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DEVELOPING COURT PRACTICE IN TURKEY REGARDING APPLICATIONS TO SET ASIDE ARBITRAL AWARDS

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With its aspiration to become an international arbitration venue, Turkey enacted new legislation on November 29, 2014 in order to establish the Istanbul Arbitration Center. With the establishment of its own arbitration center, the number of arbitration proceedings in Turkey is expected to increase substantially. It is inevitable that the increase in the number of arbitration proceedings will result in an increase in the number of set-aside lawsuits.

Although it has been more than ten years since the concept of setting aside an arbitral award was introduced in Turkey, Turkish courts are still developing their approach towards the grounds for setting aside an arbitral award, due to the distinct nature of arbitration. In an effort to show the Turkish courts' approach towards the most invoked set-aside grounds, this article aims to underline the general approach adopted by the courts of first instance of Turkey's two largest cities – Istanbul and Ankara – based on their decisions since 2012.

I. OVERVIEW OF SET-ASIDE LAWSUITS IN TURKEY

A. *Applicable Procedural Law*

There are two laws that govern arbitration proceedings in Turkey: the Civil Procedure Law (the "CPL") and the Turkish International Arbitration Law (the "IAL"). There are three types of arbitral awards: (i) a CPL-based arbitral award; (ii) an IAL-based arbitral award; and (iii) a foreign arbitral award.[1] In the presence of a CPL-based or an IAL-based arbitral award, judgment debtors can challenge the award by filing an application to set it aside.

Before the enactment of the IAL in 2001, the former Civil Procedure Law (the "former CPL") governed arbitration proceedings in Turkey and the only way to challenge an arbitral award was to appeal it. Upon the IAL's enactment, however, an IAL-based arbitral award became subject to a set-aside lawsuit, while a former CPL-based award remained subject to appeal. This was the case until the CPL's enactment in 2011, as a result of which the possibility of appeal against arbitral

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[1] A CPL-based arbitral award is an award rendered in an arbitration proceeding where (i) there is no foreign element; *and* (ii) the seat of arbitration is in Turkey, while an IAL-based arbitral award is an award rendered in an arbitration proceeding where (i) there is a foreign element; *and* (ii) the IAL is chosen as the applicable procedural law *or* the seat of arbitration is in Turkey. An arbitral award is a foreign award if the seat of arbitration is in a foreign country and the arbitration proceeding is carried out under a foreign law.

awards was abrogated and a CPL-based award became subject to a set-aside lawsuit as well.

The Court of Appeals has held that an arbitral award rendered in connection with an arbitration agreement that was concluded before the enactment of the relevant procedural law (the CPL or the IAL) cannot be subject to a set-aside proceeding, even if the award is rendered after the relevant procedural law entered into force.[2] The rationale behind these decisions is the following: before the enactment of the relevant procedural laws, the only way of challenging arbitral awards was to appeal them. As parties to an arbitration agreement could not have foreseen future legislative changes in procedural rules with regard to the method of challenges against an arbitral award at the time of signing the arbitration agreement, new procedural rules, allowing parties to file a set-aside lawsuit, should not be applicable to an award, even if that award is rendered after the enactment of the new rules.

B. *Competent Court*

The IAL provides that civil courts (among which are commercial courts, which deal with commercial matters[3]) are competent to hear set-aside lawsuits. The new Turkish Commercial Code (the "TCC"), which entered into force on July 1, 2012, however, changed the relationship between civil courts and commercial courts: both are still of the same degree, but commercial courts are no longer a division of the civil courts.

When the TCC entered into force and changed the relationship between civil and commercial courts, the competence of civil and commercial courts over set-aside lawsuits became a debated issue. As the wording of the IAL stipulates "civil courts" as competent courts, commercial courts began to dismiss set-aside lawsuits due to lack of competence.[4] On the other hand, there were civil courts which opined that commercial courts had competence over set-aside lawsuits if the dispute at stake were commercial (which was already the case before the TCC's entry into force in 2012).[5] On June 28, 2014, Law No. 6545 (Law Amending the Turkish Criminal Code and Other Laws – Omnibus Bill) put an end to this debate with its Article 45. This law provides that competent courts over set-

[2] *See, e.g.*, Decision of the 15th Civil Chamber of the Court of Appeals, E. 2013/2388, K. 2014/113, dated Jan. 9, 2014.

[3] Civil courts and commercial courts are of the same degree. The purpose of the establishment of commercial courts was to address the need to have specialized courts in commercial disputes. Commercial courts were, before July 1, 2012, a division of civil courts. If the dispute was of a commercial nature, commercial courts heard set-aside lawsuits. If otherwise, civil courts were competent over set-aside lawsuits.

[4] *See* Decision of the 50th Commercial Court of Istanbul, File No. 2013/299, dated April 29, 2014.

[5] *See* Decision of the 24th Civil Court of Istanbul, File No. 2013/476, dated Oct. 9, 2013.

aside lawsuits against arbitral awards rendered in accordance with the CPL and the IAL are commercial courts, regardless of the nature of the dispute at hand.

C. *Scope of Examination – Prohibition of Revision Au Fond*

Both the IAL and the CPL set forth nine grounds for setting aside an award, and also stipulate that in set-aside lawsuits, courts cannot examine the merits of a dispute, in accordance with the principle prohibiting *revision au fond*. Although Turkish courts (including the Court of Appeals) had a tendency to ignore this principle from time to time, they generally follow it and limit the scope of their examination:

> […] under the clear provision of the CPL, the court has no authority to examine the merits of the arbitral award […] [6]

> […] Set-aside grounds are listed as numerus clausus. The merits of the arbitral awards cannot be examined. […] [7]

D. *Parties to the Arbitral Award/Arbitration Proceedings/Arbitration Agreement*

Extension of arbitration agreements to third parties and rendering an arbitral award in favor of or to the detriment of a third party is still debated in Turkish law. Some scholars argue that arbitration agreements may be extended to at least group companies, while the majority does not accept this approach due to the exceptional nature of arbitration. The majority of scholars believe that no legal entity (even if it is a sister company) can be forced to be a party to arbitration proceedings, unless it signs the relevant arbitration agreement or gives its explicit consent to become a party to the relevant arbitration proceeding.

While Turkish courts have not directly encountered such an issue, and thus have not yet rendered a decision on this specific subject, on January 29, 2014, a local court rendered a decision that may be of guidance for future reference. In this decision, the local court accepted the existence of the arbitration clause for a non-signatory, which was a beneficiary of the concession agreement, as the third party had approved the concession agreement containing the arbitration clause and hence became a party to the arbitration agreement:

> The existence of the arbitration clause is accepted for the third parties that are beneficiary of concession agreements. . . . The agreement containing the arbitration clause is approved, hence it is accepted that the third party became a party to the arbitration agreement. The International Court of

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[6] Decision of the 24th Commercial Court of Istanbul, File No. 2013/3, dated Jan. 9, 2014.

[7] Decision of the 42d Commercial Court of Istanbul, File No. 2012/260, dated Dec. 18, 2012.

> Arbitration ordered an award for the third party, for which the concession agreement includes favorable conditions.[8]

II. THE MOST INVOKED GROUNDS FOR SETTING ASIDE

Both the CPL and the IAL set forth nine grounds for setting aside an award. In practice, the two most invoked grounds are: (i) violation of the parties' equality – i.e., their right to be heard[9] and (ii) public policy.

A. *Parties' Equality – Right to be Heard*

If a party that requests an arbitral award to be set aside proves that the parties were not treated equally (or that its right to be heard was not respected) during the arbitration proceeding, the award will be set aside. This ground is one of the most invoked by Turkish courts. In practice, examination of this ground focuses on the following claims:

(i) One of the parties has not been duly informed of the arbitration proceedings.

(ii) Arbitration-related submissions have not been duly served on one of the parties.

(iii) One of the parties has not been duly informed of the hearing.

(iv) Arguments raised by one of the parties have not been taken into account by the arbitral tribunal.

Turkish courts generally dismiss such claims based on the following reasons:

> The parties' *claims were examined in detail* by the arbitral tribunal, expert witness reports were prepared, the agreement was scrutinized; . . . *the claimant asserted his/her claims during the arbitration proceeding and these claims were assessed*, therefore the claimant's right to be heard was respected.[10]
>
> *[A]s the claimants were duly invited to the hearing* held on 2 August 2012 by the arbitral tribunal and the claimants and their attorneys used their

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[8] Decision of the 3d Civil Court of Ankara, File No. 2013/273, dated Jan. 21, 2014.

[9] Although the right to be heard is not clearly stipulated under the IAL, unlike the CPL, in practice, this concept is considered to be within the concept of the parties' right to be treated equally.

[10] Decision of the 44th Commercial Court of Istanbul, File No. 2013/268, dated Dec. 19, 2013 (emphasis added).

> right to be heard, . . . the principle of the parties' equality and right to be heard were respected.[11]
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> [I]n the arbitral award, *termination reasons asserted by the claimant were examined one by one and dismissed with legal grounds.*[12]

B. *Public Policy*

Public policy is probably the most invoked ground for setting aside an award raised in Turkey.[13] The problem arises from the interpretation of the concept, as there is no absolute definition of "public policy" in Turkish law. That said, a decision of the General Assembly for the Unification of Decisions of the Court of Appeals dated February 10, 2012 may be (and in practice, has been) of guidance.[14] This decision thoroughly examines and explains the concept, and emphasizes its variable nature. It even draws lines for the application of public policy. According to this decision, which will hopefully put an end to ongoing doctrinal discussions and unify the Court of Appeals' precedent:

> *[I]t is not possible to say that there is a contradiction with Turkish public policy in the event of breach of every statutory provision or breach of every statutory provision by foreign decision.*
>
> In that case, the framework of public policy under national law can be drawn as the contradiction with fundamental values of Turkish laws, general Turkish sense of morality, fundamental sense of justice on which Turkish laws are based, general policy on which Turkish laws are based, fundamental rights and freedoms placed in Constitution, the rules based on common international principles and the principle of bona fide under private law, common law principles which are expressions of morality and the sense of justice adopted by civil societies, society's level of civilization, political and economic regime, human rights and freedoms. (emphasis added)

In a recent decision, the Court of Appeals emphasized that public policy is a discretionary concept and it cannot be limited.[15] As a result of its discretionary and unclear character, while some courts interpret public policy very broadly,

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[11] Decision of the 24th Commercial Court of Istanbul, *supra* note 6 (emphasis added).

[12] Decision of the 42d Commercial Court of Istanbul, *supra* note 7 (emphasis added).

[13] Unlike the parties' equality, this ground must be taken into account by courts *ex officio*.

[14] Decision of the General Assembly for the Unification of Decisions of the Court of Appeals, File Nos. 2010/1 and 2012/1, dated Feb. 10, 2012.

[15] Decision of the 15th Civil Chamber of the Court of Appeals, File Nos. 2014/2183 and 2014/3226, dated May 12, 2014.

others apply a narrower interpretation. In a recent Turkish court decision,[16] the concept of "public policy" was defined as follows:

> There is no conclusive definition of public policy in legislation or doctrine. However, particularly in terms of Turkish International Private Law, it is observed that, in the Court of Appeals' decisions, elements such as contradiction with public morality and customs, incoherence with the fundamental rules and the general policy of Turkish laws are considered as a violation of public policy. In order for public policy to come into question, the contradiction with a rule must conflict with one of the fundamental principles of the local legal order or severely damage the general sense of law.

In Turkey, there were discussions for quite some time on (i) whether or not a lawsuit for cancellation of objection in terms of the Execution and Bankruptcy Law falls within the scope of public policy and (ii) whether or not an arbitral tribunal is competent to render an award for cancellation of objection in execution or bankruptcy proceedings.[17] The real problem was that, even if an arbitral tribunal examines the request for cancellation of an objection, it was not clear whether or not it could order denial compensation.[18] With the Court of Appeals' guidance, Turkish courts now accept that the cancellation of an objection is not related to public policy and arbitral tribunals can order denial compensation.[19]

The most promising decision rendered since 2012 with regard to the concept of public policy is probably the decision of the 3d Civil Court of Ankara dated January 21, 2014.[20] The court's reasoning in this decision is the exact opposite of the Court of Appeals' reasoning in its infamous decision, setting aside the arbitral award to the detriment of a GSM company.[21] The reasoning of the 3d Civil Court of Ankara was as follows:

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[16] Decision of the 16th Commercial Court of Istanbul, File No. 2013/157, dated Aug. 20, 2013.

[17] When a debtor objects to the execution proceedings initiated by a creditor for collection of its receivables, execution proceedings are (as a general rule) automatically suspended. In this event, the creditor must file for cancellation of the objection and must have the objection cancelled, in order for the execution proceedings to continue.

[18] Denial compensation is a type of penalty, which is payable (as the case may be) by the party who loses the lawsuit for cancellation of objection.

[19] Decision of the 44th Commercial Court of Istanbul, *supra* note 10.

[20] Decision of the 3d Civil Court of Ankara, *supra* note 8.

[21] Decision of the 13th Civil Chamber of the Court of Appeals, File Nos. 2012/8426 and 2012/10349, dated April 17, 2012 In this decision, the Court of Appeals overruled a local court's decision, on the ground that the arbitral award was contrary to public policy:

> Although the due treasury share and contribution to the Authority's expenses agreed in the agreement are not taxes, they are significant and continuous items of income resulting from the transfer of the public service by the State. In the present case, exclusion of a discount in wholesales from the gross sales amount . . .,

> [T]he award resulting in the decrease in public revenue alone cannot be considered as a violation of public policy. Examining the merits of the award is not possible. The request to set the award aside, which seems to decrease public revenue . . ., is not accepted due to lack of legal basis. . . . Decrease in public revenue is not sufficient alone for such acceptance.

Considering the damage that the Court of Appeals' above-mentioned decision caused (and is still causing), the number of decisions reasoned like the decision of the 3d Civil Court of Ankara will hopefully increase, which undoubtedly will make Turkey a more arbitration-friendly country.

All in all, Turkish courts seem to be adopting more arbitration-friendly decisions with a narrower interpretation of public policy. Establishment of the Istanbul Arbitration Center will play a key role in developing stronger jurisprudence in Turkey, in the area of arbitration. These developments will hopefully result in Turkey becoming a more legally sound and reliable *lex arbitri*.

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which is the basis for payment of treasury shares and contribution to the Authority's expenses, *results in a decrease in the treasury shares and contribution to the Authority's expenses*, aiming to provide continuous income. It also disrupts budget balance. Thus, it is clear that it will deteriorate economic balance and, thus, is contrary to public policy. (emphasis added).