

Amendments to the Natural Gas Market Law

August 2014

Introduction

On 4 August 2014, the long-awaited draft law (the “**Draft Law**”) that proposes comprehensive amendments to the Natural Gas Market Law¹ (the “**Law**”) was submitted to the Parliament for debate and enactment.

The Ministry of Energy and Natural Resources (the “**Ministry**”) had previously circulated the initial versions of the Draft Law in order to obtain the opinions of various agencies and parties. Therefore, many of the amendments introduced under the Draft Law have already been made publicly available and analyzed by the actors operating or having an interest in the natural gas sector. Since the expectations as to the enactment of the Draft Law has been increased with its submission to Parliament, in this client alert, we aim to recap and highlight the prominent novelties proposed to be brought to the natural gas legislation with the Draft Law.

Liberalization of the Natural Gas Market

The Draft Law foresees the creation of organized wholesale natural gas markets in a similar structure introduced to the new electricity market, with the aim of establishing a fully liberal natural gas market.

Boru Hatları ile Petrol Taşıma Anonim Şirketi (“**BOTAŞ**”) is designated as the national system operator to be in charge of curing imbalances in the system under the Draft Law². Whereas, depending on the nature of the activity, the Energy Markets Operation Joint Stock Company (“**EPIAŞ**”) and / or Borsa İstanbul (the İstanbul Stock Exchange) will be responsible for market operations and financial settlements between the market participants. Further, natural gas contracts and derivatives will be traded on the Borsa İstanbul.

BOTAŞ remains as the owner of the national gas grid in the Draft Law. However, BOTAŞ’ vertically integrated legal personality will end within maximum one year after the new law goes into effect. Thereafter, BOTAŞ will be split into three separate entities, conducting (i) transmission activities; (ii) LNG plant operations and storage activities; and (iii) other activities. The third entity which may possibly carry out natural gas trading activities will retain the name BOTAŞ.

The Draft Law prohibits BOTAŞ from entering into new natural gas purchase agreements (except for LNG) until its import rate falls to 20% of the national consumption, as required in the Law. The Draft Law also prohibits BOTAŞ from entering into new gas sales agreements other than contracts with gas distribution companies or for those executed to meet its last resort supply obligations. Also, Temporary Article 2 of the Draft Law grants BOTAŞ the right to execute new gas sales agreements to ensure gas supply security or to export gas, provided that the Council Ministers adopts a decision in this respect.

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1 Published in the Official Gazette dated 2 May 2001; No. 24390.

2 The Ministry is envisaged to be in charge of gas supply security. In this respect, the Ministry is required to prepare a natural gas supply security report each year, including its findings and suggestions on security of supply, and submit it to the Council of Ministers.

The Draft Law allows BOTAS to renew existing natural gas sales contracts. However, due to the ambiguous situation caused by the delay in the Draft Law's enactment, BOTAS is currently refraining from entering into new gas sales agreements having a term more than 1 (one) year in practice and has even refrained from long term commitments while renewing its existing contracts.

Introduction of New Market Activities

Under the Draft Law, the operation of liquidized natural gas (LNG) terminals, which is currently defined within the scope of storage activities, is regulated as a separate market activity under a separate license. An LNG terminal operation license will grant its holder the right to conduct liquidation of the natural gas, discharge and temporary storage of the LNG, re-transformation of LNG into gas, operation of the LNG terminals as well as its delivery via the transmission system and other means of transportation. According to this amendment, storage license holders that operate LNG terminals are required to obtain a LNG operation license within 6 months as of this provisions' entry into force.

In addition, the activities regarding the sale of LNG, which is currently regulated as a wholesale activity, as well as sale of concentrated natural gas (CNG) will also require the issuance of separate licenses.

Amendments Concerning License Applications

The Draft Law proposes several amendments with respect to license applications that may either simplify or complicate the application procedures.

On one hand, the current requirement that applicants for import, export, storage and wholesale licenses are required to certify their technical capabilities will be abolished due to the practical difficulties in evaluating such sufficiency. Moreover, the applicants for wholesale licenses will no longer need to certify (i) the details of the supply and transportation of the natural gas; and (ii) their storage arrangements.

On the other hand, however, the Ministry's approval will be needed as a pre requisite for issuance of import and export licenses (other than the licenses required for the import of LNG). Further, the Ministry's approval will also be set forth as a prerequisite to obtain storage licenses for the fields that are subject to exploration and operation licenses under the Turkish Petroleum Law³ as well as other open fields.

Storage Requirements

Currently, under the Law, wholesale companies must comply with certain storage requirements with respect to their sale and purchase activities with distribution companies as well as eligible consumers (e.g., compliance with storage requirements within five years as of the issuance of the license etc.).

The Draft Law abolishes the storage responsibilities of the wholesale companies. In respect of their sales to wholesale companies, in lieu of the storage requirements, the wholesale companies will be required to (i) take the certain balancing precautions to be determined by the Energy Market Regulatory Authority ("EMRA"); and (ii) provide a supply guaranty throughout their sale contracts with distribution companies.

Please note that the import license holders' responsibility to secure the storage of 10% of their annual import for a period of 5-years is maintained; although early versions of the Draft Law had provided a more flexible regime by granting a right to EMRA for the determination of the level of the storage requirement.

Market Share Restrictions

Under the Law, the total annual sale of each wholesale company cannot exceed 20% of EMRA's forecast for the national natural gas consumption in that calendar year. Similarly, the annual quantity of natural gas that an import company has imported under one or more import licenses may not exceed 20% of the total estimated national consumption in that calendar year, as announced by EMRA.

Maintaining the above 20% limits, the Draft Law however, carves the public wholesale and import companies out of this limit with the aim of maintaining supply security. In addition, the Draft Law authorizes the Council of Ministers to increase this limit for wholesale companies up to 40%.

Facilitation of Use of State Lands

The Draft Law provides that, upon the approval of EMRA, the actors in the natural gas market may be granted a usufruct right, lease right or utilization permit in relation to their activities on the lands that are owned by or at the disposal of the State or the Treasury. As per the Draft Law, the duration of such rights will be confined to the validity term of the relevant license.

Eligible Consumers

The Draft Law grants the status of eligible consumer to (i) free zones and organized industrial zones; and (ii) CNG and LNG users, in addition to the existing eligible consumer categories under the Law.

3 Published in the Official Gazette dated 11 June 2013; No. 28647.

New Tariff Categories

For the purpose of meeting the needs of the changing natural gas market environment, the Draft Law introduces the following tariff categories: (i) LNG terminal operation tariff; (ii) system facilitation tariff; and (iii) ultimate source supply tariffs.

It is also noteworthy that EMRA will now have the authority to determine the tariffs in case the Competition Authority or EMRA identifies existence of adverse pricing practices in the natural gas market.

Amendments Proposed for Distribution Activities

The Draft Law also brings significant novelties in terms of distribution activities. The prominent novelties can be listed as follows:

- The Draft Law enables distribution companies to conduct distribution and retail sale activities vis-à-vis CNG companies that operate in the distribution regions.
- The Draft Law requires distribution license holders to obtain EMRA's approval in order to sell its distribution networks to a third party before the expiration of the license.
- The Draft Law abolishes the restriction that a distribution company can hold only one license in two cities within the country. Furthermore, the Draft Law enables more than one distribution region to be combined under a single license, and the current distribution regions to be divided in more than one licensed regions.
- Distribution companies will be required to unbundle their accounts for their distribution and retail sale activities.
- In distribution license tenders, the bidder with the highest offer will obtain the license; whereas the current Law requires the most "appropriate" offer to be awarded the tendered distribution license.
- In cases where EMRA determines that a distribution company is in material breach of its regulatory obligations; or it is incapable or likely to be incapable to pay its current debts, EMRA is entitled to (i) appoint new members to the board of directors of the company, (ii) collect the monetary amounts corresponding to the default of the company in rendering its services or making investments within the scope of its tariffs, from the revenues of the company obtained through its other activities, if not sufficient, from the shareholders' dividends, and, if this is also not sufficient, from the assets of the shareholders; and (iii) take any other precautions to protect consumers and continuance of the services, including cancellation of the license and sale of the network.

Amendments Proposed for Other Market Activities

Other than distribution activities, the substantial amendments proposed under the Draft Law for other natural gas market activities are as follows:

- In line with the amended definition of natural gas, production of natural gas out of carbon containing raw materials is included into the definition of production activities. Further, the Draft Law enables production companies to sell natural gas directly to CNG companies.
- Export companies will be able to export natural gas in LNG and CNG form; and import companies will have the right to import natural gas in CNG form.
- In terms of wholesale activities, the Draft Law regulates that wholesale companies may sell natural gas to CNG companies.

Privatization of İGDAŞ

The Draft Law envisages that, if the İstanbul Greater Municipality requests so, the privatization of İGDAŞ, the İstanbul Gas Distribution Company, will be conducted by the Privatization Administration. It is also stipulated that the Privatization Administration will be responsible for the determination of the percentage of the shares that will be subject to the privatization as well as other matters such as the method and time frame of the privatization procedure.

As per the Draft Law, for 10 years as of the execution of the share purchase agreement regarding the privatization of İGDAŞ, the system utilization fee for (i) service and depreciation costs per unit will be the TRY equivalent of 0,062378 USD/m³; and (ii) delivery costs per unit will be the TRY equivalent of 0,01480 USD/m³.

Conclusion

The Draft Law introduces significant amendments to meet the changing needs of the natural gas market and achieve the target of market liberalization. However, the on-going supply security concerns still leave a question mark on the long-debated subject, which is whether or not the aimed market liberalization in the natural gas market can be achieved in the near future.