Kluwer Arbitration Blog

# Law Governing the Arbitration Agreement: Whose Side Are the Turkish Courts On?

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Identifying the law governing the arbitration agreement has increasingly proven to be a complex and confusing process. This is particularly true after the UK Supreme Court's *Enka v. Chubb* judgment, which already was the topic of extensive discussion on Kluwer Arbitration Blog (see here, here and here). In spite of being criticised by many scholars and practitioners, the UK Supreme Court's reasoning may have had a riffle effect in other jurisdictions. In this context, the recent judgement of the Turkish Court of Cassation on the same issue is particularly noteworthy. In this decision, the Turkish courts concluded that, in cases where parties have chosen the seat of the arbitration and the law governing the contract but omitted to select the law governing the arbitration agreement, the law governing the contract will also apply to the arbitration agreement. This post provides a short commentary on this recent decision.

## Facts

The dispute arose out of a personal guarantee agreement. A Bank issued a loan to a Maltese company in 2014. This loan was secured by the personal guarantee of the ultimate owner of that Maltese Company. Although the loan agreement was required to be repaid by 1 September 2016, neither the borrower nor the guarantor complied with their obligations. Against this background, the parties began settlement negotiations.

These negotiations eventually resulted in the Bank preparing an agreement called "Extension of the Personal Guarantee Agreement" ("**Extension**") in 2019. This Extension changed the forum selection of the personal guarantee agreement from German courts to ICC arbitration seated in Istanbul, Turkey, and it also stated that the Extension was governed by German law. After some discussion between the bank and the guarantor, the guarantor eventually signed the Extension.

However, the dispute between the parties resurfaced shortly after the execution of the Extension. And as a result, the bank initiated an ICC arbitration against the guarantor based on the arbitration clause in the Extension. During the arbitration, the bank transferred its receivable to a third party that continued with the proceedings as the new claimant.

## Arbitration Proceedings

The parties extensively discussed the validity of the arbitration agreement during the arbitration. However, they agreed that the law governing the formal and substantive validity of the arbitration agreement was the law of the seat of arbitration, which was Turkish law. Although the law governing the underlying contract was German law, the parties submitted that the choice of law clause did not necessarily extend to the law governing the arbitration agreement. They argued that this result followed from the separability presumption, which postulates that two separable agreements can be governed by two different legal regimes. Since the parties had not agreed on a specific governing law for the arbitration agreement, they submitted that the validity of the arbitration agreement must be analysed under Turkish law. Article 4(3) of the Turkish International Arbitration Law ("**TIAL**")supports this view, as it provides that "*the validity of the arbitration agreement is subject to the law agreed by the parties, failing such agreement to Turkish Law*."

The Sole Arbitrator agreed with the parties that the formal validity of the arbitration agreement was governed by Turkish law. However, the Sole Arbitrator differed on the law governing the substantial validity of the arbitration agreement. Presumably inspired by recent English judgments, the Sole Arbitrator explained that the issue of consent (whether or not the parties agreed to arbitrate) should be governed by the law applicable to the underlying contract, which in this case was German law. The Sole Arbitrator upheld jurisdiction and ordered the Guarantor to pay the outstanding amount under the Loan Agreement.

**Set-Aside Action Before the Turkish Courts**

The Guarantor initiated a set-aside action before the Turkish courts. In this action, the Guarantor argued that the Sole Arbitrator unlawfully assumed jurisdiction, as there was no valid arbitration agreement. In the Guarantor's view, the substantive validity of the arbitration agreement is governed by Turkish law, and under Turkish law the arbitration agreement was invalid. Furthermore, the Guarantor argued that the award violates public policy because the Sole Arbitrator applied the wrong law, i.e., German law instead of Turkish law, to the substantive validity of the arbitration agreement.

However, the Regional Appellate Court rejected these arguments and upheld the Sole Arbitrator's jurisdiction.[1)] The court determined that the Sole Arbitrator was correct to evaluate the substantive validity of the arbitration agreement based on German law, which was the governing law of the underlying contract. Furthermore, the Regional Appellate Court held that the award did not violate public policy since the Sole Arbitrator applied the correct law to the substantial validity of the arbitration agreement.

This decision was appealed by the Guarantor. However, the result remained the same. The Court of Cassation once again confirmed that "*the Sole Arbitrator's application of German law to the substantial validity of the arbitration agreement is not contrary to TIAL.*"[2)].

**Analysis**

To the best of the authors' knowledge, this is the first case in which Turkish courts had examined the law governing an arbitration agreement when the law of the seat of arbitration and the law

applicable to the underlying contract differed, at least since *Enka v. Chubb*.

During the set-aside proceedings, both parties heavily discussed recent developments on this particular topic. The award-debtor, for example, referred to the French court's reasoning in *Kabab-Ji SAL v. Kout Food Group* case. By highlighting the separability presumption, the award debtor argued that the choice of German law as the law governing the contracts is not sufficient to establish the common will of the parties to submit the validity of the arbitration agreement to German law, in derogation of the substantive rules of the seat of arbitration (Turkish law) expressly designated by the contracts. On the other hand, the award-creditor, *inter alia*, referred to the English courts' Enka v. Chubb judgment and argued that, although the separability presumption means that the choice of law of the main contract would not automatically apply to the arbitration agreement, the former could nevertheless provide some guidance as to the parties' intentions.

After having heard both parties' arguments, the Turkish courts followed the approach adopted by the English courts in *Enka v. Chubb*, which states that in cases where parties have chosen the seat of the arbitration and the law governing the contract but omitted to select the law governing the arbitration agreement, the law governing the contract will also apply to the arbitration agreement.

It appears that the diverging results between the French and English courts on the identification of the law governing the arbitration agreement have been further increasing their impact, with other countries' national courts picking their sides on these discussions. The natural conclusion to make in such circumstance would be to keep in mind these diverging approaches as early as at the stage of drafting an arbitration agreement.

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References

?1 Istanbul Regional Appellate Court, 13th Civil Division, Case No: 2021/6E. Decision No: 2022/4 dated 6.7.2022.

?2 Court of Cassation, 11th Civil Division, Case No: 2022/5454E. Decision No: 2022/8276K. dated 23.11.2022

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