

Shifting up a gear

Okan Demirkan and Ilke Türeyen of Kolcuoglu Demirkan Attorneys at Law show how the year ahead will be a memorable one in the energy sector in Turkey

Liberalisation has probably been among the most frequently used terms in Turkey's economic programmes since the 1980s, when the country began its evolution from an agriculture-based economy to a more industrial one. Among the results of this industrialisation has been a much increased demand for energy: according to public officials, approximately €160 billion (\$229 billion)-worth of investment is going to be needed in Turkey's power infrastructure in the next two decades.

A country with few oil and gas resources, Turkey has adopted the strategy of liberalising its energy sector, attempting to encourage the private sector to make energy investments, in order to make Turkey less dependent on energy generated in neighbouring countries. It became evident in the late 1990s that Turkey's energy sector had to be restructured in a manner that would gradually shift all energy activities (other than transmission) from state-owned entities to private companies.

The Electricity Market Law as well as the Natural Gas Market Law, both introduced in 2001, were significant steps in Turkey's path of establishing a well-structured energy sector. While the extent to which these laws provide a sufficient framework for full liberalisation is questionable, it is certain that the past decade has seen some very radical developments in Turkey's energy sector. Now, however, it is evident that Turkey needs to adopt new legislation to complete the liberalisation process.

Electricity

One of the primary novelties of the Electricity Market Law introduced in 2001 was the establishment of the Energy Market Regulatory Authority (EMRA), an independent public authority, responsible for – among other things – the granting of licences for electricity-market activities; introduction and implementation of electricity market regulations; and adoption and application of tariffs.

Subject to the conditions set out in the Electricity Market Law and the Electricity Market Tariff Regulation, EMRA grants licences for generation (based on the type of generation facility, for example natural gas cycled, hydro, coal, wind, geothermal or solar); auto-production; transmission; distribution; wholesale and retail activities. Although transmission is listed among the activities subject to a licence, the only entity licensed and authorised to carry out transmission is TEIAS (the Turkish Electricity Transmission Corporation). The other activities, on the other hand, can be conducted by private entities.

In 2008, 2009 and 2010, the Privatisation Administration held the tenders for privatising Turkey's electricity distribution companies and nine out of 18 companies have already been transferred. Although the tenders for all distribution assets were completed by the last quarter of 2010, the privatisation of Aras Elektrik Dagitim has been suspended by the Council of State as of March 20 2009. The reasoning for this suspension was declared

as the winning bidder's failure to comply with the bargaining procedure set out under the Law on Privatisation.

In addition, following the tender process of another electricity distribution company, Gediz Elektrik Dagitim, the Competition Board did not approve the transfer of this company's shares to the winning bidder, on the ground that a group company of the winning bidder had previously acquired the shares of the two electricity distribution companies of Istanbul (Bogaziçi Dagitim and Anadolu Yakası Dagitim), and that any more acquisitions by this group in the electricity distribution market would hinder competition.

Among the developments expected in the generation business is the privatisation of state-owned electricity generation facilities. On March 21 2011, the Privatisation Administration announced the tender for the privatisation of Hamitabat Elektrik Üretim ve Ticaret, which will be the first of many electricity generation privatisations. The Hamitabat facility is a natural gas cycled power plant with an aggregate capacity of 1,186MW. Participants in this tender are required to submit their final bids on July 28.

The Ministry of Energy has been working on certain amendments to the Electricity Market Law. In 2010, the Ministry obtained the opinions of EMRA, the State Planning Organisation and the Undersecretariat of Treasury. Reportedly, EMRA submitted a large set of comments on the draft amendment law, which the government is expecting to bring before parliament after the general elections in June 2011. The amendments are expected to be related to generation facility privatisations, operations of distribution companies, licences and the unbundling of TEIAS. Amendments to the Electricity Market Law after this year's elections will also result in new regulations by EMRA.

Early this year, EMRA made a number of amendments to the Electricity Market Licensing Regulation. A large portion of these amendments are related to renewable energy facilities, which are dealt with in another chapter of this guide. In addition to renewable energy related matters, there are amendments concerning the transfer of generation and auto-production licences; minimum share capital requirements applicable to licence applicants; and licence amendment procedures.

Another important development expected in 2011 is the establishment of a fully-functioning balancing and settlement mechanism. Although EMRA has made some amendments to the Electricity

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Market Balancing and Settlement Regulation, setting out the principles and procedures regarding the activities related to balancing and settlement of the electricity demand and supply, the mechanisms to support the aims of this regulation are still not complete. The so-called day-ahead market in the balancing and settlement system, balancing electricity supply and demand for the following day, was expected to come into force in May 2011. However, it has been postponed to December 2011.

Renewable energy

On December 29 2010, the Turkish parliament passed the long-awaited Law Amending the Law on Utilisation of Renewable Energy Sources for the Purpose of Generating Electrical Energy (Amended RES Law). Since then, it has been the target of criticism, particularly by those who feel that it could have provided more encouraging incentives for investors.

Contrary to the euro-based tariffs that had been proposed in the draft text of the Amended RES Law, which had been before parliament for two years, parliament passed the Amended RES Law with tariffs based on US dollars. Many investors feel that the feed-in tariffs, supposedly set forth for encouraging more investment in renewable energy, are lower than expected. The Amended RES Law guarantees the following prices:

- (i) \$7.3 per kilowatt-hour for wind and hydroelectric power;
- (ii) \$10.5 for geothermal energy;
- (iii) \$13.3 for energy from either waste products (for example biomass or municipal solid waste-to-energy projects); and
- (iv) \$13.3 for solar energy.

These incentives will be applicable to renewable energy generation licence holders who generate energy, for a term of 10 years, following the relevant facility's operation commencement date, provided that the commencement date is between May 18 2005 and December 31 2015. The Amended RES Law provides an additional incentive for use of local electro-mechanical equipment. Accordingly, an additional incentive of \$0.4-2.4 will be provided for five years, to facilities that start operation before December 31 2015 and where the equipment used is manufactured in Turkey.

Article 6/C provides that when evaluating generation licence applications, EMRA will give priority to facilities generating energy from renewable resources. In addition, with regard to

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Okan Demirkan, partner

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Okon Demirkan is a partner at Kolcuoglu Demirkan Attorneys at Law. After spending ten years at a large Istanbul-based law firm, he joined Kolcuoglu Law Office in August 2010, as a result of which the firm was re-branded. He has experience in international commercial arbitration, local litigation, energy and M&A projects, and has significant experience in the energy sector. Demirkan was heavily involved in all legal issues surrounding the Baku-Tbilisi-Ceyhan Crude Oil Pipeline Project, where he

played an important role in corporate, regulatory, real estate, employment and litigation related matters. He was also part of a team of lawyers advising clients in connection with the Nabucco Gas Pipeline and the Samsun-Ceyhan Oil Pipeline. Since January 2011, he has been leading the Kolcuoglu Demirkan team in the Shah Deniz Stage 2 Natural Gas Pipeline Project, where the firm has been advising on the project's legal structure in Turkey, including intergovernmental agreements, Turkey's natural gas market legislation, the Transit Law as well as public international law related matters. His energy experience also includes advice to an American energy company in its proposed bid in the privatisation of Turkey's electricity distribution entities. Demirkan advises a well-known German-based electricity generation conglomerate in connection with its corporate and regulatory issues in Turkey, as well as a Turkish electricity retail company in relation to its regulatory affairs including licensing and real estate related procedures. He is also currently advising the 'International Strategic Organisation in connection with recommended legislative changes relating to Turkey's critical infrastructure projects.



Ilke Tureyen, associate

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After spending four years at a large law firm in Istanbul, Ilke Tureyen joined Kolcuoglu Demirkan in May 2011. She focuses on M&A deals, energy law as well as banking and finance transactions, and has advised a well-known German-based energy company as well as a Russian company on Turkey's energy regulations.

In the past, she was part of a team of lawyers that advised one of the bidders in the privatisation of Ankara's natural gas distribution facilities. In addition, Tureyen played an active role in legal advice rendered in the potential sale of an electricity generation company by the Savings Deposit Insurance Fund.

applications to build a solar generation facility over a specific immovable property, if the owner of the relevant property files a licence application, no other applications will be accepted in connection with any proposed facilities over the same property. If there is more than one application for the same field or same transmission station, a competition will be conducted by TEIAS, where participants will compete by offering decreases in the amounts set out in the regulated feed-in-tariffs.

Despite criticism, the extent to which the Amended RES Law will be successful in incentivising more investment in renewable energy is yet to be tested. While some think that prices are not convincing and guarantees with a few more cents should have been given, some believe that investors

will still do business as the enactment of the Amended RES Law has at least eliminated the tariff-related uncertainties.

Nuclear energy

The Law on Establishment and Operation of Nuclear Power Plants was introduced in 2007. This was followed in March 2008 by its implementation regulation, setting out the principles and procedures applicable to the competitions to be held for selection of companies to establish and operate nuclear power plants; land allocation; incentives; fuel supply; generation capacities and electricity sales contracts.

Accordingly, a competition is organised for selecting the company to build and operate a power plant. The offers submitted by competing companies are evaluated by

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TETAS (National Electricity Trade Corporation), upon which the selected company's offer is presented to the Council of Ministers for approval.

Subsequent to the Council of Ministers' approval of the execution of a contract between the selected company and TETAS, EMRA grants a licence to the selected company. Following the granting of this licence, the electricity sale contract can be executed. Upon the commissioning of the power plant, TETAS can sell the electricity it purchases from the generation company, to wholesale and retail companies active in the electricity market.

The regulatory authority responsible for overseeing the building and operation of nuclear power plants is the Turkish Atomic Energy Authority (TAEA). The TAEA determines Turkey's national policies and programmes for the use of atomic energy; sets out the general principles for prospecting, exploiting, purification, distribution, import, export, trade, transport, use, transfer and storage of nuclear raw material, special fissionable material and other strategic materials used in nuclear fields; determines the principles and provisions for protection against the hazards of ionising radiation in activities; and grants the required approvals, permissions and licences related to site selection, construction, operation and environmental protection of nuclear power and research reactors as well as nuclear fuel cycle facilities.

Nuclear energy has been among the most widely discussed topics in Turkey this year, particularly with the recent progress in the development of the nuclear power plant to be built in Akkuyu, Mersin. Turkey signed an intergovernmental agreement with Russia in 2010, regarding the construction and operation of a 4,800MW nuclear power plant in Akkuyu. This power plant will be built and operated by a Russian state-owned company and subsidiary of Rosatom. It was reported by the Turkish Economic Press Agency in April that the nuclear power plant field has already been

opened to the Russian company for research purposes and the transfer process has begun.

Following the ratification of the IGA for the Akkuyu Nuclear Power Plant, eyes are now turned towards negotiations between Turkey and Japan, for a nuclear power plant in Sinop, which is in Turkey's Black Sea Region. In addition, there are discussions for a third nuclear power plant in Igneada, which is in the Thrace Region in the west of the country.

According to the IGA regarding Akkuyu, all licensing requirements of Turkish laws will apply in this project. In addition, the power plant's operation will be supervised in accordance with Turkish law. Thus, the Akkuyu Power Plant may be a good test for understanding the sufficiency of Turkey's legal framework for nuclear energy.

Natural gas market

The Natural Gas Market Law governs the internal gas market. It sets forth the rights and obligations of all persons conducting the following natural gas market activities: import, transmission, storage, wholesale, export, distribution within a city and distribution and transmission of compressed natural gas. All of these activities are subject to a licence to be issued by EMRA. The licensing process as well as the terms and conditions of licences are regulated under EMRA's Natural Gas Market License Regulation.

Among the most important purposes of the Natural Gas Market Law was to achieve a liberalised natural gas market. While, in theory, it has established a legal framework reflecting this purpose to a great extent, in practice the liberalisation process has not been as successful as that of the electricity market. BOTAS (National Petroleum Pipeline Corporation) is still a very dominant player in the market. It not only owns and operates the transmission network, but still imports approximately 85% of the total natural gas imported to Turkey (see the Turkish Economic Press Agency's *2010 Important Projects and Tenders Report*).

Provisional Article 2 of the Natural Gas Market Law sets out restrictions on BOTAS's gas purchases, for the purpose of liberalising the natural gas market. Accordingly, BOTAS cannot enter into new natural gas purchase contracts until the share of gas it imports falls to 20% of the annual national consumption amount. However, with the current speed of progress in BOTAS's contract transfers, its share will only decrease to a level of 45% by 2013, and that is only if the purchase contracts with Russia and Algeria are not renewed.

Provisional Article 2 further provides that EMRA should not permit any gas import company to import gas from the countries from which BOTAS already imports natural gas. As BOTAS imports gas from Russia, Turkmenistan, Nigeria, Iran, Azerbaijan and Algeria, a new entrant will not be allowed to import gas from these countries until the termination of the existing BOTAS contracts. The exception to this would be being awarded the tender for taking over BOTAS's existing gas purchase contracts, as Shell, Bosphorus Gaz, Enerco and Avrasya Gaz have done.

Another notable requirement of Provisional Article 2 is the restructuring of BOTAS by 2009, as a result of which BOTAS was supposed to be divided into companies for each of its activities. The BOTAS name was going to be used only by the company that will take over the natural gas sale and purchase contracts and conduct exportation activities. All of these companies, apart from the transmission company, were supposed to be privatised by 2007. Evidently, none of these targets have been achieved. The Privatisation Administration has not even included BOTAS within its privatisation portfolio. On several occasions, despite the clear requirements of Provisional Article 2, officers of Ministry of Energy have declared that there was no immediate plan to privatise BOTAS.

Accordingly, what were set out as statutory requirements for liberalising natural gas imports to Turkey are far from being achieved. Among others, this is reportedly one of the reasons why the Turkish government is planning to enact a new natural gas market law. Although this has been planned for quite some time now, no draft has yet been announced and it seems the new law will not become effective until 2012.

Another major liberalisation was expected to occur in the natural gas distribution business. There has been some progress on this front, with the privatisation

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of the Kocaeli Metropolitan Municipality's gas distribution company, IZGAZ, in 2008. The next big step was the privatisation of Ankara's distribution company, Baskent Dogalgaz Dagıtım, in 2010.

However, this tender was cancelled on the ground that the winning bidder failed to fulfil its obligations for signing the share transfer agreement. According to the Privatisation Administration, it is planning to re-open the tender in the July 2011, also including new districts, ie Sereflıkochishar and Kizilcahamam, to its authority. In addition to Ankara's natural gas distribution, Istanbul's natural gas distribution company, IGDAS, is also expected to be privatised in 2011.

All in all, it is evident that the targets set by the Natural Gas Market Law were not too realistic. The expectation is for a new law to come into force, to accommodate the market dynamics for actually making this liberalisation to happen.

Petroleum market

Contrary to electricity, where all activities are under the umbrella of the Electricity Market Law, petroleum related activities are subject to two separate umbrella laws and are regulated by two separate authorities. The Petroleum Law governs the exploration, exploitation and transit passage of petroleum through Turkey. On the other hand, petroleum market activities are dealt with under the Petroleum Market Law, the scope of which includes refining, processing, distribution, bunker delivery, dealership, storage, transmission and transportation.

While the authorised governmental authority under the Petroleum Law is the General Directorate of Petroleum Affairs, EMRA is the regulatory authority under the Petroleum Market Law. Since the enactment of the Petroleum Market Law in 2003, there have been confusions on which activity falls under which law, and the boundaries of the authorities of the General Directorate and EMRA.

In an effort to eliminate the confusions created by the existence of two laws and two authorities (with activities such as the refining of oil being dealt with under both laws) and also to update Turkey's legislation in line with contemporary market needs, in January 2007, the Turkish parliament passed a new draft Petroleum Law. Among the novelties of the draft law was arguably the goal of providing additional incentives for petroleum exploration and exploitation activities and to achieve a more investor-friendly legal framework.

The means for achieving these goals were largely in the form of decreases in royalty fees and elimination of certain restrictions

applicable to petroleum right holders. On February 6 2007, the President vetoed a few provisions of the new draft law and returned it to parliament. However, it is now apparent that it will not be enacted until after the next elections, which are scheduled for June 2011. The fact that the new Petroleum Market Law has not been enacted in the past four years has created an opportunity to further develop the text of this law.

In fact, according to recent news, the new draft Petroleum Law is being revised, and among the revisions is a significant change in the regulatory regime, which entails the division of EMRA into two separate authorities, one regulating the electricity and natural gas markets, and the other regulating the petroleum and LPG markets. This would be a radical change, because according to the present Petroleum Law, the term "petroleum" also covers natural gas, as the definition of petroleum includes all forms of hydrocarbons in the form of both liquid and gas.

Reportedly, the Ministry of Energy is working on the new law and among its goals is to divide EMRA in a manner following the German regulations. According to Energy Minister Taner Yıldız, this was suggested by EMRA itself. Most recently, the Energy Minister Taner Yıldız has stated in the 15th International Energy and Environment Fair and Conference that Ministry of Energy has already initiated work on division of EMRA.

Meanwhile, EMRA has been working on decrees related to petroleum market licences, setting out the licence and licence amendment application procedures applicable to refinery, transmission, processing, distribution, storage, transportation and dealership licences. These decrees were made publicly available for comments until April 26. In addition, EMRA is planning to hold meetings with representatives of the market players, including several associations, for receiving their comments regarding the current regulations as well as suggestions for a new regulatory regime. It is thus apparent that the Turkish petroleum market is likely to go through some big changes in 2011 and 2012.

Pending transit projects

The Baku-Tbilisi-Ceyhan Crude Oil Petroleum Pipeline has been Turkey's most significant step towards becoming the region's transit hub. The BTC Project's success has proven Turkey's importance in the region.

Currently, there are several pending projects and developments in transit projects, concerning the transportation of petroleum or natural gas through Turkey. The intergovernmental agreement for the long-

awaited Nabucco natural gas pipeline project was ratified in June 2010 and the legal framework of this project has been finalised on June 8 2011, upon the signing of the project support agreements.

As of the date of this article, negotiations are ongoing on the intergovernmental agreement between the governments of Turkey and Azerbaijan for the Shah Deniz Stage 2 natural gas project. This project entails the sale of Shah Deniz Stage 2 gas to Turkey as well as the transit passage of natural gas originating from Azerbaijan across the territory of Turkey. The Interconnector Turkey-Greece-Italy (ITGI) Project is also expected to speed-up in the second half of 2011.

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In June 2010, an MoU was signed between the project companies, which are Italian Edison, Greek Depa and Turkish BOTAS.

Recently, the integration of Nabucco and ITGI has been discussed, since both of the projects are designated to bring gas from Azerbaijan to Europe. Similarly, the Trans Adriatic Pipeline (TAP) is in progress. The pipeline route has been determined and the environmental impact assessment is planned for the second half of 2011. In March 2011, Metin Kilci, undersecretariat of the Ministry of Energy, stated that the most important agenda item in their discussions at the Turkish-Russian Economic Commission was the Samsun-Ceyhan Petroleum Pipeline.

Making memories

2001 was surely a landmark in Turkey's energy history. Ten years later, 2011 is promising to be just as memorable, this time not only in the electricity and natural gas markets, but in all activities based on petroleum, renewables and nuclear energy sources.

The plans to restructure EMRA, to introduce a new natural gas market law and a new petroleum law altogether demonstrate Turkey's readiness to shift to the next gear in the liberalisation process. With more renewable energy investments, nuclear plants and more private players in all energy markets, the timing seems right.