

Petroleum Affairs in Turkey

Located at the crossroads of Europe, Russia, the Caspian Region and the Middle East, Turkey is an energy corridor linking the supplier countries to principal consumer markets and thus stands as a key player in ensuring energy security through diversification of resources and routes.

Pursuant to Turkish law, both exploration and exploitation of petroleum (*i.e.* upstream activities) are governed by (i) the Petroleum Law No. 6326 of 1954 (*Petrol Kanunu*) (**the Law**), which opened the Turkish petroleum market to domestic and foreign oil companies, and (ii) the Petroleum Regulation (*Petrol Tuzugu*).

➤ **Scope and Purpose of the Law**

The purpose of the Law is to ensure expedient, continuous and effective exploration, development and appraisal of the petroleum resources of Turkey in accordance with the principle of national interest (*milli menfaatler*). According to such principle, TPAO (*Turkiye Petrolleri Anonim Ortakligi*), the national petroleum company of Turkey, enjoys certain privileges compared to other companies active in the Turkish petroleum industry.

Under the Law, the definition of “petroleum” includes: (i) hydrocarbons, in liquid or gaseous form, produced or producible from earth; (ii) asphalt and other solid hydrocarbons suitable for production with or dissolved in liquid petroleum or gas; and (iii) hydrocarbon products derived from the substances referred to under (i) and (ii). Accordingly, exploration and exploitation of both natural gas and crude oil are carried out subject to the Law.

“Petroleum right” is defined as any right that a permit¹ (*musaade*), exploration license (*arama ruhsati*), exploitation license (*isletme ruhsati*) or certificate² (*belge*) grants. The General Directorate of Petroleum Affairs (**GDPA**) and the Ministry of Energy and Natural Resources are the regulatory authorities with respect to petroleum rights.

It should be kept in mind that downstream petroleum activities (*e.g.* distribution, transmission, transportation, storage) are not within the scope of the Law and are regulated by the Petroleum Market Law No. 5015 of 2003. The regulatory body for downstream petroleum activities is the Energy Market Regulatory Authority. The same is true for natural gas except that downstream natural gas activities are carried out subject to the Natural Gas Market Law No. 4646 of 2001.

➤ **Petroleum Exploration Activities**

Under the Law, petroleum exploration activities cover both “geological investigation” (*jeolojik istiksaf*) (also doable with a permit only) and “exploratory drilling” (*arama sondaji*). In order to engage in exploration activities, an exploration license must be obtained from the GDPA. The term of the exploration license is four years for on-shore exploration areas and may be extended for an additional two-year period. Upon the extension period's expiry, the exploration license holder may request a second extension up to two years provided that a security is submitted to the GDPA together with a drilling schedule for further works. The total term of an exploration license cannot exceed eight years for on-shore exploration areas. The aforementioned license terms and extension periods are subject to a 50% increase for off-shore exploration areas³ (*deniz aramaları*).

As a general rule, an exploration license holder is obliged to commence exploratory drilling within three years from the issue date of its petroleum exploration license granted for a specific petroleum district.

For each exploration area, the exploration license holder must pay an annual fixed-amount state right (*devlet hakkı*) per hectare.

¹ Permit grants its holder a petroleum right to carry out geological investigation only. Geological investigation does not include exploratory drilling.

² Certificate means an authorization granted under the Law to conduct a petroleum operation other than exploration, discovery, development or production. A certificate may particularly be crucial when an exploitation license holder wishes to set up energy or water facilities necessary for the due conduct of its business.

³ The real property regime of off-shore exploration areas is a very contentious matter under Turkish law. Potential investors are particularly urged to seek specialist advice in this respect.

➤ **Petroleum Exploitation Activities**

As specified in the Law, in order to carry out exploitation activities, an exploitation license must be obtained from the GDPA. An exploitation license is granted for a term of 20 years and may be extended twice, each extension being ten years at most. Thus, the maximum term of an exploitation license is limited to 40 years.

The Law stipulates a number of restrictions concerning the total exploitation surface that an exploitation license holder may hold in an exploitation area.

Same as in exploration, the exploitation license holder must pay an annual fixed-amount state right (*devlet hakkı*) per hectare for each exploitation area.

➤ **Payment of Royalty (*devlet hissesi*)**

In addition to the state right, exploration and/or exploitation license holders must pay as royalty to the Turkish State 12.5% of the value of the petroleum they have produced. The royalty amount shall be calculated once the expenses (*i.e.* income tax, corporate tax, other applicable taxes and charges etc.) are deducted from the market price of the produced petroleum.

➤ **Status of Foreign Investors**

Turkey has one of the most liberal and investor-friendly legal systems for foreign direct investment. The recently enacted Foreign Direct Investment Law No. 4875 introduces the “equal treatment principle” which provides for the equal treatment of foreign investors with their Turkish counterparts. Consequently, save for a very few number of sector-specific exceptions, foreign investors may freely set up companies in Turkey.

According to the Law and the longstanding practice of the GDPA, in order for a foreign company to acquire any of the petroleum rights set forth under the Law, such company must establish either a subsidiary (*i.e.* a separate legal entity) or a branch office in Turkey. If the foreign investor does not have any official address in Turkey, it will not be granted any of the petroleum rights stipulated by the Law. The type of presence the foreign investor chooses to have in Turkey mostly depends on the applicable taxation rules.

➤ **Export and Transport of Petroleum**

Pursuant to the Law, petroleum right holders may export (i) 35% of the total petroleum products in on-shore exploration areas, and (ii) 45% of the total petroleum products in off-shore exploration areas, extracted from the exploration areas discovered after 1 January 1980. The remaining amounts shall be retained in Turkey for “country needs”.

According to the Petroleum Regulation, it is also possible for a petroleum right holder to transport petroleum via a third party’s pipeline, yet an application to the GDPA must be made for that purpose.

➤ **Incentives**

- Under the Law, petroleum right holders are entitled to import materials; fuel; and land, sea or air transport vehicles required for their petroleum operations in Turkey, free of customs and other import taxes provided that such materials are (i) considered to be necessary by the GDPA, and (ii) used exclusively for petroleum operations. However, this incentive is not applicable to materials related to the construction, installation and operation of the petroleum right holders’ building facilities and equipment, and to their administrative activities. The above exemptions shall be in effect until the end of 2020.
- Throughout the entire term of their petroleum right(s), petroleum right holders are entitled to import to Turkey crude oil, which cannot be procured from local sources and is necessary for their market operations, at the market price and free of customs and other import taxes.
- On the condition that all applicable taxes, dues, charges, state right payments and royalties are set aside, a petroleum right holder may, without any taxation, transfer abroad (i) cash funds and rights and (ii) other assets (in cash or in kind) in relation to its petroleum operations.

➤ **Joint Operating Agreements**

In accordance with the Law, petroleum rights granted by licenses and certificates, when registered with the GDPA, may be the subject of legal transactions such as a sale or mortgage. This is conditional upon certain requirements in the Law being met. The holder of a duly registered right shall

in proportion to its petroleum right enjoy the benefits and also be subject to the obligations of the petroleum right holder. In other words, separate entities might co-own petroleum rights.

The Law is flexible on different structures and thus enables privately owned petroleum companies to enter into what is called joint operation agreements (**JOAs**) with TPAO, the latter most of the time being the license holder⁴. The structure of JOAs is as follows: Short of capital, TPAO assigns a certain portion (usually 50%) of its petroleum rights under a license to the other party. In return, such party makes the necessary investment for petroleum production. The proceeds are shared between the parties.

To date, JOAs (based on the 2002 Model Form International Operating Agreement published by the Association of International Petroleum Negotiators) have been used in the Turkish upstream petroleum sector, particularly by TPAO when assigning petroleum rights under its oil exploration licenses to foreign partners in return for operating services. From a legal and practical point of view, JOAs are generally subject to the law of the country where exploration/exploitation licenses are issued (Turkey in the case at hand). Although the parties may also elect another law to govern the JOA itself, enforceability will still depend on the legal constraints set out by Turkish law.

➤ **Petroleum License as a Security**

In case of eventual collaboration with Turkish petroleum right holders, foreign investors may request and obtain additional security over petroleum licenses apart from conventional ones such as share pledge, encumbrance over real property, bank account pledge or commercial enterprise pledge.

Although the Law is not specific on the establishment of an encumbrance over petroleum licenses, the Petroleum Regulation envisages such provided that the GDPA approves the encumbrance and the encumbrance is registered with the Petroleum Registry⁵.

➤ **New Petroleum Law**

The Turkish Parliament approved a new petroleum law on 17 January 2007, which provides for significant changes in both exploration and exploitation regimes. The new petroleum law introduces a more liberal regime to attract foreign investors and to harmonize the national legislation with that of the European Community (*i.e.* Directive 94/22/EC of the European Parliament and of the Council).

The new law was expected to increase competition in the Turkish market and to ease exploration and exploitation of petroleum. Nevertheless, it has not been approved by the former President of the Republic of Turkey and, whether it will be re-approved is unknown. Once entered into force, however, it will bring crucial modifications to the present petroleum regime.

⁴ Involvement of TPAO in JOAs is not a must. JOAs may also be executed by and between private companies entitled to petroleum rights.

⁵ The Petroleum Registry is held by the GDPA and publicly available.