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HUKUK BÜROSU • ATTORNEYS AT LAW

TURKISH LAW BULLETIN August 2012

Dealership System in the Petroleum Sector and Recent Developments

The dealership system in the petroleum sector has recently been evolving, thanks to certain decisions of the Turkish Competition Board (the "**Competition Board**"). Major market players are looking for alternative operating models to enter the Turkish market. Now, the question is: *"Is the dealership system stable enough to make millions of dollars of investment?"* In order to thoroughly answer this, licensing and operating models, as well as the framework of a possible intervention by the Competition Board, should be examined.

Dealership Licenses

The Energy Market Regulatory Authority ("**EMRA**") is the authorized body regulating oil and gas retail business in Turkey. Distributors / oil companies must obtain distributorship licenses, whereas dealers must obtain dealership licenses from EMRA, in order to conduct their business. Under Turkish law, activities regarding the petroleum sector and its derivatives are dealt with under the (i) Petroleum Market Law and (ii) Petroleum Market License Regulation[1] (the "**License Regulation**"). If a company wishes to be active in the Turkish petroleum sector, it must obtain the required licenses from EMRA, depending on the type(s) of activities the company wishes to engage in. The types of petroleum market licenses are specified under the License Regulation as (i) refinery owner license; (ii) processing license; (iii) lube oil license; (iv) storage license; (v) eligible consumer license; (vi) bunker delivery license; (vii) distributor license; (viii) transportation license; and (ix) dealership license.

Under the License Regulation, EMRA should evaluate license applications within 60 days, although this term may be longer in practice. The documents required for obtaining a license are set forth in the License Regulation. However, EMRA is entitled to request the submission of further information and documents. In dealership license applications, a dealership agreement executed with a distributor must be submitted to EMRA. However, if the distributor itself is carrying out the dealership activity, submission of a dealership agreement will not be required.

Operating Models

Following the granting of a dealership license, a company may conduct its business activities under certain models. There are three common models that companies use to operate service stations: If the dealer is both the owner and operator of the service station, this model is defined as a *"dealer-owned-dealer-operated model"* ("**DoDo**"). In Turkey, this is the most common model used in oil and gas retail businesses and a majority of the stations operate with this model. If the distribution company or any of its subsidiaries own the service station and operate it as well, this is referred to as the *"company-owned-company-operated"* model ("**CoCo**"). Another model for gas and retail business is the *"company-*

[1] Published in the Official Gazette on 17 June 2004.

owned-dealer-operated model" ("**CoDo**"), in which the distribution company or any of its subsidiaries owns the property on which the service station is located and the dealer operates the service station. CoCo and CoDo models are rarely used in Turkey, as most of the dealers are the owners of the service stations in the current petroleum market.

As stated above, the most common operating model is DoDo. In this model, the dealers enter into dealer agreements with the distribution companies in connection with the leasehold rights granted by the owners of the property on which the service station is located. A protocol is signed among the distributor, the dealer and the owner of the property. Under this protocol, the owner (i.e. a non-dealer third party) of the property grants a usufruct right to the distributor, and the dealer possessing the leasehold right signs a dealership agreement with the distribution company.

This practice was interrupted by the Competition Board, on the ground that it restricts competition in a specific market as specified under the Law on the Protection of Competition (the "**Competition Law**").

Competition Board's Interventions

On 14 July 2002, the Competition Board introduced Communiqué No. 2002/2 on Block Exemptions in Vertical Agreements (**"Communiqué 2002/2"**). This was later amended in 2003, with Communiqué No. 2003/3. Communiqué 2002/2 imposed a limitation on the length of non-compete undertakings in vertical agreements (i.e. agreements between petrol distributors and their dealers). Accordingly, non-compete undertakings for indefinite terms or whose terms exceeded five years could no longer be granted a block exemption from the prohibition of agreements, concerted practices or decisions that restricted competition in a specific market.

Upon its amendment in 2003, Communiqué 2002/2 now states that in cases where the non-compete undertaking may indirectly be renewed in a manner so that the total term exceeds five years, the non-compete undertaking will be considered as an "indefinite" one. For agreements concluded before the date of entry into force of Communiqué 2003/3 (i.e. 18 September 2003), it was required that they conform to the amendment within two years, in order to be able to benefit from the block exemption. Following the amendment of Communiqué 2002/2 in 2003, distributors adopted a customary practice of revising their dealer agreements to have five-year terms, while at the same time –where the property over which the petrol stations were located belonged to the dealers- signing usufruct/lease agreements with them with much longer terms (i.e. 15-20 years). This market practice meant that although the terms of the dealer agreements expired in five years, dealers were practically compelled to renew their agreements with the distributors, simply because they were bound by the terms of the distributors' usufruct rights.[2]

Several dealers applied to the Competition Board, raising the issue of long-term usufruct rights preventing them from being able to enter into new dealer agreements with other distributors upon the expiration of their five-year agreements with current distributors. In response to these applications, the Competition Board adopted the approach that it had no jurisdiction over the terms of usufruct rights, as this was a private law matter amongst the parties and that for this reason, it could not interfere in the length of these rights. Among the Competition Board's decisions that adopt this approach was its decision dated 26 January

[2] A usufruct right grants the bearer the right to use the property with all the powers as if s/he possesses the ownership right. The respective article of the Turkish Civil Code provides that a usufruct right can be granted on real property by registering the usufruct right with the relevant title deed registry.

2006 regarding the application filed by a dealer named *Akdağ*, who was engaged by *Total*.[3] In this decision, the Competition Board asserted that in the downstream petroleum sector, dealer agreements that were concluded before 18 September 2005 and whose duration exceeded five years were to benefit from the exemption provided in Communiqué 2002/2 until 18 September 2010 and that the non-compete undertaking could only be for a maximum term of five years. This approach of the Competition Board caused distributors to maintain their market practice of signing five-year agreements with dealers, while establishing usufruct rights for much longer terms, so that upon expiration of the dealer agreements, dealers could not leave the premises to be engaged by other distributors.

However, this practice was again intervened by the Competition Board's decision dated 12 March 2009. This decision resulted in a situation where personal or real rights such as loan contracts, equipment contracts, long-term lease contracts or granting long-term usufructs related to dealer agreements could no longer be used to effectively expand the duration of the non-compete obligation. Accordingly, all personal or real rights such as loan contracts, equipment contracts, long-term lease contracts and long-term usufructs, which are related to dealer agreements, must be limited to five years.

Market players became hesitant to make investments in the downstream petroleum sector due to the short terms of lease agreements or usufruct rights and they simply could not foresee the profitability of their investments.

Possible Solution Mechanisms

Market players tried to by-pass this five-year barrier by using the CoDo model to conduct dealership activities. They acquired lands mostly in large cities and appointed third party dealers to run the service station. This structure currently allows the possession of a service station for more than five years. The service station is company-owned and is thus not subject to any term under any lease agreement or usufruct right.

However, based on past experience and general practice, this still remains a grey area, in which the Competition Board may interfere at any time, as it did with its announcement on 12 March 2009, limiting personal or real rights in favor of distributors over dealer properties. A potential intervention by the Competition Board would become particularly more likely if there is any relationship (i.e. contractual relationship, partnership, family relationship, etc.) between the dealer and the third party owner of the property who provided either a usufruct or leasehold to the company in the CoDo model. In such a case, the Competition Board may consider the structure as a circumvention of the five-year-term limitation on the dealership agreements. Thus, before obtaining the long-term lease or usufruct right over a property, the company may have to secure that there is no relationship at all between the owner of the land and the third party dealer.

Furthermore, the relationship between the distributor and the dealer may constitute a vertical integration in the future. If the vertical integration between the distributor and the dealer activities under the CoDo model leads to the prevention of other distributors from entering into the market in the long run, the company would be in a position of breaching competition law restrictions.

The petroleum distribution sector has seen through several fluctuations in the last few years. Since 2010, 16 companies entered the market while 10 companies exited it. The biggest leap was achieved by TP Petrol Dağıtım A.Ş., the State Petroleum Company. Contrary to other recent market players, which barely managed to raise their market share by 1% in the

[3] Competition Board's Total – Akdağ Decision dated 26 January 2006 and numbered 06-04/57-15.

last two years, the State Petroleum Company has raised its market share from 0.4% to 6.6% in the same period.

It would be fair to state that the CoCo and CoDo models may be used to by-pass the five-year limitation barrier. Although the interpretation and potential reaction of the Competition Board towards these models in the oil and gas retail business still remains questionable, the stance of the Competition Board towards the models for by-passing the five-year limitation does not seem to change. The retail market is at the early stages of its restructuring. For this reason, the Competition Board's stance, as well as creative solutions of new market players towards this stance, should be closely observed before entering the market.

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