



Technical Assistance Report

Project Number: 50079-001
Policy and Advisory Technical Assistance (PATA)
August 2016

Azerbaijan: Preparing a Power Sector Financial Recovery Plan

This document is being disclosed to the public in accordance with ADB's Public Communications Policy 2011.

Asian Development Bank

CURRENCY EQUIVALENTS

(as of 1 June 2016)

Currency unit	–	Azerbaijan manat/s (AZN)
AZN1.00	=	\$1.5655
\$1.00	=	AZN0.63877

ABBREVIATIONS

ADB	–	Asian Development Bank
kWh	–	kilowatt-hour
MFF	–	multitranches financing facility
OJSC	–	open joint-stock company

NOTE

In this report, "\$" refers to US dollars.

Vice-President	W. Zhang, Operations 1
Director General	S. O'Sullivan, Central and West Asia Department (CWRD)
Director	F. C. Kawawaki, Energy Division, CWRD
Team leader	T. Luo, Senior Energy Specialist, CWRD
Team members	Y. Ertenliche, Project Officer, Azerbaijan Resident Mission, CWRD
	F. Golez, Senior Operations Assistant, CWRD
	D. Pham, Financial Management Specialist, CWRD

In preparing any country program or strategy, financing any project, or by making any designation of or reference to a particular territory or geographic area in this document, the Asian Development Bank does not intend to make any judgments as to the legal or other status of any territory or area.

CONTENTS

	Page
POLICY AND ADVISORY TECHNICAL ASSISTANCE AT A GLANCE	
I. INTRODUCTION	1
II. ISSUES	1
III. THE POLICY AND ADVISORY TECHNICAL ASSISTANCE	3
A. Impact and Outcome	3
B. Methodology and Key Activities	3
C. Cost and Financing	4
D. Implementation Arrangements	4
IV. THE PRESIDENT'S DECISION	5
APPENDIXES	
1. Design and Monitoring Framework	6
2. Cost Estimates and Financing Plan	8
3. Outline Terms of Reference for Consultants	9

POLICY AND ADVISORY TECHNICAL ASSISTANCE AT A GLANCE

1. Basic Data		Project Number: 50079-001	
Project Name	Preparing a Power Sector Financial Recovery Plan	Department /Division	CWRD/CWEN
Country	Azerbaijan	Executing Agency	Ministry of Finance
2. Sector		ADB Financing (\$ million)	
✓ Energy	Energy sector development and institutional reform		1.20
		Total	1.20
3. Strategic Agenda		Climate Change Information	
Inclusive economic growth (IEG)	Pillar 1: Economic opportunities, including jobs, created and expanded	Climate Change impact on the Project	Low
4. Drivers of Change		Gender Equity and Mainstreaming	
Governance and capacity development (GCD)	Institutional development	No gender elements (NGE)	✓
Knowledge solutions (KNS)	Knowledge sharing activities		
5. Poverty Targeting		Location Impact	
Project directly targets poverty	No	Nation-wide	High
6. TA Category:	B		
7. Safeguard Categorization	Not Applicable		
8. Financing			
Modality and Sources		Amount (\$ million)	
ADB		1.20	
Policy and advisory technical assistance: Technical Assistance Special Fund		1.20	
Cofinancing		0.00	
None		0.00	
Counterpart		0.30	
Government		0.30	
Total		1.50	
9. Effective Development Cooperation			
Use of country procurement systems		No	
Use of country public financial management systems		No	

I. INTRODUCTION

1. The Republic of Azerbaijan is transitioning to a diversified, knowledge-based economy that bolsters sustainable non-oil economic growth. The energy sector (power, oil, and gas) plays a leading role in Azerbaijan's socioeconomic growth. The Government of Azerbaijan owns and manages the energy sector in Azerbaijan, and is committed to sector reform with the aim of improving system efficiency, supply reliability, and transparency. The Asian Development Bank (ADB) is committed to collaborate with the government in promoting power sector reform, efficiency improvement, capacity building, and good governance. ADB is considering a multitranche financing facility (MFF) for the Power Distribution Enhancement Investment Program to support energy efficiency improvement.¹ As a part of the sector road map under the MFF, the government has undertaken to achieve full cost recovery tariff by 2022 through pursuing tariff reform. The government requested assistance from ADB to support the preparation and implementation of a power sector financial recovery plan to achieve the committed targets.

2. ADB undertook a consultation mission in March 2016, during which the government concurred with the impact, outcome, outputs, implementation arrangements, cost, financing arrangements, and terms of reference. The policy and advisory technical assistance (TA) concept paper was approved on 2 June 2016.² The design and monitoring framework is in Appendix 1.

II. ISSUES

3. **Sector overview.** Azerbaijan's total electricity production in 2014 reached 22.70 billion kilowatt-hours (kWh), of which 94% was generated from thermal power and 6% from hydropower.³ The total installed generation capacity by end of 2014 is 6.23 gigawatts, including gas-fired thermal power plant capacity of 5.13 gigawatts (82.3%) and hydropower plant capacity of 1.10 gigawatts (17.7%). The electricity production is sufficient to cover domestic demand, with the surplus being exported to neighboring countries, taking advantage of regional synergies.⁴ Though Azerbaijan is presently going through an economic downturn, recovery is projected in 2018 and beyond. Domestic electricity sales are expected to grow due to economic recovery and improved reliability of the power supply.

4. Based on the energy sector assessment (footnote 1), key challenges facing the power sector are (i) improving operational and financial efficiency, (ii) restoring and maintaining high levels of services throughout the country, and (iii) establishing a sustainable cost-recovery financing mechanism (footnote 1). Though significant investments have been made in generation and transmission facilities since 2005, relatively little investment has been made in the distribution network because of budgetary constraints. The distribution network, particularly in rural areas, is the bottleneck of the power supply chain with high losses,⁵ and requires a \$4.6 billion investment during 2013–2025.⁶

¹ ADB. 2016. *Report and Recommendation of the President to the Board of Directors: Proposed Multitranche Financing Facility for Power Distribution Enhancement Investment Program in Azerbaijan*. Manila.

² The TA is not included in ADB. 2015. *Country Operations Business Plan: Azerbaijan, 2016–2018*. Manila.

³ Azerenerji Open Joint Stock Company.

⁴ In 2014, power exports accounted for 2% of the total production.

⁵ Including technical losses of 11.0% and commercial losses of 7.7%.

⁶ ADB. 2014. *Update of the Energy Sector Master Plan of Azerbaijan, 2013–2025: Final Report*. Manila.

5. **Reform progress.** The power sector reform in Azerbaijan began in 2006 when the government took steps to partially unbundle the sector, strengthen the regulatory framework, and encourage private sector involvement in power generation. However, private participation in power generation and separation of several distribution areas from the vertically integrated monopoly did not deliver the desired results. The overall tariff levels and the limited margins provided to the distribution companies, coupled with low collection rates, were the main barriers.

6. However, there were positive outcomes, and the Joint Stock Company Bakielektrikshebeke (i.e. Baku area electricity distribution company) was successful in reducing losses from 18% to 8% and increasing collection rate from 70% to 95% over the last 10 years. Based on this success, the government initiated new reforms in February 2015 involving separation of the distribution subsector entirely from the vertically integrated power monopoly.⁷ Through unbundling, the government aims to improve operational transparency, and accountability for losses and costs. Further unbundling is expected to be accelerated if the distribution company is successful in improving performance. Also, private sector participation in generation would be made possible through the new sector structure and more robust cash flows from the distribution subsector.

7. **Existing tariff.** Electricity tariffs (wholesale and retail) are set by Azerbaijan's Tariff Council comprised of representatives from line ministries. Electricity tariffs were recently increased in July 2016 by 16.67%. This is the first adjustment since 2007. All customers receive a universal tariff of AZN0.07 per kWh (AZN0.059 per kWh exclusive of value-added tax) and Azerishiq Open Joint-Stock Company (OJSC) pays Azerenerji OJSC a universal tariff of AZN0.043 per kWh (AZN0.036 per kWh exclusive of value-added tax) for all wholesale purchases.⁸ While the margin between the end-use tariff and electricity purchase price (AZN0.023 per kWh) for Azerishiq OJSC is considered sufficient to cover the current level of operation costs, further study is needed to determine the tariff level that fully recovers all costs including necessary capital investments to meet electricity demand and quality of supply.

8. Compared with prevailing international practice, a universal electricity tariff for all consumers is unusual. Typically, tariffs are differentiated by categories of customers (e.g., residential, commercial, industry, agriculture, etc.), and composed of a fixed component (charged as either a daily rate or a rate based on customers' peak demand) and an energy component (which is sometimes further decomposed into peak and off-peak prices). From a financial point of view, the implications of an energy-only tariff are that Azerishiq OJSC's revenue and profitability are very sensitive to sales volume which is undesirable since fixed costs (network operations and maintenance, interest costs, and depreciation) are not fully accounted for.

9. **Government sector strategy and road map.** Power sector reform in Azerbaijan is being propelled forward by the government, together with a road map and time-bound action plan for achieving results. A further impetus for reform has been the external shock to the economy mainly attributed to a substantial decline in oil export revenue caused by the falling oil prices since mid-2014. The government is embarking on broad structural reforms that include

⁷ All power distribution assets and functions were entirely transferred from Azerenerji Open Joint-Stock Company (OJSC) to Azerishiq OJSC (formerly Joint Stock Company Bakielektrikshebeke).

⁸ Azerishiq OJSC is the state-owned national distribution company and Azerenerji OJSC is the state-owned national generation and transmission company. Currently Azerenerji OJSC owns generation and transmission assets and functions, and there are no separated cost centers. The consolidated tariff for generation and transmission is AZN0.041 per kWh. It is expected that real costs for generation, transmission, and distribution will be assessed under the TA.

the power sector. Key measures include enhancing operating efficiency, providing full coverage of the electricity supply, undertaking sector reconstruction and commercialization, implementing full recovery of all costs associated with electricity supply, encouraging private sector investment, and implementing full collection of electricity bills. In March 2016, the government approved a “*Basic Directions of the Strategic Roadmap on the National Economy and Main Economic Sectors*”⁹ and an action plan for 2016–2020 for developing specific road maps, including on the privatization program, state policy on tariff, and restructuring of the power sector.

10. The government recognizes that supporting the financial sustainability of the power sector and establishment of a full cost recovery mechanism are critical factors that would promote sustainable development of the power sector. The government needs to (i) have a clear understanding on the financial performance of power utilities and identify improvement measures, (ii) obtain the best possible international experience and capacity in tariff setting and regulation, (iii) develop a strategic road map in achieving the target of full cost recovery, and (iv) develop an institutionalized and transparent mechanism of periodic tariff determination. Subsidies will be targeted to cushion the impact on poor and vulnerable sections of the population, and may also include some portion toward compensating the power distribution company for the higher cost of service to rural areas, which would also fulfill the social responsibility of the government to promote equity.

11. The tariff reform and improvement of financial sustainability provide an opportunity for ADB to help support the design and implementation of the reforms. The TA aims to develop a financial recovery plan, and to establish a cost recovery tariff and optimize tariff structure, which will help the government meet the financial needs to run the power sector utilities independently and efficiently. Supporting the government’s efforts on tariff reform and financial sustainability is in line with the country partnership strategy, 2014–2018 for Azerbaijan and ADB’s Energy Policy.¹⁰ Through implementation of the proposed TA, ADB would also assist the government to develop an institutionalized and transparent mechanism of periodic tariff determination to avoid politicization of tariffs.

12. The tariff reform progress will be closely linked with the proposed MFF for Power Distribution Enhancement Investment Program (footnote 1). Adoption and phased implementation of full-cost recovery tariffs and implementation of a sector financial recovery plan are part of the MFF road map to improve financial sustainability.

III. THE POLICY AND ADVISORY TECHNICAL ASSISTANCE

A. Impact and Outcome

13. The impact will be improved financial performance and sustainability of the power sector of Azerbaijan. The outcome will be the development of a power sector financial recovery plan.

B. Methodology and Key Activities

14. The main objective of the TA is to establish an appropriate electricity tariff mechanism along with supportive policies, rules, and regulations to help the power sector achieves full cost recovery by 2022. The full cost recovery tariff shall be a dynamic mechanism with a clear

⁹ Order of the President of the Republic of Azerbaijan, 16 March 2016.

¹⁰ ADB. 2014. *Country Partnership Strategy: Azerbaijan, 2014–2018*. Manila; ADB. 2009. *Energy Policy*. Manila.

structure of tariffs for the generation, transmission, and distribution subsectors. Such a full cost recovery tariff will take into account the (i) recovery of power production costs (including operation and maintenance costs, and capital costs); (ii) efficient signaling of future power production costs; (iii) affordability to low-income households; and (iv) distributional equity of power supply services. The tariffs will also be subject to the country's macroeconomic factors, including domestic price inflation, currency depreciation, taxes and levies.

15. The TA is structured with a sequential program of phases. The TA includes two phases. Phase 1 covers two outputs: (i) calculating the real cost of electricity supply (power generation, transmission, and distribution); and (ii) designing a new tariff structure for power generation,¹¹ transmission, and distribution, with differentiating tariffs for different customers and different generation sources (hydro, solar, water, gas) in existence and in development, to replace the current single tariff for all customers and thereby allow cross-subsidization between customer classes. Phase 2 covers two outputs: (i) developing a financial recovery road map for gradual increase in tariff, to achieve a full cost recovery level by 2022; and (ii) undertaking a public information campaign on tariff reform, case studies of good practices in other countries, and institutional strengthening. Such a road map will take into consideration an increase in operational efficiency, targeting subsidies from the government to benefit poorer segment of consumers selected using a suitable rationale. In parallel, a detailed review of the existing policy, legal, and regulatory framework will be undertaken and recommendations will be provided to the government for consideration. The TA will refer to international best practice in cost recovery tariff design in the power sector, and assess the potential application and benefits specific to Azerbaijan's power sector.

16. It is assumed that the government will remain committed to sector reform. Risks associated with this TA include (i) political influences preventing broad government support for the recommendations, (ii) negative public reaction about tariff reform, (iii) weak institutional capacity in inter-ministerial coordination and lack of accountability, and (iv) delays in the government's review and approval of the consultant's reports.

C. Cost and Financing

17. The TA is estimated to cost \$1,500,000, of which \$1,200,000 will be financed on a grant basis by ADB's Technical Assistance Special Fund (TASF-other sources). The cost estimates and financing plan are in Appendix 2.

18. The government will provide counterpart support in the form of counterpart staff, meeting facilitation, access to country data, and other in-kind contributions.

D. Implementation Arrangements

19. The Ministry of Finance will be the executing agency for the TA. A working group, led by the Ministry of Finance with representatives from various ministries and institutional stakeholders (e.g., Ministry of Economic Development and Industry, Ministry of Energy, Tariff Council, Azerishiq OJSC, Azerenerji OJSC) will also be established after TA approval.

20. The TA will require the services of a consulting firm that will provide international experts with experience and a track record in tariff regulatory policy and financial assessment for the power sector. The consulting firm will also provide national experts who will support the

¹¹ Includes exploring options for carbon pricing for thermal generation.

international experts. A consulting firm will be recruited through quality- and cost-based selection using the 90:10 quality–cost ratio, and a simplified technical proposal will be required. All consultants will be recruited in accordance with ADB’s Guidelines on the Use of Consultants (2013, as amended from time to time).

21. In addition, one individual national expert will be hired for 16 person-months as TA coordinator to support the policy and advisory TA team in gathering local knowledge and data, and to coordinate with the different government departments.

22. Disbursements under the TA will be done in accordance with ADB’s *Technical Assistance Disbursement Handbook* (2010, as amended from time to time).

23. The TA is expected to be implemented over 34 months (September 2016–June 2019). The progress of the TA will be monitored through the minutes of bimonthly coordination meetings of the TA working group. The consultants will prepare regular monthly progress reports to be used for project monitoring. All working group meeting minutes and consultant reports, including regular progress reports, will be provided to all key stakeholders. In addition, a communication and stakeholder management plan will be prepared by the consultants during the initial stages of the TA to facilitate the participation of stakeholders and dissemination of knowledge.

IV. THE PRESIDENT’S DECISION

24. The President, acting under the authority delegated by the Board, has approved the provision of technical assistance not exceeding the equivalent of \$1,200,000 on a grant basis to the Government of Azerbaijan for Preparing a Power Sector Financial Recovery Plan, and hereby reports this action to the Board.

DESIGN AND MONITORING FRAMEWORK

Impact the TA is Aligned with:			
Improved financial performance and sustainability of the power sector of Azerbaijan (Azerbaijan 2020: Look into the Future, the Government of Azerbaijan, 2012) ^a			
Results Chain	Performance Indicators with Targets and Baselines	Data Sources and Reporting	Risks
Outcome Power sector financial recovery plan developed	a. The government approves the power sector financial recovery plan by September 2017	a. Government resolution on approval of power sector financial recovery plan, implementation progress published on a government website, supported by participating companies' annual reports	Political influences prevent timely approval and implementation of the financial recovery plan Negative public reaction about tariff reform
Outputs Phase 1 1. Real cost of electricity supply (power generation, transmission, and distribution) calculated	1. Final report on determination of real cost of electricity supply approved by the government by March 2017	1. Consultant reports, working group meeting minutes	Delays in the government's review and approval of the consultant's reports
2. New tariff structure for power generation, transmission, and distribution with differentiating tariff for different customers developed	2. Final report on tariff structure approved by the government by May 2017	2. Consultant reports, working group meeting minutes	
Phase 2 3. Financial recovery road map for gradual increase in tariff, to achieve a full cost recovery by 2022	3. Final financial recovery plan, including the road map, approved by the government by September 2017	3. Consultant reports, working group meeting minutes, government approval documents	
4. Public information campaign, case studies of good practices in other countries, and institutional strengthening undertaken	4. Public information campaign, case studies, study tour, and training programs conducted by December 2017	4. Media products (e.g., infographics, social advertisements), study tour reports, case study materials of good practices in tariff reform in other countries, workshop presentations	
Key Activities with Milestones			
1. Real cost of electricity supply (power generation, transmission, and distribution) calculated 1.1 Conduct a comprehensive review and assessment of the Energy Sector Master Plan of Azerbaijan (2013–2025) and other relevant reports, and the financial performance of Azerenerji OJSC and Azerishiq OJSC (by Q4 2016) 1.2 Analyze the gap between the current practice in Azerbaijan and international best practice in system			

<p>planning and investment analysis, and identify the improvement measures (by Q4 2016)</p> <p>1.3 Develop a model and mechanism in determining the real cost of electricity supply in Azerbaijan's power sector, including in particular benchmarks for metering and acceptable levels of technical and commercial losses (by Q1 2017)</p> <p>1.4 Conduct stakeholder consultations and workshop (by Q1 2017)</p> <p>2. New tariff structure for power generation, transmission, and distribution with differentiating tariff for different customers developed</p> <p>2.1 Analyze the gap between the current practice in Azerbaijan and international best practice in tariff structure design, and develop a tariff structure that facilitates differentiated tariffs for different customers as well as different generation sources (hydro, solar, water, gas) in existence and in development in Azerbaijan's power sector (by Q2 2017)</p> <p>2.2 Conduct training and a study tour to learn international best practice in tariff design in the power sector (by Q2 2017)</p> <p>2.3 Conduct stakeholder consultations and workshop (by Q2 2017)</p> <p>3. Financial recovery road map for gradual increase in tariff, to achieve a full cost recovery by 2022</p> <p>3.1 Identify key activities and an appropriate strategy in designing a financial recovery road map based on multi-criteria analysis (by Q2 2017)</p> <p>3.2 Develop a financial recovery road map that may include recommendations for capital restructuring, write-offs or a one-time settlement of intercompany debts, and actions for gradual increase in tariff to achieve a full cost recovery level by 2022; and identify cross subsidies and/or state budget support that may need to be provided until the full-cost recovery tariff (by Q3 2017)</p> <p>3.3 Conduct stakeholder consultations and a workshop to seek feedback (by Q3 2017)</p> <p>3.4 Finalize the road map and facilitate government review and approval (by Q3 2017)</p> <p>4. Public information campaign, case studies of good practices in other countries, and institutional strengthening undertaken</p> <p>4.1 Develop media products (e.g., infographics, social advertisements) (by Q3 2017)</p> <p>4.2 Develop appropriate public information dissemination programs, including surveys, consultations, public hearings, and media interviews, to enhance the public's understanding of the energy sector and tariff reform; and encourage public engagement (by Q4 2017)</p> <p>4.3 Facilitate the executing agency, the Ministry of Finance, and other stakeholders in project administration for effective project implementation; and provide on-the-job training for key staff of stakeholders (by Q4 2017)</p> <p>4.4 Design and organize a training and study tour for 5–10 staff of the key stakeholders in at least one other country to learn of the approach taken to implement tariff reforms and the impact these had on cost and service delivery structures (by Q4 2017)</p> <p>4.5 Prepare case studies of good practices in tariff reforms in other countries, and conduct workshop to disseminate the recommendations (by Q4 2017)</p> <p>Inputs</p> <p>ADB: \$1,200,000 in 2 phases with \$600,000 each.</p> <p>Note: The government will provide counterpart support in the form of counterpart staff, meeting facilitation, access to country data, and other in-kind contributions.</p> <p>Assumptions for Partner Financing</p> <p>Not applicable.</p>

OJSC = open joint-stock company, Q = quarter, TA = technical assistance.

^a Government of Azerbaijan. 2012. *Azerbaijan 2020: Look into the Future*.

http://www.president.az/files/future_en.pdf

Source: Asian Development Bank.

COST ESTIMATES AND FINANCING PLAN

(\$'000)

Item	Amount
Asian Development Bank^a	
1. Consultants	
a. Remuneration and per diem	
i. International consultants	740.0
ii. National consultants	230.0
b. International and local travel ^b	120.0
c. Reports and communications	20.0
2. Training, seminars, and conferences	40.0
3. Miscellaneous administration and support costs	20.0
4. Contingencies	30.0
Total	1,200.0

Note: The technical assistance (TA) is estimated to cost \$1,500,000, of which contributions from the Asian Development Bank (ADB) are presented in the table above. The government will provide counterpart support in the form of counterpart staff, meeting facilitation, access to country data, and other in-kind contributions. The value of government contribution is estimated to account for 20% of the total TA cost.

^a Financed by ADB's Technical Assistance Special Fund (TASF-Others). Phase 1: \$600,000 (2016); phase 2: \$600,000 (2017)

^b International consultants, government officials, and resource persons may travel using a non-ADB member carrier in accordance with the memo of 29 October 2013 from the Office of the General Counsel and the Strategy and Policy Department.

Source: ADB estimates.

OUTLINE TERMS OF REFERENCE FOR CONSULTANTS

A. Objectives

1. The policy and advisory technical assistance (TA) aims to assist the government develop a financial recovery plan, establish a cost recovery tariff, and optimize tariff structure, which will help government meet the financial needs for independently and efficiently running the power sector utilities.

B. Scope of Services

2. A consulting firm will provide a team of international and national consultants to deliver the TA outputs. The consultant team should propose and adopt appropriate methodologies and approaches in delivering the expected outputs.

3. **Output 1.** Calculate the real cost of electricity supply (power generation, transmission, and distribution). The consultant team will perform the following tasks in meeting this output:

- (i) Identify issues concerning (a) administration and finance; (b) operation of sector facilities; (c) engineering, infrastructure, and maintenance; (d) generation, transmission, and distribution; and (e) marketing and public relations.
- (ii) Conduct a comprehensive assessment and clearly outline the investment requirements, taking into consideration both public and private sector contribution, and assess the real costs in the generation, transmission, and distribution subsectors.
- (iii) Review the current tariff policies including generation, transmission, and distribution charges. Compare the approach and methodology used to internationally acceptable standards.
- (iv) Establish and examine relevant data for the current pricing and tariff policies used by the different service providers, and validate their objectives against the government policy and the transparency of the methods used.
- (v) Prepare profit and loss, cash flow, and balance sheet projections for the period of 2016–2025 that show the ability (or the inability) to meet operating costs, investment replacement, and the supply of future power needs.

4. **Output 2.** Design new tariff structure for power generation (including options for carbon pricing for thermal generation), transmission, and distribution, with differentiating tariffs for different customers and different generation sources. The consultant team will perform the following tasks in meeting this output:

- (i) On the basis of the financing needs identified in Output 1, complete a detailed analysis on the revenue and efficiency requirements to be achieved to meet the future needs for reliable electricity supply. Identify any regulatory impediments that will impact the use of different tariff arrangements and propose changes required.
- (ii) Based on a study of different tariff models in use in comparable countries, propose one or more tariff models that can be adopted in Azerbaijan for each of the three functions: generation, transmission, and distribution of electricity. At the very least, the tariff should ensure full cost recovery for all sector participants and a fair return on invested capital. In particular, the tariffs fixation mechanism should be flexible and allow variable items of cost such as exchange rate fluctuations, interest rate or fuel, and the impact of inflation on costs to be passed through to customers in a timely manner. The tariff should allow for differentiation between different classes of customers to help the government target its subsidies to poor and vulnerable people.
- (iii) Propose a set of options for gradual increase in tariff to the full cost recovery level by

2022, and estimate the budgetary subsidies that will be required until the full cost recovery level is attained.

- (vi) Calculate the full cost recovery tariff level using various stepped tariff structure options, describe the strengths and weaknesses of each approach, and provide recommendations.
- (vii) Recommend cost recovery policies that promote sector viability and sustainable financial conditions.
- (viii) Review, identify, and propose enabling policy, legal, and regulatory changes required for the power sector to be financially viable without ongoing budget support from the government for any investment requirements.

5. **Output 3.** Develop a financial recovery road map for gradual increase in tariff, to achieve full cost recovery by 2022. The consultant team will perform the following tasks in meeting this output:

- (i) Define a set of prudential financial sustainability benchmarks for the power generation, transmission, and distribution companies, such as a capital gearing ratio, debt service coverage ratio, current ratio, self-financing ratio, accounts receivable in number of days, accounts payable in number of days, etc.
- (ii) Develop a financial recovery road map on tariff reform, to help the sector entities achieve the prudential financial sustainability benchmarks. Propose various options such as conversion of debt owed to the government into equity, debt forgiveness by the government, reduction in interest rates by the government, restructuring of debt repayment schedules on debt owed to the government, fresh equity injection, write-off of bad debts, accumulated losses, etc. The plan should (a) include a timeline for gradually achieving key benchmarks; and (b) identify the budgetary subsidy to be provided by the government (for each option chosen) until the sector entities become financially sustainable (i.e., they no longer require external financial support) due to the application of the cost recovery tariff and the improved financial structure.
- (iii) Prepare implementation schedules and action programs for implementing the financial recovery road map. Assess the capacity of government implementing agency in light of the project management and contract administration responsibilities under the proposed implementation arrangements.
- (iv) The financial recovery road map shall include relevant examples of successful implementation, conditions required for the successful implementation, benefits derived, and lessons from both successful and unsuccessful experiences from other countries.

6. **Output 4.** Undertake a public information campaign on tariff reform, case studies of good practices in other countries, and institutional strengthening. The consultant team will perform the following tasks in meeting this output:

- (i) Prepare case studies of good practices in tariff reforms in other countries, and conduct workshop to the government and disseminate the recommendations.
- (ii) Design and organize a training and study tour for 5 to 10 staff of the key stakeholders in at least one other country to learn of the approach taken to implement tariff reforms and the impact these had on cost and service delivery structures.
- (iii) Facilitate the executing agency, the Ministry of Finance, and other stakeholders in project administration for effective project implementation. Provide on-the-job training for key staff of the stakeholders.
- (iv) Develop simple and comprehensible media products (e.g., infographics, social advertisements) covering the critical questions of the public. Develop appropriate public information dissemination programs, including surveys, consultations, public

hearings, and media interviews to enhance the public's understanding of energy sector and tariff reform, and encourage public engagement.

C. Required Key Experts

7. A summary of key consultants required is presented in Table A3. The inputs for each expert will be determined by the consulting firm based on the outputs described above.

Table A3: Summary of Key Experts

International Positions	National Positions
Project Manager	Power sector and regulatory expert
Regulatory policy expert	Finance expert
Finance expert (power)	Economist
Power sector development expert	Communications and stakeholder management expert
Communications and stakeholder management expert	Tariff (power) expert

Source: Asian Development Bank staff estimate.

D. Qualifications and Experience of Key Experts

1. International Experts

8. **Project Manager.** The expert will have (i) a degree in economics, finance, engineer or law preferably with a postgraduate qualification in any of these fields; (ii) a minimum of 15 years of international project management experience and international work experience in power sector. The expert will supervise a team of experts and oversee the project planning, execution, monitoring and ensuring quality of deliverables. The expert will coordinate relevant stakeholders such as the government, Azerishiq, Azerenerji, and ADB during the engagement. The expert will provide advisories and assist the government to implement the tariff reform and financial recovery plan in accordance to agreed roadmap and communication plan.

9. **Regulatory policy expert.** The expert will have (i) a degree in economics, finance, or law, preferably with a postgraduate qualification in any of these fields; (ii) a minimum of 10 years of international work experience in the power sector, including in-depth knowledge of power sector regulations; (iii) hands-on experience with local economic and technical regulations in the power sector; and (iv) an understanding of the legal framework required to underpin tariff reforms and regulatory reforms. The expert will undertake the following: (i) preparation of the financial recovery plan and tariff reform road map, including the potential benefits and impacts of both public and private sector participation in the power sector, international best practice, and assessment of existing barriers; (ii) review, identify, and report on the enabling policy, legal, and regulatory changes required to meet the deliverable requirements; (iii) help the executing agency and other stakeholders in project administration for effective project implementation; and (iv) provide on-the-job training for key staff of the stakeholders.

10. **Finance expert (power).** The expert will have (i) a degree in accounting, finance, business, or a related field; (ii) professional certification (e.g. chartered accountants, certified public accountant, chartered financial analyst); (iii) a minimum of 10 years of international work experience in financial management, including in-depth knowledge of power sector operations; and (iv) experience in the region. The expert will undertake the following: (i) review sector information management systems and controls (particularly the financial management systems

and arrangements), including the quality and integrity of data, and the capabilities of the systems and systems, accounting, and financial management staff; (ii) determine financial conditions of the power generation, transmission, and distribution companies by reviewing their historical financial statements and preparing projected financial statements, as required, in accordance with International Financial Reporting Standards; (iii) assess financial performance indicators; (iv) assess the sector's current cost structure in relation to the current tariff; (v) prepare the financial recovery plan and road map; and (vi) review, identify, and report on the enabling policy, legal, and regulatory changes required to meet the draft tariff sector changes road map.

11. **Power sector development expert.** The expert will have (i) a degree in engineering, preferably with a postgraduate qualification in power engineering; (ii) a minimum of 12 years of international work experience in power sector development; and (iii) experience in the region. The expert will undertake the following: (i) provide inputs for determining capital expenditure, real cost assessment, and tariff recovery assessment; (ii) prepare the financial recovery plan and road map; and (iii) draft, review, and update appropriate sections of the consultant's reports and presentations.

12. **Communications and stakeholder management expert.** The expert will have (i) a degree in law, communications, or another applicable discipline, preferably with a postgraduate qualification in any of these fields; (ii) a minimum of 10 years of international work experience in development and implementation of stakeholder management plans addressing policy and regulatory framework development; and (iii) experience in the region. The expert will undertake the following: (i) prepare and implement a community and stakeholder engagement plan; (ii) develop simple and comprehensible media products (e.g., infographics, social advertisements) covering the critical questions of the public; (iii) develop appropriate public information dissemination programs, including surveys, consultations, public hearings, and media interviews to enhance the public's understanding of the energy sector and tariff reform, and to encourage public engagement; and (iv) facilitate stakeholder working group discussion and prepare working group meeting minutes and relevant reports.

2. National Experts

13. **Power sector and regulatory expert.** The expert will have (i) a degree in economics, finance, or law, preferably with a postgraduate qualification in any of these fields; (ii) a minimum of 10 years of work experience in the power sector, including in-depth knowledge of power sector regulations; and (iii) hands-on experience with local economic and technical regulations in the power sector. The expert will undertake the following: (i) provide inputs to help prepare the financial recovery plan and tariff reform road map; and (ii) review, identify, and report on the enabling policy, legal, and regulatory changes required to meet the deliverable requirements.

14. **Finance expert.** The expert will have (i) a degree in accounting, finance, business, or a related field; (ii) professional certification (e.g. chartered accountants, certified public accountant, chartered financial analyst); and (iii) a minimum of 10 years of work experience in financial management, including in-depth knowledge of power sector operations. The expert will undertake the following: (i) determine financial conditions of the power generation, transmission, and distribution companies by reviewing their historical financial statements and preparing projected financial statements, as required, in accordance with International Financial Reporting Standards; (ii) assess financial performance indicators; (iii) assess the sector's current cost structure in relation to the current tariff; and (iv) prepare the financial recovery plan and road map.

15. **Economist.** The expert will have (i) a degree in economics or finance, preferably with a postgraduate qualification in either of these fields; and (ii) a minimum of 10 years of work experience in economic analysis, including necessary knowledge of the power sector. The expert will undertake the following: (i) provide inputs for determining capital expenditure, real cost assessment, and tariff recovery assessment; (ii) assess the sector's current cost structure in relation to the current tariff; and (iii) prepare the financial recovery plan and road map.

16. **Communications and stakeholder management expert.** The expert will have (i) a degree in law, communications, or another applicable discipline; and (ii) a minimum of 5 years of national work experience in development and implementation of stakeholder management plans addressing policy and regulatory framework development. The expert will undertake the following: (i) prepare and implement a community and stakeholder engagement plan; (ii) develop simple and comprehensible media products (e.g., infographics, social advertisements) covering the critical questions of the public; (iii) develop appropriate public information dissemination programs, including surveys, consultations, public hearings, and media interviews to enhance the public's understanding of energy sector and tariff reform, and encourage public engagement; and (iv) facilitate stakeholder working group discussion and prepare working group meeting minutes and relevant reports.

17. **Tariff (power) expert.** The expert will have (i) a degree in economics, finance, or law, preferably with a postgraduate qualification in any of these fields; (ii) a minimum of 10 years of work experience in tariff design or regulatory agencies; and (iii) an understanding of the legal framework required to underpin tariff reforms and regulatory reforms. The expert will undertake the following: (i) provide inputs to prepare the financial recovery plan and tariff reform road map; (ii) review, identify, and report on the enabling policy, legal, and regulatory changes required to meet the deliverable requirements, and (iii) draft, review, and update appropriate sections of the consultants' reports and presentations.

E. Reporting Requirements

18. The consultants will prepare and submit the following key reports: (i) inception report (November 2016), (ii) cost assessment report (draft and final) (January–February 2017), (iii) tariff assessment and proposed tariff structure report (draft and final) (February–April 2017), (iv) financial recovery plan and roadmap (draft and final) (June–September 2017), (v) public information campaign implementation plan (September 2017), (vi) monthly TA progress reports.

F. Implementation Arrangements

19. The consultancy services are estimated to be carried out over 28 months, from November 2016 to March 2019. The Ministry of Finance is the executing agency for the TA. The executing agency will provide counterpart support in the form of counterpart staff, meeting facilitation, access to country data, and other in-kind contributions. A working group, led by the Ministry of Finance with representatives from various ministries and institutional stakeholders (e.g., Ministry of Economic Development and Industry, Ministry of Energy, Tariff Council, Azerishiq Open Joint-Stock Company, Azerenerji Open Joint-Stock Company), will be established after the TA commencement.