

NEW ERA IN THE TURKISH ENERGY MARKET AND LEGISLATION

As part of the commitments of the Republic of Turkey under the recent protocol with the International Monetary Fund, the Ministry of Energy and Natural Resources (the Ministry), working with the World Bank and several related Turkish government entities including the Undersecretariat of Treasury (Treasury), Turkish Electricity Generation, Transmission Joint Stock Corporation (Turkiye Elektrik Uretim, Iletim Anonim Sirketi) (TEAS) and Turkish Electricity Distribution Joint Stock Corporation (Turkiye Elektrik Dagitim Anonim Sirketi) (TEDAS), has prepared a new law re-structuring the Turkish electricity market under the name of “Electricity Market Law”. By Mesut Cakmak and Mehtap Yildirim-Ozturk of Cakmak Ortak Avukat Buros.

As a result of lengthy discussions within the Turkish Parliament, the Electricity Market Law No. 4628 (Law No. 4628)¹ was accepted by the Turkish Parliament on 20 February 2001. Law No. 4628 was further amended by Natural Gas Market Law No. 4646² dated 2 May 2001.

General

Purpose and coverage: The goal of Law No. 4628 is to liberalise the electricity market in Turkey. As a part of such liberalisation, Law No. 4628 appears to be aiming at elimination of both the purchase guarantee and Treasury guarantee for future power projects.

Law No. 4628 stipulates the licensing of electricity activities for the liberalisation of the market. Accordingly, it sets forth a licensing procedure both for generation and distribution facilities. The electricity transmission activities, on the other hand, shall be conducted by the Transmission Company (as defined below) as it shall take over all transmission facilities owned by TEAS or the Treasury in addition to its duty of planning, building and operating the new transmission facilities.

Pursuant to Law No. 4628, all private sector legal entities which shall operate in the energy market must be established either as a Turkish joint stock company (anonim sirket) or a Turkish limited liability company (limited sirket). The possibility of operating as a branch of a foreign company has not been envisaged. The requirements, including the minimum capital for such companies, shall be set forth by a subsequent regulation which has not yet been issued.

In addition, Law No. 4628 introduces some concepts new to the Turkish market such as free consumer, wholesale company and retail sales company for the realisation of a liberal electricity market.

¹ Law No. 4628 was published in the Official Gazette No. 24335 dated 3 March 2001 (repeated edition).

² Law No. 4646 was published in the Official Gazette No. 24390 dated 2 May 2001 (“Law No. 4646”).

Among others, Law No. 4628 also amends Law No. 6200³ according to which the hydroelectric power plants built and operated or to be operated by the General Directorate of State Hydraulic Works (DSI) shall be transferred to the Generation Company (as defined below).

Institutional reform: As an institutional change, Law No. 4628 envisages the re-organization of TEAS into three separate state economic enterprises, which are (i) Turkish Electricity Transmission Joint Stock Corporation (Turkiye Elektrik Iletim Anonim Sirketi) (Transmission Company) which is to be responsible for operating the national grid; (ii) Turkish Electricity Generation Joint Stock Corporation (Elektrik Uretim Anonim Sirketi) (Generation Company) which is to be responsible for operating the state-owned power generation facilities; and (iii) Turkish Electricity Trading Joint Stock Corporation (Turkiye Elektrik Ticaret ve Taahhut Anonim Sirketi) (Trading Company) which is to be involved in purchasing the electricity from the producers and the sale of such electricity to the distribution companies. Until the formation of the above mentioned companies is completed (by a subsequent regulation), TEAS shall undertake the duties envisaged in Law No. 4628 for such entities. The Ministry is still working on the draft company charters of these newly established companies and, as reported by the media, such charters are expected to be published in the Commercial Registry Gazette within a couple of weeks.

As part of the institutional reform, Law No. 4628 establishes an independent administrative institution, the Electricity Market Regulation Authority, re-named as the Energy Market Regulation Authority by Law No. 4646 (Authority), which will be responsible for the regulation and supervision of the operation of the electricity and natural gas markets. Further, Law No. 4628 sets forth the establishment and organization of the Electricity Market Regulation Board, re-named as the Energy Market Regulation Authority by Law No. 4646 (Board) which will be the decision-making body of the Authority to ensure the proper operation of the electricity and natural gas markets in a competitive environment.

In addition to its regulatory duties, the Board is also empowered to issue administrative fines which can lead to cancellation of a license in question. However, all decisions of the Board including issuance of fines can be challenged before the Council of State (Danistay).

The Board, which is to be composed of seven members appointed by the Council of Ministers, is empowered with very wide authorities concerning the regulation of the market and implementation thereof. Nevertheless, the appointment to the Board by the Council of Ministers without the possibility of any nomination by the related authorities and/or any relevant experience requirement, together with the possibility of re-appointment, are factors capable of causing politicization of the Board.

As of 20 June 2001 no members have been nominated for the Board but there are news in the media regarding the proposed names as well as the news regarding the Government's plant

³ Law No. 6200 on Organisation and Functions of General Directorate of State Hydraulic Works was published in the Official Gazette No. 8592 dated 25 December 1925 ("Law No. 6200").

that the membership of the Board shall be consist of three from the Motherland Party, two from the Democratic Left Party and two from the Nationalist Movement Party.

Licensing: Pursuant to Law No. 4628, in order to engage in electricity market activities all legal entities must obtain a license for any activity and, if the said activities are to be conducted in several facilities, a separate license for each activity before starting operation. Licenses shall be granted one time only for a period of up to forty-nine years, however, the minimum period for generation, transmission and distribution licenses shall be ten years.

The types of licenses envisaged under Law No. 4628 are as follows:

(i) Generation license: The license that must be obtained for each generation facility already existing or to be established and for the sale of generated electricity therefrom. Generation companies may not engage in any other activity in the market with the exception that generation companies may enter into an affiliate relationship with distribution companies provided that the control limitations set forth in Law No. 4628 are complied with Those individuals and legal entities, other than autoproducers and autoproducer groups who generate electricity only for their own need and who do not operate in parallel with the transmission or distribution systems, are not required to obtain a license.

(ii) Transmission license: The license that must be obtained by the Transmission Company to conduct its transmission activities. The Transmission Company may not engage in any other activity in the market.

(iii) Distribution license: The license required to engage in distribution activities in a specified area. In addition to their distribution and retail sales activities, private distribution companies may establish generation facilities provided that they obtain the required generation licenses in the area specified in their license and subject to the condition that their annual electricity generation does not exceed 20% of the total annual electricity generated for consumption in the related area. Distribution companies may purchase electricity from their own generation companies or their subsidiaries subject to the condition that such purchase does not exceed 20% of the total amount of electricity that they distributed in their specified area of activity in the previous year.

(iv) Autoproducer and autoproduction group license: The license required to generate electricity for their own needs by autoproduction groups that provide electrical energy to their shareholders. An autoproducer or autoproduction group may sell out its excess energy. The amount of the excess energy which can be sold out shall be determined by the Board under competitive conditions provided that such sold out excess energy shall not exceed 20% of the energy generated at such autoproduction facility. The Board may increase such ratio under outstanding circumstances. If an autoproducer wishes to sell out energy more than such 20% or any higher ratio determined by the Board, it must then obtain a generation license.

(v) Wholesale license: The license that wholesale companies must obtain from the Board for the wholesale of electricity.

(vi) Retail license: The license that must be obtained from the Board for retail sales or retail sales services. Unlike private distribution companies retail sellers are not subject to any geographical limitation.

Pricing: Each year, tariffs and the terms of licenses under Law No. 4628 shall be submitted to the Board for approval. The tariffs can be adjusted during the following year with respect to monthly inflation rates and other issues envisaged in the licenses as approved by the Board. The price structure specified in the tariffs shall not include any item that is not related to market activities. The tariff types envisaged by Law No. 4628 are: Connection and System Utilization Tariff, Transmission Tariff, Wholesale Price Tariff, Distribution Tariff, and Retail Sale Tariff.

Market share limitations: Law No. 4628 provides that the market share of private sector production companies together with the market share of their subsidiaries in the market may not exceed 20% of the total electricity produced in Turkey in the previous year.

Despite the fact that the relevant provision aims to prevent the creation of a dominant position in the relevant market, it may also conflict with the provisions of Competition Law No. 4054⁴ and the related communiqués where a market share of 25% is set forth as the threshold for application to the Competition Board. Law No. 4628 also appears to be creating a conflict of jurisdiction between the authority of the Competition Board and of the Board.

Nevertheless, as Law No. 4628 is more recent and more specific as compared to Law No. 4054, the 20% threshold shall be applied in the electricity market, the supervision of which will be made by the Board and/or by the Competition Board, as the case may be. However, since the approval of mergers and acquisitions still falls within the authority of the Competition Board there must be a close cooperation and coordination between these two authorities, both of which seem to have been authorized to control the competitiveness of the relevant market.

A parallel provision concerning limitation in the market share is also set forth for wholesale companies such that these companies, together with their subsidiaries, cannot sell more than 10% of the total electricity consumption in Turkey in the previous year. The above stated conflict may also be raised for that provision.

Privatisation of generation and distribution facilities: Law No. 4628 envisages the privatization of public generation and distribution facilities through the general privatization legislation, Law No. 4046⁵, which permits privatization by way of sale of assets and transfer of shares. Privatization of the assets of the related institutions such as the Ministry, TEAS, TEDAS, Generation Company and all other related authorities and subsidiaries of such institutions shall be carried out by the Privatization Administration in accordance with the provisions of Law No. 4046.

⁴ Law No. 4054 Concerning The Protection Of Competition was published in Official Gazette No. 22140 dated 13 December 1994 (“Law No. 4054”).

⁵ Law No. 4046 Amending the Constitution was published in the Official Gazette No. 23786 dated 14 August 1999 (“Law No. 4046”).

Law No. 4628 appropriately envisages that as a result of this privatization process, without referring to a specific ratio, foreign individuals and companies cannot acquire shares and assets which may lead to a controlling power in the related sector. The lack of such a provision concerning the elimination of foreign domination in strategic public services such as electricity was considered by the Constitutional Court as one of the reasons for cancellation of the related privatization laws in its earlier decisions.

Transitional Period: Law No. 4628 provides, as a transitional period, a period of eighteen months beginning from its publication date, which can be extended only one time for a term of six months, in order to complete the preparations required for the new market formation provided by Law No. 4628.

Outstanding Projects

Existing contracts: Existing contracts are defined to cover concession and implementation contracts and those contracts signed before the entry into force of Law No. 4628 in accordance with the provisions of the related regulations and Laws No. 4501, 4283, 3096 and 3996⁶.

Law No. 4628 does not invalidate Laws No. 4501, 4283, 3096 and 3996. Although it is arguable that by its Temporary Articles 4 and 8 (which are discussed in Sections 2.4 and 2.6 below) Law No. 4628 aims to provide an exception for certain BOT and TOR projects, it does not state an explicit exemption from the requirements thereunder for the projects outstanding under the above mentioned laws either. Therefore, if a conflict arises between the provisions of Law No. 4628 and the above listed laws, such conflict is to be resolved through interpretation as to the nature of such provisions. Accordingly, the applicable law will have to be determined on a case by case approach.

Pursuant to Law No. 4628 private sector distribution companies which have exclusivity in their area within the scope of their existing contracts shall amend their contracts within a time period to be specified by the Board in order to comply with free market requirements.

Further, companies which are engaged in more than one market activity at the same time shall decide in which activity they shall continue to operate under the provisions of Law No. 4628 and their contracts shall be amended accordingly.

Accordingly, other than amendment of the contracts of the previously authorized private sector distribution companies and companies engaged in more than one market activity, Law

⁶ Law No. 3096, regarding the Authorisation of Entities other than the Turkish Power Company for the Generation, Transmission, and Distribution of and for the Trade in Power ("Law No. 3096"), Law No. 3096 was published in the Official Gazette No. 18610 dated 19 December 1984. Law No. 3996, regarding the carrying out of certain Investments and Services within the Framework of the Build-Operate-Transfer Model ("Law No. 3996") was published in the Official Gazette No. 21959 dated 13 June 1994. Law No. 4283, regarding the Establishment and Operation of Power Generation Facilities pursuant to the Build-Operate Model and the Sale Power ("Law No. 4283") was published in the Official Gazette No. 23054 dated 12 July 1997. Law No. 4501 concerning the Principles to be Followed When Disputes Arising From Concession Licenses and Contracts Concerning Public Services are Submitted to Arbitration ("Law No. 4501") was published in the Official Gazette No. 23941 dated 22 January 2000.

No. 4628 does not envisage specific amendment requirements for the existing contracts in order to comply with the requirements of a competitive market.

However, it is not clear whether the Board shall request amendment in the existing contracts while issuing licenses by relying on its general authority although that is not specifically required by law. In the event an amendment in the existing contracts is requested by the Board, the rights of the project companies thereof should be protected under the general principles of Turkish law or by specific contract provisions, if applicable, as the case may be.

Licensing of existing project companies: The legal entities already operating in the market on the effective date of Law No. 4628 are not required to obtain licenses during the transitional period. However, after the enactment of the implementing regulations, the private entities operating or granted a right to operate generation and distribution facilities under their existing contracts shall apply to the Authority within the periods envisaged in such implementing regulations. The Board shall grant license to legal entities which fulfill their obligations under this Law No. 4628 within one month from the application date. Such entities shall carry out their activities in accordance with the existing procedures and principles until they obtain their licenses.

Energy sales agreements and energy purchase guarantees: The energy purchase agreements signed by TEAS which are based on the existing contracts shall be taken over by the Trading Company. In addition, the project companies that have signed their implementation/concession contracts but not signed the energy purchase agreements with TEAS shall have those agreements signed by the Trading Company after the Law goes into effect. However, the term of the energy purchase agreements to be executed between the Trading Company and generation companies shall not exceed one year.

Law No. 4628 does not repeal the purchase guarantees provided by TEAS in the existing energy purchase agreements. Nevertheless, elimination of the purchase guarantees in the existing energy purchase agreements by the Board, depending on its general authority through the licensing process, together with its consequences, still remains to be a possibility as discussed above.

Treasury guarantees: According to Temporary Article 8 of Law No. 4628 the treasury guarantee under the provisions of Law No. 3996 will only be granted for the BOT projects determined by the State Planning Organization and the Ministry before the enactment of Law No. 4628 provided that they would commission their power plants by the end of the year 2002 at the latest. The Treasury guarantees of those which were granted but not commissioned by the end of the year 2002 shall be invalid. This article does not seem to be providing a remedy for the concerned project companies to be able request time extension for the delays that are attributable to the State agencies involved and, this may form a reasoning for the Constitutional Court to annul it. Other than the above mentioned projects, no Treasury guarantee shall be granted within the framework of Law No. 3996 and Law No. 4283⁷.

⁷ Projects under Law. No. 3096 benefit from Treasury guarantees only through Law No. 3996.

Electricity Energy Fund: Law No. 4628 does not make any reference to the Electricity Energy Fund (EEF) although dissolution of the EEF was anticipated as a part of the liberalization of the energy market. It is stated in Law No. 4628 that all fund contributions applicable to electricity sale tariffs are to be regulated by the Council of Ministers. Nevertheless, a draft law abolishing, among other funds, the EEF, has been presented to the Parliament and is expected to complete the mission of Law No. 4628 in that respect if and when enacted.

30 June 2001 Deadline for TOR Projects: Temporary Article 4 of Law No. 4628 states that the contracts of those TOR generation and TOR distribution companies which cannot complete their transfer procedures by 30 June 2001 shall be invalid. As far as we are concerned, all the companies within this scope were authorized by the Council of Ministers and most of these companies had signed authorization contracts with the Ministry. Therefore, we have doubts concerning the general legal logic and the constitutionality of invalidating a project whose authorization was granted by an administrative decision as a result of a public tender by a further law.

We are of the opinion that the Council of Ministers' decree concerning such authorization must be withdrawn by another Council of Ministers' decree with justified reasoning. We believe that the companies which shall be subject to such invalidation may have legal remedies against such cancellation. Nevertheless, the nature of such legal remedies will depend on the implementation of legal action to be taken by the relevant authority.

Recently, the Turkish Government has declared its plan to extend the 30 June 2001 deadline to 31 October 2001 since most of the TOR projects will not be able complete the transfer procedures by that time. The draft amendment to Law. No. 4628 which has been prepared by the Government to that effect has already been presented to the Parliament for the completion of the enactment procedures. Although such amendment would lessen the time pressure for the TOR projects to a certain extent, it probably would not be sufficient for all the projects to conclude their transfer transactions.

Challenge against Law No 4628

In the meantime, Law No 4628 has been challenged at the Constitutional Court by the main opposition party, the Virtue Party, as being contrary to the Turkish Constitution.

The unconstitutionality claim is largely based on the arguments that provisions of Temporary Articles 4 and 8 of Law No. 4628 are contrary to Articles 2, 35, 48 and 125/1 of the Turkish Constitution on the basis that the basic principles of the Turkish Constitution (including the rule of law, equality before law, the State's obligation to protect private ownership, protection of vested rights, freedom to work and contract, and judicial review of administrative actions) have been violated.

The Virtue Party further requests in its application, until a final decision is rendered by the Constitutional Court, an injunction decision to suspend the implementation of Temporary Articles 4 and 8 of Law No. 4628 claiming that implementation of these articles would cause irreparable damages.

As we discussed above, Temporary Article 4 provides for the 30 June 2001 deadline for the completion of transfer procedures of the existing TOR projects whereas Temporary Article 8

limits, as we discussed in Section 2.4 above, the Treasury guarantees only for pre-determined projects which are planned to be commissioned before the end of 2002.

The Constitutional Court is expected to start reviewing the case on its merits before the judicial recess which is to continue all summer. Taking into account some earlier decisions of the Constitutional Court and technical merits of the claims, it is likely that implementation of these articles can initially be ceased and then these articles can be cancelled by the Constitutional Court, if the Court decides to take a technical approach rather than a strategic one.

If the Constitutional Court annuls Temporary Articles 4 and 8 of Law No. 4628 then the existing projects will continue to be subject to remaining provisions of Law No. 4628 and will preserve their rights coming from other legislation that are eliminated by those provisions of Law No. 4628. Needless to say that an annulment is likely to create another debate over the issue of which laws will govern these existing projects, in other words, whether or not they shall be grandfathered.

Investigations at the Ministry

Everyone who is following the Turkish energy market should have heard the White Energy investigation carried out by the Turkish law enforcement authorities which include claims of bribery and corruption against certain Ministry and TEAS officials, in some of the power tenders and finalization thereof. The white energy investigation has caused a number of changes in many important positions at the Ministry and TEAS including the Minister of Energy himself, although cases against such officials are still pending. However, the effects of such investigation were immediate and material on the existing projects and resulted in months of delay due to the reluctance of the remaining or new officials to proceed with those projects. Such delay especially adversely effected the projects which applied to benefit from the private law provisions envisaged by Law No. 4501⁸ and the projects which are obligated to meet the 30 June 2001 and the end of 2002 deadlines in order to keep their projects on track under Law No. 4628.

Attitude of the Treasury

In the beginning of May of this year, the Treasury announced its approach to the existing energy projects determined as eligible for Treasury guarantees by the State Planning Organization and the Ministry before the enactment of Law No. 4628. The Treasury redefined its guarantee conditions beyond the limitation brought by Law No. 4628. Accordingly, the Treasury guarantee will cover only the payment for the energy actually purchased by TEAS. Further, the EEF payment obligations would not be guaranteed by the Treasury since EEF shall be dissolved. The Treasury reasons such limitation of the energy purchase guarantees in a way that it would minimize the burden on the Treasury and would

⁸ Please refer to the article "Turkey's Attempt for a Stable Liberalised Energy Market", By Mehtap Yildirim-Ozturk and Dr. Gamze Oz, 196 Project Finance International, (June 28 2000), p.77 with respect to Law No. 4501.

let the market dynamics work better. It reasons the elimination of the EEF guarantees by stating that since the payment obligations of EEF shall be assumed by the Treasury after its dissolution the related guarantees would not be needed. We believe this approach of the Treasury is contrary to Law No. 4628 and the principles embodied in the underlying project documents for the existing projects and may cause legal actions to be taken by the developers against the Turkish State.

Conclusion

The liberalization of the energy market in Turkey has been on the agenda of the Turkish government for a long time and Law No. 4628 aims to achieve such goal. Generally, Law No. 4628 seems to be establishing a suitable structure with essential provisions to form and maintain a liberal energy market. It should be noted, however, that Law No. 4628 is vague in some aspects and with respect to certain subjects with no assistance provided in its reasoning and therefore leaves room for further interpretation and debate. The white energy probe, constitutional challenge to Law No. 4628 and announcements coming from the Treasury with respect to its future policies regarding the Treasury guarantees for the energy projects render this picture more obscure. Consequently, the whole picture might be seen only after the final decision by the Constitutional Court, issuance of the implementing regulations mentioned therein and the implementation of Law No. 4628 together with such regulations. However, one thing which seems to be clear is that in the event Temporary Articles 4 and 8 of Law No. 4628 are upheld by the Constitutional Court and the Government does not find a middle ground for the existing projects in practice, the Turkish State will face compensation claims from the owners of the existing projects either at the Turkish administrative courts or in international forums depending on the nature of the underlying documents and the ownership structure of the project company in question.