

***THE FOURTH TURKISH ENERGY CONFERENCE
LIBERALISATION – PROSPECTS AND CHALLENGES***

**THE LEGAL FRAMEWORK AND BOTAŞ’S
FUTURE**

The liberalisation in Turkey in oil and gas industry started in the year 1954 when the Petroleum Law is enacted. The Petroleum Law has the importance of being the first law, which provides the opportunity to foreign investors to render public services such as exploration and production, transporting and refining of oil and gas in Turkey under the concept of concession. All licensing issues and regulation of these activities is governed by the agency of the Ministry; that is by the representatives of the State.

The market activities in oil and gas sector until the latest liberalisation and restructuring of the legal frame was limited to the sale of oil products since natural gas importation, transmission, distribution were performed under monopoly of Botas.

The Natural Gas Marketing Law enacted in 2001 and the new bill named as the Petroleum Marketing Law separate the activities and leave the exploration and production of crude oil and natural gas in the scope of the

Petroleum Law and all midstream and downstream activities are handed over to the scope of these laws (or Bills).

The basic difference between the Petroleum Law and these new Marketing Laws (or Bills) is the concept of regulating bodies. The hydrocarbons underground are owned by the state and state grants permission to private companies to perform exploration and production activities so, therefore, governed by the state bodies. The following activities, distribution/transmission, sale are all market activities and governed by an independent regulatory body rather than the state body.

While encouraging the investment and setting the rules and regulations under the concession concept for upstream activities and while encouraging the investments and regulating the market in each law for the midstream and downstream activities, the relationship between the activities of the upstream, midstream and downstream should not be damaged for the benefit of the other and should be kept at a balance. It must be avoided to protect any player of one of the upstream, midstream and downstream activity's which may damage the other player of the other activity. The flow through vertical integration between these activities should not be hampered.

These three laws (Petroleum Law, Gas Marketing Law and Petroleum Marketing Law) interactive each other may create a conflict. Therefore, the legislator should be very careful not to damage the chain of the flow of one barrel of crude oil or one cubic meter of natural gas from the reservoir under the ground until consumed by the end user. These laws or as formulated in any other way should protect the vertical integration of the activities from upstream to downstream. Oil companies have evolved

into energy companies all over the world and have stakes in exploration, production, refining, distribution and power generation.

While the petroleum companies in the world are becoming energy companies by vertical integration, it is not rational and acceptable to prevent the enlargement of petroleum exploration and production companies by imposing restrictions on vertical integration in Turkey. On one hand, the Competition Law prevents monopoly and unfair competition in Turkey but it is not acceptable to try to prevent monopoly and unfair competition by preventing vertical integration with this new legislation. Existing Competition Law is designed to avoid unfair competition and hamper the companies benefiting from dominant position.

Botas (Pipeline transportation Company) is established in 1974. The capital is owned by the State and the Directors of the Board of Directors are appointed in accordance with the provisions of Decree at the power of Law no. 233.

The main activities of Botas can be classified as follows:

Crude oil pipeline transportation is one of the main activity of Botas. In addition to the existing transit crude oil pipeline for Iraqi oil that is currently transported from Kirkuk to Ceyhan Marine Terminal; Botas is building the Turkish section of Baku Tbilisi Ceyhan crude oil pipeline. Botas also operates Batman-Dörtyol, Ceyhan-Kırıkkale and Selmo-Batman Crude oil pipelines in the country.

The other main activity of Botas is in the field of Natural Gas. The Company is the importer of Russian natural gas (from Gasexport, Turusgas and Blue Stream Pipeline Company); Iranian natural gas (from Iranian Natural Gas Company) and will be the importer of Azeri Natural Gas.

Botas is also the importer of LNG and the operator of ReGas facility as well as being the seller of natural gas to Eligible Consumers and municipality owned city distribution companies. Botas' role also included to be the operator of the gas transmission pipelines; and the city distributor for Bursa and Eskisehir through wholly owned newly established legal entities.

When considering the Gas Marketing Law and Petroleum Marketing Law Bill together with the existing Petroleum Law either gas or crude oil exploration and production activities should be governed by the Petroleum Law and crude oil transportation, refining and distribution of petroleum products under the petroleum market Law and natural gas importation, transmission and distribution under the gas market law; will all be considered as market activity.

Only this aspect of the new gas marketing law and possible petroleum market law with significantly change the status of Botas from a state owned petroleum right holder operating pipelines with an additional opportunity to be the only player from importation up to city distribution under a monopoly right; to be one of the other market player in the oil transportation and gas importation; transmission and distribution. Furthermore Botas was obliged to take necessary actions to distribute the

wealth and power in his hand, in other words forced to knock down its own castle.

The outcome of the law will firstly abolish the monopoly. Then Botas will release the importation of natural gas sale and purchase agreements through competitive tenders to new private entrants until its import share falls below 20% by the year 2009 or 2005 as indicated in Petroleum Market Law bill amending the Natural Gas Marketing Law (at least 10% every year); then Botas will transfer Eskisehir and Bursa city distribution activities to Privatisation Board. BOTAS will be restructured as trade, transmission and storage companies after the year 2009. During the release of the import contracts may be left in a position to release its sale contracts in order to fulfil the obligation of import contract releases.

When Botas split into different companies Botas name will be kept by the state owned legal entity performing natural gas Transmission activity. However Botas will keep its activities in crude oil pipe line transportation intact. This is not an easy task for Botas but when this unbundling is realised Botas will be left with an activity which is in line of its experience and competence.

I wanted to take you to the year 2010 and try to explain you the end result. How we will see Botas, and then we will discuss the mile stones the legal and commercial problems between today and then.

At such date (2010) the remaining activities of Botas will be:

1. operating transit or local crude oil pipelines like Iraq Ceyhan Crude Oil Pipe Line; Baku Ceyhan Crude Oil Pipe Line; Ceyhan Kırıkkale Crude Oil Pipe Line; Batman Dortyol Crude Oil Pipe Line;
2. importing natural gas (pipe or LNG) from wherever which is not exceeding 20% of the total consumption;
3. operating the ReGas facility;
4. acting as a Wholeseller and selling natural gas to Free customers and to city distribution companies;
5. operating the gas transmission pipelines; and
6. operating underground storage facilities (North Marmara).

However all these activities cannot be performed under one company. Therefore In the year 2010 one company for Crude Oil pipe line transportation; another company as the operator of LNG Facility and underground storage facility; third company as the importer of natural gas (which could use BOTAS name) and lastly natural gas transmission company should be established. Thereafter except the transmission company, all other companies will be privatized.

Let us discuss the things to be happening between today and 2010 :

We have to firstly know the objective of the Law and find the answers to the questions like: why the monopoly should be abolished? why Gas Release Program should be implemented? why Botas will be unbundled? what is the benefit from all those ?

The Natural Gas Marketing Law Law concerns with liberalisation of the natural gas market and thus formation of a financially sound, stable and transparent markets along with institution of an independent supervision

and control mechanism over the same, so as to ensure supply of good-quality natural gas at competitive prices to consumers in a regular and environmentally sound manner under competitive conditions.

Furthermore; Turkey is prepared to be a member of the European Union. The EU Directives dated June 22, 1998 targeting the settlement of Natural Gas Market within the European Community aims to form a natural gas market within the Community and liberalisation of the natural gas market of the member countries in 20 years up to a certain percentage. These directives take the sale/purchase contracts of the member countries into consideration. The descriptions in the content of the directives are compatible with the Natural Gas Market Law and therefore, this situation, will allow Turkey to adopt to European market in case the status of full membership is approved.

Therefore, it is obvious that monopoly will be abolished to open the Turkish gas market to new entrants and to create basis for a competitive market. The end users will be benefiting in the form of competitive and reliable gas supply with the enhanced foreign and/or local investment and technology. The limitations in the law like 20% of the total consumption will also aimed to hamper the abuse of the dominant position in the market.

According to the Natural Gas Marketing Law the new companies wholly owned by Botas for Bursa and Eskisehir city distribution will be transferred to Privitisation Organisation to be privatized in the Model to be selected.

To enable clarity, I will use the word “import contracts” for the sale and purchase agreements signed by Botas and the suppliers outside of Turkey and “sales contracts” for the sale and purchase agreements signed by Botas as the supplier to eligible consumers.

If the objectives are so clearly defined, the release of import contracts should be based on the following criteria taking into consideration the existing price differences, different take or pay applications, different seasonal fluctuations; different delivery points, different quality of gas and different contractual obligations in different import contracts:

- There should be no discrimination. All of the new players should be applied equal conditions.
- Legal possibility of the assignment of Sales Contracts simultaneous to release of Import Contract, in order to give the opportunity to find market share for the new entrants.
- Avoid incompetent entrants by prequalifying them.

For the release of Import Contracts in order to reach a “win-win” situation all involved parties should be satisfied.

1. Suppliers: There are two type of Suppliers. One group of Suppliers is protected by the bilateral treaties between the Supplier’s country and Turkey. These types of Suppliers will request the continuation of the rights not only under the bilateral treaties but also under the Import Contracts. The second group of Suppliers based on contractual relationship. For such Suppliers the rights arising from the import contracts should not be damaged. To make the Suppliers accept the release of the Import Contracts firstly they should be

protected in their existing rights whether arising from treaties and contracts or only contracts.

2. Botas: Firstly there should be an advantage for Botas on the pricing. At least it should be the same price. Botas's further liability in case volume releases should be protected through contractual relationship. We want to remain here that at the year 2010 after unbundling today's Botas will only be an importer for a 20% of the total national consumption – possibly privatised. In case of a partial volume sale to more than one new entrant, the assignment of Botas's liabilities to new entrants may create legal problems.
3. Eligible Consumers: Although the existing Eligible Consumers will have an opportunity for a cheaper supply however in such case this reduction should be reflected to the sale price of the electricity produced. Furthermore the Eligible Consumers will lose their Treasury Guarantee. Therefore, there would be no big advantage for the existing Eligible Consumers. Other newly formed eligible consumers will enjoy the compatible pricing from new entrants.
4. Entrants: Requires sufficient customers. Transportation and storage costs may be a big burden. The difference between the purchase price and sales price depends on the factors like; the price of other new entrants, and/or the price of other alternative fuels (especially due to taxes) which are outside of control of the Entrants.

When looking to the possibility of reaching a win-win position from all sides involved and evaluating the risk under different models including but not

limited the Contract Release, or Partial Contract Release or Volume Release – which additional models can be created – it seems that Botas will not easily be releasing their import contracts. Turkey will be the only country all around the world that is trying to enter into a so large release program.

The other important issue is the determination of the tendering body for gas release. Although Botas is defined as the body in the law, it should be an independent authority like EMRA.

Although the objective of the law and the future of Botas in the year 2010 is clearly defined the methodology to reach to the objective of the Law and the unbundling of Botas will not be so easy.

Thank you for your patience.

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