

This article was prepared to presented at the Turkey Oil and Gas Summit that took place in Istanbul on 18-19 February 2014 and also at the 13. Turkey International Oil and Gas (TUROGE) Conference that took place in Ankara on 09-10 April 2014

TURKEY'S NEW PETROLEUM LAW: GENERAL FRAMEWORK AND INCENTIVES

I. INTRODUCTION

Historically, the right to explore and produce petroleum has either been exclusively owned or managed by the Turkish State. However, in recent years the strict governmental regime started to loosen up with a view to establish a competitive market where the State is now playing more of a regulatory role rather than acting as the main player.

This presentation provides a brief account of the current legal framework concerning petroleum and the incentives that have been introduced in order to attract more foreign investment to engage in petroleum activities in Turkey.

II. HISTORICAL BACKGROUND OF THE TURKISH PETROLEUM LEGISLATION

It is helpful first to look at the previous Turkish petroleum legislation in order to better understand the new Turkish Petroleum Law No. 6491 that was adopted in June 2013.

1. Petroleum Law No. 792 (1926)

The first Turkish legal regulation concerning petroleum is the Petroleum Law No. 792 that was adopted in 1926.

According to the Law No. 792 the Turkish State retained exclusive authority to conduct petroleum exploration and production activities. As such the Law did not include any incentives for foreign investment.

On 14 February 1941 Petroleum Office was established as a public corporate body under the Ministry of Trade to undertake petroleum-related activities.

2. Petroleum Law No. 6326 (1954)

Petroleum Law No. 792 was replaced with Petroleum Law No. 6326 which came into force on 16 March 1954.

The same year the Turkish Petroleum Corporation("TPAO") was established. The activities of the TPAO was the purchase, sale and distribution of petroleum and petroleum products as well as exploration, drilling, production, refining and transportation of petroleum.

An important aspect of the new Law was that it enabled domestic and foreign companies to engage in petroleum acts in Turkey.

However, Petroleum Law No. 6326, as progressive as it was for its time, still did not prove to be enough of an incentive for attracting the desired levels of investment into the petroleum exploration and production activities in Turkey.

This was largely due to the fact that legal restrictions and bureaucratic obstacles still persisted. Therefore the Turkish legislative sought to replace the Law with a new one that could respond to and also provide incentives for the investors.

3. Turkish Petroleum Law No. 5574 (2007)

On 17.01.2007 the Turkish Parliament adopted the Turkish Petroleum Law No. 5574 in order to provide a more accessible and competition-friendly legal and regulatory framework.

However, the Turkish President vetoed the Law on the grounds that it did not sufficiently protect the national interests of Turkey. The reasons for the veto were as follows and it can be easily noted that much of the concern was with regards to the “national interests” of the country:

- i. The text of the Law did not contain a reference to the national interests of Turkey as opposed to Law No. 6326.
- ii. Similarly, the Law did not provide that the review of an application for a petroleum right should be in line with the national interests of Turkey as opposed to Law No. 6326.
- iii. Thirdly, the Law did not provide any measures regarding the protection of national interests as opposed to Law No. 6326.

Finally, the fact that the new Law did not contain an obligation for the retaining of a certain amount of the petroleum that is produced in Turkey for the need of the country as per national security and national interest was also one of the reasons for the President’s veto. The previous Law No. 6326 had provided for this obligation.

III. THE NEW TURKISH PETROLEUM LAW NO. 6491

The new Turkish Petroleum Law No. 6491 officially passed into law on 11 June 2013 and replaced the previous Petroleum Law No. 6326 that was adopted in 1954.

The aim of the new Petroleum Law is to ensure that “the petroleum resources of the Turkish Republic are explored, developed and produced in a swift, consistent and efficient manner in accordance with the national interests.”

The main objective of the new Petroleum Law is to remove the hurdles to attracting foreign investment. As such the Law aims to minimise bureaucracy; simplify application procedures; produce incentives for exploration and production operations; reduce the costs of such operation; and to create a more competitive environment.

The major changes included in the new Law that concern foreign investors can be summarised as follows:

- i. Firstly, the new Law removed the restriction existing under the previous Law, which limited the person(s) acting for and on behalf of a foreign state from engaging in petroleum activities in Turkey;
- ii. Secondly, it provides incentives for foreign investors;
- iii. Thirdly, whereas the regime under the previous Law separated the country into 18 different geographical regions this is now replaced by a much simpler onshore and offshore regime. Under the new system the latter is sub-divided into territorial and non-territorial waters.

IV. LEGAL STATUS

According to the Law, the petroleum resources within Turkey are **under the sovereignty and disposal of the Turkish State**. Although it is not defined within the Law, the expression of “being under the sovereignty and disposal of the State” is generally accepted to mean that it does not allow for the

establishment of private property. It is an expression that is often used in Turkish public law. Therefore, the petroleum resources within Turkey cannot be subject to **private property**.

As such it is not possible to engage in any petroleum activities without first obtaining relevant permits and licenses.

The authority of the State includes **the territory** and **the territorial waters** of the country and **the seas beyond the territorial waters**.

V. LICENSING

According to the new Petroleum Law all permits and licenses for search, exploration and operation activities under the new Petroleum Law are granted by the General Directorate of Petroleum Affairs.

Such permits and licenses are described as 'petroleum right' under the Law. Those who are eligible to apply for a petroleum right are described by the Law as follows:

“Search permits, exploration licenses and operation licenses may be granted to capital companies or private law legal entities established as capital companies in accordance with a foreign state’s legislation provided that they are in compliance with the principles of this Law.”
(Article 22/5)

The latter company is a foreign stock company that is established outside Turkey. However, these companies are deemed to be located in Turkey for their activities in Turkey as per the regulations concerning the protection of Turkish Lira. This means that whether a foreign legal entity is eligible to qualify as a capital company will be determined in accordance with the Turkish Commercial Code.

It can also be noted here that the Law does not require the companies to have been incorporated exclusively for the undertaking of petroleum activities.

Permits and licenses under the new Turkish Petroleum Law are as follows:

1) Search permit grants the right to analyse the land by gathering data from the ground or air through topographic, geological, geophysical, geochemical and similar methods for petroleum exploration purposes and also to perform drilling works, except for exploration drillings, in order to gather geological information.

2) Exploration License includes the exploratory drilling and appraisal drilling activities. The license grants its holder the right to carry out search and exploration activities within a given area, to produce petroleum from the said area and to submit an application for discovery.

It is also possible that exploration for certain areas, which are determined at the discretion of the General Directorate, is granted through auctioning rather than licensing.

Under the new Turkish Petroleum Law on shore licenses are now granted for five years (rather than four under the previous Law) and eight years (rather than six under the previous Law) for territorial waters. They can be extended by two and three years respectively.

However, the duration of onshore licenses (including extension) cannot exceed nine years and the duration of licenses for territorial waters (including extension) cannot exceed fourteen years.

3) Operation license can be granted if petroleum is discovered during the exploration phase and it is a type of permission that is valid for the duration of the license. Therefore the operation license includes the conditions that are valid at the time of the granting of the exploration license.

Operation license is granted for the exploration and production of petroleum and the sale of the produced petroleum. Thus it covers the activities of production drilling and development, extraction of petroleum, pre-processing of petroleum, storage of petroleum in the field or in the vicinity of a field, transportation of petroleum to the storage facilities, a transmission line or to a refinery through pipeline or other means.

Operation licenses can be granted for up to twenty years and it is possible to renew them twice provided that the production plan that is attached to the request for extension has been approved.

VI. RIGHTS and INCENTIVES

Below is a summary of the incentives introduced by the new Turkish Petroleum Law. They are quite wide-ranging, varying from fiscal incentives to those concerning employment.

- a) **Income Tax:** The sum of the income tax deductions that the petroleum right holder is liable for on its net income and the income tax it is required to withhold on behalf of its shareholders will not exceed 55 per cent.
- b) **Tax Exemption:** Companies are exempt from customs duty, levies and stamp tax for oil and gas field equipment imported and supplied locally. In the event that the materials that are subject to exemption are transferred upon the approval of the General Directorate from a petroleum right holder to another petroleum holder the exemption may still continue.
- c) **Exemption from Certification of Compliance for Imported Goods:** A conformity assessment of Turkish Standards Institute marking shall not be sought for materials that a petroleum right holder has imported to use in petroleum operations that have approved by the General Directorate.
- d) **Foreign Employees:** They are now exempt from the standard work regulations for a period of six months and they can work in Turkey by obtaining a residence permit.
- e) **Permission to Build a Pipeline:** Upon request an operation license holder may be granted a permission to build a pipeline for the purpose of transferring the petroleum that it produces.
- f) **Merger:** The operators whose production fields are partially or wholly located within the same petroleum containing land can combine their petroleum procedures.
- g) **Request for Expropriation, Right to Lease and Use:** The petroleum right holder shall be able to obtain the utilisation right in respect of the field required for petroleum transaction in or in the vicinity of its exploration and operation license by agreement if the land is privately owned or by expropriation if there is a dispute, or by leasing it from the Ministry of Finance in consideration for the relevant sum, establishing easement right or by obtaining utilisation right and having the same registered in its license if the land is owned by the Treasury or under the rule and disposition of the State. The ownership right of the expropriated land shall belong to the Treasury and the utilisation right shall belong to the petroleum right holder who paid the expropriation fee. In this case, the Ministry of Finance shall grant easement right to the petroleum right holder free of charge for the duration of the license period.
- h) **Water Rights:** The explorer and operator shall have the right to search for water through several methods including drilling and to use the water found and to use such amount of the existing water that is necessary for its own operations, without violating the rights of others who may have rights on such water.

- i) **Right to Repatriation of Registered Capital:** Barriers on repatriation of capital have also been removed by the new Law. The petroleum right holder may, by filing an application with the General Directorate, transfer abroad, tax free, either in cash or in kind, and after having put aside the sum required for the payment of any taxes, duties, charges, and royalties owed to the State; their cash funds and rights thereto, and other economic assets included in capital assets.
- j) **Right to Keep the Income in Return for Exportation of Petroleum Outside Turkey:** A petroleum right holder can keep abroad the foreign currency generated from the export of the petroleum. This amount shall be offset against the remittance of the capital imported to Turkey and the transfer of net values exceeding it.
- k) **Right to Export Petroleum Products:** Petroleum right holders are entitled to export a certain amount of the petroleum and natural gas (35% for onshore and 45% for offshore) that they produce in fields discovered after 1 January 1980. The remaining part and the whole petroleum and natural gas produced in the fields discovered before 1 January 1980 shall be reserved for domestic use. The Council of Ministers has the authority to regulate the procedures and principles on the redetermination and implementation of these ratios.

VII. OBLIGATIONS

The obligations regime introduced by the new Turkish Petroleum Law are quite straightforward and easy to navigate. They can be summarised as follows:

- a) **Financial Obligations:** There are two main financial obligations under the new Law. These are:
 - i. Search permit holders are obligated to pay a fee in the amount of fifty Kurus per hectare of the search area. This fee is payable once. According to the Law the fee will be adjusted annually in accordance with revaluation rates. For 2014, it will increase by 3,93%.
 - ii. State royalty: The State share in oil and gas, payable as a royalty (in cash or in kind) remains unchanged at one-eighth of the petroleum extracted in any given field (about 12.5 per cent). However, the calculation of the royalty has changed. It will now be calculated based on the market prices for crude petroleum and the wholesale prices for natural gas, which differs from the previous regime that used pit top prices.
It can also be noted that the new Law abolished the payment of the State right which was taken as an annual fixed fee over the exploration and production activities conducted on a particular field.
- b) **Commencement of Operations:** Upon a discovery made within the exploration license the license holder is obliged to commence the development of the site and also production without any delays. The rule is to start production and operations as soon as possible in accordance the program. That is of course if there are no force majeure conditions that might cause a delay.
- c) **Collateral:** There are two types of collaterals that are required under the new Law.
 - i. Collateral for Investment: The Law requires an applicant for an Exploration license to provide a bond equal to 2 per cent of the financial commitment in the work plan as submitted in the License application. For offshore exploration where the financial investment would be higher the rate is 1 per cent of the financial commitment.
 - ii. Collateral for Loss and Damages: The payment of an additional collateral before obtaining a petroleum right in order to cover any potential loss and damages that may occur during the petroleum activities is compulsory. The rate for search permits is 0,0005% of the search charge; 0,0001% of the exploration license charge for the exploration licenses; and 0,005% of the operation license charge for the operation licenses.

- d) **Approval for Change in Capital:** All kinds of share transfer transactions that would cause a change in the control of the company, which is a petroleum right holder, are subject to the prior approval of the Ministry of Energy and Natural Resources.
- e) **Obligation to Act With Caution:** Petroleum right holders are obliged to refrain from acts that may cause a damage to the people living nearby, environment, nature, the quantity and quality of the underground, shore or sea waters, and other petroleum right holders, or put them in danger. As such they are also required take the necessary measures.
- f) **Obligation to Keep Records and Provide All Information to Relevant Public Authorities:** Petroleum right holders are obliged to keep records, accounts, information, documents related to the petroleum operations as stipulated by the law and submit them to the General Directorate of Petroleum Affairs.
- g) **Obligation to Inform the General Directorate:** Petroleum right holders are responsible to inform the General Directorate of Petroleum Affairs of any petroleum findings or discovery.
- h) **Obligation to Assist with Inspections:** Petroleum right holders are obliged to cooperate with the Ministry or those appointed by the Ministry who may initiate an inspection of their operations.
- i) **Obligation to Compensate Land Owners:** Petroleum right holders are liable to compensate all damages (including damages to the land and facilities on the land) incurred by land owners which shall include loss of product or the operational profits that the land owner has been deprived of.

VIII. PUBLIC AUTHORITIES GOVERNING THE PETROLEUM MARKET

There are four main public authorities in relation to petroleum activities in Turkey that concern the petroleum activities. These are:

- 1- **The Council of Ministers:** The role of the Council of Ministers is to decide on the incentives that are to be applied to the investments of petroleum rights holders and to issue permits and licenses for non-territorial waters.
- 2- **The Ministry of Energy and Natural Resources:** The role of the Ministry is to regulate; to decide on the cancellation of permits and licenses; to decide on auctions, expropriation, and settlement of disputes between petroleum rights holders and applicants; and to approve the change of control of any petroleum right holder.
- 3- **General Directorate of Petroleum Affairs:** The role of the Directorate is to issue permits and licenses; to review and to supervise; and to implement penalties, including administrative fines and take necessary measures.
- 4- **Competition Authority:** This institution has the authority to review all acts, agreements, mergers and acquisitions that may distort competition in all markets of goods and services, and to implement sanctions.
- 5- **Energy Market Regulatory Authority:** This institution has the authority to issue licenses for the sale and distribution of petroleum and petroleum products; to regulate, to conduct audits and supervisions and to implement penalties, including administrative fines and take necessary measures.

