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Spotlight on the new power regulatory landscape

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Since the adoption of the new Power Market Law No. 6446 in March, investors have been anxiously waiting for the new Power Market License Regulation. The licensing process almost came to a halt in the interim period. The new Power Market License Regulation has finally been published in the Official Gazette on 2 November, and in this bulletin we touch upon the main provisions in the new regulation.
The regulation covers the licensing, rights and obligations of power generation, transmission, distribution, market operator and supplier companies.

The pre-licensing and licensing of power generation projects

The licensing of power generation companies will be a multi-stage process from now on. Investors first have to apply for and receive a pre-license for each facility and fulfill some obligations in the pre-license period. Only then can they apply for a generation license.

Pre-license applications: In order to apply for a pre-license, the project company should, among other things, 1) provide a bank guarantee letter (or a number of letters from different banks to meet the requirement) at a per-MW amount to be determined by the Energy Market Regulatory Authority (EMRA), according to the fuel type and installed capacity of the project, not to exceed 5% of the expected investment amount, 2) amend its Articles of Association to increase minimum capital to 5% of the forecast investment amount (1% for nuclear power plants), 3) acquire the utilization rights of any natural resources such as water, domestic coal and geothermal sources from the relevant authorities, 4) provide the proof of land ownership for the wind and solar facilities, unless otherwise is the case with regard to the land utilization 5) provide the results of the required technical surveys in the case of wind and solar power applications, 6) provide the site license from the Turkish Atomic Energy Agency in the case of nuclear power applications, and 7) pay the pre-license fee, which will be 10% of the full amount for the applications for the renewable projects and for those to run on indigenous resources. The latter basically referring to the indigenous coal resources is one of the examples where it is already favoured over the gas-fired projects.

For any given year, wind and solar power pre-license applications will be accepted on the first and last five working days of October respectively. The Turkish Power Transmission Company (TEIAS) will announce the five- and ten-year interconnection capacities allocated for solar and wind power plants with regard to connection points and / or on regional basis every year by April 1.

These applications are required to include wind and radiation measures of at least one year which will have been recorded over the previous three years.

If there are other applications for the same piece of land, some projects are prioritized over others in the following order: 1) Land allocated to a nuclear power plant according to international agreements, 2) Underground gas storage, 3) Power plants except gas-fired power plants, 4) Oil refinery, 5) Gas-fired power plant, 6) Petroleum storage. The gas-fired plants being left to the end of the queue once again underlines the shifting policy focus away from this technology to the other segments of the thermal technologies. Whether this would add to the asset value of the existing gas-fired fleet does not seem so straightforward, given the dire spark spreads posted this year so far.

After a pre-license application is accepted for evaluation, it is forwarded to the network operator TEIAS and/or relevant distribution company for a connection opinion. Solar and wind power pre-license applications also need to receive a positive technical evaluation opinion from the Renewable Energy General Administration under the Ministry of Energy and Natural Resources. In the case there are several wind or solar power pre-license applications for the same connection capacity and/or piece of land, TEIAS shall organize tenders to determine which power plant will be granted a pre-license.

The generation license applications, which were not approved by the time the Power Market Law went into effect on 30.03.2013, will be evaluated as pre-license applications.

The pre-license application process takes at least fifteen weeks; wind and solar power pre-license applications will take longer due to the additional technical review requirement and the tender processes for the same connection points and locations.

Pre-license period: The pre-license is granted for at most 24 months and cannot be extended except in the case of force majeure situations.

Once a project company is granted a pre-license, it has to meet several obligations before it can apply for a license. The company should, among other things, 1) obtain access to the land, where the power plant will be located, by acquiring ownership or utilization rights of the land in question, 2) receive the Environmental Impact Assessment from the Ministry of the Environment and Urbanisation, if necessary, 3) receive the various zoning, construction and technical approvals required to start construction, 4) sign the final resource utilization rights agreements with the relevant authorities in the case of coal, hydropower and geothermal applications, 5) make the application to TEIAS or distribution companies to sign the system connection and utilization agreements.

Any changes to the ownership structure of the pre-licensed project company are not permitted during the pre-license period except for inheritance or bankruptcy reasons, lest the pre-license be cancelled. This provision does not apply to the transfers of publicly-listed or foreign-owned shares of the project company.

Project companies, which were licensed by the time the law went into effect, will receive a six-month extension to their pre-construction period. During this time they are obliged to meet their pre-license period obligations.

License applications: In order to apply for a generation license, the pre-licensed generation company should, among other things, 1) provide documentation that all the requirements of the pre-license period have been met, 2) provide a new bank guarantee letter at a value determined by the EMRA less the value of the pre-license bank guarantee letter and not exceeding 10% of expected investment amount, 3) amend its Articles of Association to increase minimum capital to 20% of the forecast investment amount (5% for nuclear power plants), 4) prepare a project schedule outlining the steps until the installation of the power plant is complete. 5) pay the license fee, which will be 10% of the full amount for the applications for the renewable projects and for those to run on indigenous resources. These technologies are also exempt of the annual license fee over the first 8 years of operation, again at the expense of the gas-fired projects.

Holders of the autoproducer license will be granted a generation license under the new regulation.

One point to further elaborate here is the minimum capital requirement of 20% of the forecast capex. This can be taken as a positive step in terms of capital discipline and also a measure to assess the seriousness of the project developer, although it will inevitably increase the pressure on the medium and small size players. Survival of the richest would be the immediate market reaction, which would be coupled with garage sale of non-core assets to raise capital for the more strategic projects.

Please note that the renewal of the licenses of the privatised assets is also subject to the same conditions above.

The rights and obligations of power distribution companies

As you might remember, regional distribution companies legally unbundled their distribution and retail sales functions as of 01 January 2013 andthe new retail sales companies received retail sales licenses from the EMRA.

As per the new law and the license regulation, the distribution company is responsible for operating the distribution system on an impartial basis, making the necessary maintenance and expansion investments, maintain and read the meters of the system users in its area, prepare demand projections and investment plans, and the lighting of public spaces.

Distribution companies are also obliged to establish Automatic Meter Reading Systems to help with demand projections and the loss/theft problem, but the deployment of these systems has been slow due to high investment costs. Distribution companies themselves set the consumption limit for consumers, which will be included in the system, subject to approval from the EMRA. Limits of different distribution companies range from 10 000 kWh/year to 800 000 kWh/year.

The rights and obligations of power suppliers

Upon the effective date of the regulation, holders of the power wholesale and power retail sale licenses will be awarded the power supplier license. Power suppliers will be able to sell power to eligible consumers without any regional limitations, trade power or power capacity with other license holders, participate in the organized wholesale power markets and import/export electricity with the approval of the EMRA.

Despite this terminological merger, a new differentiation emerges between the 'incumbent supplier' and the 'ordinary suppliers'.

The **incumbent supplier** is the legally unbundled retail arm of the distribution companies which are obliged:

- to supply the non-eligible customers in the respective distribution region at the regulated retail tariff to be determined by EMRA. The eligible consumer limit for 2013 has been determined as 5000 kWh/year.
- to act as the supplier of last resort to the eligible customers in the same region, who have not switched their suppliers. The tariff is determined by EMRA.

In addition to these *regional responsibilities,* the incumbents will be able to trade output and capacity with the other suppliers, operate in the organized markets and sell to the eligible customers out of their own regions and to export / import.

The rest of the players are **ordinary suppliers**, who can trade output and capacity with the other suppliers, operate in the organized markets and sell to the eligible customers without any regional limitation and without being subject to any tariff regulation.

As the non-eligible customers have no choice but to buy from the regional incumbents at the moment, no question arises regarding the price competition in this segment. However, given the (vague) target of 2016 for all the customers to become eligible and due to the very critical requirement of long-term planning in this business, questions arise regarding how the *regulated* incumbent supplier will resist the invaders from outside.

One striking clause about the incumbents is regarding the very soul of retail: brand name. As the bread and butter to this business segment, the brand name is quite crucial in creating the recognition and trust among the customers who, for years, have been buying their electricity from one single supplier: the state. However, this new regulation requires the incumbents to avoid using brand names and logos which would give the impression that they are 'the continuation' of the unbundled distribution company. Among all other things contradicting the basic rules of retailing, this is clearly ripping an economic entity off the right to use its own brand name (i.e asset) for one of its own businesses.

It is also important to point out that companies applying for a supplier license need to amend their Articles of Association and increase their minimum capital to TL 2 million. The latter would become a competition issue, as there is no such capital increase requirement for the existing suppliers.

Another question mark would be raised with regard to the differentiation between the incumbent and *ordinary* suppliers, in that the capital requirement of the former will be determined by EMRA. As this amount is yet to be disclosed, it is hard to make any comment that this would end in a disadvantage for those who will spare TL 2 million right at the beginning. However, given the scope of the incumbents as the supplier of last resort, a smaller amount should be expected. But then, as they will probably not solely act as supplier of last resort, a competition question should already be brewing.

Last but not the least, the unbundled incumbent supplier has to procure some of its power from the state-owned TETAŞ, although the Power Market Law does not specify how much. The price for power purchases from TETAŞ depends on whom power will be sold to. If the sales company will sell this power to end-users at a regulated tariff (such as the retail tariff or the last resort supply tariffs), it shall also procure power from TETAŞ at a regulated wholesale tariff. This wholesale tariff will be determined by the EMRA. The price for the remaining power purchases can be set freely between TETAŞ and the sales company. As currently, unbundled incumbents make around 80% of their power purchases from TETAŞ, this clause would appear redundant, however it is quote critical when it comes to the high expectations / concerns about the expiration of the long-term power purchase agreements between the state suppliers and the privatised distribution companies.

The rights and obligations of power market operators

The new regulatory framework has introduced a new license for power market operators. Accordingly, a new Energy Markets Operation Company (EPİAŞ) will be established to operate the day-ahead and intraday markets. The operation of the balancing power market and the ancillary services market will remain with the current system operator TEİAŞ. EPİAŞ will be responsible for the financial settlement in the markets operated by EPİAŞ and TEİAŞ. Standardized power purchase contracts and derivatives contracts based on power and/or power generation capacity will be traded in markets on the Istanbul Stock Exchange (Borsa İstanbul A.Ş.). The law also allows EPİAŞ to engage in market activities other than those specified above, including emissions trading. Draft amendments to the Natural Gas Market Law No. 4646 authorise EPİAŞ to also operate a natural gas spot market.

TEİAŞ, Borsa İstanbul, private energy and finance companies and foreign exchanges such as NASDAQ are expected to be the first shareholders of EPİAŞ. Petroleum Pipeline Co (BOTAŞ) is also likely to take a shareholding in the company when a natural gas spot market is established.

According to the Power Market Law, the Energy Market Regulatory Authority (EMRA) was required to publish a regulation to lay out the working principles of EPİAŞ within six months of the effective date of the law, i.e. by 30 September 2013. This regulation has not been published yet. Once this regulation is published, EPİAŞ will be established and it will have, along with TEİAŞ, three months to apply for a market operator license. The law requires EPİAŞ to receive a market operation license and start operation within six months of its establishment.