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Çakmak Avukatlık Bürosu is one of the largest corporate law firms in Ankara, Turkey. With clients from all over the world, as well as within Turkey, the firm has built an outstanding reputation for its legal expertise and quality of service. All attorneys are bilingual and qualified in Turkey and many have also trained or worked in other jurisdictions.

Areas of practice:

Power, Oil & Gas, Infrastructure, Mining, Privatization, Project Finance/Projects, Administrative Law & Regulatory Matters, Dispute Resolution, Mergers & Acquisitions, Banking & Finance, Competition (Antitrust), Environmental Law & Permitting, Corporate & Commercial Law, Labor, IT & Telecoms, Intellectual Property, Real Estate, Military and Defense.

Languages:

English, Turkish

Opportunities today and tomorrow

Dr Zeynep Çakmak and Dr Çagdas Evrim Ergün of Çakmak Avukatlik Bürosu describe the landscape for investors in Turkey's busy infrastructure market

The Turkish investment environment is more ambitious and livelier than ever, and the opportunities offered to investors are unique when compared to many other regions in the world. In this challenging environment, the infrastructure, public-private partnership (PPP) and construction markets take the majority share along with the power sector. Although Turkey has had its share of the poor lending conditions in Europe and the US, there is still a big window of opportunity in the country to develop big ticket infrastructure projects in the PPP market despite criticism that the market should have been tested with smaller PPP projects. In the current market, in addition to big ticket PPP projects, various sized municipal PPPs, such as subways, water treatment, wastewater, waste-to-energy projects are also in progress.

PPP, as a term, may be new to Turkey, but the concept, implemented in different forms in the last 30 years in different sectors, is not. Turkey has practised different forms of PPP models, such as build-operate-transfer (BOT), build-operate (BO), transfer of operation rights (TOR) and hybrid forms such as build-transfer-operate mainly in the energy, health, water, waste and transportation sectors. No general PPP Law has been enacted in Turkey. Although there is a draft law on the agenda based on the UK model, it has been in draft form for years now and its destiny is uncertain. Nevertheless, the legal framework is sufficient to carry out infrastructure and construction projects where there are specific laws governing the PPP and infrastructure projects separately.

The starting point

Although the BOT model was first tried in water and highway projects with some limited success, it was the experience in a number of successful BOT and BO model power projects which can be considered to be the starting point of the Turkish PPP market. Private sector infrastructure projects in the Turkish power sector date back to the early 1980s. A number of different privatisation models, such as BOT and TOR, were successfully implemented in the 1980s, and five BO model power plant projects were successfully developed and financed in the 1990s. In 2001, the Electricity Market Law was enacted to liberalise the power sector in Turkey. Despite significant progress made towards the target of liberalisation, the energy market is still dominated by state players.

The delay in the privatisation of distribution assets leads to a delay in the privatisation of generation assets. Such delay inevitably triggers stagnation in the entire electricity market, which still remains to be a fully competitive market. Out of 21 distribution regions in total, 12 have been transferred to private operators, and nine are still operated by TEDAS. Privatisation of these nine regions is expected to be completed by the end of 2012. After an unsuccessful attempt to start the privatisation of portfolio generation assets in 2011, the Privatisation Administration is expected to resume such privatisations before the end of the year.

Partly due to the increased interruption in the supply of gas to the Turkish market in recent years, the government has increased its focus on the promotion of renewable energy-based projects and nuclear power projects, which benefit from additional incentives such as price and purchase guarantees. To make it more attractive to investors, the Renewable Energy Law provides a feed-in tariff mechanism with certain guaranteed prices. It also provides further incentives for projects using mechanical and/or electromechanical parts produced in Turkey. The feed-in tariff, together with the domestic production support, provides a minimum guaranteed price ranging from \$0.096/KWh to \$0.20/KWh depending on the type of renewable energy source. No change in the feed-in tariff is expected although there is constant demand for an increase in the tariff by investors and financiers.

Despite the global decline in nuclear investments, the Turkish government is as eager as ever to switch part of its energy portfolio to nuclear power. Turkish nuclear energy policy circles around the

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Akkuyu and Sinop Projects, as well as a prospective nuclear plant in Igneada. The Akkuyu and Sinop Nuclear Power Plants have a planned total capacity of 10,000 MW; and with the third plant, this capacity is expected to increase to 15,000 MW by 2023. Although the Nuclear Energy Law has been in effect for more than three years now and a tender has already been issued thereunder, the position of the Turkish government is to develop nuclear power projects under bilateral inter-governmental treaties, subject to a special legal regime that consists of references to the Nuclear Energy Law for certain issues but with specific treaty provisions differing from the same law on certain other points.

The power sector targets announced by the government for 2023 are: (i) 12 nuclear reactors having a total capacity of 15,000 MW; (ii) new thermal power plants having a total capacity of 18,000 MW in the Afsin and Konya Coal Basins; (iii) additional hydroelectric capacity by completion of the Ilisu, Yusufeli, Boyabat and Alparslan hydroelectric power plants; (iv) share of renewable energy resources to increase to 30% (presently approximately 19%); (v) share of natural gas-fired power plants in total electricity generation to decrease to 30% (presently approximately 45%); and (vi) in total, increasing installed power to 125,000 MW by 2023 (presently 50,000 MW in generation).

"Other than the privatisation of existing toll roads, there are two mega road infrastructure projects in Turkey"

The health sector

New construction or renovation of hospitals constitutes a large part of the PPP sector in Turkey. However, the sector faces a challenge since PPP health projects are quite new to the country (although private hospitals have been in operation for quite some time). The system has been adopted from the NHS system in the UK and its success still remains to be tested.

The PPP model in healthcare envisages the construction of hospitals by contractors in locations to be determined by the administration. Medical services in these hospitals are to be conducted by the Ministry of Health. The Ministry will be a leaseholder in the hospital and pay a lease amount in accordance with an agreement to be executed between the parties. Land for the hospital will be provided either by the Ministry of Finance, where the contractor will have a surface right on such land or, in exceptional situations, the land will be leased by a private owner. In addition to the construction of the hospital, the administration may also request the procurement of medical devices and performances of specific non-medical services. The rental amount will be calculated based on the services requested by the contractor.

The state guarantees the following for the PPP model in healthcare (subject to specific legislation): (i) reimbursement of the cost of construction and equipment (rental fee); (ii) payment for non-medical services, such as cleaning, catering, cafeteria, and parking; and (iii) a minimum number of patients for the contractor (based on competitive offers obtained as part of the tenders) for profitable services, such as laboratory, imaging (ultrasonography) and sterilisation.

One of the health PPP projects is at the financing stage, four are at the contract signing stage, 10 are at the bidding stage and two are at the pre-qualification stage. None of these projects has been financed yet. There are a number of bankability issues for health PPP projects, such as: (i) termination compensation in the event of project company default and terminations due to force majeure; (ii) minimum number guarantees being generally conducted in Turkish Lira currency, thus causing currency difficulties for investors whose financing procedures are conducted in foreign currencies; (iii) difficulty in determining unit price per patient; (iv) contracts needing to be subject to Turkish law and Turkish arbitration; and (v) non-clarity of certain parts of the security package.

The establishment of medical free zones is already on the agenda of the Turkish government, which shows progress in the healthcare PPP model. A decision on the final locations of the free zones and the bidding process is expected by the Council of Ministers within 2012. The intention is to have medical free zones providing different conditions for medical investments in terms of customs, immigration, taxation and jurisdiction with respect to the rest of the country. The new ventures will be free to be managed by non-Turkish management teams and will have the liberty to employ both Turkish and international workforces. The establishment of such medical free zones is expected to attract local and foreign investors and enhance the development of the health sector as it would reduce capital and operation expenditures, would provide for the possibility of employing foreign medical personnel and would also offer other financial and administrative incentives in providing health services to Turkish nationals and foreigners.

About the author

Dr Zeynep Çakmak specialises in project finance, joint ventures, general corporate practice and privatisation. She represents clients in international commercial and financial transactions especially those involving project financing, power and infrastructure development, pharmaceuticals, military and defence, administrative litigation, environment law and administrative law matters. She has acted on behalf of sponsors and lenders in the development and financing of infrastructure projects, principally in the energy, natural resources and transportation sectors. Çakmak has also been involved in a significant number of major mergers and acquisitions. She is also active in administrative dispute matters.

Çakmak joined the Ankara Bar Association in 1990 and holds a PhD in Administrative Law from Ankara University, Faculty of Law, an LLM from University of Nottingham, School of Law, and an LLB from Ankara University, Faculty of Law. She speaks Turkish and English.

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Big ticket projects

The road projects on the agenda of the Turkish government are the most ambitious projects, not only in the infrastructure programme but in the entire Turkish PPP market. Infrastructure road projects involve the privatisation of existing state-owned assets and also the construction and operation of new roads throughout the country. The toll road privatisation process, already underway, consists of a package of eight highways and two Bosphorus bridges. This privatisation will be in the form of the transfer of operation rights of the toll road package, with a 25-year concession contract, to the winner of the tender. The dates for the pre-qualification application and the tender were November 18 and December 15 2011, respectively. After several postponements, the new tender date is October 31 2012. The continued postponements are a setback for the project. There are also a number of issues of concern regarding financing for the project, such as: (i) no toll fee (traffic) guarantee from the state and no Treasury guarantee, making financial modelling and revenue projections critical; (ii) foreign currency fluctuation risks which are not covered in the project agreements; (iii) potential for construction of competing roads/facilities, size of the required construction works as well as operation of the roads; (iv) lack of clarity regarding the availability of certain types of securities; and (v) the jurisdiction of Turkish courts for the resolution of disputes rather than arbitration.

Other than the privatisation of existing toll roads, there are two mega road infrastructure projects in Turkey, namely the Gebze-Izmir Toll Road and Izmit Bay Crossing Project and the North Marmara (Third Bosphorus Bridge) Project, both tendered out on a BOT basis.

The Gebze-Izmir Project is a 22-year BOT concession, and is the biggest private infrastructure project in Turkey to date. The total cost of the project is estimated to be $6.5 billion. The tender was won by the Astaldi-Nurol-Yuksel-Makyol-Ozaltın-Gocay Joint Venture in 2009. On September 8 2011, the joint venture signed an agreement with the Japanese IHI-Itochu Group for the turnkey construction of the suspension bridge. Financing is expected to be secured in the third quarter of 2012, but given the difficulties which have already delayed the funding, this seems to be an optimistic target. There are a number of financing difficulties surrounding the project, such as sensitivities raised by environmentalist groups and the fact that non-Turkish *lira*-denominated loans will have to be paid by revenues raised in *lira*, which is a risk for all infrastructure projects in Turkey. In order to facilitate financing of the project, the government enacted a new law on April 4 2012 to provide a VAT exemption and assumption of debts to lenders by the Treasury (in other words a senior debt repayment guarantee) for all BOT projects, including the Gebze-Izmir Project. Talks with the Treasury seem to have progressed and debt assumption by the Treasury is likely to be granted for the project for the benefit of international lenders providing financing, which would certainly expedite financing.

The second mega road project under development in Turkey is the Third Bosphorus Bridge and Northern Marmara Crossing Motorway Project. This is also a BOT model project consisting of the construction of a bridge and 95 kilometres of connection roads with an estimated value of $2.5 billion. The Ictas Insaat-Astaldi JV won the tender on May 29 2012 with an offer of a construction and operation period of 10 years two months, the shortest period offered among the four pre-qualified bidders. The main financing issues regarding this project are related to termination compensation, toll collection risk and liabilities, and limited step-in rights of the lenders. However, the positive aspects regarding bankability include the availability of signing a direct agreement between the lenders and the administration, a debt assumption by the Treasury, and a VAT incentive brought about by the recent law.

The privatisation of the State Railways General Directorate and construction of new railroads are also amongst the infrastructure projects in progress. Historically, the construction of railways was a typical sign of infrastructure development in Turkey, starting in 1923, the beginning of a new Republican era. Unfortunately, the enthusiasm of the new Turkish state to create a railway network diminished over time and attention to renewal or new construction drifted to other areas of infrastructure. After a long period of negligence, liberalisation and renewal of the railway infrastructure is back on the agenda. Construction of 10,000 km of high speed and 4,000 km of new conventional railway lines, renewal of the present railway network, at an average minimum length of 500 km annually, and connection of railways to ports are in the short- and long-term plans of the Ministry of Transportation.

A future landmark project in the pipeline is the Dardanelles Bridge Project, consisting of the construction and operation of a bridge and connection roads based on the BOT model with an approximate value of $3.5 billion. Its tender has not yet been announced but is expected in 2012. The project feasibility reports have been presented to the State Planning Organisation to obtain approval from the Supreme Planning Council.

Being a country of peninsulas, ports are also of significant importance to Turkey. Due to their strategic status, Turkish ports have historically been controlled and operated by the State. It was only after 1997 that several privatisations of ports operated by the Turkish Maritime Agency started. To date, 14 ports have been privatised by the transfer of operating rights model for 30 years. Now on the agenda to be privatised are Izmir Pasaport, Izmir Kruvaziyer, Kalamis, Kalamis-Fenerbahce, Derince, Salipazari, Tasucu Yacht Port, and Zonguldak-Filyos.

Airports constitute another important component of the transportation infrastructure projects in Turkey. In parallel to the increase in the number of passengers served by Turkish airports over the last several decades, airport privatisations have gained importance leading to the first airport privatisation (Antalya Airport Terminal 1) in 1993 on a BOT basis. Similar contracts followed over the next decade. Several civil airport terminals including Istanbul Ataturk, Antalya I and II, Ankara Esenboga, Bodrum and Sabiha Gokcen, have been constructed and/or renovated under the BOT model. Airport projects which are at the tender or construction stage include Kutahya Regional Airport Project, Izmir Adnan Menderes Renovation Project, Cukurova Airport and Aydin

About the author

Dr Çagdas Evrim Ergün specialises in energy law, project finance, administrative law and international arbitration. He has successfully represented clients before courts and arbitral tribunals with respect to administrative and investor-state disputes. He has also represented sponsors and lenders in the development and financing of a number of large projects in the energy, health and infrastructure sectors.

Ergün joined the Ankara Bar Association in 2003 and holds a PhD in Administrative Law from Ankara University, Faculty of Law, an LLM from the University of Exeter, School of Law, and an LLB from Galatasaray University, Faculty of Law. He speaks Turkish, English and French.

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Airport. Other airport projects expected to be tendered based on the BOT model include Ordu-Giresun Airport and the third Istanbul Airport.

Incentives for growth

Trends in the Turkish infrastructure, PPP and construction sectors mainly circle around investments in energy, health, railways, airports, highways and ports. There is also an increase in municipal PPPs, such as subways, water treatment, wastewater projects, waste-to-energy and waste-to-gas projects, in addition to continued interest and investment in real estate by institutional investors. Nevertheless, there are future plans for educational facilities to be established and operated on the PPP model similar to the health PPP model. The privatisation of prisons or courts, however, appears to be a remote plan for Turkey for the time being.

With respect to the financing of projects in the infrastructure market, the lending market generally suffers from the current economic conditions. There is a significant decrease in the flow of credit available by banks. Liquidity levels at local bank level are still better than those of their international peers, but interest rates are higher. After the global crisis in 2009, Turkish banks filled the gap created by international lending institutions and have aggressively extended credit lines. Turkish banks have used their dominant position by taking advantage of their market knowledge and better assessment of local sectors and practice. Nevertheless a decline in such generous financing is expected in the forthcoming years. Foreign banks and international finance institutions are more reluctant to take risks compared with Turkish banks, with the exception of investment and finance flow from the Middle East and the Gulf Region.

There is a significant effort and will by the Turkish government to attract foreign investment and to provide incentives for infrastructure and PPP projects. A New Incentive Package has become effective on June 19 2012. It provides additional investment incentives, such as VAT refunds, support for income tax withholding as well as support for employees' social security contributions. The recent law, which provides a VAT exemption for health PPP projects and both a VAT exemption and senior debt repayment guarantee for BOT projects, is another indication of the government's support for infrastructure and PPP projects. Despite the existence of certain bankability issues surrounding the big ticket projects, the availability of direct agreements between lenders and the administration as well as the provision of arbitration as the method of dispute settlement in the recent BOT and PPP projects also demonstrate the determination of the government to create an investor- and lender-friendly environment in the Turkish infrastructure market.

"Turkish banks have used their dominant position by taking advantage of their market knowledge"