

Turkey: Turkish Natural Gas Market: A Progressing Opportunity

Last Updated: 1 December 2010

Article by Şebnem Işık and Ozan Karaduman

Gun & Partners

Introduction

Natural gas does not have a long history in Turkey. The initial demand for natural gas consumption was miniscule, starting at 0,5 bcm in 1987, and increased dramatically in the following years with a growing share of natural gas use in the production of electricity in Turkey. During the first years of Turkey's acquaintance with natural gas, Petroleum Pipeline Corporation ("BOTAS"), which is a state owned company, conducted all of the activities in this newly established market. After this preliminary phase, natural gas became a considerable source for energy in households, industries and in increasing amounts in the electricity production, creating the emerging need for a liberalized marketplace. Both the need arising from the evolution of the market and the efforts of harmonizing the Turkish legislation with the European Union legislation led to the law-makers enacting the Natural Gas Market Law dated April 18, 2001 and numbered 4646 (the "NGML") The NGML aims to create a market where private entities make investments and take over major portions of the operational activities of BOTAS. In this article, we will give a brief overview of these liberalization efforts and provide practical reflections on the Turkish Natural Gas Market.

Introduction of the Market to Private Investors:

Pursuant to the NGML, private investors can enter into the Turkish Natural Gas Market. In order for an entity to conduct an activity in this market, it has to obtain a license from the Energy Market Regulatory Authority (the "EMRA"). Licenses are granted for a minimum of ten years to a maximum of thirty years. Before granting a license, EMRA always conducts an inspection on the applicant entities as to whether such entities are financially and technically capable of conducting the activity for which they make an application. Under the NGML, the activities to be conducted in the Turkish Natural Gas Market are stated as (i) import, (ii) generation, (iii) transmission, (iv) storage, (v) wholesale, (vi) export, (vii) distribution of natural gas, and (viii) distribution and transmission of compressed natural gas. The NGML aims to create a market where the above stated activities are conducted by private entities in a competitive way. In light of the provisions of the NGML, there is no legal impediment for a private entity to fulfil the necessary requirements and obtain a license to conduct activities in the market. Within the framework described by the NGML, an importer company can import natural gas into Turkey and sell it to a wholesale company which then can sell it to distribution companies. As of October 2008, the EMRA issued a total of 168 licenses, eleven for import, one export, twenty-eight for wholesale, four for storage, one for transmission, fifteen for transmission of liquid natural gas, forty-eight for compressed natural gas and sixty for distribution. As can be seen, one of the prerequisites of a liberal market has been met with the success of NGML acquiring a wide range of investors.

Establishment of a Competitive Market

Although the NGML succeeded in attracting private market entrants, this success alone is not enough to create a liberal market. Competitive relationships must be established among the actors in the market. There are a number of provisions under the NGML serving to create a competitive market. Pursuant to Article 7 of the NGML, except for the production companies in Turkey, no entity can sell natural gas in any year in an amount greater than twenty percent of the national consumption of natural gas as estimated by the EMRA each year. Pursuant to Article 4 of the NGML, distribution companies can hold licenses for only two cities in Turkey unless otherwise agreed by the Energy Market Regulatory Board (the "EMRB"). Pursuant to Article 7, distribution companies cannot purchase more than fifty percent of the natural gas that they will distribute within one year from a single legal entity unless otherwise agreed by the EMRB. Pursuant to Article 11, distribution companies must purchase natural gas only from the most efficient and reliable source. Pursuant to Temporary Article 2, BOTAS must partially and/or completely transfer its "take or pay" natural gas purchase agreements until its aggregate annual amount of import decreases to twenty percent of the annual amount of national natural gas consumption by 2009 at the latest.

The above-stated Articles clearly show the intention of the NGML to establish competition among different actors in the market by prohibiting monopolistic activities among the new entrants. However, the practice dramatically differs from the theoretical framework described by the NGML. The main reason for this is that BOTAS failed to decrease its share in the import arena. It was understood that it would transfer its take or pay contracts to the new players in the market, but only a small portion of the contracts could be transferred by (the end of) 2009. Ninety percent of the import activities are still being conducted by BOTAS as of 2010. Taking into consideration the fact that Turkey's natural gas production covers only an estimated three percent of the natural gas consumption, it can easily be understood that the supply of natural gas in Turkey mostly depends on import activities. As a result, most of the natural gas is still supplied by BOTAS to other players in the market. In such a market where all of the investors depend primarily on the supply of a sole entity, it is hard to talk about competition and impossible to apply the Articles stated in the preceding paragraph. In order to establish a real competitive market, the first step of the supply chain must be diversified which means that the share of import activities of BOTAS must decrease.

Pricing

Pursuant to the NGML, the EMRA is authorized to determine the general principles related to the pricing system. The EMRA issued the Natural Gas Market Tariffs Regulation which was published in the Official Gazette dated September 26, 2002 and numbered 24888 (the "Tariff Regulation"). The Tariff Regulation sets out the major principles regarding the tariffs in the natural gas market. In general, the transmission tariff and the retail sale tariff are determined by the EMRB and the connection, storage and wholesale tariffs are determined by the parties, provided that they comply with the principles determined by the EMRA. Pricing plays an important role in the liberalization of the natural gas market. More importantly, pricing systems

and tariff strategies are vital components in growing regulated markets, like the Turkish natural gas market, since they constitute the key factors that determine the bankability of investments. Therefore, investors tend to enter into and stay in those markets where there are clear and profitable pricing mechanisms and tariff strategies.

One of the issues in the current agenda of the EMRA and in this sector is the pricing methodology to be determined by the EMRA for retail sales. The private distribution companies are expressing the need for a profitable and clear tariff methodology according to which they will determine their investment strategies. Determination of the tariff methodology is also important in the privatization of the distribution companies of Istanbul and Ankara given the fact that it will have a considerable effect on the bids to be submitted in the tenders opened for privatization.

Conclusion

The NGML was enacted under the assumption that the Turkish natural gas market could be liberalized the latest by the end of 2009. It has become evident since the enactment of the NGML in 2001 that this was a very optimistic opinion and efforts made so far to establish a liberal market have yet to be appreciated. On the other hand, in order to complete the liberalization process, the NGML has to be amended or a new law has to be promulgated in light of the experience gained so far. The EMRA has been trying to speed up the process of liberalizing the natural gas market, the main source of which is under the control of neighbouring states, which makes it difficult to accomplish. Moreover, the market is still emerging, therefore it is normal to expect different types of challenges to arise at this stage. However, the determined behaviour of the EMRA to establish a liberal natural gas market and the growing interest from the private sector in this market brings hope that these difficulties will be overcome and liberalization will be realized.