Neutral citation [2003] CAT 17

**IN THE COMPETITION APPEAL TRIBUNAL**

Case: 1012/2/3/03

New Court
Carey Street
London WC2A 3BZ

5 August 2003

Before:

Sir Christopher Bellamy (President)
Mrs Sheila Hewitt
Professor Graham Zellick

sitting as a Tribunal in England and Wales

BETWEEN:

**AQUAVITAE (UK) LIMITED**

Applicant

-v-

**THE DIRECTOR GENERAL OF WATER SERVICES**

Respondent

supported by

**NORTHUMBRIAN WATER LIMITED**

Intervener

Mr Michael O'Reilly (instructed by Messrs McKinnells) appeared for the applicant.

Mr Jon Turner and Miss Valentina Sloane (instructed by the Director General of Water Services) appeared for the respondent.

Mr Robert Vidal of Messrs Hammonds appeared for the intervener.

Heard at New Court on 14 May 2003

**JUDGMENT (Admissibility of appeal)**

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## I INTRODUCTION

*The issue*

1. By an application dated 19 February 2003 the applicant, Aquavitae UK Limited ("Aquavitae") seeks to challenge:

   (a) the decision of the respondent, the Director General of Water Services ("the Director") to close his file on a complaint made to him by Aquavitae regarding an alleged abuse of a dominant position contrary to the Chapter II prohibition imposed by section 18 of the Competition Act 1998 ("the 1998 Act") by Northumbrian Water Limited ("Northumbrian Water"), Severn Trent Water Limited ("Severn Trent"), Thames Water Utilities Limited ("Thames Water"), United Utilities Water PLC ("United Utilities") and Yorkshire Water Services Limited ("Yorkshire Water") in relation to their alleged refusal to supply water to the applicant at a wholesale price. According to Aquavitae that decision is contained in a letter to it from the Director dated 4 September 2002 and/or in letters to it from the Director dated 3 and 5 December 2002; and

   (b) the Director's decision of 20 December 2002 refusing to withdraw or vary his decision in (a) above under section 47(4) of the 1998 Act.

2. Aquavitae considers that the letter of 4 September 2002 and/or those of 3 and 5 December 2002 indicate that the Director has made an appealable decision "as to whether the Chapter II prohibition has been infringed" within the meaning of section 46(3)(b) of the 1998 Act. Aquavitae also considers that by its letter of 9 December 2002 it requested the Director to withdraw or vary his decision of 4 September under section 47(1) of the 1998 Act and that the Director effectively refused to do so in his letter of 20 December 2002. Aquavitae contends that the Director's decision of 20 December 2002 was made under section 47(4) of the 1998 Act which Aquavitae is entitled to appeal to the Tribunal pursuant to section 47(6) of the 1998 Act.[1]

3. On the substance, Aquavitae seeks a declaration by the Tribunal that where an incumbent water company refuses to make available to a water retailer a wholesale supply of water at a reasonable wholesale price (i.e. the ordinary tariff, less a reasonable discount for retail

[1] By virtue of Articles 2 and 3 of The Enterprise Act 2002 (Commencement No. 2, Transitional and Transitory Provisions) Order 2002, S.I. 2003 no. 766, with effect from 1 April 2003 this appeal is deemed to be made to the Competition Appeal Tribunal established under section 12 of the Enterprise Act 2002. Both the Competition Appeal Tribunal and its predecessor, the Competition Commission Appeal Tribunals, are referred to in this judgment as "the Tribunal". On 20 June 2003 the Competition Appeal Tribunal Rules 2003, SI 1372 of 2003, came into force. Under rule 69 of those rules appeals not determined prior to that date continue to be governed by the Competition Commission Appeal Tribunal Rules 2000 S.I. 2000 no. 261 ("the Tribunal rules").

services), that incumbent water company thereby abuses a dominant position in infringement of the Chapter II prohibition imposed by section 18 of the 1998 Act. In the alternative Aquavitae requests the Tribunal to remit the contested decision to the Director for "proper consideration and investigation".

4. The Director takes the preliminary point that the Tribunal has no jurisdiction to entertain this appeal as he has not made a decision as to "whether the Chapter II prohibition has been infringed" within the meaning of section 46(3)(b) of the 1998 Act. Accordingly, there was no relevant decision that Aquavitae could request him to withdraw or vary under section 47(1) of the 1998 Act, and there is no decision capable of being appealed to the Tribunal under section 47(6).

5. A similar contention has now been considered by the Tribunal on three previous occasions, namely in *Bettercare Group Limited v Director General of Fair Trading* [2002] CAT 6, [2002] Comp AR 226, *Freeserve.com v Director General of Telecommunications* [2002] CAT 8, [2003] CompAR 1 and *Claymore v Director General of Fair Trading* [2003] CAT 3. In those cases, the Tribunal ruled on its jurisdiction as a preliminary issue. At a case management conference on 21 March 2003, the Tribunal ordered that the question of whether the Director has taken an appealable decision under sections 46(3)(b) and 47 of the 1998 Act be determined as a preliminary issue in the present case. In our view, the determination of that preliminary issue turns largely on the application of the principles set out in the preliminary judgments in *Bettercare*, *Freeserve* and *Claymore*.

6. This judgment deals only with the preliminary issue of the admissibility of the appeal. We set out the background, based on the material before us, only to the extent necessary to place the preliminary issue in its factual context. It is important to note that we are not at this stage to be taken as making any findings on the underlying facts of the case.

*The interventions*

7. A request to intervene in these proceedings under rule 14 of the Tribunal rules was received on 18 March 2003 by Northumbrian Water. Northumbrian Water's request for permission to intervene was granted unopposed at the case management conference on 21 March 2003. The Tribunal indicated that it did not require Northumbrian Water to serve a statement of intervention at this stage. Northumbrian Water could, however, make representations at the oral hearing concerning its position should the need arise.

8. At that case management conference it also became apparent that Aquavitae had been in correspondence with a much greater number of water companies than the 5 named water companies specifically referred to in its application to the Tribunal. In those circumstances the Director, at the Tribunal's request, wrote to those other water companies on 25 March 2002 notifying them of the existence of the proceedings and of the possibility of making a request to intervene in accordance with rule 14 of the Tribunal's rules.

9. Subsequently the Director received letters from Anglian Water Services Limited, Bournemouth and West Hampshire Water Plc, Bristol Water Plc, Dee Valley Water Plc, South West Water Limited and Dwr Cymru Limited indicating that none of them wished to intervene in the proceedings.

10. Requests to intervene were received from Thames Water on 27 March, Yorkshire Water on 2 April, and United Utilities on 3 April 2003. No objections were received from the parties regarding these interventions. On 23 April 2003 the Registrar informed Thames Water, Yorkshire Water, and United Utilities that the Tribunal was in principle minded to permit their requests to intervene but considered that their interests did not require their active participation in relation to the admissibility issue. The Registrar indicated that the Tribunal would permit them to make representations concerning their position at the oral hearing should the need arise.

11. On 18 March 2003 a request to intervene was made by Genzyme Limited ("Genzyme"). Genzyme is a pharmaceutical company against whom the Director General of Fair Trading (now the OFT) has taken a decision under the Chapter II prohibition which, according to Genzyme, raises certain issues similar to those raised by Aquavitae.

12. On 31 March 2003 a request to intervene was received from Enviro-Logic Limited ("Enviro-Logic"). Enviro-Logic, through a subsidiary company, is a water undertaking holding an "inset appointment" (see paragraph 29 below), and seeks to act as an intermediary in the water industry in various ways. Enviro-Logic has made various complaints to the Director about difficulties it says it has encountered in obtaining wholesale prices from incumbent water companies and access to water distribution networks.

13. The Director objected to the intervention of Enviro-Logic. By letters of 23 April 2003 the Registrar informed Genzyme and Enviro-Logic that the Tribunal preferred to rule on their requests for permission to intervene once it had determined the admissibility issue. Enviro-Logic indicated by telephone on 30 April 2003 that it was content with the Tribunal's

indication of how it intended to proceed. Genzyme raised no objection to this course by letter of 9 May 2003.

*The Director's voluntary disclosure*

14. Following a contested application at the case management conference on 21 March 2003 by Aquavitae for disclosure of certain documents from the Director's file, the Director very properly indicated that he would make voluntary disclosure of such documents in his possession that might adversely affect his own case and/or support the applicant's case on the question of whether he has taken an appealable decision: see [2003] CAT 3. On 4 April 2003 the Tribunal received the witness statement of Michael Saunders, Director of Consumer Affairs at the Office of Water Services ("Ofwat"), to which was exhibited the Director's voluntary disclosure. That disclosure has been of material assistance to the Tribunal.

## II BACKGROUND

*Aquavitae*

15. According to the application, Aquavitae is a limited liability company that seeks to establish itself as a water retailer in the United Kingdom. Aquavitae was set up in 2001 by a group of private investors. Aquavitae's proposal is to buy water in large quantities from incumbent water companies at "wholesale" prices and to sell it on to consumers. Initially, Aquavitae proposes to sell water only to large industrial and commercial users. It proposes to attract and retain customers by selling water at a lower price than the incumbent water companies. According to Aquavitae, this price reduction will be obtained by outperforming the existing monopoly undertakers in their customer services activities, for example through marketing, loyalty arrangements, added services, billing and customer care. Aquavitae states that similar arrangements have been successfully developed in other industries such as gas, electricity and telecoms.

16. According to Aquavitae, it has had a number of expressions of interest from potential customers for its services. In one case, we are told, Aquavitae is actually retailing water to a customer although apparently there remains an issue as to the price at which Aquavitae buys the water from the relevant water company for onward sale to its customer.

17. As we understand it, Aquavitae's proposal does not actually involve Aquavitae in the physical handling of water supplies. Aquavitae's proposed function is to supply "retail services" which are understood to be mainly billing, telephone enquiries, meter reading, account management, and advice on water efficiency and conservation.

18. According to Aquavitae, the introduction of competition into the retail segment in the supply of water is entirely feasible and likely to be highly beneficial to consumers: see, notably, *The Strategic Review of Charges 2002-2006* published by the Water Industry Commissioner for Scotland in November 2001 at pages 106, 154 and Tables 13.34 and 13.35, and the decision of the Scottish Executive to introduce a Bill permitting licensed third parties to retail water to business premises in Scotland announced on 3 February 2003; a presentation at the Water Forum on 24 April 2002 by the Business Development Manager of United Utilities; a report by Logica/British Gas entitled "Retail Competition in Water", undated but apparently prepared in 2002; and Aquavitae's response of 5 September 2002 to the Consultation Document issued in July 2002 by the Department for Environment, Food and Rural Affairs ("DEFRA") and the Welsh Assembly Government entitled "Extending opportunities for competition in the water industry in England & Wales".

19. According to Aquavitae, retail services account for between 10 per cent and 16.8 per cent of the cost of supplying water (see e.g. the report of the Water Industry Commissioner for Scotland, cited above). That, says Aquavitae, gives an adequate margin for competition to take place in the provisions of such services, which are currently supplied by "vertically integrated" water undertakings.

20. Aquavitae submits that there is no legal obstacle to the activities it proposes. In particular, Aquavitae has no need to obtain a statutory appointment to supply water, either via "an inset appointment" (see paragraph 29 below), or otherwise. Responsibility for the quality of the water supplied would remain with the statutory undertaker, as at present. Aquavitae's contentions are supported by a witness statement by Mr Michael Samorzewski, Managing Director of Aquavitae, and by two expert reports.

*The legislative framework*

21. Following privatisation in 1989, the present structure of the water industry in England and Wales results, essentially, from the Water Industry Act 1991, as amended ("the WIA"). Pursuant to the provisions of the WIA, there are currently 24 vertically integrated, incumbent water companies in England and Wales. Ten of these provide water and sewerage services, while 14 provide water only services. Although privately owned, each of these companies is a statutory "undertaker", appointed by the Secretary of State under an instrument of appointment. An undertaker must comply with the conditions set out in its instrument of appointment, and with the statutory duties and responsibilities imposed on undertakers. Each undertaker is responsible for the supply of water (and, as the case may be, sewerage services)

in a defined area of England and Wales. We refer to the undertakers collectively as "the water companies".

22. The water companies holding statutory appointments account for most of the water supplied in England and Wales, However, private suppliers of water and/or sewerage services may carry on their activities as long as they have the resources and assets to do so.

23. The water companies are subject to various forms of regulation. Most important for present purposes is economic regulation carried out by the Director under the WIA. That function is performed by the Director through Ofwat. Environmental regulation of the industry is carried out by other agencies, such as the Environment Agency, whose responsibilities include the licensing of water abstraction and the control of river water quality, and the Drinking Water Inspectorate, which regulates drinking water quality. The Secretary of State is responsible for the conditions of appointment of the water companies as statutory undertakers. The Secretary of State, DEFRA, and the Minister for Environment, Welsh Assembly Government, are responsible for the policy framework of the industry and have various reserve and other powers which are not relevant for present purposes.

24. Under section 2 of the WIA, the Secretary of State and the Director have various general statutory duties. Section 2(2) of the WIA provides in particular:

> "(2) The Secretary of State or, as the case may be, the Director shall exercise and perform the powers and duties mentioned in subsection (1) above in the manner that he considers is best calculated—
>
> (a) to secure that the functions of a water undertaker and of a sewerage undertaker are properly carried out as respects every area of England and Wales; and
>
> (b) without prejudice to the generality of paragraph (a) above, to secure that companies holding appointments under Chapter I of Part II of this Act as relevant undertakers are able (in particular, by securing reasonable returns on their capital) to finance the proper carrying out of the functions of such undertakers."

25. Section 2(3) of the WIA provides:

> "(3) Subject to subsection (2) above, the Secretary of State or, as the case may be, the Director shall exercise and perform the powers and duties mentioned in subsection (1) above in the manner that he considers is best calculated—
>
> (a) to ensure that the interests of every person who is a customer or potential customer of a company which has been or may be appointed under Chapter I of Part II of this Act to be a relevant undertaker are protected as respects the fixing and recovery by that company of water and drainage charges and, in particular—

(i) that the interests of customers and potential customers in rural areas are so protected; and

(ii) that no undue preference is shown, and that there is no undue discrimination, in the fixing of those charges;

(b) to ensure that the interests of every such person are also protected as respects the other terms on which any services are provided by that company in the course of the carrying out of the functions of a relevant undertaker and as respects the quality of those services;

…

(d) to promote economy and efficiency on the part of any such company in the carrying out of the functions of a relevant undertaker; and

(e) to facilitate effective competition, with respect to such matters as he considers appropriate, between persons holding or seeking appointments under that Chapter."

26. A number of these provisions are reflected in the conditions to be found in the instruments of appointment of the water companies as statutory undertakers. These include conditions which limit increases in standard charges by reference to changes in RPI plus an adjustment factor ("K") (Condition B); impose a charges scheme setting out standard tariffs for supplies of water for domestic purposes, which must be published (Condition D); prevent undue discrimination and undue preference between classes of customer in setting charges (Condition E); and impose detailed accounts and accounting information requirements (Condition F).

27. The overall limits on charges are, as we understand it, set by the Director by comparing the performance of each water company and setting prices on the basis of the most efficient. This is done by periodic reviews. The last periodic review in 1999 set price limits for 2000 to 2005. This system, as we understand it, is intended to promote lower charges through increased efficiency, thus acting as a kind of proxy for direct market competition between water companies.

28. The regulatory provisions as regards charges do not, however, preclude a water company from charging a non-domestic customer by special agreement rather than in accordance with a charges scheme. Such an agreement can cover price and/or non-price terms, provided that to do so does not contravene the prohibition in the water company's instrument of appointment not to set unduly preferential or discriminatory charges between classes of customer.

29. It should also be noted that, under section 7 of the WIA, a water supplier may obtain what is known as an "inset appointment", which is an appointment enabling one statutory water undertaker to supply water in the area of another statutory water undertaker, and to receive

bulk supplies of water from the latter under section 40 of the WIA. If the terms of the appointment cannot be agreed, the Director may make an order. A company that is not yet one of the statutory water undertakings may apply to become one by virtue of an inset appointment.

30. An inset appointee is subject to the same regulatory obligations as other statutory undertakers under the WIA, as well as the environmental and water quality obligations regulated by the Environment Agency and the Drinking Water Inspectorate. We understand that to date only a few inset appointments have been made, although it appears to be the case that the possibility of making inset appointments has given some incumbent water companies an incentive to introduce lower tariffs for their largest users to discourage them from switching companies.

*The 1998 Act*

31. The Director is also empowered to enforce the Chapter I and Chapter II prohibitions imposed by the 1998 Act in relation to "commercial activities connected with the supply of water or securing a supply of water or with the provision or securing of sewerage services": see section 54 of and Schedule 10, paragraphs 1 and 5, to the 1998 Act. The Director exercises those powers concurrently with the Office of Fair Trading. The effect of section 2(6A) of the WIA, which is inserted by paragraph 5(4) of Schedule 10 to the 1998 Act, is that the Director's general duties under subsections 2(2) to 2(4) of the WIA do not apply in relation to anything done in the exercise of his functions under the 1998 Act.

32. Guidelines on how the Director proposes to apply the 1998 Act have been published in OFT 422, *The Application of the Competition Act 1998 in the Water and Sewerage Sectors*, (March 2000). In cases where it is open to the Director to take regulatory action under either the WIA, or the 1998 Act, the Director will decide which statutory provision is more appropriate (see OFT 422, at 2.5 to 2.9).

33. Pursuant to his powers under the 1998 Act the Director has, as we understand it, sought to advance the possibilities for the common carriage of water – i.e. one water supplier using the pipeline network or other facilities of another water supplier in order to supply customers. As we understand it, little progress has so far been made on the introduction of common carriage, which is a complex matter in which issues such as water quality also feature prominently.

*Extending opportunities for competition in the water industry in England and Wales: the 2002 Consultation Paper*

34. On 30 March 2001, following an earlier consultation exercise during 2000, the Government announced that it intended to increase the opportunities for competition in the provision of water services in England and Wales. In particular it proposed to introduce a scheme whereby the Director would be able to license new entrants into the markets for production and retail activities, while the incumbent water companies would remain vertically-integrated statutory undertakers, retaining their strategic water resource and environmental duties. A consultation paper entitled, "Extending Opportunities for Competition in the Water Industry in England and Wales", was issued by DEFRA, and the Welsh Assembly Government in July 2002 ("the 2002 Consultation Paper"). That paper proposes a new licensing scheme, limited to larger non-domestic users.

35. In paragraphs 9 to 11 of the 2002 Consultation Paper, the Government set out its objectives for the water industry in these terms:

> "9. The Government believes that increasing the opportunities for competition in the water industry in England and Wales can bring benefits to customers through keener prices, better services, innovation and improved efficiencies. However, competition is not an end in itself and the potential benefits must be balanced against the Government's wider objectives for the water industry, which are:
>
> - to protect public health;
> - to protect and improve the environment, ensuring that the industry can continue efficiently to finance and deliver continuing water quality and environmental improvements with minimum impact on customers' bills;
> - to meet the Government's social goals, including affordability of water supplies for households, protecting vulnerable groups, the interests of customers in rural areas, and the disabled and pensioners; and
> - to safeguard services to customers, by sustaining an industry that can provide water efficiently with the highest levels of customer service; and with an effective emergency and drought regime to ensure that supplies are always available where needed.
>
> 10. As part of its sustainable development agenda, in formulating these proposals the Government is keen to ensure that public health, the environment and wider social policies are not compromised. It is also important that water supplied for domestic purposes remains acceptable to consumers in terms of taste, odour and appearance.
>
> 11. The present structure and regulatory arrangements have resulted in a very high level of drinking water quality. Following the extension of competition, the lines of responsibility for securing water quality standards will need to be very clear."

36. Under the heading "The Future Role of Competition in the Water Industry" the Government said at paragraphs 24 to 29:

> "24. Extending competition is expected to deliver the following benefits:
>
> **Choice** – at present, customers cannot choose to remove their custom from an unsatisfactory supplier, as there is only one undertaker in their area. New entrants should bring wider choices of tariff and services to attract specific customers.
>
> **Keener prices** – from new entrants and through competitive pressure on incumbents.
>
> **Services** – there may be scope for niche marketing in other areas in which incumbents have not previously concentrated. Some new entrants may offer to provide multi-utility supply packages and other services. Competition provides an incentive to provide a service which matches customers' requirements, in order to obtain and keep customers.
>
> **Innovation** – new entrants may offer new ways of doing things, bringing ideas from other industries, which may bring service and environmental benefits. For example, there should be incentives to find ways to develop previously unusable/uneconomic water sources, and to use existing resources more efficiently.
>
> **Efficiencies** – competitive pressures on undertakers and the incentives on entrants should encourage greater efficiencies, which drive keener prices and better overall value for money.
>
> **Approach to competition**
>
> 25. The Government believes that it is appropriate to take a cautious approach to opening the market to competition to enable a thorough assessment of how the competitive framework operates in practice and the implications for its public health, social and environmental goals.
>
> 26. Very careful consideration has been given to whether to introduce measures to increase competition for household customers in the prospective Water Bill. There are a number of factors to be taken into account. Water is heavy and costly to distribute (compared to its final selling price) and there is no national grid to distribute it. There are also cross-subsidies within household tariffs which competition could unwind. Prices are averaged across undertakers' areas, for example, so that people who live where water is expensive to treat and transport, which includes many rural communities, pay the same tariff as those in areas where costs are lower.
>
> 27. Increasing competition for households, while at the same time seeking to ensure that the Government's public health, social and environmental objectives continue to be met, would require a complex and costly regulatory regime, which would still leave substantial uncertainties, particularly about the effects on individual customers' bills. The added complexity would militate against effective competition and the extra costs would have to be borne mainly by customers. The Government believes that, based on evidence currently available, the drawbacks of increasing competition for household customers are likely to outweigh the potential benefits. The legislative provisions in the Water Bill will therefore prohibit new entrants from supplying water to household customers through undertakers' distribution networks.

28. There are a number of factors that make competition for large users practicable. Unlike household customers, cross-subsidies have been largely unwound. Large users often have individual service requirements that are suited to individual contractual arrangements. Large users are charged on the basis of measured volume and, therefore, it is easier to establish how much water a new entrant's customers are using and apportion distribution costs. There may also be opportunities for local competition where a small source of water, that might otherwise be uneconomic for an undertaker to develop, could be used to supply a particular customer.

29. Large users are likely to include sizeable industrial and commercial manufacturers, in sectors such as chemicals, food production and textiles, as well as hospitals, prisons and large educational establishments. On average, non-household customers provide undertakers with about a quarter of their total revenues."

37. For those reasons, the Government considered in the 2002 Consultation Paper that its proposed reforms should apply to users receiving a supply of more than 50 megalitres ("Ml") annually, but invited views on the threshold.

38. As regards the reforms themselves, the Government proposed the introduction of a statutory licensing regime under which, for customers above the threshold, licencees would have:

(a) the right to access to an undertaker's distribution network on reasonable terms and conditions, for the supply of water to an eligible customer; and/or

(b) the right to purchase water from an undertaker, on reasonable terms and conditions, for retailing water to an eligible customer.

39. The right under (a) above would effectively enable a third party who already had a source of water to use a statutory undertaker's distribution system to deliver water to an eligible customer, subject to various safeguards: see paragraphs 99 to 105 of the 2002 Consultation Paper. The right under (b) above would enable licensees without their own sources of water to purchase water from undertakers at published wholesale prices and retail water to eligible customers. The licensee would carry out billing, payment collection, metering, customer service and so on: see paragraphs 106 to 111 of the 2002 Consultation Paper.

40. Various considerations concerning how the proposed access and wholesale water charges should be fixed are set out in paragraphs 187 to 191 of the 2002 Consultation Paper. It is apparent that the Government considers that charges should not be such as to deter potential licensees. On the other hand, charges should reflect the costs incurred by the undertaker, including costs relating to earlier capital investments, and should not affect the existing

practice of averaging of costs across geographical areas. The Government stated at paragraph 190 of the 2002 Consultation Paper:

> "The Government recognises that there is an inherent conflict between promoting competition, protecting customers from knock on costs and ensuring that undertakers continue to have an incentive to invest to meet EC requirements and Government objectives for drinking water and environmental improvements. A reasonable balance must be struck, …"

41. Ofwat published its response to the consultation paper on 4 September 2002. In the section of its response dealing with the proposal for retail competition Ofwat stated:

> "2.6.1 All but one of the above issues relate to the development of competition through common carriage. We see this as the key element of the Government's proposals, because retail competition, while welcome, is likely to offer small margins if entrants are dependent on undertakers' wholesale supplies. Not only are retail costs an even smaller proportion of the total bill for large users than for households, but the incumbent is likely to incur the same costs in selling "wholesale" supplies to the new retailer as it did supplying the large user customer. Thus the wholesale price is unlikely to differ much, if at all, from the retail price.
>
> 2.6.2 Of course, retailers will also look to compete to provide better services than incumbents, and customers are likely to value service improvements as well as lower prices. But many of these service improvements will be related to on-site management and, because entrants do not need to be licensed to provide these services, there is already an established market in this area."

42. In its own response to the 2002 Consultation Paper of 5 September 2002, Aquavitae considered the Government's proposals to be "a good start", but that "retail only" competition should extend to all non-domestic measured customers. Aquavitae also considered that retail competition was already permissible and feasible, notably by virtue of the 1998 Act. Aquavitae argued that it was essential that the consultation and legislative processes should not be used as a reason for undertakers not to offer wholesale prices; that retail competition would have an insignificant impact on undertakers' revenues; and that costs would be properly allocated in order to determine "wholesale" prices (see e.g. paragraphs 48 to 50, and 188 to 200 of Aquavitae's response of 5 September 2002).

*The Water Bill*

43. The Water Bill was announced in the Queen's Speech on 13 November 2002 and was introduced by the Government in the House of Lords on 19 February 2003. Our understanding is that the legislation has now completed its passage in the House of Lords but that the Bill is unlikely to be fully implemented before 2005/2006.

44. The Bill largely follows the proposals in the 2002 Consultation Paper. Schedule 4 to the Bill amends the WIA by introducing a regime under which the Secretary of State or the new Water Services Regulation Authority ("the Authority") – which replaces the Director – will be able to grant a company a "water supply licence". Under clause 17A of a new Chapter 1A to the WIA, a water supply licence may comprise a "retail authorisation" permitting the licensee to use a water undertaker's supply system for the purpose of supplying water to the premises of its customers. A further "supplementary authorisation" is required before a company may physically introduce water into a water undertaker's supply system. A licence which gives a company a retail authorisation only is referred to as a "retail licence" (17A(4)) while a licence containing both a retail authorisation and a supplementary authorisation is referred to as a "combined licence" (17A(7)).

45. A licensed water supplier – i.e. a supplier holding either a retail licence or a combined licence – may supply water to "eligible customers", who are defined in the Bill as non-household customers whose premises are likely to be supplied with a least 50 Ml of water a year, and who are not being supplied with water by another company pursuant to a water supply licence: see clauses 17(A)(3)(a), (b) and (c) in Schedule 4.

46. According to Explanatory Note 172 to the Bill:

> "[The retail licence] enables the holder to purchase water from the undertaker to supply to its customers. This must be done through a wholesale agreement with the undertaker. Prospective licensees will therefore be able to apply to offer retail only services if they do not have or do not wish to develop a source of water. Retail services could range from simply contracting with the customer to provide a supply of water (purchased from the undertaker) and billing them for this supply, to much wider services including water efficiency planning, metering and providing tailored customer services."

47. A licensed water supplier will in certain circumstances be able to require an incumbent water undertaking to supply water to him, either by agreement, or in default of agreement, in accordance with a determination by the Authority (Clause 66(D) in Schedule 4.)

48. The charges payable by a licensed water supplier to a water undertaker under such an agreement or a determination "shall be fixed in accordance with the costs principle set out in section 66E below": Clause 66D(3). The "costs principle" is that the charges payable must enable the undertaker to recover from the supplier any expenses reasonably incurred in performing any duty in connection with making a supply available, and an "appropriate amount" in respect of reasonable expenses (whether of a capital nature or otherwise), and a reasonable return on that amount, to the extent that those sums exceed any financial benefits

which the undertaker receives as a result of the supplier supplying water to the premises of relevant customers: Clause 66E(1). The Authority is required to issue guidance with respect to the fixing of charges under Clause 66D(3): see Clause 66(D)(4) and 66(F)(5).

49. The Bill makes it a criminal offence for person who is not either an undertaker or a licensed water supplier to use a water undertaker's supply system for the purpose of supplying water to any premises of a customer (Clause 66H), or to introduce water into a water undertaking's supply system (Clause 66I).

## III CHRONOLOGY OF DEALINGS BETWEEN AQUAVITAE, THE WATER COMPANIES AND THE DIRECTOR

50. There has been voluminous correspondence between Aquavitae and the water companies as well as between Aquavitae and the Director between June 2001 and January 2003. We summarise the salient aspects of the chronology.

*The early stages: June 2001 to December 2001*

51. The first direct contact between representatives of Aquavitae and Ofwat apparently took place at a meeting held on 11 June 2001 at which Aquavitae, and its sister company, Direct Water, explained their business plan to Mr Paul Hope, Senior Economist, Ofwat, and Mr Maurice Hanratty, Competition Policy Manager, Ofwat. It was apparently explained, according to the Aquavitae note of the meeting, that Aquavitae was entering the market to bulk purchase and retail water, while it was proposed that Direct Water, Aquavitae's sister company, would undertake water production activities and prospecting. Also discussed were issues relating to common carriage and network access which related more to the proposed activities of Direct Water.

52. Ofwat officials indicated at the meeting of 11 June 2001 that although a retail licence was not a prerequisite for entering into retail activities, incumbent suppliers might nevertheless choose to increase charges to unlicensed entrants to mitigate some of the risk factors that would remain the incumbent's responsibility notwithstanding the entry of an unlicensed supplier. They also indicated that a Water Bill to be brought forward by the Government was likely to create a common format and single framework setting out the requirements for obtaining a retail and/or production licence. At the meeting Ofwat apparently considered that it would be extremely difficult for a company to enter the market in a retail only capacity other than via the inset appointment route.

53. On 9 July 2001 Aquavitae sent letters to virtually all the water companies in England and Wales stating that Aquavitae was preparing to enter the water market as a retailer and seeking from each company a list of fixed and volumetric charges for a wholesale supply of potable and non-potable water in each company's region and those with connectivity to their region.

54. Most of the water companies replied to Aquavitae's letter of 9 July 2001 quoting their published tariffs.

55. Following in most cases further correspondence, Aquavitae wrote to most of the water undertakings on different dates between August and October 2001 a second letter in essentially these terms:

> "It is probably worth explaining the background to my first letter to you. As the water market develops over the next few years, Aquavitae (UK) has a business plan to retail water to the largest industrial users on a UK-wide basis and intends to have a market share of 20-30% of this sector with a proposition based on a combination of price and service.
>
> To fulfil these contracts, at each location for each client Aquavitae (UK) will be looking to either purchase water from the incumbent water company at wholesale prices or utilize the network of the regional water company to transport water either from it's own sources or purchased from a neighbouring water company.
>
> It is recognised that the wholesale price for water will be lower than the retail price to reflect the fact that the retailer is taking responsibility for account acquisition, account management, customer service, metering, billing, cost of credit etc and also to reflect further bulk discounts for wholesale volumes as opposed to retail volumes. In addition we are assuming that there will be a different price for water supplied to a location in the region as opposed to water supplied to another incumbent's network for onward delivery to the end location (lower price as Aquavitae (UK) will bear the Network Access Costs).
>
> Aquavitae (UK) intends to source it's water from either its own sources or approximately five preferred suppliers from which it can potentially source clients in neighbouring regions.
>
> Aquavitae (UK) is looking to finalise their preferred supplier list by the end of this year. The purpose of my earlier letter was firstly to find out if [water company name] would be interested in potentially increasing turnover significantly by being one of this select group of preferred suppliers and, if this is the case, an idea of indicative prices for wholesale supply.
>
> Secondly due to the nature of other water company replies I would seek a reply to a number of questions, as this will allow cross-reference and indexing of replies for all future correspondence.
>
> **1. Standing and minimum charges**
>
> Do you offer a discount for multiple sites in your catchments, e.g. where a customer has several sites, which use water to your large user volumes?
>
> **2. Bulk purchase minus retail element**
>
> With respect to water charges minus the retail element, using the table forwarded in our letter of 9 July 2001 would you please detail a band of charges allowing

for bulk purchase? This will allow us to set our water procurement strategy, in that we can then compare them to other prospective suppliers both inside and outside your catchment.

…

**5. Licensing**

Many of the responses from water companies to date assume that we will require a license for retailing. To date there is no legislation, therefore we are seeking to enter the retail market with Aquavitae (UK) backed by competition law, as legislation is introduced or amended we will abide by it. Our associated company Direct Water will however be seeking a license for abstraction network access and common carriage."

56. Again, most of the water companies replied to Aquavitae to the effect that they were unable to supply Aquavitae except on their published tariffs and terms.

57. On 23 October 2001 Aquavitae wrote to the Director enclosing some of the correspondence it had had with the water companies, and setting out Aquavitae's business proposal in the following terms:

"As the water market develops over the next few years, Aquavitae (UK) has a business plan to retail water to the largest industrial users on a UK-wide basis and intends to have a market share of 20 -30% of this sector with a proposition based on a combination of price and service, as has happened in the electric, gas and telecommunications markets. Feedback from discussions with potential customers has been extremely positive, particularly the ability to purchase water on a UK wide basis.

Aquavitae (UK) intends to source its water from either its own sources or approximately five preferred suppliers from which it can potentially source locations in neighbouring regions. Aquavitae (UK) is looking to finalise their preferred supplier list by the end of this year. We have been in contact with water companies and the purpose of our letters was firstly to find out if they would be interested in potentially increasing turnover by being one of this select group of preferred suppliers and, if this is the case, an idea of indicative prices for wholesale supply. Obviously for a de-regulated market to work the utilities need to supply water at wholesale prices to the new breed of retailers such as Aquavitae (UK), as happens in other utility markets.

As you will see from the enclosures, I think you will agree that the responses we have received have been varied and interesting. It appears a number of water companies may not provide wholesale prices that reflect the fact that the retailer is taking responsibility for example of account acquisition, account management, customer service, metering, billing, cost of credit etc.

We would value a meeting with you in the next few weeks to share our feedback from customers and water companies. Perhaps we could arrange a meeting …"

58. On 12 November 2001, Philip Dixon, Ofwat's Senior Economist, replied to Aquavitae on the Director's behalf indicating that although Aquavitae's proposals to enter the water market were interesting, the new type of retailer suggested was similar to the new regime that the

Government was proposing to introduce. DEFRA had yet to issue a consultation paper and it was not clear when those proposals would be implemented. Mr Dixon expressed the view that it was more appropriate to postpone any meeting until the government's proposals for change were clearer, but that if Aquavitae had any "specific questions" they should let him know.

*December 2001 onwards: the question of the application of the 1998 Act*

59. In a letter of 10 December 2001 Aquavitae pressed the Director for a meeting in January 2002. Aquavitae requested the Director to seek "feedback" from the water companies on the replies that they had sent to Aquavitae regarding the possibilities of providing Aquavitae with a wholesale supply of water. He expressed Aquavitae's belief that "the Competition Act 1998 supports our proposal and this does not appear to be currently recognised." He also drew to the Director's attention the fact that Aquavitae now had a significant amount of customer demand.

60. An internal Ofwat memo of 3 January 2001 from Phillip Dixon to Beryl Brown, Head of Competition Policy, expressed the view that "None of [the water companies] has taken a stance that appears to be anti-competitive or inconsistent with their normal tariff policy".

61. The Director replied to Aquavitae on 7 January 2002 in the following terms:

> "Thank you for your letter of 10 December 2001, which we received on the 28 December 2001.
>
> As you know from the MEUC conference, the Government is currently deciding how to take forward competition in the most appropriate manner to allow it to secure benefits for customers without introducing unnecessary costs or undue complexity. We have been helping DEFRA officials to consider a number of options.
>
> One of the options, as announced by Government in March 2001, is to create a framework that includes licensing retail-only companies, as well as the current vertically integrated undertakers. But common to all options is the principle that all competitors should be licensed, in order to ensure that customers are properly protected. Where undertakers are approached for common carriage access under the Competition Act 1998, I believe that in most cases, it may not be unreasonable for them to insist that applicants are licensed, as long as the undertakers help expedite the licensing process.
>
> It is for Ministers to decide how to proceed with the new regime and I expect Government to announce its proposals soon. Therefore, with so much uncertainty at the moment, I do not think a meeting with me would be helpful. If you wish to provide us with feedback from your prospective customers and to inform us of your meetings with other stakeholders, please write to Beryl Brown, Head of Competition Policy."

62. On 8 January 2002 Messrs Merriman White, Aquavitae's solicitors, wrote to Yorkshire Water, Thames Water, United Utilities, Northumbrian Water and Severn Trent stating that Aquavitae considered that each of those water companies enjoyed a dominant position in the supply of water services in their respective geographic areas of supply, and that they were abusing their dominant positions contrary to the Chapter II prohibition of the 1998 Act. According to Aquavitae, that abuse by the water companies consisted of: (1) refusing access to their networks; (2) not discounting their prices for the bulk supply of water despite the customer related savings available; and (3) preventing Aquavitae from competing by refusing to consider its proposals, or to provide the correct cost of supplying water, thus preventing Aquavitae from marketing its business to customers. Similar letters were written at this time by Aquavitae to other water companies.

63. All the water companies concerned replied in varying terms denying any breach of the Chapter II prohibition.

64. On 19 February 2002 Aquavitae wrote to Ms Beryl Brown, Head of Competition Policy at Ofwat, hoping to arrange a meeting. In the meantime, Aquavitae had continued with further correspondence with the water companies.

65. In letters of 2, 3 and 8 April 2002 Aquavitae sent Ms Brown responses it had received from some of the water companies. The letter of 2 April 2002 to Ms Brown stated: "Your views would be appreciated".

66. On 8 April 2002 Ms Julie Cooper, an Ofwat Competition Case Manager, wrote to Aquavitae acknowledging receipt of the responses Aquavitae had received from various water companies. She stated:

> "At this point we are recording your concerns. If you consider that you are experiencing specific anti-competitive behaviour, then you should make a formal complaint to us."

Ms Cooper went on to point out that, for a complaint to be effective, Ofwat needed evidence of wrongdoing rather than mere suspicion. She advised Aquavitae to include as much information supporting the complaint as possible including evidence of the following:

> "• An explanation of the nature of your business, details of the market or markets concerned, an explanation of the relevant goods of services, and the relevant market positions of your business and the undertaking(s) complained about.
>
> • An explanation of the relationship between you and the undertaking(s) complained about.

- An explanation, supported by specific examples and any available documentation (such as notes of telephone conversations or copies of correspondence), of the alleged infringement and of its effect on your business and on the market.
- A statement about whether you are content for us to copy your correspondence to the undertaking(s) about which you are complaining. Information that you wish to remain confidential should be separated and clearly marked as confidential.

We will then be able to tell you whether we can deal with the complaint under the Competition Act 1998 or under other legislation. If we decide to investigate your case under the Competition Act 1998, you should be aware of the confidentiality provisions that will come into operation. It may be necessary to disclose information that you have supplied to another party in order to progress the case.

…

Please let me know if you would like to meet us to discuss your concerns and in particular how we consider matters under the Competition Act 1998. We can also discuss pursuing a complaint and explain the process to you."

67. Ms Cooper wrote again to Aquavitae on 17 April 2002, responding to its request for advice in its letter of 2 April 2002:

"You asked if we had any views on an appropriate way to resolve the situation with [water company]. We usually find that complainants negotiating directly with a water company in the first instance results in a more effective resolution to a problem than our initiating an investigation under the Competition act 1998 or other legislation.

It would help if you make your requirements more explicit when you write to the water companies. For example your letter to [water company] did not explain what volumes of water you might require. It also did not make clear what you were asking for in scenario 2. A water company can reasonably expect some evidence that an enquiry relates to a genuine business proposition. It is hard to understand why you expect a lower price from the water company when it is providing exactly the same service, in physical and practical terms as it did before.

Please let me know if you would like to meet us to discuss your concerns and in particular how we consider matters under the Competition Act 1998."

68. Aquavitae wrote to Ms Brown on 18 April 2002 indicating its concern at Ms Cooper's suggestion that it was difficult to see how Aquavitae could expect a lower (i.e. retail) price from a water company. Aquavitae expressed the belief that "the above interpretation could prevent Aquavitae from competing on a fair basis and would seek your feedback on this item."

69. On 26 April 2002 Aquavitae sent a further letter to a number of water companies in the following terms:

"Thank you for your letter … which was sent to our legal team. Having now had a full review of the reply we feel it would be a good idea to reiterate our proposals to you, as there appears to be some confusion that maybe as a result of our previous correspondence. We set out below our scenarios to enter the competitive water market.

**Scenario 1**

The initial scenario we will be adopting is to bulk purchase water from [water company] in order to supply industrial and commercial customer in the current [water company] supply area.

To enable this proposition to commence we require a price for water from [water company]. The price of this water should be minus your customer service charges and the profit element from this activity.

Clearly we will have obligations to our customers and these are covered by the customer services costs. We should also request that the price quoted equates to our own internal transfer pricing rules as an aid to the final cost.

We also note that there are no regional variations regarding your prices, however there are differences that relate to volumes above 20 mega litres per annum. Therefore you will be able to supply prices on a volumetric basis.

Also in this scenario we would draw your attention to the meter and standing charges, which will contain a customer services cost and profit element and again request that this is subtracted from the cost together with the associated profit.

We recognize that [water company] as a vertically integrated water company will still have to bear these costs but they are accounted for in your costs to serve your customers and are internal transfer costs which cannot be passed to Aquavitae.

…

**Future Scenarios – [water company name] Exporting Water to other Water Companies**

To support our strategic aims we understand you have existing bulk export agreements on the Special Agreement Register a copy of this is in our supply arrangements is that Aquavitae would be interested in any extra capacity available that could allow us to reduce our supply cost to customers. When this is complete any available capacity could work to the advantage of [water company] to increase their supply. However we still need to complete contract negotiations with our customers. When this is complete any available capacity could work to the advantage of [water company] as a preferred supplier, together with Aquavitae and its customers by reducing unit costs. Therefore we would be interested in your views on the matter."

70. In two letters both dated 28 April 2002 Aquavitae forwarded to Ofwat further correspondence between it and some ten water companies.

71. Ms Cooper replied to Aquavitae's letters of 28 April 2002 by letter of 1 May 2002:

"In our telephone conversation of 26 April we discussed your concerns about our understanding of the principles by which Aquavitae intends to enter into a water retail market. You said you are not currently making a specific complaint under the Competition Act 1998 against a water company. However, you will continue to copy us (mainly by email) your correspondence with water companies which

> relates to your aim of competing in a retail market for water. My email address is Julie.cooper@ofwat.gsi.gov.uk.
>
> I will ask Beryl's secretary, Elizabeth Jones, to suggest several dates in June and July when you could present to us your view of how competition is working in the retail sector and report on your progress. In the meantime, please call me if you would like to discuss any of this further. My number is 0121 625 1396."

72. By April 2002 Aquavitae had received a negative response from most of the water companies to which it had addressed its requests. Most of the water companies considered (i) that the 1998 Act did not impose any obligation to supply water for "retail" sale; (ii) that the water companies would avoid very few costs in doing so, and could not therefore quote a "wholesale price"; (iii) that it would be contrary to their instruments of appointment to discriminate in favour of Aquavitae; and (iv) that the matter was likely to be absorbed into a statutory scheme then under consideration by the Government.

73. From April 2002 onwards both Aquavitae and a number of the water companies adopted the practice of copying their correspondence to the Director. From time to time Ofwat received inquiries from water companies regarding the appropriate response to Aquavitae's proposals, (see e.g. Ofwat's internal notes of telephone conversations of 15 April 2002, 19 April 2002 and 30 April 2002, and a letter from a water company to Ms Brown of 7 May 2002). There does not appear to be any written response by Ofwat to those contacts from water companies, although various telephone conversations apparently took place.

74. In a letter to Ofwat dated 8 May 2002 enclosing a letter that Aquavitae had received from a particular water company, Aquavitae commented:

> "With varying responses from other water companies this appears to be the first outright refusal to supply prices based on our business proposition. As previously discussed we see no advantage at this stage of a referral under the Competition Act, but do feel we are fully supported by it.
>
> Therefore to enable a process to resolution we are prepared to meet with [water company] and Ofwat in an attempt to work to an amicable conclusion. We will wait for your response with proposed meeting dates at which all parties are represented, however we would urge a meeting in the next 2 to 3 weeks as the protracted time scales are affecting our market entry as we are unable to enter specific contractual arrangements with customers.
>
> We look forward to your proposal for meeting dates, with thanks in advance for your assistance."

75. On 10 June 2002 Northumbrian Water wrote to Aquavitae to the effect that they were unable to offer Aquavitae a discount off their standard charges, unless Aquavitae were to apply for an inset appointment or become licensed under any new structure to be introduced by Act of Parliament. Northumbrian Water, however, stated that they could contemplate a special

agreement if "a sufficient number of our customers wished to associate themselves with Aquavitae as an intermediary", while emphasising that "the cost-reflective discount against the standard charges is likely to be small under such an arrangement".

76. There are indications in the Tribunal's file that a meeting took place between Aquavitae and Ofwat on 12 July 2002, but the Tribunal does not have details of this meeting.

77. Further replies received by Aquavitae from water companies were copied to Ofwat during the summer of 2002. The Government's 2002 Consultation Paper (paragraphs 34 to 41 above) was published in July 2002.

78. A letter from Aquavitae to Beryl Brown of 5 August 2002 indicates that Aquavitae were awaiting a response from a particular water company following a meeting on 31 May. Mr Samorzewski commented: "At this stage this correspondence is for your information, but any feedback would be appreciated."

79. It appears from an internal Ofwat note that on 5 August 2002 Ofwat had a meeting with that same water company in which a number of matters were discussed, including Aquavitae's requests. Ms Brown is recorded as saying "We have explained to Aquavitae that there is no regime in place for them to carry out their proposals and that we do not have any powers to assist them".

80. On 5 August 2002 Aquavitae also wrote to the Director informing him of the setting up of an organisation known as the Water Forum, and requesting information about any work carried out by Ofwat in relation to cross subsidies in the water industry.

81. On 8 August 2002 Aquavitae forwarded a letter from Aquavitae to Northumbrian Water of 7 August 2002. That letter was enclosed "for information purposes as we await a response". Aquavitae also forwarded a copy of Northumbrian Water's letter dated 10 June 2002, and stated: "The assertions in this letter do require your feedback and we look forward to your response."

82. On 16 August 2002 Aquavitae wrote a letter to Ms Cooper of Ofwat headed "Possible Competition Act 1998 Complaint Re: United Utilities":

> "We now attach the latest letter from United Utilities, which we believe demonstrates that they [are] not prepared to allow Aquavitae (UK) to enter this market as they claim to have to operate a system where no wholesale price is available to Aquavitae (UK). They also cite the current regulatory regime as the

reason they will not provide a wholesale price. Our assertion is that there is no exclusion in any legislation, but that there is supporting legislation in the form of The Competition Act 1998.

Clearly the guidelines and support offered by Ofwat to inform water companies of their obligations regarding The Competition Act 1998 are valuable, but they are not a substitute for the Act as this is primary legislation.

To date we believe that we have given full detailed explanations to both Ofwat and water companies of the nature of our business and markets in which we wish to operate. The relationship we are attempting to establish with United Utilities has been articulated in previous correspondence, which is in your possession.

We are content for Ofwat to share our documentation with United Utilities, we are though not prepared to disclose our customer's details in the United Utilities area as unfortunately they feel that the dominant position held by United Utilities may jeopardise their requirements for water into the future. This may not be the case as supported by the Water Industry Act, but from an Aquavitae perspective our customer's request to not be involved initially is supported.

Finally, as you know Aquavitae (UK), did meet with [water company] on the same subject and it is our experience of that meeting, which was at your suggestion, that leads us now to request Ofwat to feedback the exact position that United Utilities must take, although we do not see the advantage of a competition act complaint, our frustration at the attached response requires your feedback to allow Aquavitae (UK) to position itself for the on going development of it business strategy. We therefore require from Ofwat, feedback on our belief that we would have grounds to complain under The Competition Act 1998."

83. On 19 August 2002 Ms Cooper of Ofwat replied to Aquavitae in the following terms:

"Thank you for your letter of 16 August regarding your situation with United Utilities. You asked us for feedback so that Aquavitae (UK) can "position itself effectively for the on going development of its business strategy."

In the light of this letter, your previous correspondence, and the discussion at our meeting on 12 July, we will write to you in more detail shortly."

84. Aquavitae also wrote to the Director on 19 August 2002 regarding Severn Trent:

"You will see from the attached we are writing to Severn Trent to confirm our view of the status of our requests and would also ask you to supply a written reply to Aquavitae (UK) with your opinion of the Severn Trent stance to date. We would be particularly interested in your views on the apparent refusal to supply wholesale prices and the assertions in earlier letters, which we passed to you, from Severn Trent that Aquavitae (UK) requires a license before Severn Trent will supply water."

85. Aquavitae apparently wrote a further letter to Ms Brown on 23 August 2002, which the Tribunal has not seen.

*The Director's letter to Aquavitae of 4 September 2002*

86. On 4 September the Director wrote to Aquavitae. The first part of his letter dealt with the issue of cross subsidies in the water industry which Aquavitae had inquired about in its letter of 5 August 2002. The Director then turned to deal with Aquavitae's proposals for water retailing in the following terms:

> **"Retail Competition**
>
> It is apparent from you recent correspondence with water companies that you are pursuing the concept of retail competition based on wholesale supplies from incumbents, at a price that contains no element of retail charges. I understand that you believe that the Competition Act 1998 ("CA98") supports you approach. I so the I need to reiterate four key points that Beryl Brown, head of our Competition Team, has already made to you.
>
> First, if incumbent water companies sell water to you for you to sell on to a single customer, and that water continues to be provided to the boundary of the customer's premises, then it is hard to see how this would achieve any reduction in the incumbent's costs of supply. You simply replace the end user as the incumbent's customer. The customer's meter will still need to be read, an account will still need to be maintained and enquiries still need to be dealt with. Would it be accurate to say that you would be acting more as a "broker" than a "retailer"?
>
> The position might be different if you were to sell the water to, for example, a new development serving a number of customers, where you would be responsible for reading individual meters, maintaining all the individual accounts, and dealing with enquiries. But even then, there might be few savings to the incumbent in retail costs. For example, the savings might only come from the undertaker having to read one meter (to monitor his supply to you) rather than a number of meters, and only having to send one bill to you rather than a number of bills to the individual customers.
>
> Second, although I would of course consider any CA98 complaint on its merits relating to terms offered by companies, the above points might well be relevant to any assessment of such a complaint.
>
> Third, under current law, you can act as your customer's agent and provide them with on-site efficiency advice, but you are not a licensed water company and have no automatic rights to bulk supplies of water. Of course, if you obtained inset appointments, this would change your rights to a bulk supply.
>
> Finally, you will know from reading the government's competition consultation paper that it proposes to create a licence to allow retail competition. However, that regime is not yet in place, and is still subject to consultation and subsequently to the need for primary legislation. As we note in our response to the government's competition consultation, it is not obvious that this produces savings to the incumbent in retail costs.
>
> Because the points I am making may be of more general interest, I copy this letter to the other members of the Water Forum and to incumbent water companies."

87. The Director's letter of 4 September 2002 was circulated, without any covering letter or comment, to all statutory water undertakers and to other interested parties.

88. An earlier draft of the letter of 4 September, dated 14 August 2002, contained this paragraph:

> "Second, the Competition Act 1998 is designed to avoid anti-competitive behaviour. The position companies are taking vis-à-vis your requests at the moment does not appear to me to be unreasonable. I find it difficult to see how you could successfully use CA98 complaints against companies, if that was in your mind, to support what you propose to do. I would of course look objectively at any such case in accordance with statute."

89. An internal memo of 15 August 2002 from the Director concerning the draft of 14 August 2002 states:

> "The proposition is for, in effect, a circular from me to the companies and entrants which tells them all that I have doubts about the practicalities of the Aquavitae scheme. I am concerned that in referring to how I would deal with complaints under CA98 I should not in any way prejudice our stance in relation to individual cases. Comments please from Huw Brooker." [Legal adviser to Ofwat].

90. Similarly an internal memo from the Director dated 2 September 2002, enclosing a more advanced draft of the letter of 4 September 2002, states:

> "I should be grateful if Huw Brooker would just review whether there are any hostages to fortune here – could Aquavitae allege that in responding in this way we are in any way prejudicing any complaints they may subsequently make?"

91. On 10 September 2002 Aquavitae apparently sent to the Director its response to the 2002 Consultation Paper (see paragraph 42 above).

92. On 12 September 2002 Mr Saunders of Ofwat, replied to Aquavitae's comments on the 2002 Consultation Paper:

> "Until Government has considered the responses to the consultation paper, taken final decisions and we know the legal framework and the likely timing of its implementation a meeting at this stage is unlikely to be useful.
>
> You mention a gap in our current prospective (sic), but without being specific. I suspect that you refer to the possible price margin that might be available to entrance to the retail market. Your response to consultation paper talks about price competition but contains little detail. Even assuming that water companies understate the overall costs of retail we currently see little or no basis for wholesale prices to large users being materially different form companies' final retail tariffs. If you are able to provide some supporting material for you views on wholesale prices this will be useful to us."

*The complaint against Northumbrian Water and the correspondence following that complaint*

93. Northumbrian Water stated, in a letter dated 9 September 2002 to Aquavitae, that they did not feel it appropriate to quote a wholesale price for water to Aquavitae: any wholesale price to

be calculated after the enactment of the Water Bill would be on the basis of the "net avoidable costs".

94. Aquavitae made a formal complaint under the 1998 Act against Northumbrian Water by letter dated 16 September 2002 in the following terms:

> "**Competition Act Complaint – Aquavitae Proposals (Northumbrian Water)**
>
> Northumbrian Water have sent you a copy of their letter of Aquavitae (UK) dated 9 September 2002 this is in response to a request for a wholesale price for water by Aquavitae (UK). The request was made by Aquavitae (UK) as we wish to operate as a retail supplier to Industrial and Commercial customers in the UK and compete with incumbent undertakers on their cost to serve customers. As you will see the Northumbrian Water letter shows that they made direct contact with the potential customer and this now leads us to refer this specific case to you as a Competition Act 1998 complaint.
>
> We have set out the necessary criteria for an investigation in our previous correspondence and additionally refer this case to you for investigation as we were advised verbally by the OFWAT Competition Case Team that direct contact by an incumbent undertaker with one of our potential customers was an infringement of the Competition Act 1998 as it was an abuse of a super dominant position.
>
> As a separate point, a previous letter from Northumbrian Water to Aquavitae (UK) on 10 June 2002 was passed to you on 8 August 2002 and we specifically requested your feedback on the assertions in that letter. To date this has not been received and we would urge an immediate response from you. The timescales for a reply are becoming unacceptable to Aquavitae (UK) and could well be seen as having a detrimental effect on our ability to trade.
>
> If you require further information on this complaint please do not hesitate to contact me."

95. On 17 September 2002, Aquavitae replied to Mr Saunders' letter of 12 September. In that letter Aquavitae stated that it had no wish to wait for further legislation given that it considered it was entitled to act as a water retailer immediately. Quoting some extracts from its response to the DEFRA consultation paper, Aquavitae estimated that non-household retail margins to be about 10 per cent in the water industry. Aquavitae concluded in the following terms:

> "As we state a value of 10 % we are interested in your estimation of a wholesale price in much more exact terms than you presently offer and look forward to your response. Again a meeting would prove useful to share our market research, which is extensive and has been compiled by industry experts."

96. On the same day, 17 September 2002, Aquavitae also wrote to the Director in reply to the Director's letter of 4 September 2002. Under the heading "Retail Competition" Aquavitae referred to the Director's letter of 4 September 2002 and commented,

"From you (sic) letter of 4th September 2002 you gave your views on retail competition and this was the specific reason we requested a meeting with you. A meeting would enable Aquavitae (UK) to share their point of view on competition issues. Waiting to see what happens is not in our view facilitating competition and our requests for wholesale prices are an immediate issue. Your points appear to be at odds with our requests for wholesale prices and by copying your letter to water companies this could put you in a position of making a decision before we have made a formal complaint.

…

As you know we believe that Aquavitae (UK) have a right to compete on the cost to serve a customer. To date Ofwat have not stated that our assertion is incorrect, is this accurate? You have though stated that there is little if any scope for a reduction in the undertakers cost of supply if we have a single customer, which is evidently not our proposition as a retailer who seeks to secure 20-30% of the market. This assumption appears to be based on a water company avoiding costs and this we believe is incorrect and supported by The Competition Act 1998. Aquavitae (UK) will compete and not duplicate in the cost to serve process, just as we have in other markets. In terms of competition we believe if we are not offered a wholesale price the incumbent is preventing us from selling its product at a possible discount. We wish only to compete with the customer service costs and allowable returns generated by the incumbent on this activity.

In response to your assumption that Aquavitae (UK) is a "broker" rather than a "retailer" we feel we need to explain the difference. A broker sells products or services that are available from various suppliers. This is not the case with our water retail proposition. We seek to purchase a product from a supplier and to retail this in competition with other retailers and the existing supplier. Although we may seek new suppliers in the future this would be as a retailer who sought to reduce its supply cost to its customers not as a brokerage who ascertained various supply arrangements for a customer to select.

The question Aquavitae (UK) need answered is what is the wholesale price for water in each undertaker's supply area? The assertion that it is small or that it does not exist is not an adequate response, as the full and detailed assessment of these must be shared. Both of our views on avoided costs will probably need to be considered by a third party if we cannot agree on areas of competition and legitimate avoided cost. When a wholesale price is determined Aquavitae (UK) and its customers will make their own decisions on the commercial viability of each case, but we are unable to act if OFWAT retain the stance *"it is hard to see how this would achieve any reduction in the incumbent's cost of supply"* without submitting the detail. The items you use are only a part of the cost to serve in which we wish to compete; we attach a list of the main items, this was supplied some time ago to OFWAT. Do you agree that the items are appropriate for customer services or otherwise?

We will always act within our guiding principles by competing vigorously but lawfully for new business and our commercial intent, although difficult for water companies and perhaps Ofwat to accept, will we believe assist in developing a water industry which can deliver the Government wider objectives. I look forward to receiving your feedback on the questions raised and a further request to meet you."

97. There is an internal e-mail from Ms Brown to Mr Saunders of 18 September 2002 about the advantages and disadvantages of meeting Aquavitae. On 20 September 2002, Mr Saunders

wrote to Aquavitae offering a meeting to discuss the issues raised by Aquavitae's two letters of 17 September.

98. Also on 20 September 2002, Ms Brown wrote to Aquavitae in response to Aquavitae's complaint of 16 September 2002 about Northumbrian Water:

> "Thank you for your letter of 16 September.
>
> It is not clear from your letter what your complaint is about. It would be helpful if you explain what you believe to be the behaviour that infringes the Competition Act 1998 and why the Competition Act 1998 supports your complaint.
>
> In the second paragraph of your letter your suggest that we advised your (orally) that direct contract by an incumbent undertaker with one of your potential customers was an infringement of the Competition Act 1998. This statement is incorrect.
>
> The response you requested in your letter of 8 August regarding the letter from Northumbrian Water Limited was dealt with in the letter from Philip Fletcher dated 4 September 2002. I apologise if this was not clear."

99. Aquavitae replied to Ms Brown on 23 September 2002 seeking to clarify their complaint against Northumbrian Water. Aquavitae's contentions were set out by reference to Ofwat's leaflet, "A guide to complaining to Ofwat under the Competition Act 1998", as follows:

> "Aquavitae seek to retail water to industrial and commercial customers. They will enter the water market as a water retailer to industrial and commercial customers and compete on an equitable basis with existing water companies. Aquavitae believe that the customer services offered by them can deliver reduced prices to customers for water and improved customer service. The proposition initially relies on Aquavitae being supplied with a wholesale price for water from the incumbent undertaker that does not include customer service charges detailed in June Returns as this is the specific area we wish to compete on. We do not agree that avoided costs are an issue as nothing prevents an undertaker taking appropriate action to reduce their loses (sic) due to a customer being supplied for retail supply by another company. Their statutory requirements remain unthreatened with regard to water supply under the Water Industry Act 1991. The market position for Northumbrian Water is that they have a monopoly position with respect to supply customer services to customers without a wholesale price we are unable to compete.
>
> …
>
> Since July 2001 Aquavitae have been requesting a wholesale price for water to allow Aquavitae to compete with Northumbrian Water as a retailer to industrial and commercial customers. The proposed relationship with Northumbrian Water requires a wholesale price for water to allow competition on retail supply. Northumbrian will only offer the full retail value for water.
>
> …
>
> Aquavitae have supplied all correspondence between themselves and Northumbrian Water to Ofwat. The correspondence demonstrates that Aquavitae are being frustrated from entering a market by an undertaker abusing a dominant

position. Only a full retail price is being offered for water and therefore Aquavitae are unable to compete, as the charges for customer services are included in the retail price, which is the specific area Aquavitae intend to compete on. Further a letter from Northumbrian Water dated 9 September 2002 demonstrates that direct contact had been made with a potential Aquavitae customer, which further seeks to advantage the dominant position held by Northumbrian Water."

*The complaints against Thames Water, Severn Trent, Yorkshire Water and United Utilities*

100. By letter of 23 September 2002 to Ms Cooper headed "Confidential: Competition Act 1998 Complaint Re: Thames Water" Aquavitae explained that although previously they had not seen the advantage of making a complaint under the Act they now felt that they had no alternative. The essence of the complaint, on which Aquavitae sought "urgent feedback", was explained in the following terms:

> "Following our letter to you on 23 August 2002 regarding our attempts to secure wholesale prices from Thames Water to allow Aquavitae (UK) to retail water to industrial and commercial customers. We did ask for your feedback on this specific situation. Now that one-month has elapsed since this request we urgently seek your feedback on the situation with regard to two issues:
>
> **1. Thames Water refuses to supply Aquavitae (UK) with a wholesale price for water**
>
> As you already know from previous meetings and correspondence it is our belief that Thames Water has to supply Aquavitae (UK) with a wholesale price for water. Thames Water has to comply with the Competition Act 1998 by virtue of the fact that it has a dominant position and their conduct is imposing an unfair purchase price on Aquavitae (UK). This action prevents Aquavitae (UK) form competing with Thames as a retailer on the cost to serve customers in their supply area.
>
> Aquavitae (UK) further believes that the subject of avoided costs is irrelevant as customer service is the sector in which we wish to compete with Thames Water. Therefore avoided costs are a matter for Thames Water to deal with in a competitive environment.
>
> We would add that there is no legislation in place that prevents Thames Water from structuring their customer service organisation to relieve any losses in this sector of their vertically integrated structure. By doing this Thames Water would not put into question their requirements to supply water from its network as part of the Water Industry Act 1991, as the supply by Thames Water is not disputed.
>
> We know Ofwat views as detailed in Philip Fletcher's letter to Aquavitae and all water companies of 4 September 2002 and the Ofwat response to DEFRA's consultation paper on "Extending the Opportunities for Competition in the Water Industry in England and Wales", but again this relates to avoided costs and is one of the specific areas we disagree with in that this is an area of competition and not one to be supported by Ofwat to ensure water companies can finance their operations.
>
> Therefore we seek your feedback on these assertions and ask what action Ofwat proposes to take regarding the Aquavitae (UK) competition complaint?"

101. On 2 October 2002 Aquavitae wrote to Ms Brown making a complaint against Severn Trent. That letter stated as follows:

> "Severn Trent Water has copied their latest letter dated 11 September 2002 to Aquavitae (UK) to you for information. The letter confirms that Severn Trent is not prepared to offer Aquavitae (UK) wholesale prices for water to enable retail supply. Therefore Aquavitae (UK) has no option but to raise a complaint under the Competition Act 1998 regarding Severn Trent Water. Their behaviour in a dominant position is imposing an unfair purchase price on Aquavitae (UK) as a retailer of water on the cost to serve a customer in the Severn Trent supply area.
>
> We have lodged similar complaints against other water companies but wish this complaint to be covered separately as the assertions made by Severn Trent in previous correspondence seeks to use the Water Industry Act 1991 as a prohibition of the supply of a wholesale price. Therefore we seek your specific feedback on this complaint and the claims in Severn Trent Water correspondence to date."

102. By letter of 3 October 2002 to Ms Brown, Aquavitae made a complaint against Yorkshire Water:

> "Yorkshire Water has copied their latest letter dated 11 September 2002 to Aquavitae (UK) to you for information. The letter confirms that Yorkshire Water is not prepared to offer Aquavitae (UK) wholesale prices for water to enable retail supply. Therefore Aquavitae (UK) has no option but to raise a complaint under the Competition Act 1998 regarding Yorkshire Water. Their behaviour in a dominant position is imposing an unfair purchase price on Aquavitae (UK) as a retailer of water on the cost to serve a customer in the Yorkshire Water supply area. This relates specifically to one customer [details omitted]. As previously stated, we have a significant number of blue chip companies who want to work with Aquavitae (UK) and a number of these are situated in the Yorkshire Water supply area.
>
> We have lodged similar complaints against other water companies but wish this complaint to be covered separately as the assertions made by Yorkshire Water to Aquavitae (UK) and our legal team in previous correspondence seeks to use their dominant position and pending legislation as a barrier to supplying a wholesale price. Therefore we seek your specific feedback on this complaint and the claims in Yorkshire Water correspondence to date.
>
> As you will know from the copy of our letter to Yorkshire Water (30 July 2002) our stated objective for a contract start date was [details omitted]. This target date has been missed and we urgently need to resolve this issue as we may seek a retrospective claim against Yorkshire Water in view of their tactics and any further delay increases this possibility."

103. By an email of 3 October 2002 and by letter of 22 October 2002 Aquavitae also "elevated" their complaint against United Utilities by stating that, further to their letter of 16 August 2002 to Ms Cooper (paragraph 82 above), they now wished to proceed under the Competition Act.

*The meeting of 11 October 2002 and subsequently*

104. A meeting took place between Aquavitae and Ofwat officials (Mr Michael Saunders and Mr Phillip Dixon) on 11 October 2002 in Birmingham. According to Aquavitae's note of that meeting the following discussion took place as regards retailing and wholesale prices:

"**Wholesale Prices**

Aquavitae (UK) has stated that it has a right under the Competition Act 1998 to request and be supplied with wholesale prices for water. To assist this process Aquavitae (UK) has issued to undertakers and Ofwat a table of items that it believes are contestable and if recognised will enable Aquavitae (UK) to compete with undertakers on the cost to serve customers. The feedback from Ofwat was that:

— The guidance issued by Ofwat regarding the Competition Act 1998 dealt with common carriage and new infrastructure. It did not foresee the possibility of wholesale pricing.

— Ofwat believe there is little to no margin available between wholesale and retail values.

— Ofwat do not possess enough data to supply a price and cannot request it from undertakers.

— Ofwat do not have the resource or time to deliver or request a wholesale price from undertakers.

— Ofwat do not have the knowledge to formulate a wholesale price, even if it did request feedback from undertakers to enable the determination of wholesale prices.

— If Aquavitae (UK) can work out a wholesale price this would enable Ofwat to assist by facilitating a wholesale price to be determined.

— If Aquavitae (UK)'s view on an interim wholesale price, from for example [name omitted], is to be supported the data should be supplied by Aquavitae (UK) and not requested from the undertaker by Ofwat in order to facilitate a wholesale price.

— Ofwat does not agree with the Aquavitae (UK) stated value of 10% for the cost to serve in the industrial and commercial sector by. (sic) Aquavitae (UK) still requires a response on the question but to date no alternative has been supplied.

Action: Michael Saunders

Bearing in mind the points above Aquavitae (UK) will provide their view of a relevant wholesale price for water to assist with the items detailed above. Aquavitae (UK) will establish a wholesale price by using reference data from appropriate items in the cost to serve in the gas and electricity markets, the Strategic Review of Charges 2002-2006 written by the Water Industry Commissioner for Scotland and the Regulatory Accounting Guidelines. Following this we would seek to work with Ofwat to review these items and ultimately be provided with an appropriate wholesale price for each customer and undertaker.

Action: Michael Samorzewski"

105. Ofwat's note of the meeting of 11 October 2002 reads as follows:

"**Main Points**

1. AV are very keen to start competing now that the decision had been made to open up the industrial and commercial sectors to competition.
   AV asked why Ofwat found it hard to see that savings could be made from retailing water.
   Ofwat explained that when CA98 came into effect, we did not see it having any implications on the retailing of water. He said now that the Government wants to introduce competition, including retail, wholesale prices for water is something we will have to start looking at.

2. Ofwat asked what are the cost savings to the undertaker by supplying AV. We said data is not available on retail costs and that in our view there are very few activities that the undertaker no longer has to do when supplying AV (or any other retailer), as opposed to an end customer. We said the cost savings would be "wafer thin".
   We added that we have asked for evidence/data on the savings from AV, but have not received anything yet.
   AV said they fear that measures to encourage competition have not been taken on board by Ofwat, making a level playing field hard to achieve and too much protection for incumbents.

3. AV said our view is wrong (regarding the difference between retail and wholesale). AV is competing with Undertakers on retail costs. It said it is not about what water companies save, it is about AV providing retail at lower cost at the boundary of the premises. AV said for this to happen costs need to be allocated correctly. E.g. where undertakers offer 'free' services, they need to be accounted for to see the true costs to undertakers of customer services.

4. AV said he has seen evidence from [name omitted] that they know what their wholesale price would be, but will only offer a retail price for water.
   AV said in the gas industry, customer services typically accounted for 15% of the total bill.
   Ofwat said it would take time to implement a plan for introducing retail competition. We need to know the margin between wholesale and retail. This is going to take time as there is no data available and analogies with other sectors are not always helpful. Ofwat is going to wait and see what is in the Water Bill before making any decisions on the complaints raised by AV.

5. AV asked if an incumbent contacting a customer after AV has spoke (sic) to them was violation of CA98?
   Ofwat said we would need to know the details of the contact to make an informed decision."

106. Following the meeting of 11 October 2002, the development of Ofwat's response to Aquavitae's complaints went through a number of stages described in section IV below. In brief, draft letters were prepared by Ofwat officials on 22 October asking Aquavitae for further information, but were not sent because Ms Brown, Head of Competition Policy, considered that Aquavitae's complaint should be dismissed as unfounded. On 23 October 2002 Ms Brown drafted a letter to that effect, but that letter was not sent either. That was because on 7 November 2002 Mr Saunders who, according to the Director, was Ms Brown's superior for this purpose, produced a further draft with a somewhat different approach.

Despite a statement from Ms Brown in an email of 7 November disagreeing with Mr Saunders' new draft, the latter draft formed the basis of the replies eventually sent to Aquavitae on 3 and 5 December, following a conversation that Mr Saunders had with Mr Huw Brooker, one of the Director's legal advisers, on 14 November 2002 (see paragraphs 125 to 129 below).

107. Meanwhile the Water Bill was referred to in the Queen's Speech on 13 November 2002.

108. On 20 November 2002 Aquavitae wrote a chasing letter to Ms Brown regarding the progress of their complaint against Northumbrian Water.

109. On 2 December 2002 Ms Brown wrote to Aquavitae dealing with a number of points made at the meeting on 11 October, and in other letters received by Ofwat from Aquavitae. Under the headings "Right To Be Provided With a Wholesale Price" and "The cost of retailing" Ms Brown observed:

> "2. **Right To Be Provided With a Wholesale Price**
>
> Points 3 and 6.1 both relate to whether Aquavitae has a right to be supplied with a wholesale supply at a wholesale price by undertakers. I understand that by "wholesale price" you mean a price that is sufficiently lower than the prevailing retail price to allow you to compete with the undertakers in providing retail services.
>
> As we discussed at the meeting, there is no specific requirement in the Water Industry Act 1991 ("WIA91") for undertakers to provide you with a wholesale supply. Under sections 40 and 40A WIA91 in certain circumstances the Director may require one water undertaker to provide a "supply of water in bulk" to another undertaker. But you are not a licensed water undertaker under WIA91, and so the Director cannot require a water undertaker to provide you with a "supply of water in bulk". As an aside, even in a bulk supply determination under WIA91, it does not automatically follow that the bulk supply price would be below the retail price paid by a customer, in circumstances where, for example, the new undertaker was simply seeking to interpose itself between the incumbent water undertaker and that customer.
>
> Under the Competition Act 1998 ("CA98") there is, of course, also no specific requirements for undertakers to provide you with a "wholesale supply" at a "wholesale price" in all circumstances. In some cases, CA98 might be relevant. In others, it will not. In order to assess the relevance of, for example, the Chapter II prohibition in a particular case, we would have to carry out a detailed investigation into such matters as, for example, the correct market definition, market power and dominance, abuse, the availability of exclusions, and any objective justifications for the relevant company's conduct. As stated above we are writing to you separately on each of the complaints you have made against specific undertakers.
>
> 3. **Cost of Retailing**
>
> Point 4 relates to the costs of retailing as a proportion of total costs. As we explained in the meeting, Ofwat does not have precise data on the costs of

retailing, nor have we sought to develop a definitive view on what activities might be classed as retailing activities, either for supply to household or large user customers. This is because retail competition is a comparatively new issue for the water industry (unlike common carriage, wholesale and retail supplies were not issues we considered in our CA98 guidance).

But the Queen's speech included a reference to a Water Bill, and you will know from reading the Government's consultation paper 'Extending opportunities for competition in the Water Industry in England and Wales' that it proposes to create a licence to allow retail competition. Under the proposed regime, new entrants who wish only to retail water will be entitled under their licence to purchase wholesale water from undertakers, on reasonable terms and conditions for supply to eligible customers (ie large users above a certain threshold). The Government considers that the methodology (or methodologies) for calculating wholesale prices will be a matter for undertakers and Ofwat. These proposals will require us to examine the activities and costs involved in retailing water supplies. We have already consulted companies on changes to regulatory accounts which will provide more information on the costs of different activities (see MD171, RD02/02 and RD21/02). We are likely to undertake further work on this and consult on how we propose to implement the Government's new regime. You will, of course, have an opportunity to influence the development of retail competition then.

…

7. **Grounds for Competition Act 1998 Complaints**

Your subsequent letters of 22 October and 20 November suggest that we have not responded to the query you raised in your letter of 23 August. That letter asked for feedback on your belief that you would have grounds to complain under CA98 about how various undertakers have responded to your requests for a wholesale price.

But you have now made specific CA98 complaints against a number of undertakers and we are writing separately to you about these complaints."

*The case closure letters*

110. On 3 December 2002 Ofwat sent a letter to Aquavitae signed by Ms Brown headed "Competition Act 1998 Complaint: Yorkshire Water" in the following terms:

"I am replying to your email of 3 October complaining about the price offered by Yorkshire Water for wholesale supply.

The Queen's speech on 13 November included a reference to a Water Bill. The Bill has yet to be published and laid before parliament. But you will know from reading the government's consultation paper 'Extending opportunities for competition in the Water Industry in England and Wales' "… that it proposes to create a licence to allow retail competition. Under the proposed new regime, new entrants who wish only to retail water will be entitled under their licence to purchase wholesale water from undertakers, on reasonable terms and conditions for supply to eligible customers. The Government considers that the methodology (methodologies) for calculating wholesale prices would be a matter for undertakers and Ofwat.

The new proposals will require us to examine the activities and costs involved in retailing water supplies, and the question of how wholesale prices should be calculated. We are likely to consult on these issues. You will of course, have an

opportunity to influence the development of retail competition generally under the Water Bill, and the particular issue of how wholesale prices should be calculated, at that point.

Unfortunately our resources are limited. Ofwat needs to focus its attention on developing the regulatory framework necessary to implement the government's proposals and to ensure the development of competition in this area. We are therefore unable to consider your complaint under the Competition Act 1998, and we have closed our file on this case."

111. In a further four letters, each dated 5 December 2002, Ms Brown notified Aquavitae in the same terms that the Director had reached the same conclusion regarding Aquavitae's complaints about United Utilities, Thames Water, Severn Trent and Northumbrian Water.

112. In a later letter to Aquavitae dated 6 December 2002 the relevant senior manager at Northumbrian Water stated:

"Perhaps the letters you have received from Ofwat (Philip Fletcher on 4 September, and Beryl Brown on 5 December) remove the need, but if you wish I am still willing to meet you here at Durham to discuss water competition issues."

113. Aquavitae responded to each of Ms Brown's letters of 3 and 5 December by five letters to the Director dated 9 December in identical terms (save as to the name of the water company concerned):

"Aquavitae (UK) have received a letter from Beryl Brown, Head of Competition Policy, Ofwat (attached) regarding the Aquavitae (UK) Competition Act 1998 Complaint against [name of water company]. Ofwat will be in possession of the full correspondence on this case. The attached letter does not we believe, make any attempt to investigate or seek to respond to the details of the complaint and concerns us greatly for the following reasons.

1. There does not appear to have been an investigation, as no outcome to the complaint has been determined.
2. Should the behaviour of [name of water company] prove to be anti-competitive then Ofwat are ignoring the behaviour of the undertaker due to the constraints of their resources, which is not a valid reason for closing this case.
3. There has been no attempt to deal with the questions raised in previous correspondence regarding [name of water company].

However if you are personally prepared as the Director General of Ofwat to fully concur with the contents of the Ofwat letter of 5 December 2002 and believe that they meet your functions with respect to competition, Aquavitae (UK) will have no option but to take this complaint to another forum, which will determine this complaint independently."

114. The Director replied to Aquavitae on 20 December 2002:

"Thank you for your letter of 9 December 2002.

> We are not under an obligation to investigate every Competition Act 1998 complaint (and indeed it would be impossible for us to do so).
>
> In this case, as Beryl Brown explained in her letter to you dated 5 December 2002, we do need to focus our attention on developing the regulatory framework necessary to implement the Government's proposals for developing competition which will address the issues you raised. I therefore agree with Beryl that we are unable to consider your complaint under CA98.
>
> You are, of course, free to consider what other options are available to you."

115. Aquavitae responded to the Director on 31 December 2002 indicating that Aquavitae's legal team were preparing an appeal under the 1998 Act.

116. On 17 January 2003, Mr Saunders wrote to Aquavitae to clarify that Ofwat's position was that the reason that it had not investigated Aquavitae's complaint was not because it did not have the resources available to do so. What Ofwat had said in its case closure letter was: "Unfortunately our resources are limited. Ofwat needs to focus its attention on developing the regulatory framework necessary to implement the government's proposals and to ensure the development of competition in this area."

117. On 23 January 2003 Aquavitae replied to the effect that Aquavitae intended to challenge Ofwat's decision and disagreed with Mr Saunders' contention that Ofwat had not investigated Aquavitae's complaint:

> "As regards the substance of your letter, we make the following comment. Whatever semantic analysis you choose, it is crystal clear that Ofwat has carried out an investigation and has satisfied itself that Aquavitae has no grounds for alleging an infringement of the Competition Act 1998. In effect Ofwat has decided that the water companies are acting lawfully by refusing to deal properly with Aquavitae, either by refusing to deal at all or by squeezing retail margins. How can the Director General's current position be interpreted in any other way given (a) his numerous public pronouncements about his competition role, (b) the significant liaison we have had with him since early 2001 and (c) the substantial periods of time spent by Beryl Brown and others investigating the issues raised in our complaints? In short, it is our case that Ofwat has made a decision that the water companies are acting lawfully, a decision, which the Director has refused to withdraw or vary. And it is that decision which will be [the] focus of the appeal to the CCAT."

118. Aquavitae's appeal was lodged on 19 February 2003. The Water Bill (paragraphs 43 to 49 above) was introduced on the same day.

## IV THE STATEMENT OF MR SAUNDERS AND THE DIRECTOR'S VOLUNTARY DISCLOSURE

119. At the case management conference held on 21 March 2003 the Director very properly gave the Tribunal an assurance that he would verify that there were no documents in his possession that might adversely affect his own case and/or support Aquavitae's case on the issue of whether there was an "appealable decision", and that, if so advised, he would make disclosure of them. In the event the Director's disclosure was provided by way of an exhibit to the witness statement of Michael Saunders, Ofwat's Director of Consumer Affairs, signed on 3 April 2003. Mr Saunders is also an executive member of Ofwat's board and the line manager of Ms Beryl Brown, Ofwat's Head of Competition Policy.

120. In his statement, and by reference to the documents exhibited to it, Mr Saunders explains, as the official responsible for the decision to close the Director's file on Aquavitae's complaint, how that decision was made. The chronology seems to be as follows.

121. Mr Saunders explains that due to staff shortages at Ofwat it was decided in "late August" 2002 that a number of responsibilities for casework under the Competition Act 1998 should be transferred from Ms Brown to Mr Saunders. Those responsibilities included authorising next steps and closure letters. Prior to this time, Mr Saunders says that he was aware of Aquavitae's complaint but had not been responsible for correspondence from Ofwat to Aquavitae. From that date he was, at the Director's request, responsible for correspondence with Aquavitae. Mr Saunders explains, however, that as Ms Brown had previously been involved in dealing with Aquavitae she retained an involvement in the handling of complaints, subject to Mr Saunders' "ultimate authority", and that letters addressed either to her or Ms Julie Cooper were responded to under her name.

122. Mr Saunders states that Ofwat's initial view was that Aquavitae's complaints "did not disclose a strong case, since they had not yet provided sufficient evidence to substantiate their claims that there was a significant margin for retail competition". An internal e-mail from Beryl Brown to Mr Saunders dated 18 September 2002 states Ms Brown's view that Ofwat should tell Aquavitae "quite plainly that they are wasting our time and their investor's money in pursuing these matters". An Ofwat internal summary apparently dated 9 October 2002 states "letter to Aquavitae to be drafted to confirm complain. Initial view – no case under CA98."

123. On 11 October 2002 the meeting took place with Aquavitae (paragraphs 104 and 105 above). Mr Saunders states that, following the meeting of 11 October 2002, it had been understood by

Ofwat that Aquavitae would provide them with a list of activities/costs that undertakers would no longer need to do/incur if they sold to Aquavitae rather than another customer using a working example. Despite both parties agreeing that this information would be necessary in order to make progress on Aquavitae's complaints, Mr Saunders states that no information of this nature was received from Aquavitae.

124. On 14 October 2002, James Noon, a member of the Director's staff, prepared a case summary for Liz Coombes, Competition Case Manager, regarding four of the five complaints. This summary concluded:

> "**Next Steps**
>
> On the face of it, my initial assessment is that there does not appear to be a breach of CA98. However, in view of the sensitivity of the complaint, the number of complaints Aquavitae is raising and the outcome of the recent meeting with them, we need to confirm our understanding of their complaints before reaching a decision. More information is required from Aquavitae. We need to be clear on the nature of their complaints and the possibility on the relevant market. Further information on the customers they have preliminary agreements with would be helpful.
>
> Also, Aquavitae complained that NNE contacted [name omitted] following discussions between [name omitted] and Aquavitae. Whilst it is not an offence to contact one of your customers, further information about the discussions could prove important to the case. If Aquavitae could assist us here the case could have greater priority. At present I believe Aquavitae have a weak case. However, some of the points they touch on are discussed in the Water Bill. Encouraging Aquavitae to 'sit tight' and wait until the legislation is finalised should be a consideration."

125. On 22 October 2002, following this initial assessment, Liz Coombes and James Noon prepared draft letters to Aquavitae which requested further information from Aquavitae regarding its complaints.

126. Mr Saunders states that those letters were not sent to Aquavitae because Beryl Brown took the view that rather than devoting resources to an investigation, the cases should be closed as she did not think that there was any substance to them in terms of the Competition Act 1998. Accordingly a draft letter to Aquavitae, dated 23 October 2002, was prepared by Beryl Brown in the following terms:

> "I am replying to your letter of 3 October complaining about [Yorkshire Water].
>
> From your letter I understand that your complaint is about [Yorkshire Water's] refusal to offer you a wholesale price for water that is sufficiently lower than its retail tariff for you to profitably enter the water retail market.
>
> I am not in a position to say with finality whether this conduct amounts to either an infringement or a non-infringement of the Competition Act 1998. However I

do not consider your complaint is sufficiently promising to warrant further consideration.

I have therefore closed our file on this case."

127. According to Mr Saunders, at paragraph 17 of his witness statement, that draft did not accurately reflect his thinking at the time or the reasons why he subsequently decided the cases should be closed. Mr Saunders considered that, given the likelihood of a reference to the Water Bill in the Queen's Speech in November 2002, Aquavitae's complaint did not justify Ofwat diverting its resources from the work necessary to implement the framework for retail competition set out in the Bill. Accordingly on 7 November 2002 Mr Saunders amended Beryl Brown's draft letter of 23 October 2002. His amendment in manuscript on the face of the draft was in the following terms:

> "In coming to this conclusion I have taken into account the government's proposals to legislate for retail competition in the water industry. Ofwat needs to focus its resources on developing the regulatory framework necessary to implement those proposals and to ensure the development of competition in this area."

128. Mr Saunders' draft amendment was circulated, notably to Ms Brown. In an internal email of 7 November 2002 Ms Brown commented:

> "Similarly I don't like the last sentence "Ofwat needs to focus its resources on developing the regulatory framework necessary to implement those proposals and to ensure the development of competition in this area." While this is one of the reasons we're retying (sic) to close cases, the main reason we're closing the AV cases is because we can't see who (sic) there is any CA98 substance to them."

129. On 14 November 2002 Mr Saunders discussed the matter further on the telephone with Mr Huw Brooker, then the Deputy Legal Adviser to the Director. Mr Brooker's note of that conversation forms part of the voluntary disclosure made by the Director and is in the following terms:

> "2. With regard to the case closure letter on the Aquavitae cases, MS said that he thought the reference to administrative priorities/Water Bill was the more important point. After some discussion, it was agreed that even if AV produced some evidence of costs they thought an undertaker would avoid, we would still not proceed with their cases. This would be because , in policy terms, it was far more sensible to focus our resources on developing appropriate policy in this area under the new regime in the Water Bill. HMB said that pursuing this issue under CA98 could only create a type of pyrrhic victory, particularly as the conclusions of a CA98 analysis might be different from the results produced under a new regime under the Water Bill.
>
> 3. It was therefore agreed that HMB would amend the case closure letter to refer simply to the administrative priority/Water Bill point. MS was happy

with the general policy letter, which he thought should be sent a day after or before the case closure letters.

4. With regard to case closure letters generally, MS said that he thought he should see these letters before they went. He was less worried about who actually signed out the letters. MS that he saw the equivalent letters from, for example, Complaints Team."

130. As is apparent from the text set out in paragraph 110 above, the letters actually sent to Aquavitae between 3 and 5 December 2002 informing it that the Director had decided to close his file on its complaint incorporate Mr Saunders' draft wording of 7 November 2002 and do not follow the earlier wording proposed by Ms Brown in her draft dated 23 October 2002.

## V ARGUMENTS OF THE PARTIES ON THE ADMISSIBILITY ISSUE

*The Director's submissions*

131. In his skeleton argument of 2 April 2003, as supplemented by written submissions of 12 May 2003 and oral submissions, the Director contends that his letter of 4 September 2002 and the associated correspondence cannot be fairly read as establishing that he has made a decision within the meaning of section 46(3)(b) of the Act "as to whether the Chapter II prohibition has been infringed." According to the Director, the Tribunal's judgments in *Bettercare*, *Freeserve* and *Claymore*, cited at paragraph 5 above, are clearly distinguishable from the present case.

132. The letter of 4 September 2002 merely expressed the Director's doubts in general terms about the practical scope for an undertaking in Aquavitae's position to make a sufficient margin as a water "retailer" to make the venture worthwhile. It did not decide whether or not any particular conduct had infringed the Chapter II prohibition. The Director points out that the letter of 4 September 2002 was not written in response to any complaint under the Competition Act. Aquavitae had expressly indicated that although it felt its position was "supported" by the Act, it did not wish at that stage to make a complaint under the Competition Act about the conduct of any specific person. Such a complaint was clearly a possibility in the future, but the Director submits that he made clear, in express terms, that he was not, in his letter of 4 September 2002, offering any view that was intended to prejudice any specific complaint that Aquavitae might eventually wish to make about any persons' conduct in the future.

133. The Director also points out that his letter of 4 September 2002, which is expressed in general terms, cannot be taken to be a decision on any particular individual's conduct because the positions taken by each water company as regards supplying Aquavitae with water were not

identical. Those differing positions were not addressed in the alleged decision of 4 September 2002 and cannot be assimilated, as Aquavitae attempts to do, into some common position to which the alleged decision in the letter of 4 September 2002 was directed. Furthermore, in some cases Aquavitae had not forwarded to him relevant correspondence with certain water companies about whose conduct Aquavitae has since complained. Accordingly the Director points out that he was, as at 4 September 2002, ignorant of the position being taken by those water companies about whose conduct he is now alleged to have made a decision in his letter of 4 September.

134. According to the Director, Aquavitae itself did not see the letter of 4 September 2002 as containing the Director's concluded view on the question of infringement, cutting off the possibility of making a formal complaint. This is underlined by the fact that Aquavitae submitted formal complaints about the conduct of 5 water companies after it received the letter of 4 September 2002.

135. As to Aquavitae's alternative case that the letters to it, dated 2, 3 and 5 December 2002, from Ms Brown, either alone or taken in conjunction with the letter of 4 September 2002, constituted decisions on the merits of Aquavitae's complaint, the Director submits that those letters cannot sensibly be so regarded. On the contrary, those letters also made clear in express terms that the Director was not addressing the substance of Aquavitae's individual complaints.

136. In particular, the Director expressly stated in his letter of 2 December 2002 that he would need to carry out an investigation into the particular circumstances of each complaint before he was in a position to make a decision on their substantive merits. The letter of 2 December 2002 itself could not amount to a decision on the merits of Aquavitae's complaint, as it expressly stated that the Director was writing separately in relation to each of the specific complaints that had been made since 4 September 2002. As to the letters of 3 and 5 December 2002, those expressly stated that the Director was not making a decision on the merits because he had decided that his resources were more appropriately deployed on the "difficult and time-consuming" task of developing the methodology for calculating "wholesale" prices under the licensing scheme proposed by the Water Bill, which might not necessarily be the same as that applicable under the Chapter II prohibition of the Act. The expert reports filed by Aquavitae indicate in this regard that there are a number of possible alternative methods which could be used to calculate a wholesale price of supply.

137. According to the Director, Aquavitae is wrong to suggest that the Director's response to DEFRA's consultation exercise on the Water Bill, also published on 4 September 2002, in which he indicated that he was sceptical about the scope for retail competition, was based on any detailed work. The conclusion expressed there was couched in deliberately provisional terms precisely because no such work had been carried out.

138. The Director submits that the documents he has voluntarily disclosed do not assist Aquavitae's case as they are "internal thinking" documents which merely demonstrate the views of Ofwat officials at the particular time they were expressed. Such documents are not relevant to the question of the decision that was actually made by the Director. The true basis of the decision to close the file on Aquavitae's complaints was that set out in the letters of 2, 3 and 5 December as explained by Mr Saunders, the official responsible for that decision. The Director submits that as a matter of principle applicants in the position of Aquavitae should not be permitted routinely to carry out "fishing expeditions" of this nature.

139. Aquavitae cannot claim the benefit of any legitimate expectation and/or estoppel as there has been no clear and unambiguous representation upon which Aquavitae has relied to its detriment. And in any event, contends the Director, the relevant question in these proceedings is whether the Director has as a matter of fact made an appealable decision for the purposes of sections 46 and 47 of the 1998 Act.

140. In addition, the Director points out that Aquavitae has failed to make any application to the Director asking him to vary or withdraw his alleged decision with supporting reasons as required by section 47 of the Act and rule 28 of the Competition Act 1998 (Director's Rules) Order 2000 S.I. 2000 No. 293 ("the Director's Rules"). Aquavitae's letter of 9 December 2002 cannot be construed as such an application. Accordingly, the Director's letter of 20 December 2002 was manifestly not an appealable decision under section 47(4) of the Act refusing to vary a decision on the merits of Aquavitae's complaint.

*Aquavitae's submissions*

141. Aquavitae's arguments are set out in its application dated 19 February 2003 as supplemented by Aquavitae's document entitled "Clarification of notice of appeal pursuant to requests by the Director of Water Services dated 3 and 18 March 2003", which was received by the Tribunal on 20 March 2003. Further "Outline submissions" were received by the Tribunal Registry from Aquavitae on 11 April 2003, followed by a note dated 9 May 2003. Those submissions mainly advance arguments based on the explanations given in, and documents

exhibited to, the witness statement of Michael Saunders received by the Tribunal on 4 April 2003.

142. In its application, Aquavitae contends that the Director's letter of 4 September 2002 demonstrates that he has, as a matter of fact, made an appealable decision to the effect that the various water companies about whose conduct Aquavitae has complained to him have not abused their dominant positions contrary to the Chapter II prohibition of the 1998 Act.

143. According to Aquavitae, the letter of 4 September 2002 demonstrates the Director's considered and strongly-held view (1) that a wholesale price was a water company's retail tariff less any avoided costs; (2) that there were no appreciable avoided costs; (3) that therefore the water companies from whom Aquavitae sought a wholesale supply acted properly in refusing to offer any discount on their retail tariffs; and (4) consequently they did not infringe the Chapter II prohibition. That decision of principle is appealable to the Tribunal. Contrary to the Director's argument, it was not necessary for him to have determined an exact wholesale price at which supply should take place before he was in a position to determine that there had been no infringement of the Act.

144. According to Aquavitae the conduct of the water companies was, "by and large", either to refuse to supply Aquavitae at all or, more commonly, to refuse to supply except on their published retail tariff, on the basis that there are no avoidable costs that would justify offering Aquavitae a wholesale price. Although Northumbrian Water may not have refused to supply it did impose conditions on such a supply which, according to Aquavitae, have no statutory basis.

145. The settled nature of the Director's view is not altered by the fact that he couched some of his conclusions in his letter of 4 September 2002 in "somewhat less than absolute terms". The views he expressed in that letter coincided with the views he had reached as a result of the work he had carried out in responding to the 2002 Consultation Paper. That response, also dated 4 September 2002, indicated that as far as retail competition in water services was concerned, the Director took the settled view that "the wholesale price is unlikely to differ much, if at all, from the retail price."

146. According to Aquavitae, there was ample material available to the Director to reach a conclusion regarding a wholesale price on a firm factual basis. In addition to his own work on the issue, carried out in connection with the DEFRA consultation, we understood Aquavitae to submit that he also had cost information submitted to him by consultants

instructed by Aquavitae. The submitted material disaggregated various costs involved in individual water companies costs of supply which enabled the Director to identify in particular the various retail costs that would be avoided by a water company supplying Aquavitae.

147. Aquavitae further submits, relying on *Bettercare* and *Claymore*, cited at paragraph 5 above, that if, contrary to its primary submission, the letter of 4 September 2002 is in some way ambiguous, then it is permissible to have regard to the surrounding circumstances in which the letter was written, including the material contained in the voluntary disclosure exhibited to the witness statement of Michael Saunders, in order to determine the true basis on which he decided to close his file on Aquavitae's complaints.

148. Having regard to the material disclosed by the Director, Aquavitae submits that it is now quite clear that the Director and his staff have throughout taken the view that a wholesale price was the retail price less avoided costs, that those avoided costs were "not appreciable" or "wafer thin", and that, in consequence, the water companies' conduct complained of by Aquavitae did not infringe the Chapter II prohibition.

149. In particular, Aquavitae contends that the draft of the letter dated 14 August 2002, which eventually became the letter of 4 September 2002 demonstrates that revisions to the drafting were made in order to obscure the Director's real view of the evidence, reduce the risk of legal challenge and stop Aquavitae's approach "in its tracks."

150. According to Aquavitae, Ofwat's disclosed internal documents demonstrate that meetings held with Aquavitae were not in reality held, as far as Ofwat officials were concerned, to encourage an exchange of information, but rather were held to discourage Aquavitae, as the internal email from Beryl Brown to Michael Saunders of 18 September 2002 makes clear. This adds further support to Aquavitae's primary contention that the Director had already reached a concluded view as to the merits of Aquavitae's complaints under the Act.

151. Aquavitae further contends that other documents, voluntarily disclosed by the Director, also demonstrate that Ofwat officials, including the Director himself, considered that Aquavitae's complaints had little or no merit. For example, Beryl Brown, the author of the case closure letters of 2, 3 and 5 December 2002, had expressed that view in her draft letter dated 23 October 2002, and in her email of 7 November 2002.

152. According to Aquavitae, Ms Brown, as the signatory to the letters of 2, 3 and 5 December, was held out by the Director as the competent official to make the case closure decisions. Considered objectively, and as a matter of fact, her view, and that of her colleagues, as revealed by the Director's voluntary disclosure, was that, as a matter of substance, there was no infringement of the Chapter II prohibition.

153. In those circumstances, contends Aquavitae, Ms Brown was the official with ostensible authority for the decision to close the case, and it is not open to the Director, through Mr Saunders, to substitute the reasons for that closure and thereby convert a decision that, as drafted by Ms Brown, was an appealable decision that the Chapter II prohibition had not been infringed, into a non-appealable decision purporting not to address the substance of Aquavitae's complaint. The fact that Ms Brown was the official with ostensible authority for the decision is reinforced by the Director's letter of 20 December 2002, whereby he confirmed that Aquavitae's complaints were being dismissed for the reasons explained by Ms Brown and with which he was in agreement. Aquavitae submitted that authority could not be taken away from Ms Brown by Mr Saunders.

154. According to Aquavitae, the purportedly agnostic view of the Director on the question of infringement that Mr Saunders sought to convey in the case closure letters he instructed Ms Brown to send to Aquavitae, and which he now seeks to explain in his witness statement, is wrong. This was not a case where the Director had "genuinely abstained from offering a view one way or the other even by implication" (*Freeserve*, at [101]; *Claymore* at [122]). Viewed in the round, the evidence demonstrates that the "predominant reason" for rejecting Aquavitae's complaints was that the Director, and Ofwat's Competition Policy Unit as a whole, considered that there was no infringement of the Chapter II prohibition.

155. Publishing the letter of 4 September 2002 to other water companies also "strongly suggests that this was a definitive ruling" in the nature of a "circular". That is how it was described by the Director in the internal memorandum of 15 August 2002, contained in the disclosed documents. According to Aquavitae, it is clear from the communications between the Director and the water companies, that the water companies understood the Director's letter of 4 September as just such a ruling: see Northumbrian's letter of 6 December 2002. Aquavitae alleges that in one case a water company discovered the identity of one of Aquavitae's potential customers, and sent them the Director's letter of 4 September 2002, which demonstrates that they saw it as a significant expression of the Director's view. According to Aquavitae, the letter of 4 September 2002 demonstrated the Director's settled view that there has been no infringement of the Chapter II prohibition.

156. According to Aquavitae, the internal documents demonstrate that despite the Director promising in his letter of 4 September 2002 to assess any specific complaints under the 1998 Act on their merits, Ofwat had no serious intention of revising its view of the merits of Aquavitae's complaint, and that consideration given to the individual complaints Aquavitae eventually submitted was "merely going through the motions".

157. Aquavitae also argues that, by its letter of 9 December 2002, it "effectively" requested the Director to withdraw or vary "the decision", and that by letter of 20 December 2002 the Director formally confirmed his decision of 4 September 2002 rejecting Aquavitae's complaint. Aquavitae contends that the Director's decision of 20 December 2002 was one that it is entitled to appeal under section 47(4) of the Act.

158. In the alternative, Aquavitae argues that the decision contained in the letter of 4 September 2002 was "re-made, made and/or perfected in the case closure letters of 5 December 2002 which dismissed Aquavitae's complaints."

159. On this hypothesis Aquavitae argues that the Director, in his letter of 4 September 2002, promised that he would make a decision on, or an "assessment" of, the merits of any complaint made by Aquavitae. That promise gave rise to a legitimate expectation on Aquavitae's part that he would carry out a "fair assessment" of the complaints. However, that expectation was breached by the Director's staff, who had already aligned themselves with the water company position as the Director's internal documents show. Aquavitae relies on *R v Devon County Council, ex parte Baker and another* [1995] 1 All ER 73, CA; *R v North and East Devon Health Authority, ex parte Coughlan* [2002] 2 WLR 622, CA; and *R v Nottingham Magistrates, ex parte Davidson* [2000] Crim LR 118.

160. Furthermore, contends Aquavitae, the Director promised that he would make a relevant decision if he received a complaint. If, in reliance on that promise, an applicant makes a complaint the Director is estopped by virtue of "a species of promissory estoppel" from objecting to the admissibility of an appeal on the grounds of the lack of a decision. In this regard Aquavitae refers to the case of *Mountney v Treharne* [2002] EWCA Civ 1174.

161. Alternatively, Aquavitae submits that, in the circumstances, it was entitled to treat the case closure letters as a "relevant decision on the basis of legitimate expectation and/or estoppel."

162. Finally, Aquavitae submits that the wording governing a statutory right of appeal should not be construed restrictively unless the language of the statute clearly so requires: see *Claymore*,

cited above, at paragraph 160,. According to Aquavitae, the Director must not be allowed to frustrate its right of appeal "by the particular nuance in the wording used by the draftsman of the decision to describe the Director's appreciation of the evidence."

## VI ANALYSIS

*The relevant statutory provisions*

163. The Chapter II prohibition is contained in section 18 of the 1998 Act and provides, so far as material:

> "18.–(1) … [A]ny conduct on the part of one or more undertakings which amounts to the abuse of a dominant position in a market is prohibited if it may affect trade within the United Kingdom.
>
> (2) Conduct may, in particular, constitute such an abuse if it consists in–
>
> (a) directly or indirectly imposing unfair purchase or selling prices or other unfair trading conditions;
>
> (b) limiting production, markets or technical development to the prejudice of consumers;
>
> (c) applying dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage;
>
> (d) making the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of the contracts.
>
> (3) In this section–
>
> "dominant position" means a dominant position within the United Kingdom; and
>
> "the United Kingdom" means the United Kingdom or any part of it.
>
> (4) The prohibition imposed by subsection (1) is referred to in this Act as "the Chapter II prohibition"."

164. Under Chapter III of the 1998 Act (Investigation and Enforcement) the OFT and other sectoral regulators such as the Director are given extensive powers to investigate and make decisions as to whether or not the Chapter II prohibition has been infringed.

165. The provisions governing appeals against certain decisions made under the 1998 Act are set out in sections 46 and 47 of the 1998 Act, as amended by the Enterprise Act 2002. Section 46 provides, so far as relevant:

> "46.-(1) …
>
> (2) Any person in respect of whose conduct the OFT has made a decision may appeal to the Tribunal against, or with respect to, the decision.
>
> (3) In this section "decision" means a decision of the OFT-

…

(b) as to whether the Chapter II prohibition has been infringed,

…"

166. Section 47 of the 1998 Act provides:

> "47.-(1) A person who does not fall within section 46(1) or (2) may apply to the OFT asking him to withdraw or vary a decision ("the relevant decision") falling within paragraphs (a) to (f) of section 46(3) or such other decision as may be prescribed.
>
> (2) the application must-
>
> (a) be made in writing, within such period as the OFT may specify in rules under section 51; and
>
> (b) give the applicant's reasons for considering that the relevant decision should be withdrawn or (as the case may be) varied.
>
> …
>
> (4) If the OFT, having considered the application, decides that it does not show sufficient reason why it should withdraw or vary the relevant decision, it must notify the applicant of its decision.
>
> (5) Otherwise, the OFT must deal with the application in accordance with such procedure as may be specified in rules under section 51.
>
> (6) The applicant may appeal to the Tribunal against a decision of the OFT notified under subsection (3) or (4).
>
> …"

167. Under section 31(4A) of the Water Industry Act 1991, as amended by paragraph 5(8) of Schedule 10 to the 1998 Act and paragraph 25(8)(c) of Schedule 25 to the Enterprise Act 2002, references in sections 46 and 47 of the 1998 Act to the OFT are to be read as including a reference to the Director of Water Services.

168. Section 46 of the 1998 Act, set out above, is directed to appeals by the parties principally affected by a decision of the Director, notably

— the parties to an agreement in respect of which the Director has made a decision "as to whether the Chapter I prohibition has been infringed" (section 46(1) and (3)(a)); or

— any person in respect of whose conduct the Director has made a decision "as to whether the Chapter II prohibition has been infringed" (section 46(2) and (3)(b)).

169. On the other hand, section 47 of the 1998 Act envisages appeals to the Tribunal by third parties who do not fall within section 46(1) and (2). That section entitles third parties to apply to the Director asking him

"to withdraw or vary a decision ("the relevant decision") falling within paragraphs (a) to (f) of section 46(3) or such other decision as may be prescribed".

170. Rules 28(1) to (3) of the Director's Rules provide :

"28.–(1) An application under section 47(1) asking the Director to withdraw or vary a decision shall:

(a) be submitted in writing to that Director within one month from the date of publication of that decision by means of entry in the register maintained by the Director General of Fair Trading under rule 8 above;

(b) comply with paragraph (2) below; and

(c) include the documents specified in paragraph (3) below.

(2) An application submitted under paragraph (1) above shall be signed by the applicant, or by a duly authorised representative of the applicant, and shall state the applicant's reasons:

(a) for considering that he has a sufficient interest in the decision referred to in paragraph (1) above; or

(b) where he claims to represent persons who have a sufficient interest in that decision:

(i) for claiming that he represents those persons; and

(ii) for claiming that those persons have sufficient interest in that decision.

(3) The documents specified for the purposes of paragraph (1) above are the following:

(a) three copies of the application; and

(b) where the application is signed by a solicitor or other representative of an applicant, written proof of that representative's authority to act on that applicant's behalf."

171. Section 17 of the Enterprise Act 2002, brought into force on 20 June 2003 by The Enterprise Act 2002 (Commencement No. 3, Transitional Provisions and Savings) Order 2003 S.I. 2003 No. 1397 ("the Commencement Order"), substitutes a new section 47 of the 1998 Act under which a third party may appeal a decision falling with section 46(3) without first having to make an application to the OFT to withdraw or vary that decision. However, that change does not affect applications made under the amended section 47(1) in relation to decisions adopted by the Director prior to 20 June 2003, and hence has no bearing on the present case: see paragraph 5 of the Commencement Order.

*The issues that the Tribunal must decide*

172. In *Bettercare* at paragraph 61, and subsequently in *Freeserve* and *Claymore*, the Tribunal identified the following relevant questions regarding whether or not an appeal is admissible :

> "(i) Does the correspondence between the OFT (or other regulator) and the applicant contain "a decision"?
>
> (ii) If so, does any such decision constitute an "appealable decision" as to whether the Chapter II prohibition has been infringed?
>
> (iii) If so, has the procedure envisaged by section 47 been observed?"

173. As to whether the Director has made a "decision" (point (i) above), the Tribunal said in *Bettercare* at [62]:

> "On the ordinary meaning of words, to take a decision in a legal context means simply to decide or determine a question or issue. Whether such a decision has been taken for the purposes of the Act is, in our view, a question of substance, not form, to be determined objectively. If there is, in substance, a decision, it is immaterial whether it is formally entitled a decision: otherwise the decision-maker could avoid his act being characterised as a decision simply by failing to affix the appropriate label."

174. As to whether any decision is an "appealable decision" (point (ii) above) he relevant principles are summarised at paragraph 122 of the Tribunal's judgment in *Claymore* as follows:

> "(i) The question whether the Director has "made a decision as to whether the Chapter II prohibition is infringed" is primarily a question of fact to be decided in accordance with the particular circumstances of each case (*Bettercare*, [24]).
>
> (ii) Whether such a decision has been taken is a question of substance, not form, to be determined objectively, taking into account all the circumstances (*Bettercare*, [62], [84] to [87], and [93]). The issue is: has the Director made a decision as to whether the Chapter II prohibition has been infringed, either expressly or by necessary implication, on the material before him? (*Freeserve*, [96]).
>
> (iii) There is a distinction between a situation where the Director has merely exercised an administrative discretion without proceeding to a decision on the question of infringement (for example, where the Director decides not to investigate a complaint pending the conclusion of a parallel investigation by the European Commission), and a situation where the Director has, in fact, reached a decision on the question of infringement, (*Bettercare*, [80], [87], [88], [93]; *Freeserve*, [101] to [105]). The test, as formulated by the Tribunal in *Freeserve*, is whether the Director has genuinely

abstained from expressing a view, one way or the other, even by implication, on the question whether there has been an infringement of the Chapter II prohibition (*Freeserve*, [101] and [102])."

175. The Tribunal also said in *Claymore* at [148]:

> "In our view a useful approach is to pose two questions: Did the Director ask himself whether the Chapter II prohibition has been infringed? What answer did the Director give when making his decision?"

176. In this case the "decisions" relied on by Aquavitae are the letter of 4 September 2002 (paragraph 86 above), or, alternatively, the letters of 3 and 5 December 2002 (paragraphs 110 and 111 above) read with the letter of 2 December 2002 (paragraph 109 above). We deal with these two possible "decisions" in turn.

*(1) The Director's letter of 4 September 2002*

177. In our view, the first point to note is that the letter of 4 September 2002 was not written in response to any specific complaint under the 1998 Act. In the period between June 2001 and April 2002, Aquavitae had various contacts with Ofwat, and forwarded to them its correspondence with the water companies, but Aquavitae did not press the matter to the stage of a complaint.

178. In her letter of 8 April 2002 Julie Cooper of Ofwat indicated to Mr Samorzewski that Ofwat "was recording Aquavitae's concerns" but stated "If you consider that you are experiencing specific anti-competitive behaviour, then you should make a formal complaint to us." Ms Cooper indicated that any such complaint should be supported by detailed information.

179. However, in correspondence with Ofwat prior to the letter of 4 September, Aquavitae expressly and repeatedly indicated that it did not wish to make a specific complaint under the 1998 Act against any particular water company, no doubt for what it considered at the time to be sound commercial reasons: see Ofwat's letter of 1 May 2002 "You said [in a telephone conversation of 26 April 2002] that you are not currently making a specific complaint under the Competition Act 1998 against a water company"; Aquavitae's letter of 8 May 2002 "We see no advantage at this stage of a referral under the Competition Act"; and Aquavitae's letter of 16 August 2002 about United Utilities "although we do not see the advantage of a Competition Act complaint, our frustration at the attached response requires your feedback".

180. The most that can be said, in our view, is that by August 2002 Aquavitae was requesting "feedback" from Ofwat with a view to establishing whether they would have grounds for a complaint under the 1998 Act. Thus, in particular, in its letter of 8 August 2002 about Northumbrian Water's letter of 10 June 2002, Aquavitae stated "The assertions in your letter do require your feedback and we look forward to your response". In its letter of 16 August 2002, about United Utilities, Aquavitae stated "We therefore require from Ofwat, feedback on our belief as to whether we would have grounds to complain under the Competition Act 1998", albeit Aquavitae also said, in the same letter, "we do not see the advantage of a Competition Act complaint". Perhaps slightly more directly, in its letter of 19 August 2002 about Severn Trent, Aquavitae asked the Director "to supply a written reply to Aquavitae (UK) with your opinion of the Severn Trent stance to date".

181. Although no particular formality is required for a complaint under the 1998 Act, and the Tribunal may well, depending on the circumstances, take a generous view as to whether a particular letter constitutes a complaint or not, in this particular case out view is that Aquavitae had not, by 4 September 2002, made a complaint to the Director. That view is confirmed by the fact that it was only after 4 September that Aquavitae lodged formal complaints against five named water companies, on 16 September, 23 September, 2 October, 3 October and 22 October (see paragraphs 94 and 100 to 103 above).

182. It follows that the Director's letter of 4 September 2002 was not written in response to a complaint of the kind Ms Cooper invited Aquavitae to make in her letter of 8 April 2002. In our view the letter of 4 September 2002 was essentially written in response to Aquavitae's request to Ofwat for "feedback" as to the application of the 1998 Act in relation to Aquavitae's request to be quoted a "wholesale" price by the water companies.

183. Whether, against that background, the Director's letter of 4 September 2002, set out at paragraph 86 above, constitutes an "appealable decision" turns largely on the terms and effect of that letter, considered in its context. Boiled down to its essentials, that letter expresses the Director's view (i) that if the water companies sell to Aquavitae for resale to a single customer "it is hard to see how this would achieve any reduction in the incumbent's cost of supply"; (ii) that if Aquavitae were to sell to a number of customers, "even then there might be few savings to the incumbent in retail costs"; and (iii) that although the Director "would of course consider any CA98 complaint on its merits relating to terms offered by companies, the above points might well be relevant to any assessment of such a complaint."

184. The Director then refers, at the end of the letter of 4 September, to the Government's proposal to create a licence to allow retail competition through legislation, and repeats his view that: "it is not obvious that this produces savings to the incumbent in retail costs".

185. The letter is also copied without comment to the water companies, and to other members of the Water Forum, on the grounds that it "may be of more general interest".

186. The letter of 4 September 2002 does seem to express in general terms the Director's then sceptical, probably highly sceptical, view about the possibility of invoking the 1998 Act in support of Aquavitae's attempts to obtain "wholesale prices" from the water companies. However, it seems to us more difficult to say that this letter, on its face, constitutes "a decision" that the Chapter II prohibition is not infringed for the purposes of section 46(3)(b) of the 1998 Act.

187. The principal difficulty is that in his letter of 4 September 2002 the Director expressly states that he "would of course consider any CA98 complaint on its merits relating to terms offered by companies", thus leaving open, or at least not precluding, the possibility of the Director giving further consideration to the matter in the light of a specific complaint about particular terms offered by water companies in specific circumstances. The wording "the above points may well be relevant to any assessment of such a complaint" does not, it seems to us, preclude the Director from considering any such complaint on its merits.

188. Aquavitae, however, invites us to hold that, by 4 September 2002, the Director had in fact made up his mind that there was no infringement of the 1998 Act, on the basis that he (the Director) considered that the incumbent water companies would avoid few, if any, costs by dealing with Aquavitae, and were therefore justified in not quoting "wholesale" prices.

189. There is some force in Aquavitae's arguments. The evidence is that relevant officials at Ofwat did not consider that Aquavitae had any case under the 1998 Act (see e.g. Ofwat's internal note of 5 August 2002). The Director himself, in Ofwat's reply to the 2002 Consultation Paper also dated 4 September 2002, publicly expressed the considered view that avoidable costs were minimal and "Thus the wholesale price is unlikely to differ much, if at all, from the retail price" (see paragraph 41 above). That view is hardly consistent with a possible infringement of the 1998 Act. The Director's draft letter of 14 August 2002 to Aquavitae is to the same effect. The fact that the Director circulated the letter of 4 September 2002 to all incumbent water companies and other interested parties is also evidence that the Director wished the view he was taking to be known to the industry.

190. On the other hand, the letter of 4 September 2002 expressly leaves open the possibility of the Director examining a specific complaint on the merits. There is also evidence before the Tribunal, from the voluntary disclosure, that the Director was personally concerned not to prejudice the stance that he might subsequently take in individual cases: see his memos of 15 August 2002 and 2 September 2002 (paragraphs 89 and 90 above). According to the Director's memo of 15 August 2002 his intention was to send:

> "in effect, a circular from me to the companies and entrants which tells them all that I have doubts about the practicalities of the Aquavitae scheme".

191. Taking all these considerations into account, we are unable to persuade ourselves that the letter of 4 September 2002 decided or determined that there was no infringement of the Chapter II prohibition. Assuming in Aquavitae's favour that the Director asked himself whether the Chapter II prohibition was infringed, in our view the answer he gave was, in effect: "I think it is highly unlikely, but I will consider on its merits any specific complaint you make". In our view, that is not "a decision as to whether the Chapter II prohibition is infringed" within the meaning of section 46(3)(b) of the 1998 Act. In other words, the Director did not quite close the door: he left it ajar, if only slightly.

192. There is a further difficulty with Aquavitae's argument. Looking at section 46 as a whole, it seems to us that, in order to be "a decision whether the Chapter II prohibition has been infringed" within the meaning of section 46(3)(b), it must be possible to ascertain both "the person" in respect of whose conduct the Director has made a decision, and "the conduct" to which the decision relates.

193. In the present case, the letter of 4 September 2002 does not refer to any specific "person", but merely refers in general terms to "your recent correspondence with water companies", and to "incumbent water companies". Similarly, the letter of 4 September does not identify particular "conduct" by any person alleged to have infringed the Chapter II prohibition. Even approaching the matter generously, we find it very difficult to hold that the letter of 4 September contains an implied non-infringement decision, either in relation to all water companies in England and Wales, or even in relation to the water companies whose correspondence Aquavitae had copied to the Director, in relation to any particular conduct. In our view the letter of 4 September is expressed in terms which are too general to amount to specific findings about the specific conduct of particular persons. In any event, the position of the 24 water companies as regards Aquavitae was not identical, and in some cases was not even known to the Director.

194. It is true that, in her letter of 20 September 2002 to Aquavitae, Ms Brown stated that the response that Aquavitae had requested in their letter of 8 August 2002 regarding the letter of Northumbrian Water of 10 June 2002 "was dealt with in the letter from Philip Fletcher dated 4 September 2002". This, in our view, could arguably suggest that the Director's letter of 4 September 2002 was to be taken as a statement of his position as regards the conduct of Northumbrian Water as set out in their letter of 10 June 2002. Similarly, in her letter of 19 August 2002 Ms Cooper said that "we will write to you in more detail shortly" in reply to Aquavitae's letter of 16 August 2002 about United Utilities. In those circumstances, it might be arguable that the letter of 4 September 2002 was to be taken as a statement of the Director's position as regards the conduct of United Utilities, as set out in Aquavitae's letter of 16 August 2002.

195. We are, however, of the view that it would be artificial to regard the letter of 4 September 2002 as a "decision" in the particular cases of Northumbrian Water and United Utilities. In both its letters of 8 August 2002 and 16 August 2002 what Aquavitae sought was "feedback", not a response to a complaint under the 1998 Act. As at 4 September 2002, negotiations with water companies such as Northumbrian Water were still continuing, and it is in that context that Aquavitae was hoping for positive "feedback". It was only after 4 September 2002 that Aquavitae made specific and individualised complaints, including complaints against Northumbrian Water and United Utilities.

196. In our view, what Aquavitae received from the Director in the letter of 4 September 2002 was, in essence, the "feedback" which it had often requested. For the reasons we have already given, we think that, in this particular case, the "feedback" given by the Director on 4 September 2002 falls short, albeit by a narrow margin, of being an "appealable decision" under sections 46 and 47 of the Act.

*(2) The case closure letters*

197. The letters of 3 and 5 December ("the case closure letters") by which the Director notified Aquavitae of his decision to close his file on their complaints make clear that they are in response to Aquavitae's formal complaints under the 1998 Act, and make specific reference to both the identify of the companies concerned and to the conduct said to infringe the Act. In our view the case closure letters contain "a decision" in that they close the Director's file. What is in dispute however, is the question as to whether in taking the decision to close his file the Director also made an appealable decision "as to whether the Chapter II prohibition has been infringed".

198. In the case closure letter of 3 December 2002 (to which we refer since the letters of 5 December 2002 are identical) the reasons given for the closure of the file are as follows:

> "The Queen's speech on 13 November included a reference to a Water Bill. The Bill has yet to be published and laid before parliament. But you will know from reading the government's consultation paper 'Extending opportunities for competition in the Water Industry in England and Wales' "… that it proposes to create a licence to allow retail competition. Under the proposed new regime, new entrants who wish only to retail water will be entitled under their licence to purchase wholesale water from undertakers, on reasonable terms and conditions for supply to eligible customers. The Government considers that the methodology (methodologies) for calculating wholesale prices would be a matter for undertakers and Ofwat.
>
> The new proposals will require us to examine the activities and costs involved in retailing water supplies, and the question of how wholesale prices should be calculated at that point.
>
> Unfortunately our resources are limited. Ofwat needs to focus its attention on developing the regulatory framework necessary to implement the government's proposals and to ensure the development of competition in this area. We are therefore unable to consider your complaint under the Competition Act 1998, and we have closed our file on this case."

199. The essential reason, therefore, for the Director's decision is, on its face, that the Water Bill will introduce a statutory licensing scheme to introduce retail competition; that that scheme will involve complex work to determine how wholesale prices should be calculated, on which consultation will take place; and that, because Ofwat needs to "focus its attention" on developing the new regulatory framework, it is "unable" to consider Aquavitae's complaint under the 1998 Act.

200. On the face of it, in our view it is impossible to construe the letter of 3 December 2002 as a decision "as to whether the Chapter II prohibition is infringed". On the face of it, the Director has abstained from taking such a decision, one way or the other, apparently on the grounds that the Director prefers to focus his resources on the introduction of the statutory scheme for retail licensing envisaged by the Water Bill, rather than pursuing a complaint under the 1998 Act.

201. Aquavitae, however, invites us to go behind the letter of 3 December 2002 on the basis that (i) it is clear that the Director thought all along that there was no infringement of the 1998 Act; (ii) that was also the view of Ms Brown who signed the letter of 3 December; (iii) the Director's assurance in the letter of 4 September that he would consider any complaint on the merits was, in fact, an empty promise; (iv) the handling of the five complaints was no more than Ofwat "going through the motions"; (v) the Director had, in fact, come to the conclusion that there was no infringement, even if that is not stated in the letter of 3 December 2002;

(vi) Mr Saunders had no authority to substitute another view for that of Ms Brown, Ofwat's Head of Competition Policy; (vii) the letter of 3 December 2003 "re-made, made or perfected" the implicit decision that there was no infringement already conveyed in the letter of 4 September 2002; (viii) the Director's letter of 4 September gave rise to a legitimate expectation that he would assess Aquavitae's complaints on their merits under the 1998 Act; (ix) the Director is in breach of that legitimate expectation; (x) the Director is thus estopped from denying that he has taken a non-infringement decision; and (xi) the Tribunal should not cut down the statutory right of appeal.

202. Again, these are forceful arguments. However, we have come to the conclusion that they are insufficient to found the Tribunal's jurisdiction in this case.

203. First, in the light of Mr Saunders' evidence, we accept that the letter of 3 December 2002 is a genuine expression of the Director's reason for closing the file. We understand that letter to indicate, in effect, that, as a matter of priorities, the Director thought it better to devote resources to working out the basis for "wholesale prices" in the context of the proposed statutory licensing scheme, rather than undertaking that exercise in the context of Aquavitae's complaints under the 1998 Act. We have no reason to doubt Mr Saunders' evidence that he had the Director's authority to instruct Ms Brown to write the letter of 3 December 2002 in the terms in which it was written. Ms Brown's internally expressed personal views as to how matters should have proceeded are not in our view relevant. We accept the letter of 3 December 2002 as stating the basis on which the Director decided to close the file.

204. The contrast between the Director's letter of 4 September 2002 ("I would of course consider any CA98 complaint on its merits") and Ms Brown's letter of 3December 2002 ("We are therefore unable to consider your complaint under the Competition Act") is in our view unfortunate. We can understand that Aquavitae may feel a sense of grievance that the investigation of a complaint apparently promised in September 2002 was, in fact, not proceeded with.

205. If the Director's statement in his letter of 20 December 2002 that "We are not under an obligation to investigate every Competition Act 1998 complaint" is intended to imply that the Director has an absolute discretion to decline to investigate apparently bona fide complaints under the 1998 Act, that is not a proposition which the Tribunal would necessarily accept. However, we do not need to consider that issue in general terms in the present case. The issue that arises in the present case is: what is the legal position where the Director expressly states his willingness to consider a complaint on its merits, and then does not do so?

206. In normal circumstances, where the OFT or a concurrent regulator has expressly indicated that they will consider a complaint on its merits, the Tribunal will expect that investigation to reach an outcome. If the outcome of that investigation is to close the file, the Tribunal will normally infer that that is because there is insufficient evidence of infringement. In most cases the result will be an appealable decision, in accordance with the principles now established in *Bettercare*, *Freeserve* and *Claymore*, cited at paragraph 5 above. As *Claymore* makes clear, at paragraphs 124 to 146, the drafting of the case closure letter is unlikely to deflect the Tribunal if the substance of the matter is a finding of insufficient evidence of infringement. Moreover, the inference that the case has been closed because the relevant regulator has concluded that an infringement is not established will normally be irresistible if, at an earlier stage, the regulator has already expressed a view to the effect that he sees little merit in the case.

207. In the present case, the Director expressed sceptical views in his letter of 4 September 2002. There is also considerable evidence that Ofwat officials considered all along that Aquavitae had no case under the 1998 Act. In those circumstances, Aquavitae invites us to draw the inference that the real reason, or at least a substantial reason, for the closure of the file was the Director's conclusion that the Chapter II prohibition was not infringed.

208. In many cases, on facts similar to these, that might well be an inference that the Tribunal would be prepared to draw. However, in the present case, it seems to us that there are exceptional circumstances, which negate the inference that might otherwise be drawn. First, there is the announcement, in the Queen's Speech on 13 November 2002, of a forthcoming Water Bill introducing a form of retail competition in the water industry through a system of statutory licensing. Secondly, it is apparent, notably from the 2002 Consultation Paper, that the Government takes the view that, if retail competition is to be introduced in the water sector it should be done in a cautious and managed way, through a statutory licensing scheme, in which a balance can be struck between varying different objectives – including the safety and quality of the water supply, clear lines of responsibility for securing water quality standards, social and environmental goals, and the need for the industry to finance its capital investment programmes: see paragraphs 35 to 40 above. Thirdly, the calculation of "wholesale prices" appears to be a complex task that may well need to be done in the context of detailed studies and industry-wide consultation.

209. In those exceptional circumstances, we accept that the Water Bill and the associated issues arising, constituted a genuine independent reason for closing the file in this case, which did not involve a decision that the Chapter II prohibition had not been infringed. Nor, on the

particular facts of this case, do we feel able to imply, or infer, such a decision from the case closure letters or the surrounding circumstances, including the letter of 2 December 2002. Nor do we accept the view that the Director's indication that he would consider any complaint on the merits, and the subsequent handling of the complaint, was merely "going through the motions". A meeting was held with Aquavitae on 11 October 2002. Steps were being taken to investigate further when, in effect, Mr Saunders intervened on the basis that a decision on the merits should not be reached in view of the forthcoming Water Bill. As we have said, we accept that was the genuine reason for closing the file. We are not prepared to infer from evidence about the internally expressed personal views of Ms Brown or other officials that the Director had also implicitly adopted a decision that the Chapter II prohibition was not infringed.

210. We are prepared to assume, without deciding, that as a result of the letter of 4 September 2002 Aquavitae did have a legitimate expectation that the Director would consider any formal complaint on its merits. In our view, the evidence is that, up to a point, the Director did so. By the stage of Mr Saunders' intervention, in November 2002, it would have been apparent that a great deal of work would be needed to construct the "wholesale price" which Aquavitae was seeking. The Water Bill then intervened. In the circumstances we can understand why the Director preferred to carry out further work in the context of the Bill rather than the individual complaint of Aquavitae.

211. However, we do not need to decide whether, or how far, as a matter of administrative law, Aquavitae's legitimate expectation that the Director would consider the complaint on its merits was not met. As the Tribunal pointed out in *Claymore*, at [182], breach of a legitimate expectation does not, in itself, transform something that is not an appealable decision into an appealable decision. Similarly, we do not find persuasive Aquavitae's analogy with promissory estoppel in private law, not least because public authorities are required to take into account wider public interests: see the comments to this effect of Lord Hoffmann in *R v East Sussex County Council, ex parte Reprotech (Pebsham) Ltd* [2002] UKHL 8, [2003] 1 WLR 348, at paragraphs 33 to 35. The one authority cited by Aquavitae in support of its submissions on this point, *Mountney v Treharne* [2002] EWCA Civ 1174 seems to us to be a rather special case in the matrimonial field confined to its own particular facts.

212. For all those reasons we conclude that Aquavitae has not shown an appealable decision in this case.

213. That means that, for better or worse, there is at present no decision by either the Director or the Tribunal on the question whether a refusal to quote a "wholesale price" for water is a breach of the Chapter II prohibition. It follows equally that the Director's letter of 4 September 2002 has no binding effect in any legal proceedings. Nor has the Tribunal ruled on the relationship between the 1998 Act and the Water Bill (assuming that the latter is enacted).

*The section 47 point*

214. In those circumstances, it is not necessary for us to consider whether Aquavitae complied with the procedure for bringing an appeal under section 47, as applicable prior to 20 June 2003 (paragraph 166 above). However, we briefly indicate our view.

215. Section 47 envisages (i) that there is a "relevant decision" for the purposes of section 47(1); (ii) that the Director has been asked to withdraw or vary that decision under section 47(1); (iii) that such a request is made in writing, within the period specified in the Director's Rules, giving the applicant's reasons for considering that the relevant decision should be withdrawn or varied, pursuant to section 47(2); (iv) that the applicant has a "sufficient interest" (section 47(3)); and (v) that the Director has decided that the application does not show sufficient reason why he should withdraw or vary the relevant decision, and has notified the applicant of his decision: section 47(4). If those conditions are satisfied, the applicant, in this case Aquavitae, may appeal to the Tribunal against the Director's refusal to withdraw or vary the relevant decision, pursuant to section 47(6).

216. Rule 28 of the Director's Rules (paragraph 170 above) requires notably that an application under section 47 be submitted in writing to the Director "within one month of the date of the publication of that decision by means of entry in the register" maintained by the Director under rule 8 of the Director's Rules: rule 28(1)(a). Since it is common ground that the decision in question has not been published by means of entry in the register maintained by the Director under rule 8 (applicable in this case by virtue of rule 30(4)), it appears that Aquavitae cannot be in breach of the time limit set out in rule 28(1)(a).

217. Aquavitae's letter of 9 December 2002 does not contain any mention of section 47 of the Act nor does it contain any express request to the Director to withdraw or vary any decision. Rather that letter emphasises that no outcome to the complaints had been determined. To our mind the letter of 9 December is more appropriately viewed as a protest about the absence of any determination of the substance of the Aquavitae's complaint, rather than an application to

him to withdraw or vary any decision he had made pursuant to section 47(1). This lends further support to our view that the Director had not made any appealable decision on Aquavitae's complaint, but rather had decided not to proceed to any such decision. It is perhaps doubtful whether Aquavitae's letter of 9 December 2002 is to be regarded as a request under section 47(1).

218. Although in *Bettercare* at [123], the Tribunal said that it should not insist on too much formality under section 47, especially where complainants were unrepresented, or their representatives were unfamiliar with the Act, in this particular case Aquavitae apparently had legal advice available to it and had written to the water companies alleging an infringement of the Chapter II prohibition. In those circumstances it is not obvious that the Tribunal should take an indulgent view regarding compliance with section 47(1). However, we leave the point open and make it clear that we are not deciding against Aquavitae on a procedural point under section 47. We also note that the section 47 procedure which applied up to 20 June 2003 no longer does so after that date.

*The Director's voluntary disclosure*

219. Finally, as regards the Director's voluntary disclosure, in our view the Director and his advisers fully discharged the high duty which rests on public authority respondents to assist a court or tribunal with full and accurate explanations of all the facts relevant to the issue the court or tribunal must decide (see for example, Laws LJ in *R (on the application of Quark Fishing Ltd) v Secretary of State for Foreign and Commonwealth Affairs* [2002] EWCA civ 1409, at [50]). However, such disclosure is, we trust, unlikely to be the norm, not least because of the limited evidential value of preparatory internal documents. In the present case, because of the particular circumstances, the disclosure did enable both the Tribunal and Aquavitae to understand more fully what had happened.

## VII CONCLUSION

220. It follows that for all the foregoing reasons we unanimously conclude that the appeal should be dismissed on the grounds that the Tribunal does not have jurisdiction to entertain it.

Christopher Bellamy Sheila Hewitt Graham Zellick

Delivered in public

Charles Dhanowa 5 August 2003
Registrar