THE NEW TURKISH INTERNATIONAL ARBITRATION LAW -WHAT AND HOW IT WILL AFFECT FOREIGN INVESTMENT AND INTERNATIONAL DEBT BANKING CONFIDENCE IN FUTURE TURKISH PROJECTS.

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ANKARA'S AWAY

On 21 June 2001, the Turkish Parliament enacted the Turkish International Arbitration Law No. 4686 ("Law No. 4686" or "Law")[1]. This new law, which has been on the agenda of the Ministry of Justice for the last few years, was finally enacted as one of the commitments of the Turkish Government to the International Monetary Fund and the World Bank.

Law No. 4686 sets forth the rules applicable to arbitration proceedings…

(1) used for resolution of disputes arising from contracts containing a foreign element, which will be held in Turkey; or

(2) used for other arbitration proceedings outside or within Turkey if and when chosen by the parties or the arbitrators thereof.

The text of Law No. 4686 and its reasoning gives the clear impression that it was based on the United Nations Commission on International Trade Law (UNCITRAL) Model Law, although there are also a number of differences.

Choice of both domestic arbitration (under the provisions of the Turkish Civil Procedural Law No. 1086 ("Law No. 1086")[2] and international arbitration (under the Turkish International Private Law and Procedures Law No. 2675 ("Law No. 2675"))[3] have been available in many circumstances in the past. But disadvantageous provisions in both laws, and the application thereof by the Turkish courts, have limited the ability of parties to benefit from arbitration to a significant extent.

The new Law No. 4686 does not recognize arbitration held in Turkey as being purely local arbitration and provides for an alternative to the application of Turkish procedural laws (Laws 1086 and 2675) in arbitration proceedings in Turkey. Selection of Turkish procedural laws and/or the venue of the arbitration being in Turkey have been the criteria most frequently used by the Turkish courts in categorizing arbitration as local. Thus, the purpose of Law No. 4686 appears to be better conduct of arbitration in Turkey and consequently to encourage the flow of foreign investment into Turkey.

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2 Published in the O.G. No. 622-4 dated 2, and 4 July 1922.
3 Published in the O.G. No. 23786 dated 14 August 1999.

The definition of foreign element[4] and therefore the scope of Law No. 4686 is enormously broad. Besides the standard factors assessed for the determination of the existence of a foreign element, such as the residence of the parties or the place of performance, the existence of foreign element is also determined with an economic approach. This aspect is very important for foreign investors that establish a Turkish company, as Turkish public and private sector entities have been unreceptive to arbitration conducted abroad due to its cost whereas foreign parties have been unreceptive to arbitration in Turkey due to the reasons stated above.

Because of the new economic approach, contracts that "local" foreign-owned companies enter into with Turkish public or private sector entities will benefit from Law No. 4686. For example: an arbitration in Ankara over a contract between a Turkish subsidiary of a Dutch company and a Turkish company and/or a governmental entity, stipulating a performance in Turkey and governed by Turkish substantive rules, will be subject to this Law and will be qualified as international.

The only limitation envisaged by the Law in its scope is for matters related with real estate and matters not subject to the free determination of the parties by law.

It is notable that arbitration procedures for the resolution of disputes arising from contracts containing a foreign element as introduced by Law No. 4501 concerning the Principles to be Followed When Disputes Arising From Concession Contracts Concerning Public Services are Submitted to Arbitration ("Law No. 4501")[5] have also been made subject to the provisions of this Law[6].

Law No. 4501 was prepared in an effort to complete and implement the August 1999 amendment to the Turkish Constitution aiming, *inter alia*, to deal with the arbitration issue which hindered international financing of Turkish infrastructure projects. Accordingly, as set forth in the Law, arbitration proceedings for the resolution of disputes with a foreign element as defined in Law No. 4501 (those arising from public service concession contracts) shall also be subject to Law No. 4686.

All provisions of Law No. 4501 related to arbitration should have been repealed since they create ambiguity. They have not been. However, we believe arbitration proceedings subject to Law No. 4501 and at the same time covered by Law No. 4686 will only be subject to other provisions referred to in Law No. 4501 if they do not contradict the provisions of Law No. 4686 since it is the more recent and more specific law of the two.

The provisions of Law No. 4686 with respect to the arbitration agreement, selection of the arbitrators, the authority of the arbitrators, assistance to be provided by the courts, procedural matters, conduct of the procedures, and evidence are generally in line with the UNCITRAL Model Law or similar regulations, although there are some differences

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4 To recognize exemptions to their jurisdiction or application of their laws, national legal systems seek the existence of certain conditions which would justify application of the laws or jurisdiction of another State, or alternative dispute resolution mechanisms such as arbitration. Such conditions constitute the foreign element concept.

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6 Please refer to the article "Turkey's Attempt for a Stable Liberalized Energy Market", By Mehtap Yildirim-Ozturk and Dr. Gamze Oz, 196 Project Finance International, (June 28 2000), p.77 with respect to Law No. 4501.

which may attract criticism. It is noteworthy, however, that there is a one year limitation for the arbitrators to render their award which can be extended by mutual agreement of the parties or by a court upon request of one of the parties but not by the arbitrators. Moreover, that period can initially be determined differently by the parties thereto.

Further, the parties can determine the rules applicable to the arbitral proceedings by referring to the rules of other laws, or international or institutional rules provided that mandatory provisions of the Law are observed. As a result, it would be possible to conduct an arbitration proceeding in Turkey pursuant to the International Chamber of Commerce Arbitration Rules without risking that such arbitration would be categorized as local.

Although Law No. 4686 envisages limitation of the role of and intervention by the courts during arbitration proceedings, it also sets forth two additional steps, beyond rendering the judgment, for an award to become final and enforceable. First, the award can be cancelled on limited grounds if brought before the courts within 30 days running from the date of notification of the award. Article 15/A of the Law stipulates reasons for cancellation as follows:

(i) Reasons to be proved by the applicant party:

(a) A party to the arbitration agreement was under some incapacity; or the said agreement is not valid under the governing law or, failing selection thereof, under Turkish law;

(b) The procedure determined in the agreement of the parties, or set forth in the Law was not followed during the appointment of the arbitrator(s);

(c) The award was not rendered within the arbitration term;

(d) The arbitrator(s) decided as per their authorization contrary to law;

(e) The arbitrator(s) decided on a matter outside the scope of the arbitral agreement, or did not decide on the entire dispute, or exceeded their jurisdiction;

(f) The arbitral proceedings were not conducted in accordance with the parties' agreement or in the absence of such agreement, pursuant to the provisions of the Law with respect to procedure and this situation affected the substance of the award; or

(g) The principle of equality of the parties was not observed.

(ii) Reasons to be considered by the court, *ex officio*:

(a) The dispute which is the subject matter of the award of the arbitrator(s) is not arbitrable under Turkish Law; or

(b) The award is in conflict with public policy.

The parties have been granted the right to waive the right to bring a cancellation action on the grounds summarized above, entirely or partially, at or before the time of the dispute in question. Finally, Law No. 4686 envisages another step before an award can become final and enforceable; the right to appeal the court's decision with respect to cancellation requests on the same grounds.

We believe the right to appeal decisions with respect to cancellation requests diminishes the main advantages, namely speed, practicality and less intervention from local courts, that international litigants seek when they select rules applicable to arbitration.

Another important issue is that Law No. 4686 creates ambiguity regarding application of the provisions of Law No. 2675 to the recognition and enforcement of awards rendered as a result of the arbitration procedures. There is an explicit provision in Law No. 4686 stipulating that unless otherwise stated, the provisions of the Law No. 1086 shall not be applicable. However, there is no clear provision in Law No. 4686 that states awards which become final and enforceable thereunder shall not be subject to the recognition and enforcement procedures set forth in Law No. 2675. Considering the purpose of Law No. 4686 - and the similarity of the matters reviewed during the recognition procedure set forth in Law No. 2675 with the cancellation grounds set forth in Law No. 4686 - we believe those provisions of Law No. 2675 should not be applicable to the awards rendered under Law No. 4686.

However, in the absence of a provision clarifying this issue, and considering the conservative approach of the Turkish courts towards arbitration and the confusion with respect to "international arbitration" and "foreign arbitration" concepts, there is a risk that Turkish courts may favor literal interpretation, and therefore cause delay in practice.

In conclusion, despite certain aspects of Law No. 4686 that can be criticized, enactment of the Law itself improves the situation in respect of arbitration in Turkey or with Turkish parties. It is a very important step towards the realization of the purpose of Law No. 4686: encouragement of conduct of international arbitration in Turkey and consequently encouragement of foreign investment in Turkey. However, implementation of the Law by the Turkish courts will determine whether its purpose will be fully realized. ⊕