

The New Electricity Market Law

22 March 2013

Introduction

The New Electricity Market Law No. 6446 (the “**New Law**”) has been enacted by the Turkish Parliament on 14 March 2013. Other than the provisions related to the organization, powers and duties of the Energy Market Regulatory Authority (“**EMRA**”), which remain in effect, the New Law repeals and replaces all provisions of Electricity Market Law No. 4628 of 3 March 2001 (the “**Repealed Law**”). The New Law will enter into effect upon approval by the President of the Turkish Republic and publication in the Official Gazette, both of which are expected to take place by the end of this month.

The New Law makes certain substantial changes in the current electricity market system, such as types of licenses, introduction of a pre-licensing mechanism and extended deadlines for certain incentives as analyzed below.

Main features of the new law

1. Changes in the Types of Licenses and Market Activities

The New Law defines each electricity market activity separately and frames the remaining provisions based on such categorization rather than types of licenses, as is the case under the Repealed Law. The electricity market activities listed under the New Law are: (i) generation activities, (ii) transmission activities, (iii) distribution activities, (iv) wholesale activities, (v) retail sale activities, (vi) market operation activities, (vii) export activities, and (viii) import activities.

There are two major amendments to the types of licenses as follows:

- (i) Wholesale and retail sale activities are combined under one license type, namely a supply license (*tedarik lisansı*). Holders of a supply license will be entitled to perform wholesale and/or retail sale activities without being subject to any regional restrictions for eligible consumers. Once the New Law goes into effect, companies holding a wholesale and retail sale license will be issued a supply license without having to pay a license issuance fee. Additionally, the total amount of electricity supplied by a private supply license holder cannot exceed 20% of the total electricity supplied in Turkey in the previous year.
- (ii) Auto-production, as a license type, will be abolished as of the effective date of the New Law. Pursuant to the New Law, an auto-production license shall be converted into a generation license within six months following the effective date of the New Law without the requirement for payment of a license issuance fee.

2. Electricity Market Operation Activities

Under the New Law, any electricity markets established or to be established in the future will collectively be called “organized wholesale markets.” This includes markets in which the retail sale of power and capacity is conducted (i.e., the day-ahead market, real time market), balancing power market, ancillary services market, and markets in which electricity agreements and by-products having electricity energy and/or capacity are traded.

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The New Law introduces a new electricity market activity called “market operation” which is defined as the “*operation of organized wholesale markets, financial settlement of activities taking place in such markets and other related financial transactions*”. This activity, which is currently mostly conducted by the Electricity Market Financial Settlement Center (*PMUM*), will be conducted by Enerji Piyasaları İşletme Anonim Şirketi (“**EPIAŞ**”). EPIAŞ will be established as a private law entity operating under a market operation license to be issued by EMRA. EPIAŞ is envisaged to operate the organized wholesale markets except for (i) the balancing power market and ancillary services market (both of which will continue to be operated by TEİAŞ), and (ii) the electricity exchange, which will be operated by Borsa İstanbul Anonim Şirketi upon its establishment once the New Law goes into effect.

3. Preliminary License

The New Law introduces a preliminary licensing mechanism whereby each generation company is issued a preliminary license for the pre-construction stage, which will be replaced by a license upon commencement of the construction stage. The period of a preliminary license is no more than 24 months, unless there is a force majeure event. EMRA shall be authorized to extend this period up to half of the period subject to the capacity and resource type of the project. Moreover, a license application which has not been concluded as of the effective date of the New Law shall be evaluated as a preliminary license application.

A legal entity shall, within its preliminary license period (i) obtain the required permits, approvals, licenses and other similar documents required under the applicable law to start the investment and construction of its generation facility, (ii) obtain ownership or an easement right for the site where the generation facility will be located, and (iii) perform any other obligations as may be required by EMRA for the relevant preliminary license holder. EMRA will not issue a license if the preliminary license holder does not fulfill such requirements.

The preliminary license shall be cancelled if (i) the shareholding structure of the preliminary license holder is directly or indirectly changed, (ii) the shares are transferred or any transaction resulting in a share transfer is conducted, or (iii) the requirements determined by EMRA are not fulfilled during the preliminary license period.

The provision on the applicability of a pre-licensing mechanism on existing generation licenses in the Draft Electricity Market Law has been amended during the discussions at the General Assembly of the Parliament. Accordingly, no generation license shall be converted into a preliminary license. Only projects which are at the license application stage shall be evaluated as a preliminary license application. Instead of converting a license into a preliminary license, a generation license holder which is (a) still in its pre-construction period, or (b) has not been able to complete the requirements of pre-construction although its

pre-construction period has elapsed, will be provided with an additional six month time period to commence construction. If the pre-construction requirements are not fulfilled during this period, for reasons other than force majeure events, the relevant generation license will be terminated by EMRA. Hence, the New Law provides that the pre-construction period of an existing generation project cannot be extended for more than 6 months, except for force majeure events.

In the event a license holder submits documents showing that it is not possible to complete the expropriation and/or railway relocation during the pre-construction period stated in its license and if the reasoning for non-completion is found appropriate by EMRA, such license shall not be cancelled at the end of the additional six month period. Considering that the expropriation process is one of the most challenging and time-consuming steps during the pre-construction stage, this provision aims to prevent cancellation of a generation license if construction cannot start in due time simply because of ongoing expropriation and/or railway relocation processes.

4. Hidden Labor

Pursuant to the Labor Law, while auxiliary works can be freely subcontracted, works that fall under the scope of the core business of a company can only be outsourced due to the required expertise for the work, the specific requirements of the workplace, and for technological reasons. All these requirements are sought as a justification of outsourcing of the core business activities to subcontractors. Otherwise, subcontracts may be challenged by claims of hidden labor.

The New Law envisages a provision stating that a license holder may outsource its operation and repair and maintenance works required for activities performed within the scope of its license. The same provision states that EMRA is authorized to determine the activities that can be outsourced. Under the general principles of Turkish law, special laws have priority over general laws, and the New Law may be considered as a special law concerning the Electricity Market as compared to the general Labor Law. Accordingly, it may be argued that the relevant provisions of the New Law, constituting a special law on a specific sector, should have priority over the general outsourcing principles set forth by the Labor Law. Additionally, although the current Licensing Regulation already includes a provision permitting a license holder to outsource the activities under its license, the existence of this provision in the Licensing Regulation alone does not always protect distribution companies from claims of hidden labor in practice since the Licensing Regulation ranks lower than the Labor Law in the hierarchy of norms. Therefore, under the New Law, a distribution company is in a stronger position to justify its outsourcing transactions against claims of hidden labor. However, since outsourcing is a disputed subject both in court precedents and in implementations by the Ministry of Labor, the provision of the New Law may not completely eliminate the hidden labor risk.

5. Provisions Specific to Distribution and Authorized Supply License Holders

Involvement in Other Market Activities:

Under the Repealed Law, a generation company may not become a shareholder in a distribution company if it results in control over such distribution company. The New Law envisages that no license holder (such as generation, distribution, supply, etc.) may be a direct shareholder in a distribution company, and no distribution company may be a direct shareholder in any license holder.

Cancellation of License:

According to the New Law, in the event a distribution license holder or an authorized supply license holder (i.e., the supply company established as a result of the partial demerger of the distribution company in the relevant region to comply with the legal unbundling requirement) fails to perform its material duties in accordance with the principles and procedures under the relevant legislation or impairs the distribution quality to an intolerable level or becomes unable to operate, the following measures (individually or collectively) may be taken by EMRA:

For distribution companies:

- Appointment of new board members replacing the current members; and/or
- If the distribution license holder fails to fulfill its obligatory services required to be performed under the scope of their tariffs, the financial burden arising out of such noncompliance shall be reimbursed from the income of the relevant company from its other operations, by the dividends of the current shareholders and finally from the personal assets of the registered shareholders; and/or
- Issuance of a new distribution license to a third party meeting the requirements stipulated by the New Law.

For authorized supply companies:

- Appointment of new board members replacing the current members; and/or
- Issuance of a new authorized supplier license to a third party meeting the requirements stipulated by the New Law.

Payment of Infrastructure Excavation License Fees:

Infrastructure works performed by transmission and distribution license holders shall be exempt from the payment obligation of infrastructure excavation license fees, which are normally payable to the municipalities.

6. Provisions Specific to Generation Companies

Issuance of a New License:

If construction of a facility had commenced based on a valid generation license, but such license had been cancelled and the construction had terminated before the effective date of the New Law, EMRA shall issue a new license for such facility provided that the Ministry of Energy and Natural Resources ("MENR")

determines that the relevant investment is at an irreversible stage and there is a public benefit in the continuance of such project. This provision is not applicable for hydroelectric power plants. This provision may be criticized for empowering two different authorities, namely EMRA and MENR, to assess the public benefit and issue a new license.

License Issuance for BOT and BO Projects:

The New Law provides that EMRA shall issue a generation license *ex officio* for the generation facilities and projects with existing contracts under Build-Operate-Transfer Laws No. 3096 and 3996 as well as Build-Operate Law No. 4283. Such licenses shall be issued within one year following the effective date of the New Law and its term will be limited with the term of the relevant existing contract. This provision may be criticized for creating additional requirements for such projects in contradiction to their vested rights under contracts that were signed prior to the enactment of the Repealed Law.

7. Extended Deadlines

A draft version of the New Law extended the deadlines of the (i) price equalization mechanism for distribution companies, (ii) 50% discount on the transmission system utilization fee for the first five years of operation of generation license holders, and (iii) exemption on stamp taxes and duties during the investment period of generation license holders through 31 December 2015. However, due to the urgency of these changes, they were extended by an amendment to the Repealed Law by Law No. 6408 Amending Electricity Market Law and Private Consumption Law on 31 January 2013. The same extensions are present under the New Law.

The New Law also provides an extension through 31 December 2023 for the term of corporate tax and value added tax exemptions in the transfer, merger or demerger of license holders as part of the privatization process for generation and distribution companies.

8. Grace Period for Compliance to Environmental Requirements

A grace period until 31 December 2018 is provided by the New Law to Elektrik Üretim Anonim Şirketi (EÜAŞ), the state-owned generation company, and its affiliates and subsidiaries which are to be privatized, to complete all required environmental permits under the applicable environmental legislation. This grace period is aimed at facilitating the generation sector privatizations by introducing a temporary exemption until the end of 2018 for private investors that will take transfer of the EÜAŞ power plants as a result of such privatizations. The Council of Ministers is authorized to extend this period for three years.

9. Wind and Solar License Applications

The current mechanism for wind applications (which includes the TEİAŞ opinion for connection to transformers and competition among multiple applications) provided by the Repealed Law and the Regulation Regarding the Selection Process for Multiple Wind Project Applications dated 22 September 2010, has been reflected to the New Law, both for wind and for solar energy generation applications. Pursuant to the New Law, standardized measuring reports prepared for a period of at least one year within the previous three years shall be submitted during the preliminary license application based on wind and solar energy. This provision may be criticized for increasing the 6-month measurement period under the current legislation for solar power to one year, only a few months before the permitted solar license application period of 10-14 June 2013.

Conclusion

As explained in detail above, the New Law makes some substantial changes in the current electricity market system (e.g., types of licenses, introduction of a pre-licensing mechanism and extended deadlines for some incentives).

One of the main objectives of the New Law is to prevent trading of generation licenses by non-investors developing such projects for the sole purpose of selling to real investors. To this end, the New Law prevents any direct or indirect share transfer at the preliminary license period, on the one hand, and brings additional or extended incentives for real investors, on the other. However,

the share transfer prohibition during the preliminary license period was criticized by several market players during discussions of the draft law at the MENR and Parliament levels for being far-reaching and for non-proportionally limiting the commercial freedom of private enterprises. Due to such criticism, the relevant provision was changed during discussions at the General Assembly of the Parliament so as to limit it to new projects licensed after the effective date of the New Law and to permit share transfers for existing licenses as explained above.

The New Law is expected to create positive effects on supply security and the interest of investors in the electricity market, and it is generally a positive step towards achieving these objectives. However, its effects remain to be seen in practice especially upon issuance of the necessary secondary legislation by EMRA, which will provide detailed provisions regarding the implementation of the New Law.