AZERBAIJAN COUNTRY PROFILE

Overview

The Republic of Azerbaijan has a GDP of USD 46,259 million and a population of approximately 8.57 million. The total primary energy supply in 2007 was 11.91 million tons of oil equivalent (Mtoe) of which 1.7% is hydro power, 64.7% is natural gas, and 33.6% is oil. The Republic of Azerbaijan (RA’s) net exports of energy resources reached 24.20 million Mtoe. Net exports are around 39.61 Mtoe. CO₂ emissions are 27.58 (measured as Mt of CO₂).

1. Institutional structure

The Ministry of Industry and Energy (MIE) is the central executive authority implementing state policy and regulation for the energy sector. Regulatory policy is implemented primarily by the MIE, and also by the Ministry of Economic Development (MED) and the Tariff Council. The MIE is largely responsible for implementing the various regulations, orders and decrees issued by the government. The MIE has a board, approved by the Cabinet of Ministers, and has authority to issue orders and decrees within its area of competence. Such competence extends to most areas within the energy sector, but not to tariff regulation, which is within the area of competence of the energy regulator, the Tariff Council.

The Tariff Council acts pursuant to authority granted to it by Presidential Decree (26 December 2005), the Regulations on the Tariff (Pricing) Council, and the Resolution by the Cabinet of Ministers (9 March 2006). The Tariff Council establishes the tariff methodology, approves the tariff level proposed by regulated companies (including but not limited to energy), proposes changes to the legal framework as it relates to pricing; and settles disputes regarding price regulation and tariff application. It is an executive authority, guided by the Constitution, laws, the President’s decrees and executive orders, the Cabinet of Ministers’ enactments and resolutions, and existing international agreements. It may act upon its own initiative within its tariff jurisdiction.

The Tariff Council has a Chairman and 12 additional Council members who serve in a Council not a staff capacity. The Chairperson is the Minister of Economic Development and the 12 Council members are Deputy Ministers (Finance; Taxes; Justice; Transportation; Industry and Power Engineering; Communication and Information Technology; Agriculture; Education; Health; and Labour) and deputy heads of Committees (Customs and Construction). In the event that the President, pursuant to a decree, replaces the Minister and deputy heads of ministries and committees, that decree automatically replaces the Council Chairperson and Council members. There are no fixed terms, with the Chairman and members serving for the duration of their appointment by the President.
The Law on the Civil Service prohibits Council members and senior staff of the Tariff Council (and all other civil servants) from occupying paid positions in other state bodies and from engaging in any paid activity outside of the Tariff Council (except for scientific and creative activities) without their supervisor’s permission. There are no conflict of interest provisions concerning ownership of property interests or occupation of management positions in regulated entities by immediate relatives of the regulatory authority’s board members or senior staff.

Salaries of heads and board members, as well as staff, are set by resolution of the President. The salaries are equivalent to those of other civil servants. The Tariff Council has 25 staff members, 90% of whom are highly qualified personnel. The total budget is 353,507 manats (approximately Euro 302,401) and comes directly from the state budget (as does the budget of the MIE). The Cabinet of Ministers, through the Ministry of Finance and the Accounts Chamber, controls the Tariff Council’s use of the funds.

Governmental bodies may cancel or change decisions made by the Tariff Council, where such right is granted to them by legislation. Regulatory decisions may also be cancelled by court rulings. Energy companies may appeal against a decision of the Tariff Council, either directly to the Council itself or through court action. Appeal does not automatically terminate a decision, but if the appeal is deemed to have merit, the applicable Tariff Council decision may be amended or a new one may be defined.

Functions of the MIE include: licensing, consumer complaints and sanctions against energy companies for non-compliance with energy legislation.

Azerbaijan has a competition authority (the State Committee on Antimonopoly Policy and Support for Entrepreneurship), established in 1993.

2. Electricity sector

a. Market framework

Azerbaijan’s electricity sector is dominated by a vertically integrated monopoly managed by Azerenergy OJSC, a 100% state-owned enterprise. Azerenergy was established by Executive Order of the President No. 423 of 17 June 1996, and is engaged in the production, transmission, distribution, purchase and sale of electricity in Azerbaijan. Azerenergy is entitled to submit proposals on tariff increases and to take part in the tariff-regulation process, but final decision-making authority with regard to tariff determination in the electricity sector belongs to the Tariff Council. Azerbaijan’s legislation neither requires transmission and distribution to be separated from generation, nor envisages the presence of a separate transmission system operator and a distribution system operator. Accounting, functional and/or managerial disaggregation has not been accomplished or envisaged by legislation. Nonetheless, partial disaggregation has occurred; some mini-power plants have been privatised and two independent regional distribution companies have been created.

Involvement of new private generating enterprises (mini-power plants) in the electricity sector is minor thus far though additional investment in new generating capacities and transmission/distribution operations is a medium term policy objective.

There is no wholesale electricity market.
b. Network access and tariffs

The Azerbaijani electricity market has not opened yet and no formal opening time frame has been envisaged.

Legislation provides for principles of non-discriminatory access to network infrastructure, though this has not been implemented in practice due to the market structure.

No grid code has been developed in Azerbaijan. Access to, and proper investments in, the network are guaranteed by the Electricity Law. There are no access tariffs for generation/retailing and transmission/distribution. All the parties requiring access to transmission and distribution networks are obliged by law to comply with the same technical specifications, without discrimination or preference for any one party over another. In cases where system (transmission and/or distribution) operators refuse to provide access to their systems, the operators are required to provide an explanation of the reasons for refusal.

The regulated entities are required to provide economic substantiation of the expenses which are part of prices (tariffs). The calculated tariffs are reviewed by the Tariff Council and published upon approval. A uniform tariff for the population and other tariffs for commercial and industrial enterprises are in force. The following types of tariffs exist in the electricity sector:

- tariff for purchase of electricity from its producer;
- wholesale electricity sale tariff;
- retail electricity sale tariff; and
- export and import electricity tariff.

Depending on the specification of services, tariffs are determined on the basis of expenses necessary to obtain profit, considering cost price, production force, technology parameters, etc.

Tariffs are calculated on the cost-benefit basis using reports for previous years and actual data, as well as forecasted data taking account of an entity’s offer. A tariff rate incorporates the subsidy amounts, which are determined by the Government and outside of the control of the Tariff Council.

c. Operational environment

Foreign capital investment in energy assets/companies is permitted and not restricted. Investments in new generating capacities are encouraged, and long-term electricity procurement is guaranteed.

Determination of the electricity balance is a responsibility of the Cabinet of Ministers, jointly with the MIE. Both the MIE and the MED are involved in monitoring expected future demand and planned additional capacity, as well as in monitoring network service quality and level. Service quality control in the electricity sector is secured by the MIE. The Tariff Council has no power to impose fines or interfere if service standards are not met. A mechanism for consumer compensation is set forth in the civil law.
The legislation does not include a supplier of last resort, though Azerenergy *de facto* performs that function.

The energy legislation does not include special provisions for vulnerable customers *per se*, but there are general social support mechanisms which cover low income customers of all public services, including energy customers. As to cross-border exchanges, the Tariff Council has no power to approve operating and planning standards.

Export and import operations need a special permit for trading activity. Insufficient system interconnections pose an obstacle for using the export and import potential.

The Tariff Council submits reports on its work to the President twice a year. The regulatory authority’s decisions are posted on the website [www.tariff.gov.az](http://www.tariff.gov.az) and published in official newspapers, only in Azeri.

The regulatory authority supports its decisions with facts, analysis and grounded conclusions, if necessary. Legislation does not envisage public hearings and does not require public consultations.

3. **Gas sector**

   a. **Market framework**

   All gas institutions remain in state hands and there are no plans to change this in the near future. The state-owned Socar produces the bulk of the country’s gas at Shah Deniz fields.

   The state-owned Azerigaz OJSC is the monopolist gas supplier. It was established by Executive Order by the President No. 326 of 31 May 1996 and is engaged in gas transportation, distribution, purchase and supply and manages access to transportation and distribution networks.

   No gas market opening plan is envisaged in the legislation. Consumers cannot purchase natural gas directly from producers; Azerenergy procures natural gas for electric plants under a contract agreement.

   In 2007, Azerbaijan began to export gas to Georgia and Turkey from the Shah Deniz gas fields (Caspian Sea). The South Caucasian pipeline (690 km long) is the main gas pipeline through which the exportation is performed. It starts at Shah Deniz fields and runs across Azerbaijan and Georgia to the Georgia-Turkey border where it is connected with Turkey’s internal gas system, with the aid of a small pipeline segment built by Georgia.

   b. **Network access and tariffs**

   No grid code has been adopted in Azerbaijan, but a Law on Gas Supply was passed on 30 June 1998. The Law regulates the process of production, processing, transportation, storage, distribution, sale and use of all types of gas (including natural gas).

   There is no third party access; access to the grid must be negotiated with Azerigaz.
As with electricity, in cases where system (transportation and distribution) operators refuse to provide access to their systems, they must (and actually do) provide full substantiation for the reasons of such refusal.

There are no access tariffs though separate tariffs exist for:

(1) wholesale purchase of natural gas;
(2) retail sale of natural gas to end consumers;
(3) transportation of natural gas.

As with electricity, the gas tariffs are approved by the Tariff Council and are mandatory for all entities in Azerbaijan. The Tariff Council regulates gas tariffs in accordance with its internal rules. Regulated entities must submit the following data to the Tariff Council:

- reference on substantiation of prices and on the need to revise them
- calculation of cost prices of the entity’s goods and services
- expense items for the last 2 years and the last reporting period
- projected costs, breakdown of expenses related to production (services), and profit
- taxes and other payments
- breakdown of payables and receivables
- auditor’s opinion on the entity’s activities
- comparative table of new and existing prices

The Tariff Council’s decision is communicated to the public through the press.

c. Operational environment

Azerigaz CJSC acts as a supplier of last resort.

Azerigaz, the MIE and the MED are involved in monitoring of the medium- and long-term fuel and energy balance in the national market. The regulatory authority takes a direct part in monitoring expected future demand.

Monitoring of network service quality and level is the competence of Gosgaznadzor (State Gas Supervision) Department within the structure of the MIE. Service quality control in the energy sector is secured by the MIE. If such service standards are not complied with, compensation to end-consumers is provided according to civil law.

All investments in the distribution network and in the gas-transportation system are implemented by Azerigaz. In practice, the following investments are determined subject to this condition: (1) potential future investments and (2) current investments (for the current year and by quarter). As for cross-border exchanges, Azerigaz is the body responsible for developing operating and planning standards.
4. Renewable energy sources/energy efficiency

A Decree of the President approved the State Programme for Usage of Renewable and Alternative Energy Sources in the Azerbaijani Republic, implementation of which is assigned to the MIE. The Agency for Renewable and Alternative Energy Sources under the MIE also was established by presidential resolution. Responsibility for implementation of policy and legislation in the renewable energy sphere is placed on the MIE, which runs a dedicated department for alternative energy and the environment.

The MIE is appointed as the Programme’s implementation coordinator. The Programme specifies basic areas for the realisation of measures related to wind energy as the most advantageous energy source for the republic, as well as to using solar energy, energy of geothermal waters, hydraulic energy of mountain rivers and river canals as well as biomass energy.

The State Programme also provides for improvement of Azerbaijan’s regulatory framework for implementation of alternative and renewable energy sources, as well as for engagement of investors in projects related to the usage of alternative and renewable energy sources, promotion of appropriate conditions for their activities, and efforts to secure top-priority marketing of environmentally safe energy products in the energy market. The action plan of the State Programme envisages public information on alternative and renewable energy sources, development of training manuals in this field, and education.

No separate national laws have been passed on: (1) combined heat and electric power production, (2) energy efficiency, or (3) usage of renewable energy sources, though the Law on the Usage of Energy Resources, passed on 30 May 1996, defines legal, economic and social fundamentals for state policy on the use of energy resources as well as main directions for policy implementation. Article 12 of the Law on the Usage of Energy Resources identifies economic measures to secure rational usage of energy resources that include:

- applying economic levers and incentives to target the organisational, scientific, technological and economic activities towards rational usage of energy resources, particularly renewable energy sources; identifying core areas and sources of funding of the rational usage of energy resources for energy-intensive production processes and product types in all economic sectors as a basis for application of economic measures of impact upon the energy supply process;
- introducing a penalty for inefficient use of energy resources in the form of differentiated mark-ups to existing prices and tariffs, depending on over-consumption of energy resources compared to consumption quotas;
- providing subsidies, grants, tax discounts, credit preferences, and other benefits to encourage the creation, introduction and operation of advanced energy-saving technologies and equipment;
- applying a system of state tariffs and prices securing rational usage of energy resources.

In addition, state bodies (MIE, Ministry of Environment and Natural Resources (MENR)) have developed energy efficiency standards, and have organised a system of environmental and energy management, among other initiatives.

According to the Decree by the Cabinet of Ministers on the Rules and State Supervision over Tariffs, the following feed-in tariffs have been approved:
- wholesale price of electricity produced by private mini-hydro power plants – 2.5 copecks per 1 kWh
- for electricity produced by wind generators – 4.5 copecks per 1 kWh

Tariffs of electricity sold by private water and wind mini-plants do not include an electricity transit transmission tariff.

The Tariff Council has powers to set tariffs for any kind of renewable energy, but only wind energy and mini hydro power tariffs have been set. There is no difference in tariffs between cogeneration and traditional electric energy systems. At present, a uniform tariff is in force.

The Cabinet of Ministers issued on 3 March 1992 the Resolution No. 122 “On the introduction of pay for natural resources, payment charges for pollutant emissions into environment, and on the use of receipts from these payments”. The Resolution approved the Procedure for “Collection of a pay for natural resources, payments for pollutant emissions into environment, and for the use of receipts from these payments as well as payment rates for pollutant emissions into the atmosphere”. MENR is the controlling authority and sets limits for specific users of admissible pollutant emission volumes. Pollutant emissions above the set limits are paid at a rate five times higher than normal.

The payment for environmental pollution takes into account the environmental situation and the environmental significance of territories. Introduction of the payment for pollutant emissions does not relieve users from the obligation to implement measures of environmental protection and observation of nature-preservation laws.

There are no schemes of subsidies aimed to encourage energy efficiency and no specific obligations to purchase renewable energy. There is no established market for renewable energy, so no special form of contract for its sale exists. Procedures for dispute settlement and appeals are specified in contracts. The generating company may sell energy in the wholesale market at the tariffs approved by the Tariff Council.

In Azerbaijan, the State pursues a policy aimed at mitigating the consequences of climate change. These efforts include adoption of the State Programme for Usage of Renewable and Alternative Energy Sources in the Azerbaijani Republic as well as the establishment of a Designated National Authorities (DNA) under the Clean Development Mechanism (CDM) within the framework of the Kyoto Protocol to the United Nations Framework Convention on Climate Change ratified in 2000.

5. Conclusion

Azerbaijan performs weakly with respect to its grouping (Group C), well below average both for electricity and gas. Within its Group, Azerbaijan has an electricity sector score of 0.368 relative to a Group C average score of 0.461. Azerbaijan has a gas sector score of 0.336 relative to a Group C average of 0.399.

The absence of a clearly independent regulatory authority contributes largely to the low score given to institutional infrastructure and regulatory framework. Similarly, the vertically-integrated monopolies which characterise the electricity and gas sectors, as well as the absence of a market opening time frame, penalise the score given to market structure.

Some elements of dynamism have been recently introduced in the electricity sector through the privatisation of mini-power plants and the establishment of two independent regional electricity distribution companies. With prospects of sustained
demand growth through to 2015, the power sector will require substantial investment for the construction of new electric generation plants, refurbishment of existing facilities and strengthening of the power grid.

Azerbaijan switched from being a net gas exporter to net importer in the 1980s. Then, in 2007, what is likely to be a long period of exports began again, with Shah Deniz exports to Georgia and Turkey. The further development of the Shah Deniz fields depends, to a certain extent, on the prospects of the Nabucco pipeline project, a key route for the security of supply of Europe.

**Electricity spider graph – Azerbaijan**

Note: The diagram presents the electricity sector results of Azerbaijan, in accordance with the benchmarks and indicators identified in the assessment model. The extremity of each axis represents an optimum score of 1.0, that is, full compliance with international best practices. The fuller the “web”, the closer the overall electricity regulatory framework approximates international best practices. The results for Azerbaijan are represented by the thick bold line. For comparison purposes, the shaded area presents the electricity sector average of the Group C countries.

**Electricity Sector - Comparative view of Group C countries**
Note: The diagram presents the gas sector results of Azerbaijan, in accordance with the benchmarks and indicators identified in the assessment model. The extremity of each axis represents an optimum score of 1.0, that is, full compliance with international best practices. The fuller the “web”, the closer the overall gas regulatory framework approximates international best practices. The results for Azerbaijan are represented by the thick bold line. For comparison purposes, the shaded area presents the gas sector average of the Group C countries.

Gas Sector - Comparative view of Group C countries