

THE RECENT DECISION BY THE COURT OF APPEAL CONCERNING THE APPLICATION OF THE INTERNATIONAL ARBITRATION ACT

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I. Introduction and Subject Matter

Until coming into force on 5th July 2001 of the International Arbitration Act (hereinafter IntArbA.), the arbitration in Turkey was governed, principally, by the provisions of the Civil Procedure Act (hereinafter CivPrA.). Following the introduction into national legislation of the IntArbA., one of the issues that gave rise to a considerable disagreement between scholars and practitioners was the applicability of this Act in connection with disputes arising out of or in relation to contracts including arbitration clauses entered into before coming into force of the IntArbA.

Court of Appeal, in a recent decision dated 18th October 2006 concluded that arbitration clauses contained in contracts entered into prior to coming into force of the IntArbA. refers to and governed by the relevant provisions of the CivPrA. and therefore IntArbA., unless expressly agreed otherwise, cannot apply to disputes arising out of or in relation to contracts made before the IntArbA. came into force.

In this article we propose to analyse the above referred to decision of the Court of Appeal.

However, before proceeding any further we find it appropriate to dwell on, understandably only briefly, the principal provisions in Turkish law, governing arbitration.

II. Overview of the Turkish Law on Arbitration

Under Turkish legal system, arbitration is governed by two different sets of

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rules¹. One set of rules is embodied in the CivPrA.² and the other is the subject of the IntArbA.³ Understandably enough, the latter is applicable in disputes having international character as defined by the Act itself and the provisions of the CivPrA. on arbitration are applied in all other categories of disputes, but ordinarily on domestic arbitration⁴.

One should also refer to International Private Law and Procedure Law Act⁵, which governs the recognition and enforcement of the foreign court judgements and arbitral awards.

1. Provisions of Civil Procedure Act on Arbitration

Conventionally, arbitration between private parties was conducted pursuant to the provisions contained in the CivPrA. Following the coming into force of the IntArbA., this Act became applicable, to the exclusion of the CivPrA. in disputes containing a foreign element as defined in art. 2, where parties were silent in their agreement on arbitration. However, the parties to an international dispute may equally decide on the provisions of the CivPrA. as their contractual choice of law to govern the arbitration. The parties may, alternatively, agree to have IntArbA. applied to their prospective dispute although the relation was purely domestic.

a. Under the provisions of CivPrA, the arbitration is allowed only in matters, resolve of which exclusively belongs to the discretion of the parties. In this sense, arbitration is not available with regard to such matters that typically are of public policy and/or governed by mandatory rules⁶. Therefore, to put it succinctly, arbitration is accepted in conflicts arising from contractual relations.

¹ Since for the purpose of this brief article, we are interested only in the voluntary arbitration conducted between the parties pursuant to their free will, we shall not concern ourselves with rules on arbitration in public law nor with the compulsory arbitration applicable between different public entities in accordance with certain particular provisions.

² Act dated 4th October 1927 and nr. 1086. This Act has been adopted from the Cantonal Act of Neuchâtel and amended several times.

³ Act dated 21st June 2001 and nr. 4686, entered into force on 5th July 2001.

⁴ Turkey is party to several international conventions governing arbitration as well as enforcement of foreign arbitral awards; e.g. *European Convention on International Commercial Arbitration, Geneva 21 April 1961*; *Convention on the Recognition and Enforcement of Foreign Arbitral Awards, New York 10 June 1958*; *Convention on the Settlement of Investment Disputes Between States and Nationals of Other States, Washington 14 October 1966*.

⁵ Act dated 20th May 1982 and nr. 2675

⁶ For instance, no arbitration clause is upheld in marriage contracts or succession disputes.

b. Arbitration agreement must be made in writing. Parties may make a separate agreement to define the way they propose to conduct the arbitration should any dispute occur in their particular contractual relation or may insert an arbitration clause into the relevant contract.

c. Existence of an agreement between the parties to refer their future dispute to arbitration, precludes them from going to courts of law for a conflict coming within the scope of such agreement to arbitrate.

It shall be for the competent state court to decide, where a dispute occurs on whether a particular matter can be settled through arbitration or not. In this regard, the CivPrA does not recognise the *Kompetenz - Kompetenz* doctrine⁷.

d. As a rule, parties are free to determine the appointment of the arbitrator (s) and the way the arbitral tribunal⁸ shall be formed⁹.

Where the parties can not agree on a sole arbitrator or where the parties have decided to have three arbitrators and one of the parties demurs in appointing its arbitrator following the notification by the other party of the appointment of its arbitrator, the latter party may request from the competent court¹⁰ to appoint an arbitrator for the demurring party or make an appointment for the sole arbitrator.

The remuneration of the arbitrators shall be freely decided by the parties; however the arbitrators are barred from determining their own fees.

e. Arbitral proceedings commence following a submission by one of the parties to the court for the appointment of an arbitral tribunal or where the parties are entitled to appoint the tribunal, following the service by the litigant declaring the appointment of its arbitrator with a request to the respondent to appoint his arbitrator.

The proceedings must be concluded within six months starting from the first session. This period may be extended either by written consent expressly declared by both of the parties or by the order of the court.

f. The decisions of the arbitral tribunals are subject to review by the Court of Appeal. The parties may not surrender their rights to appeal from the decisions of the arbitral tribunals or to request for re-hearing.

⁷ However, this is not the case with respect to IntArbA., *q.v.*.

⁸ Throughout this Chapter the term *arbitral tribunal* shall be used to refer both to sole arbitrator or a panel of arbitrators.

⁹ Judges may not be appointed as arbitrators.

¹⁰ This is the court that holds jurisdiction on the conflict had the parties made no agreement to arbitrate.

The Court of Appeal can review the decisions delivered by the arbitral tribunal based only on the following grounds (see art. 533 of the CivPrA.):

- aa. Where the decision was given after the lapse of the determined period ¹¹.
- bb. Where the decision by the arbitral tribunal covered issues not included in the claim.
- cc. Where the arbitral tribunal exceeded its power.
- dd. Where the tribunal disregarded in its judgement a claim raised by one of the parties.

In addition to these grounds determined by the CivPrA., the Court of Appeal has developed two more grounds and found it competent to review arbitral awards in cases:

- aa. Where serious procedural errors were committed ¹² and
- bb. Where the arbitral tribunal did not take into regard the substantive rules of the applicable law in their decision although the parties in the arbitration agreement directed the arbitrators to build their decision pursuant to the substantive rules of the applicable law.

2. International Arbitration Act

a. IntArbA. was drafted, based upon *Uncitral Model Law on International Commercial Arbitration* ¹³.

The Act is, as a rule, applicable to disputes that involve a foreign element and where the Turkey was selected as the seat of the arbitration. IntArbA. is also applicable contractually or pursuant to the decision of the arbitral tribunal, where the tribunal so resolves in case the parties have agreed to submit their dispute to arbitration but remained silent on the law applicable (art. 1/II).

The Act does not apply to conflicts where the subject matter involves real rights on immovables situated in Turkey as well as to such disputes means of resolve for which do not depend on the free will of the parties, i.e. to disputes that are mandatorily subject to the jurisdiction of the state courts (art. 1/IV).

¹¹ I.e. either after the expiry of the initial six months or the extension thereof where an additional period was granted.

¹² For instance, where proper summons were not made or motions by one party was not served on the other party.

¹³ The present author is of the opinion that this Act is rather a despicable attempt to introduce the UNCITRAL text into Turkish legislation.

b. IntArbA. defines what one should understand from the *involvement of a foreign element*. Art. 2 stipulates that any of the following situations reflect the presence of a foreign element and provides a basis for the application of the Act.

aa. The parties having their places of business or habitual residence in different countries,

bb. The respective places of business or habitual residences of the parties having situated in a country, other than:

i. The place of arbitration as determined in the arbitration agreement or established pursuant to such agreement,

ii. The place where a substantial part of the obligations arising out of the main contract shall be performed or the place with which the subject-matter of the dispute is most closely connected,

cc. At least one of the shareholders of the company that is party to the contract which forms the basis of the arbitration agreement, has imported a foreign capital into Turkey, pursuant to the provisions of the Promotion of the Foreign Capital Act,

dd. Loan and/or guarantee agreements were necessary to secure capital form abroad to implement the contract,

ee. The contract or legal relation forming the basis of the arbitration agreement provides for the transfer of goods or capital between countries.

c. Arbitration agreement must be made in writing. This agreement may take place either in a separate contract or it may be included as a provision in the contract regulating the fundamental relation between the parties.

Agreement to go to arbitration will also be recognised, where the respondent does not object to the filing of a suit by the claimant before an arbitral tribunal art. 4/II).

The validity of the arbitration agreement will be subject to the law chosen by the parties to govern the arbitration or where the parties had not made any choice of law for the arbitration, to the Turkish law (art. 4/III).

The arbitration clause in a contract is severable from the main contract and therefore can survive the contract, in cases where the latter turns out to be void.

d. The arbitral tribunal has power to decide on its jurisdiction as well as to resolve any dispute on the existence and/or validity of the arbitration agreement. A decision by the arbitral tribunal that the fundamental contract is null and void shall not entail the invalidity of the arbitration clause.

In this sense, the Act bestows on the arbitral tribunal *kompetenz - kompetenz*.

e. The parties are, subject to the mandatory provisions of the IntArbA., free to determine the procedure to be followed by the arbitral tribunal in conducting the proceedings. The parties may equally subject such procedural issues to a certain chosen act or to international or institutional arbitration rules (art. 8/A)¹⁴.

The place of arbitration may be freely decided by the parties or by the arbitration institution chosen by the parties. Where no such agreement exists, the arbitral tribunal will determine the place of arbitration with due regard to the particulars of the dispute.

Failing such agreement by the parties, the arbitral tribunal conducts the proceedings in accordance with the provisions of this IntArbA.

f. Where there is no agreement to the contrary, the arbitral proceedings commence on the date application was made to the court or pursuant to the agreement by the parties to the particular institution, as the case may be, for the appointment of the arbitral tribunal or where the parties retained the right to appoint the arbitrators, on the date the Claimant, following the appointment of its arbitrator requires from the Respondent to appoint its arbitrator.

Unless the parties have agreed otherwise; the final decision must be delivered within a year following the appointment of the arbitrator in cases of sole arbitrator or following the day when the minutes of the initial meeting was signed, where more than one arbitrator were appointed.

This period may be extended by the agreement between the parties or failing such an agreement, by the court, upon an application by one of the parties.

g. With respect to the procedural matters, the Act, following the Uncitral Model Law, allows substantial flexibility to the parties to set the dates of submission of their pleadings, as well as the procedure they wish to observe for the exchange of these documents. Where the parties can not reach an agreement then it shall be for the arbitral tribunal to decide on this matter.

Unless the parties have agreed to the contrary, either party may amend or supplement its claim or defence during the course of the proceedings. However, the arbitral tribunal may not allow such amendment or supplementing if the party concerned was delayed in raising it or where it

¹⁴ This is actually an introduction into Turkish law the concept of *autonomy (or sovereignty) of the parties*, which was one of the fundamental premises upon which Uncitral Model Law was constructed.

finds that such a move shall place unjustified burden on the other party.

h. The arbitral tribunal shall decide whether to hold oral hearings for the presentation of evidence or for oral argument or whether the proceedings shall be conducted on the basis of documents. However, unless the parties have agreed that no hearings shall be held, the arbitral tribunal shall hold such hearings at an appropriate stage of the proceedings, if so requested by one of the parties.

If the claimant, without showing valid cause, does not file its petition within the prescribed time, arbitral tribunal shall terminate the proceedings.

If the respondent does not file a defence, this event itself shall not be interpreted as admission by the respondent the allegations of the claimant and the arbitral tribunal shall proceed with the hearings.

If any party, without showing valid cause, does not appear at a hearing or refrain from producing evidence, the arbitral tribunal may, nevertheless, continue with the proceedings and deliver a judgement on the evidence available to it.

The arbitral tribunal is empowered to appoint experts and receive advice on the issues it determines. Unless otherwise agreed by the parties, if a party so requests or if the arbitral tribunal considers it necessary, the expert shall, after delivery of his written or oral report, participate in a hearing where the parties shall have the opportunity to direct questions to him and to introduce expert witnesses which they have appointed, to testify on the points at issue.

The parties are also entitled to request from the arbitral tribunal to appoint experts for the examination of such matters they think necessary and have the right to nominate in person such experts.

i. The arbitral tribunal shall deliver its judgement in accordance with the provisions of the contract between the parties and pursuant to the rules of the law the parties have chosen or the tribunal elected as the law applicable to the substance of the dispute.

Any decision of the arbitral tribunal shall be made, unless otherwise agreed by the parties, by the majority of its members.

However, the presiding arbitrator, if so authorised by the parties or other members of the tribunal may decide on questions of procedure.

j. The Award Shall be Served on Each Party

Within thirty days following the service of the award, any party, with notice to the other one, may request the arbitral tribunal to correct in the award

any errors in computation or any clerical or typographical errors or any similar material errors or require an interpretation of a part of or the entire award. If the arbitral tribunal, after receiving the comments of the other party, considers the request to be justified, shall make the correction or give the interpretation within thirty days of receipt of the request.

The arbitral tribunal may correct any such material errors on its own initiative within thirty days of the date of the award.

Any of the parties, with notice to the other party, may request, within thirty days following the service of the award, from the arbitral tribunal to make a supplementary award regarding such claims that were presented during the proceedings but not adjudicated upon in the award. If the arbitral tribunal considers the request to be justified, it shall deliver a supplementary award within sixty days.

k. Only an action for the annulment of the award is allowed against the arbitral awards. This action has to be brought before the competent court of first instance.

An arbitral award may be annulled under the following conditions:

1. If the party filing the suit for annulment proves that:

a. One of the parties to the arbitration agreement was not of full capacity or the said agreement was not valid under the law which the parties have subjected it or where no applicable law was chosen, under the laws of Turkey;

b. The procedure as agreed between the parties or as stipulated in this Act was not observed in the composition of the arbitral tribunal;

c. The award was not made within the prescribed period;

d. The decision by the arbitral tribunal on its competency or lack of it was not made in compliance with applicable law;

e. The arbitral tribunal made an award on a matter falling outside the scope of the arbitration agreement or the award did not cover the entire claim or that it exceeded its jurisdiction;

f. The arbitral proceedings were conducted not in compliance with the agreement between the parties or where no such agreement exists, were not conducted in compliance with the provisions of this Act and such non-compliance influenced the substance of the award;

g. The parties were not treated equally.

2. If the court finds that:

- a. The subject-matter of the dispute is not capable of settlement by arbitration under Turkish law;
- b. The award is against the public policy.

Action for the annulment may be brought within thirty days. The enforcement of the award shall be deferred following the action for annulment.

1. The parties may appeal from the decision delivered at the end of the annulment action.

The review by the Court of Appeal is limited to the grounds available for the annulment action itself.

After the award becomes final and definite, the court, based upon a request by any of the parties, issues an order for the enforcement of the award.

Even though no action for annulment was lodged, the court, prior to issuing the order for the enforcement of the award, conducts an examination to ascertain that (i) The arbitration was allowed for the subject matter of the dispute and (ii) The award did not contravene with the public policy.

III. Application in Tempore of The International Arbitration Act

The subject we would like to discuss under this heading is whether IntArbA. can be applicable to arbitration agreements entered into prior to coming into force of the Act.

1. General Principles Governing The Effectiveness Of New Acts

- a. Pursuant to the basic principle governing the coming into effect of new acts, acts enter into force upon their publication in the Official Journal.

Conventionally, the following statement is included in the relevant provision¹⁵ of each act : *"This Act comes into force on the day they it is published."*

While it is not allowed, nor even conceivable, to give acts retroactive effect; the legislature may find it appropriate to defer the entry into force of a new

¹⁵ As a rule, the *penultimate* article. The last article indicates the government organ that is responsible to implement the act in question, such as ministry of education or commerce or justice or the Council of Ministers, as the case may be, depending on the subject matter of the act.

act and consequently states the future day of effectiveness, most commonly, as: *"This Act comes into force on the xxth day following its publication."*

Accordingly, acts passed by the legislative organ and entered into force upon publication in the Official Journal become applicable to all future events, as long as the legislative organ has not stipulated an exception.

The same principle is also valid concerning the procedural rules and moreover it is generally accepted that rules relating to procedure become applicable, as soon as they enter into force, to pending cases also, unless legislature decides otherwise.

On the other hand and as an exception to the general rule, immediate effectiveness of new acts is subject to a restriction with regard to provisions bearing impact on contractual relations. Unless expressly resolved otherwise, contracts retain their power and effect derived from the provisions prevailing when they were entered into between the contracting parties, despite eventual changes that may be made through a new act on the relevant provisions regulating existing contractual relations.

b. The IntArbA. followed the conventional method and in its penultimate article simply stated that the Act shall come into force on the day it was published in the Official Journal. This, practically means, 5th July 2001.

c. Inspired by the general principles, as briefly explained hereinabove, the prevailing view appears to be that IntArbA. could, indeed should, become applicable after it came into force and consequently govern even the arbitration agreements that antedate the Act.

d. *However the Court of Appeal decided otherwise and resolved in a very recent case that the IntArbA. can not be applicable to an arbitration agreement contained in a contract that was made before the Act became effective.*

2. Decision by the Court of Appeal

a) History of the Case

The parties to the dispute in question concluded a contract on 25th November 1996 for a duration of ten years which also included an arbitration clause, stipulating for an *ad hoc arbitration*. While both were legal persons formed under Turkish law and have Turkish nationality, one of them was a subsidiary of a foreign company.

The parties have agreed that the applicable law shall be "... *the laws of the Republic of Turkey.*" and the "... *Contract shall be construed and applied and*

any dispute arising therefrom shall be subject to Turkish law."

The contract included also the following clause: *"The Parties hereto undertake and acknowledge that the disputes of whatever reason and nature arising from the interpretation and application of this Contract ... shall be settled exclusively by way of arbitration in accordance with the provisions hereunder."*

With regard to the rules of arbitration, it was agreed that: *"The arbitrators shall resolve the dispute by taking into regard both the substantive provisions and rules of procedure of the Applicable Law."*

After a while some disagreement started to develop between the parties on certain issues and one of them reverted to arbitration in February 2002. Thereafter arbitral tribunal was formed and first hearing was conducted on September 2002. The tribunal delivered its decision, after the extension by mutual agreement of the parties of the initial period of one year, on October 2004.

The arbitral tribunal decided that the arbitration should be conducted in accordance with the IntArbA.

Following the delivery of the award by the tribunal, one of the parties appealed therefrom and claimed *inter alia* that the arbitration should have been subject to the provisions of the CivPrA. This argument was based primarily on the ground that the parties have made their contract on 25th November 1996 and could only have in their minds the provisions of the CivPrA. regulating arbitration and not those of the IntArbA., which went into force approximately four years after the conclusion of their contract.

b) The Legal Process Following the Arbitral Award

The appeal was first lodged with the court of first instance, which was competent to hear the applications for setting aside the arbitral award pursuant to art. 15 of the IntArbA., which was drafted following art. 34 of the Uncitral Model Law on International Commercial Arbitration.

The court overruled the argument raised by the plaintiff to the effect that the arbitration should have been conducted pursuant to the provisions of the CivPrA. and not those of the IntArbA. and consequently approved the arbitral award by turning down also the other grounds that were submitted for the setting aside of the award.

The appellant then took the case to the Court of Appeal. The particular Chamber of the High Court found in the favour of the appellant and resolved that since the contract between the parties has been entered into before the

IntArbA., it was reasonable to infer from the will of the parties that they have envisaged the provisions of the CivPrA. when they have included the arbitration clause in the said contract.

The Chamber then returned the file to the court of first instance with an instruction to follow the relevant articles of the CivPrA. regulating the appeal procedure for the arbitral awards and refer the case to the Chamber should any of the parties file an appeal.

The court of first instance, based upon the prerogative acknowledged by the particular provisions of the CivPrA., insisted upon its initial judgement and thereafter docket was submitted to the General Assembly of the Civil Law Chambers¹⁶ of the Court of Appeal.

The General Assembly, in its decision dated 18th October 2006, decided in the favour of the appellant, consequently affirmed the finding of the particular chamber and in the meanwhile made the following assertions:

“The arbitration is an exceptional process as opposed to the general and overall jurisdiction of the regular state courts and is based entirely on the will of the parties exercised and upheld within the limits set by the law. Consequently, the will of the parties should be construed properly and rather narrowly.

In their contract the parties mutually agreed that the laws of the Republic of Turkey shall be the law applicable for all disputes arising out of the contract. The only relevant rules regulating arbitration were embodied in the CivPrA. when the parties have concluded their contract.

Since the basis of arbitration is contractual, the will of the parties ought to be given prominence above all other considerations in deciding the law applicable to the arbitration and it is only reasonable to interpret the intentions of the parties as being mutually converged on the application of the CivPrA. being the only act governing arbitration in force when they made their contract and could not have possibly envisaged the IntArbA., which even did not exist at the relevant time.

The IntArbA. went into force on the day it was published in the Official Journal and contained no further clause regarding its application *in tempore*. One may, therefore, suggest that arbitrations commenced after coming into force of the IntArbA. must be subject to this Act. But, one must also take into regard that lack of special transition clauses cannot bear effect on the prior

¹⁶ Where first instance courts disagree with the particular chamber of the Court of Appeal, the power to solve the dispute belongs to the General Assembly that is composed of all the members of the Civil Law Chambers.

intentions of the parties constituting the basis of the arbitration process and the power of the arbitral tribunal. In determining the law applicable to an arbitration, the mutual intention of the parties is the decisive factor.

Consequently, unqualified assertion that the IntArbA. is applicable to all the arbitrations after it came into force can not be upheld.”

Conclusion

This decision by the General Assembly of the Civil Law Chambers came as the conclusive answer to the disputes concerning the application of the IntArbA. to arbitration agreements concluded prior to the coming into force of this Act. It also served as a confirmation of the previous judgements delivered by the individual chambers of the Court of Appeal, resolving that IntArbA. could neither be applicable to arbitration agreements made separately between the parties nor to arbitration clauses included in the main contract, before the said Act was put into effect.

Proponents of the application of the IntArbA. to all the arbitrations once the Act came into force argued that, a reference in the arbitration agreement or arbitration clause in a contract made to the laws of Turkey or Turkish legislation or laws applicable in Turkey, should also cover the IntArbA. following its coming into effect, since the said Act became one of the elements/components of the national legislation. Moreover, it was propounded, that since this Act relates to a more specific area as compared with the provisions in the CivPrA., it should have priority over these provisions and this view should be substantiated with the maxim *Lex specialis derogat legi generali*. In addition to that, IntArbA., being a subsequent legislation, should also be applicable to the exclusion of the CivPrA., based on the maxim *Leges posteriores priores contraries abrogant*.

But, it is respectfully submitted that, *party autonomy*, to the extent honoured and safeguarded as a crucial principle by the fundamental rules of the prevailing legal system should never be surrendered in favour of the above referred to arguments. Arbitration is based on contractual resolve by the parties and within the limits allowed and recognised by the basic tenets of the law. In case of any dispute, the actual intention of the parties should be given prominence as to how they have envisaged to settle their future conflicts without going to state courts. In other words, any agreement between the parties defining ways of solution to their possible conflicts other than submission to state courts must be construed, in case of doubt, with proper deference to and compliance with their initial purpose and intent.

On the other hand, the maxims referred to hereinabove, can not serve to their purpose in the context of the present argument and are more self-

defeating than supportive, simply because the parties, on the one hand, envisage and recognise to what they concede when they agreed to accept private means of settling their future disputes instead of submitting them to the jurisdiction of the state courts and secondly they are also not interested anything more special or detailed or particular than what was available for them in making up their minds.

With regard to pending or future cases, it is now apparent that, unless one can clearly infer from the mutual intentions of the parties that they would be willing to submit to the provisions of the IntArbA., all arbitration agreements, made before the coming into force of the IntArbA. must be dealt with in accordance with the articles contained in the CivPrA., provided that the parties have not opted for entirely foreign set of rules where allowed and recognised by the mandatory provisions of the Turkish law.