXCEPTIONS?

In addition to exceptions set out in the above paragraphs, contract prices and other payment obligations arising from the following contracts concluded between Turkish residents can be determined in or indexed to foreign currency:

- Sale, purchase and lease agreements regarding movable property, except all vehicles including heavy construction vehicles/equipment;
- Sale and purchase agreements with respect to software developed abroad and service and license agreements regarding hardware and software;
- Leasing agreements for ships defined in Turkish International Ship Registry Law and Decree no. 491 regarding the establishment of the Undersecretariat for Maritime Affairs;
- Leasing agreements to be concluded within the scope of f/x loans that can be borrowed from abroad and domestically, as per Articles 17 and 17/A of the Decree;
- Agreements executed by public institutions and agreements executed by the subsidiaries of the Turkish Armed Forces Foundation (e.g. Turkish Aerospace Industries), except for sale, purchase and lease agreements regarding immovable property;
- Agreements to be entered into by and between contractors and third parties, provided that such agreements are made for carrying out public auctions, performance of agreements and international treaties made/concluded by public institutions, except for agreements regarding the sale/purchase and lease of immovable property and employment agreements;
- Agreements concluded with the banks in relation to transactions by the Ministry within the scope of Law no. 4749 on Public Finance and Debt Management;
- Save for the provisions of the Decree, creation, issuance, sale/purchase of f/x-based capital market instruments (including foreign capital market instruments and depository receipts and participation units of foreign investment funds);

- Employment agreements concluded by individuals without Turkish citizenship but who are resident in Turkey;
- Employment and service agreements concluded by the branches, representation offices, offices, liaison offices of individuals who are resident abroad, and the companies operating in free trade zones and the companies whose majority shareholdings are held by individuals who are resident abroad;
- Agreements concluded by commercial airlines performing passenger, cargo and mail transportation; companies providing technical maintenance for aircraft engines and engine components; public or private entities or their subsidiaries in which they hold at least 50% of share capital (directly or indirectly) and which have a license to provide ground services, except for agreements regarding sale/purchase and lease of immovable property and employment agreements.

It is worth mentioning here that all agreements falling within the scope of the above-mentioned exceptions and concluded before the entry into force of the Decree's amendments shall be also subject to above-mentioned exceptions.

HOW WILL AGREEMENTS BE ADAPTED TO NEW REGIME?

The Communiqué also provides for principles and exceptions as regards the conversion obligation into TRY that were previously executed and that are still in force. Accordingly, the "30-day grace period" initiated on 13 September 2018 has not been extended and will therefore expire on 13 October 2018.

- The contract prices or payment obligations determined in foreign currency or indexed to foreign currency restrictions are required to be amended by the parties by way of conversion of the contract price and payment obligations into TRY.
 - i. In the event that the contracting parties fail to reach an agreement in terms of the f/x rate for adaptation of the prices into TRY, such contract prices shall be adapted as follows:
 - The indicative effective (banknote) selling rate of the Central Bank of the Republic of Turkey (the "CBRT") announced on 2 January 2018 shall be taken into account for conversion into TRY.
 - Such converted amount shall be adjusted upwards based on the monthly consumer price index rate changes determined by the Turkish Statistical Institute, for the period starting from 2 January 2018 until the re-adjustment date.
 - ii. The rent amount determined in foreign currency or indexed to foreign currency in property lease agreements shall be converted into TRY and determined for a period of two years ("**Mandatory Adjustment Period**"), based on the following principles. First of all, current rent amount shall be converted into TRY based on the principles set forth under paragraph (i) above. At this point, in the event that lessor and lessee fail to reach an agreement in terms of the f/x rate for adaptation of prices into TRY, such rent amount shall be adapted as follows:

- Such converted amount shall be adjusted upwards based on the monthly consumer price index rates for the period starting from conversion date until the end of the relevant lease period.
 - Such adjusted amount shall be applicable for the first year of the Mandatory Adjustment Period.
 - If lessor and lessee fail again to reach an agreement on the rent amount of the subsequent year of the Mandatory Adjustment Period, it shall once again be increased and adjusted by using monthly consumer price index rates.
- iii. The above-mentioned provisions shall not be applicable to amounts already paid or due and payable (already non-performed) under the agreements subject to conversion.
- Vehicle lease agreements, including lease of heavy construction equipment, concluded before 13 September 2018 are also excluded from the above-mentioned adjustment requirement.
 - Last but not least, the Communiqué specifies that, upon request of a contracting party, the contract price and payment obligations shall be converted into TRY even for new agreements or on-going agreements that fall within the above-mentioned exceptions.

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