

# WILL ISTANBUL EVER BE AN INTERNATIONALLY RECOGNIZED ARBITRATION CENTER?

*Istanbul, thanks to its unique position as a bridge linking Europe to the Middle East and Asia, is undoubtedly one of the most – if not the most – geopolitically important cities in the world. In these times of globalization, Istanbul's importance seems to be growing even more rapidly in terms of the flow of finance and resources. While the Turkish government clearly supports Istanbul's transformation into a center of finance, Istanbul also seems to have recently assumed the role of becoming an internationally recognized arbitration center. This article concentrates on the very recent investment environment in Turkey as well as on the new draft law on the Istanbul Arbitration Center.*

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**T**urkey has been an attractive investment destination in the eyes of foreign investors from all over the world for decades. However, it was only during the 1990s that Turkey witnessed a boom in foreign investments. This was partly because worldwide foreign capital flows reached their peak in those years. As a growing and promising economy, Turkey enjoyed its own share of this foreign investment flow. Apart from the crises in 1994, 1999, and 2001, the amount of foreign investment has trended upwards since the early 1990s. However, interestingly, these crises also helped investors who saw these crises as an opportunity to invest in Turkey.

### *The Investment Environment in Turkey*

Whilst much of the world was deeply affected by the financial crisis that began with the collapse of Lehman Brothers in the US, the global crisis of 2008-09 did not impact Turkey, when considering the statistics that the then-Prime Minister of Turkey (now the President) cited. In explaining this, we believe that the precautions taken in the financial sector after the 2001 crisis played a key role. Also, in the past decade, Turkey has managed to increase its export competitiveness, diversifying its medium-tech industries, and producing more sophisticated goods.<sup>1</sup>

Turkey recently went to the polls to vote for the first directly-elected president in the country's history, following the amendment made to the constitution shifting the electoral power to the people. After the municipal elections held in March, this was the second election in which the ruling party and President Recep Tayyip Erdoğan succeeded in maintaining voter confidence this year.

Nevertheless, it seems that Turkey may not get out of the "election atmosphere" before the parliamentary elections that are scheduled for Spring 2015. The result of next year's election is expected to be determinative for foreign investors in terms of their decisions to invest or disinvest in Turkey as they – unlike portfolio investors – have a long-term outlook in relation to their investments.

Turkey received 5.1 billion dollars in foreign direct investment (FDI) during the first four months of 2014; this is up 46 percent compared to last year. Among the leading sectors that attracted foreign investment are manufacturing, electricity, gas and water supply, and finance. Accordingly, Turkey still seems to attract efficiency-seeking foreign investment even with its lack of natural resources and relatively high labor costs, meaning that foreign investors prefer to keep their investment limited to the local

<sup>1</sup> For details, please see: "Turkey Country Economic Memorandum: Trading up to High Income," *The World Bank*, <http://www.worldbank.org/content/dam/Worldbank/document/eca/turkey/tr-cem-trade-eng.pdf>

market rather than targeting neighboring economies. For sure, Turkey's large current account deficit is a concern for domestic, as well as for foreign investors, which is why it is being monitored closely. Perhaps the same thought was behind Volkswagen's decision to invest in Poland, but not in Turkey, for a new van factory in May 2014. Additionally, relatively high labor costs, and, taxes may have, among other things, discouraged Volkswagen from investing in Turkey.

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In 2013, the amount of FDI remained at the same level as the previous year. However, cross-border mergers and acquisitions transactions decreased by 68 percent to 867 million dollars, which is the lowest level since 2004.<sup>2</sup>

Nevertheless, due to its dynamic population and diversified sources, Turkey will likely remain one of the “favorite destinations” for foreign investors in the mid-term. This status is contingent on the maintenance of economic stability despite periodic volatilities and the realization of legal reforms in line with the principles of a typical liberal democratic regime.

### ***The Istanbul International Finance Center***

The Turkish government established an initiative to turn Istanbul into an international financial center by including the project in the Ninth Development Plan of the State covering 2007-13. The Strategy and Action Plan for the Istanbul International Finance Center was announced in 2009 in coordination with the Ministry of Economy. This plan anticipates the harmonization of legislation with EU legislation and practices of finance, diversification of financial products, simplification of the tax regime, encouragement of companies to go public, and training of existing finance employees.

Obviously, establishing an international finance center in Istanbul is a very positive step in the development of Turkey's economy. Nevertheless, as the government is well aware, a finance center is not just a building and an organization chart. Apart from the building and the people working in the center, many issues must be dealt with and many new steps need to be taken. No matter how burdensome or how long it takes, the government should persistently stick to this task.

2 “World Investment Report 2014,” *UNCTAD*, p. 58, [http://unctad.org/en/PublicationsLibrary/wir2014\\_en.pdf](http://unctad.org/en/PublicationsLibrary/wir2014_en.pdf)

Sadly, so far, many of the steps in the plan have not been implemented to the level desired, or even implemented at all.

### *Foreigners' Approach Towards Arbitration in Turkey*

Arbitration is an alternative method used to resolve disputes between contracting parties with the involvement of one or more independent and neutral arbitrators. Arbitration is becoming more and more common in international trade as a faster and relatively cheaper way to settle disputes. Foreign investors and foreigners doing business with local parties or passing their goods through Turkish territory frequently agree on arbitration clauses in their agreements.

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Despite this, it is very rare that a foreigner agrees on Turkey as the place of arbitration. This may be explained as follows: in Turkey, even domestic arbitration is not sufficiently common and well known by business people. There is a lack of trained human resources in the field of arbitration; it is safe to say

that not many lawyers in Turkey are familiar with domestic arbitration, let alone international arbitration. One should not forget that in arbitration, the involvement of national courts is often required, particularly on the rendering of precautionary judgments, extension of time for rendering awards by the arbitrator(s), and annulment of arbitral awards. Accordingly, a foreign party agreeing to the place of arbitration in Turkey also agrees to the jurisdiction of the courts in the place of arbitration on matters that only a national court can decide. Hence, foreigners must also believe in the competence and neutrality of the national courts, in case the matter was to be brought before a national court. We believe that this goal can be achieved by, among other things, training judges and launching a special division focused purely on arbitration in Turkey's Supreme Court of Appeals. In sum, the Turkish judiciary's independence and neutrality must be strengthened so as to protect the rights of all citizens and foreigners. This will be important for Turkey to achieve its 2023 goals, one of which includes being among the top ten global economies.

### *Structure of the Istanbul Arbitration Center*

According to its Draft Law, the Istanbul Arbitration Center (the “Center”) will be composed of a general assembly, board of directors, auditor, advisory committee, national and international courts of arbitration, and a secretary general.

The member structure of the Center's General Assembly seems to be the most important part of this composition. This is because the institutions that will appoint individuals to the General Assembly are mainly actors in the banking and finance sector (e.g., Capital Markets Board, the Banks Association of Turkey etc.). Concerns are likely to be raised due to the position of the appointing authorities. For example, will the Center only participate in the resolution process of disputes arising out of banking and finance arrangements? It is obvious that this would not be the case, as the Draft Law refers to the resolution of all private law-related disputes. Why, then, are the actors of banking and finance sector exclusively empowered to appoint individuals to the decision-making organs of the Center?

As is widely known by those who are familiar with arbitration practices, most of the disputes that are subject to arbitration have traditionally arisen out of contracts in construction and infrastructure projects. Considering this, the Turkish Union of Architects and Engineers could have, for instance, been determined as an additional appointing authority. Furthermore, the State Hydraulic Works Authority and the Turkish Highways Authority are the governmental institutions with extensive experience in terms of arbitration, given the projects they have completed. We believe that those institutions should have been named as appointing authorities for the General Assembly as well.

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One may reasonably argue that the General Assembly will not be an active organ in the management of arbitration proceedings. Instead, the Court of Arbitration to be formed within the scope of the Center will lead the arbitration proceedings. However, we think that the prioritized target should be increasing the levels of awareness, consciousness, and trust for the sake of the Center. Therefore, those governmental authorities could have contributed to the realization of such targets, particularly at the very initial stage.

Given the points discussed above, if the Center is not intended to be limited to banking and finance matters, the Draft Law should be re-examined accordingly in a way that the appointing authorities are diversified. It is very reasonable, however, that the Center may indeed be intended to be a prominent dispute resolution authority in relation to banking and finance-related disputes. This would ultimately

be a strategic decision. However, if such an approach were to be accepted, not only should the Center be structured in line with this, but also the arbitration rules to be released should also be drafted accordingly. The Center may otherwise not serve its intended purpose.

### ***Suggesting a New Name: The Istanbul International Arbitration Center***

Changing the name of the Center from “Istanbul Arbitration Center” to “Istanbul International Arbitration Center” would be beneficial due to its likely psychological and practical impact. In this way, Istanbul would avoid being considered a local finance-commercial hub, as might be the understanding by using the current name. The target and purpose of Istanbul’s conversion to an internationally recognized platform in international trade and finance thus becomes crystal clear. Istanbul is well equipped to reach such a target. Yet if the Center intends to compete with other internationally recognized arbitration centers, each and every appropriate method and medium that can effectively emphasize the international nature of this Center must be employed herein. Adding “International” to the name may be considered as one of these methods.

Needless to say, unless effective strategies and policies are developed and the human resources of the Center are enhanced; such a name change itself will not make sense. Nevertheless, we think that it would be a proper starting point.

The Draft Law states that the Center will deal with national and international disputes, and will include two different courts: namely, national and international arbitration courts. Renaming the Center as the Istanbul International Arbitration Center may thus seem to contradict with the national arbitration-related role of the Center. Nevertheless, as long as the arbitration rules applicable to national arbitration are duly executed, we do not anticipate that any problem would arise from the mere reference to the term “international.”

### ***Duties of the Center***

Although Article 4 of the Draft Law enumerates the duties of the Center, it is fair to say that its content is quite insufficient. Article 4 first states that the Center will establish the rules applicable to arbitration and other alternative dispute resolution mechanisms, as well as provide necessary services thereof. Article 4 further states that the Center will collaborate with national or foreign institutions to promote arbitration. This is all that Article 4 says about the duties of the Center.

As mentioned above, the Center is now planned to be established through legislative means, due to the fact that previous independent initiatives to establish such a body in Istanbul have failed. Nonetheless, the duties set forth in the Article 4 of the Draft Law are rather generic, which inhibits the effective function and practice of the Center. Besides, the duties must be accompanied with the clear “authorities” in order to be meaningful. The authorities of the Center have not, however, been determined in the said provision. At the very least, the following issues should be clarified in the Draft Law:

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- How the relationships with governmental authorities, including the Ministry of Justice, will be governed;
- Management of the Center’s document and information requests from governmental authorities and third parties;
- Relationship with state courts;
- Whether the Center will be entitled to enjoy special provisions during execution proceedings to be initiated against those individuals/firms that failed to pay their debts in connection with arbitration proceedings;
- Tax-related provisions applicable to the function of the Center as well as the salaries of the Center’s personnel;
- Whether foreign arbitration experts will be employed by the Center and, if so, whether there will be provisions facilitating the work permit processes; and
- Specification of the conditions under which the finalized arbitral awards will be issued on the official website of the Center.

In addition to the above mentioned points, as the Center will be established by virtue of a law and granted certain public privileges, we believe that the legal and criminal liability of the statutory organs of the Center, as well as the individuals who are members of those organs, should explicitly be governed by the Draft Law.

### *Arbitration Rules*

The Draft Law states that the arbitration rules of the Center will be issued within six months upon entry into force of the Draft Law. The arbitration rules of the Center will be a test case for the institution from which much can be learned. While the Center drafts its arbitration rules, the connection and relationship with Turkish International Arbitration Law No. 4686 and Turkish Civil Procedure Law No. 6100 should be established and crafted very carefully.

In fact, subsequent to the entry into force of the law, we rather think that the main concentration and energy should be focused on the formation of the constitutive organs of the Center. Therefore, preparation of arbitration rules in six months, as anticipated in the current version of the Draft, is neither realistic nor meaningful.

We think that the arbitration rules, as a test case for the Center, should be satisfactorily prepared by taking internationally recognized institutional arbitration rules (e.g., ICC Arbitration Rules, Arbitration Rules of the London Court of International Arbitration) and Turkey's arbitration-related dynamics and practices into consideration. Six months granted by the Draft Law is not a sufficient timeframe to realize this goal. We suggest that at least one year should be granted for the preparation of the arbitration rules of the Center. Further, this period should be initiated upon the establishment of the national and international arbitration courts of the Center instead of the Draft Law's entry into force of law.

Considering the above, we strongly believe that the establishment of the Istanbul Arbitration Center is a positive and striking step taken by the government. Yet it is fair to say that the language of the Draft Law needs to be improved so that the Center will be an independent, effective, reliable, and competitive one among other international arbitration centers. It is doubtless that all relevant scholars, practitioners, business people, and non-governmental organizations should also contribute to the realization of this target as much as possible. Such contributions would make sense not only in the establishment stage but also in the marketing and operation stage of the Center.