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July 2018

Remedies for Breach in Construction Contracts Under Turkish Law

The purpose of this note is to provide a general framework of remedies for contractual breaches under Turkish law from the perspective of construction contracts for large projects, a surprisingly complex area of the Turkish law of obligations.

I. The Statutory Framework of Remedies for Breach of Contract

Turkish code of obligations has been re-enacted in July 2012 as Turkish Code of Obligations Law No. 6098 (the "New Code of Obligations"). The previous code was Code of Obligations Law No. 818 (the "Old Code of Obligations").[1]

Article 112 of the New Code of Obligations (Article 96 of the Old Code of Obligations) sets forth the overarching principle of liability of a defaulting party in any contract by providing that if an obligor does not duly perform his obligations or does not perform at all, unless the obligor can prove that it has no fault in this situation, the obligor is liable to compensate the obligee's losses arising from such deficient performance or non-performance.

Article 113 of the New Code of Obligations (Article 97 of the Old Code of Obligations) provides that in relation to obligations to do or not to do something, if an obligation to do something has

[1] Article 1 of the Law numbered 6101 on the Effectiveness and Implementation the Code of Obligations provides: "As a principle, the code that is in effect at the time of an act or a transaction will apply to the acts and transaction that occured before the effectiveness of the [New] Code of Obligations, to whether they are legally binding and their consequences. However, defaults, terminations or liquidations that occur after the effectiveness of the [New] Code of Obligations will be subject to the [New] Code of Obligations". It is worth bearing in mind that some Court of Appeals decisions have incorrectly applied the New Code of Obligations to liquidations and defaults that have occured before the New Code of Obligations. (Court of Appeals 3rd Civil Chamber, E. 2014/2569, K. 2014/6532 T. 29.4.2014; Court of Appeals 6th Civil Chamber E. 2013/691, K. 2013/3827, T. 5.3.2013)

not been performed, the obligee may seek leave (from court) to have someone else perform the obligation at the non-performing obligor's expense.

Article 473 of the New Code of Obligations (Article 358 of the Old Code of Obligations) is specific to construction contracts. Its second paragraph provides that if during construction it becomes clear that the construction will be defective or non-compliant with the contract because of the contractor's default (by "fault" (*kusur)* and not mere negligence (*ihmal*)), the employer may give the contractor a reasonable period to cure the defect or non-compliance and notify that otherwise it will correct the defect or breach itself or retain a third party to do the same at the contractor's expense. Article 473 effectively removes the requirement under Article 113 to seek court's permission to have the defective work remedied by a third party.[2]

The first paragraph Article 473 of the New Code of Obligations (Article 358 of the Old Code of Obligations) provides that if, in a construction contract, the contractor does not start the work on time or delays the work in breach of the contract or, absent any fault of the employer, it becomes clear that the contractor will not be able to complete the works at the agreed time due to its delays, the employer may rescind from the contract without waiting for the necessary deadlines. This provision's counterpart in the Old Code of Obligations (Article 358 of the Old Code of Obligations) provided that the employer can "terminate" in this case but it had later been clarified in the legal jurisprudence and Court of Appeals decisions that the "termination" referred to therein should be understood to mean "rescission"[3] and therefore only lead to negative damages[4] (see below for an explanations of these concepts).

[2] Helvacı, Şirin. *Yapma Borçlarının İfa Edilememesi ve Hukuki Sonuçları*, Doktora Tezi. İstanbul, 2010.
[3] In the new version of this provision in the New Code of Obligations, Article 473, which does not substantially change the provision but merely modernize its wording, the "the right to terminate" wording has been replaced with

Article 136 of the New Code of Obligations (Article 117 of the Old Code of Obligations), which governs impossibility (theoretically, an excuse to performance under contract), provides in its first paragraph that if the performance of an obligation becomes impossible for reasons that cannot be attributed to the obligor, the obligation expires. This provision is used as the basis of the doctrine of impossibility of performance without fault, explained below.

II. Ways of Ending a Contract and Their Consequences

A. The Available Options

Articles 125 of the New Code of Obligations (the substance of which was covered in Articles 106 and 108 of the Old Code of Obligations) sets forth the remedies available to a non-defaulting party, at its choosing (*seçimlik haklar*), and provides that a non-defaulting party has three choices when the other party defaults under a contract:

(i) if the defaulting obligor has not performed his obligation within the cure period provided or there is no need for such a cure period, the obligee may seek (delayed) performance of the obligation and related delay damages;

(ii) the obligee, upon promptly stating that it is giving up its right under the prior option, may

(a) seek compensation of its damages arising out of the non-performance of the obligation, or

(b) rescind the contract.

"a right to rescind" the contract. This is because a termination under Article 358 can only result in negative damages.

[4] Court of Appeals 15th Civil Chamber, 14.5.2012 E. 2011/6559 K. 2012/3377.

Overall, the purpose of this scheme is to give the non-defaulting party the right to choose between actual performance and delay damages[5] ((i) above), non-performance and positive damages (*müspet zarar*) ((ii)(a) above) or non-performance and negative damages (*menfi zarar*) ((ii)(b) above). In the first and second options the contract remains effective whereas in the third option, it ends.

As explained further below, a fourth option has developed over time for ending a contract *and* seeking positive damages. In the case of instantaneous contracts, this is through the doctrine of impossibility without fault or through the Court of Appeal's substantial completion exception for construction contracts and in the case of continuous contracts, this is through Article 126 of the New Code of Obligations.

B. Termination, Rescission and the Resulting Damages

1. Main Rules

Under Turkish law, positive damages are damages that bring the non-defaulting party to the position it would have been in had the contract been properly performed (and are therefore akin to expectation damages in common law systems). The compensation that can be sought in the first and second options in Section II (A) above (*i.e.*, prongs (i) and (ii)(a)) are kinds of positive damages. The underlying premise is that in these first and second options, the non-defaulting party maintains that the contract is in effect and within this contractual realm, requires the defaulting party to make it whole under the contract either by actually complying with the contract and covering any damages for delayed compliance, or by covering the damages of having the contract performed some other way.

[5] Such performance plus delay damages is deemed to be a kind of positive damage.

In the third option above in Section II (A) (*i.e.*, prong (ii)(b)), rescinding the contract, the parties are mutually relieved from their obligations to perform under the contract and can seek a return of their previously performed obligations, and, unless the defaulting obligor can show it was not liable for the default, the obligee can seek damages arising from the ineffectiveness of the contract[6] (*i.e.*, put the non-defaulting party in the same position as if the contract had never been formed; akin to reliance damages in common law systems).

The third option of "rescinding the contract" (*rücu, dönme*) is different from the common-law concept of rescission in that it is a statutory remedy provided to the non-defaulting party to use at its discretion (rather than an equitable relief granted by the court). Its consequences are slightly different than common-law rescission as well. While, similar to common law rescission, Turkish law rescission means an unwinding of the contract that aims to bring the parties to the positions in which they were before the contract (the *status quo ante*)[7] and to not hold them liable under the contract anymore, the consequences of Turkish law rescission can go one step ahead of classic reliance damages.[8]

Negative damages that are awarded in case of "rescission" under Turkish law go one step ahead of classic reliance damages because, in case of construction contracts, as a result of a series of Court of Appeals decisions, in addition to reliance damages, negative damages cover "loss of opportunity" damages when awarded to an employer. Such loss of opportunity damages are defined as the price difference between the second best offer in the original tender concerning

6 Article 108 of the Old Code of Obligations, Article 125 of the New Code of Obligations.
7 Which, under Turkish law, includes compensating them for loss of opportunity damages, based on the idea that had this contract not happened, the employer would have proceeded with the following offer and would not now be liable for the difference between that offer and the offer it received upon re-tendering the contract as explained in footnote 12 above.
8 I am therefore using the Turkish law negative and positive damages concepts in this note rather than the more international concepts of reliance and expectation damages.

the construction and the winning offer in the re-tendering of the construction as a result of the non-performance in the first round.[9]

The Old Code of Obligations' reference to this the option as "termination" in its Article 108 caused a lot of problems and led to a myriad of jurisprudence. One theory is that the confusion was the result of problematic translation from the Swiss code of obligations and scholarly articles had to clarify the meanings.[10] In the New Code of Obligations, the word "termination" in the last option was therefore replaced with "rescission", which had by then, gained traction in the jurisprudence and the Court of Appeals decisions as the real meaning of "termination" in the previous provision.

2. Exceptions to the Main Rules

In fact, in case of construction contracts, a series of Court of Appeals decisions developed at the time of the Old Code of Obligations provided that when the third option (called "termination" in the Old Code of Obligations but by then universally understood and implemented as "rescission") is chosen in case of a construction contract that has been substantially performed, the parties may still seek positive damages[11] because where a contractor has performed most of its obligations under a contract, as a consequence of the employer's entitlement to negative damages, the contractor would be deprived of the profit it is entitled to for the completed parts of the works; which the Court of Appeals held would be unfair in case of substantially completed works.

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9 Karataş, İzzet. *Eser (İnşaat Yapım) Sözleşmeleri, Kurulması, Uygulanması, Sona Ermesinin Sonuçları*. Ankara, Adalet Yayınevi, 2009. 529. Buz, Prof. Dr. Vedat. *Borçlunun Temerrüdünde Sözleşmeden Dönme*. Ankara, Yetkin Kitabevi, 1998. 246.

10 Buz, Prof. Dr. Vedat. *Borçlunun Temerrüdünde Sözleşmeden Dönme*. Ankara, Yetkin Kitabevi, 1998. 80.

11 Öz, Prof. Dr. Turgut. *İnşaat Sözleşmesi ve İlgili Mevzuat*. İstanbul, Vedat Kitapçılık, 2013. 179. Court of Appeals General Council Decision 25.1.1984 E.19983/3 K. 1984/1; RG 18325 (27 February 1984).

The result was a Court of Appeals exception to the Old Code of Obligations provisions that where most of the work (this was defined as 80% or more of the work)[12] was completed under a construction contract but the contractor did not properly perform anymore, the landowner could seek "termination" (by then universally understood and implemented as "rescission") within the meaning of Article 106 of the Old Code of Obligations but not be limited to negative damages (the "substantial-completion exception"). Further, there is room in the jurisprudence to argue that as the main concern of the substantial-completion exception is to compensate the contractor equitably for the work it has done (and the employer benefitted from) and that the 80% is merely a convenient marker; not necessarily an set threshold.[13]

A similar concept was incorporated in the New Code of Obligations as a new provision, Article 126, which provides that in contracts of a continuous nature in which parties have started performance, the non-defaulting party may seek performance and delay damages, or "terminate" (rather than "rescind") the contract and seek damages for having to end the contract before performance under it was completed (*i.e.*, leading to positive damages). This is in contrast to the Old Code of Obligations, which, by its terms, only allowed for rescission and not termination (see explanation of Articles 106 and 108 of the Old Code of Obligations above, this is a void later filled by legal jurisprudence).

III. The Problem in Construction Contracts

A. Instantaneous Contract Categorization

As explained in Section II (B) (2) above, the New Code of Obligations has recognized the problem with the previous version, first, by clarifying that the main provision (Articles 106 and

[12] Öz, Prof. Dr. Turgut. *İnşaat Sözleşmesi ve İlgili Mevzuat*. İstanbul, Vedat Kitapçılık, 2013. 180.
[13] Court of Appeals General Council Decision 25.1.1984 E.19983/3 K. 1984/1; RG 18325 (27 February 1984).

108 of the Old Code of Obligations), refers to "rescinding" not "terminating" in its third option and second, by providing that if the contract is of a continuous nature and performance has started, then the parties would not have to choose between the initial three options of (i) keeping the contract in effect and seeking actual performance and delay damages, (ii) keeping the contract in effect but seeking positive damages or (ii) ending the contract (by "rescinding") and seeking negative damages (under Article 125 of the New Code of Obligations) but could also chose to (iv) end the contract (by "terminating") and seek positive damages as well (under Article 126 of the New Code of Obligations).

However, this recognition does not extend to construction contracts because construction contracts are, in the majority's view, not deemed contracts of a continuous nature (they are instead deemed to be the opposite of that, i.e., "instantaneous contracts"). As much as construction contracts in large, complex projects span over many years and are made up of various continuous and one-time obligations, in the majority's view, construction contracts are inherently viewed as bargains to eventually produce something whereby the final production is deemed the ultimate performance. Contracts that envisage a continuous, repetitive performance such as on-going provision of a service or the lease of a premise are classic examples for continuous contracts. So, by and large, Article 126 of the New Code of Obligations is not deemed to apply to construction contracts.

That leaves rescission, as set forth in the third prong of Article 125 of the New Code of Obligations, as the only way of ending a construction contract stipulated under the relevant provision of the Code of Obligations. As explained above in Section (II) (B) (1), this third prong leads to negative damages only (unless the substantial-completion exception applies), which is

odd, as normally the non-breaching party would be expected to be entitled to seek negative or positive damages, at its choosing.

B. Impossibility without Fault Jurisprudence

Another way of seeking positive damages in a construction project while at the same time ending the contract was therefore developed under the legal theory of "impossibility to perform without fault" (*kusursuz ifa imkansızlığı*) based on Article 136 of the New Code of Obligations (Article 117 of the Old Code of Obligations), described in Section (I) above.

This theory provides that positive damages should be awarded to the non-breaching party when the breaching party effectively abandons the performance of the contract for one reason or another (i.e., the contract becomes impossible to be performed absent any fault on the non-breaching party's part and due to the other party's breach) and relieves the non-breaching party from any further performance, thereby effectively ending the contract.[14] This theory therefore resolves the problem of rescission (and consequent negative damages) being the only way of ending the contract in instantaneous contracts such as construction contracts.

The fact that this issue is resolved under an impossibility theory, which is in essence an excuse to performance rather than a method of termination, complicates an area of law that should be robust given its importance in practice. The connection in the jurisprudence that this kind of impossibility gives rise to positive damages is made through references to a holistic reading of

[14] Öz, Prof. Dr. Turgut. *İnşaat Sözleşmesi ve İlgili Mevzuat*. İstanbul, Vedat Kitapçılık, 2013. 225.

the New Code of Obligations[15] and Court of Appeals decisions[16] and is not stated specifically under the Old or New Code of Obligations.

IV. Conclusion

On the whole, termination and its remedies, building blocks of contract law, are complicated in Turkish legal theory, especially in the field of construction contracts. There remains a need for publications that explain the matter concisely to non-lawyers, for it is as critical a business issue as it is a legal one.

A re-evaluation of the long-held majority view that construction contracts are instantaneous contracts to which Article 126 of the New Code of Obligations would not apply would also be welcome in light of the practicalities of large, complex construction projects that are frequently undertaken under Turkish law. Finally, this complexity in the legal background renders the drafting of the contracts and termination provisions critical.

[15] *Id.*
[16] Court of Appeals 13th Civil Chamber, 06.12.1985 E. 5334 K. 7531.