SİNAN ÖNCEL INTERNATIONAL COMMERCIAL ARBITRATION AS AN ALTERNATIVE DISPUTE SOLVING MECHANISM AND ITS ROLE IN THE TURKISH JUDICIARY SYTEM BILKENT 2006

# INTERNATIONAL COMMERCIAL ARBITRATION AS AN ALTERNATIVE DISPUTE SOLVING MECHANISM AND ITS ROLE IN THE TURKISH JUDICIARY SYTEM

A Master's Thesis

By

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# INTERNATIONAL COMMERCIAL ARBITRATION AS AN ALTERNATIVE DISPUTE SOLVING MECHANISM AND ITS ROLE IN THE TURKISH JUDICIARY SYSTEM

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**SİNAN ÖNCEL**

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**September 2006**

I certify that I have read this thesis and have found that it is fully adequate, in scope and in quality, as a thesis for the degree of Master of Arts in International Relations.

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Assistant Professor Nur Bilge Criss
Supervisor

I certify that I have read this thesis and have found that it is fully adequate, in scope and in quality, as a thesis for the degree of Master of Arts in International Relations.

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## ABSTRACT

### INTERNATIONAL COMMERCIAL ARBITRATION AS AN ALTERNATIVE DISPUTE SOLVING MECHANISM AND ITS ROLE IN THE TURKISH JUDICIARY SYSTEM

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Globalization has been leading to enormous changes in the world order and economy. Global market economy needs a legal system to define and protect the rights of both national and international investors against unjust competition and jurisdiction.As one of the main pillar of globalization, free movement of capital and security of capital is vital for the international investors. Legal aspect of securitization of capital is very significant especially when a dispute arise between foreign investors and state due to mistrust to local courts and complexity of the legal system. Hence, international commercial arbitration became an alternative dispute settlement mechanism. In this study, after introducing milestones for the development of international commercial arbitration in 20th century, main features and international arbitration institutions and their rules are focused to demonstrate international structure and arbitration models. On the basis of international dimension of the issue, the role and function of international commercial arbitration in Turkish Judiciary System is elaborated through focusing on Constitutional amendments, laws and legal interpretations. While concentrating on Turkish legal system, concession agreements will mainly stressed through some cases. In this study, concept of public interest and debate on “foreign element” are also covered.

**Key Words: Arbitration, Globalization, Legal Security of Capital, Turkish Arbitration System**

# ÖZET

## UYUŞMAZLIKLARIN ÇÖZÜMÜNDE ALTERNATİF OLARAK ULUSLARARASI TİCARİ TAHKİM VE TÜRK YARGI SİSTEMİNDEKİ ROLÜ

ÖNCEL, Sinan

Uluslararası İlişkiler Yüksek Lisans

Tez Danışmanı: Yard. Doç. Dr.  Nur Bilge Criss

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Küreselleşme dünya düzeni ve ekonomisinde çok büyük değişikliklere öncülük etmektedir. Küresel piyasa ekonomisi, hem ulusal hem uluslararasi yatırımcıların adil olmayan rekabet ve yargılama karşısında haklarının belirli olduğu ve korunduğu bir yasal sisteme ihtiyicaç duymaktadır. Sermayenin yasal açıdan korunması özellikle yatırımcılar ve devlet arasında doğabilecek bir ithilaf durumunda yerel mahkemlere güven duyulmaması ve yasal sistemin karmaşıklığı nedenleriyle önem kazanmaktadır. Bundan dolayi uluslararası ticari tahkim ithilafların çözümü için alternatif bir mekanizma olmuştur. Bu çalışmada, uluslararası ticari tahkimin 20. yüzyildaki gelişimindeki kilomete taşlarının sunulmasından sonra uluslararası ticari tahkimin özellikleri, uluslararası kurumlar ve bu kurumların kuralları üzerinde uluslararası yapıyı göstermek için durulmaktadır. Konunun uluslararası boyutu esas alınmak suretiyle, uluslararası ticari tahkimin Türk Yargı Sistemi'ndeki rolü, işlevi de Anayasal değişiklikler, yasalar ve içtihat ile değerlendirilmektedir. Türk Yargı Sistemi'ne konsantre olunurken, esas olarak bazı örneklerle imtiyaz sözleşmeleri üzerinde durulmaktadır. Ayrıca bu çalışma kamu menfaati kavramını ve "yabancılık unsuru" tarışmalarını kapsamaktadır.

**ANAHTAR KELİMELER: Tahkim, Küreselleşme, Sermaye Güvenliği, Türk Tahkim Sistemi**

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# CHAPTER I

# INTRODUCTION

The role of economics in international relations is flourishing since the end of the Cold War. The new markets, resources and geographies have been integrating into the world system. Economic partnership and integration is at its peak at the end of the bipolar system. In the last twenty years globalization has been leading to enormous changes in the world order. Although there are many obstacles for the new global order as well as for liberalization of capital, foreign investment and capital have become the locomotives of globalization. Almost all states including the former socialist ones have opened up their economies to foreign investors and capital. The motives of the states are unemployment, insufficient national capital, minimizing the role of the state in the economy and integrating their economies to the new global order. On the other side, foreign investors have their own motives that are intersecting with the states' motives. There is no doubt that profit is the most important motive of the capital owners.

Security of capital and liberal capital movements are also vital for the international investors. There are multiple prerequisites for attracting foreign capital and investments but in this study the regulatory structure is our primary concern.

The legal aspect is very important especially in cases of disputes which may arise from the agreements between foreign investors and the state because of mistrust to the national courts due to the unfair advantage of states[1]. In this respect, the international commercial arbitration appeared as an alternative method for solving disputes between states and foreign investors as part of securitization of the capital.

Arbitration is an ancient methodology for dispute solving especially in commercial matters. In basic terms international commercial arbitration is the settlement of a dispute based on the agreement of the parties of a contract by the authority of arbitrators.[2] International commercial arbitration is not only applicable between private entities but also between private entity and sovereign states. When private entities and foreign governments interact commercially, and dispute arises, the predominant concern is that the state may claim immunity from private lawsuits based on the principle of sovereign immunity.[3] However the absolute understanding of sovereign immunity has been changing along with globalization.

From the beginning of the industrial revolution, state capitalism emerged due to the lack of capital for investments. In other words, states became the most

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[1] Hazel Fox, " Sovereign Immunity and Arbitration" *Contemporary Problems in International Arbitration* Julian D.M. Lew (Martinus NiJhoff Publishers 1987), 323

[2]Peter Behrens, *"Arbitration as an Instrument of Conflict Resolution in International Trade: Its Basis and Limits"* Symposium on the Conflict Resolution in International Trade, (Baden-Baden: Nomos Verlagsgesellscchaft Baden-Baden, 1993), 14

[3] Daniel J. Michalchuk, "Filling a Legal Vacuum: The Form and Content of Russia's Future State Immunity Law Suggestions For Legislative Reform" *Law and Policy in International Business* Vol: 32 No: 3 (Spring 2001), 487

significant actors in the world economy. Through the mid-20th century, the role of state in national economies has been diminishing. The trend of liberalization of the national economies has been increasing since the end of the Cold War. Especially the developing states, including the former socialist ones, have insufficient capital to sustain their economic developments. Most of the East European former socialist states became EU member states which integrated them into the liberal economic order and western democracy.

As an emerging market with a liberal-based economy, Turkey has opened up its economy to foreign investments with similar motives of the other open-market economies in the last twenty years. However, the idea of international arbitration has been considered as transferring the right of jurisdiction that is based on sovereignty of the Turkish state, to another legal framework. Debates on the legal role of the international commercial arbitration in the Turkish legal system continue. However, the legislature amended the Constitution, which was disabling international commercial arbitration especially in concession contracts between the state and foreign investors. The Turkish Grand National Assembly also enacted laws that recognize the role and effect of arbitration in case of disputes based on commercial and concession contracts.

In the process of integrating Turkey into the new economic order and attracting foreign capital, restrictions for the international commercial arbitration especially in concession contracts were contradictory to liberal economic policies. In order to understand the importance of international commercial arbitration, the importance of foreign investment and capital should be evaluated.[4]

Regarding both public and private sectors there have been scarce resources for investments. In addition to insufficient capital reserves problem, there had been state monopolies in particular sectors in Turkey which were also disabling the private investments. By the introduction of liberal economic policies in the 1980s, some finance and investment models for private investments have been used such as Build-Operate-Transfer (BOT). Although these policies improved the conditions for attracting both foreign and domestic investors to engage in some unspoiled sectors for private initiatives such as energy and infrastructure, these initiatives are not sufficient to satisfy the public demand. The vast and expensive projects, which are generally planned by the government and municipalities, became questionable because of the conditions of financing the projects. Scarce resources of the public sector compelled legislators to reform some sectors and areas in order to attract both foreign and domestic investors. The applicability of international commercial arbitration is one of the prerequisites for attracting foreign investors in case of an investment dispute arises.

[4] Foreign investment does not simply provide funds but an integrated package of financial resources, managerial skills, technical knowledge, and marketing connections. It is not a debt-creating instrument; the foreign investors bear the risks of project failure, local judicial problems and politics. See Ibrahim F.I. Shihata, "*Factors Influencing the Flow of Foreign Investment and the Relevance of a Multilateral Investment Guaranty Scheme"* 21 *International Law* (1987), 671

Foreign investment or capital movements have different factors and these are making risk management, legal, political, and market conditions of the country. In this respect the tense linkages between different disciplines become vital in order to evaluate foreign investment. In this study, an interdisciplinary approach comprising international relations, economics and law, will be adopted. In the assessment of foreign investments in a country, all these factors should be connected to eliminate one-sided analysis of foreign investments and capital movements. This work will stress in addition to international and national political aspects, mostly the legal aspect.

In the first part, arbitration as a dispute solving mechanism will be focused on. There have been tremendous initiatives for the acceptance of international commercial arbitration as an alternative dispute solving mechanism. In addition to that, a brief history, the major protocols and conventions that were the milestones of international commercial arbitration, are introduced. In the second part, the institutions and features of international commercial arbitration are discussed. In this respect, the UNCITRAL (United Nations Commission on International Trade Law) that is a model law created by the UN for uniforming and harmonizing the procedures of international commercial arbitration, is examined. In the same part the ICC (International Chamber of Commerce) and the ICSID (International Centre for Settlements of Investment Disputes) will also be evaluated respectively as the major institutions for solving commercial and investment disputes. In the third part, perspectives of the Turkish Judiciary System to international commercial arbitration will be introduced. In this respect the constitutional amendments which enable the enforcement of the arbitral awards are the main objective of the fourth part. In addition to the amended Constitutional articles related laws are also discussed. In the fourth part of the study the role and importance of international arbitration on foreign investment will be discussed. During the discussion, aspects of both state and private sector are going to be focused on.

# CHAPTER II

## THE REASONS AND MOTIVES OF INTERNATIONAL COMMERCIAL ARBITRATION

Generally laws and norms particularly national and international laws are not compatible with the needs of the new economic order. Intensified international economic relations create multi-dimensional relationships between state-to-state, state-to-individual and individual-to-individual. There should be accepted national and international rules, norms and laws for the regulation of the relationships.

The legal dimension of these relationships, should be ruled by international commercial and investment norms, rules and laws in order to create a kind of rule of law in the global order. There have been lots of international attempts to protect the rights of international traders and investors who have been investing and trading in different countries such as the World Trade Organization. The reason behind those efforts is the insufficiency of trust in national laws that has also been regulating international economic disputes.[5] Until the end of the Second World War, those attempts were interpreted as part of colonialism because economically and politically powerful states had various interests in different geographies.

In the post-war atmosphere and rebuilding of international relations, political and economical barriers started to diminish in some particular areas of the world, such as in Western Europe and in Northern America. Without a doubt by intensified economic relationships and investments, international economic disputes flourished. As respective consequences of the complex and intense commercial relationships, a kind of international commercial court was proposed, but in practice it was still unrealistic, because of a variety of disputes, states and regulations.

Some international commercial disputes can not be resolved by national courts. Contracting parties generally prefer neutral dispute solving mechanisms, which can be settled though arbitration.[6] In this case, arbitration arose as an alternative dispute solving mechanism which is as old as the first commercial dispute. In basic terms, arbitration is a dispute solving mechanism between parties by the empowered institutions or individual(s) without applying to the national courts.

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[5] Philippe Cahier, "The Strengths and Weaknesses of International Arbitration involving a State as a Part" ""*Contemporary Problems in International Arbitration* Julian D.M. Lew (Martinus NiJhoff Publishers, 1987), 245

[6] Paul E. Comeaux and N. Stephan Kinsella, *Protecting Foreign Investment Under International Law* (New York: Oceana Publications Inc., 1997), 185

There are many concrete reasons and motives of preferring arbitration as a dispute solving mechanism by the international business community. The first concrete motive is the mistrust in the local courts' verdicts in case of an international party involvement in the dispute. There is a general perception by the creditors and capital owners that national courts always decide in favour of pubic interest and make partial decisions. Although this perception can also be interpreted as a biased argument, especially in developing countries where the judiciary system is not developed and corruption or politics have *de facto* capability to intervene with the judiciary, this argument may be realistic. In addition to that, national judiciary and especially the administrative courts have a general tendency to protect the public interest in its verdicts.

The second motive is that arbitration is an alternative mechanism if a party of the dispute is uncertain about the procedures and substantive rules of the host country.[7] In a national legal system there can be some commercial laws that may be insufficient and old fashioned commercial procedures that violate the international commercial practice[8]. In this case, language has also a great impact on this motive. The regional language and legal approach may also be a problem for a foreign party. However, the parties of the arbitration contract have the capacity of determining the laws and procedures which would be applied in the arbitration process.

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[7] Jan Paulsonn, "*Dispute Resolution" Economic Development, Foreign Investment and the Law* ed. Robert Pritchard (London: Kluwer Law International and International Bar Association, 1996), 210

[8] Muharrem Balci, "*Itilaflarin Çözum Yollari ve Tahkim"*, (İstanbul: Danisman, 1999), 315

The third motive is the time length of the normal judiciary proceedings. In many countries like Turkey, adjudicating a dispute take many years. However, especially in international commercial matters, the time span of a tribunal can lead to both substantive and financial losses. There is no doubt that the arbitral proceedings also take a remarkable time period but most of the arbitral tribunals are made in an intensified time zone. From a comparative perspective, the arbitration process is shorter than national judicial systems.

The fourth motive for arbitration is the secrecy of the arbitral tribunal. In the global system, there are many global firms with shares are at the global markets or there are firms that have secret commercial relations. In this respect, secrecy becomes vital for the parties.  However, the national courts' tribunals are open to the public that could be a threat to the interests of a party. International commercial arbitration tribunals are out of the public eye and the arbitral award can be kept secret between the parties.

The fifth motive is the technical capacity of the judgements. When a commercial or investment dispute arises, cases are mostly technical, which requires technical and financial expertise. On the other hand, in national courts, there is no special expertise on the subject of the dispute. However, the arbitration mechanism enables parties to select experts as arbitrator who have experience and expertise on that special case.

The sixth motive is the problem of enforcement of the "foreign court's" award in another country. It is uncertain whether the judgment would be enforceable in another jurisdiction. However, most countries signed international agreements and enacted laws that enable the enforcement of foreign arbitration awards. In the third chapter, the enforcement proceedings in the Turkish Judiciary System will be evaluated.

### 2.1 The Development of International Commercial Arbitration in the 20th Century

The general rules and norms of the international commercial arbitration have been designed and determined by international agreements, institutions and regional organizations that link the rules of arbitration to the national laws and judiciary systems. The first international agreement on the legal and procedural order of international commercial arbitration was the *Protocol of Geneva* in 1923. The Geneva negotiations aimed to introduce arbitration as an alternative dispute solving mechanism.[9] However, the international environment was not very appropriate for a wide range of participation because the WWI had just ended and protectionist economic policies were on the stage. The protocol was ratified only by 24 states. This had discouraged some of the industrialized states, which had the capability of

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[9] W. Laurence Craig, *Trends and Developments in the Laws and Practice of International Arbitration* ( www.coudert.com/practice/intcom.htm ),5

trading and investing internationally such as Britain. Although this initiative was the first international initiative that recognized arbitration as an alternative way of international commercial dispute solving, it could not ensure international participation and recognition of the arbitral awards for enforcement within national boundaries.

In order to overcome “enforcement of the awards” handicap, another convention, the Geneva Convention on the Execution of Foreign Arbitral Awards, had been summoned for the states which had ratified the Geneva Protocol in 1927.[10] However, the necessity of double ratification for completing both recognition and execution of foreign awards also limited the approval of this convention as well.

Several institutions are also involved as independent actors of the international commercial law system. The primary institution is, doubtlessly, the UN. In the postwar atmosphere of the 1950s, the desire for international commercial arbitration as an alternative dispute solving mechanism in international trade and investment became one of the primary issues of the international trade agenda. The reason was because the flourishing interaction of different nations and their national firms had especially caused different types of international disputes. The necessity for an internationally accepted dispute solving came on the agenda of the International Chamber of Commerce as well.

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[10] Ergin Nomer, Nuray Ekşi, Günseli Gelgel, *Milletlerarası Tahkim,* (İstanbul: Beta Yayım Dağıtım, 2000),21

The International Chamber of Commerce (hereinafter the ICC) which was established in 1919, pioneered a new understanding which was institutional commercial arbitration. The ICC had introduced an initial draft of procedures and rules of arbitration to the United Nations Economic and Social Council that gave the primary role to the ICC as an international arbitration institution. In addition to the institutional approach of the ICC, the recognition and enforcement of the awards, as a model, was proposed to the UN Economic and Social Council. In this respect, the UN summoned a convention in 1958, UN Conference on International Arbitration, which is also known as "the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards" (hereinafter New York Convention). Participation was wider when compared to the Geneva Convention of 1923, including France, India, the Soviets Union, Egypt, Israel and Turkey. However, ratification by the states was not fast and wide as the conclusion of the convention. The U.S.A., which was the most dominant international commercial activist for a century, did not ratify the convention until 1970. Turkey, as a signatory state of the New York Convention, ratified the convention in 1991 and amended its constitution to ensure conformity.

The international commercial arbitration has been on the agenda of several international organizations other than UN such as the World Trade Organization (WTO), the OECD (Organization of Economic Cooperation and Development) and the World Bank. All these institutions have similar concern over foreign investments, which is security of the capital by all means. In this context the WTO made tremendous efforts for the general acceptance of international commercial arbitration in global trade. In the WTO Uruguay Round, the developed states proposed high level of investor protection that allows the investors to sue the host states on every dispute with a wide scope. However, this initiative was withdrawn in Uruguay Round negotiations due to the strong oppositions of the developing states.

In the next part, on the basis of efforts which were mentioned above, institutions and features of international commercial arbitration will be focused by introducing main models, idea of sovereign immunity and *ad hoc* and institutions.

# CHAPTER III

# THE INSTITUTIONS AND FEATURES OF INTERNATIONAL COMMERCIAL ARBITRATION

## 3.1 Features of International Commercial Arbitration

The preference for international commercial arbitration has expanded in recent years parallel to the increase in international trade, investment and disputes arising therefrom. In this respect, international arbitration rules, mechanisms and institutions have been developed. Arbitration laws differ from country to country. Most of the developed countries have arbitration laws that permit and regulate both national and international commercial arbitration. Some countries enacted their own laws as the procedures of arbitration and some adopted commonly accepted rules and procedures as a model law[11].

In the context of international trade, disputes are preferred to be resolved within international trade organisations and on particular standards such as institutional commercial arbitration. Arbitration, unlike mediation that is also a type

[11] Some states like Australia, Bulgaria, Canada, Egypt, Russia and Tunisia adopted the UNICITRAL Model Law.

of alternative dispute solving mechanism, is a binding dispute solving mechanism. In order to guarantee its binding effect, parties of a contract should either agree to arbitration in a contract before the dispute arises or agree to arbitration after a dispute arises[12]. International arbitration also differs from international litigation in that arbitrating parties determine to a large extent what procedural rules will govern the resolution of their dispute. However, in litigation there are certain and common laws and procedures.

Commercial arbitration basically has two dimensions: contractual and judicial. On the contract side arbitration is based on between minimum two contractual parties. Arbitration implies that parties "agree" to submit a dispute for settlement to a person or institution instead of to courts. On the judicial side like the other national and international jurisdictions, arbitrator person or the institution should rely on an arbitration law laying down the rules for the arbitration procedure and legal effects of the award.

There are also distinctions in national and international commercial arbitration. The distinctions between national and international arbitration are generally based on the place of the dispute and the arbitral tribunal. For national arbitration, all elements (parties, dispute, and place of arbitration and arbitrators) are

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[12] Richard Hill, *"Primer on International Arbitration",* July 1995, (http://www.batnet.com/oikoumene/arbprim.html )

located within one legal system.[13] In case of international arbitration, these elements have connections with different legal system[14].There are also variations of practice, norms and rules in international commercial arbitration. In the practice field, there are two main models of commercial arbitration. These are *ad hoc* and *institutional* arbitration.

The first model is the *ad hoc* arbitration, in which the parties negotiate and determine the procedures, rules and arbitrators either before or after the dispute has arisen. The other way of deciding on the procedure of the arbitration is addressing to a particular model law or an institution that has its own procedures. The most common and internationally accepted model law on international commercial arbitration is the United Nations Commissions on International Trade Law (UNCITRAL). Although it is generally considered as a model law for *ad hoc* arbitrations, its procedures are being used by arbitration institutions such as the American Arbitration Association. The UNCITRAL, as a particular model law, is evaluated in the forthcoming part.

The second model is to addressee an institution's procedures and tribunal. The oldest and most accepted institution is the International Chamber of Commerce (ICC) which is located in Paris. Since the International Court of Arbitration was established in 1923, ICC arbitration has been constantly nourished by the experience

[13] Ergin Nomer, Nuray Ekşi, Günseli Gelgel, *Milletlerarası Tahkim,* (İstanbul: Beta Yayım Dağıtım, 2000), 4
[14] Hans Van Houtte, *The Law of the International Trade*, (London: Sweet & Maxwell 1995), 384

gained by the ICC International Court of Arbitration in the course of administrating some ten thousand international arbitration cases[15].

The various institutional rules differ in their regulation of the arbitral proceedings. In addition to the framework of the procedures, the ICC rules also contain “voluntary” procedures such as appointing a referee. As a result, there is a particular framework for arbitral proceeding in an institutional arbitration, but there are also voluntary rules that the parties of the commercial contract can decide before or after the dispute has arisen.

International commercial arbitration generally takes place between private entities, but there is an exception when a dispute may involve a sovereign entity, state, or an agency of the sovereign entity. In this case international arbitration is not as simple as it is between two private entities. When a dispute arises between a sovereign entity and a private party, it assumes both public and private international law aspects. It is an international public law issue, because there should be bilateral or multilateral investment and trade agreements between states that enable international arbitration in case of a dispute between a sovereign entity and foreign private entity. It is a private law issue as long as there is an international commercial contract between related states and the dispute become arbitrable.

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[15] ICC-International Chamber of Commerce Arbitration Rules, from the Foreword paragraph, http://www.jus.uio.no/lm/icc.arbitration.rules.1998/doc. html

### 3.2 Sovereign Immunity and International Arbitration

While private entities and foreign governments interact commercially, and when dispute arises, the predominant concern is that the state will claim immunity from private lawsuits based on the principle of sovereign or state immunity[16]. However, there is lack of uniformity in immunity rules. There are two dominant international law doctrines on the state immunity, which are: the absolute doctrine of immunity and the restrictive doctrine of immunity[17]. The absolute doctrine of state immunity has been accepted by etatist states where the national economies are closed to foreign investment. However, the practice is not parallel to the absolute doctrine of immunity[18]. Today most countries, except for a few Third World Countries, the restrictive doctrine are accepted.

States, which accepted the restrictive doctrine of immunity, determine the limits of state immunity over foreign arbitral awards and court decisions. In this respect there are international treaties, bilateral agreements and unilateral acts of the states. At the international convention level, there is the *European Convention on State Immunity,* which states that a state party to an arbitration agreement is precluded from asserting its immunity in order to frustrate the purpose of the

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[16] Daniel J. Michalchuk, “Filling a Legal Vacuum: The Form and Content of Russia’s Future State Immunity Law Suggestions For Legislative Reform” *Law and Policy in International Business* Vol: 32 No: 3 (Spring 2001), 487

[17] Georges R. Delaume, “Sovereign Immunity and Transnational Arbitration” *Contemporary Problems in International Arbitration* ed. Julian D.M. Lew (Leiden: Martinus NiJhoff Publishers,1987), 313

[18] *Ibid,314*

agreement[19]. There are also unilateral acts of some states that determine the limits of state immunity on international arbitration tribunals and awards. The most outstanding versions of unilateral acts are *the Foreign Sovereign Immunities Act* in the United States and *the State Immunity Act* in the United Kingdom. In these acts, states determine and limit the sovereign immunity over foreign judicial awards including international commercial arbitration. Although the majority of the states did not determine the limits of sovereign immunity, they adopted the restrictive doctrine, which enables international commercial arbitration and enforcement of arbitral awards.

The intensified transnational commercial activities drew the states to waive their sovereign immunity on international commercial arbitration. In order to evaluate the risks of engaging in business with transitional and developing economies, foreign governments require clear standards for determining when sovereign entities will be afforded immunity[20]. Most of the Western states adopted the restrictive doctrine of immunity and the U. S. Department of State declared that: "the increasing involvement of governments in commercial activities coupled with the changing views of foreign states to absolute immunity rendered a change

[19] *Ibid*,315
[20] Daniel J. Michalchuk, "Filling a Legal Vacuum: The Form and Content of Russia's Future State Immunity Law Suggestions For Legislative Reform" *Law and Policy in International Business* Vol: 32 No: 3 (Spring 2001), 490

necessary and thereafter "the Department" will follow the restrictive theory of sovereign immunity"[21].

Foreign investment has a primary role on waiving sovereign immunity of the states. Developed states, which have acts on the limitation of sovereign immunity, have commercial interests and investments all over the world. It should also be noted that the principle of reciprocity in international relations is still critical and those developed states are seeking reciprocal acts from the other states which limit the sovereign immunity and enable international commercial arbitration.

On the developing states' side, waiving sovereign immunity is generally accepted as one of the prerequisites for attracting foreign investment. It is expected from the developing states that they should adopt a state immunity regime which will guarantee that foreign investors will feel confident in participating in the growing foreign economies and enables international commercial arbitration.

### 3.3 Major Models and Institutions in International Commercial Arbitration

There are many models, methods and institutions, which are particularly designed for international commercial and investment disputes. In this study, UNCITRAL Rules is accepted as a major model law for international commercial

[21] M.N. Shaw, *"International Law"*, (New York: Grotius Publications Cambridge University Press 1991), 437

arbitration due to its acceptance and widespread usage in international business. As it was mentioned above, there are also institutional models for international arbitration. The International Chamber of Commerce (ICC) Arbitration rules are internationally accepted by the international business environment. Like the UNCITRAL Rules, the ICC arbitration is another cornerstone in the international commercial arbitration and this attracts us to evaluate ICC and its procedures.

The other institution to concentrate on is the ICSID. This is a particular centre, the International Centre for the Settlement of Investment Disputes (ICSID) that is a public international organization established by a multilateral treaty in 1965. It provides facilities for the conciliation and arbitration of investment disputes between Contracting States and nationals of other Contracting States[22]. In the following part of the ICSID; its rules and procedures and Turkey specifically as contracting state are examined.

As it was mentioned above, if one of the parties of an international investment contract is a sovereign entity and if there is bilateral investment treaties (BITs) between two states, the ICSID arbitration would be addressed. Turkey, as a signatory state to the ICSID convention, made tremendous changes in its judicial system to enable international commercial arbitration, especially on investment and concession contracts between the Turkish State and even its subsidiaries with

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[22] Ibrahim F.I. Shihata and Antonio R. Parra, "The experience of the International Centre for Settlement of Investment Disputes", *Foreign Investment Law Journal* 14:2 (Fall 1999)

foreign private entities. Consequently, the ICSID jurisdiction has a special importance for Turkey.

### 3.3.1 UNCITRAL As A Model Law

UNCITRAL (United Nations Commission on International Trade Law) is a model law for the international commercial disputes that was recommended by the UN General Assembly in 1985. It aims to reduce the role of national courts on international commercial disputes and enable the recognition and enforcement of the foreign awards. The commission included observers of states, intergovernmental organizations and international organizations such as the ICC (International Chamber of Commerce) and the ICCA (International Council for Commercial Arbitration). All these parties recognized that the procedures and laws that had been used until the UN initiative became insufficient as a dispute solving mechanism. Generally, the former implications were domestically designed and unable to cover the requirements of contemporary international business disputes. This initiative of the UN was created on the basis of the New York Convention and advocates the trend of arbitration in international disputes.

The adopted Model Law aims to create a model law for the states, which are preparing their own national laws and regulations[23]. The UNCITRAL rules and

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[23] Ergin Nomer, Nuray Ekşi, Günseli Gelgel, *Milletlerarası Tahkim,* (İstanbul: Beta Yayım Dağıtım, 2000),43

regulations are widely accepted among both developed and developing states[24]. Most of the states including Turkey, enacted international commercial arbitration law in line with the general understanding and regulations of UNCITRAL. The UNCITRAL regulations are also applicable especially in *ad hoc* arbitration. These regulations include very detailed rules and thus offer a solution for many procedural problems[25]. The variations of UNCITRAL Rules had also been formed in different areas such as on the disputes between U.S. nationals and the government of Iran arising from expropriations of the property of U.S. nationals[26].

The most significant and outstanding reason of global acceptance of the UNCITRAL rules is its flexible features. Article 15 of the UNCITRAL Rules enables the flexibility of the arbitral tribunals by stating that: "Subject to these Rules, the arbitral tribunal may conduct the arbitration in such manner as it considers appropriate…" Howard M. Holtzmann claimed that: "the broad power of the arbitral tribunal to determine the procedures to be followed is, firmly hedged by the introductory phase 'subject to these rules*'*[27]. The arbitral tribunal has a high degree of flexibility according to the UNCITRAL Rules. However, there are some limitations on this flexibility that include: each party must be treated with equality

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[24] Paul E. Comeaux and N. Stephan Kinsella, *"Protecting Foreign Investment Under International Law"* (New York : Oceana Publications Inc., 1997),196
[25] Hans Van Houtte, *The Law of International Trade* (London: Sweet & Maxwell, 1995), 395
[26] Paul E. Comeaux and N. Stephan Kinsella, (1997), 197
[27] Howard M. Holtzmann,"*Balancing the Need For Certainty And Flexibility In International Arbitration Procedures"* in ed. Richard B. Lillich and Charles N. Brower *"International Arbitration In the 21st Century: Towards "Jurisdiction and Uniformity"* (New York: Transnational Publishers, Inc,1994),5

and allowed to present its case in full;[28] the claimant and defendant should each submit written pleas to arbitrators and to the other party.[29]

As it was mentioned above the UNCITRAL Rules are modified by national laws. The parties of an arbitration contract may also make these modifications. The UNCITRAL Rules give the parties freedom to choose the substantive law that will govern their dispute[30]. If the parties do not choose an applicable law, the tribunal may determine the law. In a dispute involving foreign direct investment, many conflicting laws will point to the Host State's law as the governing law.[31] If the investor does not accept the Host State's law to apply then the parties of the arbitration contract can choose the UNCITRAL Rules as rules of the arbitration process.

The other important issue in UNCITRAL Rules is the recognition and enforcement of the arbitral awards. Article 50 of the UNCITRAL Rules states that "…the grounds on which recognition or enforcement may be refused under the Model Law are identical to those listed in article 5 of the New York Convention"[32].

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[28] Article 15 of the UNCITRAL Rules (http://www.uncitral.org/uncitral/index.html)
[29] Article 18 of the UNCITRAL Rules (http://www.uncitral.org/uncitral/index.html)
[30] Article 33 of the UNCITRAL Rules (http://www.uncitral.org/uncitral/index.html)
[31] Ibrahim F.I.Shihata & Antonio R. Parra, "*Applicable Substantive Law in Disputes Between States and Private Foreign Parties: The Case of Arbitration under the ICSID Convention*" *ICSID Rev- For Investment Law Journal* 10 (1994), 191
[32] Article 50 of the UNCITRAL Rules (http://www.uncitral.org/uncitral/index.html)

The New York Convention put the recognition and enforcement of the arbitral awards at top priority of the international commercial law. Article 5 of the New York Convention specified the exceptions of enforcement of the arbitral awards which solved the most problematic side of the arbitration. There are basically five exceptions, first two are substantial and the last three are procedural.

On the substantial side, Article 5 of the New York Convention empowered the signatory states to evaluate the cases whether the case is arbitrable or not. The second substantial exception is the violation of the public order and interests.[33] If the national court, which is authorized to enforce the foreign arbitral award, interprets that the arbitral award is against the public interests, the national court, on the bases of the New York Convention, has the capacity of not enforcing the award. The issue of foreign arbitral award and public interests is concentrated in the third part.

On the procedural side, the New York Convention empowered the signatory states to refuse to recognize and enforce the arbitral awards if there is not a valid arbitration agreement between the parties of the dispute. The second procedural exception is that if there is a lack of the opportunity to be heard by the arbitrator than the arbitral award could not be recognized by the national court. The third and the

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[33] The New York Convention of 1958 article V. See David P. Stewart, a senior officer at the Department of State of U.S., in "N*ational Enforcement of Arbitral Awards under Treaties and Conventions"  International Arbitration in the 21st Century : Towards "Judicialization" and Uniformity?* Ed. Richard B. Lillich and Charles N. Brower (New York: Transnational Publishers, 1994),185

final procedural exception is that if the award lacks binding effect because the competent authority suspends the award, then the arbitral award could not be recognized by the national court. States were limited with those procedural and substantial conditions so as not to act in opposition to the arbitral awards.

The importance of the arbitration protocol between the parties increased while these procedural and substantial conditions were fulfilled according to the New York Convention. In order to secure and guarantee the enforcement of the arbitral award, the arbitration protocols should fulfill the conditions of the Convention. By the securitization of the enforcement of the awards, international arbitration became a generally accepted, preferred and recognized tool in international commercial disputes.

### 3.3.2 International Chamber Of Commerce (ICC) Arbitration

The International Chamber of Commerce (ICC) created its Court of Arbitration shortly after the First World War.[34] The ICC has become one of the leading institutions that serves international commercial arbitration since the 1920s. Although the centre of the ICC is located in Paris, its service of arbitration is not limited at the centre, but all over the world. The ICC has a set of arbitration rules for usage of the arbitration applicants. In the foreword paragraph of the Rules of

[34] Jan Paulsson "*Dispute Resolution*" ed. Robert Pritchard *Economic Development, Foreign Investment and the Law* (London: Kluwer Law International and International Bar Association, 1996), 209

Arbitration of the ICC it is stated that: "ICC arbitration has been constantly nourished by the experience gathered by the ICC International Court of Arbitration in the course of administrating some ten thousand international cases, now involving each year parties and arbitrators from over one hundred countries and from a diversity of legal, economic, cultural and linguistic backgrounds".[35]

Unlike *ad hoc* arbitration, the ICC has its own institutional rules and regulations such as the confidential character of the tribunals. The ICC has a secretariat, which receives the applications and organizes the tribunal. The parties of the arbitration are free to stipulate the arbitration place as well as arbitrators. However when the ICC arbitration is preferred by the parties of the dispute, they consent to all the procedures and rules of ICC unlike *ad hoc* arbitration.

The details of the ICC Rules are not the main objective of this study hence only some particular features of the ICC Rules are taken into consideration. One of the significant features is that the ICC proposed conciliation to all the arbitration applicants before the arbitral tribunal unless the parties have agreed otherwise. The ICC Rules enable the parties to agree upon the law to be applied in the arbitral tribunal.[36]

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[35] ICC-International Chamber Of Commerce Arbitration Rules (adopted to take effect from 1 January 1998) http://www.icc.org

[36] Article 17 of the ICC-International Chamber Of Commerce Arbitration Rules (http://www.jus.uio.no/lm/icc.arbitration.rules.1998)

Another significant feature is related with the binding effect of the ICC arbitral awards. Article 28/6 of the ICC Rules claims that the arbitral award shall be binding on the parties of the arbitration. Unlike the UNCITRAL Rules that has references from the New York Convention especially on the enforcement issue the ICC Rules does not involve any provision considering Article 5 of the New York Convention. Similar to the *ad hoc* arbitration, the ICC arbitral awards are enforced in Turkey on the bases of the international agreements and national law and proceedings.

### 3.3.3 International Centre For Settlement Of Investment Disputes (ICSID)

The International Centre for Settlement of Investment Disputes (ICSID) is a public international organization established by a multilateral treaty, the 1965 Convention on the Settlement of Investment Disputes between States and National of Other States.[37] The ICSID was established to satisfy the need for an apolitical mechanism to provide facilities for the arbitration of investment disputes between states and foreign investors.

The ICSID arbitration, like the ICC arbitration, is an institutional arbitration centre and proposes conciliation before taking the dispute to the arbitral tribunal. It has also unique features that differentiate the ICSID arbitration mechanism from the

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[37] Ibrahim F.I. Shihata and Antonio R.Parra, "The Experience of the International Centre for Settlement of Investment Disputes" *Foreign Investment Law Journal* 14:2 (Fall 1999), 299

other institutional arbitration centers. Firstly, ICSID was established by international convention that 135 states signed.[38] Secondly ICSID is not just an arbitration centre, but it is also an organ of the World Bank for the encouragement of the foreign investments. Thirdly, it is compulsory arbitration when the parties of the investment dispute decide on. In other words, after consent is given to ICSID, it is irrevocable. Finally, the award made by the ICSID arbitration is certain and none of the national laws and reservations such as protecting the public interest can change the award and enforcement of the award.

Paul E. Comeaux and N.Stephan Kinsella specified the three conditions of ICSID Centre that must be satisfied to accept jurisdiction over a dispute. Firstly, the dispute must involve a Contracting State and a national of another Contracting State. Secondly, both the Host State and the investor must agree to submit the particular dispute for arbitration to the ICSID Centre. These two conditions are called "double consent". Finally, the dispute must arise directly out of an investment.[39]

Turkey, as a signatory state of the ICSID Convention, signed many Bilateral Investment Agreements where ICSID arbitration is recognized as the dispute solving mechanism for disputes arising from concession contracts. Turkey, before enabling the international commercial arbitration for the concession contracts in 1999,

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[38] *Ibid*, 300

[39] Paul.E.Comeaux and N.Stephan Kinsala, *Protecting Foreign Investment Under International Law*, (New York :Oceana Publications Inc. Dobbs Ferry, 1996), 29

recognized the ICSID arbitration where the awards are irrevocable by international agreements

Unlike the *ad hoc* arbitration and other institutions, on the base of the ICSID Convention, the enforcement of the ICSID arbitral awards has absolute binding effect for the parties. Article 54/1 of the Convention requires each Contracting State to recognize an award rendered pursuant to the Convention as binding and to enforce the pecuniary obligations imposed by the award as if it were a final judgment of the State's courts.[40]

Turkey, by its consent given under the Bilateral Investment Treaties with several states, accepted ICSID arbitration as a dispute solving mechanism for investment disputes. However, in Turkey international commercial arbitration has been presented as a new phenomenon for the concession agreements such as Build-Operate-Transfer investment model. Birsel and Budak claim that the disputes arising out of concessions regarding foreign investments were arbitrable under any arbitration mechanism including ICSID if the arbitration was provided for in Bilateral Investment Treaties. [41]

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[40] Ibrahim F.I. Shihata and Antonio R.Parra, "The Experience of the International Centre for Settlement of Investment Disputes" *Foreign Investment Law Journal* 14:2 (Fall 1999),341

[41] M.T.Birsel and A.C. Budak, "*Milletlerarası Tahkim Konusunda Türk Hukuku Açısından Sorunlar ve Öneriler"* in the Symposium "*Milletlerarası Tahkim Konusunda Yasal Bir Düzenleme Gerekirmi?"* 261 (1997)

After focusing on the features and institutions of international commercial arbitration and introducing relationship between Turkey and international arbitration institutions, next part is focusing on international arbitration in the Turkish judiciary system by concentrating on development of arbitration notion in Turkey, Constitutional regulations, concept of public interest and order, and arbitration related laws.

# CHAPTER IV

# INTERNATIONAL ARBITRATION IN THE TURKISH JUDICIARY SYSTEM

## 4.1 The Background of the International Commercial Arbitration in the Turkish Judiciary System

The concept of arbitration is as old as the Republic of Turkey. The procedure of arbitration was determined by the Hukuk Muhakemeleri Usul Kanunu (HUMK - Statute of Procedural Law) in 1927. There are also procedures and regulations that regulate international private law. In addition to these procedural regulations, Turkey signed almost all-major international agreements on the international commercial arbitration. These agreements are namely Geneva Convention on the Execution of Foreign Arbitral Awards, New York Convention on the Enforcement of the Arbitral Awards and the Washington Convention (International Centre for the Settlement of Investment Disputes). Turkey also recognized the procedure of arbitration in some Bilateral Investment Treaties (BITs) with other states in case of a dispute between the Turkish state and foreign private persons.

From an international perspective, Turkey is a country that has recognized the concept of international commercial arbitration in the early years of the republic and signed the major agreements that recognize the enforcement of the international arbitral awards. Although Turkey had signed all these international agreements, in respect to the universal ethic of international law that is *pacta sunt servanda*[42], Ankara did not ratify these international agreements until the early of 1990s. According to article 90 of the Turkish Constitution, which has been in force since 1982, the enforcement of an international agreement can be accepted by ratification of the Turkish Grand National Assembly enacting it into law. The same article of the Turkish Constitution also determined the understanding of the conflict of laws. With same the reference in the Constitution, all the international agreements are equal to the other national laws if the international agreement ratified according to the procedure, which is described in article 90 of the Turkish Constitution[43]. The recognition of foreign arbitral awards and accepting enforcement of these awards were realized through two distinct laws. The International Private Law (Law No. 2675) enabled the enforcement in Turkey of foreign arbitral awards in 1982. In

[42] Paul.E.Comeaux and N.Stephan Kinsala, *Protecting Foreign Investment Under International Law*, (New York :Oceana Publications Inc. Dobbs Ferry, 1996),201

[43] According to the Turkish Constitution, article 90 also disables the all the possible initiatives that claim the invalidity of an international agreement if it is recognised according to the procedure of the Turkish Constitution. The other significant point is that The Constitutional Court can not judge the validity and discrimination of the international agreement to the Constitution.

addition to this law, Turkey ratified the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards by Law No. 3731 in 1991[44].

Although there was not any obstacle for the practice of international commercial arbitration after the ratification of international agreements on the basis of the Turkish Constitution, there had been contradicting constitutional articles that disable international arbitration in concession agreements that relates to the public services. These contradicting articles numbered 125 and 155 had been amended in 1999 to enable the Hukuk Usulü Muhakemeleri Kanunu (Statute on the Procedural Law) and Milletlerarası Özel Hukuk ve Usul Hukuku Kanunu (The Statute on The International Private And Procedural Law) to be the applicable law to international arbitration even for concession agreements.

In Turkey, as a concept, arbitration is not common as in other countries as an alternative dispute solving mechanism. Arbitration is understood as an international dispute solving mechanism. However the HUMK (Statute on the Procedural Law) also enables the native conflicting parties to prefer arbitration to solve the disputes (Articles 516- 536)**.** But national arbitration is not a common dispute solving mechanism in practice. In developed countries, arbitration is commonly used by the business community where seventy percent of the conflicts of business law are resolved through alternative dispute solving mechanisms, mainly through

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[44] Nazan Candaner Elver, "Turkish International Arbitration Law and Restrictions on its Applications" *Journal of International Arbitration 21(5)*, 453-458

arbitration[45]. In Turkey, in addition to the enacted laws that aim to encourage foreign investments and policies of liberalization of the economy, international commercial arbitration became one of the significant components of the foreign investments just in the like globalizing economies[46].

Before evaluating the constitutional amendments which were realized to enable international commercial arbitration on concession and investment agreements, the objective and purpose for international commercial arbitration should be discussed. From a very simplistic aspect, international arbitration has been introduced as one of the prerequisites for attracting foreign capital and investments in Turkey. The relationship between foreign investment and arbitration is basically based on the lack of confidence to the local judiciary system and the awards that are made by the local courts. However this relationship can not be simplified just by introducing the issue of confidence.

The Standard & Poor's, an internationally recognized creditor and rating institution, considers the legal structure of an investment as one of the significant aspect of rating of the investment project. Standard & Poor's analyses the legal risk

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[45] Cemal Şanlı, in his panel speech on " İdari Şözleşmeler ve Uluslararası Tahkim" on 16 July 1999, Turkish Bar Assosiation, 6

[46] There are three major laws that aim to encourage foreign investments in Turkey. One of them is *The Law Concerning the Encouragement of Foreign Capital (No: 6224 Date: Jan 18, 1954)* and the second one is *Law Regarding Engagement in Investments and Services on the Built-Operate-Transfer Model (No: 3996 Date: June 13, 1994)* that has provisions on foreign capital and relationship between state departments and the foreign company. The last one is *Foreign Direct Investment Law( Law No.4875 Date: June 5, 2003).*

of the project by evaluating the choice of legal jurisdiction and enforceability of the international arbitration awards. Standard & Poor's determined the risk of enforceability as "the issues of the documentary enforceability lie at the heart of any project financing" [47]. In some respects the legal criteria that Standard & Poor's require for an investment project become vital for disabling the risks of all restrictions on tax, competition, transfer of the profit and any other conflicts that are based on matters of the investment agreement.

However, one remarkable argument was made by a Turkish Jurist, Yücel Sayman, and former chair of the İzmir Bar Association, who criticizes the creditor institution's understanding of enforceable international arbitration as a prerequisite for financing the investment projects. He claimed that "all creditor institutions only focused on the interest of the investors, company and the articles of the investment agreements. None of the creditor or investors concerns environmental issues or public interests. All the procedural rules are given up for the sake of the rapidity of the arbitration awards, cost of jurisdiction and secrecy of the conflict."[48]

From the beginning of the 1980s, Turkey has been increasing by opening its economy to international investments due to the lack of capital to sustain its development. However, especially due to political instability and economic turmoil

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47 www.standardpoor.com/resourcecentre/ratingscriteria/corporatefinance/article/energyinfra.htm#legal structure

48 www.izmirbarosu.org.tr/yargireformu2000/oturum61.

in the 1990's disabled Turkey to sustain its development projects such as GAP (Southern Anatolian Project) and other huge energy projects. The demand for new infrastructure investments which require vast amounts of financing, increased by population growth, industry and urbanization. In this respect, international arbitration is introduced by politicians and interest groups as one of the most problematic side of attracting foreign capital in the 1990s.[49] Turkey enacted several laws that aim to encourage foreign investments.[50]

An investment can not be evaluated just by focusing on its financial feasibility. As it was mentioned above, Turkey made tremendous efforts to attract foreign capital in economic terms by tax regulations and capital transfer. In addition to that, in the Turkish Judiciary System there is no prohibitive law provision to determine international arbitration where the parties of a contract are between two private entities.

Turkey faced the international commercial arbitration problem as an alternative dispute mechanism in investment agreements, by the enacting law on the

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[49] Cumhur Ersümer, Minister of Energy and Natural Resources, in his speech at the Conference on "Gas and Energy in Turkey" in İzmir on 22nd September 1999.
http://www.byegm.gov.tr/yayyinlarimiz/TURKHABER/1999/28Eylul/T2,htm

[50] The following laws were enacted due to the need for large amount of capital: 1) The law on the Authorisation of Institutions other than the Turkish Electricity Institution for Generation, Transportation and Distribution and Trade of Electricity no: 3096 dated 1984 2) The framework law on the Realisation of Some Investments and Services by Build-Operate-Transfer Model, No.3996 dated 1994. (The Constitutional Court recognised the Build-Operate-Transfer Projects as "concession agreements" in 1995. Until the constitutional amendment had been made (article 125) all the concession agreements were under the supervision of the Court of State)

Engagement in Investments and Services on Build-Operate-Transfer (B.O.T) Model to encourage foreign investment in 1994. Foreign investors and creditors demanded the applicability of international commercial arbitration in their B.O.T. contracts due to mistrust in the Turkish Judiciary System. One year later, Constitutional Court cancelled article 5 of the Law No: 3996 (Law Regarding Engagement in Investments and Services on Build-Operate-Transfer Model) that is "the contract is subject to private law provisions" that automatically enables international commercial arbitration.[51] In the same decision Constitutional Court also underlined that the B.O.T. Model was interpreted as a "concession treaty" where the administrative law is applicable[52].

In addition to the Constitutional Court's interpretation, foreign investors faced the obstacle of the supervision of the Court of State for every concession treaty due to the slow and conservative review of the Court. Algan Hacaloğlu, a former MP (Member of Parliament) underlined the importance of the Court of State in reviewing the state-to-individual contracts, including the concession contracts. He pointed out that: "the primary responsibility of the state is to protect public interests. The Court of State has the capacity of supervision of the concession contracts on behalf the public interests. By amending the related provision in the Constitution,

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[51] Constitutional Court Decision No: 1995/23

[52] A concession treaty means granting of a privilege in order to get non-governmental real and legal persons to perform services in public interests under the administrative law.

individuals would also lose their right to object to the contracts on the bases of public interests"[53].

According to the amended article 155 of the Constitution, the Court of State was the sole authority for evaluating the contracts between the administration and other private entities. The former Minister of Industry and Trade of the reform period, Ahmet Kenan Tanrıkulu, pointed out that: "the Constitutional Court's cancellation ruling did not prohibit the arbitration condition to appear in administrative contracts, but the uncertainty that arose, coupled with the negative attitude of the Council of State in this respect, led to bottlenecks in foreign capital investments"[54].

By canceling article 5 of Law No.3996, the Constitutional Court disabled the applicability of the international commercial arbitration in concession contracts. Oktay Vanlıer, Parliamentary Commissioner of Turkiye Sanayici ve İşadamları Derneği (TUSIAD- Turkish Industrialist and Businessmen Association), identified the cancellation as all the Build-Operate-Transfer Projects being under the control and supervision of the Court of State, because B.O.T. agreements were considered as concession agreements. The second point was that in case of a dispute based on the investment, the sole dispute solving institution was the Court of State. The third consequence was that in the concession contracts only the discrimination or faults of

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[53] Algan Hacaloğlu, "Uluslararasi Tahkim ile ilgili olarak Anayasanin 47.,125.,155. Maddelerinde Değisiklik Öngeren Yasa Tasarısı Hakkinda Tartışma Notu" www.chp.org.tr/tahkim

[54] http://www.yased.org.tr/en/insightyased/13/arbitration

the private investor was accepted by the administration, and in this respect the administration had the capacity to void the investment agreements[55]. There is no doubt that the final analysis of Vanlıer is the most critical argument due to the relationship between the international creditors, investors and the administration, since the security of an investment is the primary concern of the creditors.

The International Energy Association also emphasizes the same security concern on the energy investments;

> Companies and creditors will always look closely at the overall legal and administrative framework in a particular country. They want to be sure that they can, if necessary, protect their investments by recourse to law. This matters most in cases where agreements they have entered into are not being complied with other parties, or where customers have defaulted on payments. Dispute resolution is an important aspect of this issue, including whenever necessary access to international arbitration. In a wider sense companies and creditors will want to feel protected against crime and corruption[56].

In order to abolish the barriers on the applicability of international commercial arbitration for the investment agreements, Constitutional reform became unavoidable. However, discussions on the applicability of international arbitration and enforcement of the arbitral awards still continue. The constitutional amendments were realized in 1999 that enable the applicability of international commercial arbitration even in concession contracts and minimize the supervision role of the Court of State over the investment agreements. The atmosphere of this amendment in 1999 was confusing, because international arbitration was introduced as the sole

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[55] Oktay Vanlıer, "Yap-İşlet-Devret ve Uluslararası Tahkim" *Görüş*: October 1999
[56] http://www.iea.org/g8/invest/exsum.htm

obstacle for foreign investments. In addition to this, a shady strategy and rumors on energy shortage and lack of capital for financing the energy projects accompanies the campaign on international arbitration. Under this campaign, the universality of the law; institutions and concepts were introduced as the proof of international arbitration in case of a dispute between the administration and foreign investors.

**4.2 The Regulations of the Turkish Constitution**

As it was mentioned above, Turkey had ratified the major international treaties that enable the applicability of international commercial arbitration and the enforcement of the arbitral award. Although these treaties and conventions had been ratified in 1991, the conflicting articles of the Turkish Constitution remained until 1999. In 1999, the Turkish Grand National Assembly (TGNA) made Constitutional amendments in order to ensure the coherence of ratified international treaties and laws.

In the arrangement made by Article 2 of "The Act Concerning Amendments on Certain Articles of the Constitution of Republic of Turkey" (Law No.4446) which was accepted on 13$^{th}$ August 1999, the related article 125 of the Constitution was amended. By this amendment, the application of international commercial arbitration became available on disputes arising out of the concession agreements as well. However, parliament has put a reservation on this clause that international arbitration is only possible when the agreement involves a foreign element. Before evaluating the "foreign element" concept, how the Turkish Judiciary System interprets the concept of foreign element should be understood.

The International Arbitration Law, which was enacted on 21st June 2001, regulates the procedure and concepts of international arbitration in Turkey, and describes the concept of foreign element[57]. In order to apply international commercial arbitration, one of the parties of the contract should fulfill the following criteria.

The first criterion for foreign element is that at least one party of the arbitration agreement has a legal domicile other than Turkey or a different legal domicile other than the place of investment. The second criterion is at least one of the parties of the arbitration agreement has to fulfill the obligations of the Law Concerning the Encouragement of Foreign Capital where the Turkish authorities recognize the capital movement as foreign capital. The final criterion is that there should be commodity or capital movement as part of the main agreement that the arbitration relies on.

[57] International Arbitration Law No. 4686. This law specifies the Turkish procedure and rules of arbitration if the parties of a contract prefer Turkish Arbitral Rules as the procedure of their arbitral tribunal. This law will also be evaluated in the forthcoming part.

The real motive of putting the prerequisite of foreign element into the application of international commercial arbitration is to limit the preference of the contracting parties to decide on “international” arbitration. As it was mentioned above, paragraphs that there is no obstacle to prefer the national arbitration as a dispute solving mechanism[58]. Turkey generally does not prefer international commercial arbitration method in case of a dispute due to mistrust in the international arbitration institutions’ rules and procedures. Turkish Constitutional Law Professor Mümtaz Soysal also underlined his mistrust in the international commercial arbitration on the basis of political concerns. He highlighted the biased attitude of the international community towards Turkey by giving sample tribunals that were concluded against Turkey in the European Court of Human Rights[59]. Under these circumstances, the administration aimed to limit the application of international commercial arbitration unless there is a foreign element.

There is no doubt that practical difficulties made a strong impact for not preferring international commercial arbitration. However, the most significant motive is the general characteristic of international commercial arbitration institutions and their rules. It is generally believed that all the rules and procedures are designed for the protection of investors and capital. Prof. Siam Sunday also pointed out that: “especially the developing countries do not trust the arbitration

[58] The HUMK (Statute on the International Private and Procedural Law) No.516 claims that disputing parties may refer to arbitration whether before or after a dispute arises.

[59] Mümtaz Soysal, in his panel speech on “ İdari Şözleşmeler ve Uluslararası Tahkim” on 16 July 1999, Turkish Bar Assosiation, 51

institutions, and interpret the arbitration method as a design of the developed and industrialized states to protect themselves and their citizen's capital in the developing world"[60]. In order to legitimize and make international arbitration accepted universally, the United Nations has played a significant role. As it was focused in the Institutions and Models for International Commercial Arbitration Part of the study, UNCITRAL was introduced as universal rules for arbitration.

It is open to discussion whether Turkey decided to legalize and legitimize international commercial arbitration by the global liberal economic atmosphere of the 1990s or international arbitration became a prerequisite for foreign direct investments. By the year 1999, Turkey adopted international commercial arbitration in its Constitution as a component of the 1999 Constitutional reform. In the 1999 amendments, in addition to article 125, TGNA also amended articles 47 and 155 which were also contradicting with the application of international commercial arbitration.

Article 47 of the Constitution was on the Expropriation Policy of the Turkish State that had been empowering the state to expropriate if a private investment or facility has a public service feature. Doubtlessly, the application of this article might be an extraordinary situation such as in case of national security matters. However, the interpretation of this article was also made by foreign investors such that there

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[60] Prof. Saim Üstündağ, İstanbul Faculty of Law, Symposium of Reform of Law, (www.izmirbarosu.org.tr/yargıreformu/oturum 64)

was the possibility of expropriation of their investments. By the 1999 constitutional amendment article 47 was revised. Privatization became a constitutional concept and the confrontation between liberal economic policies on side of privatization of state enterprises, and the Constitutional Court was abolished.

The other amended part of the same article is that the investments and services, which were carried out by the state enterprises and institutions (which were formerly interpreted as public service), might be given as concession and this is regulated by law[61]. Yücel Sayman claims that: "by this amendment one of the constitutional traditions that specified what kind of services were interpreted as public service was left out"[62]. Finally, the amendment of Article 47 of the Constitution also ensures that international commercial arbitration can be preferred in concession contracts.

There are also foreign investments other than concession agreements. All investments contain numerous risks including political risk. Especially the investors and creditor institutions are concerned with political risk[63]. A senior officer of the

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[61] The Act Concerning Amendments on Certain Articles of the Constitution of Turkey, No:4446

[62] Yücel Sayman, The chair of İzmir Bar Assosiation, The Symposium of Law Reform http:// www.izmirbarosu.org.tr/yargıreformu/oturum 61

[63] Political Risk is defined by Paul.E.Comeaux and N.Stephan Kinsala in their book Protecting Foreign Investment Under International Law as the risk faced by an investor if a host country will confiscate all or a portion of the investor's property rights located in the host country. There are five types of political risk that the authors mentioned expropriation (including confiscation and nationalisation), de facto expropriation, currency risk, risk of political violence and the risk of breach

State Planning Organization, Uğur Emek, specified the concept of political risk in an investment as: "it is basically the unilateral acts decided by host country that limit the rights of the investors based on the investment agreement"[64]. The limitations may include the expropriation of the investment or property, revision of tax laws, additional responsibilities, transfer of capital and entirely or partially withdrawing the guarantees for which the state is responsible. Before the amendment concerning Article 47 was realized, if the administration would have decided on expropriation of an investment based on the connected article, the Court of State could have not interpreted the expropriation decision as outside the law[65]. By adding the clause that enabled the transfer of the public service as a concession, the problem was eradicated and relieved concession contracts and international commercial arbitration. Only then international commercial arbitration became available in the concession contacts by the amendment of article 125 of the Constitution.

In order to evaluate the reasons for these amendments, expectations as well as demands of the investors and creditors should be understood. As it was underlined many times in this study, the primary motive of the investors is to protect their capital and investment in the host country. However, the status quo in Turkey before the Constitutional amendment was far from the expectations of the foreign investors.

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of contract by the host state. See Paul.E.Comeaux and N.Stephan Kinsala, *Protecting Foreign Investment Under International Law*, (New York: Oceana Publications Inc. Dobbs Ferry, 1996),3-18

[64] Uğur Emek, in his speech on "*The Concession Contracts and International Commercial Arbitration"* at the Thursday Conferences (Perşembe Toplantıları) of the Regulatory Institution of Competition, 2nd December 1999, www.rekabet.gov.tr/etkinliklerimiz

[65] *ibid*

There is no doubt that there were foreign investments in various sectors and with different models including the B.O.T. Model without the opportunity to solve investment disputes by international commercial arbitration.

When the decision of the Constitutional Court was made which cancelled the article 5 of the Law No.3996, and it was decided that all the Build-Operate-Transfer Projects came under the control and supervision of the Court of State because B.O.T. agreements were considered as concession agreements. Hence, the parties of the concession contracts became the administrator and investor and in this way the administrative law had become applicable. The applicable law specifically became a drawback for the foreign investors, because the administration could act against the interest of the investors. That was the political risk of an investment, on the basis of public interest such as expropriation of the investment. Political risk had impacts even on the creditors, and rating institutions that evaluate the feasibility of an investment[66]. The political uncertainty of a host country also affects the cost of the investment due to the high level of insurance and risk premiums that are demanded especially by the creditor.

Through the Constitutional amendments, especially the political and legal risks were minimized by the ensuring applicability of international commercial arbitration even for concession agreements. The minimization of political risk can be

66 www.standardpoor.com/resourcecentre/ratingscriteria/corporatefinance/article/energyinfra.htm#legal structure

defined as prosecution of administration of its decisions and acts on the bases of a subjective understanding of public interest[67]. In this part especially the concession contracts are focused on, because international commercial arbitration is a compulsory method for solving the dispute between a host country and foreign investor(s) if there is bilateral agreement on the encouragement of investment between two states. In addition to this, the ICSID arbitration became applicable and its awards are absolute and irrevocable even when the award is against the public order.

Some of the jurists such as Akıncı have reservations on the amendment of the Article 125 on the basis of the concept of “foreign element”. He interprets the purpose of the amendment to encourage investors and eradicate their doubts about the justice system in case a dispute arises. Akıncı has interpreted the amendment as enabling the application of Turkish investors to international commercial arbitration whereupon a dispute arises on the basis of a concession contract[68]. However, Yılmaz has comprehended the same amendment in an opposite way concerning the point of “foreign element” that international commercial arbitration is only applicable when a “foreign element” is a party to the concession agreement[69].

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[67] Uğur Emek, in his speech on “*The Concession Contracts and International Commercial Arbitration”* at the Thursday Conferences (Perşembe Toplantıları) of the Regulatory Institution of Competition, 2nd December 1999, www.rekabet.gov.tr/etkinliklerimiz

[68] Ziya Akıncı,The Univeristy of Dokuz Eylül. From his paper presented at the Conference on the Judiciary Reform in 2000. http://www.izmirbarosu.org.tr/yargıreformu2000/oturum63.htm

[69] Ejder Yılmaz, From his paper presented at the Conference on the Judiciary Reform in 2000. http://www.izmirbarosu.org.tr/yargıreformu2000/oturum62.htm

Yılmaz criticized the concept of “foreign element” due to its flexible and extendable understanding because international commercial arbitration is applicable even if only one partner of a company, joint venture, and consortium fulfills the criteria of “foreign element” according to the Turkish laws. Another understanding of “foreign element” is that if the capital, credit or the guarantee of the investment is recognized as foreign according to the Law No: 6224, Law Concerning the Encouragement of Foreign Capital[70] then international commercial arbitration became applicable. In other words, international commercial arbitration became applicable for Turkish investors if the financing or guarantee for the project is ensured from another country.

There has been a very concrete experience in the Project Hydroelectric power plant of Fırtına Valley in Trabzon. The project was designed on the basis of Build-Operate-Transfer Model, which is a concession agreement. The local court decided not to recognize the environmental reports that were legitimizing the project regardless of environmental concerns. The Turkish project-operating firm, BM Holding had made an international engagement with two foreign firms, ABB and France de Electric, in order to apply to international commercial arbitration unless the dispute is solved in line their interests[71]. However, construction of a hydroelectric dam on the Fırtına River is still a debate issue that Energy Market

[70] Ejder Yılmaz, From his paper presented at the Conference on the Judiciary Reform in 2000. http://www.izmirbarosu.org.tr/yargıreformu2000/oturum62.htm

[71] *Cumhuriyet* 21st July 1999. Although the Constitutional Amendment was not realised in July 1999, the draft of the amendment was signed between the Parties represented in the parliament on 20th July 1999. See also *Milliyet* 21st July 1999.

Regulation Board (Enerji Piyasası Düzenleme Kurulu) did not approve electricity production license for that area.[72]

The adaptable concept of "foreign element" was also criticized by Özbilgiç, a senior officer in Treasury as follows: "the creditor agencies should not be interpreted as foreign element of the investment. If in a 30 years investment, the repayment of the foreign loan is made in 5 years, the investor company will protect its right by applying to international commercial arbitration on the bases of the loan contract"[73]. In other words, investor is under the protection of international arbitration only by ensuring project finance from international financial institutions.

There had been hundreds of foreign investments including concession agreements, and B.O.T. projects since 1980s. However all contracts were made under the administrative law whereby international commercial arbitration was not accessible. Most of the projects are long-term projects, such as dams, highways and power plants. Therefore most of the projects made in the late 1990s, are still under construction today. In order to ensure the justice between the project agreements, the legislature amended the second clause of Article 1 of the Law Regarding Engagement in Investments and Services on Build-Operate-Transfer Model (Law No.3996) to enable retroactivity for international commercial arbitration[74].

[72] www.ntvmsnbc.com.tr/news/382755.asp
[73] Zergül Özbilgiç, "*Uluslararası Tahkim ve Kamu Hizmeti*" Hukuk ve Ekonomi Perspektifinden Uluslararasi Tahkim ve Kamu Hizmeti, ed Ali Ulusoy (Ankara: Liberte, 2001),82
[74] Law No.4501 Regarding the applicability of international arbitration in concession contracts. This law aims to ensure coherency between the Constitutional Amendment (Law no.4446) and the Turkish Judiciary System.

According to this Law, the concession contract, which was made between the administration and investor(s) (who has fulfilled the criteria of "foreign element", can be revised according to the private law in three months[75]. By this amendment, the contracts which were signed before the Constitutional Amendment became equal to the new concession contracts.

After the enactment of Law No. 4501, the Ministry of Energy and Natural Resources declared that 117 applications were received until 12th January 2001, for the revision of formerly made concession agreements[76]. There has been similar experiences like the Fırtına Valley power plant that a foreign element has engaged in concession contracts to benefit from international commercial arbitration.

The last component of the Constitutional Amendment (article 155) was related with the supervision of the Court of State to all concession contracts. As it was mentioned, concession contracts were under the supervision of the Court of State as a part of the administrative law. Through the Constitutional amendment made by the Law No.4446, the power of supervision, inspection and decision on the acceptability of the concession contracts had been revised[77]. The duty of reviewing the concession contracts of the Court of State has been replaced by the provision that the Court of State would give its opinion on such agreements within two months.

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75 Law No.4501 was enacted on 21st January 2000.
76 http://ntvmsnbc.com/news/63164.asp
77 With the Article 3 of the Law No.4446, article 155 of the Constitution describing the duties of the Court of State (High Administrative Court) has been amended.

Although, it seems that there is not a direct relationship between the applicability of international commercial arbitration and the amendment of Article 155, international commercial arbitration can be applied through the contracts where the Court of State is responsible for giving opinion on these contracts. The limitation of the power of the Court of State was criticized by many jurists and academics. Akıncı underlined the importance of the supervision and control of the contracts by the Court of State. He claimed that: "the Turkish Judiciary is dismissed from the control over the contracts and the Executive body of the State, the government, assumes all the authority over the contracts"[78].

Hacaloğlu, a former Minister and MP, also criticized the minimized role of Court of State in reviewing the concession contracts: "the reason of establishment of administrative courts is to protect the rights of the citizens. By minimizing the role of Court of State on administrative contracts, the public interest cannot be preserved"[79].

Concerns over the dismissal of the Court of State from supervision and control of the administrative contracts are generally based on public interest and the convenience of the contract vis-à-vis the laws. The İstanbul Bar Association also criticized this amendment stating that: "the corruption and political acts would

[78] Ziya Akıncı, Dokuz Eylül University. From his paper presented at the Conference on the Judiciary Reform in 2000.
[79] Algan Hacaloğlu, "Uluslararasi Tahkim ile ilgili olarak Anayasanın 47.,125.,155. Maddelerinde Değisiklik Öngeren Yasa Tasarısı Hakkında Tartışma Notu" www.chp.org.tr/tahkim

threaten public interests including misuse of environment, cultural heritage, and natural resources”[80]. There is no doubt that all these concerns are based in the mistrust to the political system in Turkey. The chair of İzmir Bar Association, Yücel Sayman, put both similar reservations to this amendment by underlining the importance of the reviewing the contracts for the sake of public interest[81].

The raison d'être of the amendment of Article 155 of the Constitution became significant to evaluate the motives of the Executive Branch. The Court of State was criticized by the governments because of being inactive and slow while making revision on the administrative contacts. The other side of this criticism is the étatist approach of the Court of State to concession agreements. This argument is totally subjective in the same way that the other judiciary organs, justice, rule of law and lawfulness are expected from the Court of State as well. However, Balcı criticized this argument by stating that: “unlike a regular international commercial arbitration where all the parties are considered as equal, in administrative law the public and administrative interest are superior to the other parties”[82].

The amendment of Article 155 of the Constitution can also be interpreted as bypassing the Court of State in administrative contracts. Then the question was

[80] The press Conference of İstanbul Bar Association, 18th January 2000
[81] Yücel Sayman, The chair of İzmir Bar Assosiation, The Symposium of Law Reform http:// www.izmirbarosu.org.tr/yargıreformu/oturum 61

[82] Uğur Emek, in his speech on “*The Concession Contracts and International Commercial Arbitration*” at the Thursday Conferences (Perşembe Toplantıları) of the Regulatory Institution of Competition, 2nd December 1999, www.rekabet.gov.tr/etkinliklerimiz

raised as to which institution would carry on the mission of protecting public interest. The vast and significant projects had already been transferred to control and goodwill of the bureaucracy and the private investor.

### 4.2.1 Public Interest and Order

The concept of public interest and order was not described in the Turkish Constitution and Laws. However this subjective concept is being used as one of the basis of limiting fundamental rights and freedoms[83]. The right and freedom of making a contract is under the protection of the Constitution (Article 48). The parties of a contract can freely decide on the procedures of the dispute solving mechanism including international commercial arbitration. However, the subjective concept of public order and interest may limit the freedom of contract or the enforcement of an arbitral award. Ertekin and Karakaş describe public order and interest as the rules and norms which aim to protect society's social, political, economic, ethical interests[84]. Although there are different variations of describing public order and interest, almost all of them focus on the economic and social benefits of the society.

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[83] Muharrem Balcı, *İhtilafların Çözüm Yolları ve Tahkim* (İstanbul: Danışman Yayınları, 1999), 149 Balcı emphases the Article 13 of the Turkish Constitution that states fundamental rights and freedoms can be limited in favour of public interest, ethics and health.

[84] Erol Ertekin and İzzet Karataş, *Uygulamada İhtiyari Tahkim ve Yabancı Hakem Kararlarının TenfiziTanınması* (Ankara: Yetkin Yayınları,1997), 90

The linkage between international commercial arbitration and public order emerges when the enforcement of an arbitral award comes on the agenda of the national courts. Because on the basis of the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards, the Court of First Instance may decide not to enforce the arbitral award for the sake of public interests. However, there is not a universal understanding of public interests where all the international arbitral awards are subject to it. Hence international arbitrators should also consider the public order and interests while making the arbitral decision concerning the enforcement of the award[85].

There is a biased perception on the administrative law in Turkey whereby the administrative courts always defend the Turkish State against national and international investors. Soysal differentiates the understanding of public and state as follows that: "the public is not equal to state. While protecting interests of the public, the administrative law and courts consider the protection of every individual of the society"[86].

Before elaborating on the details of the public order issue, the difference between compulsory international arbitration awards and other foreign arbitral awards on the basis of enforcement should be clarified. As it was mentioned in the part where ICSID arbitration was discussed, if there is a bilateral investment

[85] Muharrem Balcı, *İhtilafların Çözüm Yolları ve Tahkim* (İstanbul: Danışman Yayınları, 1999), 156
[86] Mümtaz Soysal, in his speech at the Symposium of Administrative Contracts and International Arbitration organised by the Turkish Bar Association on 16th July 1999: 45

agreement between two states or a contract which refers to ICSID arbitration between a host country and foreign investor, the ICSID (International Centre for Settlement of Investment Disputes) is the institution empowered for arbitration. Enforcement of the arbitral award is compulsory and irrevocable in the host country even if the award is against the public order and interest[87]. There cannot be a revision of the ICSID award, when declared, by the Secretary of the ICSID, and the host country has to enforce the award like its national court award.

On the other hand, if another type of international commercial arbitration is selected by the contracting parties other than ICSID, such as ICC or other *ad hoc* arbitration, the local court has the capacity to elaborate whether the award is against the public order or not. Sayman pointed out that no state gives up its authority and control of awards made by foreign courts or arbitrators[88].

Steward also emphasizes the same point: "the New York Convention provides that recognition and enforcement of an arbitral award may be refused if the competent authority in the country where recognition and enforcement is sought finds that recognition and enforcement of the award would be contrary to the public policy of that country"[89]. All these arguments are based on Article 5 of the New

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[87] Article 54/1 of the ICSID Agreement (http://www.worldbank.org/icsid/basicdoc/basicdoc.htm) .
[88] Yücel Sayman, The chair of İzmir Bar Assosiation, The Symposium of Law Reform http:// www.izmirbarosu.org.tr/yargıreformu/oturum 61

[89] David P. Stewart, a senior officer at the Department of State of U.S., in "N*ational Enforcement of Arbitral Awards under Treaties and Conventions"* in *International Arbitration in the 21st Century :*

York Convention of 1958. Regarding same article of the Convention, Julian D. M. Lew states that: "Although arbitrators are free and indeed have a duty to investigate fully the extent of their Jurisdiction, the questions as to their competence become even more strenuously contested where serious issues of mandatory law or public policy are involved. An award made in contradiction to or merely ignoring a mandatory law or public policy could subsequently to be set aside or be unenforceable"[90].

The international legitimacy of annulling the enforcement of an arbitral award is based on Article 5 (2) of the New York Convention (1958). The domestic legitimacy of rendered not to enforce international arbitral award is by the International Private and Procedural Law (MÖHUK). The International Private and Procedural Law (MÖHUK) generally regulates the private law issues that have a foreign element such as the foreign commercial arbitral awards. Article 5 of the Law defines the discrimination of the public order as "if a decision of an authorized foreign law is clearly discriminating the Turkish public order, that decision is void"[91]. Article 45(b) of the Law more specifically annuls international arbitration awards if the award is discriminating the public order and ethic of the society.

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*Towards "Judicialization" and Uniformity?* Ed. Richard B. Lillich and Charles N. Brower (New York: Transnational Publishers, 1994), 189

[90] Julian D.M. Lew, Head of the School of International Arbitration, Centre for Commercial Law Studies, Queen Mary College, University of London "*Determination of arbitrators' Jurisdiction and Public Policy limitations on that Jurisdiction"* in Contemporary Problems in International Arbitration ed. Julian D.M. Lew (Laihen: Martinus NiJhoff Publishers 1987), 74

[91] Article 5 of the International Private and Procedural Law (MÖHUK), Law No.2675 enacted on 20th May 1982.

### 4.3 The Turkish Laws on the Procedures of the International Commercial Arbitration

In respect to the hierarchy of laws, after the constitutional amendments the legislature enacted new laws in order to ensure coherency of laws for international commercial arbitration. However, there is the International Private and Procedural Law (MÖHUK) which was enacted in 1982[92], which also concentrates on the private law issues that the "foreign element" is involved. Before evaluating the proceedings of this law as a component of the Turkish Judiciary approach to international commercial arbitration, there are two new laws on international commercial arbitration which are presented below.

The first one was enacted in 2000 that aims to identify the rules and norms which have to be obeyed in case of a dispute in concession contracts[93]. The second law was "the Law of International Arbitration" enacted in 2001 is a Turkish version of the international commercial arbitration, which is the law in force in case of a dispute. Although, the three Turkish laws which relate international commercial arbitration have the same capacity, the International Private and Procedural Law (MÖHUK) is the most comprehensive law when it is compared to the other two

[92] International Private and Procedural Law (MÖHUK).Law No.2675, enacted on 20th May 1982
[93] Law No.4501, enacted on 21st January 2000, "Kamu Hizmetleri ile İlgili İmtiyaz Şartlaşma ve Sözleşmelerinden Doğan Uyuşmazlıklarda Tahkim Yoluna Başvurulması Gereken İlkelere Dair Kanun"

laws. From this point of view, the International Private and Procedural Law are to be focused before the other laws.

### 4.3.1 The Statute On The International Private And Procedural Law (MÖHUK)

The Statute on the International Private and Procedural Law is a very comprehensive law that covers all conflicting sides of national and international law. In other words, it describes the relationship between national and international laws including the application, recognition and enforcement of the foreign courts' and arbitrators' awards. In this part, only the articles related to international arbitration will be evaluated.

Article 5 of the MÖHUK, which is also considered in the previous part related to public interest and order, specifies the understanding of discrimination against public order. According to that article, if the award or decision of the authorized foreign law definitely violates the Turkish public order, this award or decision would not be enforced. On the basis of this article, in international commercial arbitration cases where the parties decide on a foreign arbitration, *ad hoc* or institutional, the authorized Court of First Instance may not recognize the award. However in the case of ICSID arbitration, the Court of First Instance or Court of Cassation cannot question if the award is discriminating against the public order or not. The award of the ICSID arbitration is binding[94].

The second part of the MÖHUK focuses on the recognition and enforcement of the award made by a foreign court and foreign arbitrators. Article 43 of the MÖHUK relates to the enforcement of international arbitral awards stating that "the Court of First Instance can enforce certain arbitral award". Article 44 describes the procedures of petition and inspection of the foreign arbitration award in order to make it recognized and enforced.

After application to the Court of First Instance, the authorized court decides to whether enforce the decision or not according to the criteria that are described in Article 38 of the MÖHUK. The first criterion is that there should be a reciprocal agreement between Turkey and the state where the award is made for the enforcement of both states' court decisions. The second criterion is that the foreign arbitral award is not made on the area of exclusive zone of the Turkish Judiciary. In other words, the award should be a foreign arbitral award. The third criterion is again on the violation of public interest. The MÖHUK underlines the importance of public interest and by article 5 and empowers the Courts of First Instance to nullify and not recognize the foreign arbitral award by article 38(c). The forth criterion relates with the procedure of the arbitration that if the defendant side is not invited or

[94] Article 53/1 and 54/1 of the Convention of International Centre for Settlement of Investment Disputes

informed by the arbitrators to the tribunal and the defendant objected to the award, the authorized Court of First Instance has the capacity not to enforce the foreign arbitral award.

Article 40 of the MÖHUK relates to the decision of enforcement of the Turkish Courts. This article empowers the Courts to enforce the entire foreign arbitral award or just a part of it. The article is a critical one indeed because a foreign arbitral award can be recognized by the authorized court but the court may enforce a limited part of the award. Article 41 of the MÖHUK is on the procedure of appealing the award to the Court of Cassation. The foreign arbitral awards, except the award made by the ICSID, can be appealed by the parties of arbitration.

The last article of the MÖHUK, Article 45 describes the reasons of not enforcing foreign arbitral awards by the Court of First Instance. The first reason of not enforcing the award is that if there is not an arbitration clause in the contract or a separate arbitration contract between the parties of the main contract that makes reference to the details of the arbitration, then the award cannot be enforced. The second reason is also related to the public order. If the authorized court interprets foreign arbitral award is against the public order, it may reject to enforce the award. The third reason for not enforcing the award is that if the subject matter of the arbitration cannot be resolved by arbitration according to the Turkish law. The fourth reason relates to the procedure of arbitration that if one of the parties is not invited to the arbitration tribunal and objects to the arbitral award, this foreign award can not be enforced by the Turkish Courts.

The fifth reason is also related to the procedure of arbitration in that if one party is not informed during the selection of arbitrators, the enforcement of the award cannot be realized by the court. The sixth reason relates to the arbitration contract in that when the contract is invalid according to the law and procedure of the place where the contract is made. The seventh reason that if the selection of the arbitrators or the procedures which is being used by the arbitrators is against the arbitration contract, the foreign arbitral award is invalid and cannot be enforced. The following reason is on the award that is made by the arbitrators that if the scope of the award exceeds the scope of the arbitration contract, the award cannot be enforced. The final reason not to enforce the foreign arbitral award according to the MÖHUK is that if the award is not certain or is cancelled by the authorized institution; the arbitral award again cannot be enforced[95].

The MÖHUK is a very comprehensive law that consists of all the variations and relations of national and international law. It especially concentrates on private law issues that includes “foreign element”. In other words the rules and norms of the MÖHUK relating to international commercial arbitration are applicable where the parties of the contract are private persons or entities.

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[95] See Ata Sakmar, Nuray Ekşi and İlhan Yılmaz, *“Milletlerarası Özel Hukuk ve Usul Hukuku Hakkında Kanun –Mahkeme Kararları”* (İstanbul: Beta Yayım Dağıtım, 1999)

After the constitutional amendments that enable international commercial arbitration in concession contracts and investment agreements made between a private entity with a "foreign element" and the Turkish state, a new regulation was required to determine of the special procedures of international arbitration in concession contracts. In this respect, Law No.4501 was enacted in 2000 by the legislation that defines the principles that shall be followed if international commercial arbitration is decided.

### 4.3.2 The Law on the Procedures of Application of International Arbitration in Administrative Concession Contracts (Law No.4501)

This law concentrates only on the procedures and principles of making an international commercial arbitration agreement between a private entity with a "foreign element" and the administration on a subject matter of the concession agreement. Although this law is not retroactive, for the projects and investments which started before enactment this law, the temporary article 1 of the Law No 4501 enabled the retroactivity of the law if the authorized company would apply to the Council of Ministers. The concession contract could have been revised and international commercial arbitration become available[96].

[96] Ergin Nomer, Nuray Ekşi, Günseli Gelgel, *Milletlerarası Tahkim,* (İstanbul: Beta Yayım Dağıtım, 2000), 89

Article 2 of the Law enables both *ad hoc* and institutional arbitration for disputes related to concession agreements. The same article also underlines the condition of foreign element as prerequisite of applying international commercial arbitration in concession contracts. Article 3 of the Law also accepts that disputes that arise from concession can be resolved by an arbitration based on Turkish Law in Turkey, or by foreign law abroad or by an international institution such as the ICC. Article 5 of the Law is on the recognition, enforcement and appeals arbitral award. The recognition and enforcement of the awards are made by the Courts of First Instance and appeal is made by the Court of Cassation. However, this article was cancelled by the International Arbitration Law (Law No.4686) as will be discussed in the next section.

After ensuring the coherency between the Constitutional amendments and the Turkish law on the applicability of international commercial arbitration in concession contracts, Turkish legislation enacted the International Arbitration Law on 21st June 2001[97].

### 4.3.3 The International Arbitration Law, (Law No.4686)

Elber interpreted the International Arbitration Law as one that benefits foreign investors enabling them to shorten the resolution time of their disputes and

[97] Law No. 4686, International Arbitration Law (Milletlerarası Tahkim Kanunu)

prevent-within limits-the intervention of state courts[98]. This shows a fundamental difference with the MÖHUK and Law No.4501 on the application of the international commercial arbitration in concession contracts. The difference is described in the first article of the law that this law is applicable when the parties of a commercial contract, bearing a foreign element or not, decide on this arbitration law as the procedure of the arbitral tribunal. In other words, Turkish legislation has created alternative arbitration rules, procedures and regulation other than the foreign rules. The concept of foreign element is not compulsory as it is in the MÖHUK and Law on the Concession contracts. But if one of the parties bears the foreign element that was described above, then the arbitration becomes an "international" commercial arbitration.

This law describes the definition, scope, procedures and rules from the beginning of arbitral tribunal to the end of the enforcement of the arbitral award. There are also many references from the MÖHUK and Law on concession contracts (Law No.4501) such as the sensitive issue of public order.

After the Constitutional amendment, the Ecevit Government in 1999 proposed a draft law considering some amendments to the Law of Court of State to the Parliamentary Commission of Justice. According to this draft law, without enacting a law on the applicability of international commercial arbitration in case of

[98] Nazan Candaner Elver, "Turkish International Arbitration Law and Restrictions on its Application" *Journal of International Arbitration 21(5),* 454

a dispute based on a concession contract, all the concession contracts signed after 1st January 1998, can be brought to international commercial arbitration if the parties of the contract agreed to it[99]. However this draft was rejected by the Commission of Justice because this provision covers the cases which were held by the Court of State. Ramazan Toprak, former Member of the Parliament (MP), criticized this governmental proposal stating that “the retroactive applicability of international commercial arbitration on concession contracts is open to doubt because the Court of State has been inquiring whether the concession contracts are appropriate or not”[100]. Although the “retroactivity” clause had been rejected by the Commission, it was enacted by the Law No.4501.

During discussions on the International Arbitration Law in the Parliament, the majority of the MPs supported the draft Law considering it as the vital instrument for the encouragement of foreign capital. Despite the common tendency to support the draft of International Arbitration Law, most of the criticisms were made on similar issues on the definition of “foreign element” and protection of public order. On the compulsory element of international arbitration, MP Ramazan Toprak criticized the broad and flexible understanding of “foreign element”. He has underlined that a credit agreement or reference letter printed by a foreign bank or financial institution should not be describing the foreign element of a contract”[101].

[99] Draft Law No.577, proposed in 1999.
[100] Turkish Grand National Assembly Minutes, 21-3rd Legislation Year, 122nd Meeting, 21st June 2001
[101] *Ibid.*

Another MP, Veysel Candan stressed the danger of misbehaves of the Turkish investors by making fake agreements with foreigners in order to have the right of applying to international arbitration in concession contracts.

The other issue that was emphasized by the MPs was the protection of public interests. MP Mehmet Zeki Çelik criticized the international commercial arbitration for concession contracts and claimed that "there is no inspection or supervision of state organs on the contracts where long-term concessions are given"[102].

Consequently, the International Arbitration Law was enacted in 21st June 2001 with a majority where opposition parties were also involved. The period of legalizing and recognizing the international commercial arbitration in the Turkish Judiciary System especially for the concession contracts began with the Constitutional amendments and resulted in the International Arbitration Law.

As related to the retroactivity of the Law, the Turkish Court Cassation (TCC) played a significant role which limited the application of the International Arbitration Law. Elver identified the TCC decisions on the retroactivity of the Law. In brief, from the perspective of the TCC, the International Arbitrational Law does not apply to contracts signed before the enactment of the Law. Elver comment on from the TCC decision that:

> At the execution date of the commercial contract or the arbitration date, the TIAL (Turkish International Arbitration Law) was not in force hence it is not

[102] *Ibid.*

> possible to foresee the consensus of the contractual parties on the application of a non-existing law. Hence, the law adopted after the execution date of the contract by the parties or the preparation of the arbitration clause, shall not be applied to the dispute of the contractual parties.[103]

Considering the perspective of the TCC and Turkish legal principle of non-retroactivity of laws, there has been problems of application for the International Arbitration Law. Elver argues that: 'Turkish International Arbitration Law should have an immediate and even retroactive effect on all arbitration proceedings and apply to all disputes that fall within its remit, even if those disputes are related to contractual rights and obligations that arose before the date it entered into force'[104].

As final remarks related to the position of international arbitration in Turkish regulatory framework, after the enforcement of the International Arbitration Law, the applicability of the international arbitration was stressed in the new Foreign Direct Investment Law (Law No. 4875). Article 3(e) states that for the settlement of disputes which arise from investment agreements subject to private law and contracts made with the administration under which concessions concerning public services are granted, foreign investor can apply, beside the authorized local courts, to national or international arbitration, or other means of dispute settlement, provided that the conditions in the related regulations are fulfilled and the parties agree thereon.

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[103] Nazan Candaner Elver "Turkish International Arbitration law and Restrictions on its Arbitration" *Journal of International Arbitration 21(5),* 456
[104] *Ibid*

## CHAPTER V

## CONCLUSION

International Commercial Arbitration became an alternative dispute solving mechanism for international business disputes in the $21^{st}$ Century. The international efforts and initiatives considering the acceptance and recognition of international commercial arbitration had begun in the 1920s. However, the atmosphere of the World Wars disabled the development of international business and consequently acceptance of the concept of international commercial arbitration especially by the Third World states. Because the concept of international commercial arbitration has been considered as contemporary capitulations due to delegation of sovereign right of jurisdiction to international institutions or rules. As it is known, since the $17^{th}$ century, the Ottoman Empire gave legal, commercial concessions to foreigners which foreign nationals were bound with their national laws despite residing in the Ottoman territory.

Capitulations had also ensured concessions and privileges to the nationals of other states but these privileges were under diplomatic protectionism. The limits of diplomatic protectionism on commercial interests could have stretch to military interventions such as the war between France and Mexico in 1861 based on unpaid credit. There is no doubt that there is not any military confrontation based on commercial disputes at the present time. However there are different variations of diplomatic and economic sanctions over some states caused by commercial interests. Enron, an American energy giant company, has been facing having disputes on its power plant investment in India where the Indian government expropriates some of the properties of Enron in India. Kenneth Lay, the Enron Chairman, said in an interview with the *Financial Times* that: "There are U.S. Laws that could prevent the U.S. government from providing any aid or assistance or other things to India going forward if, in fact they expropriate property of U.S. companies".[105] Despite al bullying tactics, by 2005 Enron was discredited by internal scandals in the U.S.A.

The liberalization of international capital and the collapse of socialist regimes have been driving the developing states to restructure and privatize state-owned enterprises. A market economy needs a legal system to define and protect the rights of both national and international investors against unjust competition and jurisdiction. On the legal side, international commercial arbitration re-emerged in the last quarter of the 20th Century as the way of protecting commercial interests of international investors. In commercial arbitration where the parties of the arbitration are private entities, there is consent and acceptance of the parties to apply the arbitration method as a dispute solving mechanism. However, in investment projects and concession agreements where foreign investors and state are the parties of the

[105] 24th August 2001, i "Enron warns India over possibility of sanctions" Financial Times

dispute, applicability of international commercial arbitration becomes questionable because one of the parties is a sovereign entity.

From the international creditor or foreign investor perspective, the main objective is the protection of their capital, property and rights gained by the investment agreement. An investment such as the B.O.T. model or a concession agreement is not evaluated just considering financial feasibility. As it was mentioned above most of the international credit rating agencies consider the legal and political risks of the investments. In this respect, the applicability of international commercial arbitration is one of the significant criteria for international creditors in case of a dispute arises out of an investment.

There is no doubt that enforcement of foreign arbitral verdicts is also important as the applicability of arbitration. The international legitimacy of enforcement of foreign arbitral awards is based on the New York Convention of 1958. The Convention determined conditions of enforcement and legal basis of not enforcing the awards including the sensitivity on public order. However, as one of the international mainstay of international commercial arbitration, the ICSID Arbitral award is binding and irrevocable for the parties even if the award contradicts the public order and interest.

The national legitimacy of applying to international commercial arbitration is based on the international treaties and the Constitutional amendments. By the 1999 Turkish Constitutional amendments, the legislation changed article 155 of the Constitution over the statute of administrative concession agreements, which were subject to the review of the Court of State. The other amended article, article 125, legislation enabled international commercial arbitration on disputes arising out of concession agreements regarding public services. There has been the law of MÖHUK (International Private and Procedural Law) that describes the proceedings and rules of recognition and enforcement of the foreign arbitral award where the parties are private entities.

In 2000 the Turkish Grand National Assembly enacted the Law No. 4501 concerning the rules and proceedings for applying international commercial arbitration in disputes that arise out of a concession agreement in order to ensure coherency between the amended articles of the Constitution and laws. The final all, establishing the international arbitration regulatory framework in the Turkish Judicial System is the International Arbitration Law enacted in 2001. This law is based on the general characteristics of the UNCITRAL rules.

The factors that encouraged Turkey to accept international commercial arbitration and delegate some of its judicial sovereign rights for investment and concession agreements were various. As a developing country, Turkey has to sustain its development by investing on infrastructure, such as on power plants and highways. However, these investments require vast amounts of capital and sound projects. Like the other developing countries Turkey has been trying to encourage foreign investments to have the projects financed, increase tax revenues and rate of employment. In this respect, the international commercial arbitration was introduced as one of the prerequisites for attracting foreign capital and investment.

Some scholars, jurists, politicians and labour union leaders have been criticizing international commercial arbitration about administrative concession contracts. Their basic concerns are the protection of the public order and interests. Mümtaz Soysal, also underlined the importance of public order and interests and notified the increasing hegemony of the international investors and multinationals on partner countries, particularly in regard to investment contracts.[106] Mistrust towards the politicians and bureaucrats provoke reservations on international commercial arbitration. The other criticism is on the broad understanding of "foreign element" as a prerequisite for applying to international arbitration. This issue had been discussed while the International Commercial Arbitration Law was on the agenda of the TGNA. Reservations were about the possibility that even a letter of guarantee can be interpreted as a foreign element of the investment dispute.

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[106] Mümtaz Soysal, in his speech at the Symposium of Administrative Contracts and International Arbitration organised by the Turkish Bar Association on 16th July 1999

In order to draw a conclusion on the issue of applicability of international commercial arbitration while satisfying the interests of both the administration and international investors, a few of recommendations are proposed below. Firstly, the public interests and order such as the protection of fair competition and environment should be determined as not arbitrable issues in the main investment or concession agreement in order to minimize the risk of conflict between parties. Secondly, due to the limited capacity of reviewing the contracts by the Court of State, the agreements should be made by the specialists of the subject. Thirdly, by accepting the role and importance of the international commercial arbitration as a one of the prerequisites of foreign investment, internationally recognized institutions on international commercial arbitration should be established as an alternative for the hinterland of Turkey. In this framework, international commercial arbitration would play a significant role for attracting foreign capital by satisfying the concerns of both parties. All of the above presumes goodwill and excludes greed.

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