Another step forward at the Turkish electricity market: The new Electricity Market Law

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***Serra Başoğlu Gürkaynak**, head of the energy practice at leading Turkish law firm **Mehmet Gün & Partners** in Istanbul analyses the regulatory framework.*

The electricity market has been one of the most active and attractive markets for investors in the last years in Turkey. With the enactment of the previous Electricity Market Law in 2001 (the Previous EML), private investment became the principle, instead of being an exception in the market. This immediately started to show positive effects in attracting private investment - 10 years ago the private sector represented a mere 38% of the electricity market, which increased to 61% as of 2013. This increase was due to private investors' establishing new power plants and trade facilities and also a series of privatisations made by the State.

Along with the private investment, as the electricity market began to reshape, it became clear that the existing legislation did not address the issues of the market. In order to respond to those needs and problems, the Previous EML was amended several times. Ultimately, the new Electricity Market Law was enacted in March 14 2013 (the New EML) to address the needs of the market. The New EML introduced many amendments, which were welcomed by the private investors. The Energy Market Regulatory Authority (EMRA) then started to issue secondary legislation, which provided more clarity regarding investments in the electricity market.

In this article, we will give a general picture of the Turkish electricity market under the new regulatory framework.

The regulatory body

The regulatory body of the electricity market is EMRA. It is a pseudo-independent regulatory body. It is managed by the Energy Market Regulatory Board which is the representative and decision making body of EMRA.

EMRA is responsible for granting licences to legal entities in relation to the activities to be carried out within the electricity market; observing the performance of the electricity market; issuance, revision, implementation and audit of the regulations relating to performance standards and distribution and client services; determining and auditing the pricing principles and provision of the lawful acts by the market participants.

Licensing

Entry to the energy market is not free nor is it without restrictions. The path to becoming a player in the Turkish energy markets is by means of obtaining licences for each and every specific activity to be carried out.

Only limited liability companies and joint-stock companies established in Turkey can obtain electricity production licences. There are no restrictions on foreign ownership and applicant companies can have 100% foreign capital. The Licence Regulation requires the minimum capital of the applicant company to be equal to 20% of the total estimated investment amount.

The New EML introduced a new licensing system by incorporating a pre-licensing procedure before the actual licensing process. Pre-licensing is the first tier of a two tier licensing system established to facilitate all administrative and bureaucratic requirements. The Previous EML required the issuance of the generation license by the EMRA, before making certain other applications, ultimately delaying the process for generator companies to become operative. The pre-license procedure aims to solve this problem and now when a company applies for a license, it will first be granted a pre-license with a maximum period of 24 months. With this pre-license, the company will have the right to make applications for various administrative permits, licenses and related documents as well as to acquire property rights and usage rights on the land plot where the facility will be built. If the necessary permits cannot be obtained over a period of 24 months, or the obligations specified by the EMRA cannot be fulfilled, the applicant will not be granted an electricity generation license.

Although the 24-month pre-licence period has been criticised by the market for being too short, the law has not been amended to reflect this view. This demonstrates the enthusiasm of the government for new electricity generation projects to be realised as quickly and efficiently as possible. The same enthusiasm must be felt by the administrative bodies who will provide the permits required for the completion of a generation facility in order for the pre-licence holders to obtain all the required permits in the given time.

Another highly debated provision is the prohibition of share transfers from applicant companies during the pre-licence period. Except in cases of succession or bankruptcy, any transaction that would result in a change in the shareholding structure of a pre-licence holder will cause the pre-licence to be nullified. The main purpose of this restriction is to prevent any kind of licence trading which, up until now, has been a serious problem in the development of generation facility projects.

Regulated activities in the electricity market

Production, transmission, distribution, wholesale, retail sale, market operation, import and export are the regulated activities in the electricity market.

Production is the core activity in the market. The installed capacity of electricity is currently around 61,000MW in 2013. An additional capacity of 40,000MW must be installed within 10 years, if the economic targets of the government to make Turkey one of the 10 largest economies in the world, are to be met by 2023. As the State no longer establishes power plants, private investors must establish all this additional capacity, which would be a tough nut to crack. The State plans to privatise its production capacity except for a few large power plants which are considered to have strategic importance and which help to balance the power system if required.

The State succeeded in privatising all of the electricity distribution companies by 2013. Therefore, private investors now handle distribution activities. The same distribution companies also engage in retail sale activities in their respective distribution areas but they are expected to have competitors soon in the retail sales with the licensing of new investors for this activity.

Transmission is the only activity that is not to be delivered to private investment for now. The Turkish Electricity Transmission Company is responsible for the operation of the national grid with wholesale activities conducted by both the State Electricity Trading Company and private investors.

Private investors conduct the import and export of power but this is currently not in the desired level. However, Turkey has entered into the ENTSO-E System and has been making investments to increase its capacity of connection points with its European neighbours.

The Turkish Electricity Transmission Company currently conducts market operations but it will soon be delivered to the Energy Markets Operating Corporation (Epias), once this corporation is established. This new corporation has been introduced by the New EML and is welcomed by the sector and is considered a step forward for the liberalisation of the market. Epias will establish a stock exchange where a reference price may be determined, the generators will be able to forecast prices for a longer term, and electricity will be bought and sold. The market also expects Epias to pave the way for the issuance of derivatives based on the underlying power purchase contracts.

Epias will also manage the wholesale electricity market, which is now the duty of the Turkish Electricity Transmission Joint Stock Company. As a result of this change, the Company will focus its efforts on regulating and developing the country's electricity system and improving interconnection with the transmission structures of neighbouring countries. In contrast, Epias will be in charge of the financial settlement of operations conducted in the markets and will determine the market operating tariffs within the framework of the procedures and principles specified by EMRA.

One of the key questions arising from the introduction of the Epias was whether the energy stock exchange would be an independent institution or a part of the Istanbul Stock Exchange (BIST). According to the new EML, the direct and indirect share capital of public institutions and companies with public capital will not exceed 15% within the Epias, excluding the BIST. However, the Board of Ministers will be entitled to increase such rates to 30%. Some authorities claim that Epias will be independent, with the BIST as a significant shareholder; however Epias is expected to involve public and private companies as shareholders. Although the New EML required Epias to be established until September 30, 2013, it has not been incorporated yet. Therefore, this question will remain unanswered until the establishment of Epias.

Renewable energy

As a country with almost no oil and gas resources, Turkey's focus for local energy generation has shifted to renewables to minimise the negative effects of importing natural gas and oil to produce electricity. The government considers the funds transferred for the import of natural gas and oil as one of the major reasons for increasing the current account deficit, and therefore tries to decrease this import by incentivising the use of renewable energy resources for the production of electricity.

Various legislative efforts have been made to encourage investors to make investments in power plants using renewable energy resources. The most important one of all these efforts has been the Feed in Tariff (FIT) mechanism. The Renewable Energy Law, which was enacted in May 18 2005 (the Renewable Energy Law), introduced the concept of FIT to Turkey. However, it could not attract the required amount of investment as it provided the same price for every type of renewable energy, which was very low to satisfy the installation and operation costs. Taking this problem into consideration, the Renewable Energy Law was amended in 2011 and the FIT prices were increased and different FIT prices were developed for different types of renewable energy resources considering their cost-efficiency balance. A new incentive was also introduced for using local components in the renewable energy power plants, which provides an additional increase in the FIT price if certain components have been produced in Turkey.

The FIT prices are determined as ¢7.3 per kWh for hydroelectric and wind power plants, ¢10.5 per kWh for geothermal power plants and ¢13.3 per kWh for solar power plants. If a renewable energy power plant uses local components listed in the Renewable Energy Law, the feed-in tariff applied to that plant will be increased by an additional ¢0.4/kWh to ¢3.5/kWh based on the local component used in that plant. The range of the prices applied for components differs depending on the type used in the renewable plant. The incentive for using locally produced components may be subject to a dispute within the scope of WTO Agreements, to which Turkey is a party. A similar system adopted by the State of Ontario in Canada was challenged by the EU and Japan before the WTO. Ontario lost the dispute and changed its incentive system to conform with its liabilities under WTO Agreements.

Another important incentive for renewable energy power plants is a discount in the license fee. Renewable energy power plant licensees are required to pay only 10% of the ordinary pre-license and license fees.

An important amendment has been introduced for the application dates for wind and solar power plant licenses by the new License Regulation. Formerly, the application dates were not specifically set out in the legislation - the investors were obliged to wait for EMRA to declare a date when it would collect the license applications for wind and solar power plants. This prevented potential investors from making projections for their future investments. Taking into consideration this problem, the License Regulation set forth a specific provision pre-determining the application dates. According to the License Regulation, vacant capacity for solar and wind energy facilities will be declared by the Turkish Electricity Transmission Company until April 1 each year. Based on those vacant capacity figures, the investors will be able to make pre-license applications for wind power plants within the first five days of October and for solar power plants within the last five days of October every year.

As mentioned above, license application procedures for wind and solar power plants differ from the licensing procedure for other power plants. That is, investors cannot apply for wind or solar licenses at any time they want. They need to wait for the pre-determined application dates to apply for wind or solar licenses. There is a simple reason for this, the transmission system in Turkey needs to have available capacity to connect wind and solar power plants to the national grid. If a number of wind and solar power plants are connected to the transmission system at the same time and without organisation, this may create problems in terms of balancing the system as these types of power plants depend on wind and solar power to produce energy and therefore not continuously generating electricity. The Turkish Electricity Transmission Company examines its grid system annually and allocates available capacity for different connection points to which wind and solar power plants can be connected. As there are not too many available connection points declared each year, it is normal that there is more than one application for the same connection points. In these cases, a contest is opened by the Turkish Electricity Transmission Company to determine the company that will be entitled to be connected to the grid. Under the new Contest Regulation the contesting companies have to make their bids per MWh and not per kWh, which was the case under the former regulation. Finally, the Contest Regulation sets forth that the winner of the contest will make a contribution payment to Turkish Electricity Transmission Company in three installments whereas under the former regulation, the payments were made in 20 years. These amendments, under the new Contest Regulations, have been introduced to determine serious investors and to give them the chance to obtain solar or wind licenses. This is because the energy sector in Turkey has suffered from companies obtaining electricity production licenses for the sole purposes of trading them. The licenses, which are not purchased by real investors, did not turn into actual production, which had a negative impact on the electricity supply figures. The new principles under the Contest Regulations aim to avoid such problems.

One of the most welcome amendments brought about by the New EML relates to unlicensed power generation. Under the Previous EML, power plants using renewable energy resources with a maximum capacity of 500kW could generate electricity without obtaining a license. The maximum limit was constantly criticised for being extremely low. The New EML responded to the feedback from the market and increased the maximum capacity to 1MW. This created a considerable increase of interest in the equipment supply companies, mostly in the solar energy space. The investors also began to use this as an investment model by creating multiple power facilities each with a capacity of 1MW.

Privatisations in the electricity market

Since 2003, the total volume of privatisation projects has amounted to approximately $50 billion, with almost half that total ($20 billion) falling in the energy sector. All state-owned electricity distribution companies were privatised between 2008 and 2013 (with a total privatisation value of $12.7 billion). Although privatisation in the electricity market was the power behind the success of the State in overall privatisations, significant state shareholdings in power plants remain. Recently, Minister of Energy and Natural Resources Taner Yildiz, and Deputy President of the Privatisation Administration Ahmet Aksu, both made public declarations stating that they wished for the effectively state-owned electricity production companies to be privatised in the near future. 2014 is projected to be very active in terms of privatisation, particularly of electricity production companies owned by EUAS (the State-owned electricity production company), the national electricity production company. For instance, the Decision of the Council of Ministers on Implementation, Coordination and Monitoring of the Program for the year 2014 was published on October 25 2013, which foresees continuation of the privatisation of electricity generation plants belonging to EUAS. The Minister of Energy and Natural Resources, Mr Yildiz, expects $13 billion worth of income from the privatisation of these plants. The tender plans amount to a total capacity of 16,700MW. These figures are the indicators that the coming years will be very active in terms of privatisation of power plants.

A final word

Turkey has come a long way in a very short time in terms of liberalising its electricity market. However, there are still important steps to be taken for the State to withdraw itself from the market and at the same time to attract investors to install additional capacity. With the new regulatory framework that has come into force, Turkey has now responded to the principle need to build a truly liberal electricity market and showed that it is determined to respond to the further needs that may arise along the way. If the economic figures remain positive in the coming years, this would mean a constant increase in the demand for electricity and in a liberal market where there is a constant increase in the demand for tradable commodity such as electricity, there should not be too many problems attracting the investors who would create the required supply.

SerraBaşoğluGürkaynak
Partner

About the author

Serra Gurkaynak is a partner and heads the corporate and transactions group at Mehmet Gun & Partners. She focuses on corporate and commercial law and her expertise includes M&A, banking, finance, project finance as well as public and private offerings for major multinational and Turkish companies. She also leads the rapidly growing energy group at the firm and is firmly established as one of the leading energy lawyers in Turkey.

Serra worked for many years in the New York and Istanbul offices of a top tier global law firm, focusing on mergers & acquisitions, project finance, bank finance transactions and capital markets projects.

She later joined Sabanci Holding, one of the biggest conglomerates in Turkey, as the in-house lawyer. She has vast experience in the Middle East and the CIS regions and in her role as the head of legal for Coca-Cola's international operations, she managed the Middle Eastern and CIS operations and investments for the company.

Serra speaks Turkish, English and French.

OzanKaraduman
SeniorAssociate

About the author

Ozan is a senior associate in corporate and commercial department of Mehmet Gun & Partners. His practice focuses on M&A, preparation and negotiation of contracts and he specialises in telecomms and energy projects. He is a graduate of Galatasaray university in Istanbul and speaks English and French.