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IN THE COMPETITION
APPEAL TRIBUNAL

Case No 1046/2/4/04

Victoria House,
Bloomsbury Place,
London WC1A 2EB

11th May, 2005

Before:
SIR CHRISTOPHER BELLAMY
(The President)
THE HONOURABLE ANTONY LEWIS
PROFESSOR JOHN PICKERING

Sitting as a Tribunal in England and Wales

BETWEEN:

ALBION WATER

Appellant

supported by

AQUAVITAE (UK) LIMITED

Interveners

and

DIRECTOR GENERAL OF THE OFFICE OF WATER SERVICES

Respondent

supported by

DWR CYMRU CYFYNGEDIG

and

UNITED UTILITIES WATER PLC

Interveners

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HEARING: DAY THREE

APPEARANCES

Mr. Rhodri Thompson QC and Mr. John O’Flaherty appeared on behalf of the Appellants.

Mr. Michael O’Reilly (instructed by Messrs. McKinnells) appeared on behalf of Aquavita.

Mr. Rupert Anderson QC and Miss Valentina Sloane (instructed by the Director of Legal Services, OFWAT) appeared on behalf of the Respondent.

Mr. Aidan Robertson (instructed by Wilmer Cutler Pickering Hale and Dorr LLP) appeared on behalf of the Intervener Dŵr Cymru.

Mr. Fergus Randolph appeared on behalf of the Intervener United Utilities.

1 THE PRESIDENT: Just before we start, Mr. Thompson, could I just put on the table three or four
2 points that have occurred to us overnight? They are mainly directed towards the Director to
3 help us understand his position, and they are somewhat random points I am afraid,
4 Mr. Anderson, they are not necessarily linked to each other.

5 First, in relation to the distribution cost, do I correctly deduce that there is no distance
6 element in the common carriage charge, that is to say on the way this particular system works
7 the charge is a per cubic metre charge, and it does not vary according to whether the water has
8 been carried for 100 kms or 1 km?

9 MR. ANDERSON: That is correct, Sir.

10 THE PRESIDENT: Secondly, we have in the Decision the average accounting cost approach which
11 gave eventually the first access price of 19.2p per cubic metre, and I think there is a possible
12 second access price that never got very far but was about 17.74p per cubic metre.

13 MR. ANDERSON: I think it is 17.74 plus other costs which have never been identified.

14 THE PRESIDENT: Plus other costs which you have never got to the bottom of.

15 MR. ANDERSON: We do not know what it would ultimately come to.

16 THE PRESIDENT: But it might be slightly less than the 19.2, but 19.2 will do for present purposes.
17 The other ECPR/costs principle price was 22.5p per cubic metre. The first of those prices
18 gives Albion Water a margin, albeit a very small one and much less than they say they are
19 entitled to but it gives them a small margin as the interim measures' order reflects. If you have
20 two ways of doing it, as it were, and one produces a small margin and the other does not
21 produce the margin, does competition law have anything to say about which method you
22 should or might prefer? It is a question of mixed fact and law I think.

23 MR. ANDERSON: There is a distinction to be drawn between the two accusations of abuse.

24 THE PRESIDENT: Yes.

25 MR. ANDERSON: One is excessive pricing and one is a margin. On the question of the margin
26 I have addressed you at length as to why the absence of a margin is not in itself in this case
27 capable of giving rise to an abuse because there is no activity generating an abuse. The
28 question in terms of excessive pricing is the three stage test in *United Brands*, namely, have
29 costs been mis-allocated? Secondly, can it be said that the price quoted bears no reasonable
30 relation to the economic value of the service? We took the view, having undertaken both those
31 exercises, that given the end result arising out of those two exercises and the price that had
32 been quoted it could not be said that the price quoted bore no economic relation – so it was not
33 a question of choosing between two prices, it is a question of looking at the exercise that the
34 Director undertook and deciding whether, in the light of that exercise, he was right to conclude

1 that the price quoted did not bear a reasonable relationship to the economic value. That is the
2 approach the Director took and we would submit that that is the correct approach.

3 THE PRESIDENT: Yes. My next point comes at para.330 of the Decision, where you are talking
4 about the avoidable costs under an ECPR calculation. We have heard a great deal about the
5 importance of regional averaging and not disadvantaging one lot of customers or advantaging
6 certain customers over others and all the rest of it, but when we get to para.330 we suddenly
7 come down to local costs, i.e. the specific costs in this particular case of this particular source
8 of water. Is there any inconsistency, or just help me as to what is going on here.

9 MR. ANDERSON: No, there is no inconsistency. The regional averaging accounting cost method is
10 the method that is applied generally in the industry. When one is looking at ECPR one is
11 necessarily looking at a specific situation, namely the actual contract that is being, if you like,
12 displaced by the inset appointment and the common carriage. It therefore follows that one has
13 an actual price, the Second Bulk Supply Agreement, and you have an actual cost, namely what
14 Welsh pays to United Utilities. It is therefore that simple an exercise – a regulated effectively
15 approved retail price, and an effective cost. It is a separate exercise from the regional average
16 costing exercise for building or looking down at average prices across the industry, the exercise
17 that Welsh in fact undertook, the exercise that the approached price ----

18 THE PRESIDENT: No, the Second Bulk Supply Agreement is built up on a regional average
19 costing basis. It is not built up on a local cost basis.

20 MR. ANDERSON: Not in precisely the same way. Of course the actual way ----

21 THE PRESIDENT: Not at all.

22 MR. ANDERSON: ---- in which the second bulk supply price has been built is not in issue in this
23 case, and has not actually been fully analysed by the Director. He did not have to in this case
24 because it was a price.

25 THE PRESIDENT: He gave an indicative ----

26 MR. ANDERSON: Yes, he gave an indicative price.

27 THE PRESIDENT: ---- indication all based on classic regional averaging.

28 MR. ANDERSON: But that nonetheless is the price that is paid. It is now a large user non-potable
29 price, and everybody in that situation will pay, so that is a given, if you like, retail price ----

30 THE PRESIDENT: All on an average basis.

31 MR. ANDERSON: To an extent, yes; not precisely the same exercise that is undertaken for the
32 purposes of calculating this access price, it is produced in a slightly different way – but, yes, in
33 the sense that regional average prices are used for building up both the large user tariff and bulk
34 supply prices in this kind of context, that is to say, what we would call a brokerage bulk supply

1 agreement as opposed to balancing bulk supply agreements, which may be slightly different.

2 THE PRESIDENT: I am not quite sure in my own mind at the moment where that takes one.

3 MR. ANDERSON: It does not take one anywhere other than for the purposes of ECPR you take a
4 retail price which you actually know is there, and however that retail price has been arrived at
5 that is the retail price that one takes for the purposes of undertaking ----

6 THE PRESIDENT: But where it does take one, I think, and this is perhaps the point we were on
7 yesterday, that the common carriage, the derived common carriage price, is going to vary
8 depending on what the historical cost of the water in that particular situation happens to be.

9 MR. ANDERSON: There is a process that one goes through to arrive at the retail price, yes, Sir, but
10 one can identify the retail price both as between Welsh and United Utilities, and as between
11 Welsh and what would have been Shotton had it not been for the interposition of Albion.

12 THE PRESIDENT: Did you want to ask a question?

13 PROFESSOR PICKERING: If I may, Mr. Anderson, could you confirm these approaches are not
14 approaches that are required by the legislation but are policy decisions by the Director as to
15 how he intends to discharge his functions; is that correct?

16 MR. ANDERSON: That is correct at the moment, and perhaps I could just explain the relationship
17 between the Director's position on ECPR and the cost principle under the new legislation.

18 THE PRESIDENT: Yes, that would be helpful.

19 MR. ANDERSON: Because we got into quite a lengthy debate yesterday and what might or might
20 not be the relationship between Welsh and United Utilities and so on and so forth. The
21 Director looked at ECPR having identified, and you will see this in the Decision – but the costs
22 principle under 66E is a form of retail minus, as is ECPR. Neither ECPR nor regional costs,
23 nor indeed local costs or any other costs, are specified under the existing legislation. What the
24 Director has done is issued guidance, common carriage guidance, and pricing guidance, from
25 which he has indicated that undertakers ought to be consistent in their approach and if they are
26 inconsistent they may fall foul of the Act that is the source of your jurisdiction today, the 1998
27 Act.

28 When it comes to the costs principle under 66E, the Director's position in the
29 Decision is actually very limited, and perhaps I could take you to ----

30 THE PRESIDENT: It is 331, is it not?

31 MR. ANDERSON: Yes, 331. All the Director has in fact said is, "We think the costs principle
32 under the legislation would produce the same result", so all the Director has directed his mind
33 to is a hypothesis, namely if it were the case that Welsh were supplying Shotton directly at the
34 second bulk supply price, and Albion were to come to Welsh and say, "Will you please carry

1 water either purchased from United Utilities through your system to Shotton, how would the
2 costs principle under the Act, in the view of the Director, apply to that”?, and the view we have
3 taken is the view we have set out, namely you take the retail price under 66E(1)(b) and you
4 deduct the avoided costs, which in this case we say are only the price to United Utilities. We
5 have not applied our mind to, and did not need to apply our mind to, what would be the impact
6 of the costs principle either on the relationship between Albion and United Utilities, and you,
7 the Tribunal, should not trouble yourself with that either, nor have we in fact addressed our
8 mind to, because we did not need to, what will now be the position in the future given that
9 Shotton is no longer Welsh’s customer, and indeed Albion is no longer capable of becoming a
10 licensed supplier because it is now an undertaker, and you cannot be a licensed supplier if you
11 are an undertaker; you would need an exemption.

12 So the future – I mean, one simply does not know what may happen in the future, but
13 that is an entirely separate matter, and the reason why we are keen for you not to, with respect,
14 delve into areas that do not need to be delved into is quite a simple reason, and that is that the
15 Director is under a statutory obligation to issue guidance on the application of the costs
16 principle to various situations. He is in the process of producing that guidance and
17 undertakings are under a statutory obligation to follow that guidance, and I am very keen not to
18 stand up today and make remarks on the record in the light of the fact that there is that ongoing
19 process. This is really the point my learned friend Mr. Randolph was making yesterday, that
20 there is a process of producing guidance designed to cover situations, and therefore we are
21 quite keen not to delve into areas that do not need to be delved into for the purposes of these
22 proceedings. As far as these proceedings are concerned, all the Decision said was, “We think
23 the result [on the hypothesis I have explained] would be the same under 66E of the new Act
24 when it comes into force”.

25 THE PRESIDENT: I think the problem for us, Mr. Anderson, and I hear what you say, is that there
26 are two prices that were thrown up as a result of the Director’s very detailed and professional
27 work; one was a 19.2p. per square metre price which gives the applicant a small margin, and
28 the other was the ECPR price which does not really.

29 MR. ANDERSON: Yes.

30 PROFESSOR PICKERING: If nothing whatever had been said about ECPR and the costs principle
31 and all the rest of it in the Decision we might be in a different situation.

32 MR. ANDERSON: I am drawing a distinction between ECPR and the costs principle.

33 THE PRESIDENT: I see; okay.

34 MR. ANDERSON: The costs principle is simply, we say, another version of ECPR. The Decision is

1 essentially directed at ECPR.

2 THE PRESIDENT: If you read paras.317 through to 331 as a whole, they are effectively treating
3 ECPR and the costs principle as extremely closely related and are really mixed up with each
4 other.

5 MR. ANDERSON: Yes, that is undoubtedly our view. My only concern is ----

6 THE PRESIDENT: So if we are to address ECPR in some way or other it is rather difficult to avoid
7 any knock-on reflections about how the costs principle might be a reflection of ECPR.

8 MR. ANDERSON: I accept that, Sir. The only point I am making ----

9 THE PRESIDENT: We have no particular interest in deciding anything we do not have to decide, let
10 me say that.

11 MR. ANDERSON: I am directing, Sir, my point principally at the debate that we embarked on
12 yesterday about what would be the impact of the costs principle on the relationship
13 between ----

14 THE PRESIDENT: On all the various relationships, yes.

15 MR. ANDERSON: -- between Albion and United Utilities. It is that particular side of the debate
16 which we say is very far removed. Certainly, the Director has expressed the view that the
17 application of the costs principle on the hypothesis that Albion comes to Welsh as a licensed
18 supplier in circumstances where Welsh is the supplier to Shotton would have the result that we
19 have said and we say that as a matter of construction of 66E that is the same as the costs
20 principle. That is a view, yes, that we have expressed and you may or may not consider that
21 you need to decide on whether that view was right or wrong. We have only said we think it
22 would have had the same effect and it is an Act, as we say, that is not yet in force. That is our
23 position.

24 THE PRESIDENT: I think I have only one more question at the moment, and this may be going
25 over old ground and I am sure you will be able to deal with it. It comes in two parts. One is
26 the debate we were having yesterday about whether Albion was able to provide a cheaper
27 source of water. In this particular case, Albion is being sold water by Welsh at 26p which it is
28 then selling on to Shotton at the same price and Albion's hope would be, so it says, that it
29 would be able to buy water directly from United Utilities at some price below what it is paying
30 already, carry it through the pipes and sell it on to Shotton at a cheaper price. Why is that not
31 finding an alternative source more cheaply than is available at the moment?

32 MR. ANDERSON: Well, three elements to what it is buying: treatment, distribution and water
33 resource. Treatment and distribution we have been through and assessed, that is fixed, if you
34 like. It may be that in relation to the water resource aspect of the overall 26p they can find a

1 cheaper source of the water as opposed to the distribution and the treatment. That was one of
2 the bases upon which, or our understanding on which we granted the inset appointment. They
3 told us we may be able to get the water cheaply from these tunnels, from this alternative
4 source. Whether they could negotiate a cheaper price from United Utilities is a matter between
5 them and United Utilities. You have heard how the First Bulk Supply Agreement has been set,
6 they do not know whether they could get it more cheaply or not. As they said yesterday it does
7 not on the face of it seem to be any obvious explanation as to why they would be able to get it
8 more cheaply from United Utilities.

9 THE PRESIDENT: That is something that is a bit troubling and, given that this particular price we
10 have here appears to be a very low price, it is rather hard to imagine, either in relation to this
11 price or perhaps more generally, that new sources of water with all the investment that that
12 would involve and all the rest of it, could ever be developed at a resource cost that was cheaper
13 than existing sources of water where the cost has already been sunk and investment has already
14 been made and so forth and so on. We were just wondering whether it is not pie in the sky to
15 hope that anyone is ever going to find a cheaper source of water.

16 MR. ANDERSON: It is not pie in the sky hoping that people may obtain alternative cheaper
17 sources, that has happened in other examples, and there may be more examples. It just so
18 happens that in this particular case it seems pretty unlikely which is why we have always taken
19 the view that we believe Albion's business model in this case is misconceived.

20 THE PRESIDENT: Yes, I see. Thank you very much indeed.

21 MR. THOMPSON: Yes, I am grateful for those questions some of which bear on to remarks I was
22 going to make by way of introduction. What I would say by way of introduction is that I am
23 here, in my submission, confronted with an extraordinarily docile and producer-focused
24 regulator and that these exchanges only confirm our impression that the main concern of this
25 regulator is whether or not particular initiatives create savings for the incumbent, not the
26 question of whether they create reduced prices or better meet the demands of consumers, or
27 indeed promote market competition. We would respectfully remind the Tribunal that Albion
28 is, in fact, Dwr Cymru largest customer and Shotton and Corus are presumably either its
29 largest or among its largest end consumers, but no account appears to be taken either by the
30 Director or Dwr Cymru of the wishes of any of those parties. Indeed, the director has
31 confirmed that in the context of what is, by any stretch of the imagination, a major competition
32 law case for the Director – and probably the major case that he has confronted – he has taken
33 an extraordinarily narrow focus and has looked entirely at the issue of the First Access price
34 and has repeatedly stress that he has not addressed his mind to the wider implications of his

1 approach for competition on this market, and the actual prices that are going to confront this
2 competitor if his position is adopted and we say that that is quite unacceptable.

3 Further, we say that this Appeal exemplifies his approach in that he has devoted
4 enormous efforts and a great deal more rigour to the scrutiny of Albion's attempted
5 methodologies on the basis of a patchwork of information that has emerged in dribs and drabs
6 from Dwr Cymru and from the Director himself, than he ever devoted to the justifications for
7 the price that Dwr Cymru put forward both in relation to treatment and in relation to
8 distribution.

9 In relation to treatment I took the Tribunal to the justification that was ultimately
10 accepted at para.294 of the Decision on Monday, and there has been no answer from the
11 Director at all on that issue. What emerges clearly from pages 10 to 12 of the documents
12 appended to our skeleton argument is that all that was done was that effectively the MEA
13 values of a number of treatment works was compared to the throughput of those treatment
14 works. There was some modification of the figures which effectively devalue the MEA value
15 by 12,000 by obtaining a daily rate based on some depreciation principles of a very simple
16 nature, and a daily throughput figure which was simply dividing the annual throughput by 365
17 to get a daily rate, so that essentially all that was done was the ratio between the MEA values
18 of some potable plants was compared with the MEA values of two non-potable plants, and that
19 was taken as the basis for the reduction in the treatment costs. There seems to have been no
20 scrutiny whatsoever by the Director of whether the right type of treatment plants were used,
21 whether the matter was fairly assessed or anything at all, the figures simply seem to have been
22 taken from that rather basic table and put directly into the Decision.

23 In relation to distribution costs ----

24 THE PRESIDENT: You may say that this is over-simplifying it, but on treatment costs the general
25 impression that I have from paras. 292 through to 296 of the Decision is that the Director's
26 final figure of 3.2p per cubic metre in terms of ball park is perhaps not that far off from
27 various figures that Albion itself has put forward at various stages.

28 MR. THOMPSON: Indeed, and that is reflected in the direction of my fire in these submissions.

29 THE PRESIDENT: Yes.

30 MR. THOMPSON: In terms of the substance we are not particularly far apart in relation to
31 treatment. The point that we make in relation to treatment is that it evidences a somewhat
32 cavalier approach to regulation in our submission and it also has led to effectively no remedy
33 despite the fact that it manifests overcharging of about 125 per cent. or £270,000 per year
34 which, on any view, is a significant amount of overcharging for a new entrant such as my

1 client. Those are the two real complaints we make about treatment.

2 In relation to distribution costs we say that Dwr Cymru's justification has not been
3 subjected even to that degree of scrutiny as is manifested by paras. 300 to 301 of the Decision.

4 Mr. Anderson this morning has said that para.331 was, as it were, a throwaway piece of
5 analysis but in my submission it was a model of intellectual rigour by comparison to the
6 analysis that one finds at 301 which does not go beyond the point that I made by comparison to
7 red water and blue water that in principle water flowing through a pipe costs the same
8 whatever sort of water it is. In my submission that is not a sufficiently rigorous approach for a
9 competition regulator after a decade of dispute on the scale that we have seen in this case.

10 THE PRESIDENT: What do you invite us to do about this particular point, because we appear to
11 have a factual dispute? It is somewhat difficult for the Tribunal to resolve that factual dispute
12 without going into considerably more detail than we have so far done.

13 MR. THOMPSON: As I think I said in opening we say that the basic first point is that this Decision
14 must be set aside as totally inadequate in its terms. We say further that the figures are
15 sufficiently clear that one can see that there is an abuse in this case for the reasons I have
16 given. But the question of how one quantifies the extent of that abuse both in relation to
17 margin and in relation to excess pricing would require further work either by further proper
18 disclosure by the Dwr Cymru and the Director of the figures that they plainly have and which
19 we have not seen, or by the Director applying his mind with a certain amount more enthusiasm
20 to his task than he has manifested at the moment.

21 THE PRESIDENT: So in relation to the 16p per cubic metre element for distribution, what do you
22 suggest we should do about it?

23 MR. THOMPSON: I was going to come to it in relation to what, in my submission, is a relatively
24 simple calculation that can be done and which is parallel to the calculation that was apparently
25 done in relation to treatment costs. You will recall that I put in a short note on Monday which
26 neither Dwr Cymru nor the Director have made any submissions about and, in my submission,
27 one can find some quite interesting results by looking at that rather elementary document, and I
28 will come to that in a moment.

29 By way of introduction the only other point I would make is that the Director appears
30 to adopt, and I think it is implicit in some of the questioning that the Tribunal has put to the
31 Director already is effectively a "heads I win, tails you lose" approach. He appears to favour
32 local pricing where it is in the incumbent's favour, such as under ECPR or the MEA of
33 Ashgrove, at para.107 of the skeleton argument, but he favours regional average pricing where
34 it seems to be in the incumbent's favour. I am not saying this is a systematic policy but it

1 appears to be the implication here and is relevant to the 4p per unit issue. For that purpose, as I
2 understand it, the Director says that Dwr Cymru is to be deemed to be paying over 6p per unit
3 for its resources even though it is in fact only paying 3p and that is how he manages to get back
4 to a 25 to 26p per unit figure for the Second Bulk Supply price ----

5 THE PRESIDENT: I am sorry, just remind me, I have recently seen that 6p figure ----

6 MR. THOMPSON: It is actually on my little note. In my submission the first two pages of that little
7 note are rather clearer than anything that appears in the Decision because it sets out the
8 resources, treatment and distribution figures that are used by Dwr Cymru and one finds Dwr
9 Cymru, para.2 of the little note, they used figures of 3.9, 24 and 45.4.

10 THE PRESIDENT: Yes, it is 279 of the Decision; that is what I had in mind.

11 MR. THOMPSON: Yes, and when one turns to the approach in the Decision – I was going to come
12 to this – in my submission it is very inadequately evidenced and reasoned, but the effect is to
13 suddenly increase the resource costs really quite unexplained from 3.2 to 6.3p., and of course
14 that has very serious implications for my client because one finds that really without
15 explanation the resource cost is said now to be 6.3p. rather than 3.2.

16 THE PRESIDENT: Sorry, I am looking in the Decision for that 6.3.

17 MR. THOMPSON: I am sorry; I was going to come back to it. It is para.279.

18 THE PRESIDENT: I thought it was but I cannot now see it there.

19 MR. THOMPSON: I think it is implicit.

20 THE PRESIDENT: It is explicit somewhere, but I cannot now remember where I had seen it.

21 MR. THOMPSON: The allocation is not actually spelt out, but the unit treatment ----

22 THE PRESIDENT: I think it is 305, which has got a 6.8 figure in it. That is what I put a mark
23 beside anyway.

24 MR. THOMPSON: If you look at the table. Sir, the reason why I say that my little paper is rather
25 clearer than this is that there is no figure for treatment or resources actually stated in this table,
26 or indeed the other table.

27 THE PRESIDENT: Which table are we talking about?

28 MR. THOMPSON: If one looks, for example, on p.78, the table at the top there, the step 1 figures
29 that the Director gives are 73.3, which is Dwr Cymru's, and 71.8, which is the Director's. You
30 then get a step 2 figure, which is 27.9, which implies a distribution charge of 45.4 – simply
31 73.3 minus 27.9. But that is not expressly stated in the table which, in my submission, is
32 perhaps slightly unfortunate.

33 Then, correspondingly, 44.5 is the right figure for distribution on the right-hand side,
34 so 27.3 is for resources and treatment and 44.5 is for distribution. But then the next line down

1 you split out 21p. for treatment, so that implies 6.3 for resources, 27.3 minus 21. So 6.3 is for
2 resources ----

3 THE PRESIDENT: I see, that is where you get it from. Yes, I see.

4 MR. THOMPSON: So in fact all this does is split out the total revenues in fact into three elements,
5 and Dwr Cymru in fact put 3.9 for resources but the Director, by some reasoning, and we are
6 not really clear what it is, at 27.9, and the figure is not expressly stated, but the implication is
7 that 6.3p. is the right figure for resources, which of course has quite spectacular effects on the
8 final position when one adds 6.3 to 19.2 instead of 3p. So effectively we go up a ladder but we
9 come down a snake.

10 THE PRESIDENT: I see, yes.

11 MR. THOMPSON: I think the only direct inconsistency is the one that I think the Tribunal has put
12 to Mr. Anderson, is that one has a price that is being complied by various inferences based on
13 regional average costs, including an inference that 6.3p. is an appropriate resource cost, but
14 then when one applies the ECPR snake or ladder one finds one only goes down ----

15 THE PRESIDENT: You do not take the 6.3, you take the 3.5.

16 MR. THOMPSON: Yes, you have gone up to 6.3, but then you only go down 3.3.

17 THE PRESIDENT: Yes.

18 MR. ANDERSON: Sir, if I could explain that so-called inconsistency, it would probably help, and it
19 is really very simple.

20 THE PRESIDENT: It probably would actually, Mr. Anderson, so that Mr. Thompson can deal with
21 it while he is in ----

22 MR. ANDERSON: The point is simply this ----

23 THE PRESIDENT: First of all, can I just establish that the 6.3 is correct, that there is a resource cost
24 of 6.3 in the various step figures summarises at para.304?

25 MR. ANDERSON: Yes, it is effectively the 6.8 that you were referred to in ----

26 THE PRESIDENT: Yes, okay.

27 MR. ANDERSON: The point is simply this; we know the total costs of all three, resource,
28 treatment and distribution. We have identified some misallocation in relation to treatment, and
29 that misallocation is because it should have been in resources. That is the simple point. Now,
30 it has an impact on an access price because you do not pay resources; it does not have an
31 impact on the total price when you are paying for resources, treatment and distribution. It is as
32 simple as that.

33 THE PRESIDENT: Sorry, just say that again. I know it is very simple, but – take it very slowly for
34 me, Mr. Anderson.

1 MR. ANDERSON: We identified what we considered to be a misallocation.

2 THE PRESIDENT: Yes, so this is a sort of residual figure.

3 MR. ANDERSON: Well, we know the total figure, the question is how do you split it between
4 resources, treatment and distribution. We took the view that there was an inconsistency
5 between the way this, if you like, 4p. had been treated as between this first access price and the
6 new tariff. We took the view that ----

7 THE PRESIDENT: Things have been allocated to treatment that should have been allocated to
8 resources?

9 MR. ANDERSON: Of course, and that is why the resource figure goes up by the amount that the
10 treatment figure comes down. That is why the Second Bulk Supply Agreement is right,
11 whatever the allocation issues are, for the purposes of an access price.

12 THE PRESIDENT: But if the Second Bulk Supply Agreement is right for the purposes of an access
13 price, and the resource cost used for the purposes of the Second Bulk Supply Agreement is 6.8,
14 why do not take 6.8 off when you get to para.330 of the Decision? Why do you only take 3.3
15 off?

16 MR. ANDERSON: Could you just give me a moment, Sir?

17 THE PRESIDENT: Yes, of course. (After a pause): Do you want a few minutes, Mr. Anderson, or
18 is it clear?

19 MR. ANDERSON: No, Sir. It is apparent from our table we did take off the 6. You can see that if
20 you read down the table at p.304, the difference between ----

21 THE PRESIDENT: No, that is not my question. My question is, if you are taking off the 6 in that
22 context and the 6 is built into the Second Bulk Supply Agreement price, why are we only using
23 3-point-something in para.330?

24 MR. ANDERSON: Paragraph 330 ----

25 THE PRESIDENT: And para.331.

26 MR. ANDERSON: I do need a moment on that because I think it is a question of ----

27 THE PRESIDENT: There may be a very short explanation. What I suggest is, Mr. Anderson, to
28 save time, is we let Mr. Thompson go on for the time being and then we will have a pause and
29 we can all regroup and we take the time we need to sort it out.

30 MR. THOMPSON: I would say in relation to this issue that, in my submission, any remedy to the
31 express concerns of the Director about the effects of de-averaging, because those concerns
32 appear to vanish away when one comes to ECPR, and in this particular case at least they vanish
33 away at the substantial expense of my client – whereas he seems particularly concerned that
34 there should not be any disruption to the regional averaging process in other contexts, in this

1 context he seems quite content to operate on actual costs, and, in my submission, that is a
2 curious feature of his approach and one that I think it would be valuable for him to explain..

3 The next point is that I would not wish, in my submission, that it should get lost, that
4 we do remind the Tribunal respectfully that this has been an extraordinarily dilatory
5 investigation in which a Decision was only produced ultimately under pressure from the
6 Tribunal, and that that is a factor that should be taken into the mix. I make that point just very
7 briefly.

8 The other two preliminary points are, first of all, some reference has been made to the
9 gas market and to the telecoms market. We broadly accept and welcome such an analogy and
10 the light that it casts on the rather less vigorous competition that one finds in this market. Our
11 general position, and this is something Aquavitae has asked me to stress, is that, if anything, we
12 think that the analogy is somewhat more in our favour than has emerged perhaps from the
13 rather short references that have been made to it, and we would not accept that necessarily all
14 the advantages that are shared by gas and electricity consumers have entirely been aired in this
15 hearing.

16 Finally by way of introductory remark, on methodologies I would also like to make it
17 clear that we make no concession that the Director has, as it were, bottomed out the issue of
18 methodologies. As I hope I made clear in opening, we think that there is plenty here to chew
19 on as a question of principle. If one wanted to get to the bottom of the various methodological
20 approaches that there are, we do not accept at all that they are flawed as a matter of principle.
21 If there are difficulties they arise from the fact that the information is in a fragmentary state,
22 and that if one got to the bottom of it we would hope that they would be consistent with one
23 another and we would assume that they would in the end confirm rather than cast doubt on our
24 case, and we do not accept that the Director has proved or demonstrated to the contrary.

25 In terms of specific topics that I wish to address, first of all I want to address the
26 question of cost drivers in relation to non-potable distribution in the light of the additional
27 material produced by Mr. Anderson in his oral submissions, which enable one to make more
28 precise calculations. Secondly, there is the important question of the Director's policy towards
29 retail margins in this industry; thirdly, the 4p. error; fourthly, the changes in the resource cost
30 issue that was raised by the President with Mr. Anderson; and, fifthly, just briefly to explain
31 our position on the lagoons question; and then, finally, I need to deal with interim measures,
32 though I do not know whether the Tribunal wants to take its break ----

33 THE PRESIDENT: I think we would like to deal with interim measures as a completely self-
34 contained and separate matter.

1 MR. THOMPSON: Yes. When would the Tribunal like to break, now, or shall I deal with one or
2 two topics first?

3 THE PRESIDENT: I had the impression we had only just started! I think we will carry on,
4 Mr. Thompson.

5 MR. THOMPSON: As I have said, the issue of how the potable distribution and non-potable
6 distribution charges were compared is essentially dealt with in two paragraphs of the Decision,
7 parars.300 and 301, and in particular there is an issue as to whether or not the cost drivers for
8 the two are the same. There was no specific comment on the submissions that I made in
9 opening, but Mr. Anderson did say, and did helpfully clarify at p.15, lines 28-29 of yesterday's
10 transcript, the 21 kms is, in fact, the correct figure for the Ashgrove pipeline and, on the
11 assumption that that is correct one can work out the figures somewhat more precisely than I did
12 in opening. You may recall that there were essentially two issues that I addressed. First, the
13 value of the Ashgrove pipeline and secondly, the throughput of the Ashgrove pipeline.
14 I operated by reference to MEA values and, in my submission, it is appropriate to do that for
15 three reasons. First, it was the basis for the treatment comparison that was accepted by the
16 Director and used by Dwr Cymru and one finds that at para.294 of the Decision. Secondly, it
17 was a major component of Dwr Cymru own LIT justification which forms the basis of annex 2
18 to our skeleton argument.

19 THE PRESIDENT: Sorry, their what justification?

20 MR. THOMPSON: Large Industrial Tariff justification and one can find that at tab D of the Reply
21 bundle, p.35. It is a table we have looked at before. You may recall we are looking at the right
22 hand column here as the relevant comparator, the 600 mm pipes used by the two largest Dwr
23 Cymru potable customers. If you look at that table at the right hand column, you will find the
24 first four items, the adjustments are based on MEA value, 13.97p, 5.484p, 0.958p, 0.699p, and
25 then another one proportional to MEA 3.302. If you add them together you get a total of
26 23.45p, so compared to the total reduction of 34p about two-thirds of it was based on the MEA
27 value, so that was the adjustment that Dwr Cymru itself used in relation to its largest pipes.
28 The third reason which directly goes to the terms of the Decision itself are, in my submission,
29 is an MEA value is the best possible proxy for the costs' drivers relating to size, material and
30 smoothness of the pipe. Indeed, in my submission MEA value is a more direct financial guide
31 to pricing than simply looking at whether or not the pipe is smooth. In my submission, the
32 value of the pipe is a better cost driver and summarises those primary features.

33 If we then apply the 21km figure. I should say I have not got a revised note, but if it
34 would assist the Tribunal I could hand in a paper version of what I am about to say, but it will

1 appear on the transcript and the figures, in my submission, are simply matters of arithmetic. If
2 one applies the 21 km figure and assumes that this was a potable pipe rather than a non-potable
3 pipe, you may recall that on the first day I showed the Tribunal Dwr Cymru's own estimates as
4 to the value of its 600 mm pipe, and that it showed a figure of £1.622 million per km. If you
5 multiply that by 21, as the Director indicated one should yesterday, one reaches a value for the
6 Ashgrove pipeline of £34.062,000. One can find that at p.32 of tab D of the Reply bundle. If
7 one looks at the non-potable valuation of Ashgrove, the highest figure that one has is the one
8 that the Director referred to at para.107 of his skeleton argument, and which appears at p.21 of
9 tab D of the Reply bundle, which is £8.807 million which, if you divide by 21 you reach a
10 value per km of £419,370. The Director's valuation, which I think we have not looked at,
11 appears at p.101 of the Decision.

12 THE PRESIDENT: Is that the calculation in the appendix of having another pipeline?

13 MR. THOMPSON: Yes, he values Ashgrove on that basis, admittedly he assumes a 15km figure at
14 that stage as he seems to have done throughout until yesterday. Anyway, the valuation he
15 gives there is £4.59 million, so somewhat lower, indeed about half the valuation that Dwr
16 Cymru had put on the asset in its submissions to the Director. The valuation that we thought
17 was the most pertinent, which was based on the division on the total raw water aqueducts
18 kilometre-age that Dwr Cymru has put in its latest figures, by the total value of those, would
19 give a value per km of £146,000 per km. If you multiplied that by 21 you would reach a
20 valuation of £3.066 million for the Ashgrove works. So on Dwr Cymru's own figures it
21 appears that the potable pipeline would be worth about four times the non-potable valuation
22 that it itself put forward for Ashgrove. On the Director's figures it would be about 7 ½ times
23 the value, and on Dwr Cymru's figures in relation to raw water aqueducts it would be about 10
24 times the value.

25 We have looked at this as a question of reality, looking at the actual figures that Dwr
26 Cymru has put forward, which I referred the Tribunal to on Monday. If one looks at p.15 of
27 the skeleton argument bundle of documents, I think it is bundle 10 in the numbering, you will
28 see a valuation figure which we looked at on Monday of £102,190,000 in the second line down
29 against raw water aqueducts.

30 THE PRESIDENT: Sorry, which page was this?

31 MR. THOMPSON: SA15.

32 THE PRESIDENT: They say this is not an aqueduct; aqueduct has got nothing to do with it.

33 MR. THOMPSON: If I may just have a moment to make my point.

34 THE PRESIDENT: Yes.

1 MR. THOMPSON: If you turn back to p.13 you will see a total kilometre-age for these raw water
2 aqueducts of 696.65. As a check on this, the point I have already made is that the average
3 value, if one simply divides 102 by 695 is 146,000 but you may recall that the Director has said
4 that 158 kms is in fact the right figure for non-potable pipes. If you divide 102 million by 158
5 you would reach a figure of £646,772p. So even if one assumes that the other pipes are worth
6 absolutely nothing, the average value of the non-potable pipeline is only £646,772, so about
7 one-third of the value put on the potable pipeline in the Large Industrial Tariff justification.
8 I may have taken that too quickly, but what I am saying is that in terms of looking at the range
9 of the values, even if one assumed that the other raw water aqueduct materials – the sludge
10 drains, etc – are worth absolutely nothing, the average value of the non-potable pipeline would
11 be just under £650,000 per km.

12 THE PRESIDENT: Assuming that all non-potables are in the heading “Raw Water Aqueducts”.

13 MR. THOMPSON: I understand that to be common ground. That is where they are. It is simply a
14 question of what proportion – I mean the Director must know all this, but anyway he chooses
15 not to tell us and so we have to grope about in the dark. So groping about in the dark we
16 reached the conclusion that there is a minimum value of £146,000 and a maximum value of
17 about £650,000 even if you assume that the rest of the raw water aqueducts are worth nothing,
18 and we find that a bit surprising because, for example, the Bretton pipe, which is a raw water
19 aqueduct is apparently identical to the Ashgrove pipe, it is simply the same pipe flowing from
20 one source to a potable treatment works rather than the pipe that we have here. But even if you
21 assume the Bretton pipe is worth nothing the value of the non-potable pipes cannot be more
22 than about £650,000 per km.

23 THE PRESIDENT: Perhaps through you Dr. Bryan can elaborate, what exactly is an aqueduct in
24 this circumstance, as distinct from a pipe?

25 MR. THOMPSON: (After a pause) It is essentially the water before it reaches a treatment works, but
26 as Mr. Anderson I think explained, and it nobody knows any different, it appears to be used as
27 a residual category so it includes not only that classic form of aqueduct, as it were, the pipe
28 going from the river to the treatment works, but also the Shotton Ashgrove pipe, which is a
29 variant on the theme because of the fact that there is a treatment work at the top of the hill as
30 well as the treatment works at the bottom. Apparently it also includes some sludge drains, and
31 possibly some disused pipes, but we obviously do not know the breakdown. All we know is
32 that 158 kms on the Director’s information represent the non-potable network.

33 So we say there are some quite striking and revealing figures in terms of the MEA
34 value. If you look at the other cost driver identified, required flow rate, again there are some

1 quite striking figures, and this is based on p.51 of the rejoinder – it may be worth just looking
2 at that, because I am not sure it has been looked at before. You will see a statement at p.51 of
3 the rejoinder (bundle 8). It says:

4 “In relation to pipe lengths, the total regional length of the bulk non-potable
5 distribution system (158 km) is not ---”

6 THE PRESIDENT: I am sorry, where?

7 MR. THOMPSON: Page 51 of the rejoinder, there is a box saying “87” against it.

8 PROFESSOR PICKERING: That is p.50.

9 MR. THOMPSON: There is some difference in the print-outs, I am sorry about that.

10 THE PRESIDENT: In our version it is on p.50.

11 MR. THOMPSON: There is just a paragraph at the bottom:

12 “In relation to pipe lengths, the total regional length of the bulk non-potable
13 distribution system (158 km) is not that far short of the regional length of the bulk
14 potable distribution system (440 km). In addition, much less volume is pumped
15 through the non-potable system than its potable equivalent (27 million metres cubed
16 per year, versus 326 million metres cubed per year).”

17 I must say, we have had some difficulty, and it is reflected in the pleadings, in understanding
18 exactly what the like for like comparison is. The latest version that we have appears at what
19 I think will be pages 72-3 of the rejoinder – in my version it is pages 73-4, and in particular on
20 p.73.

21 THE PRESIDENT: Our p.73 says “Cost recovery of non-potable network under 2”. What do you
22 want us to look at?

23 MR. THOMPSON: There is a box called “Step 3” and then it goes over the page?

24 THE PRESIDENT: Yes, that is on p.72 in our version, it goes over to 73.

25 MR. THOMPSON: It is p.74 on mine.

26 THE PRESIDENT: You are obviously just a page out.

27 MR. THOMPSON: There should be a footnote 62.

28 THE PRESIDENT: Yes.

29 MR. THOMPSON: Where the Director says that:

30 “The 16p metre cubed as used in the Decision and refers to pipes of greater than 600
31 mm. However, for the purposes of the comparison which this methodology seeks to
32 make, pipes of both 300 ml and 600 ml are included for each system.”

33 In the main text it says:

34 “The correct length of mains to the potable trunk mains network – taking that to

1 include both 600 mm and 300 mm pipes)since the non-potable system includes some
2 300 mm pipes) is 1834 kms.”

3 Now, that has created some problems for us, because as we understand it, going back to the
4 previous text at p.50, the Director has based the throughput figure on 600 ml pipes for one
5 purpose, but has given us in fact the non-potable distribution system based on 600 and 300 ml
6 pipes. So the 158 km figure is apparently based not only on the 600 ml but also the 300 ml
7 pipe network, whereas the 440 appears to be the 600 ml pipe network. The problem is that we
8 have not got the direct comparator, like for like, of 600 ml non-potable distribution with 600
9 ml potable distribution, we have a sort of curious dog leg.

10 However, if we look at the position in relation to throughput, and you will see the
11 figure on the sixth page of my note, it is the second item. As I think has emerged, the bracket
12 should say “page 50” rather than 51 in the Tribunal’s papers. That is simply a matter of
13 arithmetic, you will see that the flow rate over the 600 ml potable network of Dwr Cymru is
14 apparently 640 megalitres per year per km, whereas the 27,000 megalitres per year over the
15 158 kms of 600 ml and 300 ml pipes is only 170 megalitres per year per km. The point that we
16 make in the note is that using the cost driver of throughput appears again to show that one is
17 dealing with a much cheaper asset than in the potable system. What we have tried to do on the
18 basis of Mr. Anderson’s clarification as to the size of the Ashgrove network, is to identify what
19 the throughput is in relation to Ashgrove itself, and we understand it to be the equivalent for a
20 potable system would be 740 megalitres x 21, which would give 15,540 megalitres per year.
21 Whereas the actual figure for Ashgrove, which one finds at para.62 of the Decision, is 26.5
22 megalitres per day x 365, which is just under 10,000 megalitres per year, so 9,672.5 megalitres
23 per year. Whereas if this had been a standard part of the non-potable network, it would have
24 had a throughput of about 170 megalitres per year x 21, or 3.57 megalitres per year. So that in
25 terms of the throughput of Ashgrove, the potable equivalent would be about 1 ½ times the
26 actual throughput and about four times the regional average throughput.

27 If one then finally tries to do a like for like comparison of the approach adopted in
28 relation to treatment, in my submission it would not be appropriate to compare the 600 mm
29 potable network with the 600 and 300 mm non-potable network because, by my calculation, a
30 300 mm pipe has about a quarter of the capacity of a 600 mm pipe, and so there is no easy like
31 for like comparison. However, of course the Ashgrove system itself, on the assumption that it
32 is typical of the regional average, and at least for the purposes of value the Director takes that
33 approach, if one compares the asset value that Dwr Cymru gives of 8.8 million with a
34 throughput of 10,000 megalitres per year, with the valuation that appears from Dwr Cymru’s

1 figures of £34 million divided by 15 megalitres per year, one finds that the MEA value divided
2 by throughout – so the approach adopted in relation to treatment – would give a ratio of about
3 2½ times between the non-potable and the potable, which would in turn give a figure of about
4 6.64p. per metre cubed as the appropriate price for non-potable water on the basis of the
5 approach adopted in relation to treatment.

6 Sir, that was my submission that I wanted to make in relation to the comparison
7 between MEA and throughput, though it may be convenient if I summarise that in writing,
8 although it should appear on the transcript.

9 The next topic I wish to address is the question of margin and the question of what is
10 the correct approach to margin in a case of this kind. My first submission is that retailing is a
11 perfectly legitimate activity, and that what is needed here is some form of market opening
12 price, and, to give the Tribunal some idea of the reality of the retailing function, in my
13 submission it would be worth looking at the retail costs of Dwr Cymru itself, which one can
14 find in the large industrial tariff justifications which were used as the basis for the step 1
15 calculation both by Dwr Cymru and the Director, and one finds that at p.33 of tab D to the
16 reply bundle. You will see the analysis for operating costs which was used and formed the
17 basis for the figure that appears in the Decision at para.258, as I understand it, and you will see
18 that there customer services are £9.2 million, scientific services 4.4, regulation 0.5, and
19 doubtful debts 4. If you add up 9.2, 0.5 and 4 you reach the figure of 13.7, and divide by 227.7
20 the total figure you reach a figure of about 6 per cent.

21 A similar figure can be reached in relation to the more recent accounts that appear at
22 bundle 2, tab 5, p.10. You will see under “Operating Expenditure” there are similar
23 classifications. There is customer services again, and then at line 15, as I understand it, other
24 business activities includes regulatory costs, and then line 18 is doubtful debts. If you add
25 those together you reach a total of £18.062 million, which again if you divide by the total figure
26 of 209,2240,000 you reach a figure of 8.6 per cent. In my submission, that gives you a sense of
27 the sort of retail element that we are talking about, even for Dwr Cymru, which of course
28 would equate to a figure of somewhere between 1½ p. and 2p. on a 25p. selling price. So, in
29 my submission, that is the sort of order of magnitude you are talking about.

30 In relation to our assertion that 5p. is needed, the point that we make is that Dwr
31 Cymru can of course spread its costs over a very wide cost base and, in particular, that the
32 regulatory costs bear very heavily on a small undertaking and, in particular, an undertaking
33 with only one customer, and in this respect although Dwr Cymru and the Director make the
34 point that at the moment most things are actually done by Dwr Cymru, you will appreciate that

1 we are a licensed water undertaker, licensed by the Director, and therefore subject to the
2 regulatory obligations of the Director and, for that purpose, we have had to satisfy him that we
3 are capable of discharging those obligations not only in relation to Shotton's non-potable
4 distribution but also its potable supply, and indeed potentially at least in relation to other
5 customers. So we would not accept that the regulatory costs that we face can be simply
6 dismissed, and there is quite a substantial manual that we have to satisfy and which are subject
7 to control by the Director.

8 Turning to the Director's approach, we say that his approach is completely erroneous.
9 We say that the common costs not only of actual retailing but also of regulation, water
10 consultancy services, and indeed brokerage, should all be allocated and a margin given. At
11 para.43 of the rejoinder the Director makes the point that his costs are effectively all common
12 costs but, in my submission, that does not mean that there should not be any allocation of those
13 common costs for the purposes of establishing a reasonable margin. In this respect, the
14 relevant test – it is a point we have made in our pleadings – we say the relevant test is the costs
15 of a reasonably efficient competitor and the test which the Director has somehow invented out
16 of the ether of what the savings are to a monopolist. That is not the right test. There may be all
17 sorts of ----

18 THE PRESIDENT: You mean not the right test for Competition Act purposes.

19 MR. THOMPSON: Not the right test for the purposes of a margin squeeze.

20 THE PRESIDENT: Yes, whatever the position under the 2003 Act might or might not be.

21 MR. THOMPSON: Yes. I heard what was said about the 2003 Act, but ----

22 THE PRESIDENT: But, anyway, yes.

23 MR. THOMPSON: In my submission, that is subject to both the submission I made about
24 reasonable expectation, but also, in my submission, and it is a point I have not taken the
25 Tribunal to but since we are on it I might just raise it, which is the amendments to the 2003 Act
26 are not only the introduction of the costs principle, but if I may take you to tab 19 of bundle 3
27 of the authorities ---

28 THE PRESIDENT: I am glad to be taken to the Act as a whole because it is always very risky just to
29 concentrate on one particular section without seeing things in their overall context.

30 MR. THOMPSON: Indeed, and I think it is worth reminding ourselves that there is in fact a new
31 provision also, as I understand it, introduced by the 2003 Act, and I believe in force, which is
32 s.22A(a), and so the first obligation imposed on the Secretary of State is:

33 "... to exercise and perform the powers and duties mentioned in sub-section.(1) above
34 in a manner in which he or it considers it is best calculated (a) to further the consumer

1 objective ...”

2 And when one turns over the page one finds that the consumer objective is to protect the
3 interests of consumers wherever appropriate by promoting effective competition between
4 persons engaged in or in commercial activities connected with the provision of water and
5 sewerage services, and, in my submission, it would take a very extraordinary construction
6 indeed against that background to suggest that the costs element was to be calculated
7 effectively without reference to the Competition Act, if that is the primary objective and
8 obligation of the Director in discharging his functions under the amended Act.

9 PROFESSOR PICKERING: Mr. Thompson, could I just ask you, consumer – customer. Are you
10 making any distinction there? Is Shotton a consumer, and how does this apply in relation to
11 2(c), which is on p.3 of this authority?

12 MR. THOMPSON: I think it is the closing wording. It indicates a priority in relation to these
13 specific categories.

14 PROFESSOR PICKERING: So Shotton is implied in that rather than in the five specific examples.

15 MR. THOMPSON: I think that is right, because I think essentially (a) to (d) are individuals, whereas
16 (e) are, as it were, a vulnerable class of customer.

17 THE PRESIDENT: Since at the moment the licensed water suppliers etc. are only operating in
18 relation to large users, we presumably assume that 2(b) is talking about those persons as being
19 the consumers, do we? That is anywhere where there is effective competition.

20 MR. THOMPSON: Indeed. It is perhaps slightly inconsistent to 2(b) and 2(c) in that the focus in
21 relation to consumer welfare seems to be one class of consumer, whereas the consumer
22 objection in 2(b) would naturally focus on the, as it were, commercial consumer. But they are
23 there and I do not think there is anything to say that competition is only in relation to supply to
24 large users, to be focused on people who are disabled or chronically sick. It is, as it were, a
25 mandatory obligation to take account of these persons. In my submission, that would be
26 consistent with, as it were, the community law approach and the universal service obligations.
27 You have obviously got to take them into account, but, in my submission, effective competition
28 and consumer must include commercial consumers.

29 THE PRESIDENT: Yes.

30 MR. THOMPSON: If I am wrong about that I am sure the Director or his counsel will leap up, but,
31 as I understand it, consumer includes all consumers, including my client and, in particular,
32 Shotton and Corus.

33 THE PRESIDENT: And just while we are on this, Mr. Thompson – sorry to trouble you – if you
34 turn through to p.8 in the same tab, we get to 6(a), which is the relationship between the

1 Competition Act functions and the Water Act functions. How does that work for the purposes
2 of your argument?

3 MR. THOMPSON: I think it is 6(b). All I am saying here is the scheme of this Act does not suggest
4 that the issue of competition, as it were, should be put on the back burner.

5 THE PRESIDENT: No.

6 MR. THOMPSON: You either get into it directly under the Competition Act or it is the primary
7 obligation in terms of the regulatory function, and insofar as it is suggested that 66E, as it were,
8 pushes the Competition Act in my submission one should look at that with some scepticism.

9 THE PRESIDENT: Yes.

10 MR. ANDERSON: Can I just remind the Tribunal, and I do not think it is a controversial document,
11 but we did way back in the dim and distant past when we served our Defence put in something
12 that dealt with the legal framework. I think it was annex 1 to our Defence.

13 THE PRESIDENT: You did, Mr. Anderson.

14 MR. ANDERSON: It sets out, we hope in a helpful and uncontroversial way, these kinds of
15 background aspects and the interplay between when the Director is exercising powers under the
16 Act he is not to have regard to his s.2 duties and so on and so forth.

17 THE PRESIDENT: Yes, thank you very much.

18 MR. THOMPSON: I have gone slightly out of my way.

19 THE PRESIDENT: I am sorry, it is my fault entirely, Mr. Thompson.

20 MR. THOMPSON: Not at all, Sir. The point I was making was that the relevant test here is well
21 established and it relates to the reasonably efficient costs of the downstream market operator,
22 not savings to the monopoly upstream operator; and, secondly, the right test ----

23 THE PRESIDENT: When you say that is reasonably established, what do you rely on in particular?

24 MR. THOMPSON: I rely on the authorities that we have set out at length, which I do not think are
25 disputed by the Director, in our skeleton argument and in the analysis in *Genzyme* inter alia.

26 THE PRESIDENT: Right, thank you.

27 MR. THOMPSON: We further say that the right test is the margin between Dwr Cymru's end price,
28 i.e. the price that it would offer to Shotton, and Dwr Cymru's price to Albion. There is no
29 guarantee that Albion will receive the full margin from an end purchaser such as Shotton, or
30 indeed anybody else, but if there is to be effective competition then a competitor such as
31 Albion, or indeed Aquavitae, needs a margin between the price at which it purchases from Dwr
32 Cymru and the price at which Dwr Cymru sells to, for example, Shotton, otherwise the whole
33 system is impossible, and it is impossible here just as it was impossible in *Genzyme*.

34 We say that the Director's approach, as we understand it, makes what he calls a

1 margin conditional on a successful negotiation or investment on another market, not a retail
2 market at all, and not a retail margin at all. The principal example he gives is of obtaining a
3 discount on the upstream resource market, and we say that that is an absurd approach to retail
4 competition. It would be as if Costa Coffee could only set up in business in the High Street if
5 it could either grow its own coffee beans in Brazil or it could negotiate a special deal with
6 growers, or indeed, I think the other alternative, identify a completely new market for coffee,
7 and we ask rhetorically why should not the margin in this industry be an ordinary
8 wholesale/retail margin on the existing market where Dwr Cymru currently makes a charge of
9 somewhere between 6 and 8 per cent., as one understands it, of its total costs, and it currently
10 enjoys a monopoly. We say in particular that it is notable the Director's examples did not
11 include a retail margin based on volume of sales. They did not make any concession that one
12 was entitled to enter the market on the basis of a retail margin, and I would simply say in
13 passing that the extent of the business that Albion has with Shotton in terms of volume should
14 not be forgotten. It is approximately 7 ½ megalitres per year and, as I understand it, that
15 equates to somewhere between 35,000 and 45,000 domestic users or the size of a medium
16 sized town. Even if that business cannot open the market then it is difficult to imagine what
17 business ever will.

18 I suspect that Shotton is the largest single customer that Dwr Cymru had.

19 The next point we make is that we say it is clear from the large industrial tariff
20 experience evidenced by the press release, that it is manifest that retail competition is a
21 powerful catalyst for competitive pricing. We say that it should be encouraged and fostered by
22 the Director, not ridiculed and driven out of the market. We say that the Director is not doing
23 all he can, indeed, he expressly condones margin squeezing and one finds that in the letter that
24 was sent in relation to this case, bundle 2, tab 7 p.6. You will see that this is a letter dated 25th
25 July 1997 to Dr. Bryan ----

26 THE PRESIDENT: It is rather a long time ago, Mr. Thompson, before the Act came into force.

27 MR. THOMPSON: As I understand it, nothing has changed in the Director's policy, and of course
28 that is one of our complaints, there was nothing we could do about this in 1997, whereas it has
29 taken us eight years to get here. The case is:

30 "The determination represents the Director's views of Dwr Cymru's costs associated
31 with the supply of water to Shotton. Dwr Cymru would be able to accept the
32 Director's judgment and, as such, match the determination price."

33 As I understand it, that has always been the Director's approach, that Dwr Cymru is entitled to
34 drive down its price to whatever price we pay, so effectively we have no margin. That has

1 always been his policy. We say he is not doing all he can in another way, and that takes us to
2 the costs principle. We say that he is interpreting new legislation in a perverse way to avoid
3 his Competition Act duties, and one finds that at para.23 of the Decision. Given the issues of
4 policy that are raised by this case, it is highly relevant to bear in mind what his approach has
5 been under this Act. He says:

6 “Under the new Water Act the access price will be calculated under specific principle
7 which under the 1991 Act undertakers will have to apply in those circumstances. To
8 the extent that undertakers will be deemed to be engaging in conduct to comply with
9 the legal requirement in doing so, the Chapter II prohibition will not apply to such
10 conduct.”

11 In my submission, although that may be correct as a matter of law, the way it is interpreted
12 appears to be that the Competition Act no longer has any application in this area because the
13 costs’ principle will dictate a figure and, in my submission, that is an incorrect interpretation
14 for the reason I have given and perversely leads to the effect that the Competition Act
15 effectively becomes a dead letter in this critical area for water competition.

16 THE PRESIDENT: The reason you have given being what he could reasonably expect?

17 MR. THOMPSON: Well there are two reasons. One, as I explained at some length yesterday, we
18 say that he has misconstrued the Act; and secondly, even if you adopted his approach
19 reasonable expectation would include legality of conduct under the Competition Act. That is
20 all I wanted to say about margin.

21 In relation to the 4p error, in my submission first of all para.294 does show a clear
22 overcharge, admittedly on a hypothetical basis, of £270,000 per year, if one simply multiplies
23 the usage by the 4p per unit.

24 The second point I would make is that there was a close relationship between the non-
25 potable tariff and the first access price, and that is clear from bundle 2, tab 9, ps. 32 and 34. So
26 at p.32, this is a letter dated 20th February 2001, to OFWAT from Dwr Cymru and para.3 says:

27 “The attached appendix shows how the price has been calculated as well as the
28 relationship between the potable and large industrial tariff and the non-potable price.
29 The latter is the price which is currently being charged to the Albion bulk supply, any
30 difference is due to the annual price adjustment clause in the agreement.”

31 Then at p.34 one sees there is a straightforward relationship between the price that appears in
32 the right hand column, and the price that appears in the middle column, and it is simply the
33 same price, identical calculation with the resource cost taken out.

34 As I understand it, the Director justifies his position by reference to the Second Bulk

1 Supply price and I think he said that it was a price on which there had been extensive
2 consultation. In my submission that is not right, and one finds that from tab 7 of bundle 2,
3 where you will see a letter from OFWAT to Dr. Bryan of 12th December 1996, at p.1. You
4 will see that in December 1996 he says:

5 “Having considered the price as suggested by Enviro-Logic and Dwr Cymru
6 respectively, I will be recommending to the Director a price of 59p potable water, and
7 26p for non-potable water, both of these prices are without an additional fixed
8 charge.”

9 So that seems to be when the determination was reached in December 1996. The consultation
10 to which Mr. Anderson referred, appears at ps.7 and following. You will see that that is an
11 advertisement put in the “Financial Times”, on December 19th 1997, just over a year after the
12 determination had apparently been made. As I understand it the consultation here was to the
13 appointment of Shotton, although it is fair to say that the figure of 26p does appear at the
14 bottom. But, as I understand it the primary purpose of this consultation related to the
15 appointment of Albion rather than the price, which had been determined a year before.

16 Finally on this issue ----

17 THE PRESIDENT: That notice does refer to the 26p price and invites anybody to make any
18 representations or objections. It is about the appointment of Albion but the question of the
19 price is mentioned in the document.

20 MR. THOMPSON: Yes, the point is as it is. In theory, I suppose, there could have been howls of
21 protest at the price, but in reality it had been determined by the Director a year before and it
22 was unlikely that anyone other than the people who had been involved were going to be at all
23 interested at the price.

24 THE PRESIDENT: While we are on the bundle, could I just flick back to p.34 in tab 9, which was
25 the original Dwr Cymru work on the Large Industrial Tariff. They arrived at a 23.2 price, they
26 were effectively doing an ECPR approach there, that is what it is, you just take 3.9 away from
27 the other costs. They may not have called it that, or conceptualised it in that way, but that is
28 what they did.

29 MR. THOMPSON: Well in substance, I agree. I guess there may be an issue about whether the 3.9
30 derived from the amount they were in fact paying Mr. Randolph’s client ----

31 THE PRESIDENT: Or whether that is the average resource costs that they incur, which probably are
32 about the same.

33 MR. THOMPSON: Yes, it is certainly true that it was simply the resource cost locked out, but as I
34 understand it in the high arts of regulation for some reason it is appropriate to move over to the

1 actual costs when one is doing an ECPR calculation notwithstanding its obvious implications
2 for de-averaging which, in another part of the forest, seems to cause the Director such concern.

3 THE PRESIDENT: Yes.

4 MR. THOMPSON: If we then look at the point that I think Mr. Anderson made in relation to the 4p
5 – I think it was endorsed by Mr. Robertson. It seems all to turn on para.279 of the Decision,
6 which we looked at earlier on about the allocation of costs between resources and treatment.
7 In my submission, para.279 is a very obscure piece of work and neither has the evidence nor
8 really the reasoning to explain why this rather dramatic change takes place. As I understand it
9 this morning Mr. Anderson said that because the treatment cost went down that showed that it
10 had been wrongly allocated and must be lumped across into resources. I have to say that that
11 is a curious argument, because the Tribunal will be well aware that the reason why the
12 treatment cost went down had nothing to do with allocation, it was because of the relationship
13 between MEA and throughput in the potable and non-potable treatment works. So unless the
14 Director is saying it does not really matter what happens because you will always end up with
15 the same price which, in my submission, would be a worrying thing for a regulator to be
16 saying, it is difficult to understand why the Director says there is some causal link between
17 para.294 of the Decision and para.279. On the face of it they seem to be completely different
18 exercises.

19 THE PRESIDENT: I think he was saying, or at least I will be corrected later if I have got it wrong,
20 that if you do not, for whatever reason, allocate the costs in question to treatment then you
21 have to allocate them somewhere and water resources is where they finish up.

22 MR. THOMPSON: But that does sound like a heads I win, tails you lose analysis, that having found
23 that the treatment costs were too low, they then say well that must mean that the resources'
24 costs are too high, although in fact they are not. In fact, the resources' costs are rather lower
25 than the amount to 3.9, but he says they must be too low and so we end up with the same price
26 in the end. In my submission, that is a very unsatisfactory position.

27 THE PRESIDENT: So where would they go these other costs?

28 MR. THOMPSON: All it is is an allocation of revenues you will recall, Sir.

29 THE PRESIDENT: It is true that the 294, just let me see – I am probably going to get this
30 completely wrong – 294 is talking about whether treatment costs should be allocated to potable
31 or non-potable. It is not talking about whether any treatment cost should fall back into
32 resources.

33 MR. THOMPSON: I am sorry, was that para.294?

34 THE PRESIDENT: Yes.

1 MR. THOMPSON: Yes, he was simply looking at the potable/non-potable split and whereas 30 per
2 cent. was the approach that Dwr Cymru had taken as a sort of de-averaging between potable
3 and non-potable treatment, in the new tariff they did a 15.2 per cent., not a split but a
4 proportion of the ----

5 THE PRESIDENT: But that is a Step 5 correction, in 279 we are talking about Step 3 correction, so
6 how are they related at all?

7 MR. THOMPSON: There is no causal relationship between them in my submission at all. It may be
8 helpful if one looks at the Dwr Cymru figure in the left hand column. If one looked at the Dwr
9 Cymru figure of 24p for treatment, as I understand it the 7.2 figure that appears in the left hand
10 column is simply 30 per cent. of 24.

11 THE PRESIDENT: Sorry, which column are you inviting us to look at?

12 MR. THOMPSON: If you look at the Dwr Cymru figure on p.78, the Step 5 figure in the left hand
13 column ----

14 THE PRESIDENT: Yes, okay, yes.

15 MR. THOMPSON: -- is simply 30 per cent. of the Step 3 figure.

16 THE PRESIDENT: Yes.

17 MR. THOMPSON: So if there had not been the adjustments made by the Director, then the
18 adjustment he makes at step 5 would have been 15.2 per cent. x 24, which would have given a
19 figure of 3.6, 4.8 instead of 3.2 for the treatment cost. The adjustment he made at Step 5 was
20 based on NEA against throughput and a ratio of 15.2 per cent. He simply applied that to his 21
21 figure at Step 2, and reached the figure of 3.2. It had no causal connection at all with the
22 adjustment he made at Steps 2 and 3, and so he could equally well have left them all alone, and
23 made the same adjustment at Step 5, when he would have reached a 3.6p, 4.8p per unit at Step
24 5. There is no causal connection between them at all.

25 PROFESSOR PICKERING: Mr. Thompson, just looking at Step 3 on this and the difference
26 between the resource cost implied of 3.9 in the first column, and 6.3 in the third column, i.e. a
27 difference of 2.4. Would you want to make any comment about the apparent absence of
28 incorporating that difference into the resultant figures for the tariff that is referred to in 305? If
29 your argument is that there was no need to put this extra 2.4 back into the resource cost, then is
30 the logic of that that actually the new tariff, if Shotton were to become a customer of Welsh
31 Water again, should actually be something of the order of 2.4p less than the 26.6p
32 approximately? Can you see the point I am making.

33 MR. THOMPSON: I can, but I think the real point I am making about the Step2/3 adjustment is that
34 the reasoning for it is obscure, and it has the effect, the snakes and ladders effect to which I

1 referred that the saving we thought we might make on treatment magically disappears by some
2 allocation process in relation to resources, but how that happens, and why is not entirely clear
3 from this Decision, but it clearly has an unfortunate impact on a client caught in the middle, as
4 it were, between resources and the end price. I do not know if anything more arises on that
5 topic. I was going, rather cautiously, to enter the field about changes in resource costs which
6 was raised by the Tribunal and this is really by way of clarification. My understanding is that
7 the analysis differs in relation to retail supply and an inset appointment and also between actual
8 costs, and regulatory costs in relation to retail supply. As I understand it Dwr Cymru bases its
9 charges on regional average prices and therefore would bear any actual increases in resource
10 costs, for example, if the price from United Utilities went up itself, whereas an increase in
11 regional average resource costs would feed through into the retail price as part of the general
12 adjustment relating to the Director's regulation. I do not know if that is helpful – perhaps it is
13 not at all.

14 In relation to an inset appointment, such as the one we are concerned with here, Dwr
15 Cymru charges only for treatment and distribution and is intended to do so on the basis of
16 regional average pricing, and excluding the regional average resource cost. But Albion must
17 pay not only Dwr Cymru's access price, but also United Utilities' resource price. The net
18 effect is that the risk of an increase in United Utilities' resource price in this situation falls on
19 Albion whether by way of regional average or individual negotiation with United. I think the
20 point is clearly illustrated at para.12 of the Notice of Appeal on p.3, where you will see a little
21 table at the bottom (figure 1).

22 THE PRESIDENT: Yes.

23 MR. THOMPSON: It shows the three situations. In the first two, essentially Dwr Cymru bears the
24 risk of a variation in the bulk supply price. In the third one, which is illustrated by the
25 possibility of a bulk supply price of above 9p, the risk is borne by Albion leading to the
26 possibility of a wholesale price of well above the actual price that Shotton Paper obtains from
27 Dwr Cymru. So clearly the resource cost is an important element for the profitability of the
28 whole exercise, but how it bears and who it bears on varies depending on the contractual
29 arrangement. It may or may not be that that is helpful, but that is what I thought I would say
30 about that.

31 THE PRESIDENT: Yes.

32 MR. THOMPSON: The last points are simply by way of roll-up. In relation to, first of all, the
33 Lagoons, the position we take is that the Director's figures appear to be completely wrong and
34 that there is broad parity in the usable capacity of Corus in relation to storage, and the usable

1 capacity of Shotton in relation to storage, and we have set out the figures in our skeleton
2 argument. However, we would accept that in practice Dwr Cymru uses the Corus Lagoons as
3 the balancing system, rather than Shotton and to that extent we recognise that there is a
4 difference between the two commercial situations.

5 THE PRESIDENT: So we do not have to address the arguments about discrimination as between
6 Shotton and Corus?

7 MR. THOMPSON: In relation to Lagoons that is what we see to be the final outcome of all this. In
8 relation to Elan Valley, the mere fact that there are two Secretaries of State involved, and that
9 the whole thing involves some rather arcane negotiations and, indeed, some rather bizarre
10 terms, in our submission does not necessarily undermine the basic thrust of the point which I
11 think was raised by the Tribunal itself, that in reality there was a broad balance of bargaining
12 power, whether between the Secretary of State and another Secretary of State, or between the
13 two undertakers, and to that extent it can be seen as a commercial transaction in the water
14 industry and should be taken into account in assessing the nature of the arrangements in this
15 case.

16 Those were the points I wanted to make apart from interim measures, but I do not
17 know whether the Tribunal wants to take a pause now.

18 THE PRESIDENT: We probably will take a pause, but we do not want to deal with interim
19 measures until we have finished the argument in the main case.

20 MR. THOMPSON: Indeed. Those are the points, as it were, on the main case.

21 THE PRESIDENT: Thank you Mr. Thompson, thank you. (After a pause) We are just going to rise
22 for five minutes or so. I imagine we will be through by lunchtime with you, will we not?

23 MR. O'REILLY: Yes.

24 (Short break)

25 MR. O'REILLY: Sir, I am very grateful to you for mentioning this paper. It has been indicated to
26 me that we do not normally have a right of reply. I hope this is not a right of reply as such, but
27 everyone seemed to be struggling with the interpretation of the various sections yesterday. It is
28 a bit presumptuous perhaps for me to think I can help, but what I have done here is to set out
29 some of our thoughts, the first one of which is, you are absolutely right, we do have to look
30 wider than s.66A to E to understand this. Section 17A sets out the licensing provisions. I am
31 informed that this is not necessarily in your authorities bundle, and can I just tell you what it
32 says. Section 17A, licensing of water suppliers, sub-section (1):

33 "Subject to the following provisions of the chapter, the Secretary of State, or (b) with
34 the consent of or in accordance with the general authorisation given by the Secretary

1 of State after the consulting the assembly, the authority may grant to a company a
2 licence (‘water supplying licence’) giving it the retail authorisation referred to in sub-
3 section (2) below ... [and so on.]”

4 So this sets up the framework for the grant of licences. There are two types of licence
5 referred to in s.17A. One is a retail licence and the second is a further licence to permit
6 introduction of water into the system. So, for example, if you were going under s.66A you
7 would simply be buying from the incumbent and selling on to your customer, so you would be
8 acting under a retail licence only, whereas if you were introducing water into the incumbent’s
9 system you would need that further licence.

10 Section 66A to C sets out three separate models, in our submission, which are
11 mutually – if “mutually” is the right word – exclusive, so that s.66A is the simplest
12 arrangement, s.66C is the one that would be proposed in the case of Shotton, and s.66B is a
13 rather more complicated animal in which you might be supplying water from your own
14 borehole and inviting the incumbent to process that in its treatment plant.

15 But in terms of the arrangement, we have s.66A to C which sets out the three models,
16 s.66D which makes provision for agreements or determinations, leads on to s.66E which, as
17 I have said, tells you how to compute the money, and then we have some supplementary
18 provisions in s.66F and following.

19 There are a number of definitions set out in the statute. The definition of “licensed
20 water supplier”, and I mean qualified licensed water supplier, does not seem to be explicitly
21 stated, but it can be inferred, we submit, from the following mentioned sections. Primary water
22 undertaker and secondary water undertaker are defined, however, and we find that in s.66A(8)
23 and s.66C(1)(a). As I say, there are three models, and each of the sections, 66A, 66B and
24 66(3), appear to contain three parts. I have said 1, 2 and 3 down the left-hand side, but perhaps
25 it should be alpha, beta and gamma, because Roman ones and A’s are used elsewhere. For the
26 scope, we find the scope set out in 66A(1), 66B(1) and (2) for that section, and s.66C(1) for
27 that section. Likewise for the duties, and they are referred to as duties, and that is an important
28 point to note, are set out in those sub-sections. And, thirdly, there are the supplementary
29 requirements and provisions.

30 Translating the words into the current context, in my submission the three sections, A,
31 B and C, translate out as follows. Section 66A refers to the situation where Albion requests
32 Dwr Cymru to provide Albion with a water supply to supply Shotton, which is the current
33 arrangement although not the proposed arrangement. Section 66B contains two elements: in
34 sub-section (1) it sets out the following:

1 “Albion request Dwr Cymru to permit Albion to introduce water into Dwr Cymru’s
2 system to supply Shotton ...”

3 And there appears to be an “and/or”:

4 “... Dwr Cymru agrees to permit Albion to introduce water into Dwr Cymru’s
5 treatment works in connection with the supply to Shotton.”

6 So, in our submission, that would work where Albion would source water from its own
7 borehole and invite Dwr Cymru to allow that water into its treatment plant, but Dwr Cymru
8 does not have an obligation to do that.

9 Section 66C refers to the situation where Albion requests United Utilities to provide a
10 supply to Albion for the purposes of using Dwr Cymru’s system to supply Shotton, and,
11 furthermore, Albion requests Dwr Cymru to permit Albion to introduce that water into Dwr
12 Cymru’s system, which is the proposed arrangement where Albion would buy water from
13 United Utilities and transport it through Dwr Cymru’s system. So, as I say, A reflects the
14 current situation, C reflects the proposed situation, and B reflects, in my submission, a rather
15 more complicated arrangement where there might be a third source which is not from a current
16 undertaker.

17 The duties are in A, set out in sub-section 2, and they are to take the steps that we
18 looked at yesterday and, secondly, to provide the supply, and that is both for a period and on
19 such terms as may be agreed or determined. And in s.66C, again in sub-section (2), there are
20 two sets of duties, one of the secondary undertaker and one on the primary undertaker. The
21 secondary undertaker’s duties are to take the steps and to provide the supply. The primary
22 undertaker’s duties are to take the steps and permit the introduction, and both for a period on
23 such terms as may be agreed or determined.

24 There is a question as to whether “to provide the supply” means simply make
25 available an opportunity to provide the supply or actually to supply the water itself, and we say
26 that that must be supplying the water itself because of the constant references to “periods” over
27 which this would occur, and there are also references to “this period” in s.66D(2) and s.66F(10)
28 which we say are relevant here.

29 The costs principle is introduced in s.66D(2) and (3), and in sub-section (2) there is an
30 express reference by section numbers to those sub-sections in A, B and C in which are housed
31 the duties, and sub-section (3) invokes the costs principle set out in s.66E. In my submission,
32 the costs principle in s.E has a top tier principle where in sub-section (1) the amount that the
33 undertaker can recover is set out quite clearly. It is the amount in A and the amount in B. It is
34 an addition. It is quite clear that that is the case. In sub-section (1)(a) it provides that the water

1 undertaker may recover his reasonable expenses in performing his statutory duties, as we think
2 they must be, described above, because it refers to “any duty under section 66A to C”, and
3 therefore it must refer to those matters described as duties in A to C. And sub-section
4 66E(1)(b) provides for an appropriate amount of qualifying expenses. Now, Mr. Anderson
5 referred to this as the “meat” of the section, and, in my submission, that is entirely wrong.
6 Albion’s interpretation is correct because the duties are recovered under A.

7 In my submission, this is absolutely a service obligation levy, and the reference to
8 “appropriate amounts” is there because ----

9 THE PRESIDENT: You mean the universal term ----

10 MR. O’REILLY: Indeed, and the reference to “appropriate amount” is required because the
11 secondary undertaker would not normally have any obligation in the primary undertaker’s area,
12 and if one looks very briefly at s.66E(3) and (5), there is a reference to “relevant customers”,
13 and therefore we think that the answer is that they would have no obligation whatsoever.

14 Sub-sections (2) to (5) are what we call “second tier” obligations, in other words, they
15 qualify and assist in the interpretation of the top tier – sub-section (1). (2) simply provides that
16 the levy in question can include for capital expenditure and obviously the return on money
17 spent, and it is that money which the undertaker incurs to carry out, and the words in the
18 sub-section are “its functions”, but I submit that that should be read as “its service obligation
19 functions”, universal service obligation functions.

20 E(3) provides that all suppliers to the region will pay a contribution irrespective of
21 whose customer the supply is made to. So even if Shotton is no longer Dwr Cymru’s customer
22 Shotton, through Albion, will have to pay a contribution.

23 Sub-section (4), the arrow section, simply prohibits double recovery, and sub-section
24 (5) refers to and defines “relevant customers”.

25 I have no further submissions to make about that. Thank you, sir.

26 THE PRESIDENT: Thank you very much.

27 MR. THOMPSON: I do not want to take up any time, it is, simply, I did not comment on this paper,
28 and I obviously welcome the support for it.

29 The only point I would introduce by way of qualification, as it were, on p.2 of the
30 document is where Mr. O’Reilly says that 66C reflects the proposed situation at Shotton. Of
31 course we have the anomalous complication here that there is a treatment works in the middle
32 of the distribution where Albion’s water passes through the treatment works and, as I think
33 I said yesterday, in relation to that part of it there is a specific provision in 66B in relation to the
34 treatment, and so, in my submission, that part of it would be covered by 66B. I am grateful.

1 THE PRESIDENT: As far as the Tribunal is concerned, we have given the appellants and Aquavitae
2 a certain amount of latitude, so we are much in your hands to make any further points you wish
3 to make and take the time that you would like to take.

4 MR. ANDERSON: I am obliged. I am not proposing to say anything more on 66E beyond what
5 I said this morning. You asked me about why the 6p. was not deducted rather than the 3p, and
6 can I just explain the distinction between average accounting costs and the ECPR.

7 So far as the accounting, the regional average figures, one can see from the table that
8 the 6p. is in fact deducted for the purposes of – it is the table at para.304 – is in fact deducted
9 for the purposes of calculating the first access price under that methodology. So if I have
10 understood your question correctly, the question is, why are you not deducting that 6p. when it
11 comes to ECPR, and the answer is simply this: under ECPR you are looking at an actual retail
12 price. It has been calculated, yes, on a regional average basis – it is the retail price – as prices
13 throughout this industry are calculated on that basis. But the question under ECPR is what
14 actual costs have you avoided as a result of somebody else undertaking the supply, and the
15 actual costs you have avoided are not your regional average resource costs, they are the actual
16 costs you have avoided in this instance, because one is looking at the consequence of this
17 particular inset appointment, or this particular interposition – in this case 3p., because we know
18 that is the price payable to United Utilities. So that is the short answer.

19 Perhaps I could just explain, by way of a hypothetical example, why, in practice,
20 Parliament has elected to go for, we would submit, an ECPR retail minus rather than continue
21 with regional average accounting; if I can just give you some hypothetical examples, and I will
22 take it slowly so that it will find its way into the transcript. Assume a regional average cost of
23 water of 10p. but in a particular situation the actual cost of water is 5p. Then assume average
24 treatment and distribution of 20p., so on your regional average accounting you would be
25 charging, for example, on your large industrial tariff, 30p. That is your regional average
26 treatment and distribution of 20p., plus your regional average cost of 10p., but in this particular
27 locality the cost is 5p. A new entrant, assume an inefficient new entrant who is able to identify
28 a local source that is 8p., that is to say, 3p. more than the local cost in that case, he could come
29 along with his own 8p., plus the 20p. distribution and treatment, total cost of 28p. He would
30 then be able to have a margin that is effectively inefficient because he is introducing a more
31 expensive source of water in that particular locality, 8p. instead of 5p. That is the consequence
32 of regional average pricing.

33 Under ECPR, however, the access price is the retail price, 30p., made up, I accept, on
34 a regional average basis, less the actual costs that have been avoided, in that case 5p., leaving

1 an access price of 25p., so the inefficient new entrant whose water resource cost is 8p. has no
2 margin to come in. That is how the two systems operate and why it is important under ECPR
3 to take the actual avoided costs and not a regional average resource cost. That is why it is right
4 under ECPR to subtract 3 and not 6.

5 I ought to clarify one other point, which is on this allocation, 4p., which
6 Mr. Thompson rightly points out has no direct cause or connection between the step 5
7 adjustment and the fact that it has come back in resources because of course the Director made
8 two adjustments, one at step 2 and one at step 5. The adjustment at step 5, which moves an
9 element of what had been attributed to non-potable treatment to potable, has of course an
10 impact on the access price, which is why we say on that allocation it will go down to 19p., but
11 if one looks at the adjustment at steps 2 and 3 there is another adjustment that we suggest
12 should have been made, which was to move about 3p. from treatment into resources, so in a
13 sense they counterbalance, which is why, at the end of the day, one is back at, when one is
14 looking at a total all-inclusive price for resource, treatment and distribution, back up at the
15 26p., the large industrial tariff.

16 THE PRESIDENT: But that is just a coincidence on your ----

17 MR. ANDERSON: It is not a coincidence, it is the result of two different adjustments. One has an
18 impact on the access price because the other adjustment is in relation to – between treatment
19 and resources. In a sense it is a coincidence, yes. But of course the point Professor Pickering
20 put to my learned friend Mr. Thompson is absolutely right, that the logical consequence of my
21 learned friend's case is that the large industrial tariff is wrong and should be lower. The large
22 industrial non-potable tariff is wrong and should be lower.

23 THE PRESIDENT: That is often the effect of competition, that when people come in it does lead to
24 prices being adjusted and going down and so forth.

25 MR. ANDERSON: I hear what you say, Sir, but not this case!

26 THE PRESIDENT: No. I am glad there is something that is not this case, Mr. Anderson.

27 MR. ANDERSON: There was nothing else that I really wanted to address you on, Sir, unless there
28 is any further way in which I can help you.

29 THE PRESIDENT: No, I do not think from our point of view there is anything further; thank you
30 very much.

31 Does that just leave the interim measures issue? Is this still a live issue?

32 MR. THOMPSON: I think it is really all in Mr. Robertson's hands. We do not think it should be a
33 live issue. We are rather surprised to find a large firm in the situation in which Dwr Cymru
34 finds itself taking a stand on this issue, because, as I understand it, Mr. Robertson and his client

1 are breathing fire and effectively not only want to defend the situation but indeed appear
2 apparently really to be questioning whether the interim order should ever have been made, so it
3 is really a matter for him. We think it is rather an inappropriate way for him to conduct
4 himself, and it is really a matter for him to explain.

5 MR. ROBERTSON: Sir, my learned friend is incorrect. We are not applying to have the consent
6 order discharged. My learned friend is applying, we submit, for a variation in that consent
7 order, and we submit there are no grounds for a variation in that consent order.

8 THE PRESIDENT: We had better hear it at two o'clock. Thank you very much.

9 (Adjourned for a short time)

10 MR. THOMPSON: Good afternoon, Sir. With a slightly heavy heart we embark on the question of
11 interim relief. Our submissions are set out in part D of our skeleton argument, pages 41 to 42.
12 You will recall that this relates to an order made by consent, which was stamped, at least, on
13 4th June 2004 based on a case management conference on 2nd June 2004. The relevant part of
14 it is set out at para.103 of our skeleton argument and, as I understand it, the power to make
15 such an order arises under I think rule 61 of the 2003 Rules.

16 THE PRESIDENT: Yes.

17 MR. THOMPSON: As you will see, we have, as it were, a two part application. We seek
18 clarification of the meaning of the order as our primary application, and what we say this
19 means is set out at para.107. We say that para.1 of the order which provides by consent
20 that ----

21 "With effect from 1 July 2004 (or the first date thereafter on which the meter is read)
22 the price payable by the appellant for the bulk supply by Dwr Cymru of non-potable
23 water – will be reduced by 2.05p per metre cubed."

24 We, in effect, say that that is to be read by reference to the actual prices being charged at that
25 time and is to take effect until further order of the Tribunal and so fixes an actual price that is
26 to be charged. So we say that the effect of the order is, as we say at 107 that:

27 "Dwr Cymru is not entitled to increase the price payable by Albion for the bulk
28 supply by Dwr Cymru of non-potable water above the level charged as of 1 July 2004
29 without the permission of this Tribunal."

30 We say that without that interpretation it enables Dwr Cymru effectively to vary the scope of
31 the order without permission of the Tribunal.

32 In the alternative, we say that if the order did not have that effect, we say that was, as
33 it were, the intention of the Tribunal because the whole point was to preserve the status quo
34 pending the outcome of the appeal, and so we say that it should be either varied or an

1 alternative order made to say that:

2 “Dwr Cymru shall not increase the price payable by Albion for the bulk supply by
3 Dwr Cymru of non-potable water above the level charged as of 1 July ... “ etc “...
4 until the final judgment in this case or further order.”

5 That was a skeleton drafted on 18th April. Since then there has been a development which is
6 relevant in that we have a bill dated 4th May 2005 so that there would need to be some
7 technical variation to take that into account. I assume that either a credit note would have to
8 be issued, or else this Bill would have to be withdrawn and another Bill issued.

9 THE PRESIDENT: Does the bill reveal exactly what the price increase actually is? There is some
10 uncertainty when the evidence was first prepared as to what we were actually talking about.

11 MR. THOMPSON: Well it says the actual price, it sets it out – I have copies of the Bill if it would
12 be helpful.

13 MR. ROBERTSON: Sir, if I can help, the actual price increase is set out at para.32 of our
14 skeleton ----

15 THE PRESIDENT: I am sorry, Mr. Robertson.

16 MR. THOMPSON: Yes, that is a price of 26.5p going up to 27.29 an increase of 0.79p per cubic
17 metre, and it is pointed out to me that on the actual Bill the charge that appears is 25.24, which
18 I think, by a matter of arithmetic, ought to be 2.05 removed from 27.29 – yes, that seems to be
19 right.

20 THE PRESIDENT: So you have 27.29 minus 2.04 – did you say 25.29.

21 MR. THOMPSON: 25.24 is the amount that appears on the Bill. I have been informed that
22 apparently Dwr Cymru’s prices went up by about ½ p per metre cubed since 1997 so this is, at
23 least in historic terms, quite a substantial rise. It represents substantially more, in fact, 60 per
24 cent. more, than the price has increased since 1997 in a single jump.

25 THE PRESIDENT: Historically speaking this is a situation that Albion has lived with up to now in
26 the period between April to August ----

27 MR. THOMPSON: Yes, that is right. But as I have said, the increases up to now cumulatively have
28 been less than this single increase. In cash terms ----

29 THE PRESIDENT: I see, the cumulative increase up to now ----

30 MR. THOMPSON: Has been ½ p as I understand it over the last eight years. The amount of the
31 increase in cash terms represents about £4,500 per month as against a £12,000 benefit from the
32 interim order, so approximately 35 per cent. of the benefit is eliminated. Contrary to what is
33 said by, I think, Dwr Cymru this is not a cash flow issue. Shotton will not accept any increase
34 in price under its contract until August, and one finds that in the terms of the contract , that is at

1 tab 12 of bundle 2. It is provided for in Schedule 3, there is a specific provision in relation to
2 the price system, which permits increases in price on 1st August each year after 1998.

3 THE PRESIDENT: Sorry, which page was that?

4 MR. THOMPSON: Page 59 of tab 12. It is particularly, I think, Schedule 3, note 2. As far as I
5 understand it the trigger date for the variation in the price is 1st August each year. We say that
6 there has been no material improvement in the financial position of Albion since the interim
7 order was made, and you will have seen that there is a statement from Dr. Bryan. In summary,
8 the position is that although a member of staff has been lost and that has obviously involved
9 some saving the services that he was previously performing continue to be performed by
10 temporary staff, and in addition there have been the costs of legal representation in this appeal.
11 So in summary, there is no basis for assuming any improved financial position.

12 The other point that is taken, I think, by Dwr Cymru is that no application was made
13 for interim measures in the Thames case. In our submission that is an entirely irrelevant
14 consideration. There is no current commercial relationship between Albion and Thames, and
15 so there was no question of any interim payment or margin from Thames, unless some form of
16 mandatory order had been made that Thames should pay money to my clients to finance an
17 appeal. So in my submission there is no real analogy to the Thames position.

18 THE PRESIDENT: But what has the Bath House case got to do with it?

19 MR. THOMPSON: The point is made by Mr. Robertson in para.42, he notes that we have not made
20 an application for interim relief in the Bath House case. I do not think there should be any
21 assumption that we are sailing along cheerfully bearing the costs of Bath House, it is merely
22 that we do not see any realistic way of asking for money from Thames, simply because they
23 have an interest in the outcome of that case, given that we have no current commercial
24 relationship with Thames. We say that is a completely irrelevant point.

25 THE PRESIDENT: So your problem is what – a cash flow problem? Or a viability problem, or
26 what? What is the nub of it?

27 MR. THOMPSON: It is set out in the hearing before the Tribunal, and the basis for the consent
28 order. As I understand it, at that time it was accepted – I was not represented or present – it
29 was accepted by the parties and by the Tribunal and indeed expressly by Dwr Cymru that this
30 would be an appropriate case for interim relief of some form, and that is why the consent order
31 was entered into. As we understand it there is no positive suggestion that anything has
32 changed since then. The question is whether or not the status quo should be preserved pending
33 the outcome of this appeal, and we say that it should, and that the effect of the price increase is
34 very materially to affect the status quo, and that that was not something that was envisaged in

1 the order of the Tribunal.

2 THE PRESIDENT: Yes.

3 MR. THOMPSON: I do not know whether the Tribunal wants to see the actual Bill – perhaps

4 I should hand it in just for the sake ----

5 THE PRESIDENT: I think probably for completeness we ought to have a copy for the Registry.

6 (Document handed to the Tribunal) So that is £4,500 a month, you said, I think?

7 MR. THOMPSON: It is equivalent to an addition of £4,500 a month, which is about 600,000 cubic

8 metres.

9 THE PRESIDENT: Right, which is £18,000 – is that right?

10 MR. THOMPSON: Over the four months, yes. There is one feature that I should perhaps note, but

11 in a spirit of goodwill, Mr. Robertson made something of the goodwill gesture, or the dividend

12 that is being paid to customers and you will see reference there to a £9 dividend. The only

13 qualification to that as a goodwill gesture is that of course, in proportionate terms, I think we

14 represent approximately 40,000 customers, so whereas an ordinary individual would get a £9

15 discount on a £150 bill – about 6 per cent. – we get a discount of £9 on about £2 million or

16 0.0005 per cent.

17 THE PRESIDENT: So you get the £9 do you? (Laughter)

18 MR. THOMPSON: We represent 1 per cent. of revenues and we get 0.0005 per cent. of the benefit,

19 I think.

20 THE PRESIDENT: Yes, I see.

21 MR. THOMPSON: Those are my submissions.

22 THE PRESIDENT: Yes, thank you. Yes, Mr. Robertson.

23 MR. ROBERTSON: Sir, I would be grateful if the Tribunal could turn to part B of my skeleton, it

24 starts at para.30.

25 THE PRESIDENT: Just a moment. Yes.

26 MR. ROBERTSON: Just to put the consent order into context first, this consent order has lasted for

27 a lot longer than was originally envisaged. The agreement was reached between the parties at

28 the case management conference on the 2nd June last year, and at that time you indicated that –

29 this is on p.12 of the transcript of the hearing:

30 “If we can manage this appeal in a way that does try to concentrate on the main points

31 and not try to get into points that we do not need to decide we should be able to bring

32 this appeal on for hearing in the latter part of the year.”

33 In other words, the last part of 2004.

34 “We are possibly looking to a judgment on the principal issues in the early part of

1 next year if everyone can operate in a fairly disciplined and responsible manner.”
2 And obviously it has not been possible to bring it on that quickly. But I make that point just to
3 emphasise that when Welsh costed the likely cost of this undertaking it was working on the
4 basis it was going to be in position in about six to eight months. It is obviously going to be in
5 position for a lot longer than that. The Tribunal’s hearing in the latter part of June – I do not
6 know when the Tribunal is likely to hand down judgment, but it is probably going to be well
7 after a year after the consent order.

8 THE PRESIDENT: Yes.

9 MR. ROBERTSON: Why are we resisting their application? Our concern really is one of spiralling
10 costs in relation to this appeal. As we submitted yesterday, money to Albion is money out of
11 the pockets of our other customers, and, just to put that into context, the overall cost of dealing
12 with this investigation, this appeal, translates to about £1 per household customer in Wales, so
13 it is a significant overall expense.

14 THE PRESIDENT: How many household customers are there in Wales?

15 MR. ROBERTSON: The figure is in our skeleton argument.

16 THE PRESIDENT: It is there, yes.

17 MR. ROBERTSON: It is 1.2 million households – that is at para.2 of our skeleton argument.

18 THE PRESIDENT: So you spend over £1 million on the case; is that what you are telling us?

19 MR. ROBERTSON: That has been the cost of dealing with the investigation throughout, the
20 administrative proceedings and then through the appeal, but not obviously on the appeal itself.

21 THE PRESIDENT: I see, yes, but over the period since 2000 when it all began.

22 MR. ROBERTSON: Yes, exactly. Sir, we have a concern about costs and we do not want to give
23 more money to Albion than we are required to do, than we ought properly to do.

24 The discount so far under the consent order is now worth – well, the figure I gave at
25 para.30 of my skeleton argument is over £105,000. That was to the beginning of March and we
26 have had April since, so it is getting on for £120,000 now.

27 We should also remember that when Albion initially sought interim relief from the
28 Tribunal the figure that it sought by way of discount was 2.6p. per cubic metre. We offered
29 1.5p. per cubic metre to step into the shoes of Shotton, who the Tribunal will recall were
30 funding Albion to the tune of 3p. per cubic metre, but had then withdrawn half of that funding.
31 The funding had been put in place by Shotton to fund effectively the appeal. As they have
32 withdrawn half of it we thought it was fair to hold the ring and to step into their shoes. In the
33 event, and in light of the indications given by the Tribunal that it would like to get matters on
34 quickly, we met the appellant halfway, which is how we arrived at 2.05. I mention that only by

1 way of background but also to say that we were being told at that time that 2.6 was the
2 minimum necessary for the appellant. In the event, the appellant was happy to agree on 2.05,
3 and that is why we are not inclined just to take statements at face value, and nor should we be
4 asked to do so. If one sees evidence that interim relief is merited one has got to see hard
5 evidence behind it, and we have not seen anything for this application by the appellant.

6 There is one other point I want to deal with by way of introduction, and that is that my
7 learned friend pointed out that this was, relatively speaking, a large increase in price. That is
8 true for all water customers this year. The industry has been faced with rising costs. The cost
9 of power has increased quite dramatically, for example. Pensions need funding, both existing
10 pensioners and future pensioners, so those costs are being faced across the industry. The price
11 increase is regulated and approved by OFWAT, so this is not Welsh unilaterally imposing a big
12 price increase specifically targeted at Albion ----

13 THE PRESIDENT: It is an across-the-board increase.

14 MR. ROBERTSON: It is an across-the-board increase approved by OFWAT.

15 I have set out at para.31 of my skeleton the provision upon which we rely to pass on
16 the price increase to Albion, and that sets out the basis for the price increase to be passed on.
17 As I say at para.32, there have been annual changes, both up and down actually, since these
18 terms came into effect in April 1999, and you have already looked at the actual scale of the
19 price increase.

20 Albion's application is actually expressed to be either a declaration or a variation, and
21 we say it must be a variation, requiring us to continue charging Albion at 24.45 until final
22 judgment or further order. That, in any event, must be wrong because the only problem that
23 they have identified is the gap between April, when our price increase kicks in, and August,
24 which is when they can pass on the increase to Shotton. Obviously we do not know when
25 judgment is going to be, but the period could only be for that limited period, because that is the
26 only time at which they say they cannot pass on the increase.

27 THE PRESIDENT: Judgment before the 1st August is unlikely I think if we are going to hear the
28 Bath House case at the end of June. That is fairly tight given the Tribunal's other
29 commitments. A case like this has to take its place in the queue.

30 MR. ROBERTSON: Yes, absolutely. So any order would have to be for a limited period of time. It
31 could not be until judgment because that is likely to be after they can then pass on the price
32 increase.

33 Dealing first with their application for a declaration upon para.34, we say the consent
34 order is just clear on its face. It provides for a discount from the price payable under the Bulk

1 Supply Agreement. There is a good reason why it does not deal with variation expressly, and
2 that is because at the time the consent order was entered into all parties concerned were
3 working on the basis of the time estimate given by the Tribunal for final judgment, so no one
4 was looking to the situation that might apply in April 2005 and onwards, because we were
5 hoping to have judgment before then.

6 THE PRESIDENT: As far as the Tribunal is concerned, as I recall it, not having read back through
7 the transcript, we simply made an order in the terms of the agreement between the parties.

8 MR. ROBERTSON: That is right, Sir, you did, because you had indicated at the previous case
9 management conference that it would be sensible to hold the ring, and we looked at the position
10 of Shotton and ----

11 THE PRESIDENT: Yes, and we encouraged the parties to reach a statesmanlike interim solution,
12 for which we were very appreciative.

13 MR. ROBERTSON: Yes. We approached it constructively and we continue to do so.

14 THE PRESIDENT: Yes, absolutely.

15 MR. ROBERTSON: And that is why we are not applying to have the consent order discharged. We
16 will live with it for the time being.

17 THE PRESIDENT: Yes.

18 MR. ROBERTSON: Sir, we say the consent order, para.1, is perfectly plain on its face. It provides
19 that the price payable by the appellant for the bulk supply by Welsh of non-potable water based
20 on a continuation of the Second Bulk Supply Agreement will be reduced by 2.05p. per cubic
21 metre, and that we say is clear; that is the price from time to time. The agreement applies, the
22 price applies, subject to a discount of 2.05.

23 THE PRESIDENT: Yes.

24 MR. ROBERTSON: Sir, we submit that they are not entitled to the declaration that they seek. If
25 that were wrong then we would make an application to have the consent order varied so that it
26 accords with our understanding of the agreement that it ----

27 THE PRESIDENT: But you are saying that that is what the agreement was, and there was no
28 agreement that covered this particular situation.

29 MR. ROBERTSON: That is right. Nobody applied their minds to it.

30 THE PRESIDENT: Yes.

31 MR. ROBERTSON: As an alternative, Albion seek a variation of the consent order, that they
32 continue to pay 24.45. So that would effectively mean that there was an increase in the
33 discount of the price increase. The price increase is 0.79p., therefore added to 2.05 that is an
34 increase in the discount to 2.84p., so that is even above the 2.6 that they initially applied for last

1 year.

2 They claim to be in difficulties because of their supply agreement with Shotton,
3 having an annual price review date of the 1st August, as we have seen it does. The problem –
4 and I do not know whether it is correctly expressed as cash flow or whatever – but, anyway, the
5 problem is an April to August problem, because in August they will be able to charge the
6 higher price on to Shotton, as we have seen.

7 We observe at para.41 of our skeleton that Dr. Bryan states in his witness statement,
8 served with the appellant’s skeleton for this hearing, that the discount is being sought because
9 of legal costs incurred by Albion since the consent order. That contradicts ----

10 THE PRESIDENT: Sorry, I am just cross-checking where that is said. It is para.16 ----

11 MR. ROBERTSON: That is correct, of his witness statement, which is annex 4 of the appellant’s
12 skeleton, bundle 10.

13 THE PRESIDENT: I have it here, yes.

14 MR. ROBERTSON: He says:

15 “We have been supported by counsel who appear before you now. I confirm our legal
16 costs exceed the combined income and costs savings achieved since the order of the
17 4th June.”

18 At the 2nd June case management conference Dr. Bryan, who was then appearing for
19 himself, told the case management conference that ----

20 THE PRESIDENT: Now, have I got the transcript to hand? I probably have somewhere. Here we
21 are. This is in the other case. We are technically in ----

22 MR. ROBERTSON: Yes, this is the one that is published on the website of the Tribunal.

23 THE PRESIDENT: Yes. It is all right, we just have it in a different file.

24 MR. ROBERTSON: This is pre-Decision.

25 THE PRESIDENT: It is pre this Decision?

26 MR. ROBERTSON: Yes.

27 THE PRESIDENT: We are technically in the interim measures application case, in the interim
28 measures appeal rather than in the main appeal, technically speaking, not that anything turns on
29 that.

30 MR. ROBERTSON: But at p.20, line 23, you turn to Dr. Bryan. He says:

31 “Sir, I think there is a degree of confusion about the difference between the 1.5 and
32 2.6. None of that is in our mind allocated to ...”

33 And you say:

34 “Not related to the cost of the appeal?”

1 And he says:

2 “Indeed, Sir.”

3 THE PRESIDENT: Right. There was quite a discussion on that occasion as to whether there were
4 possibilities for Albion to be professionally represented.

5 MR. ROBERTSON: That is right. There was a suggestion that it might done pro bono, there was a
6 suggestion of an amicus curiae, Mr. Randolph alerted the Tribunal to the possibility of
7 conditional fee arrangements and so on, but in the end it turned out ----

8 THE PRESIDENT: It was not to do with the legal expenses.

9 MR. ROBERTSON: Yes, but it turns out what actually does appear to have happened is that as a
10 result of us entering into the consent order the appellant has been put in funds and has
11 expended funds on employing counsel..

12 At para.42 I note that Albion has not made an application for interim measures in its
13 appeal in the Bath House case, and we know that appeal is ongoing and we know they are
14 represented by counsel. That is as much as we ----

15 THE PRESIDENT: I would not have thought that is your strongest point, Mr. Robertson.

16 MR. ROBERTSON: In that case I will move on to para.43. The cost to us of what Albion are
17 seeking is further loss of revenue, it is a further loss of income. It will increase the revenue that we
18 are losing by a further £4,500 a month. If it is just limited to four months, then it is roughly about
19 £18,000. If it were to continue until judgment or further order it is more open ended than that.

20 THE PRESIDENT: Can you just remind me in broad, ball park terms what your client’s annual
21 turnover is at the moment?

22 MR. ROBERTSON: It is about £440 million. The point is, as I said at the outset, we are concerned
23 about costs spiralling out of control here, and at the end of the day that is a cost, the cost of
24 these proceedings is a cost that has to be borne by our customers. Unlike the raw material, it is
25 not going to fall from the sky, it is borne by our consumers, and so we cannot just hand over
26 money to this particular customer without a good reason for doing so.

27 THE PRESIDENT: No, absolutely.

28 MR. ROBERTSON: We submit that Albion has made out no case for a variation of the consent
29 order. The jurisdiction under which the consent order is made, as my learned friend pointed
30 out, is Rule 61. The Tribunal has considered that on a number of occasions, not just this case,
31 in discussion in case management conference, the *Napp* interim relief case, the *Genzyme*
32 interim relief case. The principal purpose, as the Tribunal said in *Napp* was to preserve the
33 integrity of the appeal. The principles are summarised in the interim relief case in *Genzyme*,
34 and they are set out at para.45, and they are really developing what is set out in Rule 61 of the

1 Tribunal's Rules.

2 Item 2 – is urgency established? 3 – is the applicant likely to suffer serious and
3 irreparable damage if interim relief is not granted? What is the likely effect on competition or
4 relevant third party interests of the grant or refusal of interim relief, what is the balance of
5 interests?

6 We say, as to serious irreparable damage, it is insufficient simply to show financial
7 loss. Obviously this is going to cost them some money, but that is insufficient. It must
8 threaten the survival of the undertaking, and we have seen no evidence to that effect. We did
9 see it, as you will certainly recall in the *Genzyme* case when Healthcare at Home applied for
10 interim relief. Its chief executive's witness statement backed up with detailed accounts
11 showing the problems it would encounter, and explaining why its viability is indeed
12 threatened. We have seen nothing of that nature in this case.

13 Here, and this is a point we made in the June case management conference, set out at
14 para.48, its original application for interim relief measures. It said that its survival was not
15 under threat and I think that continues to be its case. It said:

16 “For the avoidance of doubt, the relief is not necessary to manage Albion Water as a
17 marginally profitable water company, that requires the continuing preparedness of the
18 customer to fund the reduced uplift of 1.5p.”

19 Shotton, we understand, continues to provide the 1.5p underpinning to Albion. We are in a
20 position to know that because when the cheques come in from Shotton we see the amount that
21 comes to us and then a separate check, because of the escrow arrangements were put in place
22 as a consequence of the consent order, we see the amount then going to Albion, so we know
23 that Shotton continued to fund that uplift, and we have not been told otherwise.

24 So we say that since last June Albion has enjoyed a substantial input of funds from
25 Welsh. There is no evidence before the Tribunal that their application is urgent. There is no
26 evidence that it will suffer serious or irreparable damage. It simply appears to be making this
27 application based on an assertion by Dr. Bryan at para.16 of the witness statement, which we
28 have already looked at, that our proposed price increase will indeed have adverse financial
29 consequences for this company. Even if that is true, and obviously paying high prices, if you
30 cannot immediately pass them, you will have adverse financial consequences. We submit that
31 does not even come close to providing evidence capable of supporting this application.

32 By contrast, if their application were granted we would suffer financial loss,
33 irrecoverable from Albion in the future and that is ultimately loss that has to be borne by our
34 other customers and consumers.

1 Sir, unless I can assist you further, those are our submissions.

2 THE PRESIDENT: Thank you, Mr. Robertson.

3 MR. THOMPSON: Sir, as I understand it, the position now is that Mr. Robertson is effectively
4 making a two-pronged application, either for effectively a declaration saying that it means
5 what he says it means, or else an order varying it. It seems to me in those circumstances that
6 the declaration ----

7 THE PRESIDENT: I think it is the other way around, you are making the application, are you not?

8 MR. THOMPSON: I think he also said that if he was wrong about the declaration then he said it
9 should be varied to mean what he says it means, as I understood listening to him just now. In
10 those circumstances I am wondering whether the declaratory route is going to be particularly
11 fertile because, one way or another, the Tribunal has to decide what should happen.

12 THE PRESIDENT: Speaking for myself, without having consulted my colleagues, I would have
13 thought that it might be a bit difficult to say that the original order had covered this
14 situation ----

15 MR. THOMPSON: Well exactly, that was the point I was ----

16 THE PRESIDENT: -- because I do not think anybody really thought about whether it covered this
17 situation or not.

18 MR. THOMPSON: Everyone was hoping that this case would be done before where we have got to.

19 THE PRESIDENT: Yes, so it has probably got to be a variation – some form of variation.

20 MR. THOMPSON: Some clarification has to be made, maybe a variation or whatever.

21 THE PRESIDENT: Yes.

22 MR. THOMPSON: The suggestion that Mr. Robertson has made is that this should only go on until
23 1st August in any event.

24 THE PRESIDENT: Yes.

25 MR. THOMPSON: I think we would accept that, that we are in fact talking about a relatively short
26 period of time and, at least in Dwr Cymru’s case, a relatively small amount of money. We are
27 talking about £18,000, and whether the ring should be held, as it were, in our favour pending
28 1st August or in Dwr Cymru’s. I am not sure there is a great deal more for me to say about
29 that. We say that in all the circumstances it would be appropriate for the ring to be held in our
30 favour and, for what it is worth, I put in the ring the question that I raised on Monday, namely,
31 the fact that on the Director’s own findings there was a 4p element which was debated this
32 morning which equates to some £270,000 a year. So if we are talking about who is paying
33 whom in my submission it is perhaps not a very profitable line in terms of there is no doubt we
34 are paying Dwr Cymru, however they may feel about the money, we are still paying a large

1 amount of money to Dwr Cymru and we say that £18,000 is a relatively small amount to them
2 and a very large amount to us, and that it would be appropriate in all the circumstances to hold
3 the ring in our favour until 1st August. I think that is really the nub of what we say, and I am
4 not sure there is much more to be said about it.

5 THE PRESIDENT: Well could you just talk us through the steps envisaged by Rule 61, if you
6 happen to have it to hand. It is p.400 of the **Butterworths'** 10th Edition. I suppose we are
7 under 61(1)(c), or 61(2) generally.

8 MR. THOMPSON: Yes.

9 THE PRESIDENT: We are under 61(2) I think actually. First of all "as a matter of urgency", and
10 then the second ----

11 MR. THOMPSON: Yes, it is a curious situation in that ----

12 THE PRESIDENT: -- "preventing serious irreparable damage."

13 MR. THOMPSON: As I understand, the issue of urgency was effectively before the Tribunal at the
14 time of the original order and we are talking here about a variation of that order. So in the
15 sense that the matter is under the jurisdiction of the Tribunal, read albeit by consent, in my
16 submission we do not need to show a new case for urgency. It is, as it were, still part of the
17 same case that it was last June. The real question is whether or not there is evidence of serious
18 damage, and whether it is irreparable. We say it is irreparable in the sense that we have no
19 basis for recovering that money.

20 MR. ROBERTSON: Sir, I am sorry to interrupt, my learned friend was not at the hearing in June,
21 we did not specifically discuss urgency in front of the Tribunal. The matter went by way of
22 consent, a constructive approach by us so that we could get on with the Appeal.

23 THE PRESIDENT: Yes, having Dr. Bryan at that stage unrepresented was clearly invoking the
24 various considerations under the Rules in order to persuade us to make some kind of order if
25 agreement could not be reached, so to that extent I suppose it is correct to say that they were
26 then arguing that these conditions were fulfilled, though it is perfectly true that we did not
27 discuss it in any detail and certainly did not pronounce upon it. I am sorry, Mr. Thompson?

28 MR. THOMPSON: I must confess, to some extent this hearing is taking a course that I had not
29 entirely anticipated in that effectively we seem to be reopening the whole question which, as I
30 understood went by consent last June. Dr. Bryan is here, and what he says to me now is that
31 Albion's profits last year were less than £10,000 even taking account of substantial takings'
32 reductions made by the directors in order to sustain the business. From that perspective
33 £18,000 is very material amount of money for them, and in my submission to have an abusive
34 monopolist, on our case, come before the Tribunal and say that £18,000 out of £440 million is

1 an unacceptable loss to the 1.2 million customers in Wales is something which the Tribunal
2 should view with some scepticism. That is the gist of it.

3 THE PRESIDENT: Yes, thank you. (After a pause) The Tribunal will rise for a few minutes.

4 (For Ruling see separate transcript)

5 THE PRESIDENT: The Tribunal would also like to take this opportunity, if we may, to pay
6 particular tribute to the clarity and helpfulness of the submissions that we have received from
7 all parties, the Appellant, the Director and the Interveners, and also to the extremely
8 professional and helpful way in which everybody has sought to present their case in as clear
9 and persuasive a way as possible, including all those that form part of the various back-up
10 teams who often go unsung in these proceedings but play a very useful role, and we are very
11 conscious of the work that has gone on and we would particularly like to express our
12 appreciation for the help that you have all given us.

13 Thank you all very much indeed.

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