Supreme Court View on Adapting Contracts due to Fluctuation in Currency Exchange Rates and Recent Change in the Decree No. 32

Introduction

Under Turkish law, contracting parties should be bound by the terms and conditions of the contract under the sanctity of contract principle. However, following the conclusion of a contract, a change in circumstances may affect the performance of contractual obligations and applying the sanctity of contract principle could be against the principle of good faith.

Turkey has recently faced higher currency exchange rates and a significant change in the Decree No. 32 on the Protection of the Value of Turkish Currency ("**Decree No. 32**"), which has raised the question of whether these incidents constitute a change in circumstances that affect the fulfilment of contractual obligations.

The Presidential Decree numbered 85 and dated September 12, 2018 ("**Decree No. 85**") amended the Decree No. 32 and included the following provision therein; "*Public or private persons resident/established in Turkey shall not determine the contract price and other contractual payment obligations born from the same contracts in a foreign currency or indexed to a foreign currency for the contracts for the sales of real estate or movable property, all kinds of renting of real estate or movable property including financial leasing and vehicle renting, leasing and employment, service and construction signed between themselves, excluding the exemptions to be determined by the Ministry of Treasury and Finance*".

As foreseen in the Decree No. 85, the Ministry of Treasury and Finance (the "**Ministry**") published the Communiqué on the Amendment of the Communiqué Regarding the Decree No. 32 on the Protection of the Value of Turkish Currency ("**Communiqué**") and determined the exemptions of the Decree No. 85.

Accordingly, sale or renting contracts of movables (except the sales of transportation vehicles including construction vehicles), contracts of work signed for shipbuilding or repairing or maintenance, employment contracts of persons resident in Turkey who does not have a citizenship connection with the Turkish Republic, employment and service contracts having a party who constitutes as a branch, agency, office or liaison office in Turkey of a person resident/established abroad or whose shares of more than fifty percent are directly or indirectly owned by persons established/resident abroad, etc. may be entered into in or indexed to a foreign currency.

Contract prices determined in scope of contracts that shall not be executed in or indexed to a foreign currency must be re-determined by the parties in Turkish currency. The Communiqué sets forth a calculation method in case the parties fail to determine the contract price in Turkish currency. However, considering the current high currency rates in Turkey, the calculation method in the Communiqué may put the parties -especially the creditors- in an unfair and difficult position since the Turkish Lira equivalent of the contract price previously determined in or indexed to a foreign currency turns out considerably low as the result of the said calculation method.

Thus, it is currently being discussed whether it would be possible to file adaptation lawsuits due to the unjust and financially compelling consequences of the Decree No. 85 and the Communiqué.

Relevant legislation

Under Turkish law, if parties cannot agree on a revision of the terms and conditions of a concluded contract, they are entitled to apply to the courts and request the adaptation of the contract in view of the new circumstances as per Article 138 of the Turkish Code of Obligations ("**TCO**"), provided that the following conditions are met:

- An extraordinary event which was not anticipated or could not have been anticipated when the contract was concluded should have occurred.
- The party requesting adaptation should not have caused the extraordinary event.
- The extraordinary event should have changed the circumstances to such an extent that requesting performance of the contract would violate the good-faith principle.
- The party requesting adaptation should not yet have performed its obligation.

As per Article 138(2) of the TCO, the article also applies to foreign currency debts.

Supreme Court view

Pursuant to Supreme Court precedents, for a court to accept an adaptation request:

- the new conditions must be extraordinary and objective;
- the obligations of both parties must be excessively and explicitly imbalanced due to changing circumstances and conditions;
- there should be no provision in the contract stating that one of the parties undertook the risk that arose due to the changing circumstances and conditions;
- the party that requests the contract adaptation should not cause the changing circumstances and conditions; and
- the changing circumstances and conditions should be unpredictable or unexpected.

The party that requested adaptation must prove that the abovementioned conditions have been met. If the court determines that the conditions required for adaptation have been met, it may decide to revise the content or term of the contract. If these revisions are insufficient to balance the performances of the parties, the court may decide to terminate the contract.

Long-term lease contracts and foreign exchange loan agreements constitute the majority of the Supreme Court's precedents regarding adaptation requests. For adaptation requests based on the higher currency exchange rates, the Supreme Court has contradictory precedents. In some of its decisions, the Supreme Court overruled the decision of the first-instance court due to the insufficient examination of whether the exchange rate fluctuation had caused an unpredictable event. There are also precedents where the Supreme Court has refused adaptation requests by stating that the fluctuation in currency exchange rates is predictable when the economic structure and dynamics of Turkey are considered.

On the other hand, the Decree No. 85 and the Communiqué have been very recently published; therefore, there are no cases finalized by the Supreme Court in terms of those regulations yet. Nevertheless, as long as those regulations have changed the circumstances to such an extent that requesting performance of the contract would violate the good-faith principle, adaptation requests of parties should be accepted by the courts and the Supreme Court considering the other conditions stipulated under Article 138 of the TCO are valid.

Just to set an example; considering that a supplier entered into a sales contract in foreign currency relying on a foreign loan that he took out from a bank or a financial institution. How can this supplier pay back its loan if the contract price of this sales contract is converted in Turkish lira based on a low currency exchange rate which is determined per the calculation method in the Communiqué? Clearly, in such a case, there would be a gross injustice between the parties which violate the good-faith principle.

Comment

The contradictory nature of the Supreme Court's precedents has been criticised by scholars who argue that:

- each case should be based on its own circumstances; and
- it must be decided whether the fluctuation in currency exchange rates is an unpredictable event for the contract in dispute.

It appears that the recent higher currency exchange rates and the significant change in the Decree No. 32 in Turkey will increase the number of adaptation requests before the courts. As there is no settled Supreme Court precedent regarding whether a fluctuation in currency exchange rates or the recent changes in the Decree No. 32 requires the adaptation of contracts, first-instance courts will need to examine the circumstances of each case.