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WHICH PARTIES ARE BOUND BY THE ARBITRATION AGREEMENT UNDER TURKISH LAW?

(*RATIONE PERSONAE* OF ARBITRATION AGREEMENTS)

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Under Turkish law, the contracts cannot confer rights or impose obligations upon any person who is not a party to the contract (privity of contracts). And an arbitration agreement – like any other contract – can only produce its effects *inter partes*, i.e., between the contracting parties. It follows that, as a matter of principle, third parties are neither bound by an arbitration agreement, nor can they rely on it.

This general rule has some exceptions. The first exception is succession. Turkish legal scholars and case law accept that an arbitration agreement also binds the legal successors of the contracting parties.[1] This applies both in relation to legal succession and singular succession. Further exceptions to the rule include arbitration agreements in favour of a third party and the rare instances in which it may be justified to extend the scope of an arbitration agreement to a non-signatory or to pierce the veil of a corporation in order to allow for a direct claim against its beneficial owners. This article tries to summarise these exceptions.

A. Universal Succession

As a matter of Turkish law, an arbitration agreement concluded by a deceased will also bind his or her heirs (except the strictly personal rights). This result does not require the consent of the heirs to the transfer of rights and obligations.

The same principles apply to the various instances of legal succession under company law, e.g. for mergers, spin-offs, restructurings and transfers of assets.

The same considerations also apply in case of economically motivated restructurings of *state-owned enterprises*. A state-controlled enterprise must be considered bound by a valid arbitration agreement both before and after the restructuring.

B. Singular Succession

I. Assignment of claim

[1] See Baki Kuru, Hukuk Muhakemeleri Usulü V. VI., İstanbul,2001, page 5982; Keser Berber page 100, 221-222

The vast majority of the Turkish legal scholar and case law are of the view that an assignee of a claim is bound by and may rely upon an arbitration agreement which covers that particular claim.[2] However, there are different views as to how the binding effect of the arbitration agreement on the assignee should be construed.

The Turkish Court of Cassation and most commentators consider that the arbitration agreement governing the assigned claim is included among the "privileges and ancillary rights" which pass on to the assignee along with the assigned claim.[3]

The alternative view is that a person, who concludes a contract with an arbitration clause, from which assignable claims arise, has not just waived its right of access to courts in relation to its immediate contracting partner.[4] Instead, such person, must be deemed as having implicitly waived such right also in relation to any potential assignee (waiver with *erga omnes* effects). This view is also supported by the argument that any person who concludes a contract that does not prohibit the assignment of claims must be aware that any claim arising from such contract may at any time, without its consent, be assigned to any unspecified third party.

The foregoing considerations apply not only to the assignment of claims by way of a contractual disposition, but also *mutatis mutandis* to the transfer of an individual claim by operation of law (legal succession or subrogation) or as a result of a judicial decision. Therefore, for example, a surety who has paid the creditor and intends to claim an indemnity from the principal debtor, may rely on the arbitration agreement concluded between the principal debtor and the creditor.[5] The reason for this is that under Turkish law the surety, up to the amount it has satisfied the creditor's claims, acquires the creditor's rights against the principal debtor by operation of law (subrogation).[6]

A guarantor who makes payment to the creditor in lieu of the principal debtor is entitled to the same treatment as the surety, to the extent that the guarantee is drafted in a similar way to a surety. By contrast, if the guarantor has promised to pay "irrevocably and irrespective of the validity and the legal effects of the secured contract and waiving all rights of objection and defence arising thereof" ("non-accessory" guarantee), there is no transfer of rights from the creditor to the guarantor by operation of law (no subrogation).

II. Assignment of debt

Under Turkish law, an assumption of debt that releases the previous debtor from its obligations takes place by means of a contract between the person assuming the debt (the "new debtor") and the creditor. As with an assignment of a claim, it is

[2] See Şanlı, Konişmentonun Devri, page 784-785; Nihal Uluocak, "Milletlerarası Tahkim Şartının Alacağın Temliki ile İntikali-Fransız İçtihadı", MHB, 1999-2000, page 1001

[3] See Dayınlarlı op. cit. page 311; in the same opinion Bozer, Ali "Borçlar Hukuku (Genel Hükümler)", Ankara 2002, page 264/265; Feyzioğlu, op. cit. page 641; Aydıncık, op. cit. Page 176 and also Kuru, Baki "Hukuk Muhakemeleri Usulü"

[4] See, Gürzumar "Alacağın Devri ve Tahkim Anlaşması" page 7

[5] See, Rasih Yeğengil L'Arbitrage, İstanbul 1974, page 189; Gülerci page 89; Melis Sılacı Korkmaz, "New York Konvansiyonu Uyarınca Tahkim Anlaşmalarının Geçerliliği ve Etkileri", page 52-53

[6] See, Article 546 of The Turkish Code of Obligations (TCO) "To the extent that the guarantor performs to the creditor, he becomes the successor to his rights."

accepted that the effects of an assumption of debt extend to an arbitration agreement that covers the corresponding claim.

III. Assignment of contract

As a matter of Turkish law, an assignment of contract means that a party withdraws from the legal relationship and is replaced by a third party in relation to its entire standing. An assignment of contract thus not only affects an individual right, but the legal relationship as a whole. Thus, an assignee of a contract is bound by and may rely on an arbitration agreement governing the assigned contract.[7]

IV. Arbitration agreement in favour of a third party

A contract in favour of a third party means that the contracting parties confer a right on a third party; they agree that performance of the contract is due to a third party. Turkish law distinguishes between "simple" and "genuine" contracts in favour of a third party. A genuine contract in favour of a third party requires that, the beneficiary has an independent right of its own to compel performance of the contract. In the situation of a simple contract in favour of a third party the beneficiary has no right of its own to claim performance, this right being left exclusively with the promisee who may claim from the promisor to perform in favour of the beneficiary.

Whilst the court decisions are not entirely clear on this issue, our view is as follows:

If a genuine contract in favour of a third party contains an arbitration clause, the question is whether the beneficiary is entitled to invoke the arbitration clause when claiming performance from the promise. This requires an arbitral tribunal to examine the question whether the promisor and the promisee as the contracting parties had the common intention that not only their contract but also their arbitration agreement contained therein shall be vested with the effect of a genuine contract in favour of a third party. Unless the arbitration agreement clearly states otherwise, we consider that the contracting parties must be deemed to have had that intention.

On the other hand, if a simple contract in favour of a third party means that the promisor and the promisee had no intention to grant the beneficiary an actionable and enforceable claim of its own under their contract. On that basis, we consider that the promisor and the promise must be deemed to have had no intention to afford the beneficiary any rights under the arbitration clause contained in the contract. Thus, if only a simple contract in favour of a third party is at issue, in our view the beneficiary is not entitled to rely on the arbitration clause, unless the latter would clearly state otherwise.

Lastly, it is also conceivable that the promisor (or the promisee) can arbitrate against the beneficiary to enforce purported rights, arising from the contract in favour of a third party by relying on the arbitration clause contained therein? To the best of our knowledge, the Turkish Court of Cassation never had a case with this particular setting before. We consider that, the starting point to address this issue

[7] See, Akıncı page 104; 19 HD. 2014/11942 E., 2014/17697 K., 09.12.2014 T.

is the determination that it is impossible for two parties (here the promisor and the promisee) to conclude a contract at the expense of a third party and, thus, also impossible for them to conclude an arbitration agreement at the expense of a third party. It thus follows that, as a matter of principle, the beneficiary of a contract in favour of a third party cannot be forced to arbitrate under the arbitration clause contained therein. The only exception might be if the beneficiary has specifically consented to be bound by that arbitration clause. This is largely related to the extension of arbitration agreement to non-signatures, which be examined just below.

V. Extension of arbitration agreement to non-signatories

A party seeks to extend an arbitration agreement to a non-signatory, that issue depends on whether there is sufficient evidence to conclude that the third party must be deemed to have intended to become a party to the contract and the arbitration clause contained therein. If Turkish law is applicable, an extension to a non-signatory cannot be accepted lightly and the evidence adduced in support of such extension is subject to a restrictive interpretation. An extension may only be justified if the third party intervened in the conclusion or performance of the main contract in such a way that the party seeking the extension had legitimate reasons deserving protection to assume that the third party thereby, in fact and law, intended to become a party to the contract with the arbitration clause contained therein.

An extension of an arbitration agreement to a non-signatory may thus be justified where the third party, by its conduct, creates the appearance of intending to be bound, whether in whole or in part, whether instead of or in addition to a contracting party, by the main contract including the arbitration clause contained in it ("liability based on appearance"). In such a case, the legal basis for the liability of the third party is thus the main contract, which means that the party from which the extension is derived and the third party are both liable on the same legal ground.

The situation is different if the liability of the non-signatory is sought on another legal basis, which is independent of the main contract, e.g., based on torts, infringement of company or corporate law, or on a breach of the principles of good faith ("liability based on trust"). If, i.e., the liability of two distinct parties is sought on different legal grounds, an arbitration agreement concluded by only one of them is not binding upon and thus cannot be extended without more to a non-signatory – unless the latter has independently expressed its intention to be bound by such arbitration agreement.

VI. Piercing the corporate veil

Under Turkish law, stock companies, limited liability companies and other legal entities have their own separate identity and existence. They must be distinguished from their shareholders and other affiliated or closely related persons or entities.

Nevertheless, it is established practice under Turkish law that, based on the principle of good faith, the independent status of a legal entity can be disregarded and the underlying economic reality be considered as decisive where the insistence

on the separate existence of such legal entity would amount to an abuse of rights ("piercing the corporate veil"). For example, a company established for the sole purpose of frustrating the justified claims of third parties or in order to avoid contractual or statutory obligations is considered as an abuse of rights.

The effects of the contract concluded by the legal entity now denied its independence are thus reallocated as a matter of substantive law to the person (controlling shareholder, parent company) that tried to hide behind it. On that basis, it is appropriate to conclude that piercing the corporate veil also reallocates the effects of the arbitration agreement to the person behind the veil.

Properly analyzed, veil piercing is therefore not about an extension of the arbitration agreement to a third party. Instead, it only involves a substitution or replacement of one of the parties who have been involved in the conclusion of the arbitration agreement.

VII. No application of Group of Companies Doctrine

French case law has produced a number of decisions holding that, where several entities belong to the same group of companies, the effects of an arbitration agreement may be extended to another entity of the same group.[8] This is even without further justification, in particular without having to show a violation of the principles of good faith or an abuse of rights (*théorie des groupes de sociétés*).

In Turkey, a majority of commentators does not support the "group of companies doctrine". Under Turkish law a caution should be exercised before ruling that a company was bound by an arbitration agreement concluded by another company belonging to the same group of companies. More precisely, such a conclusion should only be drawn where factual circumstances exist which may justify to assume a "liability based on appearance".

On this basis, we consider that an arbitral tribunal with its seat in Turkey, when having to decide on a request for extension of an arbitration agreement to another entity within the same group of companies, shall apply to that situation the (same) general principles applicable to piercing the corporate veil.

Conclusion

An undertaking to arbitrate does not necessarily create a closed circle of participants. A variety of strangers, such as assignees, beneficiaries, successors may be entitled to rely on an undertaking to arbitrate.

Hence, the question is not whether the respondent agree to arbitrate with a particular person as with respect to a transaction. Rather, the correct question is whether the respondent has consented to arbitration of claims, arising from a certain transaction - irrespective of who brings it.

[8] ICC Award No.4131, Yearbook Commercial Arbitration, Y.1984, pp. 131-137. (For access: https://www.trans-lex.org/204131/_/icc-award-no-4131-yca-1984-at-131-et-seq-/ , 02.10.2020)

And it may be a mistake to ask whether someone is a "third party" when the relevant question is whether the dispute is arising from a contract, subject to arbitration, in which such a "third party" has chosen to become involved.

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