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ENERGY SECTOR UNBUNDLING IN TURKEY

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The notion expressing restructuring of the enterprises that include the relevant network infrastructure for delivery of the energy services to the consumers is called "unbundling".[1] Unbundling aims for separation of competitive sections of vertically integrated structures from non-competitive sections, so that such sections can be opened up for competition.[2] From the energy sector standpoint, unbundling is generally understood as separation of different market components such as generation, transmission, distribution and/or marketing from each other.[3]

In order to have a better understanding of the notion of "unbundling", it is important to understand the horizontal and vertical integration from the perspective of competition law. In the current work, firstly the concepts of horizontal and vertical integration will be elaborated, then the relationship between unbundling and competition will be addressed, subsequently the unbundling practices will be reviewed and finally, unbundling and its models will be examined from standpoint of the legal frameworks of the Turkish electricity and natural gas markets.

1. Horizontal – Vertical Integration

One of the main distinctions from the competition law perspective (aiming for establishment of fair and uninterrupted competition in the free market) in the mergers or cooperations between the enterprises active in the market is the distinction of horizontal and/or vertical integration.

Unification of enterprises (which are conducting manufacturing on the same field or distributing same products) as a single unit through mergers or acquisitions is called horizontal integration. For example, acquisition by a firm active in the field of electricity distribution of another such firm constitutes horizontal integration. On the other hand, control takeover by an enterprise of another enterprise (which is providing goods, products or services to itself or making sales of goods, products or services produced by it) through either a merger or an acquisition is called vertical integration. For instance, merger of a firm active in the field of electricity distribution with another firm active in the field of electricity generation constitutes

1 Selen Yersu Şahin, Turkish Competition Board, Professional Dissertation No. 131, Ankara, 2012, p. 10.
2 *ibid*.
3 Muzaffer Eroğlu, Unbundling Practices in Energy Sector, Turkish Journal of Competition, Turkish Competition Board, 2010, (11)/1, 109-148, p. 109.

a vertical integration. In the horizontal integrations, what is at stake is an extension (growth) on the same field of activity; whereas in the vertical integrations, an extension (growth) towards different fields of activity is at stake.

Horizontal and vertical integrations have different results from the competition law perspective. Horizontal and vertical integration transactions (e.g., mergers and acquisitions) and models produce certain consequences from competition law perspective; however, at the same time, existence and sustainment of horizontally or vertically integrated structures as they are would have consequences from standpoint of establishment of fair and uninterrupted competition.

2. Unbundling in the Energy Sector for Establishment of Competition

The type of integration which is of primary importance for the energy sector unbundling is vertical integration. Restriction of vertical integration in accordance with the rules of the laws/regulatory institutions or separation of vertically integrated structures into different units are primary grounds for energy sector unbundling practices. The reason for this rests within the objective of unbundling, as unbundling aims to separate and distinguish different activity components from each other rather than growth of the enterprise's market share in the same field. In other words, unbundling addresses the establishment of competition on a vertical level. Accordingly, unbundling provisions serve for the purposes of unbundling of the enterprises active in different components of the same sector (e.g., as in distribution and retail sections of electricity and natural gas sectors) and prevention of the vertical integrations in order to provide for fair and uninterrupted establishment of competition in the free market. Through unbundling (which may happen in various means) of an enterprise active in one field of the market from another enterprise active in another field, intervention of an enterprise in various components of the market and the enterprise's discriminatory behaviors towards its affiliated enterprises would be prevented. Although existence of vertical integration in the energy market has certain economic advantages from standpoint of prices[4] amongst the disadvantages set forth above, the

4 İzak Atiyas, Vertical Unbundling in the Distribution Activities in the Process of Restructuring of the Electricity Sector, June 18, 2006, http://myweb.sabanciuniv.edu/izak/files/2008/10/izak-atiyas-rekabet-dergisi-elektrik-dikey-ayristirma.pdf, p. 3-5.

current tendency in the European Union ("**EU**") Law leans towards unbundling for sustaining a healthy and functioning competition environment. With the recently adopted advisory (non-binding) "Google Resolution" of the European Parliament, it is observed that the unbundling trend is strongly ongoing within the EU.[5] In this resolution dated November 27, 2014, European Parliament has declared an opinion for unbundling of search engine services and other commercial services of digital service companies (such as Google).

3. Unbundling Practices

There are various models pertaining to the unbundling practices. Some of these models may concurrently be implemented. Such practices are generally classified as below:[6]

(i) **Accounting Unbundling**: This is the unbundling type which provides for separate and individual keeping of accounting records and calculations for every single activity in a vertically integrated enterprise. By this, financial transparency and account/accounting separation would be achieved and an examination would conveniently be able to be made from the standpoints of competition, price control and non-discrimination obligations.[7]

(ii) **Management Unbundling**: This is the unbundling type which requires for separation and independence of management of each company active in different sectors within a vertically integrated enterprise. By this, management of each activity would consist of different persons and management of each activity would be able to be carried out in accordance with benefits and interests of the relevant activity/enterprise.

(iii) **Functional Unbundling**: This is the unbundling type which requires for functional separation of each activity within a vertically integrated enterprise. In this model, every

5 European Parliament's Resolution on supporting consumer rights in the digital single market, 2014/2973(RSP), http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//TEXT+TA+P8-TA-2014-0071+0+DOC+XML+V0//EN&language=EN
6 Competition Board Opinion on the "Draft Procedures and Principles on Legal Unbundling of Distribution and Retail Sales Activities", p. 2-3.
7 Müberra Güngör / Ayhan Tözer / Gökhan Evren, Competition Problems and Functional Separation: Scope, Practice, Experiences and Suggestions, Information and Communication Technologies Authority, Ankara, May 2009, p. 30.

activity is definitively independent from each other. Such independence shall extend to every field (accounting, management, personnel, operation systems, units, strategies, support systems, goods and services, information systems, etc.).[8]

(iv) **Legal Unbundling:** This is the unbundling type which combines accounting, management and functional unbundling methods and requires for operation of each activity through structuring under a different legal entity. In this model setting forth a structural separation, different activities (e.g., electricity distribution and generation) would be carried out by different legal entities even if such legal entities are ultimately owned by the same shareholder(s). By this, rights and liabilities will be accumulated under different legal entities, each of which constitute a separate legal person.

(v) **Ownership Unbundling:** This is the unbundling model which requires not only for unbundling of accounting, management, functional structure and/or legal entities, but also the shareholding structure. By this, activities in different fields will fully be controlled, executed and carried out by absolutely different legal entities. Accordingly, ownership unbundling is the model which provides for the highest level of unbundling through operation of different activities under umbrellas of different legal entities with different shareholders.

The approach which is currently adopted in EU acquis is more based on the ownership unbundling, on the ground that even legal unbundling remains insufficient for establishment of the competition. Accordingly, Directive No. 2009/72/EC, which is the legal framework in force, has been based on the model of ownership unbundling in contrast with the Directive No. 2003/54/EC (i.e. former legal framework in force), which was based on the model of legal unbundling.

8 *ibid*, s. 32-35.

4. Unbundling in Turkish Energy Law

a) Electricity Market

The provision constituting the basis for unbundling under the former legal framework for energy was the abolished Article 3 of the Law No. 4628 (published in the Official Gazette dated March 3, 2001 and numbered 24335, formerly named the Electricity Market Law and currently named the Law on Organization and Duties of the Energy Market Regulatory Authority) (the "**EMRA Law**"). This provision brought obligations for separate and individual accounting and licensing requirements for each activity or facility subject to a license. Accordingly, unbundling practices in the energy markets had mainly been based on accounting and licensing unbundling; in other words, the rule of separate and individual accounting, bookkeeping and license obtainment for each and every activity or facility. However, as a result of the amendments on the provision in December 2008, the new unbundling model has been legal unbundling.[9]

Subsequently in 2012, with a decision adopted by the Energy Market Regulatory Council (the "**Council**"), namely the Procedures and Principles on Legal Unbundling of Distribution and Retail Sale Activities (Council Decision dated September 12, 2012 and numbered 4019) ("**Unbundling Decision**"), legal unbundling (via separation of legal entities, accounting, management and license) of the distribution and retail sale activities has been regulated. As per Article 4 of the Unbundling Decision, a legal unbundling obligation has been brought and distribution and retail sale activities have been decided to be carried out under separate legal entities starting from January 1, 2013. Pursuant to Article 5 of the Unbundling Decision, it was accepted for the unbundling to be made through implementation of a corporate transaction for partial division (furthermore, as per Article 9 of the Unbundling Decision, it was provided for the newly established company to be a joint stock company). As per Article 6 of the Unbundling Decision, the management structure has also been necessitated to be unbundled (i.e. management of different activities to consist of different individuals) from January 1, 2013 on; yet, this does not extend to the shareholding structure. However, we observe that the

9 Competition Board Opinion on the "Draft Procedures and Principles on Legal Unbundling of Distribution and Retail Sales Activities", p. 2-3.

opinions of the Competition Board on (i) extension of the scope of the Unbundling Decision to generation activities and (ii) extensive regulation of the procedures and principles set forth in the Unbundling Decision and subsequent full implementation of legal unbundling have not been taken into account in the final version of the Unbundling Decision.[10]

Article 2 of the EMRA Law on electricity market activities and Article 3 of the EMRA Law on license procedures and principles have been abrogated with the new Electricity Market Law numbered 6446 (published in the Official Gazette dated March 30, 2013 and numbered 28603) ("**EML**") and replaced with Articles 4 and 5 of the EML respectively. However, the new articles that have been brought instead of the detailed abrogated articles have been kept in a framework level and detailed regulation has been left for the secondary legal framework (i.e. regulations). However, most of the secondary legal framework has not been issued yet.

Under current legal framework, Provisional Article 1/3 of the EML provides for continuation of all the accounts to be kept unbundled until December 2015 in accordance with their relevant legal frameworks. In other words, account unbundling has been temporarily sustained through this provisional article. Furthermore, separate licensing requirements for each activity and facility still exist in accordance with Article 5/2(a) of the EML. Meanwhile, as per Provisional Article 3/3 of the EML, unbundling of distribution and retail sale activities has been set forth to be done in line with the procedures and principles determined pursuant to the EML. With this provisional article, it is hinted that a new unbundling decision will possibly be adopted, in a way differing from the Unbundling Decision from the standpoints of principles and procedures.

However, as of January 2015, despite the fact that EML has entered into force a long time ago, most of the secondary legal framework has not yet been issued and no new decision on unbundling has been given. Accordingly, the characteristics and scope of the future unbundling rules in the electricity market are still unclear. Is the legal unbundling model going to be kept as it is, extended or narrowed down? Or is the new model going to be ownership unbundling as in the EU acquis? Due to Turkey's EU candidacy and legal harmonization obligations coming therefrom, the expectation is for ownership harmonization to be included

10 *ibid*, s.5.

in the Turkish energy legislation in a certain time span through secondary legal framework and in accordance with the provisions of the Directive No. 2009/72/EC.

b) Natural Gas Market

In various sections of the Natural Gas Market Law numbered 4646 (published in the Official Gazette dated May 2, 2001 and numbered 24390) ("**NGML**"), principles relating to accounting unbundling has been included (e.g. Articles 4 and 7 of the NGML) and accordingly, General Communiqué on Accounting Implementation and Financial Reporting Related to the Principles and Procedures of Accounting Unbundling Practice that is Mandatory for the Urban Natural Gas Distribution Companies in Connection with their Distribution and Sale Activities (Communiqué No. 2002/1, published in the Official Gazette dated May 23, 2002 and numbered 24763) has been issued. The model has not yet been upgraded due to the facts that NGML is outdated and the Draft Law on Amendment of the Natural Gas Market Law (the "**New NGML Draft**"), which is expected to enter into force for a long time by now, has not yet entered in force. Another matter which is important from standpoints of the NGML and the New NGML Draft is a matter exclusive to Turkey. In certain components of the natural gas market, dominance of the public legal entity Boru Hatları ile Petrol Taşıma Anonim Şirketi ("**BOTAŞ**") that almost reaches to a monopoly level has not been managed to be curbed despite the objective of the NGML to make the natural gas market freer. BOTAŞ has been keeping its dominant market share in an important portion of natural gas market activities (e.g., storing, transmission, import, export, wholesale). The fact that BOTAŞ has such a powerful share and effect in the market restricts the competitiveness of other enterprises against BOTAŞ, which shows the characteristics of a giant vertically integrated enterprise. In this context, it is necessary to act cautiously in natural gas market regulations and examine public interests and exclusive conditions well. Therefore, practical determination of the unbundling model in the natural gas market is relatively more of a complicated matter.

The model set forth in the New NGML Draft currently appears to be unbundling of BOTAŞ through ownership unbundling and creation of two separate enterprises out of BOTAŞ.[11] One of the enterprises are designated to carry out the storing and transmission

11 Competition Board Opinion on "the Draft Law on Amendment of the Natural Gas Market Law numbered

activities, whereas the other one is designated to carry out the import, export and wholesale activities.[12] By this, BOTAŞ's giant vertically integrated enterprise structure will be able to be unbundled relatively to smaller pieces. This unbundling is expected to be beneficial for competition in the natural gas market, although only to a partial extent (due to the fact that new enterprises would still hold strong positions despite unbundling). Despite all this, the New NGML Draft does not envisage any legal unbundling for distribution and retail sale companies in contrast to the model designed in the electricity market. This issue appears to be an important deficiency in the New NGML Draft. The New NGML Draft is currently pending before the Grand National Assembly of Turkey after having been delivered therein on August 2014.

4646", p. 1.
12 *ibid*., s. 5.