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**IN THE COMPETITION**  
**APPEAL TRIBUNAL**

Case No. 1166/5/7/10

Victoria House,  
Bloomsbury Place,  
London WC1A 2EB

22 October 2012

Before:

VIVIEN ROSE  
(Chairman)  
TIM COHEN  
BRIAN LANDERS

Sitting as a Tribunal in England and Wales

**BETWEEN:**

**ALBION WATER LIMITED**

Appellants

– v –

**DWR CYMRU CYFYNGEDIG**

Respondent

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**HEARING (DAY 6)**

Note: Excisions in this transcript marked “[...][C]” relate to passages excluded.

## **APPEARANCES**

Mr Thomas Sharpe Q.C., Mr Matthew Cook and Mr Medhi Baiou (instructed by Shepherd Wedderburn LLP) appeared on behalf of the Claimant.

Mr Daniel Beard Q.C., Mr Meredith Pickford and Ms Ligia Osepciu (instructed by Hogan Lovells International LLP) appeared on behalf of the Defendant.

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Monday, 22 October 2012

(10.00 am)

THE CHAIRMAN: Good morning, everybody.

MR BEARD: Good morning, madam.

DR JEREMY BRYAN (continued)

Cross-examination by MR BEARD (continued)

MR BEARD: Dr Bryan, I'm hoping to be very brief in the light of your answers on Friday. I just want to try to agree on one or two things. You talked about what prices you would have to beat in order to have any chance of winning business at Corus, Llanwern and Trostre and so on. I just wanted to confirm some figures, whether or not we agree on those. Could you have bundle 9A, tab 358.

If you could turn through to 3294M, I think this is a document that you prepared; is that correct, Dr Bryan?

A. It looks very much like a spreadsheet that I prepared using Dwr Cymru data, yes.

Q. On it you have actually inserted the names of the Corus steelworks by reference to the WSHNONPOTS, as they have been pronounced, so WSHNONPOT 5, Llanwern; 12, Trostre; 13, Shotton. Then we move across volumes and then volumetric charges, and we see, for Llanwern, it is 10.36p WSHNONPOT; Trostre, 27.93; Shotton, 22.5.

Those are the prices that you would have to beat in

1 2003/2004; is that right?

2 A. Those are the prices that are in the -- the Dwr Cymru  
3 special agreements register. So, yes, those the prices  
4 that would have to be beaten.

5 Q. Yes. And if we just take the first of those, Llanwern,  
6 there is no basis for you saying that you could have  
7 produced prices which would have enabled you to beat  
8 this price?

9 A. Not on the basis of the discussions we were having, no.

10 Q. I think that's probably enough on that document.

11 So we have looked at the process of potential  
12 negotiations and so on and what would be needed and  
13 pricing. Obviously, in order to secure business with  
14 Corus, you would actually have to negotiate agreements  
15 with Corus and put in place any permits or arrangements  
16 which would be needed for those supplies; and this may  
17 be a matter for legal submission but do you accept that  
18 you would have needed an exemption under the Water  
19 Industry Act as amended, if you wanted to pursue your  
20 arrangements with Corus?

21 A. No, Mr Beard, not at that time. Those requirements only  
22 came in subsequent to 1 April 2004, which is when an  
23 alternative agreement would have started, and my  
24 understanding is that that particular bit of secondary  
25 legislation was not retrospective.

1 Q. So you accept that once that legislation had come into  
2 force, you would have needed exemptions but if you were  
3 dealing with a period prior to the legislation coming  
4 into force, you wouldn't; is that the position?

5 A. As I understand it, we would have needed an exception or  
6 exemption if the agreement came into force after the  
7 effective date of this particular secondary legislation,  
8 which I believe was towards the end of 2005. And the  
9 guidelines that Ofwat did issue in 2004, which were  
10 preliminary discussions, indicated very clearly that  
11 existing agreements would not be affected by such  
12 provision. And, of course, it wouldn't have affected by  
13 arrangement we managed to make for Trostre and Llanwern  
14 because it did not affect a bulk supply driven inset  
15 relationship.

16 Q. Can I just check in relation to that, you referred to  
17 bulk supply for Llanwern and Trostre. We referred to  
18 a letter of October 2006 on Friday. I won't take you  
19 back to it unless you want to go, but you didn't ever  
20 subsequently ask Dwr Cymru for a bulk supply price for  
21 Llanwern or Trostre, did you?

22 A. No, we didn't.

23 Q. And you didn't ever ask for a common carriage price for  
24 Corus Shotton, did you?

25 A. No, we anticipated that the common carriage price for --

1           sorry, for Corus Shotton?

2       Q.   Yes.

3       A.   Yes.  No, the first point was to get a fair price for  
4       Shotton Paper --

5       Q.   I'm just confirming.  I didn't think we had actually  
6       been disagreeing on these matters.  There is one last  
7       thing I do want to take you to you to, not related to  
8       Corus; it arose in relation to a reference to your  
9       Competition Act 1988 complaint that you brought on  
10      11 December 2000, which included various heads.  And if  
11      you remember, one of the complaints you made, you were  
12      suggesting that Dwr Cymru had confirmed that prices were  
13      based on D average costs, and there was a reference to  
14      a letter from Mike Brooker of 17 February 2000?

15      A.   Correct.

16      Q.   You remember that.  And we went to the document, just  
17      for the record, at folder 3, tab 43, and I think we all  
18      agreed that didn't look like the right letter?

19      A.   That's right.

20      Q.   Now, it appears there was some confusion in relation to  
21      compilation of the bundle and, helpfully, another letter  
22      of 17 February from Mike Brooker has been found, and it  
23      has now been slotted into bundle 18, tab 5.

24           As I say, I can take you back to your December  
25      complaint if you want but could you just have a look at

1           that letter and have a look through it and see whether  
2           or not you think this is the letter that was being  
3           referred to by you in your 11 December 2000 complaint.

4       A. I think it must be, yes.

5       Q. You think it is? So, just to be clear, is it the last  
6           paragraph on the first page you had in mind when you  
7           said that Mike Brooker had confirmed that there was  
8           de-averaging?

9       A. I'm sure that that will have influenced matters but  
10           I suspect it's the first paragraph on the second page.

11      Q. Right; certainly. That paragraph says:

12                 "This is based on the agreed price for the  
13           Ashgrove System but recognised that the particular  
14           circumstance that applied to Corus, in particular  
15           capital investment and operating costs for the lagoons,  
16           which enable efficient supply to be available to both  
17           Corus and Shotton Paper, and also their acceptance of an  
18           interruptibility clause which enables the non-potable  
19           supply to be sustained to both sides under certain  
20           circumstances."

21                 That's the bit you rely upon?

22      A. Yes, and the paragraph that follows.

23      Q. "As both the new tariff for Corus and your own charge  
24           are based on the agreed price for the Ashgrove System,  
25           we don't believe that your request for a reduction in

1 charge is appropriate."

2 That's not accepting a de-average cost starting  
3 point for the analysis, is it?

4 A. Well, a price that is system-specific or reflects the  
5 particular characteristics of a system is, by  
6 definition, a de-averaged price; it's not based on the  
7 cost shared amongst all customers in whatever class you  
8 care to define.

9 Q. The agreed price being referred to is the 26p, isn't it?

10 A. It is.

11 Q. And that was based, not on a de-averaged cost price, but  
12 on an average cost price, wasn't it?

13 A. We never saw the information on which that was based  
14 other than the 1986 -- sorry, the 1996 derivation, which  
15 did talk about local costs. If you remember, that long  
16 paper did include reference to local costs.

17 Q. But this account is entirely consistent with regional  
18 average cost pricing adjusted for particular  
19 circumstances, isn't it?

20 A. We clearly -- I clearly did not take that view at that  
21 time and --

22 Q. But do you take that view now?

23 A. I am still in the dark about how -- what Ofwat was told  
24 about pricing in 1996, the investigations that they took  
25 and the basis on which they created the minded to

1 determinations.

2 Q. I don't have any further questions for you, Dr Bryan.  
3 The tribunal may have some questions and Mr Sharpe may  
4 have some questions, so could you remain there.

5 A. Thank you, Mr Beard.

6 THE CHAIRMAN: Let's have re-examination first and then we  
7 will see if we have any remaining questioning.

8 MR SHARPE: I'm disappointed that I have no questions in  
9 re-examination. Thank you.

10 Questions from THE TRIBUNAL

11 THE CHAIRMAN: Just one matter I wanted to ask you about,  
12 Dr Bryan, which is the original handwritten note of your  
13 early discussions with United Utilities. Your evidence  
14 was that when you had these discussions with them, what  
15 you were talking about was getting the common carriage  
16 price, working out then how much there was --

17 A. Of benefit.

18 THE CHAIRMAN: Of benefit.

19 A. Yes.

20 THE CHAIRMAN: And then working out a price for the water  
21 based on that.

22 A. Yes.

23 THE CHAIRMAN: At some point things got shifted, either in  
24 your mind or in United Utilities' mind or in both, to  
25 this long run marginal cost approach, which seems to me

1 a different approach from the initial approach, although  
2 I'm not quite sure when that happened or at what stage  
3 you were aware of that shift in their thinking.

- 4 A. It was certainly not mentioned during the negotiations  
5 in 1999 and in the early part of 2000, but it's clear  
6 from the contemporaneous evidence that has been  
7 disclosed that United Utilities were looking very  
8 carefully at the mechanisms that they could use and,  
9 I suspect, particularly the mechanisms that they could  
10 use to justify to Ofwat a substantial increase in the  
11 price charged to Albion versus the price fixed,  
12 effectively, for Dwr Cymru. And, in that regulated  
13 sphere, they would have had to be able to justify that  
14 difference in price. And I think that the evidence  
15 shows very clearly that they couldn't do it on an  
16 accounting cost basis because that was the basis of the  
17 Dwr Cymru figure. And in that context, long run  
18 marginal cost was very much flavour of the month --  
19 well, flavour of several years -- for Ofwat and it did  
20 allow a certain amount of flexibility in terms of  
21 justifying numbers. And the discussions we had with  
22 United Utilities in the middle of 2000 -- and I can't  
23 remember now whether it was June or July but the  
24 evidence is in the bundle -- I'm not sure whether those  
25 contemporaneous notes mentioned long run marginal cost

1 but my memory is it was mooted as a justification  
2 mechanism, but at that time, so we are talking mid-2000,  
3 my understanding was that long run marginal cost would  
4 be a useful tool to justify whatever negotiating  
5 position we arrived at. What had changed between the  
6 middle of the year and the end of 2000 appears to be  
7 that United Utilities decided that they would set  
8 a price rather than negotiate on the basis that we would  
9 original started discussing.

10 THE CHAIRMAN: When you then got the later letter from them  
11 which prompted you to send them the heads of agreement  
12 to see if they would sign it, and they didn't, what did  
13 you, at the time, think was happening with that exchange  
14 of correspondence? How did you interpret that in terms  
15 of United Utilities' attitude generally towards the  
16 negotiations?

17 A. You are asking me to speculate. I'm happy to do so --

18 THE CHAIRMAN: No, I'm asking if you can remember at the  
19 time what you thought was going on.

20 A. At the time we had two thoughts. The first was: they  
21 are being greedy. The second was that we had already  
22 met -- and we didn't have that ultimatum until  
23 the January. We had already met a certain amount of  
24 resistance from Dwr Cymru. We were struggling to get  
25 them to engage -- we were certainly struggling to get

1           them to give us a price. We knew that United Utilities  
2           were very heavily engaged with Dwr Cymru because they  
3           wanted a very large operational contract. They ended up  
4           managing all of Dwr Cymru on contract, effectively,  
5           apart from the head office functions. So we -- part of  
6           us was suspicious that there was some sort of deal that  
7           had been done that United Utilities had effectively  
8           concluded that common carriage was a dead letter, that  
9           we would never get a sensible price, and therefore they  
10          wanted to set a marker as to the price that they wanted  
11          to put on Heronbridge, really as a lever in subsequent  
12          discussions with Dwr Cymru for that supply, in the  
13          absence of Albion being a credible competitive force  
14          that would help our process.

15                 But -- those were the thoughts at the time, but not  
16          based on any tangible evidence.

17       THE CHAIRMAN: Thank you very much. You will be pleased to  
18          hear, Dr Bryan, that that then concludes your evidence.

19       A. Thank you very much.

20       MR BEARD: I was going to assume that there was no further  
21          evidence.

22       MR SHARPE: Yes.

23       MR BEARD: In which case the next stage would be -- well,  
24          there are two issues. One is whether or not we call  
25          Miss White, who would be our first witness, or whether

1 we deal with unpleaded issues.

2 We had exchanges over the weekend and it was hoped  
3 at one point that the issue would dissolve and go away;  
4 sadly it hasn't. However, I do understand from  
5 Mr Sharpe that at least in relation to Miss White, and  
6 possibly, although I won't held him to it, in relation  
7 to Mr Williams, these matters don't arise.

8 In those circumstances, it may be most sensible if  
9 we simply press on with Miss White's evidence at this  
10 stage. We have prepared, in some haste, a speaking note  
11 that I was going to speak to in relation to the  
12 unpleaded issues. It may be, if we can hand that up and  
13 over the short adjournment that can be considered or, if  
14 necessary, overnight, that might speed the plough in  
15 relation to our application over unpleaded issues.

16 Otherwise, I'm very happy to air it now, but, conscious  
17 of time, and since Mr Sharpe has very helpfully  
18 indicated that these matters do not arise in relation to  
19 Miss White, we are very happy to call her and press on.

20 MR SHARPE: I'm happy to deal with these matters at any time  
21 but I'm also extremely concerned about our timetable.

22 Dr Bryan has endured his fourth day of cross-examination  
23 by two counsel when two days were budgeted. I'm now  
24 faced with the prospect of cross-examining witnesses in  
25 my time budget of up to three days, finishing on

1 Thursday, with the prospect of finishing a  
2 cross-examination and getting up and closing. I'm happy  
3 to do that but I don't think it's very sensible and  
4 I don't think, with respect, it's in the tribunal's  
5 interests to get unconsidered submissions. So I think  
6 the less time we waste the better.

7 So my own view is that we should proceed with White  
8 and possibly even Williams. These matters only seem to  
9 arise in my friend's mind in relation to Edwards. If he  
10 still wishes to pursue them then we will have to have a  
11 discussion before Edwards, quite likely to be on  
12 Thursday.

13 THE CHAIRMAN: Let's have Miss White's evidence.

14 MR BEARD: I'm grateful. Dwr Cymru therefore calls  
15 Miss White as a witness.

16 MR SHARPE: I need to re-arrange my things here in order to  
17 be able to cross-examine. This is where the  
18 configuration isn't ideal. Would you mind retiring just  
19 for three or four minutes to allow me to do that?

20 MR BEARD: Miss White can then be read in --

21 THE CHAIRMAN: We will come back at 25 to.

22 MS JANINE MELANIE WHITE

23 Examination-in-chief by MR BEARD

24 THE CHAIRMAN: Do sit down.

25 A. Thank you.

1 MR BEARD: Good morning. Could you give the tribunal your  
2 name, please.

3 A. Janine Melanie White.

4 Q. Could you take folder 1. It should be in a rack behind  
5 you. Thank you very much. Turn to tab 1. This is  
6 entitled "Witness statement of Janine Melanie White".  
7 Could you, please, turn through to page 9. Is that your  
8 signature on page 9?

9 A. It is.

10 Q. Is this your witness statement?

11 A. It is.

12 Q. Is it true to the best of your knowledge and belief?

13 A. Yes, it is.

14 Q. Could you turn on to tab 5 in the same bundle.

15 A. Yes.

16 Q. This is entitled "Second witness statement of Janine  
17 Melanie White". Could you turn through that document to  
18 page 97.

19 A. Yes.

20 Q. Is that your signature?

21 A. Yes, it is.

22 Q. Is this your witness statement?

23 A. Yes, it is.

24 Q. Is it true to the best of your knowledge and belief?

25 A. Yes, it is.

1 Q. I don't have any questions for you. Mr Sharpe will have  
2 questions for you and the tribunal may also have  
3 questions for you along the way. At the end there may  
4 be one or two further questions from me.

5 A. Thank you.

6 MR BEARD: Thank you very much.

7 Cross-examination by MR SHARPE

8 MR SHARPE: Good morning, Miss White. I saw you sitting  
9 patiently through the earlier proceedings. I have a few  
10 questions for you and, however long I take, I will not  
11 take as long as my friend took with Dr Bryan.

12 You tell us you have worked for United Utilities  
13 since 1987; that's correct, is it?

14 A. Yes, that's correct.

15 Q. Tell us what you did before then.

16 A. I joined what was North West Water straight from  
17 university. I did an economics degree at Bangor  
18 University in north Wales. Prior to that I had a gap  
19 year when I worked, and before that I was at school.

20 Q. You tell us you trained as an accountant?

21 A. That's correct.

22 Q. That was within North West Water?

23 A. Within North West Water, yes.

24 Q. Did your duties extend beyond accounting early on or  
25 were you an accountant for a while?

1 A. I was an accountant for about -- I'm trying to remember  
2 now -- I'm not sure if it doesn't say in there. I would  
3 have to look it up.

4 I worked as an accountant for about four or five  
5 years within the more sort of mainstream accountancy  
6 function and then I worked on capital accounting, fixed  
7 asset accounting and the management of capital  
8 programmes until the point at which -- when I talk about  
9 here, when I took on this Competition Act project, which  
10 was meant to be part time for six months and I'm still  
11 here.

12 Q. As is the Competition Act. You date that around  
13 about September 1999?

14 A. Yes.

15 Q. Tell us what this involved.

16 A. Sorry, the project?

17 Q. The project, yes.

18 A. The company was aware that the Competition Act was  
19 coming in, and at the time I had been asked -- I had  
20 actually applied for a job and got on job working  
21 outside the more traditional finance in a sort of  
22 business strategy role, and I was told that this would  
23 consist of a number of different projects which I might  
24 be asked to do at any -- whatever the company needed  
25 doing. And by the time I started this, said --

1           actually, the first thing we need to look at is this --  
2           the Competition Act, and mainly at the time this was  
3           from a compliance perspective; and I wasn't familiar  
4           with it but neither was anyone else in North West Water.  
5           So I was asked to have a look at that, see what would  
6           need to be done in terms of compliance and things. And  
7           it was envisaged as being kind of a review of what the  
8           company needed to do. What happened then was that Ofwat  
9           then said: this opens the way for common carriage, and  
10          all of a sudden it was clear that this was a big, big  
11          thing and not -- not a kind of "We need to set  
12          a compliance programme up and leave it to run". So it  
13          suddenly became a much, much bigger issue.

14        Q. In July 2000, you tell us, you were appointed  
15          Competition Strategy Manager?

16        A. Yes.

17        Q. And that was your title, and that's still your title?

18        A. Competition and Economics Manager is my title at the  
19          moment but job titles change from time to time.

20        Q. And they are not always as meaningful as they should be,  
21          perhaps?

22        A. No.

23        Q. I was puzzled, you see. You may have answered it  
24          already but I didn't think water companies faced much  
25          competition, then or now?

1 A. We certainly have to be prepared for competition. We  
2 have always faced competition from sort of  
3 non-regulated, on-site solutions. So customers have the  
4 choice -- large customers have always had the choice of  
5 having their own abstraction or coming to the water  
6 company for water, and they do that. Even, you know,  
7 now that's still the case.

8 There are more -- this happens more on the waste  
9 water side, where, large companies, you have discharges  
10 for what's called trade effluent, so where they are  
11 charged on the strength as well as the volume of the  
12 effluent. They can put in pre-treatment works in order  
13 to reduce the costs that they then pay to the water  
14 company. So there has always been -- for large  
15 customers, there has always been an alternative of doing  
16 it themselves.

17 Q. And inset appointments?

18 A. Inset appointments came in more recently. So, yes --  
19 pre-treatment has been around for ages.

20 Q. Yes.

21 A. So then inset appointments had come in, although there  
22 hadn't been a great deal of activity on inset  
23 appointments.

24 Q. That's a slight understatement. There was only one  
25 inset appointment, wasn't there?

1 A. I think there was only one new appointed.

2 Q. And that was Albion, wasn't it?

3 A. There were other appointments which were other water  
4 companies. So some of the water companies or water and  
5 sewage companies that already existed had started to  
6 have inset appointments in other areas outside of their  
7 own area. So I think if you look at Ofwat's inset  
8 register, you will see there are others.

9 Q. Were you in the tribunal on my opening?

10 A. Yes.

11 Q. I think you were, yes. And I think I took the tribunal  
12 to that schedule, I think dated 1988, where we saw  
13 32 inset appointments, 30 had -- applications. There  
14 were 32 applications, of which 30 were made by Albion.  
15 Do you remember?

16 A. I remember you taking us to it, yes.

17 Q. It was 30 out of 32 were applications made by Albion at  
18 that time. This was just before you came on the  
19 competition scene, so you can be forgiven for not  
20 knowing the full details of that.

21 So competition relates to the sewerage and disposal  
22 and that side of it, which was pretty old and  
23 established, and then we have common carriage and inset  
24 appointments and so forth. What does "strategy" mean  
25 here, in your title?

1 A. That's a good question. I think that it was intended to  
2 reflect that it was quite an open-ended role. It wasn't  
3 something where I was being told, you know, the role  
4 involves do A and do B and do C but the role involves  
5 actually understanding what's going on, working out what  
6 needs to be done and then doing something about it or  
7 tasking people with doing something about it.

8 Q. Would it be fair to say that the focus of your concern  
9 was ensuring that the company didn't really take any  
10 risks, simply because, like any other water company, you  
11 were in a dominant position and, as a result, you  
12 were -- I think you know the phrase I'm going to use,  
13 special responsibilities not to distort competition.  
14 Would that be fair?

15 A. Yes, I think that's part of it. I think it was  
16 a compliance role generally. I mean, there was more to  
17 compliance than the chapter 2 prohibition, so -- but it  
18 was compliance with the Act, understanding what kinds of  
19 compliance processes we ought to have in place, and also  
20 compliance with the requirements that Ofwat were then  
21 coming out with, relating to statements of principles,  
22 access codes and so on. So it was looking across the  
23 piece, because we do generally -- we do try to be  
24 compliant.

25 Q. I'm very grateful for that. So, basically, you had to

1           ensure that your colleagues stuck to the straight and  
2           narrow?

3       A.   Yes.

4       Q.   Yes.

5       A.   Make sure they know what the straight and narrow is  
6           first.

7       Q.   Yes, we have all heard that lament from compliance  
8           officers before.  But I think then it does follow that  
9           although you were in an important position in advising  
10          your colleagues, again would it be fair to say you  
11          weren't directly involved in marketing and business  
12          strategy?

13      A.   I definitely wasn't involved in marketing and business  
14          stage.

15      Q.   Thank you.  We know you weren't on the board of  
16          United Utilities and of course that's right.  You do  
17          mention -- because Mr Lafon, in one of his documents,  
18          referred to agreements or proposals to Albion as being  
19          approved by the Board, capital B.

20                Now, you advert to that in your second witness  
21          statement, and just simply for the reference -- there is  
22          no point in taking Miss White to it, because I'm sure  
23          you know it -- it's volume 1, tab 5, page 89 at  
24          paragraph 10.  We are reasonably clear that's not the  
25          UU board?

1 A. Yes.

2 Q. But you think it might have been another board?

3 A. I at the time wasn't aware of the email at all.

4 I became aware of it when I sort of gathered together  
5 all the documents and did a document search to try to  
6 find, you know, information for my witness statements.  
7 For the second witness statement, I went to the  
8 company secretariat and said: can you search through the  
9 company board minutes and find me this board minute?  
10 And they said there was no board minute that related to  
11 that.

12 I can only assume that Mr Lafon was referring to  
13 a board that was not a company-level board. I mean,  
14 there are meetings held within companies, there are  
15 project boards and programme boards, and there are -- if  
16 there are functional areas, there may be a board for  
17 that functional area. Nowadays we would probably call  
18 them steering groups because that's the in phrase but at  
19 the time if probably would have been called a board, but  
20 given that it's not in the UU minutes, it must have been  
21 another lower level board.

22 Q. I'm grateful for that. It's probably called a cluster  
23 group now.

24 A. I'm behind the times.

25 Q. Well, London.

1           So yes, we will have to come back to that perhaps,  
2           maybe not with you, but he called it "a board with  
3           a capital B"?

4           A. Yes, he did.

5           Q. And fairly emphatic about it. We also see mention in  
6           the evidence of something called a Sales Strategy Group.  
7           What was that?

8           A. The Sales Strategy Group was, as  
9           I understand it, a meeting that -- of the people who did  
10          the marketing and business development activity, at  
11          which they would present papers to say, you know: this  
12          is a proposal and, you know, these are the options and  
13          this is the recommend the alternative or whatever.  
14          I would have thought it would have included our --  
15          I could have looked that up if I had known you were  
16          going to ask me -- customer services director and other  
17          people who worked for him, probably the finance  
18          director, somebody like that, and they would go: yes, go  
19          ahead and pursue this, kind of, interesting line of  
20          enquiry; or, you know, go and talk to this customer or  
21          offer them this; or, no, this is too risky or we won't  
22          do that.

23          Q. Thank you very much. In the evidence, it's a capital S  
24          Sales, capital S Strategy, capital S Group. So it's not  
25          an ad hoc group?

- 1 A. No.
- 2 Q. Just to confirm, you are not on that group?
- 3 A. No.
- 4 Q. Thank you. We have to ask you this because, you see, we  
5 have not seen any minutes or records of any Board, with  
6 a capital B, or of this strategy management group --
- 7 A. No.
- 8 Q. -- and have no idea what it did. So I'm very grateful  
9 to you for informing us.
- 10 From your evidence, you first became involved with  
11 Albion's request for bulk supply in October 2000.
- 12 That's right, isn't it?
- 13 A. Yes.
- 14 Q. So, again, it would be fair to say you had no direct  
15 involvement in Albion's discussions and so forth, which  
16 I think started on or about 20 May 1999 and then were  
17 resumed in July. And simply for the record -- and  
18 I don't want to take you to this -- that's at bundle 2,  
19 tab 25, page 393.
- 20 So, for a good chunk of the pre-history, at least,  
21 you weren't directly involved?
- 22 A. No, I wasn't.
- 23 Q. Were you aware of it at all?
- 24 A. I don't think I could recollect that at this distance,  
25 to be honest.

1 Q. Thank you. In your evidence you referred to three other  
2 individuals being involved. One of them is a man called  
3 Clive Elphick.

4 A. Yes.

5 Q. What do he do?

6 A. I would have thought his title was something like Group  
7 Strategic Director. At the time he was -- he would have  
8 been on the board and he would have acted as the -- the  
9 regulation director for Ofwat purposes. You have to  
10 have somebody who is designated as the regulation  
11 director, to whom they can send those RD letters. So he  
12 would have been -- the regulation director -- well, he  
13 would have been more than that, he would have been  
14 looking at other things, like business planning and so  
15 on.

16 Q. Did you have much to do with him at all?

17 A. No.

18 Q. And then John Lafon. I think he is Head of Business  
19 Sales and Marketing; is that right?

20 A. Yes.

21 Q. Did you have much to do with him?

22 A. No, I did not have much directly to do with John.

23 Q. And John Lees, Business Sales Manager?

24 A. John Lees. Once I was asked to become involved, I did  
25 speak to John Lees because he was one of the people who

1           was already involved and was asking me about things, and  
2           I was asking -- getting information from him on, you  
3           know, what this supply was like, how it worked.

4       Q.   So he kept you briefed?

5       A.   Yes.

6       Q.   On everything?

7       A.   I wouldn't say kept me briefed on everything, no;  
8           certainly not having read the emails.

9       Q.   All right.  Just for completeness, because you are  
10           really the only person we can ask about

11           United Utilities, a couple of other names, Ken Hickman?

12      A.   Yes, Ken Hickman would have been a similar kind of level  
13           to John Lees.  Worked more on kind of business  
14           development which was out of region -- so trying to find  
15           new business out of region.  So, for example, I talked  
16           about pre-treatment plants.  We had a customer who was  
17           in another company's area whom we operated  
18           a pre-treatment plant for and he was involved in that,  
19           so more kind of on the contract side of things.

20      Q.   Thank you very much.  Just one last name: Wendy Johnson?

21      A.   So Wendy Johnson -- I think John and Ken both worked for  
22           Wendy.

23      THE CHAIRMAN:  Which John?

24      A.   Sorry, John Lees and Ken Hickman, I think, would have  
25           both worked for Wendy.  I think.  I haven't got

1           a structure from that time.

2       MR SHARPE: But that would be the pecking order?

3       A. That would be the pecking order, yes.

4       Q. What did she do?

5       A. So Wendy had a remit that covered the customers who

6           were -- the large business customers who are within our

7           area and -- but also these other customers who were kind

8           of similar large users but were outside our area, and

9           I guess she might have been a similar level to

10          John Lafon, but I'm not entirely sure about that.

11          I didn't work in that section and it's hard enough --

12       Q. I'm grateful. That's fine. She was quite a senior

13          person --

14       A. Yes.

15       Q. -- and to your knowledge fairly experienced and

16          knowledgeable about North West Water?

17       A. Certainly experienced about the area in which she

18          worked, which was within the customer department.

19       Q. Yes. Thank you.

20                So we pick up the story in October 2000, when you

21          came in.

22       A. Yes.

23       Q. Unless my learned junior has other ideas.

24                Thank you.

25                For the rest of the story, which -- I think I'm

1 arbitrarily going to say, to bring the curtain down in  
2 relation to United Utilities round about March 2001  
3 because that's where I think the paper trail ends -- for  
4 obvious reasons, with the breakdown of FAP -- did you  
5 have any direct links with Albion at all?

6 A. I don't recollect any direct links. Generally I would  
7 have been providing information to other people --

8 Q. Yes.

9 A. -- within North West Water.

10 Q. Your name doesn't appear on any of the documentation  
11 within UU in relation to Albion. So we are assuming  
12 that you were at one stage removed?

13 A. Yes.

14 Q. Were you ever blind copied to any of their  
15 correspondence with Albion? It's not a trick question.

16 A. Not generally. Sometimes I think emails -- well, from  
17 the records, I know that emails were sometimes forwarded  
18 on to me if it was felt that it was relevant.

19 Unfortunately I don't keep my records that far back.

20 Q. That explains why we haven't seen any of these emails?

21 A. Yes.

22 Q. Okay. Just to round off the point, you had no direct  
23 dealings -- I think I'm allowed to say that, that is  
24 very much Albion's view, and if necessary --

25 A. Yes, that would be my view.

- 1 Q. We are in agreement, yes. Okay.
- 2 You were familiar -- we are starting the story  
3 from October 2000 -- that in terms of its water  
4 business, you divided it into five resource zones; is  
5 that right?
- 6 A. Yes, at the time.
- 7 Q. You knew that. And by the far the largest was the  
8 integrated zone. That's right as well?
- 9 A. That's right, yes.
- 10 Q. And I think, from your own documentation, you used  
11 documentation, it accounts for about 95 per cent of the  
12 area?
- 13 A. Yes, that's right.
- 14 Q. So it is pretty big. And I think it's agreed, isn't it,  
15 that the Heronbridge pumping zone is within that  
16 integrated zone?
- 17 A. It is.
- 18 Q. Thank you. Were you aware -- I think you are, but I'm  
19 afraid I have to phrase it this way -- that Ashgrove was  
20 sold to Welsh Water by North West Water, as it was then?
- 21 A. I became aware when we started -- when I was trying to  
22 get some information about what is this supply and how  
23 is it made and how is it, you know -- so to understand  
24 the physical nature of the supply, I then became aware  
25 that this was assets that had previously belonged to

1 North West Water and that they had been transferred.  
2 I'm not sure "sold" was ever the word that was used but  
3 certainly transferred.

4 Q. Transferred, then. I'm happy to use that. You very  
5 helpfully provide some of the documentation, which, very  
6 helpfully, is the first document in the bundle. May we  
7 go to it, please. It's bundle 2, folder 2, tab 1. Do  
8 you have it?

9 A. Yes.

10 Q. Some of this is well-known us now, well-known to the  
11 tribunal, so I'm not going on detain you particularly on  
12 it. But we do see some of the pre-history of the  
13 relationship. Can we pick it up at paragraph 7. Do you  
14 see?

15 A. Yes.

16 Q. "Early in 1984 a new water ...(Reading to the words)...  
17 Shotton Paper decided to develop the paper mill on  
18 Deeside ..."

19 A. Yes.

20 Q. And then:

21 "... then sought to get their water."

22 That was within the Welsh Water area. Then we see  
23 at paragraph 8 that:

24 "Northwest entered into negotiations with  
25 Welsh Water requesting a section 13 agreement, which

1           would enable North West Water to supply the new  
2           facility, even though it was outside their area of  
3           supply."

4       A.   Yes.

5       Q.   Okay.  Then there was an internal reorganisation at  
6           paragraph 9.  Now you see this:

7           "Revised proposals were put to North West Water  
8           whereby Welsh Water would provide the supply to  
9           Shotton Paper.  The principal option available to  
10          Welsh Water was to provide this supply from the Bretton  
11          Water Treatment Works, where considerable spare capacity  
12          was available following the acquisition of the Alwen  
13          supply from North West Water."

14          Do you see that?

15       A.   Yes.

16       Q.   And it goes on:

17          "But this option would have involved the laying of  
18          a new main from Bretton Water Treatment Works at an  
19          estimated cost of £2.5 million."

20       THE CHAIRMAN:  I think it's 2.25, actually.

21       MR SHARPE:  2.25.

22       THE CHAIRMAN:  Yes.

23       MR SHARPE:  Old age, I'm sorry, I didn't see it:

24          "... 2.25 million or, alternatively, the laying of  
25          a shorter length of new main, estimated £850,000, to

1 link with the Ashgrove to Sealand main ..."

2 Sealand, I think you will recall, is where the paper  
3 mill is situated.

4 "... in which case an arrangement would have been  
5 required with North West Water for Welsh Water to take  
6 over a section of that main."

7 Do you see that?

8 A. Yes.

9 Q. It looks as if the genesis of the Heronbridge Agreement  
10 rested on the significant costs of laying it from  
11 Bretton, £2.25 million, as against laying a pipe from  
12 Ashgrove to --

13 A. Yes.

14 Q. Then the rest, I think, is of little concern to us.  
15 That's the genesis of the arrangement. But we might  
16 take it up at page 100. You quite rightly picked me up  
17 when I said "sold"; it was transferred under a statutory  
18 scheme.

19 A. Yes.

20 Q. Am I right that the consideration for this appears to  
21 have been the assumption of the outstanding debt. Do  
22 you see that in the penultimate paragraph?

23 A. Yes, and you know as much as I do on this. I have been  
24 there a long time but I have not been there since 1984.  
25 So, yes, I know what I have read in this document and

1           that's what I believe to be true.

2       Q.   But as an accountant:

3            "In addition to the above, outstanding debt of  
4       £165,000 on the assets acquired isto be taken over by  
5       Welsh Water."

6       A.   Yes.

7       Q.   I take that to be the consideration for the arrangement.  
8       Of course, I think you were in the tribunal when in my  
9       opening I pointed out that the annual profits were in  
10      the order of £700,000 or £800,000 a year. So it doesn't  
11      appear to have been a bad deal for Welsh Water in  
12      straight commercial terms, does it?

13      A.   No, it doesn't.

14      Q.   No.

15      THE CHAIRMAN: Can I just be clear: the Ashgrove System  
16      pre-dated this agreement then?

17      MR SHARPE: It would seem so.

18      A.   If I can be of assistance --

19      THE CHAIRMAN: Just let me finish my question. Did they  
20      then have it build a link between Ashgrove and Sealand  
21      for 850,000 or however much it cost? Do you understand  
22      what actually had to be done?

23      A.   Yes. It's obviously not terribly clear here, but my  
24      understanding is, the existing arrangement, which was  
25      for the two customers who were listed under 13.1 and

1 13.2, British Steel, at Shotton, and Bees Nurseries, who  
2 are not mentioned anywhere else because they have  
3 closed, a long time ago, that would have been from  
4 Ashgrove, as the case is now. And I'm sure Dr Bryan  
5 will know if that's not the case. And so I think that  
6 this 165,000 may have been an alternative to spending  
7 £850,000 providing, say, water from Bretton to Ashgrove  
8 or something like that.

9 THE CHAIRMAN: But did anything have to be built then to  
10 enable Shotton Paper to be supplied by the  
11 Ashgrove System once this transfer had taken place?

12 A. I'm not aware of anything having to be built. It's  
13 quite a considerable increase in demand. I don't know  
14 whether that then entailed some expenditure, either at  
15 Ashgrove or --

16 MR SHARPE: Madam, can I help? I'm instructed that no  
17 material expenditure was involved. As you point out,  
18 the pipeline had been there in order to service the two  
19 other customers, one of which has gone out of business.  
20 The other one is now Corus. And it was simply  
21 a question of re-arranging -- increasing the throughput  
22 through the pumps stations.

23 You will recall also the pumping stations themselves  
24 do also pump significant quantities of water into the  
25 United Utilities system as well, don't they?

1 A. They do, yes.

2 Q. So I think the way to look at this is to say 850,000  
3 against 2.25 million were the options they were  
4 discussing but in fact, at the end of the day, I'm  
5 instructed that no material expenditure was in fact  
6 incurred, except, of course, the assumption of the debt,  
7 to which my learned friends took you to earlier on, but  
8 I don't think they actually took you to the document.

9 So --

10 MR LANDERS: Sorry, when you talk about the two options,  
11 what you are saying is: at the time those two options  
12 would involve not going through Heronbridge, so they  
13 looked at two options of not going through Heronbridge,  
14 one of which cost 2.25 million and one of which would  
15 cost 850,000, and they decided that they would go with  
16 neither, they would go through Heronbridge, at no extra  
17 cost because it was already there?

18 MR SHARPE: Respectfully, absolutely right. We have the  
19 thinking process here in the documentation. So we see  
20 the transfer, if you like, the assumption of debt at  
21 165,000, and then United Utilities drops out of the  
22 picture as far as the supply of Shotton Paper is  
23 concerned, the direct supply.

24 A. The direct supply, yes. We just continued to operate  
25 the pumps and the pumping station at Heronbridge.

1 MR SHARPE: And supply the water.

2 A. And abstract the water under our abstraction licence.

3 Q. We will come back to that. So you indicated you made  
4 yourself -- you have done your homework, you have made  
5 yourself aware of this historic arrangement, and you  
6 were presumably aware this was the only way in which  
7 Welsh Water could obtain water for these customers.

8 That's right, isn't it?

9 A. They -- obviously they would have had the same options  
10 as they talk about in this paper that you just took us  
11 to.

12 Q. But they were expensive options, weren't they?

13 A. Yes.

14 Q. And they ruled them out?

15 A. Yes, but that doesn't mean they couldn't do it at some  
16 point in the future.

17 Q. No, no, no. But everything has a price?

18 A. Yes.

19 Q. But this was quite a high price. So let me put it to  
20 you that Welsh Water was really pretty dependent on  
21 United Utilities, because you had the abstraction  
22 rights, for the pumping station, and without your  
23 ability to abstract and to pump the water at that point,  
24 they would have been in some difficulty in supplying  
25 customers, the options being rather expensive ones;

1           that's right, isn't it?

2           A. I think that -- I wasn't aware, and actually I'm not  
3           particularly aware now, of the arrangement of the other  
4           supplies that Welsh Water have within the area, although  
5           I understand that there is a potable back-up supply that  
6           goes Shotton Paper, so clearly there is something in the  
7           area. So I'm not familiar with what other options they  
8           would have had. And I think that one of the -- you will  
9           come on to pricing and we will talk about that, but the  
10          point about pricing appropriately is to send the right  
11          economic signals so that whatever is the lowest cost to  
12          the economy as a whole is the thing that's undertaken.

13          Q. We will come on to that and I promise you I will  
14          question you on that but all in good time.

15          MR COWEN: Can I just clarify, while we are talking about  
16          the transfer, that North West Water are responsible for  
17          the management of the pumping station?

18          A. Yes.

19          MR COWEN: Is there any management for the Ashgrove System  
20          more generally, that North West Water was responsible  
21          for?

22          A. No, Welsh Water are responsible for the management of  
23          the Ashgrove System. They just contact -- North West  
24          Water -- well, United Utilities, as it now is, to  
25          actually ask for pumping to be started or stopped,

1           depending on the volumes of water that they need.

2       MR COWEN: Thank you. Just for clarity, so I understand the  
3           position, Ms White, if you could correct me if I am  
4           wrong, but prior to the transfer Ashgrove had been owned  
5           and managed by North West Water, hadn't it?

6       A. That's correct.

7       Q. So, as part of the transfer, it went over to  
8           Welsh Water. You will also know that none of  
9           United Utilities' other supplies were connected to  
10          Ashgrove. That's right?

11      A. Yes, none of our other supplies were connected to  
12          Ashgrove.

13      Q. I just had to round off the point. So Ashgrove gets its  
14          water from Welsh Water, through assets, pumping station,  
15          which is still owned by United Utilities, and through  
16          Ashgrove, which had formerly been owned by  
17          United Utilities, now by Welsh Water.

18                Let's turn to the agreement, the Heronbridge  
19          Agreement, and that's at bundle 2 of folder 2. I'll  
20          assume that you are pretty familiar with this agreement?

21      A. Yes.

22      Q. When did you first see it?

23      A. It would have been about the same time, around  
24          about October 2000. As I mention in my statement, one  
25          of the things that had been identified -- I had

1 identified as needing to be done in order to understand  
2 the impact of the Competition Act was to look at all  
3 agreements for supply of water, whether they were  
4 special agreements with customers or bulk supplies, to  
5 ensure that we thought that those agreements were  
6 compliant. And, because of this coming up, this was one  
7 of the first ones that I looked at. It became  
8 a priority to actually look at this agreement to try to  
9 understand and -- to look at it and see whether we  
10 thought it was compliant.

11 THE CHAIRMAN: Compliant with what?

12 A. The Competition Act, sorry. The Competition Act 1998  
13 coming into fore.

14 THE CHAIRMAN: You said, "because of this coming up, this  
15 was one the first" --

16 A. Because of the approach from Albion Water --

17 THE CHAIRMAN: For bulk supply.

18 A. For a bulk supply -- it became important to have a look  
19 at this one.

20 MR SHARPE: What were you told about the agreement?

21 A. I was told about the agreement that it was -- quite  
22 a lot probably. I was told that the assets had  
23 transferred, that they had previously been ours, that  
24 for some time the situation had operated a bit  
25 informally, without a formal agreement, and that then an

1 agreement was put in place that reflected what had  
2 already been taking place.

3 Q. Yes. Were you told that it purported to be  
4 cost-related?

5 A. I can't remember if I was told or not but I have read  
6 the agreement.

7 Q. Yes. Did anyone suggest to you -- and we are talking  
8 now in straight cash terms here -- that United was  
9 losing money on the deal?

10 A. I don't think anybody put it to me in those terms, no.

11 Q. I wonder if the terms they put it to you were like this:  
12 it is our water, we sell it to Welsh Water for  
13 thruppence, and they are making a fortune out of Shotton  
14 and perhaps Corus.

15 A. I don't recollect that coming up. I think the concerns  
16 about cost were probably more mine.

17 Q. Yes. I haven't really talking about cost, was I?  
18 I think I was talking about, to use our language,  
19 "profits foregone"?

20 A. I would not have thought about it in those terms. I was  
21 more concerned about the actual cost.

22 Q. Understood. Let's go to the agreement quickly. The  
23 tribunal is familiar with this so I'm not going on  
24 detain you long.

25 We know from clause 7B that it entitles Welsh Water

1 to a maximum quantity of supply of up to 36 million  
2 megalitres a day. That's right, isn't it?

3 A. Not 36 million megalitres.

4 Q. 36 megalitres per day. Yes. And clause 9 provides  
5 Welsh Water to contribute to any capital expenditure in  
6 Heronbridge to the extent that it is of benefit to the  
7 Ashgrove supply. You can see that as well?

8 A. Yes.

9 Q. And at clause 11 we see that the agreement provides for  
10 United to:

11 "... determine each year the actual cost  
12 attributable to Heronbridge in respect of capital  
13 financing, charges, fixed operational costs and  
14 overheads."

15 That's right, isn't it?

16 A. Yes.

17 Q. And while the entitlement of up to 36 megalitres a day  
18 remains, Welsh Water is required to pay 22 per cent of  
19 those costs. That's right, isn't it?

20 A. Yes.

21 Q. Yes. And we are assuming that 22 per cent represents  
22 the proportion of water pumped at Heronbridge -- being  
23 the proportion of Heronbridge's capacity which  
24 36 megalitres represents each day?

25 A. That's my understanding.

1 Q. That's right. And the rest is pumped into the  
2 United Utilities system?

3 A. Yes, it is.

4 Q. That has been our assumption all along, and I'm grateful  
5 for you clarifying it.

6 And it's not just those costs. 11(b) refers to the  
7 actual cost of abstraction licences levied by -- it's  
8 now the Environment Agency, isn't it?

9 A. Yes, it's now the Environment Agency.

10 Q. Right. In a sense, it doesn't matter how much water  
11 Welsh Water takes, they are still liable for those  
12 costs, whether they take 36 megalitres a day or 1 litre?

13 A. For those costs, (a) and (b).

14 Q. Yes. And you are reminding me that electricity costs  
15 would be deducted from that because they wouldn't have  
16 been incurred in --

17 A. Yes, so they are more variable.

18 Q. That's right. That's 11(c), isn't it?

19 A. Yes.

20 Q. Thank you. That's based upon actual consumption?

21 A. Yes.

22 Q. So, on a straightforward view, this is a cost-related  
23 agreement, isn't it?

24 A. It's related to some of the costs, yes.

25 Q. Yes. Costs-related? Right. And those costs have been

1 identified. Let's just clarify that last answer. It's  
2 costs related to all of the accounting costs identified  
3 there, isn't it?

4 A. But they are not all of the accounting costs. So, for  
5 example, it's related to fixed operational costs --

6 Q. Yes.

7 A. -- but not to variable operational costs, other than the  
8 electricity.

9 Q. Are they material?

10 A. They can be.

11 Q. Such as?

12 A. For example, one of the things that we have been unable  
13 to recover under the contract has been operational  
14 maintenance of the pumps. So some maintenance of assets  
15 can be capitalised and is a fixed cost and would fall  
16 under the other -- the paragraph we looked at earlier --  
17 I think it's 9 -- but maintenance in terms of visits by  
18 an engineer -- a field service engineer, who would come  
19 out to inspect pumps to ensure that they are operating  
20 satisfactorily, to lubricate them and to do some minor  
21 repairs, would all be operational costs; and those are  
22 variable operational costs, they are not fixed.

23 Q. I'm very grateful for that. Can we turn now to  
24 folder 9, please. I'm afraid we are all going to find  
25 folder 9, tab 315, a little difficult for reasons which

1 will be obvious.

2 Let's go to page 3009, tab 315, page 3009.

3 Ms White, for somebody who can't tell a quarter from  
4 a half in the bundle, this has been a challenge to me,  
5 but do you have it in front of you?

6 A. I do.

7 Q. Yes. Do you recognise this document?

8 A. Yes, I do.

9 Q. What is it?

10 A. It's a supporting back-up to an invoice from  
11 United Utilities to Welsh Water, to recover -- well,  
12 from North West Water, as it was at the time.

13 Q. Yes. And these would be sent annually, wouldn't they?

14 A. I think at some periods they may have been -- they  
15 normally would be billed semi-annually but that would be  
16 based on an estimate and then this is the -- this would  
17 be the true --

18 Q. The annual reconciliation?

19 A. Yes.

20 Q. Yes, fine. I think the first entry beneath the heading  
21 "Summary of recharges to Hyder" is financing charges; is  
22 that right?

23 A. Yes.

24 Q. Can you see that split into two parts?

25 A. Yes.

- 1 Q. One is, I think, "Current costs depreciation charges".  
2 Is that right?
- 3 A. Yes, the first line is "Current cost depreciation."
- 4 Q. Thank you. And the second line is a financing charge  
5 based upon the net book value?
- 6 A. That's correct.
- 7 Q. That's right. Have I got this right: United Utilities  
8 are getting both depreciation and a return on capital  
9 employed. Is that right?
- 10 A. Yes, but -- yes, that's correct.
- 11 Q. And Welsh Water is paying 22 per cent of that?
- 12 A. Correct.
- 13 Q. Thank you.
- 14 THE CHAIRMAN: Just remind me who Hyder is?
- 15 MR SHARPE: Hyder, I understand, was the parent company of  
16 what was Welsh Water, which then bought Swalec and then  
17 decided it could go into M4 management, and then went  
18 bust and I think was sold for a pound and, as my friend  
19 put it, a lot of debt. Welsh Water was sold for a pound  
20 and a lot of debt.
- 21 A. I think Hyder was bought by Western Power Distribution,  
22 who didn't want Welsh, they only wanted the electricity.
- 23 Q. That's right. That would have been the contracting  
24 party, presumably, or -- no, Welsh Water would have  
25 been ... anyway.

1           We also see from this, just, that Welsh Water pays  
2           its share of the abstraction charges. Is that right?

3           A. Yes, that's correct.

4           MR BEARD: I'm sorry, Mr Sharpe, I don't know if it assists  
5           but there is actually a clean copy of this document at  
6           tab 357, just for ease of reading. It's in  
7           bundle 9A. I don't want to take you out of your way,  
8           but given the concerns about reading it.

9           MR SHARPE: I can read it through but I'm much obliged to my  
10          friend. Give me the reference again.

11          MR BEARD: It's tab 357 in folder 9A. It's the identical  
12          document. It's just not got the background texture.

13          A. That's much better.

14          MR SHARPE: I think all is now clear. I think I can say for  
15          once I'm grateful for the duplication in the bundle.

16                 Thank you.

17                 But I think -- we are drawing to a close but  
18                 nevertheless -- and we see -- we have been through the  
19                 abstraction charges; we see that Welsh Water pays its  
20                 share of the power costs based on actual metered  
21                 consumption. That's right, isn't it?

22          A. Yes.

23          Q. And finally it pays its share of the operating costs  
24                 involved in the pumping station. Am I right you are  
25                 going to caveat your reply by reference to matters which

- 1           you say are not included in the accounting?
- 2       A.   Yes.
- 3       Q.   Thank you.  I think we can put away that particular  
4       bundle for the moment.  Thank you very much.
- 5           I'm not going to take you to it but your witness  
6       statement at paragraph 20 refers to the Heronbridge  
7       Agreement as being a non-costs reflective agreement?
- 8       A.   Yes.
- 9       Q.   Let's try to cut through to this.  You do not mean those  
10      aspects of cost to which you drew attention a moment  
11      ago, which are not included in the accounting, do you?
- 12      A.   No, I don't.
- 13      Q.   You are referring to, if I can put it in shorthand, an  
14      economist's view of costs, being the opportunity cost,  
15      rather than the accounting cost.  Would that be right?
- 16      A.   Yes, that would be correct.
- 17      Q.   We will come on to that in a minute, and that might be  
18      the reason why United Utilities did not suggest in its  
19      subsequent application to have this agreement varied  
20      under section 40, that the price wasn't cost-reflective  
21      in the accounting sense.  That's right, isn't it?
- 22      A.   Yes.
- 23      Q.   Or that you were losing any money on it?
- 24      A.   Yes.
- 25      Q.   If you had been losing money, that would have been one

1 of the reasons that Ofwat should have taken into account  
2 in assessing whether or not it should have been  
3 renegotiated?

4 A. If they had decided to accept the application, yes.

5 Q. If they -- yes. I'll come back to that but if it had  
6 met their criteria --

7 A. If it had met their criteria, then it would have  
8 considered --

9 Q. -- then they would have considered whether or not you  
10 were earning a reasonable return, in the statutory  
11 language of section 40A(7), to which I took the tribunal  
12 in opening.

13 Let's go to that application at bundle 4, tab 166.

14 Do you recognise this document?

15 A. Yes, I do.

16 Q. Yes. Would it be fair to say you wrote it?

17 A. Yes.

18 Q. Please describe the document. What is it?

19 A. It was a letter from me to George Day, who was Head of  
20 Water Resource Economics at Ofwat, letting him know that  
21 we were intending to seek for a section 40A, since it  
22 isn't an application in itself, because that would have  
23 to go at the time to the Director General, and -- I'm  
24 just checking -- I think I may have said I wanted to  
25 discuss it with him. I'm not sure.

- 1           But certainly to let him know.
- 2       Q.   So the third full paragraph describe the statutory  
3           background, which we have discussed?
- 4       A.   Yes.
- 5       Q.   Then the last paragraph on page 1037 relays what you  
6           have already told us about the relatively informal  
7           arrangement that existed.
- 8       A.   Yes.
- 9       Q.   Lays down conditions for charging, which are that DCC,  
10           Welsh Water, pay the direct operating costs associated  
11           with their part of the abstraction. Then running  
12           through essentially the invoice I have just taken you  
13           to?
- 14      A.   Yes.
- 15      Q.   That's right, isn't it. Then you talk about the costs:  
16           "This has historically been equivalent to 3p per  
17           cubic metre."
- 18      A.   Yes, at the time.
- 19      Q.   At the time, yes. It talks about variation by  
20           agreement. The third paragraph refers to  
21           United Utilities opening up negotiations with  
22           Welsh Water:  
23           "... regarding amending the price and other contract  
24           conditions of the bulk supply in ..."  
25           I think that's November 2000.

1 A. It is.

2 Q. And they have proceeded slowly, and ultimately Welsh  
3 have refused to agree to any variation in the current  
4 contract. That's right, isn't it?

5 A. Yes.

6 Q. Now, this is a letter dated 21 January 2002. So you had  
7 had a -- date received, on the 21st, and it's dated the  
8 18th, I think, isn't it?

9 A. Yes.

10 Q. Sorry, let's have that up. Right. Now then, you say  
11 that you believe that:

12 "... the current contract conditions do not secure  
13 the efficient use of water and are also potentially  
14 discriminatory and anti-competitive."

15 This is you writing, isn't it?

16 A. Yes.

17 Q. You report that you have received an approach from  
18 Albion requesting bulk supply, which, of course, is  
19 entirely accurate:

20 "... to replace the current bulk supply from  
21 Welsh Water to Albion Water."

22 Then you say:

23 "This wouldn't change the operation of our export at  
24 Heronbridge."

25 That's right?

1 A. No, there wouldn't be any change.

2 Q. It's paperwork, really?

3 A. Yes.

4 Q. You would be supplying water to Albion directly rather  
5 than supplying Welsh Water who then supply Albion. Then  
6 you say:

7 "In order to provide this supply, the agreement  
8 between ourselves and Welsh Water would need to be  
9 varied, variations which they have refused to agree."

10 That's right, isn't it?

11 A. That's right.

12 Q. What had you in mind in relation to variation there?

13 A. There were a number of -- well, there were a number of  
14 aspects which we believed needed to be varied. We  
15 certainly would have preferred Welsh Water's contract to  
16 reflect the fact that they were no longer taking this  
17 water and that they didn't unnecessarily reserve water  
18 which they were not going to use. There were metering  
19 issues, which meant that, without an agreement between  
20 the three parties as to how much water was taken by  
21 Welsh Water and how much was taken by Albion, we would  
22 be unable to bill both the parties, so there is no --  
23 it's a single pipe that comes out from Heronbridge and  
24 there was no way that we could meter Welsh and Albion  
25 separately. Therefore we relied upon coming to an

1 agreement -- and there is a number of ways in which you  
2 could do that, because there are issues around how much  
3 water is leaked out of the pipe -- Welsh's pipe on the  
4 way, and then -- and is used in the water treatment  
5 process. So you need to come to an agreement that  
6 either says, "We measure you both and then we use those  
7 proportions", or "We measure Albion's and say they pay  
8 for that and Welsh pay for the rest". Well, Welsh would  
9 have to agree that that was what was going to happen.

10 Q. These are important matters --

11 A. And other --

12 Q. Yes, of course. Let's pick them up over the page, 1039,  
13 where you go into some detail -- not a lot of detail, it  
14 must be said, in a page and a bit. Let's start off with  
15 volume supplied. You see the maximum quantity,  
16 36 megalitres a day, and we know about that?

17 A. Yes.

18 Q. But then you correctly point out that following the --  
19 if this went through, Welsh Water would only need enough  
20 to supply Corus. That's right; isn't it?

21 A. Yes.

22 Q. About 6 megalitres a day?

23 A. Yes.

24 Q. Did it ever occur to you that Welsh Water could find  
25 a use for the other 22 megalitres?

1 A. Yes.

2 Q. Realistically?

3 A. I didn't consider it to be realistically. They already  
4 had -- they were already taking 10 megalitres less than  
5 the contract allowed them to take. 10 megalitres a day  
6 is a lot of water, it's quite a sizeable amount.

7 Q. It's ten Olympic swimming pools.

8 A. Every day.

9 Q. Every day, yes. They had that surplus.

10 A. And they had not shown any indication this they were  
11 going to find a use for that 10 megalitres, so having  
12 some more to use didn't necessarily seem likely that  
13 they would use it.

14 Q. Thank you. We see the payment terms here:

15 "Current agreement specifies no payment terms ..."

16 I suppose that's strictly true, isn't it?

17 A. Yes.

18 Q. But then:

19 "... prepared to agree any reasonable payment  
20 terms ..."

21 And so on, but then at the bottom:

22 "Price. For reimbursement of costs incurred as  
23 described ...(Reading to the words)... fails to ensure  
24 the efficient use of water and restricts potential  
25 competitive entry."

- 1 A. Yes.
- 2 Q. You say:
- 3 "The proposed price ..."
- 4 Here we are again, just to remind you, January 2002:
- 5 "... is 12p per cubic metre, and that price is
- 6 supported by the estimated regional LRMC of this element
- 7 in the supply chain."
- 8 Over the page you say:
- 9 "The current price [3p] is significantly below LRMC
- 10 and as such may conflict with Ofwat's guidelines on the
- 11 application of the Competition Act."
- 12 Pausing there, I can understand an argument based
- 13 upon economic efficiency and long run marginal cost, and
- 14 we will deal with that later; you are saying that this
- 15 is -- the existing price is well below long run marginal
- 16 cost, in your view?
- 17 A. Yes.
- 18 Q. Sends the wrong signals, doesn't encourage Welsh Water
- 19 to think of alternative methods of supply?
- 20 A. Yes.
- 21 Q. They can be a bit lax on leakage and all the sort of
- 22 efficiency type arguments with which economists are
- 23 familiar. What's the competition point here?
- 24 A. I think I'm right in saying that the guideline says that
- 25 prices that are above long run marginal cost would not

1 be deemed to be predatory.

2 Q. I see, your concern was predation.

3 Now, implicit in that reply -- and it's not meant to  
4 be a trick at all -- if you weren't in a dominant  
5 position, it wouldn't be an issue, would it?

6 A. No, it wouldn't.

7 Q. So I'll put it like this. There is a strong arguable  
8 case that you might have been in a dominant position?

9 A. Well, I think I say it may conflict, and our position on  
10 dominance in any event would be that dominance would  
11 have to be proved.

12 Q. Of course.

13 A. However, we would -- in this case, it would seem far  
14 more --

15 Q. Prudent?

16 A. Yes, "prudent" is a good word. Far more prudent to  
17 operate on that basis in order to avoid any sort of  
18 potential issues.

19 Q. I just want to examine very briefly the scenario that's  
20 implicit here. I think I understand a little bit about  
21 predation but the idea is -- and correct me if I am  
22 wrong -- if you price below marginal cost -- forget  
23 about long and short run at the moment.

24 A. Yes.

25 Q. The argument goes: that can only really be justified on

1 the basis that you are trying to exclude somebody from  
2 coming into the market, because only an idiot would make  
3 losses on each incremental unit of output.

4 A. Yes.

5 Q. That's the theory, isn't it? And the short run and long  
6 run doesn't matter. If I remember the case correctly --  
7 and there is always a big "if" there -- if you don't  
8 cover that, then it's virtually automatic it would be an  
9 abuse, wouldn't it?

10 A. I'm not familiar with the case law, I'm sorry.

11 Q. I understand. I wasn't asking for a legal opinion but  
12 this is where you are coming from?

13 A. Where I'm coming from, yes.

14 Q. At this point. We have established you have the  
15 abstraction rights on the River Dee.

16 A. Yes.

17 Q. In order for this to be a valid concern, you have to  
18 have some notion about what sort of competition is being  
19 distorted; yes?

20 A. Yes.

21 Q. What competition had you in mind?

22 A. Well --

23 Q. Allow me to rephrase it and make it clearer.

24 A. Okay.

25 Q. Who else did you envisage supplying Shotton?

1     A. I think there could be -- there could any number of  
2       potentials that you could envisage. So, for example --  
3       and it doesn't necessarily have to be Shotton Paper  
4       because the supplier supplies another customer, and  
5       there could be potential other customers in the area.  
6       But for a supply in the area there could be -- you know,  
7       there may be other supplies. We certainly know that  
8       there is the Halkyn Mountain supply, Milwr Tunnel,  
9       I think it's called in some of the papers that are in  
10      here, which Western Power Distribution were trying to  
11      sell at that time, and in the end we bought it, but that  
12      supply would be a potential supply -- infrastructure  
13      pipes would have to be laid. Clearly if the end price  
14      is going to be 3p plus some capital, whenever the  
15      capital comes about, it may not be worth doing that,  
16      whereas a price that's more appropriate might mean that  
17      the Milwr Tunnel, which has a lot of spare capacity,  
18      would become an economic option.

19     Q. So this is an example of you putting your colleagues on  
20       the straight and narrow, so: don't look at the  
21       accounting costs because they don't really reflect the  
22       true economic cost?

23     A. Yes.

24     Q. And we run the risk of a predation charge because we are  
25       probably in a dominant position so watch out?

- 1 A. Yes, we may be.
- 2 Q. Then you go on, you would intend to supply both  
3 Welsh Water and Albion at the same price in order to  
4 comply with licence condition E?
- 5 A. Yes.
- 6 Q. We haven't heard a great deal about licence condition E;  
7 could you remind us what it says?
- 8 A. I could, and I think this is an error in the letter but  
9 it reflected my understanding at the time.
- 10 So all of the water and sewerage -- or water-only  
11 companies have a licence condition, a number of licence  
12 conditions, which are all lettered. So licence  
13 condition E, as part of it, requires that companies  
14 don't show undue discrimination at -- I couldn't give  
15 you the exact wordings -- between different classes of  
16 customers. So that doesn't mean you can't charge  
17 individual customers differently but the way in which  
18 you charge that class needs to not discriminate.
- 19 Q. And maybe show undue preference as well?
- 20 A. Yes, it may well -- I'm sure we will have it in the  
21 papers somewhere.
- 22 Q. Don't worry. So you treat like parties like?
- 23 A. Yes.
- 24 Q. Thank you very much.
- 25 A. At the time -- and this was clarified later by Ofwat in

1 another circumstance -- they pointed out that they  
2 didn't consider bulk supplies to be covered by licence  
3 condition E, but this reflected my understanding at the  
4 time.

5 Q. But you were on the right lines, though, because if you  
6 were in a dominant position, you would have a very firm  
7 obligation not to discriminate and show --

8 A. Yeah, I mention the Competition Act as well.

9 Q. Absolutely.

10 A. And that would still be the case.

11 Q. Thank you. So we have reached the position that United  
12 was covering its costs, obtaining a return on capital  
13 under the Heronbridge Agreement --

14 A. Some of its costs.

15 Q. Some of its costs. There are so many things in  
16 contention in this case, why shouldn't we add another  
17 one?

18 But you were unhappy, you United, with the  
19 arrangements?

20 A. Yes.

21 Q. You were unhappy from a sort of professional compliance  
22 standpoint?

23 A. Yes.

24 Q. But I put it to you once again, these assets,  
25 transferred for essentially a song, looking back --

1 A. Yes.

2 Q. -- to Welsh Water, were generating huge sums of money  
3 for Welsh Water, and they weren't doing it with their  
4 own water, they were doing it with your water --

5 THE CHAIRMAN: Can I just ask, did you know when you wrote  
6 this letter -- or are you coming to that?

7 MR SHARPE: No, no, please.

8 THE CHAIRMAN: Did you know, when you wrote this letter, the  
9 price that Dwr Cymru was selling the water to  
10 Shotton Paper?

11 A. Yes.

12 THE CHAIRMAN: You did?

13 A. Yes, I think it would have been in the special  
14 agreements register at the time.

15 THE CHAIRMAN: So it was in your mind?

16 A. Yes. I would like to address -- am I allowed to do  
17 that?

18 MR SHARPE: No.

19 A. Okay, you carry on.

20 THE CHAIRMAN: I think just answer --

21 MR SHARPE: I think you have answered the tribunal's  
22 question, which indeed was my own.

23 THE CHAIRMAN: Yes.

24 MR SHARPE: Would this be a convenient moment to adjourn to  
25 allow our stenographers a moment's respite?

1 THE CHAIRMAN: Yes.

2 MR SHARPE: I'm about to move on to another topic anyway.

3 THE CHAIRMAN: Are you? Away from this letter?

4 MR SHARPE: I was planning to.

5 THE CHAIRMAN: Let me just ask one question. This letter  
6 that you wrote, was this your idea or did someone  
7 suggest getting the ball rolling on a section 40A -- how  
8 did it come about that this section 40A route was  
9 starting to be considered?

10 A. I can't remember if it was my idea, but it would  
11 certainly have been something that I would have put  
12 forward as a possibility. We are negotiating with Welsh  
13 Water; they are not prepared to vary the agreement; is  
14 there another -- can we terminate it? No. Can we --  
15 there was no kind of provision to deal with the  
16 agreement other than a section 40A. So I certainly  
17 would have been aware of it, and if I didn't suggest it,  
18 then somebody else would have suggested it.

19 THE CHAIRMAN: When you say you would have put it forward,  
20 put it forward to whom?

21 A. Who would it have been at the time? At the time it  
22 would have been either to Wendy Johnson or to another  
23 manager who I worked for for a while, called  
24 John Farmer, both of whom would have worked for our  
25 Director of Customer Services, Bob Armstrong, and it



1 A. It looks like a letter from our head of legal to Ofwat's  
2 head of competition. I don't specially recognise it but  
3 I'm sure I will have seen it at some time in the past.

4 Q. Yes. What it is essentially -- it's not that relevant  
5 but basically you were dragged into the Albion  
6 complaint.

7 A. We were.

8 Q. Yes. And Ofwat asked you for advice, exercising its  
9 powers under section 26?

10 A. Yes.

11 Q. Information, not advice. I just want to take you  
12 briefly, please, over the page at page 1076.

13 A. Yes.

14 Q. You read at 4(a):

15 "The maximum daily volume of water that could be  
16 abstracted from the River Dee at Heronbridge under the  
17 Heronbridge abstraction licence is 236.39 megalitres."

18 A. Yes.

19 Q. Then:

20 "Subject to the aggregate limit for the three  
21 abstraction points ..."

22 Which I'm not going to detain you. So we have an  
23 overall figure of 236.39 megalitres?

24 A. Yes.

25 Q. And then if we go over the page at 1077, at 4(c) in the

1 middle of page, we're moving from the maximum permitted  
2 under the abstraction licence to the actual average  
3 daily volume of water abstracted from the River Dee?

4 A. Yes.

5 Q. Do you see the column of numbers? The data goes back  
6 to January/March 1999, and then it's annual data up to,  
7 broadly, the date of the letter. Do you see that?

8 A. Yes.

9 Q. So the figure for the average from 1 January to  
10 31 March 1999 was 138.77 megalitres, and it seems to  
11 have fallen by three something megalitres in the period  
12 1 April to 5 August 2002.

13 A. Yes.

14 Q. That's correct, isn't it?

15 A. Yes.

16 Q. So there is quite a difference between the two numbers,  
17 236 against 135. So there was plenty the headroom. If  
18 you wanted to, subject to adequate pumping and piping  
19 and everything else, you had the right to take out more  
20 water from the river. That's right, isn't it?

21 A. I think that the question of whether there is headroom  
22 would depend on how much was being abstracted at the  
23 other points that were part of the conjunctive licence.

24 Q. Yes.

25 A. So the licence has -- as I understand it, there are

1           licences that have individual volumes but then there is  
2           an overall cap which is lower than the sum of the  
3           individual volumes.

4       Q.   I think that's clear from the caveat in 4(a)?

5       A.   Yes.

6       Q.   And I'm not sure we actually have any data --

7       A.   That's what I was looking for.

8       Q.   -- on the difference; I have not been able to find it.

9           And we are sure, of course, that water was abstracted  
10          from the other points?

11      A.   Oh, definitely abstracted from the other points.  One of  
12          the other points is one of our major treatment works.

13      Q.   Yes.  But I'm putting it to you that on these facts the  
14          other stations would have had to have somewhere in the  
15          order of 100 megalitres because that's the surplus.

16      A.   Well, the other sources, the other abstraction points,  
17          would have had individual caps at those points.

18      Q.   Yes.

19      A.   But also there is an overall you can't take any more off  
20          the river on this stretch than this much altogether.  So  
21          whether, if you took -- how close we were to that as  
22          a whole for those particular years, I can't say.

23      Q.   We don't know.

24      A.   And it may not necessarily be relevant because what's  
25          relevant is how close we are in a dry year, where there

- 1 is the possibility of a drought.
- 2 Q. Yes. I thought you were going to say it's not relevant  
3 because we are only interested in the Heronbridge cap.
- 4 A. No, because if we were taking less at Heronbridge, then  
5 we will be taking more at the Huntington Water Treatment  
6 Plant, for example.
- 7 Q. I don't think the evidence --
- 8 A. We don't have the numbers, so we are not able to say.
- 9 Q. Let's look at the question more broadly. Let's look at  
10 the overall picture of the water position in the Dee  
11 area. We are going to pick it up at folder 2 at tab 26.  
12 Folder 2, tab 26. It's paginated at 395A. In fact I'm  
13 only going to take you to one small bit of it. Do you  
14 recognise this document?
- 15 A. I recognise this document.
- 16 Q. And what is it?
- 17 A. It's a report that was done by a consultancy called  
18 Oxford Economic Research Associates, or Oxera, for  
19 North West Water, looking at the Deeside area.
- 20 Q. But it was actually commissioned, wasn't it, to consider  
21 the options in relation to the Albion application?
- 22 A. Certainly to consider the options in supplying customers  
23 in the area, not necessarily -- but possibly supplying  
24 Shotton Paper directly, and Corus -- or British Steel,  
25 as it was then.

1 Q. If one looks at the executive summary over the page --  
2 I just want to complete the point -- at 395B, if it  
3 wasn't specifically to deal with Albion, certainly the  
4 suggestion is that Albion was the catalyst for it.  
5 Would be that fair?

6 A. Yes.

7 Q. Thank you. If we go very quickly to page 395T -- I'm  
8 going to take to you the middle of the page as stated in  
9 3.2, but I really don't think there is any necessity at  
10 this stage to take to you solutions 3b and 4b, as they  
11 have no particular bearing on the case. But it's simply  
12 making the point that:

13 "Future demand from Shotton Paper ..."

14 If that's a redaction, it can only be Corus, but:

15 "As stated, the future demand from Shotton Paper and  
16 whatever site combined is likely to be in excess of that  
17 provided for under the Heronbridge agreement.

18 Therefore, North West Water would have to ensure that it  
19 operated within its web of abstraction limits for the  
20 Dee."

21 Then it goes on:

22 "In 1998 North West abstracted [whatever] megalitres  
23 from the Dee, compared with a maximum limit of  
24 686 megalitres a day."

25 A. Yes.

1 Q. "The reported level of North West abstraction has also  
2 been in constant decline since 1995. Therefore, it  
3 should at least be possible for North West to  
4 accommodate the forecast increase in demand ... "

5 It goes on:

6 "... by these solutions."

7 But then there is the concern about the reduction of  
8 the abstraction licence. Did you read that?

9 A. Yes.

10 Q. The important point for us is there was a growing  
11 surplus resulting from a decline in demand, I think,  
12 from those two customers. Is that fair?

13 A. It's not just those two customers; it's customers  
14 generally who were on that supply system, and it would  
15 certainly appear that there is a falling demand in the  
16 short-term, yes.

17 Q. And you were well aware of this in your time from  
18 October 2000, weren't you?

19 A. No, I wasn't.

20 Q. You weren't?

21 A. I was only aware of this report when it was provided --  
22 I think when it was provided to the CAT, although  
23 I think it had been provided to Ofwat under a section 26  
24 that I wasn't closely involved in because I was on  
25 holiday.

1 Q. You've answered in terms of the report but in terms of  
2 the information it contains, whether or not the area was  
3 in surplus, you were aware of that at the time?

4 A. I would have been aware -- I certainly got information  
5 about the usage in the short-term but that wasn't  
6 particularly as important as the long-term information.

7 Q. No, all right. And the decline?

8 A. Yes.

9 Q. Yes, thank you.

10 A. Which is all forecast in the water resource management  
11 plan.

12 Q. Indeed, yes, we will come on to that, thank you.

13 So if we take it up then at the same bundle at  
14 tab 21, I suspect you know this document very well. Is  
15 that right?

16 A. I certainly would have done at the time, yes.

17 Q. Yes. This is the Ofwat document dated 31 March 1999,  
18 entitled "Publication of long run marginal cost data".  
19 That's right, isn't it?

20 A. Yes.

21 Q. Appended to this, I think -- I'm sorry, I have been  
22 reminded -- I just assumed this was appended but it  
23 isn't, so I'm going to take you immediately to another  
24 document, which you are probably even more familiar  
25 with, which is at page 382B. I assumed that it was in

1 the same tab. What is this document?

2 A. This is our water resources plan.

3 Q. What is a water resource plan?

4 A. A water resource plan is a 25-year plan for supplying  
5 customers with forecasts of demand and supply and  
6 with -- based on a level of service, in order that there  
7 is enough water to avoid having a hosepipe ban more  
8 frequently than a given number of years.

9 Q. Yes. How often do you produce it?

10 A. Every five years.

11 Q. So it rolls forward for 25 years every five years?

12 A. Yes.

13 Q. Yes. Let's pick it up at page 382H. We start at the  
14 top. The heading is, "Initial supply/demand balance".

15 We see:

16 "If leakage were to be maintained at 1988/1999  
17 ...(Reading to the words)... introduced, dry year demand  
18 for water, referred to as baseline demand, would be  
19 increase by 5 per cent across the region by 2025, with  
20 some significant local variations."

21 A. Yes.

22 Q. Yes. If we pick it up in the next paragraph, that deals  
23 with the integrated zones:

24 "Supplies to the integrated resource zones would be  
25 adequate ...(Reading to the words)... some distribution

1 reinforcement to the supply system would be necessary in  
2 the short run."

3 A. Yes.

4 Q. Okay. Take it over the page to 382I. We have the  
5 demand management strategy?

6 A. Yes.

7 Q. Do you see that?

8 A. Yes.

9 Q. I'm right, aren't I, that you were planning to:

10 " ... substantially reduce demand for water through  
11 very significant investments in further leakage  
12 reduction and a household metering programme, as well as  
13 enhancing our other demand management actions."

14 A. That's correct.

15 Q. Then we have your details of the leakage reduction  
16 programme and that indicates what you were planning to  
17 do.

18 A. Yes.

19 Q. We continue:

20 "Our substantial investment in leakage control  
21 measures."

22 The numbers don't concern us but then it goes on:

23 "These leakage savings, which reflect the expected  
24 profile of mandatory leakage targets, will result in  
25 a modest supply surplus for the major part of the region

1 during the period up to 2015."

2 "Mandatory leakage targets" means essentially that  
3 Ofwat were going to tell you to do this and you were  
4 really ahead of the game. Is that right?

5 A. I couldn't say whether it was Ofwat or the Environment  
6 Agency, who would have been called the National Rivers  
7 Authority, probably, then.

8 Q. Yes, thank you. It's fair to say, isn't it, that  
9 leakage, in particular, was of a technical and almost  
10 a reputational issue as well because you have to justify  
11 your charges to customers?

12 A. Yes.

13 Q. And if water is simply being wasted, people get fed up  
14 paying for it, and who can blame them? That's right,  
15 isn't it?

16 A. Yes, that's right.

17 Q. So Ofwat and the Rivers Authority -- Ofwat, I think, was  
18 involved -- were keen for all water companies to reduce  
19 their leakage for all sorts of reasons. That's right,  
20 isn't it?

21 A. Yes, that's right.

22 Q. And you too were concerned about leakage because it's  
23 one of your arguments in relation to long run marginal  
24 cost, isn't it?

25 A. Yes.

1 Q. So it's fair to say you didn't have much choice in the  
2 matter; you had to embark upon this expenditure whether  
3 you liked it or not?

4 A. Yes.

5 Q. That's right, isn't it? Yes, okay. That would be true  
6 whether the region was in balanced supply and demand,  
7 wouldn't it?

8 A. We would have been in discussion about what level the  
9 leakage targets should be and so I can't say whether the  
10 leakage targets would have been different or not if we  
11 had been in a different situation.

12 Q. No. In fact it would be fair to say that -- whether you  
13 were in surplus or deficit, you would still have been  
14 required to spend money on leakage reduction?

15 A. I am sure there would have been leakage targets.  
16 I don't know if they would have been the same.

17 Q. No, I think that's fair. I know from the evidence that  
18 you as a company were looking at this very carefully  
19 across the piece but when it comes to leakage reduction,  
20 this is expenditure you really had to bear, and the real  
21 issue is how much?

22 A. Yes.

23 Q. Thank you. If we go over to the page to 382VV -- can  
24 you do that? Do you have it? This is the page that's  
25 headed, "Household metering programme".

- 1 A. Yes.
- 2 Q. This is another aspect, isn't it, and adjunct to leakage  
3 reduction? If households are metered, the theory goes  
4 they are much more conscious of their charges. Sorry,  
5 if they know how much it's costing per bath, they will  
6 presumably wash less.
- 7 A. That's the assumption.
- 8 Q. Or not waste it anyway. All right. You say -- the  
9 first thing -- let's look at it:
- 10 "Although metering options are not the most  
11 cost-effective measure to ...(Reading to the words)...  
12 requirements and expectations."
- 13 So you are gritting your teeth?
- 14 A. Yes.
- 15 Q. You don't agree with this but you have not much choice  
16 about it? I can understand that.
- 17 So this is expenditure that, once again, was  
18 compulsory, or you deemed it to be compulsory?
- 19 A. There certainly were regulatory expectations and again  
20 there might have been variations around what level --
- 21 Q. Well, what you are saying here -- it's a technical point  
22 but I don't want to pick you up:
- 23 " ... in recognition of regulatory requirements, on  
24 the one hand, and expectations on the other."
- 25 So you were looking at both sides of the coin?

- 1 A. Yes.
- 2 Q. Fine, thank you. As with leakage, this is expenditure  
3 that you would have incurred, like it or not, whether  
4 there was a surplus or a deficit or the region was in  
5 balance. That's right, isn't it?
- 6 A. We would certainly have had to incur expenditure on  
7 household metering. Again the level depends, for  
8 example, on how actively you promote the free meter  
9 option and where you promote it, how actively you  
10 promote demand management metering, so metering of  
11 people who have swimming pools and sprinklers and  
12 things, which you can see from the fact that the plan is  
13 for the first five years. It's for a lower number of  
14 properties and then it goes up a little -- it goes down,  
15 sorry, a little after that, in the following 15 years.  
16 So you would -- there would be flexibility about how  
17 that was done, and indeed it's quite hard to identify  
18 who has got sprinklers at all. So it depends on how  
19 much effort you want to put into that.
- 20 Q. That's very helpful. Can we turn back to 382II in the  
21 bundle?
- 22 A. Yes.
- 23 Q. We see a table. Just remind us what AISC means?
- 24 A. "Average Incremental and Social Costs" is what it stands  
25 for and it relates to the way in which the costings are

1 required to be done for the water resource management  
2 plan, which it takes into account. Very unhelpful that  
3 the column then says "AISC" without environmental and  
4 social ... because the AISC is the cost with -- taking  
5 into account an estimate of the environmental impact and  
6 other social costs, kind of cost/benefit-type --

7 Q. It's quite a complicated calculation, I would guess, but  
8 if we can go to the very first line:

9 "Option R9 Fylde."

10 A. Yes.

11 Q. Boreholes?

12 A. Yes.

13 Q. What you seem to have here is you can -- benefits to  
14 supplier/demand balance. It's a positive number, 15?

15 A. Yes.

16 Q. And cost with or without environmental services: 0?

17 A. Yes.

18 Q. So you could increase the capacity in the region by  
19 15 megalitres a day for no cost. That's what it seems  
20 to say?

21 A. That is certainly what it seems to say. I find that  
22 quite puzzling but that is what it says.

23 Q. It's your document and it's what you gave to Ofwat. So,  
24 forgive me, I'm assuming that it is accurate?

25 A. I'm sure it is, because that's what we said at the time,

1 but I haven't asked anybody how we worked it out.

2 Q. No, understood. If we take you on to Redcar, the second  
3 one, you can redevelop groundwater at Redcar -- is it  
4 Redcar or Redscar?

5 A. Redscar.

6 Q. I thought it might have been a typo. And you get an  
7 extra 10 million megalitres per day.

8 A. 10 megalitres. Not 10 million megalitres; that's an  
9 awful lot of water.

10 Q. Did I say 10 million? I'm sorry. Bear with me, I'll  
11 try to be cleverer. 10 megalitres per day, and you get  
12 that at a cost of 8.2p per cubic metre. That's right?

13 A. Yes.

14 Q. So United Utilities had a surplus in the integrated  
15 zone, and even if it needed additional sums, it could  
16 certainly add 10 megalitres a day at zero cost and 25 at  
17 relatively small cost.

18 A. The first one is 15 and the two together are 25.

19 Q. 25, yes, 25 megalitres. Right. Obviously we can go  
20 down the column. I don't think it's necessary to detain  
21 you but I think you have got the point that actually the  
22 efforts you are making at zero or very little cost can  
23 bring forth significant liberation, if you like, of  
24 water capacity.

25 If we go on to 382J, which is back in the document,

1           here we have a -- have you got it, 382J?

2           A. Yes.

3           Q. "Our demand management strategy and in particular  
4           leakage reduction will result in water savings of  
5           over 150 megalitres a day in dry weather by 2004/2005."

6           Do you see that?

7           A. Yes.

8           Q. Then we have the heading "Integrated zone".

9           A. Yes.

10          Q. "The demand management strategy will defer any need for  
11          water source enhancements until after 2015."

12          That's right, isn't it?

13          A. Yes.

14          Q. Then it says:

15                 "Local reinforcement will, however, be necessary  
16          before 2005 to ensure peak demands can be met and that  
17          local source outlets can be reduced to sustainable rates  
18          at times of dry weather."

19          A. Yes.

20          Q. That's fine, thank you. I'm sorry to do this in a round  
21          about --

22          A. No, that's okay.

23          Q. Well, so I read this -- I mean, the point is clear on  
24          its face -- that the demand management strategy would  
25          defer any need for water source enhancements until after

- 1           2015. That's correct, isn't it?
- 2       A. Yes.
- 3       Q. Thank you. If we go to page 382LLL, here we actually
- 4           see the strategy for the integrated resource zone. If
- 5           you go to the column for 2014 and 2015 --
- 6       A. Hang on.
- 7       Q. Page 382LLL.
- 8       A. LLL, sorry, I apologise. Yes, I have that now.
- 9       Q. Just give yourself a moment to look at table 18, and I'm
- 10           going to take you to the third column, the one that's
- 11           headed "2014/2015"?
- 12       A. Yes.
- 13       Q. I see from this -- and we see it on the left near the
- 14           bottom, the third one up:
- 15           "Available headroom."
- 16           We see a figure of 139 megalitres for that year,
- 17           based upon the demand management strategy I have just
- 18           taken you to?
- 19       A. Yes.
- 20       Q. That's right, isn't it?
- 21       A. Yes.
- 22       Q. So in 2000 United Utilities knew it had a surplus of
- 23           water in the integrated zone which would last for at
- 24           least 15 years, didn't it?
- 25       A. No, sorry. In 2000 it knew that it would have some

1 water that would last until, I would say, from the look  
2 of this, 2004/2005, when the surplus only 8, which is  
3 very small -- the 2014/2015 headroom is based on the  
4 development of the leakage-free meter options, demand  
5 management and water efficiency in the period --  
6 although it only lists it as 2004/05 and 2014/15, there would  
7 actually be, of course, an intervening five-year period  
8 as well.

9 Q. Yes.

10 A. So all of that would need to take place in order -- so  
11 we didn't know in 2000 that we had enough water; we knew  
12 that if we carried out those strategies, we forecast  
13 having enough water.

14 Q. That's very clear, thank you. That's really what it  
15 says, isn't it:

16 "Forecast reductions in demand due to demand  
17 management strategy."

18 A. Yes.

19 Q. So if you did what you planned to do and in particular,  
20 I think, metering and leakage, the surplus would really  
21 catapult to 139. That's right, isn't it?

22 A. It would -- it was forecast to be 139.

23 Q. Yes, okay. And if we take it to 2024, we see that the  
24 extra water source enhancement considered would provide  
25 an additional -- is it an additional 65 million

1           megalitres a day?

2       A. 65 megalitres.

3       Q. Megalitres a day, that's right, and that would give

4           a headroom of 132 megalitres a day?

5       A. It would.

6       Q. Yes. So the possibility that additional capacity would

7           be required seems to me to depend on quite conservative

8           assumptions, wouldn't it, and perhaps rightly so, given

9           the importance of the industry. But they are

10          conservative assumptions, aren't they?

11       A. I'm not sure what you mean by "conservative

12          assumptions". Which assumptions do you mean?

13       Q. These are projections?

14       A. Yes, they are.

15       Q. I don't see any margin of error here, unless I have

16          missed it. How firm were these projections on the

17          one hand?

18       A. They are based on the headroom, which is where the --

19          where you capture the risk of being in 1999 and trying

20          to work out what demand is going to be in 2025 and also

21          what supply is going to be in 2025. So that's captured

22          within the headroom calculation, which is a calculation

23          that the Environment Agency set out in their guidelines

24          for water resource plans. So if, in the sense of being

25          conservative, you are referring to the level of

- 1 headroom, we are required to meet the level of headroom.
- 2 Q. Thank you. So what this meant was, unless all the worst  
3 case scenarios happened, no expansion of capacity would  
4 have been required after 2015, would it?
- 5 A. I'm sorry, I don't see what you are getting that.
- 6 Q. I'm asking you the question. In the worst case would  
7 you have had to increase capacity?
- 8 A. Clearly there is expansion of capacity between 2014/2015  
9 and 2024/2025, both in terms of leakage reduction, which  
10 further changes metering, and also in terms of the water  
11 source enhancements that you point out.
- 12 Q. Yes.
- 13 A. All of that enables the books to balance, as it were,  
14 and there is actually a planned balance of zero.
- 15 THE CHAIRMAN: Water source enhancement is just taking more  
16 water out of the rivers?
- 17 A. It could be rivers, it could be boreholes, it could  
18 be --
- 19 THE CHAIRMAN: But opening up or increasing the actual  
20 offtake of water?
- 21 A. It's something that we just read a moment ago, where it  
22 said we would need to review these enhancements. Those  
23 would be possibilities. And it also said that we would  
24 need to kind of review these enhancements with the  
25 Environment Agency. So I get the impression from that

1           that -- what they are going to be is not decided at this  
2           point in time.

3       MR SHARPE: I think my point about conservative estimates  
4           is, if one looks at the target headroom, one sees that  
5           it has virtually doubled from 1997/1998 to 2024/2025.

6       A. Yes.

7       Q. Was that externally imposed by the Environment Agency?

8       A. The calculation for headroom, which depends upon -- I'm  
9           not actually familiar -- I couldn't do a headroom  
10           calculation but I do know that the way in which the  
11           headroom calculation is done, which looks at assumptions  
12           that are made about the water that is available,  
13           probably didn't at this time but now looks at climate  
14           change assumptions and the assumptions that are made for  
15           each of the different types of demand, those -- that  
16           calculation is in the Environment Agency's guidelines,  
17           and when they call them "guidelines", we do have to  
18           follow them.

19      Q. Rather like leakage and metering; it's sort of mandatory  
20           requirements?

21      A. We have to follow the guidelines.

22      Q. Absolutely. Thank you for that. As a matter of  
23           interest, then, since this plan was formulated  
24           in March 1999, have you had to increase water production  
25           capacity at all?

1 A. I couldn't answer that question without going and asking  
2 somebody. I'm trying to remember. We have built some  
3 boreholes recently, in about the last five years or so.

4 Q. Forgive me, I have to confine my question to what we are  
5 only really interested in, which is the integrated zone?

6 A. Okay. I certainly know that we have built some  
7 boreholes in the integrated zone and we have also put in  
8 a very significant and expensive transfer main within  
9 the integrated zone, which is called the "West/East  
10 Link", which goes from Liverpool to just north of  
11 Manchester and provides additional capacity to move  
12 water around within the region, and that was done for  
13 a number of things, one of which is to provide security  
14 of supply if there is an incident and a terrorist blows  
15 up a treatment works or something like that, but it also  
16 contributes to our water resources plan, and our latest  
17 water resources plan relies upon that.

18 So that's probably the biggest investment that we  
19 have made.

20 Q. Thank you very much. So an element of that at least was  
21 externally imposed?

22 A. No, it was our choice. The West/East Link?

23 Q. Hm-mm.

24 A. That was the way in which we chose to do it because it  
25 enabled us to efficiently cover a number of investment

1 drivers at once. One was the supply/demand, the  
2 security of supply and the risk of terrorist threats,  
3 and also it enabled us to do some -- to more efficiently  
4 carry out some refurbishment of some of the large  
5 existing aqueducts that we have. So it had multiple  
6 drivers, and we developed the scheme and took it to  
7 Ofwat.

8 Q. I'm very grateful for that answer but my specific  
9 question was: had you increased water production  
10 capacity?

11 A. No, sorry.

12 Q. What I took from your answer --

13 A. Just the boreholes that are close to Prescot(?) are the  
14 ones that I am aware of and there --

15 Q. Putting it crudely, it's moving water from one area to  
16 another?

17 A. The link is moving water, which is a very important  
18 thing, but, yes.

19 Q. Bulk distribution is rather an important matter in this  
20 case but it is bulk distribution, not enhancing capacity  
21 of water. I just want to make sure I have understood  
22 that properly.

23 A. Yes.

24 Q. Thank you. We might want to round off the story but  
25 only very quickly. May I take you to bundle 8 and

1 I want you to go to tab 295. Of course, this is  
2 bringing the story pretty well -- not quite up-to-date  
3 but nearer to our time. Do you have it?

4 A. I do.

5 Q. This is rather more recent, and I'm not going on detain  
6 you very long, but this is the 2009 September plan.

7 A. Yes.

8 Q. This is the outturn. So we can look back. Go over the  
9 page, we see the integrated zone and we see the story?

10 A. Yes.

11 Q. We see here, if I understood it correctly, that in --  
12 you are predicting a significant surplus at least until  
13 2019/2020 in the integrated zone; do you see that?

14 A. Yes.

15 Q. Supply/demand in balance; of course it falls to 6.9 in  
16 2019, your estimate?

17 A. Yes.

18 Q. But you are also noting that the target headroom appears  
19 to be doubling over the same period. That's right,  
20 isn't it?

21 A. Yes.

22 Q. This is the same headroom that is determined externally  
23 by the Environmental Agency?

24 A. The method of calculation was determined externally. We  
25 calculate it.

1 Q. So, if we look from just three years ago, we are seeing  
2 a picture where Armageddon hasn't quite materialised,  
3 has it, and you have increased capacity but not by very  
4 much, I would guess, from the boreholes, and there have  
5 been no other major increments to capacity; that would  
6 be right, wouldn't it?

7 A. Reductions in demand on the system are significant  
8 increases in capacity. They give you more water.

9 Q. They have the same effect but you have not enhanced  
10 capacity, you have done it, as it were, indirectly,  
11 through metering leakage and other resources?

12 A. Yes.

13 Q. Now, that's all I wanted to do, just to see the picture  
14 taken up, because you answered the question very fairly  
15 that the increments in capacity have been limited to  
16 boreholes and specific plants?

17 A. As far as I can recollect.

18 Q. You are still predicting a surplus of water in the  
19 integrated zone for at least another 15 years or so,  
20 aren't you?

21 A. Well, it's a 2009 plan, so it's about ten years,  
22 probably September 2009.

23 Q. Ten years, okay. So that's very nearly 20 years from  
24 Albion's first discussions?

25 A. Yes.

1 Q. Yes, okay. Just one final point on this. Throughout,  
2 you have indicated that there is expenditure you are  
3 incurring or, I presume, have incurred, on leakage?

4 A. Yes.

5 Q. And metering?

6 A. Yes.

7 Q. And some of the distribution expenditure, which doesn't  
8 concern us, has essentially been externally determined,  
9 and I think you did answer that you would have had to  
10 incur it whether you were in deficit or surplus, though  
11 there may be issues about how much expenditure you would  
12 have had to incur?

13 A. Yes, there would have been.

14 Q. Let me take you back to your undergraduate days as an  
15 economist.

16 A. Yes.

17 Q. Do you remember the definition of marginal cost?

18 I think most people would agree that the marginal cost  
19 is the relationship between an increment or decrement in  
20 cost as a function of output?

21 A. Yes.

22 Q. That would be right?

23 A. Yes.

24 Q. And sometimes that's represented by the first  
25 differential as an equation?

- 1 A. Yes.
- 2 Q. But what is important is that it's a cost that is  
3 related to output. Now, the costs you have  
4 identified -- and very fairly -- are costs which are not  
5 really related to output at all, are they; they are  
6 related to meeting regulatory requirements of the  
7 Environmental Agency or Ofwat. That's right, isn't it?
- 8 A. They are costs that we would have to some extent had  
9 to -- and I can't say to what extent -- would have had  
10 to incur in any event.
- 11 Q. I think I'm going to put it to you, I hope fairly: these  
12 aren't really, in our definition of marginal costs,  
13 short or long run -- they are not really marginal costs  
14 as such because you do not have that vital relationship  
15 between price and quantity; you just have an increase in  
16 the cost, but it's not in any sense a long run marginal  
17 cost?
- 18 A. I think the definition of long run marginal cost would  
19 be taking a time period over which all inputs are  
20 variable. Clearly, we don't have that because we can't  
21 go that far forward, but it would certainly -- if all  
22 inputs were truly variable, you would be able to -- you  
23 would consider all of the costs. So --
- 24 Q. I see where you are coming from but I don't think it  
25 quite hits the point, because in the long run, as Keynes

- 1           said, we are all dead, remember?
- 2       A. Yes, but the aqueducts will still be there.
- 3       Q. But the issue essentially is: are these costs which vary  
4       with output? You see, whether they are fixed or  
5       variable. The long run we can, I think, agree is the  
6       situation in which no costs are fixed and everything is  
7       variable, as you have just told us?
- 8       A. Yes.
- 9       Q. But these costs are not variable as such. Let me put it  
10      another way. They are additional. They are not  
11      variable with output, with no fixed cost; they are  
12      something you had to incur. And your own evidence says,  
13      particularly in relation to metering, whether you liked  
14      it or not. And it is obvious you didn't like it. So  
15      not really in that sense costs which you can say vary  
16      with output over time, they are costs which you had to  
17      grin and bear and incur but are not really marginal  
18      costs whether they are short run or long run. Do you  
19      see? Do you understand?
- 20      A. I do think that they would have been different if we had  
21      had to supply a different volume of water, and that we  
22      would have -- we would have had a different view of what  
23      the economic level of leakage would be and we would have  
24      had a different -- we may have considered that we  
25      approached the promotion of free meter options and of

1 demand management metering in a different way, in order  
2 to do more or do less, so -- and also water efficiency,  
3 which was also on their other -- a very small amount.

4 Q. But you told us earlier that you couldn't really  
5 identify what proportion -- how it would differ. You  
6 were faced with a set of regulatory requirements or  
7 expectations and you had to adjust your expenditure to  
8 take that into account.

9 In doing that, I think I can accept that an element  
10 of that expenditure -- the precise amount may well  
11 change. You know, if you are chundering out masses of  
12 water, the question of leakage reduction may well be  
13 relevant to the volumes of water that are being  
14 disgorged, are being pumped. But that's not the point  
15 here, is it? What we are interested in is the extent to  
16 which those costs increase incrementally with output.  
17 I'm putting it to you that actually that is the wrong  
18 calculation here. We can't do that calculation simply  
19 because such expenditure would have been incurred  
20 whether or not output increased or not. The only issue  
21 is will it be higher or lower. Nevertheless it's  
22 still -- it's not a changing marginal cost; it's just  
23 a changing costs?

24 A. One of the things that was said to me by the people who  
25 were producing the water resources management plan --

1 and this is not in 99, because I wasn't involved then,  
2 but five years later, when I was involved in actually --  
3 not the detailed calculation for the water resource  
4 management plan but the way in which schemes were being  
5 selected on the basis of cost and the optimisation was:  
6 if we need to get some water, we have to get it from  
7 leakage first, was how it was expressed to me at that  
8 time. And indeed we did then do the ranking of schemes,  
9 based on that: well, ideally you would rank them like  
10 this and do these ones first, but the Environment Agency  
11 will expect us to do some leakage. So we put that kind  
12 of at the top of the list.

13 Q. Whether you liked it or not?

14 A. And that doesn't necessarily mean if there was no need  
15 for any additional water over the 25-year period that  
16 you would -- that you would be expected to significantly  
17 reduce leakage.

18 THE CHAIRMAN: There were too many negatives in that  
19 sentence. Are you saying that even if there was no need  
20 for any additional water over the 25-year period, you  
21 would still be expected to reduce leakage significantly,  
22 even if this meant that then you didn't take as much  
23 water out of the rivers or boreholes?

24 A. I think that the expectation would be much less. If  
25 there was no need for water, then there would be less

1 pressure on reducing leakage. So less expectation.  
2 There would probably still be some, and that would be  
3 related to, perhaps, reducing abstractions in certain  
4 areas that were damaging.

5 MR SHARPE: Well. I'm very grateful for that. I think  
6 that's common ground that some --

7 A. I understand where you are coming from.

8 Q. Thank you very much. I'm grateful.

9 Now we move on to another topic. When you were  
10 first briefed about Albion's application for bulk  
11 supply, were you told that Albion had originally said  
12 that it was investigating the possibility of alternative  
13 supply of water?

14 A. Yes.

15 Q. And raised that point? Were you aware that Albion had  
16 at least one discussion with you with a view to united  
17 participating in the financing and construction of the  
18 project?

19 A. Yes.

20 Q. If we go quickly to bundle 2, folder 2, bundle 2,  
21 tab 23, page 387. Do you have it?

22 A. I do.

23 Q. Do you see the letter here?

24 A. Yes.

25 Q. The paragraph begins:

1 "The first ..."

2 We are talking about a number of options, two ways:

3 "The first would involve your company ..."

4 Your company being North West Water:

5 "... supplying us with water currently abstract from  
6 River Dee, under your own abstraction licence, and that  
7 would represent the equivalent quantity currently  
8 supplied by ...(Reading to the words)... abstracted."

9 That's right?

10 A. Yes.

11 Q. And so on. But then the relevant paragraph:

12 "Enviro-Logic ..."

13 And I call them Albion.

14 A. Yes.

15 Q. "... is also investigating the potential use of an  
16 alternative source of supply probably but not  
17 necessarily from within the DC area. Should this prove feasible, a  
18 quantity

19 of water could be made available to your company based  
20 on your ability to use the Heronbridge source for your  
21 own purposes, rather than for transfer to another  
22 undertaker."

23 Do you see that?

24 A. Yes.

25 Q. "Please let me know whether you would be willing, in

1 principle, to participate in the financing and  
2 construction of any necessary infrastructure to support  
3 an alternative source."

4 Over the page, Mr Jeffery says:

5 "If you want any clarification, let us know."

6 A. Yes.

7 Q. So you have that?

8 A. I do.

9 Q. Did you see the letter at the time?

10 A. No.

11 Q. No. If we go over the page to tab 25 --

12 THE CHAIRMAN: So what they are suggesting there then is  
13 that if Shotton Paper is now supplied from a different  
14 water source that frees up some of the water that's  
15 being extracted at Heronbridge, and -- that may have  
16 a value to UU so that they may be prepared to contribute  
17 to the creation of that alternative water source?

18 MR SHARPE: Yes. We can translate it and say: if the  
19 marginal cost of that is high, then you are saved that  
20 and you can sell it to a customer that might be prepared  
21 to pay more.

22 THE CHAIRMAN: Or use it --

23 MR SHARPE: Or use it ... yes, well -- no, they are in  
24 business to sell water: use it for the purposes of  
25 selling it to somebody else who would pay more than

1 Welsh Water. That's how I interpret Mr Jeffery's  
2 letter.

3 A. I would imagine -- I don't know because I am not  
4 Mr Jeffery, but that Mr Jeffery would have been thinking  
5 about -- when he says, "using the Heronbridge source for  
6 your own purposes", he was probably considering  
7 supplying the customers that we had on our regulated  
8 tariffs rather than finding somebody new to sell the  
9 water to.

10 Q. Yes. We go over the page to tab 25. We can see the  
11 reported response. Do you see, this is a note of  
12 a meeting and this is, I think, your own note of the  
13 meeting, you being United Utilities?

14 A. Yes.

15 Q. It's a note of the meeting --

16 A. It certainly looks like it is.

17 Q. It's a note of a meeting with Wendy Johnson, John Lees  
18 and Ken Hickman, whose role you described right at the  
19 beginning?

20 A. Yes.

21 Q. Now, the purpose of the meeting was to discuss the  
22 possibility of supplying water directly or for  
23 North West to provide finance in some way to assist  
24 Albion in developing an alternative source.

25 So that was the purpose of the meeting?

1 A. Yes.

2 Q. And then right off, the first bullet point,

3 Wendy Johnson says:

4 "North West have no requirement for additional  
5 supplies from the Dee catchment and there is unlikely to  
6 be any financial benefit which North West could share if  
7 the Dee source were replaced as the supply to  
8 Shotton Paper by an alternative source."

9 A. Yes, that's what it says.

10 Q. That's what it says. If we can go on tab 24. I'm  
11 giving you this by way of corroboration?

12 A. Yes.

13 Q. We have seen this before in the hearing. These are the  
14 periodic reports from Dr Bryan to his board and we can  
15 pick it up at page 391. And it's the last paragraph,  
16 I think:

17 "Three routes to the achievement of lower bulk  
18 supply. New pipeline, common carriage and  
19 a redetermination based on the British Steel tariff."

20 Redetermination, I think he is referring to the  
21 possibility of going to Ofwat and using the section 40A  
22 procedure. In the industry, a redetermination would  
23 mean that, wouldn't it? Yes?

24 A. Yes.

25 Q. Yes.

1           "The last of these is likely to be the most  
2           attractive but it depends on regulatory decisions that  
3           has been described before. North West's enthusiasm for  
4           the common carriage approach is welcome but we must  
5           ensure that we maximise our gains from any such  
6           collaboration:

7           "Then it goes on:

8           "The pipeline option will be retained but not  
9           progressed until the other options have been exhausted.  
10          North West have indicated that they would put no value  
11          on the recovery of 36 megalitres a day of Dee water  
12          because they have sufficient resources in that area for  
13          the foreseeable future."

14          Do you read that?

15         A. I read that, yes.

16         Q. Obviously, you weren't party to the meeting and so forth  
17          but it was one of your colleagues, a fairly senior  
18          colleague, Wendy Johnson, who has reported the remark.  
19          So she was reported saying that in your company's  
20          minutes and it's reported in Dr Bryan's minute?

21         A. Yes.

22         Q. Yes. So we have no reason to doubt that this is what  
23          she said at the meeting?

24         A. No reason to doubt it at all.

25         Q. Thank you. And it's, on reflection, fairly easy to see

1           why she said it, isn't it, because at the time the  
2           integrated zone was in surplus, as we have gone some way  
3           towards showing?

4       A.   Yes, at the time.

5       Q.   Yes.  In other words, you didn't need any additional  
6           water at that time?

7       A.   At that specific time.

8       Q.   Thank you.  Of course, she doesn't quite limit the  
9           statement to "at that time", does she, because she is  
10          talking -- the minutes refer to, "and for the  
11          foreseeable future"?

12      A.   But our notes don't.

13      Q.   It's Dr Bryan's note?

14      A.   Yes, Dr Bryan's note says "for the foreseeable future".

15      Q.   He wasn't taken to that in his lengthy  
16          cross-examination.  If there was any doubt as to the  
17          accuracy, no doubt he could have been taken to it?

18      THE CHAIRMAN:  I don't think that's something that this  
19          witness can really comment on.

20      MR SHARPE:  Of course not, no, no, no.  Yes.

21                 Anyway, as a result, what she is saying is that the  
22                 additional water, the substantial increment to water,  
23                 bearing in mind the numbers we have seen elsewhere, was  
24                 worth nothing to United Utilities?

25      A.   Yes.

- 1 Q. It wasn't worth the extra investment that was put before  
2 her, and that's what Miss Johnson was saying at the  
3 meeting. Is that right?
- 4 A. Yes.
- 5 Q. Thank you?
- 6 A. I would say that was right.
- 7 Q. If we go back to the Oxera report briefly, at bundle 2,  
8 which is at tab26, just a couple of tabs over,  
9 and we go to page 395R. We see here the engineering option?
- 10 A. Yes.
- 11 Q. This is the proposal that was in part being advanced by  
12 Dr Bryan, and the actual details really don't concern  
13 us. Construction of a new pipeline by North West to  
14 serve Shotton Paper. Do you see?
- 15 A. Yes.
- 16 Q. This had been taken quite seriously within  
17 United Utilities at that time. They wouldn't have  
18 commissioned Oxera to do it?
- 19 A. No, they wouldn't.
- 20 Q. And we see here that United Utilities have calculated  
21 the costs involved would amount to somewhere between 4.8  
22 and £5.8 million in total capex?
- 23 A. Yes.
- 24 Q. Do you see that? And 250/270,000 in annual opex and  
25 there was an alternative which would cost 9.9 million in

- 1 capex and 530,000 in opex?
- 2 A. Yes.
- 3 Q. And we see here this is obviously, I take it, Oxera  
4 reporting Shotton -- Shotton Paper had declared they  
5 weren't willing to provide any funding, and absent that  
6 funding, you knew well -- United knew well that Albion  
7 couldn't possibly pursue an alternative source of  
8 supply. It simply didn't have the resources to do so.  
9 That's right, isn't it?
- 10 A. I'm not sure whether the paper considers whether Albion  
11 would have been able to pursue an alternative. What it  
12 does say is that -- and I don't believe that Oxera would  
13 have spoken to Shotton Paper. So I think they will have  
14 been told, by someone who did speak to Shotton Paper,  
15 that Shotton Paper aren't willing to fund it, and their  
16 comment then is, "Therefore, would North West Water be  
17 prepared to fund it without some funding or commitment  
18 from the customer?"
- 19 Q. There is no evidence as to who Oxera spoke to --
- 20 A. No, but it would be unusual for us to let them speak  
21 directly to the customer.
- 22 Q. I'm not going to challenge that because I really have no  
23 information at all as to where Oxera got their  
24 information from?
- 25 A. No, I haven't.

1 Q. And I recall this is an internal consultancy report to  
2 United Utilities?

3 A. Yes.

4 Q. So if they couldn't speak, then somebody from  
5 United Utilities must have told them?

6 A. Yes.

7 Q. That's a fair assumption, isn't it?

8 A. Yes. Oh, I believe it would be somebody from  
9 United Utilities. I'm not suggesting it wouldn't.

10 Q. No, thank you. Of course, Shotton's unwillingness to  
11 participate is mirrored by United Utilities, and we have  
12 seen the report and so forth. Can we pick it up at  
13 tab 28 of the same bundle.

14 A. Yes.

15 Q. Have you seen this before?

16 A. Yes.

17 Q. Did you see it at the time?

18 A. No.

19 Q. It's dated 2 September 1999. Tina Boulton. Are you  
20 aware of who she was?

21 A. I have never come across her. I only know her through  
22 this paper.

23 Q. Through this paper; virtually, in other words. So she  
24 is business sales and marketing. Okay. If we go to  
25 page 402 directly, we can see here, "Alternative option

1 assessment":

2 "The engineering options are not considered  
3 advisable since they would be extremely costly and  
4 Shotton was not willing to contribute any funding and  
5 the Regulator would view them as economically  
6 inefficient."

7 Do you see that?

8 A. Yes.

9 Q. So the simple point that I'll conclude on in relation to  
10 this was that the water from Heronbridge, from the  
11 Heronbridge extraction point, was the only commercially  
12 viable source available to Albion and to Welsh Water,  
13 wasn't it?

14 A. I think that would depend on other aspects. So, for  
15 example, Albion's position in terms of what they were  
16 paying to Welsh Water and what they would have paid to  
17 us and to Welsh for common carriage would be different  
18 to the position that we were looking at, and it might  
19 also depend on the commitment from the customer in terms  
20 of a long-term contract and things like -- you know --  
21 do you know what I mean? In order to ensure that you  
22 would be able to get the funding back over a period of  
23 time and it would depend upon their ability to raise the  
24 funding. I don't think I can comment on the commercial  
25 viability of their options.

1 THE CHAIRMAN: Are you saying that even with the Heronbridge  
2 water it might not be commercially feasible for them or  
3 are you saying that those factors might make it  
4 commercially better for them to use some water other  
5 than the Heronbridge water?

6 A. I think Mr Sharpe is asking me to comment on the  
7 proposition that this paper shows that there would not  
8 be a commercially viable alternative for Albion Water,  
9 and I am really saying that I can't comment on what  
10 would have been commercially viable for Albion Water  
11 because I would never have done such a calculation.  
12 I am not even aware of how the calculation was done for  
13 United Utilities -- well, for North West Water in terms  
14 of why this option was rejected. So I don't know why it  
15 was decided it wasn't commercially viable for us, and  
16 I certainly can't comment on whether or not it was  
17 commercially viable for Albion. I'm sure that Dr Bryan  
18 could have answered that question.

19 MR SHARPE: It wasn't put to him. Madam, I wonder if this  
20 might be a convenient moment.

21 THE CHAIRMAN: Yes, thank you.

22 MR BEARD: Madam Chairman, sorry, earlier on I mentioned the  
23 possibility of handing up a speaking note in relation to  
24 unpleaded issues. I don't know whether we are going to  
25 get to these issues today. Mr Sharpe indicated they may

1 not even arise in relation to Mr Williams.

2 THE CHAIRMAN: Let's see the speaking note you have  
3 prepared.

4 MR BEARD: I'm grateful, thank you. (Handed)

5 Thank you very much.

6 THE CHAIRMAN: Ms White, you have heard me give the witness  
7 warning to Dr Bryan, but just to reiterate, of course,  
8 it applies to you as well, that you mustn't, during any  
9 breaks or overnight when you are giving your evidence,  
10 speak to anybody on your team about the case. We will  
11 come back at 2 o'clock.

12 (1.02 pm)

13 (The short adjournment)

14 (2.00 pm)

15 MR SHARPE: Ms White, let's go back to bundle 2, please.

16 This is the Tina Boulton document at tab 28, page 399 it  
17 starts. I think we established you hadn't seen this  
18 document when it was produced in September 1999, which  
19 is readily explicable by your ...

20 I think we have established you have seen it but  
21 only in the context of your preparation for this  
22 litigation; that's right, isn't it?

23 A. In the earlier case in the tribunal.

24 Q. I beg your pardon, thank you. Did you give evidence in  
25 it?

1 A. No, but we were an intervenor, so I have seen the  
2 document --

3 Q. I understand, thank you.

4 Now, Ms Boulton, who I think you said you didn't  
5 know, but she described herself as Business, Sales and  
6 Marketing. So she is very much on the commercial side  
7 of the business --

8 A. Yes.

9 Q. -- and you were on the straight and narrow side.

10 So it's fair to say you weren't involved in any of  
11 this. You didn't know her. You weren't party to any  
12 discussions in relation to this document?

13 A. No.

14 Q. But I still would like your comments on it. So if we  
15 start off at the top, as you see, she has been asked to  
16 prepare a recommendation for the realisation of  
17 cross boundary sales of non-potable water to  
18 Shotton Paper. That's right, isn't it?

19 A. Yes.

20 Q. And we saw, she recommended that you should approve the  
21 negotiation of a bulk supply agreement between UU and  
22 Albion at Heronbridge. That's right as well, isn't it?

23 A. Yes.

24 Q. And she sets out the background, and in the first  
25 paragraph -- it's actually something I took the tribunal

1 to in my opening:

2 "Under this agreement North West is obliged to  
3 supply ..."

4 And we see:

5 "... at cost."

6 A. Yes.

7 Q. We have established that means recovery of the  
8 accounting costs. Then she goes on to consider  
9 a variety of options before making her recommendation,  
10 namely the bulk supply agreement with Albion.

11 A. Yes.

12 Q. All right. Over the page -- and I don't want to detain  
13 you in this -- you see the various solutions which were  
14 under discussion. I don't think I want to detain you  
15 there but I will take you on to page 401. If we look at  
16 the final paragraph:

17 "The negotiating stance opposite Albion will be that  
18 any agreement between North West and Albion ..."

19 The names have been changed?

20 A. Yes.

21 Q. "... will be subject to North West receiving a minimum  
22 of £250,000, additional sales margin or a 50/50 split of  
23 the overall benefits, whichever is the greater."

24 A. Yes.

25 Q. Right:

1           "Potential gains are therefore between 250,000 and  
2           £700,000, and 250,000 is based on an assumed use of  
3           system charge ..."

4           We call that common carriage. And it can only mean  
5           common carriage levied by Welsh Water?

6           A. Yes.

7           Q. "... of 11p and a 26 megalitre per day demand. £7,000  
8           is based on an assumed use of system charge of 6p and  
9           relies on Shotton increasing usage to 36 megalitres  
10          a day. This is predicted from year 2000."

11          A. Yes.

12          Q. Now, we are not terribly worried about those  
13          predictions, which obviously have proved to be false  
14          predictions. I'm instructed -- I don't think it is  
15          particularly relevant -- there was the prospect of  
16          Shotton expanding, and that was known to  
17          United Utilities. And that's in why this internal  
18          document those numbers were included but it's of no  
19          particular relevance.

20          This has been described as a negotiating stance and  
21          it proposes, at a minimum, increase in sales margin of  
22          a quarter of a million a year. Measured across  
23          Shotton's volumes, that's equivalent of  
24          3.6p per cubic litre. It's a matter of simple division.  
25          Were you aware that this was United Utilities'

1 negotiating stance?

2 A. No.

3 Q. Since the Heronbridge Agreement involved Welsh Water  
4 paying 22 per cent of the costs regardless of the  
5 volume -- you are well on top of that?

6 A. Yes.

7 Q. So United Utilities carried on receiving the revenue  
8 whether they took a litre, still less a megalitre, of  
9 water. That's right, isn't it?

10 A. Yes.

11 Q. This meant that United Utilities could achieve its  
12 minimum negotiating stance, quarter of a million pounds  
13 a year, for an increase in price -- actually, for  
14 a penny more than 3.6p, for a price to Albion of -- let  
15 me rephrase the question, I'm so sorry.

16 The figure of 3.6/7p was the price at which United  
17 was receiving from Welsh Water at that time?

18 A. I think the papers that you have earlier taken me to  
19 refer to an average at that time of about 3/3.1p.

20 Q. Yes. I think the two simple points I want to make here  
21 is -- looking at the Boulton report, as it stands. She  
22 is positing that the negotiating stance, the opening  
23 position is going to be a gain of -- what should be  
24 a quarter of a million pounds, right, and that's broadly  
25 equivalent to 3.6p per cubic metre. Okay. So that's

1           the first point. So any revenue greater than that would  
2           be -- would be incremental revenue to United Utilities?

3       A. Yes, the 3.6 is --

4       Q. Would it help if I distinguish between the two  
5           situations --

6       A. I can see how you are getting to that.

7       Q. Let me be more precise. We have the Boulton calculation  
8           which says: if we negotiate and get into a bulk supply  
9           agreement with Albion, our minimum position would be --

10      A. A quarter of a million pounds.

11      Q. -- a quarter of a million pounds. We just accept that  
12           and it's a matter of arithmetic?

13      A. Yes.

14      Q. And the basis of the Boulton document.

15           If the Heronbridge Agreement remained the same --  
16           that is to say they persisted in paying for the water  
17           even though they didn't take it -- they would be paying  
18           the sum of money broadly equivalent to that. But it's  
19           just coincidence?

20      A. Yes.

21      Q. So the gain would be to United Utilities would be what  
22           Albion paid and what Welsh Water would pay?

23      A. So the gain would be what Albion paid because Welsh  
24           would be paying the same as they were always paying.

25      THE CHAIRMAN: You would be selling the same water twice,

1           basically.?

2           A.   Yes.

3           MR SHARPE:  You would be selling the rights to Welsh Water  
4           and you would be selling the water which you deliver.

5                     If 3.6p per cubic metre is worth -- well, what is it  
6           worth?  Somewhere in the order of a quarter of a million  
7           pounds, you can readily see, double that -- this could  
8           be a very attractive proposition to United Utilities,  
9           wouldn't it?

10          A.   Yes, I'm not sure if that's the way in which -- and  
11          obviously we don't know, but I'm not sure if that's the  
12          way in which Tina Boulton will have worked that out  
13          because I don't think they will have been familiar with  
14          the agreement.

15          Q.   I can help you.  I don't think it was because I don't  
16          think she was very interested or knew or was in  
17          a position to guess what Welsh Water were going to do.

18          A.   No, but I'm not sure she was that familiar with the --  
19          I don't know whether she was familiar enough with the  
20          existing agreement or whether she was actually --

21          Q.   Respectfully, it doesn't matter.  What she is doing here  
22          is saying:  our negotiating position with Albion should  
23          be this?

24          A.   Yes.  Well, I don't know whether that equated to 3.6  
25          because I don't know how she worked that out.

- 1 Q. Well --
- 2 A. If she hadn't understood the agreement, she may have  
3 assume that had we actually needed to recover more money  
4 than that to get an additional 250. She may not have  
5 understood in that the way the agreement was written, we  
6 would recover the 250,000 from Welsh in any event. And  
7 I don't -- I have not read this for a while but I'm not  
8 sure if it's clear that she understood that. So -- it  
9 definitely says 250,000. I can't comment on what -- how  
10 that calculates back.
- 11 Q. I think it's sufficient for our purposes today that she  
12 was advising her colleagues, this is our negotiating  
13 position; and if she knew, she knew, and if she didn't,  
14 nevertheless, it's still the negotiating position?
- 15 A. Yes.
- 16 Q. Right. Of course, if that indicated a figure of 3.6 or  
17 so pence per cubic metre, that terminology terminology  
18 might suggest that United Utilities would be willing to  
19 go perhaps even below it, mightn't they? After all it  
20 was a negotiating position.
- 21 A. Below the 250,000? Not necessarily below what we are  
22 trying to -- I'm -- I'm sort of a little bit sort of  
23 cautious because the other thing it says a bit further  
24 up is that DC paying North West 9p at Heronbridge, which  
25 obviously they don't. So I don't know what -- I'm not

1 quite sure the basis on which any numbers have been  
2 calculated. So 250,000 additional sales margin, yes.  
3 How that works out in terms of pence, I wouldn't like to  
4 say --

5 Q. I did it by dividing the 26 --

6 A. Yes, but that may not be what she meant.

7 Q. I think the truth of the matter is --

8 A. We don't know.

9 Q. Can I just put to you and we will move on. You weren't  
10 involved in any of this?

11 A. No.

12 Q. You weren't involved in any of the commission  
13 discussions and negotiations?

14 A. No, so we are at all guessing.

15 Q. And you really can't comment on commercial negotiation,  
16 or, still less, form a judgment on the negotiating  
17 stance?

18 A. No.

19 Q. Thank you.

20 THE CHAIRMAN: But you do not know whether UU at the time,  
21 whether that's you or Ms Boulton or anyone else, in  
22 discussions, what assumptions they were making about how  
23 much money UU would continue to receive from Dwr Cymru  
24 in the event that there was a common carriage  
25 arrangement put in place and UU sold the water through

- 1           Ashgrove to Albion.
- 2           A. I don't know what assumptions they were making at this  
3           time.
- 4           MR SHARPE: Or the year later in 2000 as well. We do know  
5           an assumption. That's right? We don't know the  
6           assumption in 1999, obviously, but we don't know the  
7           assumption the next year, do we?
- 8           A. No.
- 9           Q. Okay. But we do know something about the assumptions,  
10          of course: we have the use of system charge and the  
11          range, as I asked you about a moment ago, assumed  
12          a system charge of 11p for common carriage. That was  
13          the assumption that they were making. As a matter of  
14          fact --
- 15          THE CHAIRMAN: That's not the point I was referring to.
- 16          MR SHARPE: I appreciate that, Madam Chairman. May I just  
17          draw to your attention what an external observer at the  
18          time was saying what a common carriage might have been.  
19          I simply make that observation, Ms White, and don't ask  
20          you a question on it.
- 21                 Anyway, now, in this report -- and we will  
22          conclude -- as far as I can see, there is no reference  
23          to long run marginal cost, is there?
- 24          A. No.
- 25          Q. Is that because she wouldn't have known what the terms

- 1           meant?
- 2       A.   Yes.
- 3       Q.   Probably?
- 4       A.   I'm not sure that our business sales team necessarily --
- 5           well, they wouldn't necessarily have understood
- 6           regulatory guidance and things like that, and they may
- 7           have had some ideas of their own, and then, when they
- 8           came to ask for a price, we would have said, "No, you
- 9           can't do that".
- 10      Q.   You see -- we will come on to that.
- 11            Anyway, good.  I think we can put that document
- 12           away.  It represents some internal thinking from the
- 13           commercial side.  As you say, you had no direct
- 14           knowledge of that at the time, did you?
- 15      A.   No.
- 16      Q.   Good.  Now we go on to Albion's application.  I would
- 17           like to you pick up bundle 3.  We are going to tab 46.
- 18      A.   Yes.
- 19      Q.   I think we established, when you took up your new
- 20           responsibilities, you were very much aware of the fact
- 21           that you had a local monopoly, near enough.
- 22      A.   Potentially.
- 23      Q.   Not potentially.  You had a local monopoly over a great
- 24           area in your supply area and you were therefore -- I'll
- 25           put it neutrally -- vulnerable to complaints?

1 A. Vulnerable to complaints, certainly.

2 Q. And it's your job to make sure that those complaints, if  
3 they came at all, could be swatted away?

4 A. Well, we don't do anything that will lead to a finding  
5 of abuse.

6 Q. If we go -- this letter, dated 8 March 2000?

7 A. 9th.

8 Q. Do you have it?

9 A. 9th of -- the one over the page? Yes.

10 Q. 548.

11 A. Yes.

12 Q. I'm so sorry, 548. Before it was an internal email.  
13 I wasn't going to take to you it. My junior remarked in  
14 the context of this case it shows it actually went and  
15 was delivered.

16 Okay, so we have the letter. It's from Dr Bryan to  
17 John Lafon, you mentioned earlier:

18 "We have received your statement of principles for  
19 the shared use of your water supply system and  
20 acknowledge that they represent a satisfactory approach.  
21 We seek access to a facility, which we believe to be an  
22 essential facility by virtue of your dominant position  
23 and because alternative abstraction licensing from the  
24 same source is not possible. Our proposals wouldn't  
25 require any require change in operating regime but would

1           increase net revenues".

2           It's clear from the letter that Dr Bryan was making  
3           abundantly clear that he considered you to be in  
4           a dominant position?

5           A. He was, yes.

6           Q. And that the Heronbridge pumping station was an  
7           essential facility?

8           A. In his view, yes.

9           Q. In his view. I would define an essential facility as  
10          something which was essential and which would be  
11          impossible or difficult to replicate easily -- would be  
12          that be fair?

13          A. I think there is a -- possibly a more technical  
14          definition, but I'm prepared to go along with that.

15          Q. I thought that was technical enough. But nobody could  
16          come along and -- an abstraction licence had been  
17          granted, you would have to build new pumps and things,  
18          and that simply wasn't on?

19          A. It certainly wouldn't be technically difficult to build  
20          a pumping station at the side of the river. It's not  
21          beyond the wit of man.

22          Q. In any response to this, and in the bundle generally, we  
23          have not seen anybody coming back and saying, "You are  
24          silly, we are not in a dominant position, these aren't  
25          essential facilities," do we?

- 1 A. No, I think we generally just ignored it, that  
2 particular comment. From my review of the paperwork,  
3 I think we have just not responded to the comment.
- 4 Q. So if we go over the page at folder 3 tab 50, we have Mr Lafon's  
5 reply.
- 6 A. Sorry?
- 7 Q. Is it tab 50?
- 8 A. Oh, tab 50, right.
- 9 Q. Mr Lafon's letter dated 15 March 2000. Do you have it?
- 10 A. Yes.
- 11 Q. He doesn't challenge that United were in a dominant  
12 position or that the Heronbridge pumping station was an  
13 essential facility?
- 14 A. No, he doesn't comment on those, which would probably be  
15 what I would normally expect.
- 16 Q. He doesn't challenge it, of course, but look at the  
17 heading, "Accesses to essential facilities"?
- 18 A. I think that might refer to the original heading. Yes.  
19 It refers to the heading on the original letter, which  
20 was "Request for access to essential facilities."
- 21 Q. It does, but if you were sensitive about the issue,  
22 thought it was worth fighting about, one would have  
23 expected him to have queried it, wouldn't you?
- 24 A. If we had thought we were going to fight about it, we  
25 would have probably queried it on the letter. It

- 1           doesn't imply that we accept or reject it either.
- 2       Q.   Can I put it another way and then we will move on.  You  
3           didn't think it worth fighting about, did you?
- 4       A.   No.
- 5       Q.   No.  You refer in your witness statement -- and I'm not  
6           going to take you to it but you will remember -- to the  
7           guidance which Ofwat had given to companies about  
8           pricing access requests?  You referred to it there,  
9           didn't you?
- 10      A.   Yes.
- 11      Q.   Now, by the time you became involved, the most  
12           up-to-date guidance was MD163, wasn't it?
- 13      A.   I would have to check all the dates but that doesn't  
14           sound wrong.
- 15      Q.   If we go over to tab 59 in the same bundle.  Now, of  
16           course, the tribunal has seen this more than once --
- 17      A.   Yes, certainly, then, because that was June 2000.
- 18      Q.   That's right.  And you will recall some of the earlier  
19           MD letters, particularly MD154, was more in the nature  
20           of an invitation to consult rather than something that  
21           came to settled conclusions?
- 22      A.   Yes.
- 23      Q.   Good, thank you.  If we can go to the principles over  
24           the page, at page 610, we see -- do you see?
- 25      A.   Yes.

1 Q. These are the principles that govern Ofwat's assessment  
2 of company access prices, wider tariff issues relating  
3 to competition. They are set out below. Then he gives  
4 his duties at (i) and then (ii):

5 "Each company should charge entrants as it would  
6 charge itself and should be able to demonstrate this  
7 both to entrants and to the Regulator if asked to do so.  
8 Companies should also charge different entrants on  
9 similar terms for access under similar conditions."

10 Under "circumstances", sorry?

11 A. Yes.

12 Q. Did you read that?

13 A. Yes.

14 Q. So two points there, really: one, we are talking here,  
15 essentially, of non-discrimination, aren't we?

16 A. Yes, we are.

17 Q. You mustn't show yourself any undue preference and you  
18 mustn't discriminate against any customer. So like  
19 situations must be treated alike?

20 A. Yes.

21 Q. Also underlying it is the notion that you must be in  
22 a position to justify any price that was offered?

23 A. Yes.

24 Q. That's right, isn't it? Yes. By the same token, if you  
25 had different entrants, you could charge different

1 entrants different prices if the circumstances differed?

2 A. Yes.

3 Q. You understand that. If we go over the page, we see  
4 what Ofwat said about access pricing.

5 A. Yes.

6 Q. So we see:

7 "In assessing disputes or complaints about access  
8 prices, Ofwat will focus on the effect of the price on  
9 competition in individual cases and on the cost  
10 information on which it is based."

11 Right? Just help me about bit: what does "focus on  
12 the effect of the price on competition in individual  
13 cases", mean to you?

14 A. That they would look at -- I would expect that to mean  
15 that they would be looking at whether there was  
16 a distortion -- an effect on competition in the markets.  
17 It's something like how the chapter 2 refers to it.

18 Q. Do you think so? Don't you think it might mean -- or  
19 bear the meaning at least:

20 "Will focus on the effect of the price on  
21 competition in individual cases as to whether or not the  
22 pricing would exclude competition."

23 A. Yes.

24 Q. Yes. Not necessarily solely in terms of acknowledged  
25 abuses of a dominant position, such as Welsh Water's, an

1 excessive pricing, but a more general injunction: Ofwat  
2 will focus on the effect of the price in competition in  
3 individual cases?

4 A. Ofwat would only be able to use the tools which it has  
5 at its disposal. So they would have to have a way of --  
6 so, for example, it's not part of a scheme of charges,  
7 so Ofwat's approval wouldn't be required in the way that  
8 they approve charges schemes. So they would have to  
9 have -- it doesn't necessarily talk about things which  
10 would be subject to a section 40 or a section 40A; Ofwat  
11 need a mechanism by which to sort of impose their view,  
12 as it were.

13 Q. Forgive me --

14 A. So, given that this is a general thing, which is talking  
15 about pricing for -- anything that might be considered  
16 to be an essential facility and very much in terms of  
17 access code was focused on network assets, so pipes,  
18 rather than sources of water because it was largely kind  
19 of -- I think the way people thought it would develop at  
20 the time was that entrants would have sources of water  
21 or would develop sources of water and treatment, if  
22 treatment were needed, and the thing that was really  
23 going to prevent them from supplying customers would be  
24 access to the pipe network because the pipe network  
25 really is theoretically difficult or -- you know,

- 1 extremely difficult to duplicate.
- 2 Q. An essential facility?
- 3 A. Yes. The -- so it was the network was pipes that was --
- 4 at the time, would have been the focus of attention.
- 5 Q. But you are not saying this couldn't apply to section 40
- 6 or section 40A?
- 7 A. I'm not saying it couldn't, although section 40, as we
- 8 know from having looked at it, has its own very specific
- 9 requirements.
- 10 Q. Including --
- 11 A. And so you would have to -- you would have to actually
- 12 be able to make a section 40 or believe you had
- 13 jurisdiction before you could then start to apply
- 14 anything about pricing, you would be held within the
- 15 wording of the Act.
- 16 Q. I'm not taking you to the Act, nor the tribunal, but
- 17 I think we all remember it has a specific reference to
- 18 competition, doesn't it?
- 19 A. It does, once there is jurisdiction.
- 20 Q. Jurisdiction is an easy matter, which we will discuss
- 21 later, I think. And on the cost of information on which
- 22 it is based. So this is a reiteration that you have to
- 23 have some justification for the numbers. You just
- 24 cannot throw numbers at a company?
- 25 A. Oh, no.

1 Q. Absolutely. Then we see that access pricing can be  
2 based upon -- well, three methods. Let's go back to  
3 them. The tribunal has seen these before but forgive me  
4 for labouring the point with you:

5 "Accounting costs, the book value of the assets to  
6 which access is sought."

7 Accounting costs, I think we know what that means?

8 A. I know what I think that means, yes. I'm not sure that  
9 the description there is particularly good. It's only  
10 part of the cost.

11 Q. We can quibble. Then a book value of the assets to  
12 which access is sought. How would you interpret that:  
13 to which access is sought?

14 A. I think that I would expect Ofwat to be referring to the  
15 same mechanism as is used for determining prices to  
16 customers, to end-users, which looks at the costs of  
17 operation of the system and then the -- when it says  
18 "book value", it's the return on the regulatory capital  
19 value, which is neither a historic cost or a current  
20 cost of the asset because of the way in which the  
21 regulatory system works. So it's what the company was  
22 bought for on privatisation, plus additions and less  
23 depreciations since then, and then the cost of  
24 depreciation and that would normally be what we would  
25 expect them to mean by an accounting cost because we

1           would expect --

2       THE CHAIRMAN: I think Mr Sharpe is focusing your attention

3           on what are the assets to which access is sought.

4       A. I do apologise.

5       THE CHAIRMAN: Not at all.

6       A. So the assets to which the access is sought? So

7           whatever those assets are.

8       MR SHARPE: Yes. Thank you very much for that answer. Then

9           the second point is the long run marginal cost of that

10          part of the incumbent system to which access is sought.

11       A. Yes.

12       Q. We discussed LRMC earlier on, but that part of the

13          incumbent system, obviously it means something less than

14          the whole system to which access is sought, and we have

15          the same dialogue which the chairman drew your attention

16          to. We are talking about the specific assets to which

17          access is sought. That's right, isn't it?

18       A. I don't know whether they mean that to refer to the

19          specific assets or when it says "the part of the

20          system", the specific type of assets; in other words,

21          the part of the value chain. So particularly in

22          terms -- thinking in consideration again about networks,

23          which is where we were all thinking at this time, you

24          can't say that the water to a particular customer goes

25          through a particular bit of the network because the

1 networks are interconnected and water can take different  
2 paths at different times. So --

3 THE CHAIRMAN: We are talking about the main network?

4 A. Yes. So I know that the Ashgrove System isn't like  
5 this, so I would have been thinking about as in the  
6 distribution network, the treated water distribution  
7 network, or as in the water treatment system, because  
8 again water treatment -- the treated water that goes to  
9 a customer can come from different treatment works at  
10 different times. So I would have expected it to mean  
11 that part of the value chain.

12 MR SHARPE: Forgive me, you mentioned Ashgrove. This is  
13 really rather different, isn't it? Ashgrove is A to B,  
14 isn't it?

15 A. Ashgrove is different, in the sense that there aren't  
16 alternative paths for the water to take, yes.

17 Q. When I said Ashgrove, of course, I didn't just mean  
18 Ashgrove to Shotton, I meant Heronbridge/Ashgrove,  
19 Ashgrove/Shotton. It's a set of pipes on an A to B  
20 system where the concept of a network doesn't fit quite  
21 easily, does it?

22 A. No, but you were asking me -- I don't think Ofwat wrote  
23 this with Ashgrove in mind. You were asking me about  
24 what I thought they meant by that.

25 Q. I'm going to have to question you on that because there

1 is no specific managing director letter in relation to  
2 bulk supply arrangements such as Ashgrove. So I'm going  
3 to assume that they did not exclude the  
4 Ashgrove/Heronbridge/Shotton arrangements from the MD  
5 letter?

6 A. I'm sure they didn't exclude anything specifically but  
7 it is about common carriage and so -- it talks about  
8 pricing access to -- then to our networks, at the bottom  
9 of 609, which isn't to say that it can't apply to other  
10 essential facilities as well.

11 Q. Thank you. So, just to round off the point, when it  
12 talks about the assets to which access is sought in  
13 relation to a situation such as Heronbridge, it would be  
14 the Heronbridge assets to which, in our case, Albion  
15 sought access?

16 A. I wouldn't interpret it as being the specific assets.  
17 And as we know, when they actually were asked to  
18 consider this, Ofwat have not interpreted the system as  
19 being the specific --

20 Q. Are you referring to the determination which is now  
21 under review?

22 A. It's under review, I know. I'm aware it's under review.  
23 I am referring to the determination that Ofwat have made  
24 in which they have taken --

25 Q. Until I win that or my friend loses or he wins it and

1 I lose --

2 A. But in terms of what Ofwat were thinking about, that's  
3 the only clue I have, probably.

4 Q. Okay, all right. That's a qualification to the MD  
5 letter you put in.

6 When we talk about the long run marginal cost, there  
7 can be no argument that it refers to that part of the  
8 incumbent system to which access was sought. That's  
9 what it says and that's right, isn't it?

10 A. It says that, yes.

11 Q. And the only argument between us, which we are not going  
12 to be able to resolve, is what do we mean by that part  
13 of the system?

14 A. Yes.

15 Q. Yes. When one -- and I'm not going to talk about the  
16 efficient component pricing rule.

17 A. I am glad.

18 Q. But when one looks at this document, we don't see any  
19 requirement on the part of any company to price on the  
20 basis purely of LRMC, do we?

21 A. No.

22 Q. It's one of the options available to you?

23 A. Yes.

24 Q. Indeed, if you look at the paragraph that begins:

25 "Most companies ..."

- 1           The next one, can you read that?
- 2     A.   Yes.
- 3     Q.   "Most companies have indicated that they intend to  
4       charge for the use of their systems principally on the  
5       basis of the book value of the assets."
- 6           Do you see that?
- 7     A.   Yes.
- 8     Q.   "And some companies have indicated that entrants will,  
9       where appropriate, be charged ...(Reading to the  
10      words)... providing access, including the costs of new  
11      access ... "
- 12           Then it says:
- 13           "... although none has suggested that it would  
14      charge purely on the basis of LRMC."
- 15           That's right, isn't it?
- 16    A.   Yes.
- 17    Q.   And that didn't give you pause for thought, that you  
18      perhaps might be slightly out of step?
- 19    A.   No.
- 20    Q.   No? Okay. How many water companies would have been  
21      subject to this?
- 22    A.   I don't know how many there were at the time, probably  
23      more than 22, probably -- I know we went from 26 to 20  
24      and we were somewhere in between at that point.
- 25    Q.   I think it's 22 but don't hold me to that, I'm not

- 1 giving evidence. But quite a lot?
- 2 A. Yes.
- 3 Q. And none of them adopt the LRMC except for yourself?
- 4 A. We were following the guidance for bulk supply pricing  
5 because it is a bulk supply. It may or may not be an  
6 essential facility but it's definitely a bulk supply.
- 7 Q. You are not saying that none of the other water  
8 companies had bulk supply issues, are you?
- 9 A. No, I wouldn't know what issues they had but they  
10 wouldn't have mentioned them in their statements on  
11 access pricing if they had bulk supply issues.
- 12 Q. If we go over the page, we will pick it up at  
13 "Acceptable pricing conduct". Here the director is  
14 making it clear that in any complaint terms of access  
15 could be considered unreasonable if they applied  
16 dissimilar conditions.
- 17 A. Yes.
- 18 Q. You will find that actually --
- 19 A. Yes, at the top --
- 20 Q. Thank you. You obviously complied with that. Now, you  
21 mentioned this morning condition E, and you,  
22 respectfully, quite rightly, corrected what was, if you  
23 like, a regulatory error. But that was your view at the  
24 time, though, wasn't it?
- 25 A. Yes.

1 Q. Yes. And I think you said you changed your mind quite  
2 a long way down the line --

3 A. Yes, I think that Ofwat have clarified this in the more  
4 recent past.

5 Q. They did, yes, but at the time the advice you would have  
6 given -- and I'll call them your clients because I'm  
7 beginning to see you having -- dare I say this -- rather  
8 like an in-house lawyer role. I know you are not but  
9 you were giving your clients advice in a fairly detached  
10 and objective way?

11 A. Yes.

12 Q. And rightly or wrongly -- and I make no criticism,  
13 because it was very complex -- it took a long time to be  
14 resolved anyway -- the advice you would have given your  
15 clients would have been the condition you would have  
16 applied?

17 A. Yes.

18 Q. Thank you. Under "Information requirements", do you see  
19 at the bottom of the page, 613?

20 A. Yes.

21 Q. We have -- what is now familiar:

22 "In the event of a complaint regarding the price  
23 offered for access, Ofwat would require robust  
24 information regarding the costs and benefits of  
25 providing access."

1 A. Yes.

2 Q. There is no argument about it. As I said earlier, you  
3 can't throw a number at somebody and say, "That's it"?

4 A. No.

5 Q. It has got to be ...

6 May we turn to tab 60 in the same bundle. This is  
7 another one of Dr Bryan's reports to his board,  
8 dated August 2000. Do you have it?

9 A. I do.

10 Q. In this we see, under "Shotton Paper" on page 618 -- and  
11 pick it up in the second paragraph. Would you like to  
12 read it:

13 "Negotiations with North West Water regarding  
14 alternative bulk supply arrangements have proceeded  
15 well, albeit slowly. We have now reached agreement on  
16 the sharing of benefits that will obtain from a higher  
17 bulk supply price of 8p, compared to 3p currently, and  
18 the agreement provides for a lump sum payment of £25,000  
19 and the signing of the bulk supply agreement, plus  
20 a further £25,000 on the finalisation of a common  
21 carriage agreement with Welsh Water."

22 Then we go on:

23 "Thereafter we will receive 50 per cent of the  
24 benefits for a period of six months, about 85,000, plus  
25 30 per cent for a period of 12 months, about 105,000.

1           The total income is estimated at £240,000."

2           Do you see that now?

3       A. Yes.

4       Q. Were you familiar with the state of negotiations with  
5       Albion in or before August 2000?

6       A. No.

7       Q. No. Were you aware in any way of the benefit-sharing  
8       discussions that had been taking place?

9       A. No.

10      Q. However, from the record, would you agree with me that  
11      it indicates the kind of figure that was going between  
12      Albion and United Utilities at the time?

13      A. I'm sorry, what indicates the kind --

14      Q. This document.

15      A. Yes, I think we established earlier on in Dr Bryan's  
16      cross-examination that the 8p came from --

17      Q. I'm not worried about 8p -- anyway, the case isn't going  
18      to hang or lose on a penny, I hope.

19           And the figure of 8p -- or 9p or 8p -- would have  
20      provided more, if you multiply that by the megalitres  
21      involved -- and forgive me if I ask you to do this in  
22      your head but I think you are more than capable of it,  
23      if you multiply 0.8 or 0.9 by 6,800 megalitres a year --  
24      my learned junior should be doing this, not me -- you  
25      get a figure well in excess of a quarter of a million

- 1 pounds?
- 2 A. Yes, I would imagine -- yes, I'm sure it would come out  
3 to more than a quarter of a million pounds.
- 4 Q. And that was the base figure that Ms Boulton had put  
5 forward to her colleagues as worthy of negotiating  
6 position, and now we have something which looks, on the  
7 face of it, financially extremely attractive to  
8 United Utilities, doesn't it?
- 9 A. I would say attractive to our customers. I think there  
10 has been a lot of talk about profit and things and no  
11 recognition that we don't get to keep this money.  
12 So ...
- 13 Q. I'm sensitive to that and I think -- take it as read  
14 that I understand that you operate in a related  
15 environment and you operate and do your best for your  
16 customers?
- 17 A. Yes.
- 18 Q. But you are not a non-profit-making company, are you?
- 19 A. No, but the profit is regulated and --
- 20 THE CHAIRMAN: I don't think we need to go into this. The  
21 money would come into the company; whether they give it  
22 back to customers or shareholders or spend it on  
23 expensive holidays is not really our concern. Let's  
24 move on.
- 25 MR SHARPE: All right. Either way, wherever the money goes,

1           it's a pretty substantial increment to the revenue that  
2           United was receiving at the time, wasn't it?

3           A. To the revenue from that supply, yes.

4           Q. Yes, if that deal had gone through. In parallel to  
5           this, on one side, you were attempting to renegotiate  
6           the Heronbridge Agreement with Welsh Water, weren't you?

7           A. That's correct.

8           Q. From the record we have seen this first being raised  
9           in November 2000?

10          THE CHAIRMAN: You personally or ...

11          A. United Utilities, but again, I was the -- what I think  
12          you referred to as the kind of in-house adviser, maybe.

13          MR SHARPE: Yes. It's one of those cases where "you"  
14          actually does mean you, both in terms of  
15          United Utilities attempting to do it and we will see  
16          some of the correspondence to which I'm going to take  
17          Ms White.

18                 That was first raised in November 2000 and we will  
19          see now what United was saying about its position. Can  
20          we go to further on in bundle 3 to tab 89. Do you see  
21          the letter tab 89 dated 28 November 2000?

22          A. I do.

23          Q. It's signed by John Lees. Had you seen it before it  
24          went?

25          A. I can't remember if I saw it before it went. I'm sorry.

1 Q. Okay. It states they had had a meeting in November, two  
2 weeks before. He believes it imperative to renegotiate  
3 the bulk supply agreement at Heronbridge. Then he goes  
4 into the pre-history, with which we are now familiar.  
5 Do you see that in the first, second and third full  
6 paragraphs. Then it goes on:

7 "North West is reviewing all its bulk supply  
8 arrangements ..."

9 That's you, isn't it?

10 A. Yes, it is me.

11 Q. "... to ensure the terms, conditions ...(Reading to the  
12 words)... Competition Act and will not be open to  
13 challenge under the Act."

14 Then he goes on:

15 "We believe that the agreement with yourselves for  
16 the supply of Heronbridge will not be sustainable under  
17 challenge for the following reasons."

18 The first reason, as you see, doesn't reflect the  
19 following requirement of a bulk supply agreement as set  
20 out in section 40. Shall we look at that?

21 A. Yes.

22 Q. I think the first three bullet points are essentially  
23 derived from the Act. Does it look familiar to you?

24 A. Yes, yes.

25 Q. And the first one is very important. It doesn't secure

1 the efficient use of water resources or the efficient  
2 supply of water.

3 A. Yes.

4 Q. It doesn't facilitate effective competition and doesn't  
5 secure a reasonable return on capital.

6 Now, you are, I guess, judging by your earlier  
7 answers, pretty familiar with section 40, section 40A.  
8 These are the sort of pre-conditions before Ofwat will  
9 engage in a redetermination, aren't they?

10 A. The first one is a pre-condition.

11 Q. Yes.

12 A. And the others are -- come into play when it actually  
13 decides that it will take on the --

14 Q. Absolutely --

15 A. -- the determination.

16 Q. If an agreement does secure the efficient use of water  
17 resources, and it does secure the efficient supply of  
18 water, they will walk away from any attempt to  
19 renegotiate it. Is that right?

20 A. That's right.

21 Q. Thank you. Then we go on:

22 "The current arrangement between North West and DC  
23 for the supply, as set out in the draft heads of  
24 agreement ... does not adequately cover what we believe  
25 should be obtained within the formal bulk supply

1 agreement, in particular it doesn't cover leakage,  
2 pipeline ..."

3 And so on. I think it's perhaps less important,  
4 isn't it? But he is making the point which you made  
5 earlier this morning that these matters of detail have  
6 to be attended to?

7 A. Yes, and I guess it plays to the efficient use of water  
8 resources point.

9 Q. Right. Now, but the other ingredient he is introducing  
10 into this -- I'll call them minor points -- not because  
11 they are trivial, I know that they are important to you,  
12 but, really, what seems to be instrumental in this -- or  
13 appears to be -- is in paragraph 2 above it. He reports  
14 here that North West and Albion are negotiating a bulk  
15 supply agreement?

16 A. Yes.

17 Q. "The current agreement with DC will be seen as predatory  
18 under the Competition Act when compared to the agreement  
19 between North West and Albion."

20 The implicit assumption there, perhaps explicit, is  
21 that Albion's price would be higher than the lower  
22 price?

23 A. Yes.

24 Q. Then:

25 "In determining the price under the agreement with

1 Albion, North West will ensure that the price reflects  
2 both long run marginal cost and average accounting  
3 costs."

4 Yes? We will come back to that in a moment.

5 A. Yes, okay.

6 Q. So he is saying, "Look, we have this arrangement. Once  
7 we negotiate a deal with Albion at a higher price, then  
8 there will be two prices, and if the price with Albion  
9 reflects long run marginal cost, it therefore follows,  
10 by definition, the price to Welsh Water would be below  
11 long run marginal cost and therefore predatory".

12 A. Yes. I think if I had been asked to comment on the  
13 letter, I might have said, "may be seen", but, yes.

14 Q. You have been hanging round lawyers for too long.

15 A. Yes.

16 Q. I do see your point but nevertheless that's the position  
17 that has been put forward?

18 A. Yes.

19 Q. Okay. So it wasn't just a question of predation, of  
20 course, because you were presumably -- and he was  
21 presumably -- concerned about discrimination between two  
22 companies?

23 A. Yes.

24 Q. Yes. And if you had advised him -- and I don't regard  
25 this as legal advice -- you would probably have said

1           they have got to be treated broadly the same, because  
2           you couldn't see any real difference between them, could  
3           you?

4       A. No, there is no difference between the suppliers and --  
5           they would need to be treated the same.

6       Q. Thank you.

7       THE CHAIRMAN: This was after you had got involved in this  
8           whole review?

9       A. Yes, it is.

10      THE CHAIRMAN: I'm not quite clear about your involvement  
11           then with Mr Lees in the formulation of the wording of  
12           this letter.

13      A. I don't recollect it but I wouldn't expect to remember  
14           every letter that I looked at 12 years ago. So I can't  
15           say whether I looked at it or not. If I looked at it  
16           now, I definitely would not let him write, "We will be  
17           seen as predatory", I would have made him change that to  
18           "may", but I don't know whether I would have done that  
19           at the time.

20      THE CHAIRMAN: So you were more senior to him at the time?

21      A. No, I was in a different team and acting in an advisory  
22           capacity.

23      THE CHAIRMAN: I see.

24      MR SHARPE: You see, I confess, when I read this I thought,  
25           ah, you must have written this for him.

1 A. No.

2 Q. But you have told us you didn't.

3 A. No.

4 Q. He wrote it for himself?

5 A. Well, as far as I can remember --

6 THE CHAIRMAN: This idea that if you were charging Albion 9p  
7 for water and charging Dwr Cymru 3p for the water, that  
8 this might create a risk of being seen as predatory  
9 pricing, where did that idea originate from?

10 A. That was my concern because, although the price is --  
11 isn't exactly 3p, it's whatever the costs come to plus  
12 any capital costs if there are any capital costs, it  
13 appeared to be at a price that was below the long run  
14 marginal cost and we got, you know, guidance which said  
15 that prices above long run marginal cost will not  
16 normally be considered to be predatory. So immediately  
17 it kind of flags a concern, and it seemed that if  
18 a third party, which could be an industrialist that had  
19 an abstraction licence, wanted to -- thought that they  
20 could -- they weren't using that water and they could  
21 actually provide it to Albion, then it would prevent  
22 them from doing so. It would keep them out of the  
23 market.

24 THE CHAIRMAN: So that was the idea that you gained from  
25 reading the Ofwat guidance?

- 1 A. Yes.
- 2 THE CHAIRMAN: Did Mr Lees come to that same realisation on  
3 his own at the time you wrote this or was this something  
4 you discussed with him or ...?
- 5 A. No, I think that, although I don't think I wrote --  
6 I don't think I necessarily wrote the wording of the  
7 letter, and certainly not all of it, but this reflects  
8 discussions that we had had.
- 9 MR SHARPE: Thank you. Can we now go to tab 95 in the same  
10 bundle? This is a letter from Ofwat to you, dated  
11 11 December 2000.
- 12 A. Yes.
- 13 Q. Do you remember the letter?
- 14 A. Yes.
- 15 Q. And they appear to be asking you a number of questions  
16 about the approach that United Utilities was taking at  
17 the time. I think it goes without saying you understood  
18 how important this was and the importance of giving  
19 accurate answers, and one assumes that they were  
20 accurate. And that's a reasonable assumption, isn't it,  
21 of course?
- 22 A. Yes.
- 23 Q. Fine. So if you care to just refresh your memory as to  
24 what they were asking you, the first point about  
25 Welsh Water having to reduce supply to enable Albion's

1 supply. That was an issue that arose. But I think we  
2 can move on from that for the moment. It's not that  
3 important.

4 "Clarify the following: price range you have agreed  
5 in principle. When did you begin your bulk supply  
6 negotiations? What issues remain to be resolved? What  
7 issues have to be resolved ..."

8 A. Yes.

9 Q. "What issues have to be resolved, and by whom, before an  
10 agreement with Albion Water can take place? Have you  
11 and Welsh Water reached any agreement on the revisions  
12 to their current arrangements?"

13 Over the page, an entire sequence of actions  
14 required from now on:

15 "How do your negotiations with Welsh Water affect  
16 your negotiations with Albion?"

17 Then confirmation about the agreement.

18 A. Hm-mm, yes.

19 Q. Let me go now to tab 106 at page 762. That is reply  
20 from you to the case manager at Ofwat?

21 A. Yes.

22 Q. If we just spend a moment refreshing your memory in  
23 relation to the answers and looking at the date now,  
24 20 December 2000:

25 "We haven't agreed in principle any price range but

1 we advised them that the price would be up to 9p, an  
2 indicative price ..."

3 And so on. 5 is important, isn't it? You are in  
4 the process of reviewing all contracts to ensure they  
5 comply with the provisions of the Competition Act. That  
6 has been brought forward as a result of Albion's  
7 application.

8 A. Yes.

9 Q. And 6 relates to the possible renegotiation of the  
10 agreement with Welsh Water, doesn't it?

11 A. Yes.

12 Q. Yes. And the bullet points really reflect the  
13 provisions of section 40A.

14 And 7, you are not involved in those common carriage  
15 negotiations, not directly, and you outline the course  
16 of events. Can I just take you back to 6? Your concern  
17 here, in dealing with the appropriate price, is first of  
18 all to make it compatible, compliant, with the  
19 obligations as you see them under section 40 --

20 A. Yes.

21 Q. -- of the Act. And also to comply with the provisions  
22 of the Competition Act and to be consistent with our  
23 high level principles for the shared use of water?

24 A. Yes.

25 Q. So you are very much aware of the Competition Act at

1           that time. Then you say:

2           "Currently we are in the process of analysing our  
3           LRMC for resources into its constituent components in  
4           order to set the price."

5           And then if we pick it up at 8:

6           "Our negotiations with Albion and Welsh Water are  
7           related for two reasons. Firstly, it's important that  
8           we ensure no undue discrimination between the two  
9           parties. In particular, we are not contravening the  
10          Competition Act by applying dissimilar conditions to  
11          equivalent transactions with other trading parties,  
12          thereby placing them at a competitive disadvantage."

13          You go on:

14          "We envisage that the contract terms for both bulk  
15          supply agreements will be identical, except where the  
16          requirements of the two customers are different."

17          You have already indicated a moment ago you saw no  
18          material differences that would justify any --

19         A. No.

20         Q. Thank you. So certainly at that date, it was very much  
21          your intention to arrive at a solution where, at the  
22          very least, the prices payable by Welsh Water and by  
23          Albion would be the same?

24         A. Yes.

25         Q. You raised this directly with Welsh Water, didn't you?

1 Let's go back, if we may, to tab 89 of the same  
2 bundle -- I beg your pardon, we have seen that, I think.

3 A. Yes.

4 Q. We have seen that letter being sent by Mr Lees to  
5 Mr Holton. If we go to tab 102, we can see the reply.  
6 He addresses head on Mr Lees' argument/belief that the  
7 agreement was contrary to the Competition Act. There is  
8 a potential for it to be challenged:

9 "Welsh Water's position ..."

10 This is line 3, the second paragraph:

11 "... is that the arrangements constitute a vertical  
12 agreement and therefore, as set out in section 50 of the  
13 Competition Act 1998, is exempt from the challenge you  
14 describe."

15 Right? So that's his reply?

16 A. Yes.

17 Q. It doesn't apply at all.

18 A. That's his reply.

19 Q. That's his reply. Now can we look at United Utilities'  
20 response to that, which I'm afraid takes us into the  
21 fourth bundle, at tab 111. I think it's the first tab.  
22 I take it this is United Utilities' considered response.  
23 And it's very short:

24 "Further to my letter of 20 December, I feel we are  
25 now at the stage where we need to make progress on bulk

1 supply. I note your view that, as stated in your letter  
2 of 15 December, the arrangement constitutes a vertical  
3 agreement and is, in your view, exempt from challenge.  
4 North West Water do not agree."

5 He doesn't go into any detail but it is an  
6 expression of corporate disagreement that is used, isn't  
7 it?

8 A. Yes.

9 Q. So, you believed at that time that it would be  
10 susceptible to challenge under the Competition Act?

11 A. Yes.

12 Q. And was not exempt by virtue of section 50?

13 A. Section 50 would only exempt it from chapter 1 but I saw  
14 no point in us going into any dancing on pinheads with  
15 Welsh, which is just going to introduce delay; I just  
16 want to talk to them about the agreement and get  
17 something sorted out.

18 Q. Yes. Just the only other point on the letter, if  
19 I recall, over the page, the price which you were  
20 seeking from Welsh Water:

21 "At our meeting you raised the question of price  
22 ...(Reading to the words)... North West do not  
23 expect this price to exceed 9p per cubic metre."

24 Do you see that?

25 A. I see that, yes.

- 1 Q. And that represented the accurate view at the time,  
2 namely mid-January 2001?
- 3 A. Yes, it did.
- 4 Q. That's right, isn't it?
- 5 A. Yes.
- 6 Q. Just pick it up again at tab 124. This is just three  
7 weeks later on so, isn't it?
- 8 A. Yes, yes.
- 9 Q. On 7 and 8 February.
- 10 A. February.
- 11 Q. We see at the start of Mr Lafon's email to Dr Bryan --  
12 this is on page 863. This refers to a conversation  
13 between Mr Jeffery, who at the time was on the board of  
14 Albion, and John Lees, your colleague at United. And it  
15 seems that they had intimated to him that the price  
16 which had earlier been given, of up to 9, was now up to  
17 12.1 per cubic metre. That's right, isn't it?
- 18 A. Yes.
- 19 Q. "... as a product of that detailed work ..."  
20 It's your detailed work, isn't it?
- 21 A. Yes.
- 22 Q. We will come back to that:  
23 "... and is relative to the supply at Heronbridge."  
24 Yes?
- 25 A. Yes.

1 Q. And the price has "board approval". Do you see that?

2 A. Yes.

3 Q. Thank you.

4 A. I won't forget that bit.

5 Q. In relation to the conversation between Jeffery and  
6 Lees, you weren't a party to that conversation, were  
7 you, you weren't present?

8 A. No.

9 Q. And if we go over the page to 864, we see Dr Bryan's  
10 response and we see what can only be described as  
11 a fairly incendiary response from Dr Bryan. He states:

12 "Such a price would run counter to competition law  
13 and regulatory guidance."

14 A. Yes.

15 MR BEARD: Sorry, I don't mean to interrupt but it's a chain  
16 of emails that reads backwards. So I'm not sure it  
17 would be right to put to the witness that this was  
18 a response. It's dated 7 February.

19 MR SHARPE: My friend is absolutely right.

20 MR BEARD: Sorry.

21 MR SHARPE: Mr Lafon's reply to Dr Bryan is a response to  
22 the earlier incendiary response. Thank you. I'm most  
23 obliged. But nevertheless it is Dr Bryan's response to  
24 the information he received, doubtless from Mr Jeffery.  
25 Do you understand?

- 1 A. Yes.
- 2 Q. So we are no wiser from that intervention but we are  
3 better informed. Nevertheless you understand Dr Bryan's  
4 concern and we see that he regards this as sort of  
5 anti-competitive and contrary to regulation?
- 6 A. Yes.
- 7 Q. Before we move on on that, you were aware of the 12.1p  
8 figure?
- 9 A. I calculated the 12.1p figure.
- 10 Q. Were you privy to the discussion that it should be  
11 offered to Albion?
- 12 A. I understood that it would be offered to Albion, yes;  
13 that's why I was being asked for it and being put under  
14 pressure to produce it.
- 15 Q. Give us a little bit of background here because I am  
16 afraid we don't have that in your witness statement.  
17 It's not meant as criticism but were you at a meeting,  
18 were you telephoned? How did it work?
- 19 A. I don't recollect. They would probably have phoned me  
20 to say, "Can you hurry up with this price, please,"  
21 because as we saw in the letter to Julie Griffiths,  
22 I had said that I was working on the price. But I was  
23 being chased and I was chasing colleagues who needed to  
24 provide me with information.
- 25 Q. All right. We see Mr Lafon's response on 8 February,

1 and specifically he says:

2 "It's the product of detailed work relative to the  
3 supply of Heronbridge."

4 And that -- I think he also said says that the 9p  
5 figure -- he has remarked the 9p figure was based on  
6 early work and specific circumstances. That's right,  
7 isn't it? Did you do the earlier work?

8 A. No.

9 Q. No, so someone else created the 9p per cubic metre?

10 A. I don't recollect doing anything that came to 9p a cubic  
11 metre although I may have been asked to comment on  
12 whether it sounded reasonable but I'm afraid I don't  
13 remember.

14 Q. Have you any idea who might have been entrusted with  
15 that responsibility?

16 A. Mr Hickman.

17 Q. Mr Hickman? Forgive me. That's not your evidence?

18 A. I'm sorry.

19 Q. So we have an earlier figure. Now, Mr Hickman, was he  
20 part of the compliance team?

21 A. No, he worked in the businesses sales and marketing  
22 department, having previously worked in finance, and he  
23 was a qualified accountant. If they were looking at  
24 prices for non-regulated activities like I spoke  
25 about -- as I mentioned earlier, they would usually ask

1           him to work out some pricings. And that was fine  
2           because those aren't part of the regulated business and  
3           so, therefore, it's up to them to decide what they want  
4           to charge, you know, in a position where they wouldn't  
5           be dominant. Their problem here was that this is  
6           regulated activity and so they then -- we then had to  
7           say: no, we have to work the price out based on the  
8           regulatory guidance.

9       THE CHAIRMAN: What do you mean this is regulated activity?

10      A. A bulk supply to another water company is a regulated  
11         activity under the Water Industry Act 1991, and there is  
12         Ofwat guidance which we would be expected to follow, and  
13         we also know that if we don't follow that, that we know  
14         that Ofwat can intervene at the request of either party  
15         if negotiations break down. So -- and if you know Ofwat  
16         are going to do that, there is no point trying to come  
17         up with a price that's different to what they are going  
18         to determine anyway because it's always in one or other  
19         party's interest for it to move.

20      MR SHARPE: So Mr Hickman produced the figure on which  
21         everyone had been relying for some considerable time  
22         here and it was also the figure that had been  
23         communicated to Ofwat by you, I think?

24      A. Yes, that was the figure that I understood and I was  
25         working -- doing some more detailed calculations.

1 Q. But you told us a moment ago you hadn't communicated  
2 that to Mr Hickman?

3 A. No, sorry, I hadn't --

4 Q. Or had you?

5 A. What, that I was doing some more detailed calculations?

6 Q. Had you communicated a figure of 9p to Mr Hickman in  
7 advance of communicating to Ofwat?

8 A. No, I think it was the other way round that, he had --  
9 that I had become aware that 9p was what was being  
10 discussed.

11 Q. Up to 9p?

12 A. Up to 9p, and I was reporting back to Ofwat on what the  
13 situation was at that point in time and collecting  
14 information from people in order to do that.

15 Q. But Mr Hickman, not being part of your team and having  
16 your responsibilities, would have approached this from  
17 an somewhat different perspective, wouldn't he?

18 A. He would see, yes.

19 Q. Yes. Do you think it was appropriate to inform Ofwat of  
20 a figure which was based -- on a basis which frankly  
21 couldn't constitute --

22 THE CHAIRMAN: You need to ask her a prior question,  
23 I think.

24 Did you have any discussion with Mr Hickman as to  
25 what this price of 9p was supposed to represent? In

- 1 terms of how he had arrived at it?
- 2 A. If I did, I don't recollect that. I think what I was  
3 reporting to Ofwat was factual, because I was saying:  
4 Albion have been told -- this was the situation that we  
5 had told them.
- 6 THE CHAIRMAN: Was it presented as being a calculation of  
7 actual accounting costs, long run marginal costs, some  
8 other --
- 9 A. No.
- 10 THE CHAIRMAN: None of those?
- 11 A. I'm not aware -- I don't recollect being told how  
12 specifically it was calculated.
- 13 MR SHARPE: It was produced by somebody who really wasn't  
14 involved in regulatory pricing decisions.
- 15 A. That's right.
- 16 Q. You didn't verify it, did you?
- 17 A. Well, that's what I was in the process of trying to do.
- 18 Q. You didn't verify the 9p figure, did you?
- 19 A. No.
- 20 Q. No. Fine. Mr Lafon's email refers to early LRMC work.  
21 Could you, please, describe what he meant by that? Do  
22 you know?
- 23 A. I'm looking for the -- it's --
- 24 Q. It's on page 863, four lines from the top.
- 25 A. Right. I'm not sure what that means but I'm afraid --

1           it's a long time ago.

2       Q. I do appreciate it was a long time ago but the language  
3       is fairly clear. He is trying to justify a movement  
4       from 9p, which you had told Ofwat all about, you had  
5       told Dr Bryan; by this time you had told or were on the  
6       verge of telling Welsh Water what the price would be.  
7       You had told them, I think?

8       A. Yes.

9       Q. But we don't know where on earth it came from and  
10      actually, probably, who did it, do we?

11      A. I personally don't know that, no.

12      Q. No documents have emerged in relation to that, have  
13      they?

14      A. No, they haven't.

15      Q. Madam, I'm wondering whether this might be a convenient  
16      moment for a very short break?

17      THE CHAIRMAN: Can I just ask: when Mr Hickman mentioned  
18      this price to you of 9p, why was he telling you this  
19      price? What were you supposed to do with that 9p price?

20      A. I think they were hoping that I would come up with  
21      something that would be broadly in the same ballpark but  
22      also I would have required it in order to respond to the  
23      letter from Julie Griffiths at Ofwat. So although the  
24      letter was addressed to me, not all of the things that  
25      were asked would have been within my direct



1 A. I think that's the detailed LRMC work.

2 Q. Yes:

3 "In advance of detailed work that has been ongoing  
4 for some time relating to our preparations."

5 A. Yes.

6 Q. What he is saying is: this isn't just for Albion, this  
7 is for the general proposition.

8 You were involved in that, weren't you?

9 A. The detailed LRMC work, yes.

10 Q. Yes. And we have not seen any papers in relation to  
11 that?

12 A. No.

13 Q. Your witness statement says it was all done orally.  
14 There were no documents because it was all a question of  
15 conversation; is that right?

16 A. No, I would have had calculations at the time which  
17 would have shown where the figures came from and the way  
18 in which they had been broken down, so to the  
19 calculation of the long run marginal cost generally and  
20 then allocating it across the value chain, because  
21 obviously it wouldn't be right for this supply to bear  
22 costs that related to distribution and treatment when  
23 there is no distribution and treatment.

24 But I don't have any papers that go back to 2000,  
25 and I certainly wouldn't keep papers for that long

1 relating to something that would -- a price that was  
2 given and not accepted, not taken up.

3 Q. I understand the latter aspect of your remark; what  
4 I find more difficult is calculatings (sic) to some  
5 generalised common carriage charge which would have been  
6 applicable not merely to the rejected Albion situation  
7 but would have been a general application. Do you not  
8 share my surprise?

9 A. No -- such prices would by now, you know, have been  
10 completely superseded by the Water Act 2003, which  
11 brought in a totally different method of pricing and so  
12 I wouldn't have had any -- and had not been the subject  
13 of -- hadn't been in support of any contract at that  
14 time. So, therefore, if we had contracted with somebody  
15 prior to the Water Act 2003 on the basis of those old  
16 prices, then I would have expected those to be with the  
17 contract documentation, but there is no contract that  
18 relates to that period and --

19 THE CHAIRMAN: You can't remember how -- what was the  
20 exercise that you undertook to get to the 12.1? Is that  
21 what you are saying?

22 A. In broad outline I looked at the water resource plan,  
23 which Mr Sharpe took us to earlier, and considered how  
24 that -- you know, the long run marginal cost that that  
25 indicated. But then that had to be --

1 THE CHAIRMAN: On the whole company then?

2 A. Yes, on the whole -- and then that had to be -- I think  
3 I probably would have looked at the integrated zone as  
4 a separate case, although that's nearly all of the  
5 company but ... and then had to try to get information  
6 from colleagues about the way in which that would split  
7 across the value chain. My recollection --

8 THE CHAIRMAN: What do you mean the value chain?

9 A. Well, the different components of the -- of the -- so,  
10 if you imagine that what we actually provide in this  
11 instance is raw water abstraction. There is no --  
12 across the system generally there would be raw water  
13 distribution, there would be water treatments, there  
14 would be treated water distribution as well, but for  
15 this particular supply none of that is relevant. There  
16 were no additional treatment costs. So it takes only  
17 a part of the total service, whereas if you were an  
18 end-user of treated water, you take all those aspects of  
19 service. This takes just the raw water abstraction and  
20 it was identifying ways in which that could -- the  
21 overall figure could be allocated across those different  
22 components, which was the problem that was causing  
23 delays in the process.

24 MR SHARPE: You had been at it for about a year by this  
25 time, had you not?

- 1 A. Not for this particular case, no.
- 2 Q. But for common carriage you had?
- 3 A. For common carriage, looking at network costs, we  
4 wouldn't have been -- it was -- we were more concerned  
5 with principles and also with the network situation and,  
6 of course, we had only had the water resource plan  
7 information for about a year, just over a year.
- 8 Q. So, from the best of your recollection -- and we have no  
9 documentary evidence at all --
- 10 A. No, I'm sorry about that.
- 11 Q. -- we have a situation where you may have looked at the  
12 integrated zone -- well, you point out that's  
13 95 per cent of the company anyway?
- 14 A. Yes.
- 15 Q. And then from that you would have deduced long run  
16 marginal cost but there is quite a big leap that from  
17 statement to the conclusion which I don't know if we are  
18 going to get very much further --
- 19 A. I think most companies -- as I think one of the Ofwat  
20 letters said, companies were asked to publish long run  
21 marginal costs anyway, in total. That's in an Ofwat --
- 22 Q. That's true. But it only relates to potable water,  
23 doesn't it?
- 24 A. Yes. And the hard bit is then to say: well, how do we  
25 split this down across the components? Because that's

1 quite a hard question when you are looking at  
2 interventions that are in specific areas.

3 Q. But the truth is, regrettably --

4 A. And we don't know how that was worked out. But what we  
5 do know is that was what I worked out at the time.

6 Q. Yes, well. So the 12.1 figure is the figure you gave --

7 A. Yes, that's the figure I gave.

8 Q. -- Mr Lafon but the figure of 9 has been discarded,  
9 derived from Mr Hickman's work?

10 A. Yes.

11 Q. Okay. When we look more closely at what Mr Lafon is  
12 telling Dr Bryan, he says this 12.1 figure is a product  
13 of that detailed work; right? Relative to the supply of  
14 Heronbridge.

15 Now, that sort of suggests to me that we are not  
16 looking at the integrated zone, it's somehow related to  
17 the supply of Heronbridge. I'm right you hadn't seen  
18 this email before?

19 A. I hadn't, but that may refer to the fact that it was to  
20 do with the integrated zone, which Heronbridge is part  
21 of, rather than being to do with the company-wide  
22 number. I don't know.

23 Q. You do not know, do you?

24 A. No, I don't know.

25 Q. So the ordinary natural meaning relative to the supply

1 of Heronbridge means the long run marginal costs  
2 associated with the supply at Heronbridge, not at  
3 Penrith or Crewe or Liverpool or Birkenhead, all of  
4 which are in the integrated zone. That would be fair,  
5 wouldn't it?

6 A. I understand the point which you are making, yes.

7 Q. Thank you.

8 THE CHAIRMAN: What is your response to the point?

9 A. I don't know what was -- I didn't write the email and --

10 THE CHAIRMAN: When you were doing your calculations, did  
11 you just look at Heronbridge or did you look at  
12 Liverpool, Birkenhead, Crewe, et cetera.

13 A. Liverpool, Birkenhead, Crewe -- I'm not sure that  
14 Penrith is in the integrated zone but it might be --

15 MR SHARPE: I believe it is.

16 A. But -- because that's the relevant area to consider  
17 because of the fact that water can be moved about within  
18 that zone. That is the relevant situation to consider.  
19 If we don't need to use that water at Heronbridge, we  
20 can use it somewhere else.

21 Q. Forgive me, geography was never my strong suite, but you  
22 have got the River Dee and you have got Heronbridge; you  
23 are not saying that water comes from Birkenhead to  
24 Heronbridge, are you?

25 A. Water goes from Heronbridge to Birkenhead.

- 1 Q. It goes that way, yes --
- 2 A. That way --
- 3 Q. Yes, but it's a one way traffic, isn't it?
- 4 A. So if we had more water -- if we had water available at
- 5 Heronbridge because Shotton Paper was supplied from the
- 6 Milwr Tunnel or something like that, then that water
- 7 could be transported to our Sutton Hall Treatment Works.
- 8 It could also, via the Huntington Water Treatment Works,
- 9 which is just upstream, it could then go to all of
- 10 Cheshire, into Liverpool, across to Manchester if
- 11 necessary; we could also transfer it across to Crewe.
- 12 Q. Thank you.
- 13 A. So it's quite integrated.
- 14 Q. That's why it's called the integrated zone?
- 15 A. Yes.
- 16 Q. But nevertheless, I'm afraid we still have a query
- 17 surrounding precisely what Mr Lafon meant and he is not
- 18 here to tell us and we can only guess, can't we?
- 19 A. Yes.
- 20 Q. That would be right, isn't it? If we go back to this
- 21 question of board approval, we can shrug this off,
- 22 I mean, he could have meant some lower board or no board
- 23 for that matter, but normally when someone says the
- 24 price has board approval, they mean it has gone quite
- 25 a long way up the hierarchy. That would be the ordinary

- 1 natural meaning, wouldn't it?
- 2 A. Yes.
- 3 Q. Without wanting to make a ridiculous point, if you  
4 capitalise, "Board", it has -- in my world, we talk of  
5 a defined term -- it has a rather special meaning, it's  
6 "the Board", typically?
- 7 A. I think if I was saying to somebody that a programme  
8 board had seen a particular paper or something, you  
9 know, or a project board, I would still use a capital B.
- 10 Q. But you probably would have "Project" in front of it,  
11 wouldn't you, unless you were talking to somebody who  
12 knew --
- 13 A. Yes.
- 14 Q. If you are talking about somebody outside the company  
15 and said, "This has Board approval", I think what you  
16 are trying to convey is this is a strong agreed price.  
17 It would have the effect of improving his bargaining  
18 position, wouldn't it?
- 19 A. Yes, it would.
- 20 Q. Thank you. And you said earlier, very helpfully, but  
21 just to reinforce it -- you took the time and trouble to  
22 explore whether or not there was any minute anywhere in  
23 the company --
- 24 A. I did.
- 25 Q. And we have not been able to find one. Thank you. If

1           we look further down the email, we see it's not the end  
2           of the story, the 12.1p, is it?

3           A. No.

4           Q. We see Mr Lafon and -- as my learned friend very  
5           helpfully pointed out, in response to the onslaught from  
6           Dr Bryan. And in one email Dr Bryan managed to secure  
7           a 25 per cent reduction in the price, didn't he?

8           A. Yes.

9           Q. If 12.1 per cent was the long run marginal cost, as  
10          you said it was, and if you were concerned about  
11          competition implications, you must have been extremely  
12          alarmed that this had gone down to 9.1 per cent?

13          A. Pence.

14          Q. Pence.

15          A. In light of the strong email, I was approached by  
16          Mr Hickman and he was concerned that with the level of  
17          the price.

18          THE CHAIRMAN: Wait a minute, what strong email?

19          A. The one of 7 February from Dr Bryan. So I was  
20          approached --

21          MR SHARPE: He was concerned about the higher price of  
22          12.1p?

23          THE CHAIRMAN: Who was? Mr Hickman?

24          A. No, so Dr Bryan was concerned about the 12.1p. I was  
25          approached by Mr Hickman, who was concerned that this

1        would mean that we would lose the opportunity to agree  
2        this contract and also that it didn't agree with the  
3        kind of more approximate prices that he had done.

4                We had a discussion about the supply and he  
5        suggested that one of the things which I had not taken  
6        into account was that this supply doesn't benefit from  
7        any back-up arrangement. So the majority of supplies to  
8        domestic customers are normally -- they are normally  
9        able to be served by more than one source of supply. And  
10       certainly for something as large as this, you would  
11       expect there to be -- sometimes there are twin mains so  
12       that if one bursts, another main is still available, or  
13       there may be an ability to get water from another area  
14       or storage for a particular -- domestically, locally,  
15       there is usually 24-hour storage, which gives you time  
16       to fix something. And he pointed out that that wasn't  
17       the case here, and if we weren't able to pump at  
18       Heronbridge because there was a power failure or because  
19       the pumping station was flooded, because it is right on  
20       the banks of the river, or for whatever reason that --  
21       so he was kind of -- if you imagine, instead of saying,  
22       "You have raw water abstraction and then raw water  
23       distribution and so on as you are supplying", he was  
24       saying, "You have another service as a back-up, which,  
25       because this" --

1 THE CHAIRMAN: He was trying to explore with you ways to get  
2 the 12.1p back down to 9p?

3 A. Yes, he was. And this was the point -- the point that  
4 was put forward was that this supply has no back-up, and  
5 for this reason they actually have to pay for a back-up  
6 from Welsh Water, which, if our supply was more secure,  
7 then there would be less -- there may be less need for  
8 that.

9 So, in consideration of that, and also in  
10 recognition of the fact that a non-abusive price is not  
11 a point price, it is something which is not so low as to  
12 be predatory and not so high as to be exploitive but  
13 it's somewhere in between, would it be acceptable if  
14 they were to continue with that price and -- so in the  
15 end we agreed that they could go back on that basis but  
16 not any lower at all.

17 THE CHAIRMAN: When did this discussion take place?

18 A. I would imagine it took place between the two emails.

19 So, yes, I can remember them being quite concerned.

20 I can remember Ken Hickman being concerned about this  
21 and saying, "What are we going to do?"

22 THE CHAIRMAN: So you gave them the okay to go back with the  
23 9p price?

24 A. Yes.

25 MR SHARPE: So whatever the 12.1p was, it wasn't a final

1 price, was it, in the event?

2 A. No, in the event an LRMC may be a point price but  
3 obviously there is negotiation between parties and so we  
4 might have thought we could get a bit more than that but  
5 not so much as to be abusive. And we might have, as --  
6 you know, we went down but I didn't feel to a level that  
7 was predatory, given the specific circumstances which he  
8 pointed out to me.

9 Q. To your knowledge, did Dr Bryan ever raise the question  
10 of interruptibility at any time, before this or at all?

11 A. No, and I think that it was an indication of -- that  
12 they were keen to strike the deal.

13 Q. Perhaps a bit of a fig leaf?

14 A. It certainly is interruptible and I did phone -- in kind  
15 of -- in consideration of this, I spoke to people --  
16 well, the managers who looked after the site and said,  
17 you know, "Do you interrupt it? What happens if this  
18 happens? What happens if there is pollution in the  
19 river?" and so on. And they said that it can be  
20 interrupted if there is a power failure. If there is  
21 pollution, we contact the users to see whether it will  
22 affect them, and if it would affect their processes,  
23 then we would have to switch off because you can't take  
24 the water from somewhere else. So if the river is  
25 polluted, you would have to turn it off.

1 Q. Let me put an alternative scenario to you.

2 Dr Bryan knew all about pollution and interruption  
3 and he may just have easily have assumed that it was all  
4 part and parcel of the 9p offer?

5 A. Yes.

6 Q. Let me put it to you again -- and I think you have  
7 agreed with me here -- although it's an important  
8 consideration, it's not a consideration that had been  
9 raised by Dr Bryan. For all I know, he may well have  
10 incorporated it into his analysis of the 9p offer but  
11 from your perspective and your colleagues, it was  
12 a quick and easy means of trying to assuage Dr Bryan --

13 A. It wasn't something that had been raised by Dr Bryan  
14 with me, and it wasn't something that I was told had  
15 been raised. Whether or not it had, I can't say.

16 Q. Fine, but it got you back to 9 anyway?

17 A. Yes.

18 Q. So that's what one email can do?

19 A. Yes.

20 Q. Yes, absolutely. Of course it's not the whole story, is  
21 it, because this was conditional and we see that again  
22 in the body of the email at 863?

23 A. Yes.

24 Q. And we see:

25 "Prepared to revert to 9 but you've got to

1           acknowledge that the price is fair and reasonable."

2       A. Yes.

3       Q. Now, if he signed up to it, whether he signed and said  
4       it was fair and reasonable is pretty well irrelevant, he  
5       had signed up and bound himself to do it. What do you  
6       think that Mr Lafon was attempting to achieve by  
7       imposing this condition?

8       A. I don't know. I think it has been assumed that it was  
9       something to do with the -- that he wouldn't then come  
10      back with a Competition Act complaint about it. But  
11      I wasn't -- I didn't speak to Mr Lafon directly. So ...

12      Q. So you can't really help us on that?

13      A. No.

14      Q. But the speculation is that it might have been -- as you  
15      say, you were concerned about Dr Bryan. One thing you  
16      can say about Dr Bryan, he knew where Ofwat lived, and  
17      he wasn't frightened of using the competition laws when  
18      it was appropriate. I think that's fair?

19      A. No.

20      Q. And I think, perhaps, section 40, or 40A as it would  
21      have been, to renegotiate the agreement once it's  
22      signed?

23      A. I think that would have been less of a concern, because  
24      if you had looked at the guidelines for section 40 and  
25      they said the use of that long run marginal cost, then

1 I think Ofwat might have come out nearer to the 12p than  
2 the 9p because that would have followed their own  
3 guidelines.

4 Q. Yes. Thank you. But I think it -- you tried to impose  
5 this as a condition and he also wanted the bulk supply  
6 agreement with you to be signed in advance of  
7 a successful negotiation with Welsh Water. Were you  
8 aware of that as a pre-condition?

9 A. I wasn't aware of it prior to it being sent out, no.

10 Q. No. You were asking him to lock himself into an  
11 arrangement with you in advance of knowing what price he  
12 was going to pay for common carriage. That the right,  
13 isn't it?

14 A. Yes, but our price for our product isn't, as far as we  
15 are concerned, dependent on the price that Dr Bryan has  
16 to pay in other part of the value chain.

17 Q. Ms White, you knew very well -- and I won't insult your  
18 intelligence -- the whole basis of this was to arrive at  
19 a price which would enable Dr Bryan to make a profit,  
20 more than he was getting with a zero margin from  
21 Welsh Water. Therefore, if he was charged an abusive  
22 common carriage price, as eventually materialised -- and  
23 has been declared by the tribunal -- then he would have  
24 had no margin given his commitment to you. So the two  
25 are related, aren't they: the lower your bulk supply

1 price, the lower the common carriage, the greater the  
2 margin. That was understood by your colleagues, wasn't  
3 it?

4 A. I think that was -- it was understood by them that this  
5 was all part of an overall deal but that doesn't mean  
6 that our price can just be flexed to suit whatever the  
7 common carriage price is, any more than we can go and  
8 say to somebody who makes chlorine, "Well, we are not  
9 making very much money here so could you charge us a bit  
10 less".

11 Q. "Flexed" is your word. What he wanted to do was to have  
12 the building blocks in place -- and we have heard his  
13 evidence -- he wanted to establish what the common  
14 carriage price would be so that then he could see what  
15 margin he had to deal with, his negotiating margin with  
16 you. That's his evidence?

17 A. Yes, sorry, in terms of the question -- if the question  
18 is, you know, do I think he ought to have signed the  
19 bulk supply agreement before 15 March, then I can  
20 obviously understand why he didn't do that.

21 Q. He would have been daft to, frankly, wouldn't he?

22 A. Well, he would have got £25,000, but given the size of  
23 the overall supply -- but obviously you then take  
24 that -- you know, the risk that the price might be  
25 different if you come back in 12 months or 24 months or

- 1           whatever.
- 2       Q.   There is a dispute about the timing of this but it seems  
3           a very odd pre-condition to put in when he had made it  
4           abundantly clear that he was seeking, ultimately, to  
5           share some of the benefits with United Utilities, wasn't  
6           he?  And you are aware of that --
- 7       A.   Well, yes, and the benefit sharing would obviously still  
8           have come into effect.
- 9       Q.   But there would only be benefits to share if the common  
10          carriage price allowed the benefits to accrue; that  
11          would be right, wouldn't it?
- 12      A.   Well, the benefit sharing in the contract didn't depend  
13          upon that.
- 14      Q.   His overall pot --
- 15      A.   His overall -- yes, but he wasn't going to share his  
16          benefits with us and the benefit sharing that's in the  
17          contract is about the sharing of the benefits that  
18          would -- we would see.
- 19      Q.   But you would agree, from his perspective he had to see  
20          both sides of the story.  He wanted to lock in common  
21          carriage so he knew whether he had a viable economic  
22          future buying water from you.  Therefore, is it not  
23          strange that you should seek to impose this as a term?  
24          What economic commercial rationale is furthered by it?
- 25      A.   I think it's commercial rationale, isn't it?

- 1 Q. Is it?
- 2 A. Yes. Going back to a term that we found earlier, it's  
3 a negotiating position.
- 4 Q. Thank you. Thank you. Returning to the benefit sharing  
5 arrangements, I think you will understand what took  
6 place, did you discuss them at all with your colleagues?
- 7 A. No.
- 8 Q. But the effect of the benefits sharing arrangements  
9 would surely have been: one, to reduce the effective  
10 cost to Albion of the price that it would be paying you,  
11 on the one hand, and increase the effective price to you  
12 by virtue of the extra benefits or that proportion of  
13 the benefits you would receive. You understand that, do  
14 you not?
- 15 A. Well, the effect of the contract is to increase the  
16 revenue to United Utilities and its customers. The  
17 effect of the benefit sharing arrangement is to pass  
18 some of that over to Albion Water for a short period of  
19 time.
- 20 Q. For 18 months, I think?
- 21 A. Something like that.
- 22 Q. I think we saw it earlier.
- 23 A. Six, and then a lower amount for a longer period.
- 24 Q. I'm making a simple point, which I think you will agree  
25 with me, that an element of that will go to

- 1 United Utilities?
- 2 A. No. It is a --
- 3 Q. It would accrue to Albion --
- 4 A. Yes, in reflection of the benefit that United Utilities  
5 were getting.
- 6 Q. Yes. And would therefore have reduced the effect cost  
7 to Albion per cubic metre, wouldn't it?
- 8 A. It would have reduced the effective cost; it wasn't  
9 dependent on cubic metres directly.
- 10 Q. Yes, that's right. Thus reducing the effective price  
11 below the long run marginal cost, whatever that may have  
12 been.
- 13 A. I think that those -- that that kind of short-term  
14 contractual term -- I wouldn't have considered it in  
15 terms of reducing the price per cubic metre. It's  
16 a side kind of contract, isn't it? And I don't think  
17 there would have been concern about that taking place  
18 for a short period of time, although, as I said,  
19 I wasn't involved in it at the time. So my opinion was  
20 not sought.
- 21 Q. That's really very much a commercial matter and you were  
22 somewhat detached from it?
- 23 A. Yes.
- 24 Q. Fine, thank you. I think now we will go further on in  
25 bundle 4 to tab 153; do you recognise this document?

1 A. Yes, I mean -- yes, sorry.

2 Q. What is it?

3 A. It's a report from the Sales Strategy Group.

4 Q. Prepared by Mr Lees?

5 A. Yes.

6 Q. And it's dated 15 June 2001?

7 A. Yes.

8 Q. And it's actually a paper requiring endorsement by that  
9 Sales Strategy Group, isn't it?

10 A. It asks for approval, yes.

11 Q. What was it seeking?

12 A. I'm just looking. Sorry, when you say do I recognise  
13 it, that doesn't mean I remember all the words.

14 Q. Perhaps I can help. It's really quite a simple --

15 A. Ofwat should be approached for a determination on bulk  
16 supply.

17 Q. Yes, that's right. And we see that over the page,  
18 "Current situation", paragraph 4:

19 "The meeting was held on 5 June. They confirmed  
20 they'd finally received legal opinion on our position.  
21 Not surprisingly the opinion was there was no need no  
22 change the agreement. It's not their problem. It's not  
23 compatible. Effectively, it is not Welsh Water's  
24 problem if it is not compatible to have two different  
25 supply prices from the same point to different people."

1           So they weren't really in a mood to help you out  
2 here to avoid discrimination. You can't blame them, in  
3 a way, because they were getting a very advantageous  
4 price, weren't they? Given the low level of costs that  
5 had to be covered.

6           "They also feel that the existing agreement contains  
7 all the necessary points that would be required in  
8 a section 40 supply agreement. A reply is to be  
9 forthcoming to our January letter in that vein."

10          It goes on:

11          "It is clear that the only way to dislodge the  
12 existing supply agreement and price would be to seek  
13 a determination on price with Ofwat. This needs to be  
14 done irrespective of Albion making progress on the  
15 usages of charges with DCC."

16          It goes on:

17          "The grounds for determination with Ofwat would have  
18 to be related to efficient use of water resources,  
19 section 40A(1). This allows the DG to initially examine  
20 the case. It would then be drawn into facilitating  
21 effective competition by UU. The initial argument would  
22 be related to the 3p versus LRMC calculated charge of  
23 12p."

24        A. Yes.

25        Q. 12p, not 9 now?

1 A. No, that's the LRMC-calculated charge of 12p.

2 Q. Okay. I think that's as much of that as I want to take  
3 to you.

4 So that's hovering round in the background and we  
5 will come back to that provision later.

6 A. Okay.

7 Q. I'm now going to take to you tab 134. So we have  
8 established shortly after this, somewhat after this,  
9 that confirmation that Welsh Water weren't going to help  
10 you out. We have seen Mr Lafon's reply to Dr Bryan.  
11 It's of 8 February. Now I'm going to take to you  
12 Dr Bryan's reply to Mr Lafon of 20 February, which is at  
13 the top of the page on page 886. Do you have it?

14 A. Yes.

15 Q. Very simple. He said:

16 "The new LRMC based on 12.1 is a product ..."

17 I'm sorry, I have a hole punched and I can't read.

18 "... I note that this LRMC figure relates to  
19 Heronbridge supply and is presumably not a regional  
20 average figure. Would it be possible for you to help me  
21 understand the breakdown of this figure, how it compares  
22 with the current tariff paid by Welsh Water and how  
23 a subsequent reduction to 9p might be justified."

24 Then he carries on:

25 "I'm still having a crack at Welsh Water."

- 1           Do you see that?
- 2     A.   Yes.
- 3     Q.   I took you earlier to Ofwat saying to all companies,  
4        "You've really got to be prepared to justified prices,  
5        there ought to be some transparency.  You just can't  
6        give a company a number and tell them to take it or  
7        leave it, you have to be prepared to justify it"; that's  
8        right, isn't it?
- 9     A.   You took me to it, what, in MD163?
- 10    Q.   I did, and one or two other points.  You agreed with me  
11        and you saw no particular ground for dissent.  So I'm  
12        putting it to you that Dr Bryan here is asking for  
13        exactly that sort of justification that Ofwat had in  
14        mind, isn't he?
- 15    A.   He is certainly asking for a breakdown of the figure.  
16        He doesn't refer to Ofwat at all.
- 17    Q.   He doesn't need to.  Both parties would have understood,  
18        surely, that Ofwat guidance here was very clear: there  
19        ought to be transparency.  It's the other side of being  
20        a monopolist.  You can have the joys of being  
21        a monopolist but in return you have to have a fairly  
22        open book approach to issues such as this.  So Ofwat has  
23        said in terms repeatedly -- and I have taken you to  
24        these extracts -- that if asked, you must justify.  
25        There is no argument about that, is there?

1 A. No.

2 Q. Good. So he is saying, first of all:

3 "It's presumably not a regional average figure ..."

4 That's the reference to Heronbridge. Which confused  
5 Dr Bryan a little bit. Then he wants to understand the  
6 breakdown of the figure, and particularly how it  
7 compares with Welsh Water.

8 And then he wants to ask: but you have reduced it  
9 to 9, how can the subsequent reduction be justified?

10 It's not enough to say, "Oh, well, that's because it's  
11 interruptible or non-interruptible"; how do you arrive  
12 at a figure of 3?

13 I think we know the answer to that, don't we,  
14 Ms White because, as you said earlier, it was a means to  
15 an end, wasn't it, to reduce from 12 to 9 and try to get  
16 Dr Bryan off your back?

17 A. No, to try and get him signed up.

18 Q. Yes, absolutely.

19 A. To a long-term relationship.

20 Q. Yes, interruptibility was a useful way of putting it but  
21 it was a negotiating ploy. I think that's how you put  
22 it?

23 A. Position.

24 Q. Position, sorry. If we go to 136, tab 136, we have the  
25 Mr Lafon's reply to Dr Bryan?

1 A. Yes.

2 Q. Do you have it at the top?

3 A. Yes.

4 Q. This is long on generalities but -- I think you agree  
5 with me?

6 A. Yes.

7 Q. But very, very short on detail. He says:  
8 "Using components which are regional averages ..."  
9 Oh, the result is 12.1p. Then:  
10 "... is a review of the application to this  
11 particular circumstance supply not being secure, lower  
12 level of reliability ..."

13 And so on. And I think we are all agreed that the  
14 word which none of us can read is "not":  
15 "This one is not ..."  
16 Okay?

17 A. Yes.

18 Q. Then:  
19 "You attempt ..."  
20 It's familiar now:  
21 "... to marginalise the Welsh Water agreement. It's  
22 a historic agreement, determined by government  
23 ...(Reading to the words)... not applicable today."  
24 And:  
25 "The basis of an offer is what I said on

1           8 February ..."

2           That's it.

3       A. Yes.

4       Q. I'm putting it to you that's a long way short of

5           justification, isn't it?

6       A. I think it's certainly not what Dr Bryan would like.

7       Q. I put it to you that nobody would be satisfied by this

8           and I don't think the Director General of Water

9           Regulation would have been terribly pleased to see it.

10          It was precisely not what he had in mind when he said

11          the companies should justify their numbers. At the very

12          least there should have been some calculations,

13          spreadsheets and other things to back up the numbers

14          underlying 12.1 and 9. None of that was forthcoming,

15          was it?

16       A. No.

17       Q. And it begs the question, the obvious one, why? Why

18          not? Did you discuss a reply to Dr Bryan with Mr Lafon?

19       A. No, I didn't discuss it with him, no.

20       Q. So this is him replying on his own bat?

21       A. Yes.

22       Q. Without any regulatory advice at all?

23       A. Yes.

24       Q. He refers to regional averages. What is he referring to

25          when he talks about regional averages?

1 A. The email is slightly inconsistent -- well, is -- with  
2 his earlier email, and I don't know whether he is -- he  
3 meant regional averages or whether he meant the  
4 integrated zones, which is, as we discussed, not  
5 a regional average but is most of it.

6 Q. Hm-mm.

7 A. So I don't know what he is referring to or whether he  
8 just didn't understand exactly how the numbers had been  
9 worked out. He wouldn't have had access to the detailed  
10 calculations. I mean, he could have come and asked me  
11 for them but he didn't.

12 Q. Of course he would have had access to them.

13 A. He chose not to access them.

14 Q. I'm afraid I must go back to your own, what I call the  
15 internal, calculations, which we haven't seen. Why are  
16 you looking at regional averages?

17 A. Sorry, why were we looking generally?

18 Q. Yes.

19 A. Do you mean in terms of access pricing overall?

20 Q. No, we are talking very specifically of applications  
21 dealing with Albion, with very specific abstraction  
22 licence, pumping pipes to Ashgrove and quantities of  
23 water. Why were you looking at anything to do with the  
24 region, as opposed to the actual assets involved?

25 A. Well, I thought I had explained that, sorry. Although

1 the system that goes to Ashgrove and then to Shotton  
2 is -- you know, doesn't connect in anywhere else, that's  
3 not ours. We are only looking at Heronbridge, at  
4 Heronbridge. The water from Heronbridge could be used  
5 in a number of other places if it wasn't used at  
6 Heronbridge. So it might be used in that -- on that  
7 supply at certain times of year because the -- if there  
8 is a dry year, the abstraction licence overall capacity  
9 is reduced, or it might be used -- because the  
10 abstraction licence is conjunctive, as we have already  
11 seen, it might be used at another abstraction point on  
12 the River Dee. So it's not -- so we would be  
13 considering it in the context of the whole of the  
14 integrated zone and the way in which that water might be  
15 able to be used to support other areas, rather than --  
16 we certainly wouldn't have been thinking about Shotton  
17 because Shotton is not in our area.

18 Q. I'm not asking you about Shotton. You are not charging  
19 for Shotton, are you?

20 A. No.

21 Q. Quite so. We are only concerned with Heronbridge,  
22 pumps, a bit of pipe, off to Ashgrove, aren't we?

23 A. Yes. But the value there is in the water, which can go  
24 somewhere else.

25 THE CHAIRMAN: But the costs of doing it are the costs of

1           that equipment, aren't they?

2       A. But the cost of doing it might be the fact that you have  
3       to then save water elsewhere or you have to build new  
4       sources elsewhere. So the real -- the true cost is to  
5       say, well, if we didn't have to supply this water,  
6       actually we might use that water at Huntington Treatment  
7       Works and then that water would go into supply Liverpool  
8       and then we wouldn't have built boreholes at Prescot(?)  
9       because we wouldn't have needed to.

10      THE CHAIRMAN: And that's your understanding of long run  
11      marginal cost? That's what you are calculating when you  
12      work out your long run marginal cost?

13      A. The long run marginal cost calculation is looking at the  
14      cost in order to -- so we saw that there was  
15      a requirement for more water and that -- over the  
16      25-year period and that otherwise there would have been  
17      a shortage, and the long run marginal cost calculation  
18      is saying how are we going to make up this shortfall.  
19      So are we going to do some additional metering, some  
20      leak detection and eventually some source enhancements.  
21      If we had whatever was -- this was, 20 megalitres,  
22      something like that, 18/20 megalitres a day -- if we had  
23      been able to use that water, then we would have had to  
24      find less water from elsewhere in the integrated zone  
25      and so the true cost is those costs, and that's how long

1 run marginal cost works and that's why Ofwat -- that's  
2 one of the reasons that Ofwat would prefer -- would --  
3 at that time were recommending its use, both for bulk  
4 supplies and, to the extent possible, within the tariff  
5 structures, which is much harder.

6 MR SHARPE: Well, let me put it to you. You see, earlier on  
7 I took you to the note of the meeting, the  
8 United Utilities -- with Wendy Johnson and what I call  
9 the corroborative internal note with Albion. When the  
10 opportunity was put to you very substantially to  
11 increase the amount of water available, the offer was  
12 rejected because there was no need for any water  
13 because, far from being in deficit, you were and  
14 remained in surplus in the integrated zone, and I took  
15 you earlier, did I not to the data which showed that,  
16 with relatively low expenditure, indeed zero expenditure  
17 in the case of one place, you could dramatically  
18 increase the amount of water available to you.

19 So what I'm doing is puzzling here why there should  
20 be such a massive gap between the accounting actual  
21 costs of supplying the service, as represented by the  
22 Heronbridge Agreement, and by your long run marginal  
23 cost. Is that explained by the cost of reducing leakage  
24 in Penrith having to be borne by Albion Water at  
25 Heronbridge?

1 A. I can't answer for something that was said by somebody  
2 else at a meeting that I was not there.

3 Q. But you agreed she was as a responsible and senior  
4 person within United Utilities and, moreover, as  
5 I understand it, subsequently in correspondence that  
6 issue has never been challenged. I appreciate it has  
7 been challenged today.

8 A. And in my witness statements and more recently with  
9 Dr Bryan --

10 Q. Yes.

11 A. -- in my discussions with him.

12 Q. I have put the evidence to you that for zero cost you  
13 could get an extra 10 megalitres a day. You may have  
14 done so, for all I know, in the ten years in between.  
15 I hope so.

16 A. I don't know because I don't know where Redscar is.

17 Q. Neither do I. I am just relying on your own --

18 A. I'm sure we can find out. But the issue about, well,  
19 why should -- I think there is two things. One is, this  
20 question, well, why should Albion Water fund leakage  
21 control in Penrith, any customer could say that. The  
22 point is that all of the customers of the system fund  
23 the investment that was required in the system;  
24 otherwise, we would be charging people who lived close  
25 to water treatment works a lower bill, a lower pence per

1 cubic metre, and we would be charging people who lived  
2 in the middle of nowhere a higher pence per cubic metre  
3 for the same service. That is not the way in which the  
4 industry charges. Generally, charges are generally  
5 geographically averaged. That's compliant with Ofwat's  
6 duty to protect the interests of rural customers and is  
7 seen by Ofwat and government as being a generally  
8 desirable characteristic, that charges are  
9 geographically averaged.

10 So the -- if action that Albion took by continuing  
11 to take a supply -- continuing to take a supply resulted  
12 in expenditure in another area, then it's right that  
13 they should contribute towards that.

14 The beauty of charging long run marginal cost is  
15 that it actually drives that kind of behaviour. So if  
16 we had charged -- let's go back to the LRMC. It doesn't  
17 matter if it's 12 or 9, but if we had charged 12p per  
18 cubic metre for the water, then if Albion were able to  
19 develop a new source at less than 12p per cubic metre,  
20 they would have done so. If they weren't, then we would  
21 continue to supply the water and that would have been,  
22 over the long run, costing us 12p per cubic metre.

23 So it means that whatever is the most cost-effective  
24 way of supplying that customer is the one that is  
25 selected and this is one of the desirable features of

1 pricing on long run marginal cost, is it should lead to  
2 an overall economic efficiency.

3 Q. Well, I'm not sure you have answered my question, which  
4 I will repeat: when you consider this, you have a figure  
5 which you have derived for long run marginal cost; did  
6 you agree with me when I said it was -- you have yet to  
7 answer my question -- that it would be consumers,  
8 probably, of potable water in Penrith, right, getting  
9 the benefit in reduced leakage as a result of Albion's  
10 price to you for non-potable water at Heronbridge. Is  
11 that right?

12 A. This was why I said to you that the reason that there  
13 was a delay in producing the price, and what I was  
14 working on when I wrote to Julie Griffiths on  
15 20 December, was to try to split that out because, no,  
16 the long run marginal cost as a whole would have been  
17 more and it's important to ensure that users of  
18 non-potable water only pay for non-potable -- the  
19 elements of it, and at Heronbridge, where they are not  
20 even taking the whole of the non-potable service, which  
21 is raw water abstraction and then raw water  
22 distribution, they should only pay for the raw water  
23 abstraction.

24 THE CHAIRMAN: What is it then that resulted in the price  
25 that you arrived at being so different from the price

1 under the Heronbridge Agreement, if, as you say, you  
2 discounted all the services that they were not using?

3 A. The Heronbridge Agreement is based on local costs at  
4 Heronbridge, but if you look -- if we are selling  
5 26 megalitres a day to Welsh Water and demand is rising  
6 or supply is falling and we have to find that  
7 26 megalitres from somewhere else, they won't  
8 necessarily be as cheap as the 26 megalitres at  
9 Heronbridge. Heronbridge is a pumping station at the  
10 edge of a river. Some of our -- quite a lot of our raw  
11 water abstraction is large reservoirs with big dams and  
12 alternatively some of it is boreholes, boreholes and  
13 impounding reservoirs.

14 THE CHAIRMAN: What kind of assumptions did you make about  
15 how additional water would be sourced in the event that  
16 you were short of water because of this supply?

17 A. I used information from the water resources plan 1999.

18 THE CHAIRMAN: That's what Mr Sharpe is asking you, that it  
19 seems from that plan that actually you could make up any  
20 shortfall without much cost. I think that's why he is  
21 asking you: looking at that plan, he can't see what you  
22 can have factored in from that that could have resulted  
23 in the price being 12.1p. Is that a fair summary of  
24 your question?

25 MR SHARPE: Yes, madam.

1 A. Yes. So what I looked at was the investment that was  
2 actually planned over the 25-year period, the volume of  
3 water that that was intended to generate over the  
4 25-year period, and tried to find -- get information to  
5 enable me to allocate that across different parts of the  
6 value chain. So -- because if some water leaks --

7 THE CHAIRMAN: So that would have been including what  
8 proportion of the water leakage investment or the  
9 metering?

10 A. That would have been including any leakage and metering  
11 investment that was actually planned to take place.

12 THE CHAIRMAN: Anywhere in the --

13 A. In the integrated zone, not in the other isolated bits.

14 MR LANDERS: In all the time this case has rumbled on -- you  
15 don't have the original calculations -- has anybody  
16 tried to go back and reform those calculations that have  
17 been lost and to see if they arrive at a figure that's  
18 more or less than 12.1?

19 A. I haven't gone back to try to kind of rebuild the  
20 original calculation until fairly recently with the --  
21 with this case. It really hasn't been something that's  
22 at issue at all because in the original tribunal case  
23 United Utilities' costs or prices that were quoted were  
24 never at issue and I think -- I felt it would be  
25 somewhat disingenuous to go back and say, "This is how

1       it's worked out," when I don't think that -- I don't  
2       even have the original information that was provided to  
3       me. And so, to get that, it would be bound to be based  
4       on current information. We wouldn't -- to the extent  
5       that we struggled to find, you know, the -- some of the  
6       documentation, like the water resources plans going back  
7       over time.

8       MR COWEN: Over and above the 3p, is there any internal  
9       transfer charge number that covers, if you like, the  
10      cost to you or the price that you would have got had you  
11      sold the water elsewhere?

12     A. We could have calculated -- I didn't but we could have  
13      calculated a price that was based on saying, "Well, if  
14      we use that -- if we were able to use this water at  
15      Huntington -- big treatment works, able to take it, it  
16      would be very useful, particularly in dry years -- then  
17      that would mean that we would be able to switch off some  
18      other sources which are more expensive to operate and  
19      look at that. That would have been a way of doing it.  
20      I think it would have come out with a higher number.

21     THE CHAIRMAN: A slightly different question, but what we  
22      have heard is that 78 per cent, say, of the capacity for  
23      abstraction at Heronbridge goes into the  
24      United Utilities' system and only 22 per cent is  
25      destined for the Ashgrove System.

1 A. Yes.

2 THE CHAIRMAN: Is there an internal transfer price of that  
3 water into the United Utilities system?

4 A. No, we don't operate an internal market or any internal  
5 pricing.

6 THE CHAIRMAN: But when you are justifying the end price to  
7 the customer, don't you have to indicate what the cost  
8 of the water itself is?

9 A. No, we need to be able to substantiate costs to Ofwat,  
10 but those are done on a company-wide basis because of  
11 the fact that charges are all geographically averaged.  
12 At the time we are talking about Ofwat didn't really  
13 want any more detail than that. If we were to do it  
14 now, some of the work that I struggled with then in  
15 splitting it up would have been done for me because  
16 Ofwat now asks for costs split across the value chain,  
17 but not, "How much is it at Heronbridge? How much is it  
18 here?" But, "How much do you spend on water resources,  
19 how much do you spent on water treatment?" Those kind  
20 of questions, which were never done at the time because  
21 they weren't asked for.

22 MR LANDERS: Following on from that, where in MD163 under  
23 "Principles", it says, "Each company should charge  
24 entrants as it would charge itself," there was never  
25 an attempt to work out what you should charge yourself?

1       A. No, we don't charge ourselves as such. So the  
2       importance, I think, would be if you did get some -- if  
3       you did get competition where you had entry into certain  
4       parts -- certain activities, then you would need to be  
5       able to demonstrate that the way in which you charged  
6       for those activities was then consistent with the way in  
7       which you set your charges for the rest of your  
8       customers.

9       MR SHARPE: I think Mr Landers' question pre-empted mine.  
10       You didn't even do that exercise as a sense check, to  
11       see whether or not you were in the right ballpark?

12       A. I considered the price that we were quoting compared to  
13       what we charge for the most similar service, which is  
14       a non-potable supply. There were some customers, who,  
15       as it happens, are supplied from Heronbridge and who  
16       take two services. There is the raw water abstraction  
17       and then raw water distribution. And they are some  
18       industrial customers, so they take non-potable. So they  
19       are on the special agreements register that we were  
20       looking at yesterday. Was it yesterday? Not yesterday,  
21       Friday.

22       So we do have customers -- so I did consider whether  
23       it appeared to be sensible in relation to the charges  
24       that were being made to those non-potable customers,  
25       because clearly you wouldn't expect it to be greater

1           than that; you would expect it to be somewhat less than  
2           that, which indeed it is.

3       MR SHARPE:  You make no mention of this in your witness  
4           statement, do you?

5       A.  No, sorry.

6       Q.  And we haven't any corroborative --

7       A.  No.

8       Q.  Thank you.

9           But you would agree, wouldn't you, that any  
10          calculation of long run marginal cost is going to have  
11          an element of uncertainty in it.  That's right, isn't  
12          it?

13       A.  Yes, definitely.

14       Q.  Let's go to bundle 5, tab 187.

15       MR BEARD:  Can I just -- I don't think how long Mr Sharpe is  
16          going to be.  I'm just slightly conscious of the time in  
17          relation to these matters.  I don't know whether you  
18          would prefer to start again tomorrow morning or --  
19          depending on how long Mr Sharpe is going to be.

20       MR SHARPE:  I'm in your hands.  As a general rule, I think  
21          it's oppressive to press witnesses much beyond ordinary  
22          court hours.  But we are pressed for time but on the  
23          other hand I'm very conscious that this is not a happy  
24          experience for any witness and if you wish to call  
25          a halt now, it's as convenient a moment --

1 THE CHAIRMAN: How much longer have you got?

2 MR SHARPE: I think I probably -- half an hour to  
3 40 minutes, but I'm quite content to start tomorrow at  
4 any time you wish.

5 THE CHAIRMAN: I think it's probably better to start  
6 tomorrow. Are you coming to a different topic now?

7 MR SHARPE: Yes.

8 THE CHAIRMAN: All right.

9 We do need to start thinking about timetable and  
10 what is the position if we are not able to finish by the  
11 close of Friday. Generally, I don't consider it to be  
12 right that one side has to produce their closing  
13 submissions immediately and then there is a hiatus and  
14 the other party has a longer period to consider.

15 So, unless we were able to continue straight over on  
16 to Monday, we would be looking at a break before we  
17 could all regather.

18 MR SHARPE: That would be extremely bad news for Albion.

19 Sorry -- I can't anticipate any break being short. We  
20 would very much like to conclude this hearing this week,  
21 if we can. Albion is, as you know, not in the best of  
22 health and the quicker we get this matter resolved, the  
23 better. There perhaps might be other solutions, which  
24 I have not shared with my friend but you can anticipate  
25 them. I think I'm going to be about a day with

1 Mr Williams and probably a day at least with Mr Edwards.  
2 That takes up two days. That pushes us into Thursday.

3 One way would be -- when I have finished with  
4 Mr Edwards, which would probably be well before the  
5 afternoon -- query -- I don't know -- well, let's say  
6 lunchtime -- for us to all withdraw and, instead of  
7 having a day each, we just give ourselves half a day  
8 each and then perhaps supplement that with some written  
9 submissions, if that would suit you.

10 THE CHAIRMAN: Is Monday possible --

11 MR SHARPE: Monday is possible for me.

12 MR BEARD: I will check what the situation is for Monday for  
13 me. Certainly, I think that half a day closing is  
14 a little ambitious because I think there are a number of  
15 strands that are going to be needed to be pulled  
16 together, not least what has been the subject of  
17 questioning this afternoon, about long run marginal cost  
18 methodologies, for example, which is not, with all the  
19 best will in the world, the fastest topic to work our  
20 way through. So I think a day each, even if we have  
21 written speaking notes, is going to be what is a minimum  
22 here.

23 I will check with those behind me in relation to  
24 availability for Monday but I'm sure all those involved  
25 will do their absolute utmost to ensure that they could

1 be available to run on if the tribunal is concerned in  
2 relation to ...

3 Perhaps it is something better to revisit tomorrow  
4 morning, when everyone has had an opportunity simply to  
5 discuss the helpful indication that has just been given  
6 by Mr Sharpe.

7 THE CHAIRMAN: Yes. Should we start again at ten tomorrow  
8 morning?

9 MR BEARD: I would have thought, if the tribunal prefer it,  
10 that would be sensible, particularly as I anticipate  
11 that Mr Sharpe is not going to be dealing with Ms White  
12 all of tomorrow. So --

13 MR SHARPE: I intend to finish with Ms White as soon as  
14 possible tomorrow, and I said 20 to 40 minutes.

15 MR BEARD: Exactly.

16 THE CHAIRMAN: Very well, we will start again at ten  
17 tomorrow.

18 (4.30 pm)

19 (The court adjourned until 10.00 am the following day)

20

21 I N D E X

22

23 DR JEREMY BRYAN (continued) .....1

24 Cross-examination by MR BEARD (continued) .....1

25 Questions from THE TRIBUNAL .....7

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MS JANINE MELANIE WHITE .....12

Examination-in-chief by MR BEARD .....12

Cross-examination by MR SHARPE .....14