



Possibility of Arbitration in Turkish PPP Projects

Public Private Partnership (“PPP”) is described as the collaboration of public and private sector entities, in order to provide public services that are traditionally provided by the state. PPPs are mostly used for the construction and operation of major infrastructure facilities (e.g. power plants, motorways and hospitals). The purpose of PPPs is to ensure the financing, design, implementation and operation of infrastructure facilities through the allocation of: (i) resources, (ii) risks, (iii) rewards, and (iv) responsibilities.

I. COMMON PPP MODELS IN TURKEY

1. Build – Operate – Transfer (“BOT”)

The first PPP model introduced into Turkish legislation was the BOT model. BOT is a PPP model where a facility is built, financed and operated by the private sector. The constructed facility is transferred to the relevant public authority after the private entity’s operation term. During the operation term, the revenues generated are used to repay a large part of the financing. BOTs are more commonly implemented in complicated long term projects such as (i) highway constructions, (ii) airport constructions and (iii) power plants. Sabiha Gökçen Airport International Terminal and Atatürk Airport International Terminal are two of the most notable BOT projects in Turkey, in addition to many hydroelectric power plants. Laws No. 3096,¹ 3465,² and 3996³ deal with the implementation of BOT projects in Turkey.

2. Build – Operate (“BO”)

In the BO model, a facility is also built and operated by the private sector. The difference between the BO model and BOT model is that in a BO project, the facility’s ownership is not transferred to the relevant public authority at the end of the operation term. This model is commonly implemented in power plant facilities. The İskenderun Thermic Power Plant is one of the most notable BO projects aside from a few natural gas combined cycle electricity plants. Law No. 4283⁴ governs the implementation of the BO model for the construction and operation of thermic power plants.⁵

¹ Law No. 3096 on the Generation, Transmission, Distribution and Trade of Electricity by Third Parties Other than the Turkish Electricity Authority was published in the Official Gazette dated 19 December 1984 and numbered 18610.

² Law No. 3465 on the Construction, Maintenance and Operation of Highways was published in the Official Gazette dated 2 June 1988 and numbered 19830.

³ Law No. 3996 on the Realization of Certain Projects under the Build-Operate-Transfer Model was published in the Official Gazette dated 13 June 1994 and numbered 21959.

⁴ Law No. 4283 on the Establishment and Operation of Electricity Generation Plants and Energy Sales under the Build-Operate Model was published in the Official Gazette dated 19 July 1997 and numbered 23054.

⁵ Under Article 1 of the Law No. 4283, hydroelectric, geothermal, nuclear plants and the plants using other renewable energy resources are outside the scope of this law.

3. Transfer of Operation Rights (“TOR”)

In this model, the public authority transfers the operation right of an infrastructure facility to the private sector, for a certain period, in return for an agreed price. Proprietary rights are not transferred to the private entity. Ownership remains with the state. This model is commonly implemented in power plant facilities and ports. Sabiha Gökçen Airport and İzmir Adnan Menderes Airport are two of the most notable TOR projects in addition to many power plants and ports. Laws No. 4046,⁶ 5335,⁷ 3465,⁸ and 3096 deal with the implementation of the TOR model.

4. Build – Lease (“BL”)

In the BL model, the private sector finances and builds a facility and subsequently leases this facility to the relevant public authority. The state provides the public service. The infrastructure facility is leased for maximum of 49 years and, during the lease period, the public authority pays a lease fee to the private investor and operates the facility. The private investor sometimes transfers the facility’s ownership to the public authority at the end of the lease period. This model is more commonly used for healthcare facilities (e.g. Bilkent Health Complex and İkitelli Health Complex)⁹. Article 20 of Law No. 351¹⁰ and Article 23 of Decree Law No. 652¹¹ govern the implementation of BL projects.

5. Build – Lease – Transfer (“BLT”)

On 9 March 2013, the BLT model was introduced into Turkish legislation by Law No. 6428,¹² commonly known as the City Hospitals Law. This model will be used for healthcare facilities. In this model, the private sector is given a right of construction (*üst hakkı*) over the Treasury’s immovable property, for a maximum of 30 years. The hospital will be built by the private sector and the private sector will lease the hospital for 30 years and operate it during this period.¹³ At the end of lease term, the facility on the immovable will automatically be transferred to the Treasury.

It is worth emphasizing that although the above listed PPP models are the most common PPP models used in Turkey, as PPP contracts are subject to private law provisions (as will be explained below), parties can create a whole new PPP model, within the framework of their freedom of contract.

⁶ Law No. 4046 on Privatization was published in the Official Gazette dated 27 November 1994 and numbered 22124.

⁷ Law No. 5335 regarding the transfer of operation rights of airports and passenger terminals by the State Airports Authority was published in the Official Gazette dated 27 April 2005 and numbered 25798.

⁸ Law No. 3465 on the Construction, Maintenance and Operation of Highways was published in the Official Gazette dated 2 June 1998 and numbered 19830.

⁹ These projects are in the construction phase.

¹⁰ Law No. 351 on Higher Education, Loan and Hostels Institution was published in the Official Gazette dated 17 August 1961 and numbered 10883.

¹¹ Law No. 652 on the Organization and Duties of the Ministry of National Education was published in the Official Gazette dated 14 September 2011 and numbered 28054.

¹² Law No. 6428 on the Construction and Renewal of Facilities under the PPP Model by the Ministry of Health was published in the Official Gazette dated 9 March 2013 and numbered 28582.

¹³ The Ministry of Health provides the health services.

II. POSSIBILITY OF ARBITRATION IN PPPs

In Turkey, PPP contracts were born as a derivative of traditional concession agreements, which are subject to public law and the Council of State's review. Due to the nature of traditional concession agreements, the private sector (particularly foreign investors) did not want to invest in public services. This lack of investment was preventing or delaying the realization of certain critical infrastructure facilities and projects. In order to attract more private investment, the state decided to grant private law agreement options to public services, instead of traditional concession agreements. In 1999, after prolonged legal discussions regarding the legal regime of PPP models, changes were made in the Turkish Constitution. Private law agreement options were permitted for public services:

*"Investments and services carried out by the State, state economic enterprises and other public corporate bodies that can be performed by or delegated to persons or corporate bodies through private law contracts shall be determined by law."*¹⁴

*"Disputes arising from concession contracts and agreements regarding public services may be settled by national or international arbitration. Only those disputes involving an element of foreignness may be submitted to international arbitration."*¹⁵

With these amendments to the Constitution, the Turkish Parliament put an end to doubts regarding the possibility of arbitration in disputes arising from PPP contracts. Furthermore, most of the laws governing the use of different PPP models permit the application of arbitration to the relevant PPP model, by stipulating that (i) the relevant PPP contract is subject to private law provisions or that (ii) the parties can freely agree on settling disputes through arbitration.¹⁶

Furthermore, Turkey has ratified many bilateral and multilateral investment agreements regarding the protection of investments. Turkey is party to the Convention on the Settlement of Investment Disputes (ICSID Convention). These agreements also allow for the settlement of disputes through arbitration.

III. DRAFT PPP LAW

In November 2007, the State Planning Organization prepared a draft PPP law (the "**Draft Law**"). Although it has been more than six years, the Draft Law has not yet been brought to the Turkish Parliament's agenda. Since 2007, some of the changes contemplated in the Draft Law have been implemented through amendments made to various current laws.

¹⁴ Last paragraph of Article 47 of the Constitution of Turkish Republic.

¹⁵ First paragraph of Article 125 of the Constitution of Turkish Republic.

¹⁶ Under Article 5 of the Law No. 3996, agreements to be executed between a public authority designated by the High Planning Council and private companies are subject to private law provisions. On the other hand, Under Article 4/11 of the City Hospitals Law, the parties can decide that disputes will be settled within framework of the International Arbitration Law, although the applicable law must be Turkish law, and the arbitration proceeding must be held in Turkey.

KOLCUOĞLU DEMİRKAN KOÇAKLI

If enacted, the Draft Law will combine all PPP related legislation and abolish the current legislation.¹⁷ The Draft Law's significant features are as follows:

- It defines PPP models as investment models where the public and private sectors share the costs, risks and rewards in delivering a service or facility to the public.
- PPP is defined as a general model covering all sub-models such as BOT, BO, TOR and BL.
- The scope of the Draft Law includes agriculture, irrigation, mining, manufacturing, energy, transportation, communication, information technology, tourism, real estate, municipal services, health, security, general administration infrastructure investments and services.
- Public administrations can only execute PPP models that fall within their fields of activity.
- It specifies the authorization and tender processes in detail.
- The Draft Law stipulates that the governing law of implementation contracts must be Turkish law.
- It expressly permits arbitration.
- Private investors must incorporate a Turkish joint stock corporation.
- Public authorities can enter into partnerships with private investors. However, the public authority's share in the partnership cannot exceed 49%.
- New guarantee mechanisms are made available.¹⁸
- It provides for the formation of the Public and Private Partnership General Directorate.

At this stage, we cannot foresee a time schedule for the Draft Law's enactment. However, regardless of whether or not the Draft Law is passed, most contracts related to PPPs may already stipulate for an arbitration clause. We believe that the passage of the Draft Law will also increase investment (especially foreign) due to new guarantee mechanisms.

Okan Demirkan (odemirkan@kolcuoglu.av.tr) & Burak Eryiğit (beriyigit@kolcuoglu.av.tr)

© Kolcuoğlu Demirkan Koçaklı Attorneys at Law, 2014

¹⁷ If enacted, the Draft Law will abolish (i) Law No. 3096, (ii) Law No. 3465, (iii) Law No. 3996, (iv) Law No. 4283, (v) certain provisions of Law No. 4046 and (vi) Article 33 of the Law No. 5335.

¹⁸ Guarantee mechanisms include:

- (i) payment guarantee by Treasury or Ministry of Finance,
- (ii) purchase guarantee by Treasury or Ministry of Finance under some circumstances, and
- (iii) guarantee to financial institutions for repayment of financing.