



## **POSITION PAPER**

**In respect of the Proposed Addendum No. 6 – Of The Concession Contract For The Management And Operation Of The Water Supply Services In Port Vila.**

12<sup>th</sup> JULY 2018

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## 1. EXECUTIVE SUMMARY

The Utilities Regulatory Authority (“**the Authority**”) has been requested to provide its independent advice on the proposed Addendum No. 6 – of the Concession Contract for the Management and Operation of the Water Supply Services in Port - Vila.

We have been informed that the Government intends to sign the proposed amendments to the Port Vila Water Concession Contract with UNELCO. As Regulator, and in the interest of consumers and the Government of Vanuatu, it is one of our primary responsibilities to make the Government aware about the issues relating to, and the implications of signing these proposed amendments.

The proposed amendments have been reviewed by our staff and the Authority notes the following issues with these proposed amendments:

1. Inconsistency with the following:
  - **COM’s decision 93/2018;**
  - **The Port Vila Water Concession Contract;**
  - **The Government Contracts and Tenders Act [CAP 245] in 1998;**
  - **The Utilities Regulatory Authority Act No. 11 of 2007 (as amended).**

### **AUTHORITY’S POSITION:**

The Authority is of the view that the proposed amendments are inconsistent with the framework as stated above and the implications they carry will not be in the best interest of neither the Government nor the consumers. Thus, the Government should seriously consider the Authority’s independent assessment herein and to resolve the inconsistencies and adverse impacts.

## 2. BACKGROUND

The Port Vila Water Concession Contract was entered between the Government of the Republic of Vanuatu and UNELCO on 23<sup>rd</sup> December 1993. On 19th December 2013, the Government exercised its right under Article 4 of the Concession Contract which provided for the 'review of contract at mid term'. According to Article 4, the parties to the contract were to discuss the concerns of the Government relating to the performance of the contract and examine the programme of works to be constructed during the remaining five years of the contract. However, instead of discussing the concerns of the Government, the parties mutually agreed to amend the contract in order to include all the small water utilities within the network of UNELCO.

The Council of Ministers (COM) in their 13<sup>th</sup> ordinary meeting held on Friday, 1<sup>st</sup> June 2018, approved the *“Proposed Amendments To The Port Vila Water Concession In Order To Increase Access To Clean, Reliable And Affordable Drinking Water In The Areas Surrounding Port Vila”* (Decision 93/2018). This is the 6<sup>th</sup> amendment to the Port Vila Water Concession Contract and referred as the Addendum No. 6 – of the Concession Contract for the Management and Operation of the Water Supply Services in Port - Vila.

## LEGISLATIVE FRAMEWORK

The Port Vila Water Concession Contract was signed by the Government of Republic of Vanuatu and UNELCO in 1993. Since then, there have been significant developments in the overall legislative framework of Vanuatu including the enactment of the following:

- The Public Finance and Economic Management Act [CAP 244] in 1998;
- The Government Contracts and Tenders Act [CAP 245] in 1998;
- The Water Resources Management Act [CAP 281] in 2002, and subsequent amendments in 2010 and 2016; and
- The Utilities Regulatory Authority Act No. 11 of 2007 (as amended).

The Port Vila Water Concession Contract is a comprehensive document that determines the terms and conditions for the supply of water service in Port Vila and outlines some key provisions which, under the current regulatory scheme, should now be made redundant. However, considering the history of this particular contract and the legal framework at that time (1993) and absent the current legal framework listed above, the reasons for some of the provisions in the concession contract can be well understood.

Given that the Vanuatu Government and Parliament has, now put in place, a proper legal and regulatory framework, any amendments to the Port Vila Water Concession Contract should reflect the current legal and regulatory framework.

The Authority notes that the proposed Addendum No. 6 – of the Concession Contract for the Management and Operation of the Water Supply Services in Port – Vila is to allow for the extension of the water network to new areas outlined in the proposed Addendum. In doing so the Authority is of the view that the Addendum must reflect the current legislative framework and also the processes laid out in the Acts listed above.

### UTILITIES REGULATORY AUTHORITY ACT NO. 11 OF 2007 (AS AMENDED)

The Authority as established under section 4(2) of the Utilities Regulatory Authority Act No. 11 of 2007 (“**the URA Act**”) is an independent body corporate with perpetual succession. The URA Act empowers the Authority to regulate utilities with respect to the provision of water and electricity services in Vanuatu.

The legal mandate of the Authority is provided in section 2 of the Act;

- “(a) ensure the safe, reliable and affordable regulated services;
- (b) maximise access to regulated services throughout Vanuatu;
- (c) promote the long term interest of consumers.”

One of the most important functions of the Authority as defined under section 12 of the URA Act is to provide advice, reports and recommendations to the Government relating to utilities.<sup>1</sup>

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<sup>1</sup> Section 12(1)(b) of Utilities Regulatory Authority Act No. 11 of 2007 (as amended)

### 3. PURPOSE

The purpose of this position paper with respect to the proposed Addendum No. 6 – of the Concession Contract for the Management and Operation of the Water Supply Services in Port - Vila, is to provide the Authorities regulatory views on the proposed Addendum which includes:

- an independent review of the Addendum in light of the current legal and regulatory framework of the Republic of Vanuatu;
- an independent financial and economic review of the proposed amendments to the Port Vila Water Concession contract in order to determine whether the proposed amendments ensures a balanced interest of the Utility, Government and the Customers.
- Advice and recommendations of the Utilities Regulatory Authority (“**the Authority**”).

This position paper will be divided into two sections; Section 1 of this document will provide the Authority’s review of the proposed amendments in light of the current legislative framework and laws of Vanuatu and Section 2 will present the financial and economic review of the proposed addendum in relation to the key element of affordability.

## SECTION 1

### 4. INCONSISTENCY WITH THE COM'S DECISION 93/2018 ON THE "Proposed Amendments To The Port Vila Concession Contract In Order To Increase Access To Clean, Reliable And Affordable Drinking Water In The Areas Surrounding Port Vila" As Approved On Friday, 1st June 2018

The recommended base rate of 66.72 vatu in the proposed addendum, in addition to being inconsistent with:

- (i) the process laid down under Article 22 of the Port Vila Water Concession Contract: and
- (ii) with the Authority's power under section 18 of the URA Act;

**is also inconsistent with the decision approved by COM.**

#### 1. The Reference Rate (P)

In paragraph 5(a) of the COM Decision, it is provided that, "*in order to accommodate this change in perimeter, the tariff is reviewed and,*

- a. The Reference Price (P) remains the same as the one currently in effect: 66.72 Vatus."*

It is evident from the COM Decision that there will be no changes to the current tariffs and both the current base rate (Po) and the Reference Rate (P) are to remain same. However, in the proposed amendment, the base rate has been increased to 66.72 vatu which is an increase of 62% from the current base rate of 41.17 vatu and is inconsistent with the COM Decision.

Therefore, Article 6 of the Proposed Amendments, does not correctly reflect the COM decision at paragraph 5(a). It contrarily provides that, "*the price at which the OPERATOR is authorized to sell water to the subscribers, at Time) (T0), is referred to as the Base Price (P0) and may not exceed the maximum rate of:*

*P0 = 66.72 vatu."*

#### 2. The Subscription Rate

The Authority noted that the proposed amendment requires an increase in the quarterly subscription fees for the different size of the meters which is substantively very high compared to the current rates (on average more than 70% increase for size of the meter ranging from 15mm to 40mm and more than 100% increase for other range).

In contrast, the COM Decision(5b) requires the subscription rate of modest customers(15 and 20mm meters) to be decreased by 20% and does not require any further pricing changes. The proposed amendment to significantly increase the subscription rate is inconsistent with the COM Decision.



3. Security Deposit

The Authority also noted that there has been a major change in the pricing structure of the security deposits which has led to a significant increase in the price of the security deposits for different size of the meters. For example, the current security deposit rate for a size of 25mm is 1400 vatu and under the proposed amendment has been increased to 13,344 vatu. With reference to COM Decision, no such increases have been approved or discussed.

4. Rise and Fall Formula

The COM Decision provides under Paragraph 5(d) that, *‘the Rise and Fall Formula, which dictates the evolution of the price between tariff reviews, is adjusted to:*

- i. Take into account the existence of a reliably published Consumer Price Index (which did not exist at the signature of the contract) and*
- ii. take into account the actual evolution of the asset base every year (in order to create unnecessary flexibility required by adding the new zones based on an a prior implementation calendar).’*

The proposed amendments has added new provisions. Under the Proposed Amendments, Article 7, paragraph 2 provides for the Review of Maximum Base Rates and Corrective Terms; Article 7, paragraph 3 provides for the Conditions for the Application of the Rise and Fall Formula –Three Member Commission and further, Article 8 provides for the Security Deposit.

**The above quoted provisions of the Proposed Amendments were not provided for by the COM Decision and should not form part of the Proposed Amendments. By adding these provisions, it no longer would be an addendum to the Contract but rather a major amendment varying the existing terms of the Contract with significant financial implications.**

**In addition, the proposed amendment in regards to the Rise & Fall formula includes the decoupling principle which is a major departure from a common regulatory practice and should be considered with appropriate care as it transfers the entire risk of revenue shortfall directly to the Customers. No such approvals to incorporate such a principle into the Rise & Fall formula was approved in the COM Decision.**

5. Water Development Fund

Under paragraph 6 of the COM Decision, a Water Development Fund will be created within the next 3 months:

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- b. “A water Development Fund Contribution, initially set at 5 Vatus per m<sup>3</sup>, will be collected by UNELCO, in addition to the Reference Rate, and filly remitted to the Government Fund every quarter. Per year, the contribution from UNELCO concession would be around 23M Vatus based on 2017 cubic meter volumes.”*

As per the above requirement, the water development fund contribution must be fully remitted to the Government Fund every quarter.

In the proposed amendments however, it is provided that,

*“the Concessionaire shall remit, every calendar quarter, the amount of the Water Development Fund Contribution invoiced to customers during the previous quarter. The amount remitted during the 2<sup>nd</sup> quarter of every calendar year shall be abated by the Water Development Fund Contribution portion of any customer debt that was uncollected and duly written off by the Concessionaire in the previous year.”*

According to the quoted provision of the proposed amendment above, the amount remitted during the 2<sup>nd</sup> quarter every calendar year will be reduced by the Water Development Fund portion of any customer debt that was uncollected and written off by the Concession in the previous year.

**There is nothing in the COM Decision that refers to customer debts to that regard.**

## **5. THE GOVERNMENT CONTRACTS & TENDERS ACT [CAP 245]**

Section 3A(1) of the Government Contracts and Tenders Act [CAP 245] provides for a procedure in respect of renewal and variations to a Government Contract. Section 3A (1) states that:

*“A Government Contract, must not be renewed unless it has complied with the procurement methods as set out in this Act.”*

Further, Section 3A (1A) provides:

*“This section does not apply to any extension or variation executed in accordance with the terms of the original Government Contract unless:*

- (a) such extension is made only once;*
- (b) **such extension does not have a value exceeding 50% of the original contract; and***
- (c) **such variation complies with subsection 4(2).”***

Subsection 4(2) provides for the scope within which variation to a Government Contract may be allowed without a new procurement process. It states that:

*“The terms of Government Contract may be varied or discharged:*

- (a) by the contracting agency – **where such variation does not lead to an increase of more than 10% in the price of the original terms; or***
- (b) in all other cases – in the same manner as described in subsection (1).*

This means that in case of any variation to a Government Contract, it has to be in accordance with subsection 4(2) of the Government Contracts and Tenders [CAP 245]. However, if these variations are beyond the scope of subsection 4(2), they will have to go through the procurement process as laid down under section 4(1).

In the proposed amendment, there is a proposal of a base price of 66.72 vatu m3 which is an increase of 62% from the contemporary base rate of 41.17 vatu m3. Therefore, the proposed variation of 62% to the base rate is inconsistent with Subsection 4(2)(b) of the Government Contracts and Tender Act. Concomitantly, there are also proposed increases in the price of the subscription and Security deposits which are above 10%.

## **6. THE UTILITIES REGULATORY AUTHORITY ACT NO. 11 OF 2007 (AS AMENDED)**

As aforesaid, the proposed addendum recommends an amendment of the water tariff and consequently proposes revision of the base rate which is unilaterally fixed by UNELCO. This proposed amendment, in addition to being inconsistent with the process laid down under Article 22 of the Port Vila Water Concession Contract, **also violates Authority's power as granted to it under section 18 of the URA Act.**

Section 18 of the URA Act provides for maximum prices and subsection 18(1) states that:

*"The Authority may determine the maximum price which may be charged to consumers in relation to any aspect of a regulated service in any place."*

The power of Authority to determine maximum price for a regulated service was also affirmed by the Court of Appeal in its decision in Civil Appeal Case No. 3472 of 2016 where it declared that while the URA had the authority and powers to establish maximum price for Port Vila water services such price determination must be subject to Section 3. In the last water tariff review, the court found that the Port Vila water decision was inconsistent with the concession contract because URA had not adopted the review process laid out in the concession and thereby rendered the Decision invalid. The Court noted:

*"the valid procedure [under the Water Concession Contract] was not adopted by the Regulator in determination of Water Tariffs, which involves the determination of the issue by a Commission of three members, one to be nominated by the Government (or the Regulator), the second by UNELCO, and the third by the two members then so appointed." (Paragraph 90)*

Under the URA Act, several contractual rights of the Government to administer the concession contracts including tariff review have been assigned to the URA. Section 20(2) of the URA Act provides:

*"The rights exercisable by the Government in the contracts described in Part B of Schedule 1 are assigned to the Authority, but may only be exercised by the Authority upon receiving the written approval of the relevant Minister."*

Based on the ruling of Court of Appeal and the interpretation of the URA Act above, we are of the view that **the primary responsibility and jurisdiction of undertaking the tariff review under the concession contracts lies with the URA. Any amendment that departs from this will be a violation of the URA Act.**

Further, for the purpose of better regulation in the interest of consumers, utilities and Government and to avoid any unnecessary litigation, the Authority wishes to clarify its position with respect to the Addendum No. 6 – of the Concession Contract for the Management and Operation of the Water Supply Services in Port - Vila, in particular on the following matter:

### **APPLICATION OF SECTION 3 OF THE URA ACT**

Section 3 of the URA Act (as amended in 2016) states that:

*"Subject to subsection 29B(7), this Act applies to a regulated service to the extent that it is not inconsistent with a provision in any concession agreement under the Electricity Supply Act [CAP 65] existing on or before the commencement of this Act or a provision of any other Act".*

In the past, UNELCO has asserted the applicability of Section 3 of Utilities Regulatory Authority Act No. 11 of 2007 (URA Act) to its PV water concession agreement, which requires URA to act in a manner not inconsistent with the concession contract.

Section 3 of the URA Act clearly states that it only applies to the agreements that existed on or before the enactment of URA Act. The Act does not mention the application of section 3 in respect of amendments made to those concession contracts subsequent to the URA Act. Any amendments to the concession contract are not subject to Section 3 restrictions. Further, it is also our view that any material and substantial amendments to an existing contract can be deemed to be equivalent to entering into a new contract and thus the entire contract is outside of section 3.

Therefore, we are of the view that **if there is any material or substantial change in the Port Vila Water Concession Contract, the amended contract will be regarded as a new contract for the purpose of section 3 of the URA Act.**

The terms of the amendments and/or new contract should therefore reflect the regulatory regime currently in our laws.

## SECTION 2

### 7. THE PORT VILA WATER CONCESSION CONTRACT

Paragraph E on page 1 of the proposed addendum states the following:

*E. “The Government and the Concessionaire have agreed that the Port-Vila Concession Contract shall be varied in accordance with this Addendum to allow the extension of the water concession to surrounding and nearby areas of Port-Vila and **to provide for the amendment of the water tariff** and the creation and use of a water fund to finance the extension of the Port-Vila Water Concession.”*

Further, Article 6 of the proposed addendum provides for the MAXIMUM RATE FOR WATER. It replaces Article 21 of the Schedule of Conditions of 23<sup>rd</sup> December 1993 and Article 2 of Addendum N°3 of 1 August 1998 and **proposes a new base rate (P.) as 66.72 vatu.**

This is not in accordance with the process laid out under Article 22 of the Port Vila Water Concession Contract which provides for the Review of Maximum Base Rate and Corrective Terms. It states the following:

*“In order to maintain the tariffs in harmony with operating costs and depending on the variations in the economic conditions, **the base rates shall able to be reviewed at the request of either the OPERATOR or the Government:...**”*

The base rate can only be reviewed when a request for the same is made by either by the Government or by UNELCO and both parties have to be clear on what the implications are behind the new rates. Through the proposed addendum, **UNELCO has unilaterally revised the base rate without following the process of making an application request to the Government in accordance with the provision of their contract.**

## **8. INDEPENDENT FINANCIAL & ECONOMIC REVIEW OF THE PROPOSED AMENDMENT TO THE PV WATER CONCESSION CONTRACT**

### **8.1 Purpose of this Section**

The purpose of this section is to provide an independent financial and economic review of the proposed amendments to the Port Vila Water Concession contract and provide regulatory advice on any substantial matter affecting the safe, reliable and affordable delivery of water services in Port Vila.

Pursuant to the Council of Ministers Decision 93/2018, one of the key elements of the proposed amendment is to achieve an AFFORDABLE drinking water in the areas surrounding Port Vila. This part of the document mainly provides review of this key element from an economic and financial perspective and whether the proposed amendment is likely to achieve the intention of the Government. Matters affecting the other key elements (safe and reliable) of the proposed amendment are discussed in other sections of this position paper.

The Authority through its comprehensive review of the proposed amendment provides due consideration to the following financial matters:

1. Whether the original intention of the Government to enable affordable drinking water in the areas of Port Vila is being fulfilled through the proposed amendment, in particular the impact of the new Rise & Fall formula and the amendment to the Water Development Fund.
2. The extent to which the binding financial agreement provisions in the proposed amendment affects the legitimate interest of the Government and Customers.
3. Consider alternatives to the proposed amendments.

### **8.2 Review in Response to Article 7(RISE AND FALL PROVISIONS) of the Proposed Amendment**

The purpose of the Rise & Fall Provisions is to allow fluctuations in certain input prices (electricity cost, wages and materials) to be passed through to water customers. This allows UNELCO to collect sufficient revenue to supply water services should input prices increase, and allow customers to benefit when input prices fall.

The Rise & Fall Provisions only takes into account external factors that are outside the control of the utility and has a material impact on the utility's ability to recover the allowed revenue determined during the tariff review, such as electricity price fluctuations that are dependent on fuel market supply and demand and forms a major portion of the utility's costs.

The Rise & Fall formula is an integral part of the overall proposed amendment which will drive the tariff calculations for the upcoming tariff period. The Authority upon through assessment determined that the new mechanism proposed under the amendment to calculate reference price

P differs significantly from the current contract approach and is designed to largely protect UNELCO's interest by purportedly transferring the major segment of the business and financial risk to the water consumers.

The proposed amendments to the Rise and Fall formula should justify values and principles that would align the interest of the major stakeholders and more specifically should demonstrate alignment of the utility's strategic objectives with its current and future customers' expectations for reliable and reasonably priced service, accomplishment of government objectives in the water sector and should reflect best international practice in Utilities operations.

The new mechanism proposed under the amendment is driven by the following principles which are discussed and have been reviewed by the Authority as follows:

### **8.2.1 Revenue Decoupling (Demandn-1/Demando)**

The new formula includes full decoupling as one of its key principles which seeks to decouple UNELCO's compensation from volumes sold and customer mix and attempts to guarantee fixed level of returns to UNELCO without a contra adjustment to the rate of return to reflect the reduced risk to the Utility.

Decoupling represents a departure from common regulatory practice and should be considered with appropriate care. UNELCO has not supported its proposed option for Revenue decoupling with a proper plan incorporating efficiency targets, cost benefit analysis of each program/project, cost effective conservation plans, voluntary utility programs, projected annual water savings, reduction in per capita water use etc which can demonstrate that the option for revenue decoupling would be most effective in achieving Regulator/Commission objectives, needs of the Utilities and provides greatest benefit to Customers. In the absence of such plans, any such proposals would seem to be mainly in the interest of the Utility.

The following summarizes the risks and impacts of accepting the proposed Rise & Fall formula incorporating the Revenue decoupling principle:

- (1) A very large potential risk of revenue instability is shifted from UNELCO to Customers. It shifts all risk of under recovery to rate payers, typically with no recognition of the reduced risk through a reduction on return on equity. The theory and practice of ratemaking is that rates are set to enable a utility the reasonable opportunity to earn its allowed return. Decoupling and high customer charges give a utility the virtual certainty that it will earn the allowed rate of return. The risk that UNELCO will over earn is shifted to the customers (and particularly to the lower usage customers). With high customer charges recovering all or most fixed costs, customers provide the full revenue requirement, regardless of UNELCO's performance. While decoupling mechanism adjustments yield both refunds and surcharges, research shows that surcharges are more likely than refunds. The research conducted by Pamela Morgan states that after decade of Decoupling experience across all US electric and gas utilities 62% of adjustments were

surcharges and 38% were refunds<sup>2</sup>. Since the Company's risk is lowered significantly if recovery of fixed costs is done through high charges, the utility's required return should also be lowered by a meaningful amount to reflect the reduced risk.

- (2) Since decoupling adjusts actual revenues to align them with revenue requirements, it reduces regulatory lag. Revenue decoupling appears to eliminate or significantly reduce the positive effect of regulatory lag which provides an incentive for utilities to operate efficiently in order to maximise profits. For a monopoly like UNELCO, this concept is very important for its own interest but any new rate design should not forgo the benefit of this traditional ratemaking principle.
- (3) Revenue decoupling will result in imposing a hefty customer charge while reducing volumetric rates which are contrary to the goals of water affordability and conservation. Indeed, such a rate design discourages conservation, as usage is not tied to cost for the customer, thereby taking away an incentive to conserve. At the current stage, high customer charges will be harmful to low income customers who already struggle with water affordability.
- (4) Revenue decoupling will incentivise UNELCO to focus mainly on cost minimisation initiatives(which may not be economical in the sense of reduction in the quality of services provided by UNELCO) in order to achieve a level of cost of services which is below the level of allowed cost of service to obtain further increases to bottom line profitability. Another side effect could be that UNELCO will feel less pressure to offer services tailored to customer needs.
- (5) Revenue decoupling will also mean potential changes in management behaviour that makes them less likely to respond quickly to avoid sales disruption. For example, Brennan (2012) notes that after Hurricane Isabel, the electric utility may have been slow to respond because they knew they would receive their revenue requirement regardless of whether their sales took a hit from the storm.
- (6) Relative to other countries (including in the Pacific Region), water access levels in Vanuatu are unusually low. Access to clean, reliable and affordable water is one of the top priorities of the Government. Throughput incentive (removed by full Decoupling) refers to the financial incentive for utilities to increase water sales as means to increase revenue and profits. While throughput incentive works against water conservation programs it is aligned in that regard with Government's priority to significantly improve water access levels in Vanuatu as these are ultimately translated into increased water sales.

When considering the option for incorporating Revenue decoupling into the Rise & Fall formula, due consideration should be given to the impact on utility bills, especially lower usage and low income customers, public policy goals that needs to be advanced, level of risk to

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<sup>2</sup> <sup>2</sup> A Decade of Decoupling for US Energy utilities: Rate impacts, Designs, and Observations by Pamela Morgan, Graceful Systems, LLC



customers and the appropriateness of decoupling mechanism at the current stage. Currently, the issue of accessibility and affordability of water services is posing a major hindrance to Vanuatu's overall economic development and specially is burdening the low income earners. With the recent increase in inflation and cost of living in Vanuatu, affordability of water services is a prime concern for the Low income earners and they should be able to count on lowering their bills if they consume less water. That is an outcome that truly aligns the customer and utility interest at the current stage of Vanuatu's economy.

### **8.2.2 “Return Of” and “Return On” Capital Employed (Capexn-1/Capexo)**

The current Rise & Fall formula does not provide parameters to reflect the evolution of returns to be based on the actual investments by the Utility or allows exclusive compensation of the management of third party assets. Both the principles proposed under the new formula are reviewed and discussed as follows:

#### **Compensation of the Management of Third Party Assets**

The new formula proposes to create dual compensation system by getting return on investment for assets acquired by the Concessionaire and O&M management fee for assets acquired by third parties but managed by the Concessionaire.

The Authority considers the inclusion of the additional third party asset management fee in the calculation of the reasonable return to be inadmissible due to the following reasons:

- (1) The standard regulatory principles<sup>3</sup> is that no profit beyond the cost of capital is anticipated or provided for in a regulated utility. The risk premium allocated to the Cost of Capital (WACC) is calculated based on the risk assessment of the overall utility operations and not just the component of the operations funded by the Utility. Therefore, UNELCO's claim that the share remaining to be compensated for the risk associated to the management of third party assets is unjustified and has already been compensated for in the cost of capital allocation.
- (2) The third party assets are provided to UNELCO at zero capital cost and all the necessary expenses required for operating and maintaining these assets are also provided in the tariffs. There are no such provisions in the concession contract that penalises the utility for improper management of the third party assets. Penalties only apply to interrupted services (subject to no proper justification) and such penalties are also financially immaterial. Therefore, the Utilities risk exposure to financial risk associated with the management of third party assets is minimum and has been adequately incorporated in the cost of capital calculation. Furthermore, the risk assessment (WACC) and the contractual rate of return of 12% stipulated under sub article 7.3 of the PV Water Concession Contract does not account separately for the management of third party assets and UNELCO funded assets. If this has been the case, the rate of return

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<sup>3</sup> Accounting for Public Utilities 2013, Volume 1, Hahne, Aliff, page 3.02

contractually allocated to UNELCO would have been reduced taking into account the minimum risk associated with the management of third party assets. UNELCO is currently at an advantage of being having its risk premium calculated at the overall business level.

- (3) The proposal is outside the bounds of the concession contract which provides the rights and obligates the Concessionaire to take possession of all the land and facilities (third party funded assets) necessary for the production and distribution of water services and earn reasonable compensation through optimal use of these assets. It would not be possible for UNELCO to generate the optimal level of returns without the use of the third party funded assets which has been provided at zero cost. In other words, the part of the revenues generated through the utilization of third party assets does not incur a corresponding capital cost to UNELCO. Moreover, the concession contract does not require dual compensation to be paid to the concessionaire for undertaking the rights of the concession.
  
- (4) It is also uncertain as to how and on what basis the return of 2.7% is calculated in the formula.

#### Incorporating Actual Asset Base in the Rise & Fall Formula

The prudent and standard industry and regulatory practice for the determination of the Regulatory Asset Base requires the Utility's to be only compensated for those investments which are considered to be prudent, used and useful. The proposed new mechanism forming the basis for determining the RAB for the inclusion into the tariff formula does not provide provisions for independent regulatory review and a proper assessment by the Regulatory Authority to determine the reasonable level of RAB to be included into the tariff formula. UNELCO's RAB calculations are based on actual values published in the certified financial statements with no provision in the proposed formula for any adjustment for imprudent investment.

Using the Actual Asset Base in the tariff formula is also inconsistent with the standard regulatory practice which requires the RAB to be determined mainly based on a 5 year average investment cost basis. Using the actual asset base in the tariff formula without implementing any investment caps would trigger unexpected rate shocks and may create Averch-Johnson effect.

The proposed formula also results in a double charge of annual depreciation expense and provides no offset of the Customer Security deposits to the working capital requirement.

#### **8.2.3 CPI Adjustment**

The new formula proposes to use local inflation as a basis for the evolution of operational cost. Inflation adjustment tend to be offered within the context of a limited range of costs/expenses and cannot be used a proxy for evolutions of other costs that may be recovered through separate recovery mechanisms and determinations. The important question to be discussed is whether a consumer focused index (Vanuatu general CPI) is relevant for the water sector, as the majority of the costs of this sector relates to personnel cost, equipment & materials and purchased power.

The bundle of domestic products and services used in determining the overall inflation adjustment may not bear a strong resemblance to the input price of the water industry in Vanuatu. In any case, an industry specific index has the potential to more accurately reflect the particular costs of the Utility.

The proposal to use local CPI poses a huge risk in that using the general Vanuatu CPI and indexing to overall Operational Cost (excluding purchased power and reasonable return) can easily equate to the pass through of inflated cost (above actual cost) without sufficient regard to efficiency and productivity considerations. It is important to note that UNELCO's proposal for inflation adjustment will adjust tariff rates based upon changes in quarterly inflation as published by VNSO. It may be true that certain category of expenses may show an increase or decrease in prices throughout the economy. However, such changes in prices do not necessarily flow directly, dollar to dollar, to a utility's cost. It does not allow for cost savings that may result from increased efficiencies on the part of the Utility or cost that may not change due to existing contracts. Furthermore, such an arbitrary adjustment proposed will not encourage innovation and efficiency on the part of Utilities. There is simply an insufficient nexus between changes in inflation and the actual cost incurred by Utilities.

### **8.3 Review in Response to Article 4 (INDEMINITY BY THE GOVERNMENT) of the Proposed Amendment**

Article 4 of the proposed amendment requires the Government to fully indemnify the Concessionaire from and all claims, suits, actions and proceedings arising out of or relating to the Government satisfying the conditions precedent under Article 3.

Article 3 provides a joint obligation for the Concessionaire and the Government to ensure that the conditions precedent under Article 3 has been satisfied before the Concessionaire begins the transition process described under Article 5. In particular Article 3(f & g) imposes specific requirements on the Concessionaire to fulfil its obligation under Article 3.

In view of the above explanation, placing the entire financial burden on the Government under Article 4 of the proposed amendment seems to be unjustified and contractually unfair.

### **8.4 Review in Response to Article 9 (WATER DEVELOPMENT FUND) of the Proposed Amendment**

Article 9 of the proposed amendment requires a contribution of 5 Vatus per cubic meter to the Water Development Fund which is an increase of 400% from the pre-existing contribution of 1 vatu under Article 29 of the PV Water Contract and an increase of 12% from the current base rate of 41.17 vatu per cubic meter.

The Authority notes the following concerns on the proposed amendments:

- (1) Article 9 intends to replace the pre-existing Article 29 of the contract; however it does not specify the objectives of the newly proposed Water Development Fund.

- (2) Assuming the proposed Article 9 is intended to serve the same purpose as the pre-existing Article 29 of the contract which is to benefit the low income earners via assisting in the funding of water connections; then the affordability of the water tariffs in view of the increase by 12% should be a matter of great concern to the Government. This may have an adverse effect on the low income users resulting in greater rate of disconnections.
- (3) No timeline for the annual appropriations to the Water Development Fund has been provided. The fund will accumulated an average of around 20m vatu a year and requires a proper funding plan and strategies to be consulted with the general public.
- (4) In light of the current increase in VAT, Inflation, cost of living in Vanuatu, proposed increase in water tariffs and imposition of regulatory fees on the customers, in the short run it would be unfair to impose further burden on the customers with a drastic increase of 400% to the contribution fund.
- (5) Customer Contributions should be regarded as a last resort to financing such development initiatives by the Government. Other funding mechanisms such as donor financing, foreign donations and loans should be exhausted upfront followed by Customer contribution funding the remaining requirements.

## 9. VANUATU SERVICE ENGIE REPORT

In 2017, the Ministry of Lands considered expanding several of the water supply networks in peri-urban areas of Port Vila networks. In that regard a preliminary assessment of the water supply networks current status was required.

The Vanuatu Engie Services (VSE) was assigned with these assessments to oversee the status of operation and evaluate its ability to be expanded. The study covered the areas of Tuk Tuk, Boukoura, Mele Maat, Mele, Beverly Hills, Bellevue, Teoumaville, Eratap and Narpow Point.

One important aspect of the study was focused on the likelihood of connecting each of the identified small water networks to the existing UNELCO network.

From the study, it can be concluded that the UNELCO's physical network will be limited to only Port Vila and eventually Beverly Hills and Bellevue once asset transfer arrangements are completed. Although the involvement of UNELCO as described herein will surely improve access to clean and reliable water supply service to SWS customers, there are some significant shortfalls that could be an issue going forward:

Firstly, Article 3 of the Proposed Amendments provide for certain conditions precedent that must be agreed to by the Government and UNELCO prior to UNELCO commencing the transitioning process. The condition precedent set out under Article 3 must accommodate the support of all Small Water Suppliers/networks prior to the Government signing any agreements with UNELCO. The action of the Government to pursue the idea of establishing a water concession on Efate should only be entertained upon a proper and fair acquisition of the Small Water Suppliers/networks by the Government.

Secondly, the cost of accommodation of sectors identified in the proposed amendments is uncertain at this stage given the report prepared by VSE is the only official document detailing the technical and financial assessments of the identified small water suppliers/networks. The Government's efforts to establish such costs in still in the preliminary stages and require further assessments prior to agreeing on a way forward.

## 10. THE AUTHORITY'S RECOMMENDATION

In response to the detailed review and discussions of the proposed amendment to the Port Vila Water Concession Contract, the Authority would like to summarise its advice and provide the following recommendations on the important factors that needs to be considered by the Government prior to formalising the stated amendment:

1. The proposed amendment to the PV Water Concession Contract should reflect the current legislative requirements and laws of Vanuatu and should ensure that an equitable and transparent process is being followed to avoid contractual disadvantage to the affected parties. The Authority under Section 1 of this document has highlighted that the proposed amendment results in major inconsistencies with the relevant laws of Vanuatu and therefore has recommended a preliminary proposal in respect of the amendments to the PV Water Concession Contract for the Government's consideration and negotiation with the Concessionaire (please refer attached to Annexure 1). The preliminary proposal by the Authority ensures that the prescribed amendments incorporates the current legislative requirements and development in the laws of Vanuatu and incorporates the current economic conditions of the country maintaining a fair and balanced interest of the contracting parties and the Customers.
2. The proposed new mechanism and principles introduced in the Rise & Fall formula (Article 7 of the proposed amendment) does not present an outcome that truly aligns and balances the interest of the Customers, Government and the Utility. It is designed and structured in a manner which largely protects the interest of the utility, results in a contractual disadvantage to the Government and transfers a significant portion of unwarranted business and finance risk to the customers. Concomitantly, the proposed mechanism does not provide any provision for regulatory scrutiny by the Regulatory Authority and places undue pressure on the water prices.

The Authority provides its advise that the tariff calculations requires an advance level of financial and economic analysis to be conducted and a specialised knowledge inherent to determine each elements of the building blocks of tariff and therefore recommends that such exercise should be carried out by a competent Authority and in particular by the Utilities Regulatory Authority under the powers assigned to it under the URA Act.

3. The Authority would like to request the Government to reconsider the contribution rate of 5 vatu to the Asset Renewal Fund in light of the affordability matters discussed under Section 2 of this document and set clear objectives and administrative rules of such fund.
4. The Authority recommends that the COM's decision 93/2018 to increase access to clean and reliable water should be done through the regulatory framework as opposed to the proposed amendments. The Authority notes that the proposed amendments do not take into account the intention of COM's decision 93/2018.

5. The Authority insists that a separate section is to be inserted into the amendments describing the various elements of the Utility operations that are to align to the government's vision on increasing access to clean and reliable water by customers.

## ANNEXURE 1

### **ADDENDUM N° 6 –**

### **OF THE CONCESSION CONTRACT FOR THE MANAGEMENT AND OPERATION OF THE WATER SUPPLY SERVICES IN PORT-VILA**

BETWEEN:

The GOVERNMENT OF VANUATU represented by its Prime Minister and the Minister for Lands and Water Resources duly authorized by the Council of Ministers (hereinafter referred to as the “Government”),

AND

UNION ELECTRIQUE DU VANUATU LIMITED (referred to as the “Concessionaire” and “Operator”).

### **WHEREAS:**

- A. The Government and the Concessionaire entered into a concession contract dated 23 December 1993 for the management and operation of the water supply services in Port Vila (water production and distribution) by the Concessionaire for a term of 40 years and any further extension (as subsequently amended by Addenda No.s 1 – 4 and the Addendum dated 11 September 2013, the "Port Vila Concession Contract").
- B. Under Article 4 of the Port Vila Concession Contract, the Government may, on the twentieth year of the contract, and subject to prior written notice to the Operator, decide to terminate the Port-Vila Concession Contract at the end of the twenty fifth year of the contract.

C. On 19 December 2013, the Government exercise its rights to terminate the Port Vila Concession Contract at the end of the twenty fifth year under Article 4 of the Port-Vila Concession Contract (“Notice”).

D. Following the Notice, the Government and the Concessionaire have held discussions regarding the Port-Vila Concession Contract.

E. The Government and the Concessionaire have agreed that the Port-Vila Concession Contract shall be varied in accordance with this Addendum to allow the extension of the water concession to surrounding and nearby areas of Port-Vila and to provide for the amendment of the water tariff and the creation and use of a water fund to finance the extension of the Port-Vila Water Concession.

F. The Government hereby withdraws the Notice to allow the Concessionaire to operate the Port-Vila Water Concession until the expiry of the contract in 2033 in accordance with the terms of the Port Vila Concession Contract as amended by this Addendum.

G. Since the signing of the Concession Contract to this year 2017, the legal framework governing certain matters included in the Concession Contract is in a more advance stage;

H. The legal framework referred to under F comprise of:

(i) Public Finance and Economic Management Act [CAP 244] (enacted in 1998) and subsequent amendments;

(ii) Government Contracts and Tenders Act [CAP 245] (enacted in 1998) and subsequent amendments;

(iii) Water Resources Management Act [CAP 281] (enacted in 2002) and subsequent amendments;

(iv) Utilities Regulatory Authority Act No.11 of 2007 (enacted in 2007) and subsequent amendments.

I.

THEREFORE, it is agreed as follows:



## CONDITIONS

### **ARTICLE 1 - RECITALS**

The second paragraph of the RECITALS is deleted and replaced with the following text:

- Accordingly the OPERATOR shall, within the limits of the Contract and the applicable regulations and laws of Vanuatu undertake the following obligations: manage and operate the water supply services in PORT VILA.(water production and distribution)
- finance and construct the works including renewals, upgrading, extensions and rehabilitation of the network in conformity with this contract.

### **ARTICLE 2 – Geographical area of the Concession**

Subject to the satisfaction of the conditions precedent in Article 3 of this Addendum, the geographical area of the Port-Vila Water Concession is extended to include sectors of the following areas: Boukura, Teoumaville, Mele Maat, Tuk Tuk, Bellevue, Beverly Hills, Narpow Point, Mele, Eratap and Etas (individually referred to hereinafter as “Area” or collectively referred to hereinafter as the “New Concession Area”).

### **ARTICLE 3 – Limits of the Concession BY SEPARATE ADDENDUM**

The Government and the Concessionaire will define the limits of the New Concession Area and will sign a separate Addendum for the concession extension to each individual Area identified in Article 2.

This Addendum will:

- a) stipulate the conditions, if any, which may be specifically applicable to an Area; and
- b) include the relevant plan which describes the limits of the concession.

### **ARTICLE 4 – CONDITIONS PRECEDENT**

The Concessionaire shall begin the transition process (described in Article 5) for an Area, once and only if, the Concessionaire and the Government agree in writing that the following conditions precedent have been satisfied for that Area:

- a) the Government has obtained rights of passage and easements on a band of 3m along the entire existing and planned water infrastructure, either voluntarily or by compulsory acquisition under the *Land Acquisition Act [Cap 215]*;
- b) the Government has lifted any and all claims from any individual and/or entities currently providing water services within the Concession New Area.
- c) the Government has obtained full-unencumbered property and ownership of any useful existing infrastructure to provide water service (the Government may finance any required transfer costs using the funds accumulated in the Water Development Fund provided for in this Addendum and any other means at its disposal);
- d) the Government has formally transferred these assets into the Port-Vila Water Concession (these assets will be considered as third party financed assets);
- e) the Government has taken all the necessary steps to ensure that the relevant water source(s) and resource(s) of the New Areas are adequately protected;
- f) the Concessionaire has completed the zone-specific transition and development study;
- g) the Concessionaire and/or the Government, as relevant, has lifted any conditions specific to an Area as required in Article 2;
- h) the Government has sufficient existing funds and/or provisional contributions earmarked in the Water Development Fund to deploy the required investment.

For the avoidance of doubt, in case of disagreement of the Concessionaire and the Government as to whether the conditions have been met, the conditions will be taken to have not been met.

## **ARTICLE 5 – INDEMNITY BY THE GOVERNMENT**

The Government releases and indemnifies the Concessionaire from and against all claims, suits, actions and proceedings arising out of or relating to:

- a) the provision of water services in the area prior to the Concessionaire first providing service to customers in accordance with Article 6; and
- b) the Government satisfying the conditions precedent in Article 4.

## **ARTICLE 6 – TRANSITION CONDITIONS**

The Concessionaire shall begin providing service to the first customers in an Area no later than twelve (12) months after the Government and the Concessionaire have agreed in writing that all conditions precedent described in Article 3 have been satisfied for that Area.

In consideration of the state of the existing water infrastructure (if any) at the time at which it is incorporated into the Concession, and the time required to bring the water service to standard, the penalties, service level and quality requirements prescribed by the Port-Vila Concession Contract shall not apply for the first twenty-four (24) months from the Concessionaire first providing service to customers in accordance with this Article.

## **ARTICLE 7 – DURATION OF THIS CONTRACT**

(Replaces sub article 2.2 of the Contract)

“The OPERATOR may request the renewal of the contract no later than four years prior to its expiry”.

The Request for renewal is subject to the requirements of the Government Contracts and Tenders Act [CAP 245] (as amended).

## **ARTICLE 8 – RECOVERY OF THE UTILITY AT THE END OF THE CONTRACT**

(Replaces second paragraph of Article 3 of the Contract)

“The OPERATOR shall be granted an indemnity for those works which have not been totally depreciated, which were constructed by the Operator during the last ten years of the contract and to which the OPERATOR had contributed financially”.

“The OPERATOR shall be granted an indemnity equivalent to the investments financed by the Operator (which will be subject to review and authorization by the Utilities Regulatory

Authority) after deducting depreciation proportional to the period until the contract is terminated. The value of investments and the accumulated depreciation to be calculated under this provision will be determined based on the original cost recorded by the OPERATOR as per its audited financial statements”.

#### **ARTICLE 9 – SPECIAL CONDITIONS**

(Addition to sub article 7.2 of the contract to be inserted after the last paragraph)

“An annual report shall be submitted to the GOVERNMENT and the Utilities Regulatory Authority giving a progress on the implementation of the Master Plan”.

(Third paragraph of sub article 7.3 is amended as follow):

“The maximum tariff for the supply of water will be reviewed and determined by the Utilities Regulatory Authority in such a way as to ensure a reasonable level of compensation to the OPERATOR”.

Second paragraph of sub article 7.4 is amendment as follows:

“The OPERATOR shall supply water to all persons requesting a subscription within the concession boundaries. The subscription shall be established in accordance with the rules established by the Utilities Regulatory Authority”.

#### **ARTICLE 10 – GENERAL CONDITIONS**

(Amendment of Article 8 of the contract)

After Insert sub article 8.6 insert

“8.7 Applicable laws

This Contract, as a whole, is subject to the laws of the Republic of Vanuatu”.

#### **ARTICLE 11 - Compliance With and Changes in Laws and Regulations**

“Both parties to this agreement shall at all times observe and comply with all Applicable Regulations in carrying out their obligations under this Agreement. Both parties shall be deemed at all times to have full knowledge of the relevant laws and regulations of Vanuatu”.

## CONSEQUENTLY

### **ARTICLE 12 – Water – Quantity, Quality and Pressure**

(First paragraph of Article 11 amended as follows):

“The OPERATOR undertakes to supply water for the public and private use in the Concession Area up to 400 liters per dwelling per day”.

### **ARTICLE 13 – Fire Hydrants**

(The following paragraph is inserted at the end of Article 19):

“The fire hydrants can be used for emergency Water Supply or water trucking as requested by the Government. UNELCO shall be involved in the decision in order to mitigate impact on the service.”

### **ARTICLE 14 – MAXIMUM RATE FOR WATER**

(Replaces Article 21 of the Schedule of Conditions of 23 December 1993 and Article 2 of Addendum N°3 of 1 August 1998).

Base Rate

“The Price for which the Operator is authorized to sell water to the subscribers must be set by the Utilities Regulatory Authority according to the provisions of the URA Act.”

This Base Rate ( $P_0$ ) is adjusted every three months, based on the Rise and Fall Formula described in Article 22 of the Schedule of Conditions, in order to calculate the Reference Rate (P).

To the applicable Reference Rate, are added:

- the Water Tax as provided for in Article 23 of the Schedule of Conditions of 23 December 1993,
- the Water Development Fund, as provided for in Article 29, as amended by this Schedule of Conditions of 2018
- the Value Added Tax (VAT), in accordance with VAT Act N° 12 of 1998, at an applicable rate of 15% as of the signature of this amendment but automatically updated to reflect any future evolutions of this rate as mandated by Customs and Inland Revenue,
- and any mandated Regulatory Surcharge automatically updated to reflect any future evolutions.

The Water Tax, Water Development Fund, VAT, and the Regulatory Surcharge, shall form an integral part of the invoice and failure to pay the full amount, including these three elements, will result in the interruption to the supply of water by the OPERATOR as is the case in the event of non-payment of the full amount of the part of the invoice corresponding to the water consumption.

## 1. Subscription Fee

The subscription fee (A<sub>0</sub>) to be charged to subscribers must be as set by the Utilities Regulatory Authority.”

The Subscription Fee is charged every three months, based on the characteristics of the water meter of each customer and irrespective of the volume of water consumed

Subscription Fees obtained by the application of the coefficients above shall be rounded off to the nearest vatu.

The Subscription Fee includes maintenance costs of water connections, the rental and the maintenance costs of meters. The meters remain the property of the Operator.

In order to accommodate for the logistics constraints of meter readings, and the fact that the interval between meter readings shall not always be exactly a Standard Quarter (90 days), the Subscription Fee shall be prorated based on the actual days of each customers' billing period. The Reference Price and the corresponding Subscription Fee at the time of the beginning of the meter reading cycle are the rates applicable to the entire customer invoice.

## 2. Proportional Rate

Coefficients shall be applied to the Reference Rate according to the consumption range, as follows:

Consumption range per standard quarter	Unit price at T <sub>0</sub> (vatu per m <sup>3</sup> )	Coefficient to calculate the PROPORTIAL RATE at P
from 0 to 50 m <sup>3</sup> per quarter	41.17	1.00 x P

Consumption range per standard quarter	Unit price at $T_0$ (vatu per m <sup>3</sup> )	Coefficient to calculate the PROPORTIAL RATE at P
from 51 to 100 m <sup>3</sup> per quarter	53.52	1.30 x P
from 101 to 200 m <sup>3</sup> per quarter	57.64	1.40 x P
Beyond 200 m <sup>3</sup> per quarter	61.75	1.50 X P

Prices obtained by the application of the coefficients above shall be rounded off to the nearest second decimal point,

In order to accommodate for the logistics constraints of meter readings, and the fact that the interval between meter readings shall not always be exactly a standard quarter (90 days), the thresholds of each consumption range shall be prorated based on the actual days of each customers' billing period. The Reference Price and the corresponding Proportional Rate at the time of the beginning of the meter reading cycle are the rates applicable to the entire customer invoice.

#### **ARTICLE 15 – RISE AND FALL PROVISIONS**

*(Replaces Article 22 of the Schedule of Conditions of 23 December 1993 and Article 3 of Addendum N°3 of 1 August 1998).*

##### 1. Rise and fall equation

The Base Rate ( $P_0$ ) and ( $A_0$ ), defined in Article 21, shall be adjusted every three months, on calendar quarters (on or about the fifth of the month of January, April, July, and October) by application of an Adjustment Factor set by the Utilities Regulatory Authority.

##### 2. Review of Maximum Base Rates and Correctives Terms

“In order to maintain the tariffs in harmony with operating costs and depending on the variations in the economic conditions, the base rate shall be reviewed and determined by the Utilities Regulatory Authority at the request of either the Operator or the Government or initiated by the URA.”

#### **ARTICLE 16 – SECURITY DEPOSIT**

*(Replaces Article 24 of the Schedule of Conditions of 23 December 1993).*

The security deposit and the related terms and conditions shall be determined in accordance with the rules prescribed by the Utilities Regulatory Authority.”

### **Article 17 – Billing**

(Article 25 is repealed and replaced with the following):

The frequency of billing subscribers will be as prescribed in the Utility Billing and Payment Rules issued by the Utilities Regulatory Authority.”

### **Article 18 – Cost of Water Connections – Construction and Maintenance**

Article 28 is repealed and replaced with the following:

The Cost of construction of water connections established by the Operator must be reviewed and approved by the Utilities Regulatory Authority.”

Construction costs for connections shall be adjusted every six months in accordance with the economic conditions which shall be justified by the price of « Labour and Materials » in the construction of a water connection.

### **ARTICLE 19 – WATER DEVELOPMENT FUND**

*(Replaces Article 29 of the Schedule of Conditions of 23 December 1993 and Addendum dated 11 September 2013)*

The Concessionaire shall include a « Water Development Fund Contribution » on each water invoice issued to the consumers. The Water Development Fund Contribution is set at ... Vatus per cubic meter sold by the Concessionaire.

In accordance with the *Public Finance and Economic Management Act [CAP 244]* (as amended) the Concessionaire shall remit to the Government, every calendar quarter, the amount of the « Water Development Fund Contribution » invoiced to customers during the previous quarter. The amount remitted during the 2nd quarter of every calendar year shall be abated by the « Water Development Fund Contribution » portion of any customer debt that was uncollected and duly written off by the Concessionaire in the previous financial year.

For the avoidance of any doubt, the Concessionaire’s role shall be limited to remitting the Water Development Fund Contributions to the Government; the subsequent care, management and



use of the Water Development Fund is the full responsibility of the Government and not governed by this Addendum.

The balance of the remaining funds, if any, from Article 29 of the Schedule of Conditions of 23 December 1993 which may have accrued prior to this Addendum, shall be remitted to the Government with the Water Development Fund Contribution of 1 October 2018.

#### **ARTICLE 20 – REVIEW OF CONTRACT AT MID TERM**

The Government withdraws the Notice and waives any rights that it has or, but for the execution of the Addendum, may have had under Article 4 of the Port-Vila Concession Contract.

#### **ARTICLE 21 – SUBMISSION OF FINANCIAL RECORDS**

(replaces sub article 33.3 of the Schedule of Conditions of 23 December 1993 and Addendum dated 11 September 2013):

The OPERATOR shall carry on its business and affairs with due diligence and efficiency and in accordance with sound international financial and commercial standards and practices and shall fully account for all aspects of its business by preparing financial statements and delivering them to the Government and the Regulatory Authority as follows:

- (a) at the end of each financial year and in accordance with the deadline stipulated under sub article 33.1, the OPERATOR shall prepare and submit to the Government and Regulatory Authority the OPERATOR's balance sheet, a profit and loss account and a statement of cash flow drawn up in accordance with generally accepted international accounting practices and applicable corporate laws in Vanuatu and certified by qualified corporate auditors registered in Vanuatu;
- (b) the OPERATOR shall prepare and submit to the Government and to the Regulatory Authority a quarterly statement of the OPERATOR's revenues and disbursements, expected trends for the next quarter, progress concerning current investment and proposed additional investments ;
- (c) the OPERATOR shall prepare for submission to the Government and Regulatory Authority such other information on the financial position of the OPERATOR as the Government and the Regulatory Authority may from time to time reasonably request to monitor compliance with the Applicable Regulations and with this Agreement.

At the end of each financial year the Government shall be entitled to appoint, at its own expense, its own qualified auditor to verify the information provided by the OPERATOR pursuant to Clause (a) above and the OPERATOR shall provide all reasonable assistance to such auditor.