

The New Petroleum Law

19 June 2013

The New Turkish Petroleum Law No. 6491 (the “**New Law**”) was published in the Official Gazette No. 28674 dated 11 June 2013 and entered into effect on the same date. The New Law repeals and replaces all provisions of Petroleum Law No. 6326 of 16 March 1954 (the “**Repealed Law**”).

The New Law basically attempts to restructure legal regime and policy in relation to upstream petroleum activities, and to bring new rights and obligations to petroleum right holders. In addition, it brings certain incentives including but not limited to certain tax exemptions, a work permit exemption, and a used material and import exemption as analyzed below.

Main Features of the New Law

1. Regulatory Bodies

Petroleum activities in Turkey are regulated by three governmental authorities namely the Ministry of Energy and Natural Resources (“**MENR**”), the General Directorate of Petroleum Affairs (“**GDPA**”) and the Energy Market Regulatory Authority (“**EMRA**”).

- MENR is responsible for preparing and implementing high-level energy policies, strategies and plans in co-ordination with its affiliated institutions, and other public and private entities.
- GDPA, which is affiliated with MENR, is responsible for setting the national policy for petroleum affairs, ensuring the utilisation of oil fields and granting oil exploration, and operation licences (that is, the upstream segment).
- EMRA is an independent regulatory authority that is administratively and financially autonomous. EMRA mainly implements midstream and downstream petroleum activities that are all governed by the Petroleum Market Law No. 5015 unlike the Repealed Law and the New Law.

2. Petroleum Registry

Petroleum rights arising out of or in connection with research, exploration and operation licenses are required to be registered in the petroleum registry being recorded by GDPA. Any and all changes in the petroleum rights including the termination of such rights are also registered accordingly. Unlike the Repealed Law, the actual operators, which are assigned by a mutual agreement entered into by and between license holders having a common interest in the same license area, must be registered in the petroleum registry.

As a matter of the New Law, the transfer of share stakes which lead to a change in control is now subject to the pre-approval of the Minister of Energy and Natural Resources. The New Law preserves the approach and practice of the Repealed Law in connection with the announcements of decisions of the GDPA that the issuance, expiry, transfer, and termination of petroleum rights excluding the research permit will be issued in the Official Gazette, and considered as an official notification to the relevant market players.

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3. Secondary Legislation

The current secondary legislation has not been repealed directly with the effectiveness of the New Law. The New Law envisages that new secondary legislation regarding implementation will be issued by MENR in six months following the effective date of this Law. Moreover, until the issuance of the new secondary legislation, the current provisions of the secondary legislation which are not contrary to the New Law will continue to be implemented.

The New Law also envisages that no license application will be accepted within one year following the effective date of the Law. The purpose of this provision is to allow time for the issuance of the new secondary legislation and to be prepared for the full implementation of the New Law.

4. Division of the Petroleum Districts

In conjunction with the Repealed Law, Turkey was geographically divided into 18 petroleum districts covering jointly the exploration and operation license areas, by a decision of the Council of Ministers. This division was not made based on sea and continental districts; therefore, the same provisions were applied for petroleum activities performed in sea areas and continental areas. As a consequence, this division created certain negative impacts on investors especially when considering the difficulties and costs of activities performed in sea.

In accordance with the New Law, Turkey is divided into two districts; as a sea district and a continental district. Therefore, the negative impact arising from the implementation of the same provisions for both sea and continental areas are supposed to be prevented. The sea district is further divided as continental waters and non-continental waters. Research permits and exploration and operation licenses for non-continental waters are subject to the consent of the Council of Ministers.

5. Usufruct Rights

In accordance with the New Law, in the case where the lands falling within the scope of a license are owned by private persons, the legal options to utilize such lands are: (i) purchasing; (ii) establishing a usufruct right over the land; (iii) leasing; and, (iv) having the land expropriated. These options were also being implemented under the Repealed Law. Additionally, the New Law brings an accelerated expropriation option to prevent delays in projects due to expropriation procedures.

Further, under the New Law research activities may be performed in forestry lands provided that required permits are obtained in accordance with the relevant legislation.

Regarding the license area, the Repealed Law envisaged that the operation license area would not exceed 50% of the exploration license area. The New Law does not require a limitation for license areas. However, such a limitation may be imposed by virtue of the forthcoming secondary legislation.

6. Special Requirements of the New Law

Pursuant to the New Law, right holders are obliged to reimburse land owners for damages arising from petroleum activities, including the loss of any agricultural products.

The New Law puts into place the decommissioning of physical structures at the end of operations. Decommissioning obligations shall be governed by a regulation to be issued by MENR.

Commercial enterprises and foreign legal entities are entitled to obtain research permits and exploration and operation licenses.

The petroleum right holders are required to avoid endangering the environment and community, and thus required to utilize proper facilities and equipment. In order to secure such obligations, the license applicants are obliged to provide a bond per hectares. Accordingly, this amounts to 0,0005 of the research charge for the research permits, 0,001 of the exploration license charge for the exploration licenses, and 0,005 of the operation license charge for the operation licenses.

Privately held companies which will apply for petroleum licenses will be subject to Turkish Commercial Code No. 6102 dated 13 January 2011. Foreign legal entities are considered to be resident in Turkey given their activities as per the provisions of the protection of the Turkish currency.

The provision of petroleum activities and the required security distances to national borders, military zones, historical remains and residential areas shall be governed by the regulation.

Petroleum right holders are entitled to export a certain amount of the petroleum and natural gas (35% in continental, 45% in sea districts) they produce in the areas discovered after 1 January 1980. The remaining part and the whole petroleum and natural gas produced in the areas discovered before 1 January 1980 shall be allocated for domestic use. The Council of Ministers is authorized to change these ratios and to regulate principles and procedures regarding the implementation.

7. Employment of the Foreign Staff

The New Law slightly changes the legal regime concerning employment of foreign staff. The Repealed Law indeed envisaged that foreign staff may be employed by the work permit to be issued by the Ministry of Labor and Social Security in accordance with the opinion of the Ministry of Energy and Natural Resources and Minister of Internal Affairs. Pursuant to the New Law, the Ministry of Internal Affairs will issue the resident permit through which foreigners will be able to work for a maximum period of six months without being subject to Law No. 4857 Regarding the Work Permits of the Foreigners. If and to the extent that the total working time exceeds six months, the foreigner must obtain a work permit under Law No. 4857.

8. New Incentives

The New Law introduces a decrease in the amount of withholding tax on the self-employment income of limited taxpayers. Although the withholding tax rate on the self-employment income of limited taxpayers is in the amount of 15% as set forth by Corporate Tax Law No. 5520¹, the New Law limits this rate to 5% for self-employment income payments made for exploration activities.

The New Law provides an exemption to foreign companies regarding revenues – except the State share – which are generated during the period between the import and transfer of their capital in foreign currency and at the exchange rate on the date of transfer, from corporate and income taxes. Under the New Law, the expenses shall be amortized by means of depreciation. In addition, the petroleum right holders are entitled to decide which expenses will be capitalized.

Under the New Law, the import of materials and equipment necessary for petroleum activities remains exempt from customs tax and duties. Exemption from taxes also covers materials and equipment purchased in Turkey. As a significant change, the New Law sets forth that the importer or the transferee petroleum right holder shall have full discretion on transfer of the materials and equipment imported with tax exemption once 10 years have passed from the time of their import to Turkey.

With an amendment to Stamp Tax Law No. 488², agreements between petroleum right holders regarding exploration and production activities concluded within the framework of the New Law shall be exempt from Stamp Tax.

The New Law also introduces some incentives for activities in sea districts. First of all, the term of an exploration license in a sea district shall be eight years, whereas the term of an exploration license in a continental district shall be five years. License applications for sea districts require submission of a performance bond in the amount of 1% of the total investment cost. This rate is determined as 2% for continental districts. Lastly, petroleum right holders in sea districts may export 45% of the raw petroleum or petroleum products produced in the areas discovered after 1 January 1980. However, this rate is determined as 35% for petroleum right holders in continental districts.

9. Royalty Payments and State Share

Under the Repealed Law, a licensee was required to bear the obligation to pay Royalty for each license area. The Royalty payable yearly per hectare of the license area was: (i) TL 40 for the first three years; (ii) TL 80 for the fourth and fifth years; and, (iii) 120 TL for each year after the fifth year. The New Law does not include any royalty payment requirement.

¹ Published in the Official Gazette No. 26205, dated 21 June, 2006.

² Published in the Official Gazette No. 11751, dated 11 July, 1964.

Both the Repealed Law and the New Law envisage that petroleum license holders are required to pay a state share in the amount of one eighth (1/8) of the petroleum produced under the exploration and operation license. However, unlike the Repealed Law, the price determination will be made in accordance with the market price under the New Law. The New Law also determines a charge in the amount of TL 0.5 per hectare for research permit areas, which will be paid once only.

10. Cash Money Transfer

The exchange rate guarantee, provided by the Repealed Law, was suspended by the Court of Accounts in 1996. However, this caused some uncertainties in the sector and the need for a regulation arose. The New Law regulates the exchange rate at which capital is transferred. Pursuant to the New Law, foreign companies are entitled to transfer their imported capital in the same foreign currency in which it was imported with both corporate and income tax exemptions and at the exchange rate on the date of transfer.

The New Law envisages that imported equipment, current funds and other economic assets shall be registered by GDPA. Petroleum right holders, upon application to GDPA, may transfer current funds, rights related thereto and other economic assets included in capital holdings, with an exemption from taxes. However, the New Law, like the Repealed Law, states that the amount payable for taxes, levies, duties and State shares cannot be transferred.

Under the New Law, like the Repealed Law, a petroleum right holder may always request transfer by setting off against its capital. After the completion of capital transfer, net assets may be transferred at the end of every three month period in the current year. The transfer declaration shall be submitted for offsetting after the submission of a corporate tax declaration. In addition, a petroleum right holder may keep abroad the amount of foreign exchange generated from exported petroleum. This amount shall be set-off against the imported capital and transfer of net assets exceeding the imported capital.

The principles and procedures regarding the inclusion of a petroleum rights holder's revenues generated from activities other than petroleum activities in its capital, transfer request and the allocation of foreign exchange to be exported within this framework shall be governed by a regulation.

11. Resolution of Disputes and Competent Court

The Minister of Energy and Natural Resources shall ultimately resolve disputes between petroleum right holders. The Minister's decisions including those decisions that are related to research permits, exploration, and operation licenses may be challenged before the Council of State as a court of first instance. Under the Repealed Law, the lawsuit filing period

was stated as 20 days. The New Law does not envisage such a limitation. Therefore, since administrative transactions will be challenged before the Council of State, the lawsuit filing period will be subject to Administrative Procedure Law No. 2577³ and will be 60 days.

12. Sanctions

The New Law envisages certain administrative fines between the range of Turkish Lira 10.000 and 500.000 depending on the nature of a breach. Administrative fines which are imposed by GDPA may be challenged before the administrative courts within 30 days after the notification of the fine.

The New Law further provides administrative precautions. For instance, if and when it is discovered that petroleum activities are being conducted without due exploration or an operation license, GDPA will seize the oil and income generated therefrom.

If license holders fail to act in compliance with the requirements of their petroleum rights, a grace period of 90 days is granted by GDPA to remedy said deficiencies. GDPA will be entitled to grant an additional 60 days following the expiry of the 90 day grace period. Otherwise, the petroleum right of the license holder will be cancelled by GDPA.

In addition to the sanctions set forth above, if license holders endanger either the land owners or other petroleum right holders and fail to compensate the damages, GDPA may either cancel the petroleum right or grant a cure period of 90 days. If a license holder persists on the breach of the legislation, GDPA may either cancel the petroleum right directly or suspend the operations for a period between 90 or 180 days.

If and when a petroleum right holder fails to start operations within one year upon the issuance of the license, or suspends the operations, GDPA will instruct the right holders to restart the operations. Otherwise, the right holder is finally granted a period of 180 days at the expiry of which the license will be cancelled. The research permit, exploration license, and operation license may only be cancelled upon the decision of the Minister of Energy and Natural Resources.

13. Status of Türkiye Petrolleri Anonim Ortaklığı (“TPAO”) and Foreign Companies

The New Law introduces significant changes regarding the status of TPAO and foreign companies. The Repealed Law granted TPAO the right to obtain a permit, an exploration license, and an operation license on behalf of the State. However, the New Law does not provide for such a provision.

The New Law maintains the provision of the Repealed Law regarding the areas where operation rights have expired, which sets forth that an operation right shall be established on said areas on behalf of TPAO instead of being auctioned upon the request of TPAO.

As to the status of foreign state owned companies, the New Law, unlike the Repealed Law, does not include a provision requiring the Council of Ministers’ approval for the issuance of exploration and operation licenses. As per the New Law, equity companies under relevant foreign jurisdictions may be granted a research permit, an exploration license, or an operation license.

In addition, with an amendment made by the New Law to Cabotage Law No. 815⁴, foreign entities holding petroleum rights may perform exploration and production activities within Turkish territorial waters.

The New Law also amends the Natural Gas Market Law No. 4646⁵ and introduces that petroleum right holders (including foreign entities) and their branches in Turkey engaged in natural gas production may be granted a wholesale license for the sale and export of produced natural gas to wholesale companies, exporters, distribution companies or eligible consumers, without storage requirement.

14. Securities over Petroleum Rights

The Repealed Law provided for the exploration and operation licenses, the petroleum rights arising from these, and petroleum rights corresponding to any part of an exploration or operation licenses would be subject to security establishment, sale and similar agreements. The licenses and petroleum rights would be registered with the Petroleum Registry in order to be subject to such agreements. These provisions are also present under the New Law.

15. Current Projects

The New Law sets forth that the rights and requirements under the current exploration and operation licenses will be reserved until their periods have elapsed. However, the rights and requirements under the operation licenses hold by TPAO will be reserved until the end of production period.

³ Published in the Official Gazette No. 17580, dated 20 January, 1982.

⁴ Published in the Official Gazette No. 359, dated 29 April, 1926.

⁵ Published in the Official Gazette No. 24390, dated 2 May, 2001.

Conclusion

As explained in detail above, the New Law makes substantial changes in the current petroleum legislation such as division of the districts, cash money transfer, status of TPAO and foreign state owned companies and incentives. The main purpose of the New Law is the utilization of petroleum sources in an efficient and expeditious manner by promoting the contribution of national and foreign market players. The New Law also aims to liberalize upstream petroleum activities. Accordingly, certain privileges of TPAO as a state owned company are not included in the New Law.

The New Law is expected to positively affect the interest of investors. However, its effects remain to be seen in practice especially upon the issuance of the necessary secondary legislation by MENR, which will provide detailed provisions regarding the implementation of the New Law.