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CASE ANALYSIS: KASIMLAR HYDROELECTRIC POWER PLANT (HPP) CASE: CONTRACT INTERPRETATION, CAUSALITY, BETTERMENT, AND FOREIGN CURRENCY PROHIBITION

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Kasımlar Hydroelectric Power Plant (HPP), that was planned in 2012 amid debates about its potential damage to the environment and tourism economy, continued to remain a topic of discussion even after becoming operational in 2016. After being hit by a severe landslide in 2019, the HPP was able to recover only a small portion of its damages from its insurer Thus, it initiated arbitration proceedings before the Insurance Arbitration Commission for the remaining damages, which amounted to 7.5 million US dollars (USD). The claimant's case involves approximately 3 million USD in 'repair, recovery, and prevention' costs, as well as around 4.5 million USD in lost profits.

The primary reason the insurer rejected this claim was the “repair” costs were intended to correct errors made during the design and construction phases of the power plant, which was essentially serving the purpose of “improving the insured value”. Similarly, the recovery and prevention' costs following the repairs were for reinforcement activities that could only be accepted if it was certain that the landslide would continue.

The expert examination conducted during the proceeding and the subsequent decision by the Dispute Arbitration Board also concluded that “the damage in question would not have occurred if the claimant had constructed the HPP properly during the initial installation” and that “the defendant insurer was not liable for the betterment costs”.

The Appellate Arbitration Board did not consider the claimant’s “repair, recovery, and prevention” costs as “improvement costs” and accepted them within the scope of insurance coverage. However, the Appellate Arbitration Board did not completely disregard the issue of 'defective construction,' which was the basis for the initial rejection of the claim. According to the Appellate Arbitration Board, the claimant's failure to consider during construction the soil conditions that contributed to the landslide constituted a contributory negligence that warranted a 50% reduction in compensation.

The Court of Cassation in its reasoning spared only little place to the defective construction which the arbitrators had heavily dwelled on. Ultimately, it did not find the defective construction sufficient to exclude the damage from insurance coverage

or to warrant a reduction in compensation for a damage that was included within the coverage. Although the exact reasoning for this outcome is not entirely clear from the reasoning, there can be two possible explanations: the Court may not have fully accepted the causal link between defective construction and damage, or it may have considered that the insurer was aware of (or should have been aware of) the structure's existing condition prior to the issuance of the policy.

The main concern of the Court of Cassation was whether the costs incurred to improve the insured asset could be considered within the scope of insurance. To answer this question, it checked the findings of technical experts and concluded that the repair, recovery, and damage prevention activities aimed at "controlling the landslide to a degree that would allow construction" could not be characterized as "betterment."

Although the details of the case and the thought processes of the judicial authorities are not clearly understood from the reasoning of the decision, this ruling is significant for observing the reflections of fundamental insurance principles in practice. Below, key issues that were addressed in this decision will be examined:

I. Damages Arising from Defects in the Insured Property Can Be Covered by Insurance

Article 1453 of the Turkish Commercial Code (TCC) is one of the fundamental provisions concerning the scope of the insurance contract, which the defendant insurance company relied upon. According to this provision, "damages arising from defects in the insured property are not covered by insurance unless otherwise agreed in the contract". The defendant argued that the damage was outside the scope of coverage by asserting that "the facility was designed and constructed defectively."

As reported in the ruling, the technical expert opinion supports this defence. Indeed, this was why the Dispute Arbitration Board concluded that "the damage in question would not have occurred if the claimant had constructed the HPP properly during the initial installation"

The Court of Cassation, particularly the 4th Civil Chamber (the "Chamber") that issued the decision under the review, has consistently rejected insurance claims based on defects. Recently, at the beginning of 2023, the Chamber also rejected claims under a policy covering landslide risks on the grounds that 'the property was defective and the contractor was at fault.[1]

In the case under review, the same Chamber reached a contrary conclusion despite the arbitrator's acknowledgment of defective. One of the two reasonable explanations for this, although not clearly stated in the reasoning, is the acceptance that the insurer contractually included "damages arising from defects" within the scope of insurance coverage (The other reasonable explanation is addressed in the following section regarding root cause analysis).

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[1] The Court of Cassation 4th Civil Chamber, Case no:2021/10172 E., Decision no: 2023/4236 K., Date: 22.03.2023.

The statement by the Court of Cassation that could support this conclusion is as follows:

> "... a risk analysis and valuation were conducted at the risk address before the policy in question was issued, and the scope of coverage for the insured hydroelectric power plant was determined... therefore, attributing 50% fault to the claimant for the reasons stated above is not appropriate..."

The Court of Cassation likely viewed the insurer's decision to provide coverage for landslide risks, despite being aware (or being in a position to be aware) of the defective condition of the insured structure prior to the policy issuance, as evidence of an implicit agreement between the parties that 'damages arising from defects' were included within the scope of the policy.

However, arriving at this conclusion in such a straightforward manner is open to criticism. Article 1409 of the TCC establishes that the insurer is only responsible for the risks explicitly stated in the policy, which is a new and specific provision compared to Article 11/4 of the Insurance Law, which counts unspecified risks as included in insurance coverage. Therefore, the insured claimant must more clearly demonstrate that "damages arising from defects" are covered in the policy. This was also adopted in the Chamber's decision numbered 2023/4236 rendered in 2023.[2] Such proof would typically require the claimant to demonstrate that the proposal (questionnaire) or the terms of the agreement exchanged during contract negotiations differed from what was written in the policy[3], in accordance with Article 1425 of the TCC. However, there is no evidence of such an attempt seen in the reasoning of the decision under review. Nonetheless, the 'risk analysis and valuation' referenced in the Chamber's reasoning may indicate the existence of such an agreement.

Another point that could support this conclusion is the application of the "interpretation in favour of the insured" rule, also based on Article 1425 of the TCC.[4] In the case under review, although the Chamber does not explicitly state this, it implicitly expressed its recourse to interpretation in favour of the insured in the following manner:

> "In addition, it is understood that the Modular Insurance Policy in question is a type of policy that encompasses a variety of extensive coverages and is based on multiple General Terms and Conditions due to its nature."

With this expression, the Chamber appears to have a tendency to interpret the insurance coverage as broadly as possible. It may have considered the 'landslide'

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2 "… unless otherwise agreed, damages arising from the property's own defects cannot be considered within the scope of coverage, and since it has not been claimed or proven that the parties have agreed otherwise, the case has been dismissed on these grounds."

3 The Court of Cassation 11th Civil Chamber, Case no:2015/5034 E., Decision no:2015/12732 K., Date: 30.11.2015

4 The Court of Cassation Case no: 2023/503 E., Decision no: 2023/2633 K., Date: 28.02.2023: "...according to Article 1425 of Law No. 6102, the interpretation in favour of the insured is fundamental, and therefore, there is no procedural or legal flaw in the decision of the first-instance court,' resulting in the dismissal of the defendant's appeal on its merits."

clause added by the parties to the General Conditions of Fire Insurance as a contractual arrangement that includes defects normally outside the scope of coverage. The relevant clause is open to interpreting that all landslide events, regardless of their root cause, are included within the scope, as follows:

> "Damages that occur directly to the insured property as a result of landslides or soil subsidence occurring on or near the land where the insured building is constructed... have been added to the coverage."

However, it is also quite possible to oppose such a broad and pro-insured interpretation on the grounds that the same clause reserves the provisions of the General Conditions of Fire Insurance. The referenced general conditions include among the 'A.4: Exclusions from Coverage' "damages incurred by the insured property due to its own defects without causing a fire". In such a case, it is more reasonable to conclude that there is no ambiguity that would necessitate recourse to the rules of contract interpretation. Indeed, in its 2023 case that serves as precedent, the Chamber didn't consider the damages arising from defects within the scope, despite the additional coverage for landslides, precisely referring to this general condition no A.4.[5]

II. Root Cause Analysis is Determinative in Identifying the Risk Causing the Damage

Above, one of the two reasons that could reasonably justify considering the insurance claim within the scope despite the defective construction—namely, the intent of the parties—has been addressed within the framework of general interpretation principles. As explained earlier, although this reason is among the possibilities, it is subject to criticism based on both legislation and precedents.

The other explanation (which is more likely than the first), which would make it reasonable for the Court of Cassation to view the insurance claim within scope, is the inability to establish an absolute causal relationship between the damage in question and the defects in the structure. Although the Dispute Arbitration Board exclusively attributed the cause of the damage to the defective structure by stating that "the damage in question would not have occurred if the claimant had constructed the HPP properly during the initial installation"" this clear statement was departed from in the later stages of the proceedings."

The Appellate Arbitration Board on the one hand did point to defective construction by stating that "the root cause of the landslide was the soil structure known to both parties". But on the other hand, it also mentioned that "the soil structure of the region was also influential in the occurrence of the damage," thus acknowledging the presence of multiple contributing factors.

Although the reasoning is not entirely clear, the Chamber may have gone a step further than the Appellate Arbitration Board by completely breaking the causal link

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[5] The Court of Cassation 4th Civil Chamber, Case no: 2021/10172 E., Decision no: 2023/4236 K., Date: 22.03.2023.

between the defective structure and the damage, as suggested by the following statement, which is based on the expert report:

> "The existing landslide was catastrophic (sudden and unforeseeable), and there was no opportunity to foresee or prevent it in advance. The primary cause of the landslide in the region was the rainfall, which was above normal levels. (…)"

The Court of Cassation, particularly the Chamber handling the case in question, has long accepted damages outside the scope of insurance coverage, such as 'damages occurring during the transport of excessive loads or passengers,' as being within the scope of coverage if no causal link exists between the violation of loading rules and the damage.[6] This essentially reflects the application of the "adequate causality"[7] test, which is adopted in both insurance law and general principles of obligations law.

The adequate causality test is a thought experiment used to determine which of the successive or triggering events should be considered as a risk. According to this:

> "If one cause triggers another, and it can be said that the first cause inevitably leads to the second, then the first cause should be considered the principal cause. In this case, the insurer liability will depend on whether the principal cause falls within or outside the scope of coverage."[8]

If the Chamber had considered the (excluded) defective construction and the (covered) landslide as two contributing factors, as the Objection Arbitration Board did, the conclusion it would reach remains uncertain in Turkish practice. The example mentioned above regarding transportation damage shows that the insurer's claim would still be accepted without any deductions, since the defective construction was not the sole (exclusive) cause of the damage. This suggests that the Chamber may have deemed the discussion regarding the role of defective construction in the occurrence unnecessary in the specific case.

However, it should be noted that the 'all or nothing' approach adopted by the Court of Cassation has been criticized in the doctrine. According to these views, it would be "a more balanced and appropriate solution" for the insurer to be liable to the

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6 The Court of Cassation 4th Civil Chamber, Case no: ,2021/10089 E., Decision no: 2023/5226 K., Date: 11.04.2023; See also Samim Ünan, Commentary on the Turkish Commercial Code, Volume 1, p. 112: "In Turkish law, the Court of Cassation generally requires that in order to rule that the insurer is not liable, the risk must have occurred "exclusively" (solely) because of a condition out of the cover."

7 Ayşegül Buğra, Causation in Insurance, 2018, p. 5.

8 Kübra Yetiş Şamlı, Some Issues Regarding the Determination of Risks Covered in Damage Insurance, 2020, p. 102; Samim Ünan, Commentary on the Turkish Commercial Code, Volume 1, p. 105: "Although the occurrence of the damage (or the event leading to the insurer's payment) may arise from a cause that is excluded from coverage, if this (non-covered) cause is an inevitable result of a cause that is included in the coverage, the insurer can be held fully liable." Indeed, as the Court of Cassation has occasionally done accurately (Court of Cassation 11th Civil Chamber, Case no: 2008/8644 E., Decision no: 2010/327 K., Date: 14.01.2010), statements indicating that a specific risk's 'directly occurring damages' are within the scope of coverage lead to a stricter application of the adequate causality test in favour of the insurer.

extent that the damage can be considered to have arisen from a covered cause.[9] The Appellate Arbitration Board may have been attempting to achieve this solution when attributing contributory negligence to the insured.

III. Article 1438 of TCC: The Insurer's Knowledge of the Actual Situation Prevents It from Requesting a Reduction Based on Misrepresentation

As we emphasized while summarizing the decision under review, the Chamber discussed the defective structure of the building not in terms of determining the limits of insurance coverage, but rather in relation to whether it necessitated a reduction in the damages within the coverage. This issue was discussed within the context of the pre-contractual information obligation of the insured/insurance policyholder:

> "When determining the degree of liability of the insurer, it is necessary to consider both the obligation to disclose factors that would aggravate the risk and the obligation to take measures to prevent the aggravation of the risk together."

The obligation regulated by Art. 1435 of TCC indeed requires the insured to inform the insurer of all significant matters that they know or should know. If these important matters were not properly disclosed, and it can be said that the insurer would have entered into the insurance contract under different conditions had they been disclosed, a "reduction based on the degree of negligence" will be merited according to Art. 1439/2 of TCC.

In the concrete case, the Chamber emphasized not only the fact that "there were not many indicators or displacements related to the occurrence of the landslide," but also that "a risk analysis and valuation were conducted at the risk address before the policy was issued." Based on this, the inability of the Chamber to establish a causal link between any negligence attributable to the claimant and the existing insurance conditions can be based on two different factors:

i. The Court of Cassation may consider that the insured has fulfilled their responsibility by accurately completing the questionnaire provided by the insurer to the extent of the available information, as referred to in Art. 1436 of TCC.[10]
ii. The Court of Cassation may completely exempt the insured from the information obligation imposed by Art. 1436 of TCC, arguing that the

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[9] Samim Ünan, Commentary on the Turkish Commercial Code, Volume 1, p. 113; Kübra Yetiş Şamlı, Some Issues Regarding the Determination of Risks Covered in Damage Insurance, 2020, p. 102: "In cases where the inevitability is disputed, it would be a fairer solution to rule on the insurer's liability in proportion to the effect of the included cause on the outcome, rather than applying an 'all or nothing' approach."

[10] "If the insurer has given to the policyholder a list of questions to be answered, the policyholder shall not be liable for any circumstances remaining outside the scope of the questions contained in that list, unless the policyholder has hidden an important issue in bad faith."

insurer has received the information and documents expected from the insured based on Art. 1438 of TCC.[11]

This has not been discussed in the decision under review; however, the Court of Cassation may have prioritized the disclosure obligation imposed on the insurer by Art. 1423/1[12] of TCC over the information obligation of the insured, concluding that it is incorrect to attribute fault to the insured as long as the insurer has not fulfilled its own obligation.[13]

IV. "Betterment Costs" May Also Be Included in the Scope of Insurance

In the case under review, discussions regarding whether the risk causing the damage falls within the scope of coverage and if so, whether any fault could be attributed to the insured, have concluded in favour of the insured, as noted in the previous sections.

Another discussion that concluded in favour of the insured relates to the determination of the actual amount of damage that remains within the coverage. To put it more concretely, the Chamber seeks to answer whether the insurer is responsible for the costs incurred in constructing a better structure than the damaged one.

In fact, the Court of Cassation had provided an answer to this question much earlier:

> ""In this case, the defendant's liability for compensation consists solely of the expenses required for the repair of the incurred partial damage or for restoring that part to its previous condition. The intention of the mentioned [New Value Clause] is to protect the insured against inflation; however, allowing the claimant to benefit unjustly or using the opportunity of partial damage to construct an ideal-sized new retaining wall instead of a low-standard wall that was primitive and non-conforming with scientific requirements, with the insurance payout, does not align with the principles of insurance law and does not suit the essence of the specified clause."[14]

11 "If the real situation with regards to non-disclosed or incorrectly disclosed circumstances or facts is known to the insurer, it shall not have the right to avoid the contract arguing that the duty of disclosure has been violated. The burden of proof shall lie with the policyholder."

12 "Before the conclusion of the contract and sufficiently in advance for due consideration, the insurer and its agent shall inform in writing the policyholder of all matters related to the insurance contract, the insured's rights, the provisions to which the insured has to pay special attention, notification duties that may arise in the course of the insurance cover. Moreover, the insurer shall, independent of the policy, let know the policyholder during the contract period of the facts and developments that can be of importance to the insurance relationship."

13 Court of Cassation 11th Civil Chamber, Case no: 2016/8157 E., Decision no: 2016/8157 K., Date: 17.10.2016, "Since it has been established that the nature of the goods is specified in the insurance policy, and despite this, the defendant insurer issued a policy that did not provide adequate coverage and acted contrary to its obligation to provide information regarding the policy's content. Therefore, evaluating the degree of fault of the claimant insured on the grounds that they acted against their information obligation, and dividing fault between the parties, was incorrect; thus, the ruling should be overturned in favour of the claimant."

14 Court of Cassation 11th Civil Chamber, Case no: 2002/11478 E., Decision no:2003/2866 K., Date: 27.03.2003.

The insurance legal principles mentioned by the Court of Cassation (especially the prohibition of using insurance as an enrichment tool) and Article 1459 of the TCC that obliges the insurer to pay only the actual loss of the insured[15] generally prevent the insured value from being replaced with a higher value.

However, in our specific case, there is a reason for the Chamber not to be satisfied with this solution: the deformation of the land structure due to the landslide necessitating the dam construction be done in a different and stronger manner than before. The Court of Cassation addressed this issue by referring to the expert report as follows:

> " … it was stated that deformation occurred along the channel route due to the landslide, making reconstruction essential. In engineering geology (applied geology), the best-known rule for areas affected by landslides or for areas where construction needs to occur after a landslide is that the toe of the existing landslide must be supported (stabilizing forces), and the section flowing under the crown of the landslide, which creates load (sliding forces), must be removed. Without these measures, any structure built will deform again... the excavation works, stone masonry works, stone toe works, and concrete formwork, among other expenses related to the repair costs were found to be appropriate based on the total amount of expenditure documents, cubic calculations, and expenses made according to the projects presented in the case file…"

It is unclear from the decision which method the parties chose for the calculation of "compensation amount" as outlined in the General Terms of Fire Insurance: "market value" or "replacement value (new value)." If no choice was made, the method to apply is 'market value,' which requires the insurer to pay only the market value of the damaged property at the time of the damage. Even if the parties had agreed on the "new value" method, the value to be replaced would not exceed "the insurance subject value at the place and time of the risk occurrence." As noted in a precedent by the Court of Cassation in 2003, the new value principle does not, on its own, serve to improve the insured value in technical and schematic sense.

It seems that the Chamber has sought an exceptional solution, thinking that the insured value at the time of the risk's occurrence (even if the new value principle is applied) would be insufficient for the replacement of the damaged structure. Accordingly, if the new structure must inevitably be better (or more valuable) due to the changing ground conditions, the cost of the new structure has been considered under the insurance coverage as a repair expense rather than a betterment expense.

Some other works carried out by the insured after the landslide were evaluated within the framework of "damage prevention" as defined in Article 1448 of the TCC. Here, the Chamber could navigate more safely without entering uncharted waters, as experts determined that if these expenses were not incurred, "the displacement would continue, a larger area would be exposed to landslides, measures would need to be taken over a larger area, and therefore costs would increase."

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15 The insurer shall indemnify the (true) loss sustained by the insured.

As a result, actions that improved the existing structure compared to the previous one was considered within the policy coverage to the extent these actions are necessary for "bringing the landslide under control in a manner conducive to construction.".

V. Should the Foreign Currency Receivable Be Converted to Turkish Lira?

The insured claimed their damages in foreign currency at the exchange rate of the US Dollar for loss of profit. Both the Dispute Arbitration Committee and the Appeal Arbitration Committee converted this amount into Turkish Lira referring to the Presidential Decree dated 13.09.2018 on the Protection of the Value of Turkish Currency. Although the claimant raised this conversion issue as aground for appeal, the Chamber found no error in terms of the "applicable legal rules" and rejected the appeal request.

The mentioned Presidential Decree amended the Cabinet Decision No. 32 on the Protection of the Value of the Turkish Currency (dated 07/08/1989) and stated that the parties could not agree on their payment obligations in foreign currency or indexed to foreign currency:

> "Article 4: Foreign Currency
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> [...]
>
> g) Except in cases determined by the Ministry, the contract amount and other payment obligations arising from any sale and purchase of movable and immovable property, including all types of leasing, rental agreements for vehicles, and employment, service, and work contracts between individuals residing in Turkey cannot be agreed upon in foreign currency or indexed to foreign currency."

The transitional provision of the same decree (Temporary Article 8) requires that the amounts agreed upon in foreign currency in these contracts be redefined in Turkish Lira by the parties within 30 days.

Among the types of contracts listed in the relevant provision, insurance contracts are not included. Although the Treasury Undersecretariat detailed these restrictions in its circular (2008-32/32), it still did not provide a specific provision regarding insurance contracts. Ultimately, the Insurance and Private Pension Regulation and Supervision Authority confirmed that "there is no provision that prevents foreign currency transfer transactions regarding insurance policies," thereby affirming that there are no legal obstacles to agreeing on determining insurance contracts in foreign currency.[16]

[16] The letter dated September 1, 2022, written by the Insurance and Private Pension Regulation and Supervision Authority to the Union of Chambers and Commodity Exchanges of Turkey (https://www.tobbsaik.org.tr/files/20221103120104414.pdf)

Moreover, the Court of Cassation has repeatedly seen no issue with the parties agreeing on the insured value and payment obligations in foreign currency in insurance contracts, even after this Presidential Decree.[17]

Therefore, it has been unfortunate that in the case under review, the Chamber allowed the arbitration committees to convert the foreign currency receivable into Turkish Lira, citing a regulation that does not cover insurance contracts, despite the claimant's clear objection.

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[17] Court of Cassation 11th Civil Chamber, Case no: 2021/2709 E., Decision No:2022/5888 K., Date:14.09.2022:" Since the policy was issued in foreign currency and the premium was not paid based on the currency rate on the payment date, it is correct to consider the value of the damaged machine in Turkish Lira as of the risk date."; Court of Cassation 11th Civil Chamber, Case no: HD, 2008/14143 E., Decision No: 2010/10122 K., Date:12.10.2020:" It is clear that the insurance interest was determined in Turkish Lira, and the foreign currency value of the damaged goods should be determined in Turkish Lira based on the exchange rate on the policy issuance date, and the defendant should be held liable."