Independent utilities regulation: The case of Vanuatu

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Vanuatu is a small island country in the south-west Pacific Ocean. It consists of 82 islands of which 65 are inhabited, with a total population of about 270,000. The country spans a large geographical area, with the distance north to south being more than 1,300 km. Only four islands have a power grid of which Efate is the largest and includes the capital, Port Vila. The islands are not connected electrically.

The total electric system peak load in Port Vila is approximately 11 MW with about 2 MW in the remaining islands – a small system by any measure. Vanuatu is unique in the Pacific region, in that private companies have operated and provided electricity for more than six decades under some form of management contract or concession. Service is generally reliable and there are few blackouts or brownouts save during extreme weather conditions. However connectivity to the grid is very low – only around 70 per cent of the population has grid connections in urban Port Vila, and overall less than 30 per cent of households have access to electricity. The government’s goal is to achieve 100 per cent connectivity by 2030. This is a challenging task as the cost of extensions to remote and rural areas is prohibitively high, especially in relation to levels of use (average monthly household use is 70 kWh in Port Vila and 40 kWh in rural areas).

The bulk of electricity generation relies on imported diesel, supplemented by copra oil, 1.2 MW in hydro projects in the north and a 3 MW wind farm on Efate. Overall costs are high, but there is significant cross-subsidy from large customers, resulting in the smallest households paying below-cost prices.

The discussion in this article is confined to power sector regulation, although it could apply to the water sector as well.

Regulatory framework, mandate and powers

In 2007 the parliament enacted the Utilities Regulatory Authorities Act (URA Act) which established the Utilities Regulatory Authority (URA) as an independent statutory body to regulate water and power utilities. The URA is tasked with regulating utilities in Vanuatu to ‘ensure provision of safe, reliable and affordable services (and) maximize access to utility services’. The charge of the authority is to exercise functions and powers of the URA Act; set maximum utility prices and advise the government on utility matters. In 2010 the legislature amended the URA Act to include ‘promoting the long term interests of consumers’ as an additional objective of the act and a 2013 amendment added ‘least cost generation’ as a tariff setting criteria.

The URA has a three-member commission which includes the chairman and two part-time executive commissioners, one of whom is also appointed as full time CEO to manage strategic and day-to-day regulatory issues, administration and staff development. At least two commissioners must be citizens of Vanuatu (the current CEO is an expatriate). Commissioners are selected in an open, transparent process by an independent panel ‘guided by merit’, cannot be removed without cause and cannot be personally sued in performance of their duties. The appointment process has worked reasonably well during the URA’s six-year existence; however, commission replacement can take a long time. All major decisions are put before the public for consultation and comment prior to a final decision. All final decisions and orders are approved pursuant to a majority vote. Certain decisions must be ‘gazetted’ (officially published) to take effect.

The URA Act clearly defines and elaborates the URA’s powers in establishment and enforcement of safety and reliability standards. It is less prescriptive on establishing the prices, but broadly defines that long-term consumer interests should be protected, prices should reflect lowest cost generation, due regard be given to comparison with regional prices; and interests of consumers, businesses and government policy should be taken into account. The URA Act contains all the protections of due process, grievance procedures and judicial review that are afforded to utilities and interested persons.

All this makes Vanuatu stand out as having one of the few advanced utility regulatory statutes in the region.

Constraint on regulation

It should be said that a regulatory body is truly independent only if it can take decisions and actions without referring to another authority, and that it can perform its functions and exercise powers without interference or undue influence from the government or vested interests.

At careful reading, the URA has broad powers to establish principles and methodology in setting tariffs including lowest cost generation, cost-based tariffs, benchmarking, balancing utility, and consumer interests and governmental policies.

Economy of Vanuatu

Vanuatu has a relatively high income per capita among Pacific islands, stable low inflation and a robust central bank – the Reserve Bank of Vanuatu. The country’s adequate reserves, generated primarily from tourism, allow capital to flow back and forth freely in hard currency. Personal or corporate income is not taxed, but VAT is charged at 12.5 per cent. However, consumer interest rates are generally high at 15–20 per cent.
There is one caveat, however. As mentioned above, the concessions for provision of utility services are awarded to private entities under long-term concession agreements that were entered into in the 1980s and 90s, long before a utility regulator was conceptualised. Concessions are basically bilateral contracts where a utility operates more or less as an investor-owned utility, while the government, as the grantor, has had very little discretion or interference in the utility’s affairs. No money passes from the utility to the government as a royalty or profit sharing for use of public assets. In the past utilities were more or less allowed to operate as absolute monopolies with almost unrestricted power to set their own price. Provisions in the contracts were carefully drawn to protect private assets and interests. Contracts were unduly complicated for the size of the systems and customer base, perhaps on purpose. It is reasonable to assume that concession contracts were written in an environment where the government had little experience in concessions as Vanuatu had only recently gained independence in 1980. On the other side were highly experienced private utilities, backed by a much larger parent company. It is likely, therefore, that a level playing field was absent.

The government of Vanuatu recognised this, which may have been a motivating factor in establishing an independent regulator with broad powers.

At the same time as recognising that contractual rights in Vanuatu must be respected, the URA Act allowed that the URA may exercise its powers and functions by taking any action, provided that such action is not inconsistent with concession contracts entered in prior to the act. Further to this, in 2010, the government amended the Electricity Supply Act to encourage private investment by allowing third-party generators within the existing concession area, thus diluting the ‘exclusive manufacture and supply’ provisions in the concessions.

Needless to say, the entrenched utility companies are uncomfortable with the new regulatory compact. From the outset they have attempted to water down the powers and role of the utility regulator, asserting the superiority of the concessions over provisions in the applicable acts.

**Challenges in reducing electricity costs**

In order to tackle the root causes of high electricity prices, regulatory activity is focused in three areas:

- Stimulating consumer demand for electricity
- Introducing lower cost generation sources
- Strengthening regulation of monopoly utilities

**Stimulating consumer demand for electricity**

Since 2010 the growth in electricity consumption in Vanuatu has slowed dramatically. This slow growth is causing delays to improvements in efficiency and cost reductions from higher system use.
The Global Partnership Output-Based Aid (GPOBA) programme, sponsored by the World Bank, has established a subsidy scheme to encourage up to 4,000 low-income households to connect to the electricity network. This could increase growth by up to one per cent a year for the next four years. However, additional demand will not, in the short term, reduce overall prices due to low usage at subsidy rates by low-income households. This scheme is now in the final stages of implementation.

The URA has adopted and released a proposal for a Business Development Incentive (BDI) tariff for the Port Vila network, which offers a lower rate for increased electricity subscriptions (either from existing or new commercial customers). The analysis of the current system peak and system capacity indicates there is an excessive reserve margin, of more than 200 per cent over peak load. The URA has proposed that this excess margin can be utilised by offering discounted prices to certain eligible commercial users. Final order was issued on 5 December 2014.

Based on short-run marginal cost, the BDI tariff offers around a 30 per cent discount for incremental electricity use, without any negative impact on the utility. The aim of this incentive is to increase the growth of commercial and high voltage connections and improve growth rates to allow for lower average prices in the medium-term. Objections to this proposal have claimed that the URA does not have the power to implement it, but have not necessarily indicated that it is a bad idea.

A contractual investment support fund has been set aside by the government buildings in Vanuatu. The URA is currently advising the government and utility providers on the power purchasing arrangements. These funds have been assigned to electrify part of West Tanna in the hope of stimulating the growth of the local network, which is one of the smallest in Vanuatu.

**Introducing lower cost generation sources**

Diversification away from imported diesel is a key strategic aim of government energy policy, and may help to reduce the cost of electricity. The aim of the URA is to ensure that any changes in electricity generation will improve overall efficiency and drive down prices for consumers.

The United Arab Emirates Pacific Partnership Fund has announced plans to donate a 500 kW rooftop solar installation for two government buildings in Vanuatu. The URA is currently advising the government and utility providers on the power purchasing arrangements. The total cost saving from the installation is estimated to be 19.4 million vatu per year. Under current proposals the government could receive 75 per cent of benefits from the project, with the remainder transferred to electricity customers (which will result in an approximate 0.14 per cent reduction in prices).

The EU is co-financing the construction of a 1–1.5 MW solar installation (and some additional extensions and connections for the incum bent utilities). Moving forward, it is important for decision-makers in Vanuatu to decide what kind of electricity sector is desirable.

A utilities provider has petitioned for the Vanuatu Supreme Court to perform a judicial review of certain URA decisions, challenging their legality, while the URA continues to vigorously defend its actions, claiming that they are on a solid legal footing. In the
Meanwhile the URA will continue to press forward and exercise its mandate and obligation to protect consumer interests and promote consumer rights to a safe, reliable service at a reasonable price. The URA must protect consumers from unfair billing practices and service disconnections, and ensure that customers receive friendly, polite and fair treatment. The URA is also committed to a transparent regulatory process where decisions are publicly vetted and the interests of the utility company and consumers are balanced. The URA also believes that consumers are entitled to pay prices that reflect efficient system operations and reasonable costs. Consumers should be given options to manage their utility bills whether through conservation, solar installations or other means. The URA is also working to develop a public advocacy group to provide better transparency and give an opportunity for consumers, especially small users, to be represented in tariff reviews, consumer protection reviews and commission deliberative processes.

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