

TUROGE 2008 SPEECH TEXT

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On behalf of the 28 PETFORM member companies engaged in petroleum and natural gas exploration – production and transmission in Turkey, I believe it will be correct for me to present a brief summary of the past 54 years within the framework of current Petroleum Law before commenting on the impacts of the new Turkish Petroleum Law on investments.

The Petroleum Law dated 1954 no. 6326, regulating the entire E&P operations within the borders of Turkey, was drafted by an American expert considering the petroleum engineering data and economic indicators of the respective period. Upon the enforcement of the Law, E&P investments began to be made to Turkey where total 240 companies, including 202 foreign and 38 domestic firms, made investments in Turkey in the past 54 years.

Whereas the Petroleum Law has made many serious changes within years, the most important arrangement positively affecting oil production of Turkey was the law dated 1983 no. 2808. As a result of this arrangement made in the Law, investments increased by folds; domestic oil industry achieving a peak point with 4.4 million ton production in 1991 began to cover a substantial part of the oil need of our country. However, certain legal arrangements of the 90's intended for private oil companies and acts of terrorism taking place in the Southeastern Anatolian Region caused many companies to leave Turkey and consequently the rate of domestic oil production substantially tended downwards. In parallel with industrialization, Turkey's energy need is increasing by folds each year; and domestic petroleum production steadily decreased as of 1991, exploration operations decreased by %75 and production decreased by %50 in the past 17 years.

At the present day, energy import comprises the largest expense item of imports with 35 billion dollars, in which petroleum expense is increasing by 3 folds in only 5 years reaching to 15 billion dollars. According to the BP World Energy Report, energy consumption of Turkey is increasing by 2,5 fold in respect to world average while domestic production has decreased to 2.2 million tons which is the exact half of the peak value it had achieved in 1991. Today, only 7% of oil consumption of the nation,

which is over 30 million tons, is being able to be covered by local resources and this ratio has been decreasing each year to the disadvantage of Turkey.

As of 2007, the remaining producible reserve of Turkey is 41,5 million tons (284 millions of barrel). Although a marginal value in comparison to the oil-rich countries of the world, we should bear in mind that these reserves are yet only consisting of a reserve located as a result of researches conducted in very limited areas. Researches have only been conducted until today in 20% of potential onshore and 1% of potential offshore areas. In other words, Turkey does not have any knowledge as to the quantity of petroleum present in 99% of its offshore and 80% of its onshore areas. Each year 20.000 wells in average are drilled in the world while total number of wells is only 3.326 during the course of Republic of Turkey history. Even these data expressly show how little we know of our own resources.

This decrease in the domestic petroleum production of Turkey has naturally implied the need of renewal of 54 years old legal foundation. Thus the new draft Petroleum Law begun to be prepared in 2001 by the General Directorate of Petroleum Affairs (GDPA) was brought to the General Assembly on 11 January 2007 following the 6 years of preparations and the preliminary works of TBMM (Turkish Grand National Assembly) Energy Commission. The Turkish Petroleum Law no. 5574 approved in the General Assembly on 17 January 2007 was vetoed by his Excellency Ahmet Necdet Sezer and sent to the TBMM for the four articles including one provisional article, to be discussed again.

I will not expressly mention these articles since I believe these four articles, intensively discussed in the public opinion in the last year, obscures great expansions in the essence of the law and important articles that will trigger the investments in Turkey. I would only like to mention the following: It is absolutely a wrong and serious allegation to state that nobody in the private or public authorities protected the national interest in the preparation stage of the law. A law that is prepared by the collective mind of Turkish and foreign companies, General Directorate of Petroleum Affairs and the Ministry of Energy bureaucrats and members of the TBMM shall naturally serve the national interests. There may be deficiencies, or points in need of improvement; these are natural. However to be involved in discussions to be carried on about patriotism will only cause the further loss of time of Turkey and nothing else.

Now let me mention some points we believe are of importance regarding the content of the Turkish Petroleum Law no. 5574 on behalf of the 28 PETFORM member energy companies:

1) Maintaining the transparent and encouraging spirit: In addition to the tax & royalty model implemented in Turkey, the world also implements the “production

sharing” and “buy back” models. For the Production Sharing model, taxes belong to the state while the share that remains on the investor (in consideration of the exploration risk) varies between 9% and 35%. Exploration risk in countries implementing the Buy Back model such as Iran and Turkmenistan is almost zero. Countries such as Turkey willing to attract new investments are in obligation to compete with other countries entertaining the exploration risk. It is obvious that investor shall direct its investment to any country in which such risk is lower than it is in Turkey. In this context, it is inevitable in the world to administer a policy which is competitive with other countries entertaining the same level of risk as Turkey and to maintain the share of the state with the interest to be hold by the company at a certain balance. The New Turkish Petroleum Law is prepared in observance of this purpose.

Furthermore the criteria based for the drafting of Law no. 5574 is the constitution of a fair, transparent and competitive energy market as stipulated in the European Energy Charter Treaty to which Turkey is a party. In this sense the lack of conditions to create a privilege necessitates the constitution of an active competition environment. For the foregoing reasons, it is of great importance to secure the content of the Law which encourages private sector investments, increases the competitive advantage of Turkey in the global petroleum E&P platform and ensures the constitution of a transparent and competitive market.

2) Protection of the graduated royalty: 120 petroleum and natural gas fields are discovered since 1954 and 3.326 wells have been drilled since in these fields. In other words, 27 wells in average are drilled in each field where underproduction is carried out. Substantially increasing the exploration costs and consequently the investment risk, this situation also eliminates the possibility of attracting new investments within the current legislation prepared per the conditions of our country and international petroleum sector of 54 years ago.

Main part of the production in Turkey comes from the wells of which daily productions are accepted as very low as per the world standards. Currently there exists a very suitable investment environment in terms of technology and finance in order to gain more production from these wells called “marginal wells” in the world and also from the reproduction of the wells which were closed (which are said to be concreted deliberately) due to being uneconomical.

In the recent years, technological advances developed in the global oil sector is allowing to moving deeper in exploration wells (horizontal drilling, gas and steam injection) as well as gaining higher production capacity with the current reserves via “secondary production methods”. The figures of the economical contributions to be made by these technological innovations are the following; Turkey managed to produce only 126 million tons of the total 984 million ton reserves located as of 2007

in Turkey. We believe with the help of new technologies, the ratio of “producible reserves” to the “total reserves”, which is currently about 13%, shall be increased substantially through the secondary production methods.

With reference to the foregoing figures dominated by the small production fields, the royalty which is determined as 12,5% in the current Law is now stipulated stepping between 2%-12% thus operation of fields with smaller reserves is encouraged. Thereby, investment cost per well shall be reduced and total production will be increased by ensuring not just the large fields but also the operation of smaller fields. In such a case, total revenue of our country shall without doubt increase.

3) Strengthening TPAO (Turkish Petroleum Corporation) and continuity of its mission: We very much appreciate the pioneering role assumed by TPAO in the last 54 years and the mission it carried out on behalf of our country. I believe it will be helpful for me to underline this point since there are some misunderstandings in this regard: None of the private sector authorities request the division of the current structure of TPAO or the termination of its mission. The only requested matter is the formation of fair and transparent market mechanism in which no privileges will be given to actors. As a matter of fact, as shall also be agreed by the TPAO authorities present here, certain privileges given in the current law started to function against TPAO in the course of time. With the incentives provided by the new Law, it is foreseen that companies tending to make investments in Turkey shall prefer to build a partnership with TPAO (without any legal obligations in this respect) just like in the previous years because:

- TPAO is holding exploration licenses of the fields expected to have large oil potentials (especially offshore),
- TPAO is having deep knowledge gained in decades,
- Companies are in need of sharing the exploration risk

The share of the country as a result of this type of partnership will reach in total 82% of the reserve with the TPAO share at about 50%, subject to change according to the partnership structure along with the 2-12% allocated upon the location of larger reserves in addition to the 20% tax imposed for the explorations carried out in the seas with a great oil reserve potential. The exploration firm will be allocated with the contractor’s share between 18% and 28% for small reserves. On the other hand, graduated royalty implementation will also trigger the production in smaller fields held by TPAO and substantially increase the production and income of TPAO.

4) Securing the operation principle according to work and investment program: The Law stipulates fundamental changes in the phase of license granting. It is considered that the submission of work and investment programs by firms for a certain field, the acceptance of the most active program among the ones submitted to

the GDPA and principle of implementing the operations per the program stipulated in advance instead of the legal obligations of the licenses, should increase investments as well as the efficiency on field basis.

5) Strengthening the structure of GDPA: Pursuant to the new law, GDPA shall be transformed into a “regulatory body” that assesses the company which submitted the most appropriate work and investment program for each field and subsequently inspects whether or not the said company works pursuant to the program for years. For this, it is proposed that the legal arrangement must be enforced by which the public corporation of GDPA shall be transformed into a private budget institution with administrative and financial autonomy.

5) Including transit pipelines within the scope of the Law: Positioned between the countries with the world’s energy resources and consuming countries, at an important geopolitical position, it is obvious that Turkey will be accommodating many national and international oil and gas pipeline projects in the coming period. The constitution of the legal infrastructure pursuant to the Turkish Petroleum Law shall be an adequate strategy for our national interests and guidance for the investors showing the current market conditions.

The last but not the least I would like to state that Turkey now has the opportunity of attracting important amount of investment more than ever. Currently, the price of oil which has become 100 dollar per barrel rendered production fields attractive such as Turkey where underproduction is carried out in marginal fields and “heavy oil” is drilled with high refining costs. It is apparent that in our country, where the risk of E&P cost per barrel is much higher than global standards, the operation of current fields or opening of the new fields will become more economic in parallel with the increase in the world markets.

However, technological advancements and high oil prices are not alone sufficient to attract investments to Turkey. Turkey must provide the economical and legal ground where it can compete with other countries with similar reserves and investment opportunities. We are hoping that the legal basis stipulated in the Turkish Petroleum Law no. 574 shall cause the domestic and foreign companies to create a strong investment stream in onshore and offshore which our knowledge is limited with only 1% and where only 30 wells had been drilled until today. In the event of provision of such an investment environment, we believe both Turkish and foreign many small, medium and large scale companies will go for E&P investments within their own resources and the foreign companies will create an immense area of employment in Turkey by building partnerships with TPAO or Turkish private companies. As a matter of fact upon the review of the production data of the period between 1954 to date, it is clear that domestic as well as foreign investments show substantial increase during the period where investment environment is improved

(1954-73 and 1984-91); yet production substantially decreased during the periods when the investment environment was hindered.

In summary, we believe that the Turkish Petroleum Law no. 5574 shall, in spite of a few deficiencies, eliminate the legal uncertainty on the way of the current and potential investments, and increase the activities aimed at E&P in virgin soils of our country, increase production thanks to the secondary production methods in smaller fields, increase the “recovery factor” in these discovered fields, increase the knowledge of mainly TPAO and all other Turkish companies by building partnerships with foreign companies and block billions of dollars flowing into imports with the increased domestic production.