

## Energy & Natural Resources - Turkey

### Potential challenges to domestic component of renewable energy feed-in tariff

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#### Introduction

In May 2013 the Appellate Body of the World Trade Organisation (WTO) rendered a decision against the Ontario government regarding a prerequisite that renewable energy power plants use a certain percentage of domestic components in order to be eligible for the feed-in tariff (FiT) mechanism. Although this decision is not binding on Turkey, it has important implications, as Turkey also incentivises the use of domestic components in renewable energy power plants.

As a country with an expanding economy and industry that lacks sufficient domestic fossil fuel resources, Turkey has become increasingly dependent on foreign energy resources. This dependence has made the economy vulnerable to continuously fluctuating oil and gas prices and has caused the government to seek alternative domestic solutions to solve the situation.

Renewable energy resources are a good domestic alternative to fossil fuels. In order to increase electricity production by using renewable energy resources, the Renewable Energy Law (5346/2005) was enacted. The cornerstone of the Renewable Energy Law was the FiT mechanism. However, the first version of the FiT mechanism provided the same FiT prices for every type of renewable energy resource. These prices were considered too low for certain investments. Therefore, the initial version of the Renewable Energy Law failed to attract a significant amount of investment. The law was thus amended in 2011 to improve the FiT mechanism. The amendment also included an incentive that increased the FiT prices when certain domestic components were used in a power plant.

Although incentivising the use of domestic components has certain economic advantages, it raises questions in terms of Turkey's compliance with the WTO agreements to which it is party. The WTO Appellate Body's May 2013 decision against a similar practice in Ontario may shed some light on these questions.

This update analyses the domestic component incentive in Turkey and Turkey's compliance with its WTO agreements in light of the WTO Appellate Body's report.

#### Feed-in tariff mechanism and domestic component incentive

Under the FiT mechanism, electricity suppliers must first purchase their electricity from renewable energy power plants that have been accredited in accordance with the Renewable Energy Law and related legislative measures. Unlike the former Renewable Energy Law, the amended law also distinguishes between different types of renewable energy, allowing different prices to be charged for different methods of energy production.

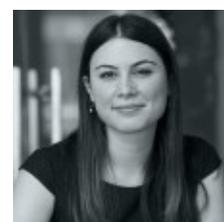
The amended law also introduces an amendment that increases the standard FiT rate where domestic components were used. Currently, the FiT prices vary from \$0.073 per kilowatt (kWh) to \$0.133 per kWh, according to the type of the renewable energy resource. If a renewable energy power plant uses domestic components at the required percentages (as stated in the Renewable Energy Law and the Domestic Component Regulation<sup>(1)</sup>), the FiT rate for that power plant will be increased by an additional \$ 0.004 per kWh to \$0.035 per kWh, based on the type and percentage of domestic components used. This increase will apply only during the first five years of operation for facilities that commence operations before December 23 2020.

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## WTO challenge to Canadian feed-in tariff mechanism

Ontario has a similar FiT mechanism, which includes provisions relating to the use of domestic content. However, the Ontario FiT mechanism specifies the use of domestic content as a mandatory requirement to enter into the FiT mechanism, rather than as grounds for increasing the FiT prices. As per Ontario's previous FiT mechanism, the domestic content requirement was stated as 50% for wind power projects over 10kW and 60% for solar photovoltaic projects. The percentage requirements for domestic content are assessed over the total project cost, and designated activities – from manufacturing components to engaging labour services within Ontario – all count towards satisfying the requirement.

These domestic content requirements, as applied by the Ontario government, were challenged before the WTO by Japan in 2010 and by the European Union in 2011. Both complainants argued that the domestic content requirements were inconsistent with Canada's obligations under the General Agreement on Tariffs and Trade (GATT), the Agreement on Trade-Related Measures and the Agreement on Subsidies and Countervailing Measures. Both complaints focused particularly on inconsistency with Article III (4) of GATT, which provides that products imported from other contracting parties should not receive less favourable treatment than products of national origin. The WTO Appellate Body accepted both complaints and recommended that the Dispute Settlement Body request that the Ontario FiT mechanism be brought into line with Canada's WTO agreement obligations.

Following the rulings, Ontario adhered to the WTO Appellate Body's findings and lowered the domestic content requirement. The new domestic content requirements now range from 19% to 28%, depending on the type of power plant.

### Implications

The essential element of any potential challenge to Turkey's domestic component incentive is whether it can be considered inconsistent with Turkey's obligations under the WTO agreements, particularly the GATT provision that relates to favourable treatment of domestic goods. The main difference between the FiT mechanisms in Canada and Turkey is that the Canadian mechanism had – and still has – a mandatory requirement for local components to enter into the FiT mechanism, while under the current domestic component incentive in Turkey, the use of domestic components only increases the FiT prices. Thus, the Turkish domestic component element is not as restrictive as its Canadian counterpart.

However, regardless of the level of protection afforded to domestic components, it is also evident that an economic advantage to domestic goods is being provided through legislation and regulation. Were any party to determine that the Turkish incentive scheme offers a serious advantage to Turkish goods, and that in practice the incentive scheme leads to frequent preference of Turkish components over foreign components, a complaint could be submitted and the WTO Appellate Body could accept such complaint.

If a complaint against Turkey's incentive scheme were accepted, questions would arise as to how the ruling would affect investors in, or willing to enter into, the FiT mechanism. As the incentive scheme is at a cross-section of administrative and private law – involving both state-supported incentive schemes for a regulated industry and the purchase of electricity by private companies at a predetermined price – the matter is complicated. If such a ruling were rendered against Turkey, Turkey would have to abolish or make amendments to its domestic component incentive. In such a case, investors that were already benefiting from the domestic component incentive should continue to benefit from the incentive until the five-year period elapsed. Any amendments should be applicable only to investors applying for the FiT scheme after the changes in legislation came into force.

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### Endnotes

(1) Published in the *Official Gazette* on June 19 2011.

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