

The New Electricity Market Licensing Regulation in Turkey

6 November 2013

Introduction

On 2 November 2013, the Turkish Energy Market Regulatory Authority ("EMRA") has issued the new Electricity Market Licensing Regulation¹ (the "New Licensing Regulation"), which implements the recently enacted Electricity Market Law No. 6446² ("Electricity Market Law"). The New Licensing Regulation repeals and replaces all provisions of the 2002 Electricity Market Licensing Regulation³ (the "Repealed Licensing Regulation").

Main features of the new licensing regulation

New Structure for Organized Wholesale Markets

The New Licensing Regulation makes certain changes in the market structure for electricity wholesale activities as follows:

- (i) the day-ahead market and intraday market shall be operated by Enerji Piyasaları İşletme Anonim Şirketi ("EPIAŞ") replacing the current market operator (Piyasa Mali Uzlaştırma Merkezi- PMUM);
- (ii) the balancing power market and ancillary services market shall be operated by Türkiye Elektrik İletim Anonim Şirketi ("TEİAŞ"), the state-owned transmission company; and
- (iii) the Borsa İstanbul Derivative and Options Exchange Market shall be operated by Borsa İstanbul Anonim Şirketi, in which electricity agreements and by-products of electrical energy and/or capacity shall be traded.

The Derivatives Exchange Market (VOB) of İzmir, where electricity agreements and by-products had been traded since 2011, was acquired by the Borsa İstanbul Derivative and Options Exchange Market on 5 August 2013.

The intraday market is a new market type to be operated between the day-ahead market and the balancing market and is created in order to increase the balance of the electricity system. This market has not yet been established, however, the New Licensing Regulation provides the legal basis for its establishment. In addition, the draft Electricity Market Balancing and Settlement Regulation, which EMRA published on its website on 24 September 2013 for the opinions of the public, envisages making the intraday market operational beginning on 1 January 2014.

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¹ Published in the Official Gazette No. 28809 dated 2 November 2013.

² Published in the Official Gazette No. 28603 dated 30 March 2013. Law No. 6446 repealed and replaced the Electricity Market Law No. 4628 of 2001.

³ Published in the Official Gazette No. 24836 dated 4 August 2002.

The chart below shows the organized wholesale markets and their operators under the Repealed Licensing Regulation and the New Licensing Regulation:

	Repealed Licensing Regulation	New Licensing Regulation
Day-ahead market	PMUM	EPIAŞ
Intraday Market	-	EPIAŞ
Balancing Power Market	PMUM	TEİAŞ
Ancillary Services Market	TEİAŞ	TEİAŞ
Borsa İstanbul Derivative and Options Exchange Market	Partially, Derivative and Options Exchange Market (VOB)	Borsa İstanbul A.Ş.

The New Licensing Regulation also provides that all transactions conducted in any of the above-referenced markets shall be exempt from stamp tax.

Changes applicable to generation companies

Share Transfer Restrictions

The Electricity Market Law prohibits the direct and indirect transfers of the shares of generation companies during the preliminary license period. Prior drafts of the New Licensing Regulation provided an exemption for generation license holders who previously received temporary acceptance for any of their projects. In other words, license holders who had a power plant in operation were not subject to the share transfer restriction during the preliminary license period. However, the New Licensing Regulation does not include this exemption. Instead, it introduces a new exemption for indirect share transfers by foreign shareholders of generation companies.

Environmental Impact Assessment Decision

Pursuant to the draft versions of the New Licensing Regulation, an environmental impact assessment decision was required to be obtained prior to the preliminary license application. However, the New Licensing Regulation states that such a decision must be obtained during the preliminary license period; i.e., subsequent to the issuance of the preliminary license.

Reporting Requirement

Pursuant to the Repealed Licensing Regulation, generation license holders were required to submit an annual activity report to EMRA as long as they held a license. The New Licensing Regulation amends this requirement and accordingly, generation license holders will submit a progress report to EMRA each year only during their construction period. Therefore, there is no longer a requirement to submit annual activity reports during the operation period.

Amendments to the Articles of Association

Pursuant to the Repealed Licensing Regulation, generation license holders were required to obtain prior approval of EMRA for all amendments to their articles of association, except for amendments regarding the address of the company. Under the New Licensing Regulation, generation companies are not required to obtain EMRA's approval for any amendment to their articles of association.

Criminal Records

Under the Repealed Licensing Regulation, real persons holding, directly or indirectly, 10% or more shares in a license applicant company (including generation license applicant companies) or members of board of directors, statutory auditors or other senior directors were required to be not convicted, based on a finalized judgment, for infamous crimes such as bribery, fraud, corruption, or for rigging the tender. The New Licensing Regulation removes this prohibition, and only requires that real persons holding, directly or indirectly, 10% or more shares (5% or more in publicly listed companies) and members of the board of directors must not have acted as a shareholder holding, directly or indirectly, 10% or more shares (5% or more in publicly listed companies) or members of the board of directors of another license holder whose license has been cancelled by EMRA within the last three years period.

Changes applicable to distribution and assigned retail sale companies

Available Securities for Financing

The New Licensing Regulation explicitly sets forth that establishing pledge over shares and accounts of distribution and assigned retail sale companies is subject to the approval of EMRA. The wording of the Repealed Licensing Regulation and EMRA's implementation were not clear in terms of pledge over bank accounts.

Under the Repealed Licensing Regulation, all license holders were entitled, at least theoretically, to provide a step-in right to their lenders under financing agreements, whereby EMRA was required to issue, subject to certain conditions, a new license to a new investor nominated by the lenders in the event of default under the financing agreements. The New Licensing Regulation restricts this right to the generation license holders only.

Reporting Requirement

As in the Repealed Licensing Regulation, distribution companies are required to submit an annual activity report to EMRA under the New Licensing Regulation. However, unlike the Repealed Licensing Regulation, the New Licensing Regulation requires distribution companies to post such reports on their websites. In addition, distribution companies are required to submit a report regarding the progress made in the legal unbundling process. In accordance with the drafts of the New Licensing

Regulation, this report was required to be submitted each year until the end of October. However; the final version of the New Licensing Regulation states that this report is required to be submitted until the end of November.

Amendments to the Articles of Association

Pursuant to the Repealed Licensing Regulation, distribution and assigned retail sale companies were required to obtain prior approval of EMRA for all amendments to their articles of association, except for amendments regarding the address of the company. Under the New Licensing Regulation, distribution and assigned retail sale companies are required to obtain EMRA's prior approval only for amendments to the purpose and fields of activity provisions of their articles of association.

Procurement of Services (Hidden Labor)

Pursuant to Labor Law No. 4857⁴ (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 when a certain expertise is required for the work, for specific requirements of the workplace, and for technological reasons. All of these requirements, together, are considered as a justification for the outsourcing of core business activities to subcontractors. Otherwise, subcontracts may be challenged by claims of hidden labor, which could result in the payment of certain compensations and fines.

The Electricity Market Law provides that a license holder may outsource its operation and the repair and maintenance works required for activities performed within the scope of its license. The same provision states that EMRA is assigned to determine the activities that can be outsourced. In the draft versions of the New Licensing Regulation, cut-off and connection, meter reading, breakdown repair and maintenance and customer connection were listed among the activities that could not be outsourced by distribution companies. However, these activities are not included in the final version of the New Licensing Regulation. It may, therefore, be interpreted that distribution companies can outsource these activities. Under Turkish law,

special laws have priority over general laws, and the Electricity Market Law may be considered as a special law concerning the electricity market as compared to the more general Labor Law. However, since outsourcing is a disputed subject both in court precedent and in the implementation by the Ministry of Labor, the outsourcing provision of the Electricity Market Law and the New Licensing Regulation may not completely eliminate the above-stated hidden labor risk.

Conclusion

As stated above, the New Licensing Regulation, in parallel to the recent Electricity Market Law, provides certain mechanisms aimed to increase supply security. Accordingly, it increases supervision for generation companies at the construction stage (such as the share transfer prohibition during the preliminary license period) while reducing supervision during the operation period (such as the removal of the reporting requirement during the operation period, and removal of the EMRA approval requirement for amendments to their articles of association).

The requirement for the appointment of an independent board member for distribution and assigned retail sale companies (even before the occurrence of a default), as provided in the draft version of the Licensing Regulation, was subject to criticisms by market players, and consequently, such requirement has not been included in the final version of the Regulation as a positive change.

In conclusion, the New Licensing Regulation is generally a positive step for addressing some concerns of the market players and clarifying the implementation of the recently enacted Electricity Market Law on subjects such as the timing of environmental impact assessment studies and the procurement of services (hidden labor issue). The restructuring of the organized electricity wholesale markets and the introduction of the intraday market as well as the electricity exchange are also forward movements in developing the Turkish electricity market.

4 Published in the Official Gazette No. 25134 dated 10 June 2003.