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IN THE COMPETITION
APPEAL TRIBUNAL

Case No. 1166/5/7/10

Victoria House,
Bloomsbury Place,
London WC1A 2EB

25 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

*Transcribed using LiveNote by Opus 2 International
10 Fetter Lane, London, EC4A 1BR
Tel: +44 (0)20 3008 5900
info@opus2international.com*

HEARING (DAY 9)

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.

Thursday, 25 October 2012

(10.30 am)

MR PAUL EDWARDS (continued)

Cross-examination by MR COOK (continued)

THE CHAIRMAN: Good morning. Good morning, Mr Edwards.

Before we start, can I just set you some more homework, I am afraid, which is that we would find it useful to have in one place: first of all, what RPI was over the relevant period of the claim; also what PPI was; what was the offtake from the Heronbridge pumping station; and what volume of water was supplied to Corus Shotton and to Shotton Paper; how much potable back-up supply was used over the period, and in back-up I include top-up, I think; what price Corus paid for water over the period; and what monies were paid by Dwr Cymru to United Utilities over the period, both for the water and for any other capital contributions that were paid.

I recollect from Ms White's evidence that there may be a difference between what United Utilities billed Dwr Cymru and what Dwr Cymru actually paid, and if there is a significant difference between those two figures, then it would be useful to see both of them.

There may be other things we want to add to that list, but that will keep you busy for the time being.

1 As far as when we would need that, it would be
2 useful, I think, to have it in advance of the 5th and
3 6th date submissions. If you can get some of it to us
4 by close of play tomorrow, that would be great.

5 I imagine that a lot of those figures are actually
6 somewhere already in the evidence, but it would be
7 useful if they could be pulled out and put in --

8 MR SHARPE: On our part we will undertake to do what we can
9 do. Some of this evidence hasn't been disclosed and
10 must actually be in the knowledge of Welsh Water, but we
11 will give you everything that we can from our side. But
12 much of it, I'm afraid does fall --

13 THE CHAIRMAN: Yes. If there are confidentiality issues
14 involved, then of course we will listen to submissions.

15 MR BEARD: We will obviously go through. I think much of
16 this material is in the bundle, so it's a matter of
17 pulling it together from the bundle rather than
18 producing anything new at all, but we will go on and
19 double-check.

20 MR SHARPE: And it's historic documentation of some
21 antiquity. Thank you.

22 THE CHAIRMAN: Sorry about that, Mr Edwards, a bit of
23 housekeeping, but now we are ready to continue.

24 MR COOK: Mr Edwards, just to get back to where we left off
25 yesterday, you will recall that Albion made its

1 application for common carriage on 28 September 2000,
2 and do you remember that date?

3 A. I remember that date, yes.

4 Q. And that you became involved in the process, you said,
5 in early November 2000. That's right?

6 A. That's correct, yes.

7 Q. And the first reference I found to your involvement in
8 the documents was on 9 November 2000. Would that be
9 about the right kind of time?

10 A. Which document is that? Could you point me to the
11 document?

12 Q. Certainly. It's 9 November 2000. It will be bundle 3,
13 tab 78.

14 A. That would probably be about the time I started to get
15 involved with the discussions around the common carriage
16 application.

17 Q. So you became involved, sort of, roughly 40 days after
18 Albion had made its application for common carriage?

19 A. That sounds about right, yes.

20 Q. Looking back, what progress had been made on Albion's
21 application when you became involved in the process?

22 A. At the time I was unaware. Reading the documents now,
23 I believe that network access questionnaire had been put
24 together and sent out and returned.

25 Q. Was that it in terms of what Welsh Water had done on its

- 1 side?
- 2 A. I'm not sure. You would have to ask Dave Holton and
3 Paul Henderson. I'm sorry.
- 4 THE CHAIRMAN: You mean the network access questionnaire,
5 that was what was sent to Albion to complete?
- 6 MR COOK: I think it's in the bundle at 18 October.
- 7 In terms of a pricing methodology, it's right to say
8 at that time that Welsh Water didn't have a methodology
9 it was planning to use to calculate the price for
10 Albion, did it?
- 11 A. We had a methodology of average cost pricing overarching
12 methodology, but the actual numbers we didn't have.
- 13 Q. To be clear, you had the words "average cost", but you
14 didn't have a mechanism by which you would calculate
15 those average costs?
- 16 A. Not at that time, no.
- 17 Q. Can I ask you to turn to bundle 3, tab 90. This is
18 email from Mr Henderson of 29 November, and we will come
19 back to this email in a little bit more detail later
20 this morning, but I just want to show you this email at
21 the moment. This is Mr Henderson. You are familiar
22 with this email. Would you like the opportunity to
23 read it?
- 24 A. I'm familiar with this email, yes.
- 25 Q. What we see in the middle of the page is Mr Henderson

1 saying:

2 "Where this leads me is to think that what we will
3 probably have to look at it is the overall reduction of
4 the 49p tariff to around 26."

5 To assist the Tribunal, 49p was the non-potable
6 standard charge that you said yesterday was paid by
7 effectively almost nobody in terms of volumes involved?

8 A. That was the figure in the scheme of charges, yes.

9 Q. And 26p, of course, was what Albion was paying. And
10 then he goes on to put together a structure, which we
11 will come back to, in terms of how he thinks that
12 process could be done and put together.

13 So was that the first point that a process -- I mean
14 a methodology in that sense -- of trying to calculate
15 the average costs you wanted to use was being talked
16 about within Welsh Water?

17 A. I think as far as the bundles are concerned and my
18 recollection at the time, this appears to be the sort of
19 first sketch of how the methodology or the numbers would
20 be arrived at.

21 Q. Presumably that put you, to some extent, in a difficult
22 position because you were telling, or wanted to tell
23 Albion that you calculated all your existing special
24 agreements on the basis of the average cost methodology
25 that you were planning to use for them?

1 A. I don't think we were telling them what we priced all of
2 the special agreements on that. I think all the special
3 agreements that were negotiated freely since
4 privatisation were based on that basis.

5 Q. But you didn't have a methodology, did you, so you might
6 have used the word "average costs", but you didn't have
7 a method for calculating average cost that you used
8 elsewhere, did you?

9 A. There was a method for each of the prices that we
10 calculated for the special agreements that we entered
11 into in the 90s.

12 Q. But you weren't planning to use those methods; you
13 weren't even looking back to find out what those methods
14 were, were you?

15 A. Me as in -- "you" as in me or "you" as in Welsh Water?

16 Q. The team that you were involved in wasn't making any
17 attempt to look back and see what methods had been used
18 in the past, were you? You were, as you see in
19 Mr Henderson's email, coming up with a method at this
20 point in time for this particular application,
21 weren't you?

22 A. Mr Henderson was aware of how Large Industrial Tariff
23 was produced at the time, but for what else he used or
24 what else he was aware of I'm not sure at that time.

25 Q. Because you weren't suggesting at any point that there

- 1 was an existing methodology which had been be used.
2 That's why Mr Henderson had to work a new one out;
3 that's right, isn't it?
- 4 A. I think because of the nature of the special agreements,
5 each time a special agreement was entered into, this
6 calculation would be done again. I don't think we had
7 a model that we put numbers into at any particular time.
8 Dennis Taylor would have produced the numbers in order
9 to support the particular negotiation, but it would have
10 been on the same methodology.
- 11 Q. You didn't have a model, so it couldn't have been on the
12 same methodology if you didn't have an established
13 methodology?
- 14 A. He would have taken the same approach then, rather than
15 methodology. He would have taken the same approach to
16 get the numbers -- so take the numbers from the accounts
17 and produce the numbers for the special agreements.
- 18 Q. You were very much aware, weren't you, that as a result
19 of MD163 -- and we can go back to it if you would
20 like -- that Welsh Water was required -- all companies
21 were required -- to charge entrants as they would charge
22 themselves? Are you familiar with that?
- 23 A. Yes.
- 24 Q. Yes. So since you didn't have an established
25 methodology that you had used previously, this wasn't

1 a situation where you could simply say, "This is how we
2 have been charging all along", was it?

3 A. I think we had an established methodology, we didn't
4 have an established model.

5 THE CHAIRMAN: We seem to be getting a bit hung up on what's
6 a methodology here. I don't really understand at the
7 moment what you had in your mind, or what you now have
8 in your mind as being the way in which you approached
9 establishing the prices in -- looking at the special
10 agreements, for example. You said, and others have
11 said, "When they came up for renewal, we applied an
12 average pricing methodology". Now you have said, "We
13 didn't actually have a model that we used".

14 So what do you mean when you say that that was the
15 methodology that was used for the other contracts?

16 A. I think, when Dennis would set about understanding the
17 costs of the contract, he would start with the average
18 cost of water, which was the total income divided by the
19 total volume of water supplied, and give a figure. And
20 then he would reduce then the costs of the service that
21 weren't taken by the particular entrant -- sorry, the
22 particular customer. So that was the approach he would
23 have taken. And some of the documents here, which are
24 clearly Dennis' work, all used those steps to come up
25 with a number.

1 THE CHAIRMAN: So you always start with the total income of
2 the company?

3 A. Yes. Net off a few special income lines and then you
4 divide it by the total volume of water.

5 THE CHAIRMAN: Supplied by the company to everybody.

6 A. Yes.

7 THE CHAIRMAN: And that gives you a price per metre cubed,
8 say. And then, how do you go about reducing that then
9 to take account of the particular customer?

10 A. I think some of the documents go into that in more
11 detail, but in this particular instance we work out what
12 that customer didn't take. For instance, it didn't take
13 full treatment, and the calculation was then around the
14 partial treatment, what portion of the treatment costs
15 should be attributed to that particular service.

16 This is where the 30 per cent came in, where
17 typically 30 per cent off the full treatment costs, or
18 the costs of treating water is attributable to partial
19 treatment and therefore the special agreement would only
20 pay 30 per cent of the average treatment costs.

21 THE CHAIRMAN: And that was always for bulk supply
22 presumably because there was no common carriage before
23 this contract?

24 A. That particular calculation was for the bulk supply in
25 1996, but the other calculations for the special

1 agreements, which weren't bulk supplies, were done on
2 the same basis. Bulk supply is only supply of water
3 from one undertaker to another undertaker.

4 THE CHAIRMAN: Oh, right, okay. I meant supply of water
5 rather than common carriage of water.

6 A. Oh, sorry.

7 MR COOK: You said there was an allocation of costs.

8 A. Yes.

9 Q. But you didn't have a model, you didn't have a standard
10 approach of allocating costs that you used all the time,
11 did you?

12 A. I think the standard approach and model is two different
13 things. So we would have had a standard approach, which
14 we would have taken from the way Dennis Taylor did it,
15 but we did not have a model at that time.

16 Q. If we go back, sorry, to bundle 3, tab 90 then, which is
17 what Mr Henderson was suggesting, because Mr Henderson
18 is suggesting something what different from looking at
19 all of the income the company receives, isn't he? He is
20 suggesting using the potable standard tariffs and the
21 LIT in order to calculate these costs. He is not
22 regressing back to all of the income the company
23 receives.

24 So this is a different approach to looking at the
25 same issue of allocation of costs, isn't it?

- 1 A. You are right. Paul Henderson is looking at the
2 volumetric charge for potable water and using the LIT.
- 3 Q. And this was the approach that was being suggested and
4 which Welsh Water carried on using up until February,
5 when you came up with the final mechanism used in the
6 FAP?
- 7 A. No.
- 8 Q. When did that change?
- 9 A. I think around December.
- 10 Q. We will come to that. So Mr Henderson is suggesting an
11 approach which is different from the one that has been
12 used previously; is that right?
- 13 A. That's correct.
- 14 Q. You don't come back at any point and say, "There is an
15 established approach to doing this and you are changing
16 it"?
- 17 A. Not at this stage, no.
- 18 Q. Let's just be clear: until Mr Henderson put that email
19 together, there wasn't a planned approach, other than
20 simply average pricing, that Welsh Water decided it was
21 going to use for this common carriage application, was
22 there?
- 23 A. I don't know, I wasn't involved until this sort of time,
24 so I can't comment on that.
- 25 Q. As far as you were aware, there wasn't one until

1 Mr Henderson's email of 29 November?

2 A. As far as I can recall, that's true.

3 Q. So just to be clear on terminology, I use the word
4 "methodology" to mean an agreed process of allocating
5 costs. Is that a term you would be comfortable with as
6 a description?

7 A. Yes.

8 Q. That's how you would have used the term internally at
9 the time. Is that fair?

10 A. I don't think so, because we talk about methodology in
11 the network access code and in other areas at this time
12 to mean the whole company average price, rather than the
13 process of constructing that price on a de-averaged
14 basis.

15 Q. Let's go to tab 79 now, which is minutes of a meeting
16 between Enviro-Logic Limited and Welsh Water on
17 10 November, and it's a meeting that you attended on
18 behalf of Welsh Water along with Mr Holton and
19 Dr Boarer, and there was Dr Bryan, Mr Jeffery and
20 Mr Monroe for Albion.

21 Over the page, in terms of timescales, it says:

22 "Access price to be issued fairly shortly". It's
23 a "fairly simple case of updating existing methodology
24 with current data."

25 But at that point you didn't actually have a way of

1 carrying out that process, did you?

2 A. Can you point me to that, please?

3 Q. Sorry, it's the final paragraph "Timescales":

4 "Access price to be issued fairly shortly." It's a
5 "fairly simple case of updating existing methodology with
6 current data."

7 You didn't actually have a way of doing that at the
8 time, did you?

9 A. I believe at the time, from reading the emails, that
10 Paul Henderson was attempting to create a non-potable
11 large industrial tariff. We had the standard
12 non-potable tariff, and that's the 49p, and he was
13 looking to create a non-potable large industrial tariff.
14 So I think what Dave was referring to there, we had
15 a methodology for creating the large industrial tariff
16 for potable water, and the belief in the team would be
17 that we would use the same methodology to create the
18 non-potable large industrial tariff.

19 Q. Let's go back to tab 90, then, and see what Mr Henderson
20 is doing. That's three weeks later. That's the stage
21 he is starting to try and come up with some way of doing
22 this, isn't he?

23 A. I think the earlier email you took me to was some of his
24 initial thoughts on it. So it wouldn't have been
25 started around that time.

- 1 Q. So there was an earlier email that I took you to?
- 2 A. You took me to one from 9 November.
- 3 Q. If you want to 9 November, that was tab 78. That's not
4 referring to anything to do with modelling at all.
- 5 A. I think this email is indicative that Mr Henderson and
6 Mr Holton were discussing at the time these issues.
- 7 Q. They are starting to think about leakage. He certainly
8 hasn't got anywhere close to coming up with some form or
9 way of apportioning costs, has he, and he doesn't until
10 29 November?
- 11 A. I think this email is referring to specific questions
12 that Dave and Paul had been discussing that morning.
- 13 Q. So there isn't a way of allocating in place until
14 29 November, is there?
- 15 A. There is no evidence of it.
- 16 Q. And you have no recollection of it, do you?
- 17 A. I was not involved at the time, no.
- 18 Q. You were involved on 9 November and you have no
19 recollection of it during those three weeks, do you?
- 20 A. No.
- 21 Q. So let's go back then, please, to tab 79, which was
22 a meeting on 10 November. You were saying:
23 "Access price to be issued shortly." It's a "fairly
24 simple case of updating the existing methodology with
25 current data."

- 1 You didn't, in fact, have any way of doing that at
2 the time and wouldn't for another three weeks. That's
3 right, isn't it?
- 4 A. I think at the time Dave would have believed that it was
5 a fairly simple case of inputting data into the Large
6 Industrial Tariff.
- 7 Q. There wasn't a Large Industrial Tariff for non-potable,
8 was there?
- 9 A. Sorry, the Large Industrial Tariff methodology. But
10 I wasn't involved in the detail at the time. So ...
- 11 Q. If you were, as we saw in tab 90, planning on using
12 a different approach from one you had used previously,
13 that would cause problems in the sense that you wouldn't
14 be charging entrants as you were charging yourself.
15 That's right, isn't it?
- 16 A. Can you repeat the question?
- 17 Q. If you were going to be calculating it by reference --
18 as Mr Henderson was suggesting, producing a non-potable
19 LIT using the potable and potable (sic) LIT prices, then
20 that would not be in accordance with the approach that
21 you suggested had been used previously, would it?
- 22 A. I think that's correct, yes.
- 23 Q. So that would create an issue in terms of the
24 requirement you knew about from MD163 that you should
25 charge entrants as you charge yourself?

1 A. That's correct, yes.

2 Q. Was that why, if we go back to tab 79, you were trying
3 to suggest that there was an existing methodology,
4 because as soon as you were changing the methodology you
5 were using, Albion was in a position to say, "Well,
6 there is a different form of averaging going on,
7 consequently averaging is no longer applicable"?

8 A. I'm not sure I understand the question.

9 Q. Well, if you were going to change the methodology, then
10 that would give Albion a route to say, "You were no
11 longer pricing as you did previously, consequently
12 average costs", which are your desired route, "might no
13 longer be available"?

14 A. If we were proposing to change the pricing, that's
15 correct.

16 Q. That's correct?

17 A. Yes.

18 Q. And that's why you were suggesting that you were simply
19 using an existing methodology so that you could say to
20 Albion, "This is simply the same as we have always done"
21 when you knew that wasn't right?

22 A. I can't comment for Dave, but I think he believed this
23 was the same methodology Paul Henderson was using. So
24 he was aware of the Large Industrial Tariff methodology
25 that Ofwat had seen, and he was saying at this point --

1 THE CHAIRMAN: When you talk about the Large Industrial
2 Tariff methodology, is what you are saying that you had
3 a standard potable tariff and a large industrial users'
4 potable tariff?

5 A. That's correct.

6 THE CHAIRMAN: And they bore a certain relationship to each
7 other?

8 A. That's correct, yes.

9 THE CHAIRMAN: You had the standard, non-potable tariff,
10 which was the 49p, used in farm troughs and theme parks,
11 whatever, what you didn't have was large users'
12 non-potable tariff?

13 A. That's correct, yes.

14 THE CHAIRMAN: And what Mr Henderson is trying to do on
15 29 November is work out if you could use the same method
16 by which you got from the standard to the large users'
17 potable tariff to get from a standard to a large user
18 non-potable tariff, on the basis that Albion would then
19 be part, the common carriage part, of that large user
20 non-potable tariff?

21 A. I think that's exactly what Paul Henderson was trying
22 to do.

23 THE CHAIRMAN: What figure does he come up with then that it
24 would be? 17p. That's on page 720 of tab 90. I'm just trying to
25 work out: what is the implication -- is what he is

1 saying at page 720, "If we did that exercise, then
2 a large user non-potable tariff would be 44p."

3 MR COOK: 44p would be the LIT 5. That's the potable top
4 band.

5 THE CHAIRMAN: Potable?

6 MR COOK: Yes.

7 THE CHAIRMAN: Okay. So --

8 MR BEARD: No, I don't think that's right, and I'm concerned
9 about Mr Cook giving evidence. 44p appears twice on
10 this document. Once it is LIT 5, but lower down
11 it's not.

12 THE CHAIRMAN: All right. I'm just trying to work out or
13 understand what Mr Henderson was saying the common
14 carriage price would be because that's presumably then
15 a subparticle of what you work out the large user
16 non-potable tariff -- so you work out what the large
17 user non-potable tariff would be and then you work out
18 what would be the common carriage element of that. And
19 that then could be a price to quote for Albion.

20 Is he saying that if you do that on the same basis
21 as you used moving from the standard potable to the
22 large user potable tariff, you would get a figure of 17p
23 as the bulk distribution cost, ie the common carriage
24 cost?

25 A. I think that's exactly what he is doing, but I think he

1 is also recognising this is very, very high level, which
2 is why he is saying "The maximum cost would be ..."

3 It's his first stab at trying to establish exactly
4 what. What he is saying in the last sentence is because
5 the common carriage is actually asking for partial
6 treatment, we need to then split resource and treatment.
7 So he is identifying --

8 THE CHAIRMAN: So you would get to 17p, plus some element of
9 the 27p to represent partial treatment?

10 A. Using this methodology, yes.

11 THE CHAIRMAN: Using that methodology?

12 A. Yes.

13 THE CHAIRMAN: Yes, thank you.

14 MR COOK: If I could just ask to you turn to tab 75, these
15 are minutes of a board meeting of 6 November, so just
16 before you got involved. Of course, you didn't attend.
17 We go to page 686, the next page, to see what they were
18 calling it. Firstly, it says:

19 "All arrangements necessary to implement common
20 carriage are now in place."

21 You would agree, presumably, that was not strictly
22 right in the sense that you didn't actually have a way
23 of calculating at this stage, certainly in relation to
24 non-potable, did you?

25 A. We didn't have the process to calculate the numbers.

1 Q. And then if you go to the next paragraph:

2 "Application has been made by Enviro-Logic for the
3 common carriage of water from North West Water to its
4 customer, Shotton Paper. This will have a relatively
5 neutral cost effect for Welsh Water for so long as
6 average cost of distribution can be applied to such
7 arrangements."

8 Presumably that was something that you were also
9 aware of within the team at the time, that that would be
10 the effect of using average cost of distribution in
11 revenue neutrality?

12 A. I think the team would have been aware of revenue
13 neutrality.

14 Q. So looking at the wording of that, it says:

15 "... for so long as average costs of distribution
16 can be applied."

17 And based on that, you also knew that if you
18 couldn't use average cost of distribution, then you
19 would end up with something that would be considerably
20 worse than revenue neutrality?

21 A. It may be different. I don't know considerable or
22 worse.

23 Q. You knew in practice it would be worse, didn't you?

24 A. Not in this particular application. I don't think they
25 would have done that analysis.

1 Q. Saying:

2 "... for so long as average cost of distribution can
3 be applied. Revenue neutrality is a desirable outcome
4 for Welsh Water."

5 So they are obviously focusing on the alternative
6 being a bad outcome, aren't they, so you would lose
7 revenue and that was the concern of the board at the
8 time?

9 A. I haven't seen the board paper so I can't comment on
10 that.

11 Q. This was the concern of the team at the time, that if
12 you couldn't keep average costs of distribution, then
13 you would lose money?

14 A. I believe the concern at the time was to ensure that the
15 costs were robust, transparent and able to be presented
16 to Ofwat with no fear of any reprisals.

17 I think it was a -- we were more concerned with
18 maintaining existing methodologies and ensuring that
19 Ofwat were happy with the numbers than the outcome of
20 the numbers.

21 Q. We will see if that's the case, Mr Edwards, in a moment.

22 Could you ask you to turn --

23 MR COWEN: Can I just make sure that I have something
24 because I'm not sure that it appeared in the transcript.

25 You said that you were aware of the revenue

1 neutrality objective, that the team would be aware of
2 that at the time?

3 A. I don't know about the revenue neutrality objective.
4 I think I would be aware that so long as we managed the
5 same pricing policies or methodologies, then on average
6 the income would stay roughly the same. I'm not
7 sure if it was an objective of the team, revenue
8 neutrality.

9 MR COWEN: Okay.

10 MR COOK: You say you are not sure. Would that be on the
11 basis that it was the income team that would be worrying
12 about that and you were simply engaged in the numbers?

13 A. From a personal level, I never heard anybody set an
14 objective of that.

15 Q. If we turn on from the meeting on 10 November, so if you
16 go to tab 84, which is a letter that was sent from
17 Mr Jeffery, but signed by Mr Monroe, to Mr Holton on
18 16 November. And in the final paragraph, it says:

19 "I would appreciate a breakdown of DCC's proposed
20 average cost for non-potable water. As you said at the
21 meeting, this information has been previously sent ...
22 [previous] derivation ... I therefore suggest an updated
23 version of this would prove a useful starting point."

24 So Albion was at that time seeking a breakdown of
25 what the price was going to be. That's right?

1 A. That's what he says, yes.

2 Q. And you knew that was something that you would have to
3 comply with, given the guidance in MD154 that you have
4 to establish to the satisfaction of the entrant that you
5 were charging appropriately?

6 A. That's correct, yes. I would have known that.

7 Q. If we can go to tab 85, then, that's an email from you
8 to Mr Holton and you are reporting the contents of
9 a conversation you have obviously had earlier on that
10 day with Mr Monroe. It says:

11 "Jerry [Dr Bryan] is keen to move this on'.
12 "He wants prices.
13 "I told him these weren't available until at least
14 mid-December as would need to go to the board.
15 "He wanted draft prices.
16 "I told him no.
17 "He wanted the methodology we would be using to
18 apportion the costs.
19 "I told him it would be consistent with the
20 methodology we had used to calculate the current price."
21 Stop there. He said "consistent with the
22 methodology". At this stage you didn't have a clear
23 methodology. You saw there wasn't one in place or even
24 being thought about until Mr Henderson's email, which
25 was six days later. So how were you in a position to

- 1 say that at the time?
- 2 A. Because I believe that's what we were intending to do,
3 consistent methodology with the previous price.
- 4 Q. He said he would like more detail. You would discuss it
5 with him. Then there is a discussion section, which is
6 obviously you providing suggestions to Mr Holton about
7 what you should do. It says:
- 8 "For various reasons we don't want to give them our
9 'methodology'."
- 10 The methodology is in inverted commas there. Why
11 would you have put it in inverted commas?
- 12 A. I think this is, as we've already established this
13 morning, understanding what the word meant. I think
14 this meant we don't want to give him our actual numbers,
15 as opposed to the approach.
- 16 Q. You weren't providing them with any idea of approach
17 other than simply the words "average cost"; you didn't
18 want to tell him any more than that?
- 19 A. Average cost and consistent with previous methodologies.
- 20 Q. So you didn't want to provide him with any guidance of
21 actually how the apportionment was going to take place,
22 did you?
- 23 A. No.
- 24 Q. And why you were highlighting in inverted commas the
25 word methodology is because you didn't actually have

1 a way of carrying out that apportionment at that time,
2 did you?

3 A. We hadn't finished the calculations at that time.

4 Q. You don't need to carry out calculations to know how
5 that process is going to be undertaken, and at this
6 stage you didn't even know how the process was going to
7 be undertaken, did you?

8 A. Personally I didn't, because I was not fully involved
9 with producing the prices.

10 Q. You knew actually it was up in the air and that's why
11 you've put it in inverted commas, haven't you?

12 A. I knew we were having discussions on what the final
13 methodology would be.

14 Q. You say:

15 There are "various reasons" ... "for various reasons
16 we don't want to give him our methodology."

17 You do not go on to provide the various reasons.
18 What you do go on to say is:

19 "Suggest I ring him tomorrow and say that prices
20 will be determined as in the NAC, actual methodology is
21 commercially confidential."

22 That wasn't a true reason, was it? There was
23 nothing that was going to be confidential about the
24 method of apportionment?

25 A. I think that's a true statement. They will be

1 determined as in the access code, and at that time the
2 actual methodology was commercially confidential. This
3 was 23 November. We had already met in Hammersmith,
4 where Albion Water had made it very clear that they
5 would strongly oppose any average costs, and therefore
6 at that time I was aware of the issue of commerciality
7 around these figures.

8 Q. You knew you would have to disclose the methodology to
9 Albion, didn't you?

10 A. I fully intended to disclose the methodology as openly,
11 as transparently as possible, yes.

12 Q. So there was nothing commercially confidential about it
13 apart from the fact that in reality you didn't have
14 a methodology at that time?

15 A. We did not have a robust methodology at that time.

16 Q. So why didn't you simply say, "We are trying to work out
17 what our methodology is going to be"? You give him the
18 impression there was something already in place, and
19 there wasn't.

20 A. I'm not sure I take that from what I read in here.

21 Q. You are saying:

22 "The actual methodology is commercially
23 confidential."

24 Why didn't you simply say:

25 "We haven't determined the final methodology and you

- 1 will get it once we have determined it"?
- 2 A. I could have said that, but I chose to put it this way.
- 3 Q. You are trying not to let Albion know that the
4 methodology is in flux. That's right, isn't it?
- 5 A. We didn't reveal to Albion Water that the methodology
6 was in flux.
- 7 Q. You didn't want them to find out because you thought
8 that would expose average cost to attack?
- 9 A. I was concerned that if we gave them numbers that we
10 weren't confident with, then they would definitely be
11 open to attack.
- 12 Q. It's nothing to do with numbers. This is about
13 methodology, this is simply what process were you going
14 to use to carry out the apportionment. And you didn't
15 want Albion to know that you were thinking about
16 multiple possible processes.
- 17 A. I think my background was in computer programming and
18 modelling, and the way that the methodology would work
19 was I would go through a process of creating the model
20 as I went. And therefore the methodology itself would
21 never be finalised until I actually got the numbers at
22 the end, so that each stage was robust and transparent.
23 So I don't think that's right.
- 24 Q. What you mean is you wanted to know what the outcome was
25 before you decided if that was a workable methodology?

1 A. I don't agree with that. I think I was more concerned
2 with the actual method of calculation, rather than the
3 number at the end. I wanted to make sure the input
4 numbers are correct, the model was correct and the
5 number at the end of it would be the number at the end
6 of it.

7 Q. That's not what you have just said. What you just
8 said is:

9 "The methodology itself would never be finalised
10 until I actually got the number at the end."

11 It was very much the numbers at the end which would
12 determine when you had finalised it?

13 A. The number at the end would be the final point once the
14 inputs and the model were correct.

15 Q. What you mean is the number at the end didn't suit you,
16 you would try and find a different model?

17 A. The number at the end -- I don't think the -- the actual
18 number, quantum, at the end, wasn't anything really
19 I was concentrating on.

20 Q. So if we go back to the email, you are sending an email
21 to Mr Holton and it's making a suggestion that you
22 should ring Mr Monroe and say, "The actual methodology
23 is commercially confidential". So that's what you're
24 proposing. Is that something that Mr Holton agreed with
25 you about?

1 A. I can't remember. Is there a conversation recorded of
2 my conversation afterwards?

3 Q. There is not a conversation recorded with Mr Holton.
4 There is a conversation, which we will come to, where
5 you tell Mr Holton the outcome of the conversation you
6 had with Mr Monroe. I'm just asking if you remember?

7 A. I don't remember, no.

8 Q. If we go to 87, we can see your email you sent to
9 Mr Holton. So it looks from that like Mr Holton did
10 agree that you should make sure Albion didn't know that
11 the method was in flux?

12 A. I would have discussed this with Mr Holton at the time
13 and he would have told me or said that I can ring
14 Albion Water.

15 Q. And the outcome of that appears to have been that he
16 told you, "Don't tell them the method is in flux"?

17 A. I don't recall him telling me that.

18 Q. That was the outcome of it, wasn't it?

19 A. The outcome that we didn't tell them that it was in
20 flux?

21 Q. Absolutely.

22 A. I can't deny that.

23 Q. Following your recommendation.

24 A. I don't think I recommended that we didn't tell them
25 that. I recommended that we told that we were getting

- 1 on with calculating the price.
- 2 Q. No, if you go back to tab 85, you did say:
- 3 "We don't want to give them our methodology
- 4 I suggest I ring him tomorrow and say actual methodology
- 5 is commercially confidential."
- 6 So you were certainly saying, "We should give them
- 7 an excuse and not let them find out the state of our
- 8 actual methodology position"?
- 9 A. I'm saying I didn't want to give them the sketches that
- 10 Paul Henderson had come up with. That's all I'm saying
- 11 there. Where we were at the moment, I was not confident
- 12 that we could release them.
- 13 Q. But meanwhile you are letting Albion think you actually
- 14 had a methodology that you were working your way through
- 15 in terms of inputting the data into that methodology.
- 16 That's what you were doing, wasn't it?
- 17 A. We were telling Albion we were getting on with
- 18 calculating the pricing model.
- 19 Q. You weren't telling them you were getting on with
- 20 modelling. You led them to understand that there was
- 21 a methodology and you were simply putting in the data
- 22 into that model, weren't you?
- 23 A. At the meeting Dave Holton earlier on, I think that's
- 24 what Dave believed at the time.
- 25 Q. You were now having conversations with Albion in which

1 you were maintaining that position, that there was
2 a methodology and you were simply putting the data
3 within it?

4 A. I wouldn't have said that we had a model that we were
5 putting data in. That wouldn't have been true.

6 Q. You kept on referring to a methodology when there
7 wasn't one?

8 A. There was a methodology, which was regional average
9 pricing. This is the whole problem throughout a lot of
10 this is understanding what was meant by "methodology" at
11 each point.

12 Q. Albion wanted to know -- let's go back, it's your own
13 email, tab 85:

14 "He wanted the methodology we would be using to
15 apportion the costs."

16 So everyone was very clear: that's what we are
17 talking about, the methodologies, the route you are
18 going to use to apportion the costs, and you were
19 suggesting to Albion there was such a route when in fact
20 he was still trying to work out a way to do it. That's
21 right, isn't it?

22 A. They want the numbers and we didn't have the numbers.

23 THE CHAIRMAN: They don't just want the numbers:

24 "He says he wanted draft prices. I told him no. He
25 wanted the methodology we would be using to apportion

1 the costs."

2 So what he is asking for in addition to the numbers
3 is how are you intending to go about arriving at that
4 price that you have given me, and you are saying for
5 various reasons you don't want to tell them that. What
6 you are being asked --

7 A. I think the reason was that the apportionment that we
8 had at that time wasn't robust enough to be revealed.

9 MR COOK: Because you didn't have an apportionment at all at
10 that time, did you, an apportionment process at that
11 time?

12 A. Is Paul Henderson's email before or after this?

13 Q. Paul Henderson's email is tab 90, which is another six
14 days later.

15 A. In that case -- I'm not aware whether we had a --
16 whether Paul had started sketching these things out
17 before then or not.

18 Q. If he was sketching it out, you hardly had a firm view,
19 did you?

20 MR COWEN: You referred back to tab 79, which is the
21 10 November meeting.

22 A. Yes.

23 MR COWEN: Where it's quite clearly stated by Dave Holton
24 that:

25 "Access price would be issued shortly as a fairly

1 simple case of updating existing methodology with
2 current data."

3 And you were aware of that at the time. That's what
4 you have just said?

5 A. I was aware of him saying that, and what I think he
6 means is that Paul Henderson had got the 1998
7 methodology and Paul believed that he could put the
8 numbers in. I wasn't that involved with -- at this
9 point, therefore I can't say exactly what methodology we
10 had or what model we had, or where Paul Henderson had
11 got on those issues.

12 But from the earlier email Dave Holton was obviously
13 discussing the common carriage application with
14 Paul Henderson, and therefore I have no reason to
15 believe that Paul wouldn't have been progressing these
16 issues. But as far as my recollection is concerned,
17 I was not heavily involved with the pricing issue
18 until December.

19 MR LANDERS: Could you just remind us: Dave Holton, what was
20 his background? Would he have understood modelling and
21 costing? Had he done it before?

22 A. Probably not, no. He was an operational manager in
23 North Wales and then he was commercial manager for one
24 of our -- Welsh Water's non-regulated businesses.

25 MR LANDERS: What does "commercial manager" mean? Sales or

1 operations?

2 A. The enterprise was a pipelines business, which
3 Welsh Water had set up outside the regulated area, and
4 I think he was a commercial manager for that, making
5 sure the contracts -- he negotiated contracts.

6 MR COOK: Mr Edwards, it's simply not good enough. If you
7 go to tab 85 you were very much aware of what was going
8 on because you were in a position to make
9 recommendations.

10 Firstly, you were the point of contact with Albion,
11 and secondly, you were in a position to make
12 recommendations to Mr Holton about what should or should
13 not be going on. So you obviously knew what the
14 position was in terms of there being a methodology or
15 not at that time.

16 A. At that time I think I had met Roddy Monroe at the
17 10 November meeting, and I think at that time I was --
18 I had met Roddy through -- he was doing the same course
19 as I did at City University, and therefore that's why
20 I was in contact with him.

21 I wouldn't say I was well aware of the pricing
22 methodology, but I wasn't confident enough to go forward
23 with that proposal when it was very clear that once
24 a methodology was given to Albion, we had to make sure
25 that that methodology was very robust, because we knew

1 it would be challenged.

2 Q. You had to make sure as well that you knew what the
3 outcome was going to be, didn't you?

4 A. I was more concerned that the modelling itself was
5 robust.

6 Q. Go to tab 86 next. This is an internal Welsh Water
7 email of 24 November 2000 from Mr Holton to Mr Henderson
8 first, and also to you, headed "Cost information
9 collection".

10 This effectively is going through recording what he
11 says is some possibilities about cost information
12 collection and various people who have information.
13 I mean, at this stage, this was trying it find out what
14 information was available because you couldn't work out
15 the way in which you would calculate costs without
16 knowing what costs data there was. That's right, isn't
17 it? (Pause)

18 A. I read the email. Could you repeat the question,
19 please?

20 Q. Yes. I'm saying at this stage you were trying to work
21 out what information was available because obviously the
22 methodology would need to take account of what the
23 sources that you could use were?

24 A. I think this is a different exercise. Top-down, whole
25 company average pricing I don't think would need this

- 1 sort of level of detail.
- 2 Q. You were clearly gathering that level of information at
- 3 the time. Mr Holton clearly thought that was relevant
- 4 information, didn't he?
- 5 A. I think Dave and Paul were collecting data at the time.
- 6 Q. And the reason they were collecting data was for
- 7 a number of reasons. Firstly, there are references here
- 8 to "costs of large works". That would be large
- 9 treatment works, wouldn't it? So they are trying to
- 10 understand the extent to which partial treatment costs
- 11 are referable to full potable costs, aren't they?
- 12 A. I don't think you can infer that from here.
- 13 Q. That was a key question that you would have to determine
- 14 in the context of this process, wouldn't you?
- 15 A. That's a key question, yes.
- 16 Q. So they are looking to see costs information and that
- 17 would be one of the key things they would want cost
- 18 information on, wouldn't they?
- 19 A. That's correct.
- 20 Q. If we go back to tab 44, this was what you described as
- 21 a compliance checklist that you put together, if you
- 22 remember this document?
- 23 A. Yes.
- 24 Q. And we looked at page 533. Part of your compliance
- 25 checklist included in relation to excessive prices:

1 Number 7, that Ofwat would look at excessive prices in
2 relation to stand-alone costs. So your own compliance
3 checklist made clear that you wanted to have some idea
4 of what stand-alone costs would be in order to consider
5 whether you were going to be engaging in excessive
6 pricing?

7 A. The checklist makes it clear that Ofwat would look at
8 excessive prices in relation to stand-alone costs.

9 Q. So that's something you would need to check. If you
10 were going to issue a lawful price, you would want to
11 know what the outcome of that process would be,
12 wouldn't you?

13 A. Yes.

14 Q. So that would be one of the key purposes of gathering
15 the information we saw at tab 86, wouldn't it? Looking
16 to try and find out what the stand-alone costs would be.

17 A. To see whether we could establish the stand-alone costs.

18 Q. That process of looking at stand-alone costs was
19 something that Welsh Water had been engaged in for some
20 considerable period of time. Were you familiar with
21 a document -- if we go back to tab 35 -- of
22 January 2000? There are two parts to this. The first
23 one is top-down calculation, but the second part of it
24 is what's called a bottom-up calculation. So if you
25 look at this, were you familiar with this document at

1 the time?

2 A. Yes.

3 Q. You were? Do you know who drafted it?

4 A. Me.

5 Q. You drafted it? And why did you carry out this analysis
6 of bottom-up prices?

7 A. I think the -- this was done just after I had arrived in
8 the competition team and I think what I was trying to do
9 in these two documents is put down the approaches we
10 could be taking in order to price what the price
11 implications of common carriage was.

12 This particular document looks at bottom-up prices,
13 and what we are trying to do here is offer a menu of
14 services to potential entrants, and I think, as I said
15 yesterday, the whole focus at this time was around
16 potable water, and we were expecting -- or Ofwat were
17 suggesting that the main focus for common carriage at
18 that time would be entrants who came in, developed their
19 own sources and potentially treated them more
20 efficiently than we were. Therefore, common carriage
21 would be used to take their treated water to our
22 customers.

23 And what I was trying to do in this document is to
24 say, in that case then we need a menu of prices to offer
25 people, and the bottom-up refers here to you take this

1 menu and choose each one, and that is the basis -- your
2 price will be made bottom-up.

3 But the table in the handwritten notes on the right
4 would suggest this is basically a regional average
5 approach, where each of these lines -- you would have
6 regional average for each of these particular elements,
7 and the second section then is -- I can't read my own
8 writing for that word, but the 12 would be the 12 areas
9 that Dave Holton referred to in the email we just got
10 to, and the 40 -- I believe at the time 40 was the
11 number of water resource management zones that we had,
12 and we were looking to see whether or not we could split
13 the costs across each of these for each of those
14 services.

15 Q. It wasn't simply a regional basis, was it? I mean, if
16 you look at the question in the middle of the page in
17 the main bit of text. What you are doing is saying:

18 "To what extent do current cost centres, objective
19 codes allow this split to be achieved? To what extent
20 can this split be achieved on a geographical basis: by
21 resource zones, North Wales/South Wales or regional
22 costs only?"

23 So what you were doing at this stage is finding out
24 if there were the costs centres available to produce
25 splits on a geographical basis, or whether it had to be

1 a regional average?

2 A. I think the way costs centres work in the water industry
3 is that the actual direct costs of a costs centre would
4 not be the total costs of that service. There is
5 a large proportion of our costs are shared and a large
6 proportion of our costs are common costs, and what I was
7 trying to do here is to see whether or not we could
8 allocate sufficient of the small number of direct costs
9 to each of these boxes to make it meaningful. Then we
10 could attribute the shared costs and the common costs
11 across each of these areas.

12 So I think -- I remember at the time, after I had
13 done this, I visited the management accountants in the
14 regions to find out what costs we had available, and
15 I can't remember the costing going anywhere just because
16 of the -- the way the industry is set up is there is so
17 much smearing of common costs and shared costs that it
18 doesn't add that much to go down to a very local level.
19 And therefore, that's why we start at the regional
20 average basis.

21 Q. Well, except you said only a month later in your
22 compliance checklist that you would need to be aware of
23 the stand-alone costs. You were familiar with the fact
24 that it was something that was going to need to be
25 looked at, weren't you?

- 1 A. I was familiar with the fact, yes.
- 2 Q. You knew at this time -- we are talking here about
3 January/February 2000 -- that Welsh Water needed to be
4 ready to engage with common carriage applications from
5 1 March 2000?
- 6 A. That's their statement of principles?
- 7 Q. 1 March is when the Competition Act came into effect.
- 8 A. I beg your pardon, yes.
- 9 Q. So you knew that you needed to be in a position to look
10 at these kind of bottom-up prices from that point
11 onwards. Can you help us with why it appears that
12 almost nothing was done on this at all until we get to
13 late November, the email we just went to?
- 14 A. I think from my recollection at the time my workload was
15 geared towards getting the statement of principles ready
16 and the network access code ready. So why I was
17 assigned that task, I can't remember.
- 18 Q. What about when Albion's application was made at the end
19 of September, so it became a real exercise? Why was it
20 nearly two months into the process that Welsh Water
21 started trying to work out what costs information was
22 available?
- 23 A. When Albion's application was made in September, I was
24 heavily involved with the interim determination of K,
25 and therefore I had no contact with the team at that

1 time. So I am not able to comment on ...

2 Q. The process started on 24 November, and you had been
3 involved for several weeks by then?

4 A. I had had some input. I wouldn't have had much time to
5 contribute to this. The interim determination was
6 a very high workload, very short timescale exercise.

7 Q. So you are saying that's something that Mr Holton and
8 Mr Henderson would know about, but you don't?

9 A. Whether it was Jeff Williams, Jackie or Dave, between
10 them, they were the ones leading the project.

11 Q. If we go to tab 68, this is an invitation to tender,
12 which you see at the bottom right was apparently issued
13 by Dave Holton because it's asking if he will submit
14 their tenders to him by 31 December 2000. So it was
15 obviously issued some time before that date.

16 Was this something you were familiar with at the
17 time, that Welsh Water was going out to consultants? We
18 see here, it's the second bullet point:

19 "We are inviting a small number of selected
20 consultants to bid for the provision of a methodology
21 for determining these local prices and a report
22 detailing their quantum."

23 Were you familiar with that at the time?

24 A. I don't recall seeing this at the time.

25 Q. Well, were you aware this tender process was going on?

- 1 A. I was not.
- 2 Q. There aren't any, or no documents have been provided
3 showing responses to that. Can you help us as to why
4 that would be?
- 5 A. I have never seen a response to this. So I can only
6 believe -- this is clearly a draft, so the conclusion
7 I would draw is that it was never sent.
- 8 Q. If you look at what it says here in terms of the working
9 method, it was saying:
- 10 "Our revenue and capital costs are held on
11 a SAP R3-based system and our asset configuration is
12 held on a GIS system and asset database to which the
13 successful bidder will have access."
- 14 So certainly in terms of the drafting of this, it
15 was saying: the costing information is available, we
16 simply want consultants' assistance to provide
17 a methodology for helping to determine these local
18 prices. That's fair, isn't it? That's what it's
19 saying?
- 20 A. I think it's saying costing information. I wouldn't say
21 "the" costing information.
- 22 Q. The person writing it clearly thought that costing was
23 available to look at local costs, didn't they? That's
24 the whole point of the tender process.
- 25 A. I think the whole point of this is we are making

1 available to them the costs we have, the revenue and
2 capital costs. I'm not sure if Dave would have known,
3 but he should have done, the level that we kept the
4 revenue and the capital costs on SAP, and also split
5 between our GIS system and also our asset -- above
6 ground asset database.

7 Q. So he should have known, and therefore the fact that
8 this was being drawn up indicates he thought that
9 costing was sufficient to calculate local costs?

10 A. What he was asking for is: given our level of costs, can
11 you please help us produce the local costs.

12 Q. Go to tab 78, please. This is the first email you are
13 copied into concerning leakage. And we see under the
14 heading "Leakage", it's talking about possible ways of
15 calculating it. And at the end, under "Average", he
16 says:

17 "This can either be the regional (whole company)
18 leakage figure or the supply zone (Dee-Alwyn) figure.
19 Both of these figures are available for trunk mains and
20 are expressed in m³/km of main. Real data is coming
21 from Phil Bendry."

22 That real data doesn't seem to have been provided,
23 hasn't been disclosed. Can you help us with what
24 happened to that data on leakage?

25 A. I have no idea.

1 Q. Why if it was come be from Phil Bendry. Do you know who
2 Mr Bendry is?

3 A. I think in the water resource management team he kept
4 all our data records for a number of properties and
5 things like that.

6 Q. He's a reliable individual? You would expect if he was
7 asked for some data, he would have provided it?

8 A. Very reliable, yes.

9 Q. Can you help us with what happened to that data, then?

10 A. I imagine it would have been supplied.

11 Q. What happened to it after that?

12 A. I have no idea.

13 Q. Because if the real data is coming, it would show the
14 difference between locality leakage, regional company
15 leakage or supply zone. So it would be a real piece of
16 information on local versus regional average costs,
17 wouldn't it?

18 A. Yes, but I have no reason why it's not available.

19 Q. Go now, then, back to tab 86, which is the email we
20 started this on with Mr Holton asking Mr Henderson about
21 some possibilities. He has clearly been talking to
22 Dr Boarer, because we see a reference to her, "Jackie",
23 in the first line of it. It says:

24 "Jackie believes the spreadsheet Gareth Williams
25 sent through is the work she has in mind."

1 Who is Mr Williams?

2 A. At the time, he was a -- he worked in North Wales. He
3 would have been aware of the costs and the cost centres
4 in North Wales.

5 Q. So he had sent through a spreadsheet showing the actual
6 local costs in North Wales?

7 A. The local costs as they were kept, at the level they
8 were kept at. I would imagine that's what this
9 refers to.

10 Q. Can you help us with what happened to that spreadsheet?

11 A. I have no idea.

12 Q. "Jackie in addition believes that Colin Pike did some
13 work on this."

14 Who was Mr Pike?

15 A. Mr Pike was an operational manager, I believe, in
16 southeast Wales in the mid to late 90s. At this time he
17 would probably work for Hyder Industrial. So Hyder
18 Industrial were a company that was set up outside the
19 regulatory business looking at opportunities, and
20 I think at the time he was working for those.

21 Q. So it seemed like he had done some work. Were you aware
22 of that?

23 A. I don't know what work she is talking to. I'm not aware
24 of it, no.

25 Q. Again, can you help us as to what has happened to that

1 work?

2 A. No.

3 Q. Then:

4 "[Dr Boarer] telephoned Neil Lewis, who confirmed
5 that they had the costs to large works and within the
6 12 areas."

7 So clearly it's costs to large works. That would be
8 water treatment works, wouldn't it?

9 A. I think that's a sensible conclusion. This was talking
10 about water area, so Neil would have had costs of large
11 sewage treatment works as well.

12 Q. Sewage wouldn't have been relevant to what they were
13 doing here, would it?

14 A. No.

15 Q. Again, it's confirming that Neil Lewis obviously had
16 some data. Presumably you would expect it would have
17 been sought and obtained from him, wouldn't you?

18 A. Yes.

19 Q. Can you help us as to what happened to that data?

20 A. No.

21 Q. If we go on to the next thing, there is also
22 a suggestion Dave Brotherton would be familiar with the
23 work done, and then:

24 "Neil suggested Phil Wynne, who is based at Alltami
25 in North Wales ... as somebody who can help with

1 North Walian costs (obviously relevant to Ashgrove)."

2 So there was a desire at this point to find out what
3 the Ashgrove costs were. Is that right?

4 A. I think that's a fair conclusion.

5 Q. Phil Wynne is suggested as somebody who could help with
6 the costs. Were you aware whether he was approached for
7 that information or not?

8 A. I'm not aware of who Phil Wynne is, and I don't know
9 whether he was approached or not.

10 Q. The next reference is to Mr Holton was going to contact
11 him. You can't help as to what happened to that, any
12 information he provided?

13 A. No.

14 Q. Then there are references to whether there are any
15 individuals at Welsh Water who can help in the process.

16 There is then a reference to suggesting a meeting is
17 possible with:

18 " ... all potential knowledge holders to ascertain
19 in one swoop the possibilities that the current system
20 ... "

21 There is a list of individuals there. Were you
22 involved in any meeting concerning cost information
23 collection?

24 A. I don't recall that, no.

25 Q. Do you have any reason to think that meeting didn't go

1 ahead?

2 A. I have no idea.

3 Q. Well, it's Mr Holton making a suggestion to

4 Paul Henderson -- I mean, Mr Holton is the boss there,

5 isn't he?

6 A. I'm not sure if Paul worked for Dave. I think Paul

7 worked for Jackie.

8 Q. But Mr Holton was more senior, wasn't he?

9 A. Yes, correct, yes.

10 Q. So it's a senior person suggesting a meeting to a more

11 junior person. It seems likely it went ahead,

12 doesn't it?

13 A. I don't know.

14 Q. Now, in terms of the availability of information, can

15 I ask you to turn to bundle 6, tab 241?

16 A. Shall I keep number 3 open?

17 Q. Certainly, we will be coming back to number 3.

18 A. 241, sorry?

19 Q. Yes. Tab 241 is the second witness statement of

20 Mr Jones, who I believe is the finance director of

21 Welsh Water, filed in the previous tribunal proceedings.

22 If you could turn to the final page, 1943, in the

23 bundle, you should see a printout of costs associated,

24 we see in the middle of the page, with Ashgrove Water

25 Treatment Works, WTW. So this was clearly simply a

1 printout from your accounting system, which showed
2 considerable detail, a whole range of costs associated
3 with water treatment works totalling £354,905.18 at the
4 bottom. Do you see that?

5 A. Yes.

6 Q. So in terms of the operating costs of the works itself,
7 that information was readily available from the
8 printout, simply from the printout from the financial
9 system, wasn't it?

10 A. These aren't all the works associated with the plant,
11 but these are -- these level -- is available in 2000,
12 yes. Some of the costs would have been held at
13 a different location. It was controlled from, I think,
14 Bretton Treatment Works. So some of the costs
15 associated with --

16 Q. They would be matters like telemetry. It wouldn't
17 actually be the costs of the works itself. It would be
18 the connection, the telemetry, simply sending messages
19 to the plant?

20 A. Operation of the telemetry as well. It's basically some
21 of the costs of the Ashgrove Water Treatment Works.

22 Q. In terms of the works itself, this is the majority of
23 the operational costs, isn't it?

24 A. I haven't done an analysis, so I can't say whether it's
25 the majority or not.

- 1 Q. And you were aware that this kind of information was
2 readily available, weren't you?
- 3 A. I would have been at the time, yes.
- 4 Q. And the other members of the team would also have been
5 aware that that kind of information was readily
6 available, wouldn't they?
- 7 A. I'm not sure what information they would have known,
8 which is why they were contacting the likes of Neil
9 Lewis, just to see what information was available.
10 I think that's the point of Dave's email earlier.
- 11 Q. So once they asked they would have been told that kind
12 of information was readily available?
- 13 A. If they asked, yes.
- 14 Q. Can you go to tab 242. This was the asset register for
15 the Ashgrove works. It shows both the works and the
16 mains, and this shows the original capital expenditure
17 and depreciation and updated capital expenditure that
18 would have taken place on the works. So, again, this
19 was something that was readily available, wasn't it?
- 20 A. These are the historic accounts. So these are the sort
21 of book value -- historic book value of that works.
- 22 Q. And also showing you what capital expenditure had taken
23 place on an ongoing basis because each new item of
24 capital expenditure would be added to that, wouldn't it?
- 25 A. I'm not sure if all of the capital expenditure would

1 have been added in this way. The capital expenditure
2 that was directly costed to the cost centre would have
3 been added, but I don't think all capital expenditure
4 would have been added to this.

5 Q. So a large portion of the costs associated with the
6 water treatment works would have been available simply
7 by asking the right accountant to print out these
8 documents, would it?

9 A. No.

10 Q. Certainly it's agreed that most of the operating costs
11 would have been available?

12 A. The very direct operating costs of the works, but the
13 shared costs and the common costs, which were also
14 a considerable portion, when they are allocated out to
15 the treatment works, wouldn't, and this isn't
16 necessarily -- this isn't much use for pricing policy
17 because this is historic costs, and pricing would be
18 based on current costs, the MEAV.

19 Q. So you would have to ask for accounting records from
20 a different part of the company for things like
21 telemetry, and, again, that information would be
22 available, it would just be a question of
23 apportioning it?

24 A. All the information would be available. It's a question
25 of apportioning it, yes.

1 Q. And Ashgrove was the only water treatment works carrying
2 out exclusively partial treatment, wasn't it?

3 A. I think, as I said yesterday, I think all treatment
4 works carry out partial treatment.

5 Q. That's why I used the word "exclusively".

6 A. As a treatment works because the Corus site is part of
7 another larger treatment works, it is separate because
8 of the non-potable nature, but as a treatment works, as
9 I understand, it's the only one that only does partial.

10 Q. So looking at it anywhere else would have to involve an
11 apportionment between full potable and partial
12 treatment, but Ashgrove was somewhere where looking at
13 that treatment works would tell you the cost of partial
14 treatment, at least at that site, wouldn't it?

15 A. It would give you an indication of the cost of partial
16 treatment.

17 Q. Madam, would be that a convenient moment?

18 MR COWEN: Can I just ask one question?

19 MR COOK: Yes.

20 MR COWEN: If you go back to 241, I think the schedule you
21 just took us to, there are some handwritten comments in
22 the right-hand side of CJM. It's page 1943. It looks
23 like calculations and it looks like that perhaps what
24 was being indicated by those calculations is something
25 like 0.868p per metre cubed.

1 MR COOK: I don't think that's something the witness would
2 be able to answer. I can tell you that I understand --

3 MR COWEN: I just want to know where it came from.

4 MR COOK: I understand that those are Dr Bryan's
5 calculations. The "excluding BS" would be "excluding
6 bulk supply", which is one of the cost entries here. So
7 it's the cost of the water. So it's taking all the
8 other costs allocated across the water to find out what
9 operating costs were on a per metre cubed basis, which
10 comes to slightly below 1p per metre cubed.

11 MR BEARD: Just to be clear, that tab which Mr Cook rightly
12 says was annotated by Albion, it says so in the index,
13 that was an exhibit to the second witness statement of
14 Christopher Jones, we have seen in the preceding tab, so
15 there may be some explanation.

16 THE CHAIRMAN: Yes, we will come back at 12 o'clock.

17 (11.52 am)

18 (Short break)

19 (12.06 pm)

20 MR COOK: Mr Edwards, we are now coming back chronologically
21 to tab 90, which is the email from Mr Henderson of
22 29 November we saw earlier on.

23 A. Do I need bundle 6 again?

24 Q. Bundle 6 can go for now.

25 We saw this email before. I would like you take you

1 to it now in a bit more detail. You notice the topics
2 under "Sensitivity", it's confidential. From what
3 I have seen, it's the only email that was sent with that
4 special confidential flag in the bundle. What was so
5 particularly confidential about this discussion that
6 wasn't true of all the other discussions you had with
7 your colleagues?

8 A. I don't know.

9 Q. It then says:

10 "Dave/Paul, please eat this email once you have
11 read it."

12 That's not something you would put -- basically
13 heightening the fact this is a hyper confidential
14 document, isn't it, the point Mr Henderson is trying to
15 make?

16 A. I'm not sure I read it that way. It's just Paul being
17 Paul.

18 Q. Look and see what Mr Henderson is doing in the rest of
19 the document. He explains why there is not a lot of
20 scope in the network structure for a non-potable Large
21 Industrial Tariff, and then says:

22 "Where this leads me is to think that what we will
23 probably have to look at is the overall reduction of the
24 49p tariff to around 26p. The argument would have to
25 come from the fact non-potable appears to hardly use

1 local distribution. So we would then construct the
2 non-potable price as [follows]."

3 What he is doing there is starting with a target,
4 isn't he? The target is 26p and he is trying to find an
5 explanation for how you could get there. That's what he
6 is doing, isn't he?

7 A. What he is trying to do here is -- sorry, the network
8 structure he is talking about here is a table that he
9 produces in a later document and his analysis of the
10 pipes that non-potable users take. So he is trying to
11 replicate the Large Industrial Tariff process model to
12 calculate a non-potable. So you start with 49p for the
13 standard non-potable rate. If we would have used the
14 same process of the LIT, you then work out the savings
15 due to the service they don't take to get the large
16 non-potable. And what he is saying here is the analysis
17 of those pipe lengths means that that isn't going to be
18 achievable, that we aren't --

19 THE CHAIRMAN: Listen to the question that Mr Cook asked.

20 He will ask you the question again.

21 A. Sorry.

22 MR COOK: My question was: what he is doing is starting at
23 that target, which is 26p, and trying find an
24 explanation or a methodology that will allow Welsh Water
25 to get there, isn't he?

- 1 A. Yes.
- 2 Q. As far as the team was concerned, it was the outcome
3 that was important. He worked out what the outcome he
4 wanted was and he would find a method to get there,
5 didn't he?
- 6 A. I think it was the explanation was the important bit, to
7 explain how we got from 49 to 26. It was using the same
8 methodology as before, the pipes that were or weren't
9 used, and that is what he was aiming for there, was not
10 the answer, it was the methodology for arriving at the
11 answer.
- 12 Q. Yes. But he is setting out what the answer has got to
13 be. That's what he is doing, isn't it?
- 14 A. I wouldn't say got to be. I mean, he is looking at
15 where he believes the answer will be.
- 16 Q. The reality is that you knew, Mr Henderson knew,
17 Mr Holton knew that that's what you were being tasked to
18 do: to come up with a price that maintained revenue
19 neutrality as the board had been told could be achieved?
- 20 A. I don't think that's correct at all.
- 21 Q. That's clearly what Mr Henderson is doing here, isn't
22 it? 26p revenue neutrality and that's the target?
- 23 A. The target is to justify a methodology -- via
24 a methodology to Ofwat of how we arrived at a price of
25 26p, which I think Paul would have believed was the

1 correct price for the Large Industrial Tariff for
2 non-potable users.

3 Q. He might have believed it was the correct price, but it
4 was only because that's a revenue neutral price. He
5 hadn't calculated it yet. So he doesn't know what the
6 answer is based on having done the maths, so it can only
7 be because that's the target he wants?

8 A. The 26p would have arisen out of the analysis that
9 Dennis would have done during the 90s.

10 Q. He is clearly not looking at that, because if that was
11 the case, they would simply be looking at -- sorry,
12 I forget Dennis' surname?

13 A. Mr Taylor.

14 Q. Mr Taylor -- they would simply be looking at what
15 Mr Taylor had done previously. This is a different
16 methodology trying to justify a number that's already
17 set, isn't it?

18 A. This is a different number -- sorry, a different
19 methodology using the Large Industrial Tariff. So, yes.

20 Q. And what's clear is Mr Henderson knew full well that you
21 could only get a number of around 26p by looking at
22 potable costings. That's right, isn't it?

23 A. I don't believe that's correct. I believe Paul had
24 tried this method and found that there was no
25 justification for reducing the numbers from 49p, so he

1 had used another method, using other information he had
2 at a high level to produce this figure.

3 Q. Which figure?

4 A. These figures here. This is the methodology.

5 Q. But those are -- because he has already decided 26 is
6 the target and he is just trying to get there?

7 THE CHAIRMAN: I think we might be at cross purposes as to
8 whether the 26p being referred to there is a bulk supply
9 price or a common carriage price.

10 MR COOK: The 26p is a special -- well, the term "bulk
11 supply", Madam Chairman. It's the non-potable price,
12 isn't it, as opposed to a common carriage price?

13 A. Yes, that's correct. It would be the price we paid
14 either to special agreement customers for non-potable
15 water, for large non-potable customers, or for a bulk
16 supply -- non-potable bulk supply.

17 Q. So it's trying to get to 26 as being the supply price,
18 and then you simply take off water at the final element
19 which would give you something around 23p, given water
20 is around 3p, wouldn't it?

21 A. What was the specific question?

22 Q. I said if 26p was the target for a non-potable price
23 because you knew that would give a common carriage price
24 roughly 3p more -- 3p less, so maintaining revenue
25 neutrality?

1 A. I'm not sure I agree with the target. The way it would
2 have worked is Paul would have known that the outcome
3 should be around 26p because that's what has been done
4 in the past. He was new to this area, so that was his
5 benchmark figure. And he knew that 49p minus a little
6 bit was a long way away from that, therefore that was
7 the wrong methodology to take. So I don't think it was
8 a target price that he had been set --

9 THE CHAIRMAN: What was your understanding that that 26p
10 price was?

11 A. It was a benchmark figure that had been established over
12 a number of periods as the non-potable partially treated
13 price for special agreements. And we hadn't got
14 a specific -- I think what Paul is trying to do here --
15 I'm speaking for Paul. Maybe I shouldn't, but what Paul
16 is trying to do here is establish a non-potable Large
17 Industrial Tariff that we could put on the scheme of
18 charges because we hadn't got one and it was causing
19 problems. As our expired agreements were coming up, it
20 was causing problems that we hadn't established one and
21 I think this was the start of a process.

22 What Paul would have been asked to do is come up
23 with a non-potable Large Industrial Tariff, and this is
24 his first thoughts on how he could achieve that.

25 MR LANDERS: So when you say there wasn't a tariff and he

1 was trying to create one, you are suggesting that there
2 was not a tariff, but some sort of standard that had
3 prevailed beforehand, which came to 26p?

4 A. Yes.

5 MR COOK: The only person paying 26p was Albion, wasn't it?

6 A. At what time?

7 Q. This time, 2000, the only person paying 26p was Albion,
8 wasn't it?

9 A. Well, the agreements that would have been in place from
10 the 90s would have been indexed. So the answer to your
11 question is I don't know, but it was highly unlikely if
12 somebody was charged 6p in 1996 that they would still be
13 paying 26p in 2000.

14 Q. If there have been a target price, he would have known
15 what that price would be at that time?

16 A. If there had been a target price, he would have known.

17 Q. The only person who was paying 26p at that time was
18 Albion?

19 A. I don't know, I haven't analysed -- at that particular
20 time, I think all of the agreements since privatisation
21 had been --

22 Q. I just want to look at bundle 16, tab 2, please. This
23 is Welsh Water's special agreement information. You see
24 the table in front of you: The volume on the left-hand
25 side. We can ignore the first one; that's a potable

1 water one. Then below it: WSHNONPOT 1 to 15, with the
2 various non-potable agreements?

3 THE CHAIRMAN: Sorry, tell me the tab again?

4 MR COOK: Bundle 16, tab 2, Madam Chairman.

5 That's 1999/2000. If we look across, we can see the
6 volumetric charge for 2000/2001. Again, on the page,
7 looking through that, there simply isn't some kind of
8 standardised 26p for anybody, is there?

9 A. In terms of numbers, nobody is paying 26.00p.

10 Q. The range is dramatic, isn't it? It's going as high as
11 31p, WSHNONPOT 2, and then going down there are a number
12 of far smaller ones down at 14p.

13 A. I'm not aware of which ones these refer to, but the 13
14 and 14p would probably be the inherited agreements and
15 the 26.17, 29, would be the "26p" inflated from whenever
16 the agreement was made.

17 Q. It's not a standard charge being paid by everybody.
18 There is a fairly substantial range, isn't there?

19 A. That's because we hadn't got a standard large industrial
20 non-potable tariff. These were agreements entered into
21 whenever the negotiations took place with an indexation
22 clause, which meant the price --

23 Q. It meant that you didn't actually have a standard way of
24 calculating these prices, either, did you? In terms of
25 a standard way of apportioning costs.

- 1 A. We didn't have a standard model, no, but I have already
2 said that.
- 3 Q. So each one could be calculated differently. There
4 simply wasn't a standard approach to calculating special
5 agreements for non-potable water, was there?
- 6 A. As far as I know, if Mr Taylor calculated them, he would
7 have calculated them all in the same way.
- 8 Q. So far as you know. You simply don't know, do you?
- 9 A. I don't know, no.
- 10 Q. And the figures hardly support that, do they?
- 11 A. Hardly support what?
- 12 Q. Hardly support the notion that they were all done in the
13 same way?
- 14 A. They were all done at different times. So you can't
15 draw the conclusion that they are not done the same way.
16 They are a consequence of negotiations.
- 17 Q. The reality was that 26p -- the significance of that
18 number, that was what Albion was paying and you knew
19 that's why there was a confidentiality to this email
20 because it was targeting the outcome, wasn't it?
- 21 A. I don't think "targeting" is the right word.
- 22 Q. In terms of what Mr Henderson is doing in this email,
23 calculating the FAP?
- 24 A. Can I put bundle 16 away?
- 25 Q. Bundle 16 can certainly go away.

- 1 If I could hand something up to you, Mr Edwards.
- 2 A. Yes. (Handed)
- 3 Q. I have tried to summarise, Mr Edwards, what was going on
4 at this point in time in terms of the methodology.
5 Would you like to read the document first?
- 6 THE CHAIRMAN: Is this a re-expression of what's in
7 Mr Henderson's email?
- 8 MR COOK: It's an attempt to simplify it, madam, yes.
9 (Pause)
- 10 A. Okay.
- 11 Q. Have you had the opportunity to read that now,
12 Mr Edwards?
- 13 A. Yes.
- 14 Q. I can go through it in detail with you. Have you
15 understood what the document says in front of you?
- 16 A. I have understood what you are trying to do.
- 17 Q. I appreciate the one thing on this document, I would
18 say, is that the 30 per cent figure of treatment, of
19 course that's a figure that comes in later. At this
20 stage, Mr Henderson hasn't got to the 30 per cent
21 treatment element. That comes later, so I would accept
22 that this is intended to summarise the general process
23 rather than in isolation this document. Do you agree
24 that's a fair summary of what's going on at this time?
- 25 A. Without reconciling it completely, I would not be

1 comfortable agreeing it, but I have no reason to
2 suggest --

3 THE CHAIRMAN: Can I just ask: what does "then apportion
4 from ABC between R and T and D"? What's "ABC", do you
5 know, in the email? Do you know?

6 A. It's the activity-based costing tables. These are
7 the June return tables from Ofwat, table 1.

8 THE CHAIRMAN: Activity-based costing?

9 A. Yes.

10 THE CHAIRMAN: Those are sort of regulatory returns?

11 A. They are specifically geared for Ofwat for their
12 comparative efficiency purposes, and they are governed
13 by RAG, Regulatory Accounting Guidelines.

14 MR COOK: That's the process of actual -- I have said they
15 are calculated from company accounts, resource potable
16 treatment and potable distribution, but the ABC is what
17 you go to carry out that process.

18 A. The ABC was a proxy for the costs of these in terms of
19 pricing. The ABC tables aren't completed with pricing
20 in mind; they are completed with efficiency in mind.
21 But we -- on the basis that that's the only evidence we
22 have got, we believe they are a fair proxy.

23 Q. If we go through the methodology -- I would just like to
24 take you through it quickly because it will hopefully
25 assist in terms of the questions we are going to come to

1 in some of the later documents.

2 We can put on one side the summary for a moment
3 because that's the end of the process. In terms of
4 a standard potable price, which was 83.74p at the
5 time -- you see the detailed price comes later.
6 Mr Henderson was using the rounded price of 83 in this
7 document. That was, you were saying split effectively
8 into four elements: resource, potable treatment, potable
9 bulk distribution and potable local distribution.

10 And Mr Henderson wraps into that, customer services.

11 A. The volumetric charges covers a contribution to those
12 four, yes.

13 Q. Come down to the next entry, which is the top band in
14 the potable large industrial tariff. The top band, that
15 meant for the customers taking the largest volumes of
16 water?

17 A. That's the -- the LIT was split into four or five bands,
18 and the top band was the largest customers we had, yes.

19 Q. Hence the lowest price?

20 A. Yes.

21 Q. The same in relation to that, the top band, effectively
22 that consists of three elements: the resource, the
23 potable treatment and the potable bulk treatment. So
24 the element that has come out is potable local
25 distribution and also customer services which will be of

1 a completely different scale for thousands of individual
2 households than they would for a single large user?

3 A. That was the rationale for Large Industrial Tariff, yes.

4 Q. And then what Mr Henderson is suggesting, and we see in
5 the later documents you go on to try and do, is
6 apportion from, as Madam Chairman says, from the ABC
7 company accounts, the proportion of these costs which
8 are going to be resource, potable treatment and potable
9 distribution?

10 A. Yes, because the ABC tables are constructed to work out
11 the water resource and treatment function and the
12 distribution function, we then had to split up both of
13 those into resource and treatment and then to infer the
14 bulk distribution element.

15 THE CHAIRMAN: So there in that stage, you are trying to
16 work out what part of the 44.64p is made up of resource
17 potable treatment and potable distribution?

18 A. I don't think so. I think the large industrial tariff
19 was there because the justification for the Large
20 Industrial Tariff is that the large industrial customers
21 do not take the smaller mains, and there is quite a bit
22 of work goes on the smaller mains and we had stripped
23 those out.

24 So what Paul is suggesting is we have already done
25 that work, therefore --

1 THE CHAIRMAN: Yes, that's the 39.1p.

2 A. And I think he had used that as a proxy for that, but
3 the work he was trying to do was the overall split of
4 resource and treatment. So to return to your question,
5 I think it was doing it for the top element, splitting
6 out resource and treatment from the whole costs rather
7 than from the large industrial tariff costs.

8 THE CHAIR: I see, yes.

9 A. If that answers your question.

10 THE CHAIRMAN: So it's working out what part of the total,
11 both large industrial and standard, is --

12 A. Yes, it's trying to split out the total costs into those
13 elements. And then once you have got those total cost
14 elements, the LIT would be used to split the water
15 distribution costs into customers who take large mains
16 and customers who take the costs associated with the
17 smaller mains.

18 MR COOK: So as we see in the next line, you end up with the
19 potable local distribution count and that's calculated
20 automatically from the difference between the two top
21 band LIT and the standard potable price, 39.1p.

22 A. Where is that on Paul's report? We know the local
23 distribution is 39p, he is saying there, yes. So
24 therefore, once he has split out the resource and
25 treatment and distribution, then ...

- 1 Q. Then finally you calculate potable bulk distribution by
2 deducting that local potable distribution figure, 39.1,
3 from the total distribution cost figure, which is going
4 to be calculated using this process, and we see it's
5 there. Actually, it's 56p in this calculation.
- 6 A. Yes, I think that's what Paul has done. He has split --
7 the ABC table only accounts for a proportion of the
8 costs required for pricing. It covers the operating
9 costs. It covers the shared costs. And it has got the
10 depreciation and infrastructure renewals costs, and then
11 you have to add on the return on capital. So that's why
12 he has added that -- that's why he has done the figure
13 at the bottom. So the ABC costs only cover a portion of
14 those -- of the costs required for pricing.
- 15 Q. So the access price -- so the common carriage price
16 being suggested by Mr Henderson would then be the
17 potable bulk distribution plus -- and in this document
18 he is saying a proportion of potable treatment, and we
19 come on to see that 30 per cent is the figure that's
20 used?
- 21 A. I think the way he has calculated here, I think that's
22 right.
- 23 Q. So if we look at the summary, effectively that's the end
24 result. His distribution is the top band potable LIT,
25 32.64p, less the resource and potable treatment costs,

1 and then you add back 30 per cent of treatment. That's
2 the summary at the top of the page.

3 A. I never thought of it like that, but ... so ... that's
4 not the way I have looked at it, so I can't comment
5 unless I look at it in more detail.

6 Q. Perhaps you could think about that over lunch, if you
7 get the opportunity.

8 So that was what was being proposed at that time.
9 In making that kind of calculation -- I mean, firstly,
10 what was being recognised, of course, is that you
11 wouldn't expect somebody who is taking partial treatment
12 to pay for all the potable treatment costs, would you?

13 A. No.

14 Q. So you need to make a modification to reflect whatever
15 is an appropriate partial treatment cost?

16 A. Yes.

17 Q. And that's not in this document, but we will come back
18 to where it appears later on. But the key assumption
19 that's inherent in all of this is that Mr Henderson is
20 assuming that non-potable distribution costs are the
21 same as potable water distribution costs, doesn't it?

22 A. No.

23 Q. Well, he is just using the potable distribution costs as
24 being what Albion should pay for the transport element,
25 isn't he?

1 A. I think in this analysis he is probably assuming that on
2 average the cost of bulk distribution is the same.

3 I don't think he is assuming that (inaudible) the same.

4 Q. He is assuming that Albion should pay the cost of
5 potable distribution, not the cost of non-potable
6 distribution?

7 A. In this analysis, using the volumetric standard tariff,
8 that's correct.

9 Q. But looking at this, Mr Henderson hasn't made any
10 attempt to actually confirm that the costs as stated
11 here for non-potable distribution are anything like the
12 costs associated with potable distribution, has he?

13 A. Looking from this, he hasn't.

14 Q. In fact did you do any work looking at that issue at the
15 time?

16 A. I have never done any work looking at the different
17 costs.

18 Q. So this is all based on an assumption that they are the
19 same and that simply wasn't tested?

20 A. I don't think it's based on the assumption. I think
21 it's based on the fact that average costing shares, the
22 different -- the costs of operating a distribution
23 network, regardless of whether it's potable or
24 non-potable, or shared between everybody.

25 Q. Well, you are also operating a network of treatment

1 centres?

2 A. Yes.

3 Q. But you are only charging people who use a particular
4 element of that network, the partially treated element,
5 you are only going to charge them for the part they are
6 using; that's right, isn't it?

7 A. That's correct, yes.

8 Q. So in relation to the logic you are adopting on
9 treatment, the same issue applies in relation to
10 non-potable pipes. They are completely separate pipes.
11 The water is not going through the same pipes. So it's
12 a different distribution network, isn't it?

13 A. They are completely different water treatment works.
14 Just the way -- in terms of average pricing, I'm a bit
15 more familiar with water treatment works and I know that
16 on an average basis borehole water -- customers who take
17 water treated from a borehole would have a lower than
18 average cost, and customers who take river water would
19 have an higher than average cost.

20 So therefore, we don't distinguish between where you
21 take your water from. We say that everybody who takes
22 water through a water treatment works pays the average
23 price. So if by accident you happened to live near
24 a borehole, you may be paying -- your average charge may
25 be more than your actual local charge. If by accident

1 you take water from a river source, you will actually,
2 on average price, be paying less than what, on average,
3 the cost of -- that's standard practice. I think at the
4 time Ofwat had produced econometric models which used
5 that evidence to show -- compare efficiency, and they
6 were very clear that it was known at the time that river
7 water was more expensive to treat.

8 Q. That's because both customers there are the same class
9 of customer, but you are talking about different classes
10 of customers taking a different product; you would
11 expect them to be paying the costs associated with their
12 service, not the costs of a different service?

13 A. Their service was --

14 Q. Their service was the distribution of non-potable water
15 through a separate non-potable distribution network?

16 A. I think their service, as we priced it, was distribution
17 of water.

18 Q. Through a separate network.

19 A. Well, a --

20 Q. With separate costs?

21 A. A lot of customers took water through separate networks.

22 Q. You knew, didn't you, that the costs associated with
23 that non-potable network were much cheaper than the
24 costs associated with the potable network, didn't you?

25 A. I didn't, no.

1 THE CHAIRMAN: You did or you didn't?

2 A. I didn't. I have never done analysis of the costs of
3 that works.

4 MR COOK: You accept that's indeed the case. You are
5 presumably aware of that now?

6 A. I haven't seen the evidence to suggest on the average
7 that the --

8 Q. Turn to bundle 8, please, tab 274 and go to
9 paragraph 7.83. This is the referred work, it was
10 called. It was the of the analysis carried out by Ofwat
11 for the Tribunal during the course of the liability
12 phase of the proceedings. And this was the authority
13 considering the extent to which there was a comparison
14 between potable and non-potable distribution costs.

15 You see at paragraph 7.83 the authority says:

16 "... of the view that bulk potable mains are the
17 best comparator for bulk non-potable mains."

18 We see below it then goes on to make adjustments.
19 So it starts off with potable costs, but then adjusts
20 those costs. We see at 7.84, Welsh Water was arguing
21 that the whole bulk network should be used as the
22 comparator for all potable distribution costs. And you
23 see at the end of 7.84, Welsh Water was therefore
24 suggesting a 100 per cent weight should apply to those
25 costs. At 7.85, Ofwat then says it disagrees with this

1 comparative approach. It says at the second sentence of
2 7.85:

3 "The authority has therefore applied a nominal
4 estimated weighting factor of 10 per cent, rather than
5 100 per cent, to the capital costs of 300- to
6 600-millimetre pipes."

7 So in that category it has applied a 10 per cent
8 weighting. Then it says, at 7.86:

9 " ... some account needs to be taken of the fact
10 that bulk non-potable distribution mains ... appear to
11 be smaller, on average, than their bulk potable
12 equivalents."

13 So it compared the average unit cost, concluded that
14 a weighting factor of 50 per cent, which it said
15 reflected the fact that non-potable was £664 per metre,
16 as opposed to £1,262 potable distribution.

17 So in this calculation it applied a 50 per cent
18 weighting to that element of the potable mains. So in
19 terms of -- and this is capital costs -- the authority
20 carried out its analysis and concluded it should take
21 account of 10 per cent of costs of 300- to
22 600-millimetre potable mains, and 50 per cent of the
23 costs of the 600 millimetres, and in excess of,
24 non-potable mains. So that was the analysis carried out
25 by the authority.

1 You are presumably aware that that took place?

2 A. I'm not aware of the detail, no.

3 Q. You refer in your witness statement to the fact that
4 this work was carried out. You refer to it as taking
5 place with more granularity than you conducted at the
6 time. Do you recall saying that?

7 A. Yes.

8 Q. So you were aware that the work was taking place?

9 A. I was aware the granularity, I wasn't aware of the
10 detail.

11 Q. You accept that when the actual analysis is carried out,
12 the end result effectively is non-potable distribution
13 is half the capital cost of potable distribution?

14 A. That's what this analysis says.

15 Q. That was capital costs. If we go down to 7.93, we see
16 7.93 reflects actually the findings made by the Tribunal
17 that minimal maintenance was carried out on non-potable
18 mains.

19 Presumably you were familiar with the fact that by
20 its very nature there would be less need to carry out
21 maintenance on non-potable systems because you are not
22 sending water to somebody who is going to drink it? So
23 you are less concerned about a leak appearing and water
24 getting contaminated. So you are less worried about
25 carrying out maintenance than you would be for potable

1 mains. Are you familiar with that?

2 A. I'm not sure if I was familiar with that description at
3 the time.

4 Q. You also presumably are familiar with the fact that
5 because potable water is more expensive, it has been
6 treated at high cost, therefore there was a need to
7 ensure it didn't waste away? Therefore, that made it
8 more important to carry out maintenance work on potable
9 mains than non-potable. You are familiar with that,
10 presumably?

11 A. I would have been aware of the economic argument, yes.

12 Q. If we then with go down to paragraph 101, it's for
13 non-potable customers:

14 "The Authority has argued [...] that service (reservoir and bulk
15 distribution capital costs are likely to be

16 50 per cent lower and the authority believes this will
17 translate into a similar reduction in associated repairs
18 and maintenance activity. In addition, it could be
19 argued the economic value of non-potable water and hence
20 the economic level of leakage management is, at least
21 theoretically, some 50 per cent lower, the result of the
22 reduced/water treatment on non-potable systems."

23 So reduced the weighting factor for network
24 operating costs by 50 per cent for non-potable
25 customers.

1 So, again, in relation to those ongoing maintenance
2 costs, the authority concluded those would be half the
3 level in relation to those repair costs, and, again, you
4 presumably are aware of that since you refer to this
5 report in your witness statement?

6 A. Sorry, are you saying am I aware of that paragraph?

7 Q. You are aware that these conclusions have been reached
8 by Ofwat, weren't you, that in round terms non-potable
9 distribution cost about half of what potable
10 distribution cost?

11 A. No, I wasn't.

12 Q. I'm just clarifying.

13 A. Sorry?

14 Q. You are aware of it now. I'm not saying you were aware
15 of these findings in 2000.

16 A. I beg your pardon, I'm aware of it now.

17 Q. You said you were aware of the economic arguments being
18 made here and, consequently, the fact that it was always
19 likely that those costs were going to be the low quality
20 and level, low cost water?

21 A. Yes, in the same way as river water is more expensive
22 and borehole water is cheaper. As part of average
23 variable -- sorry, regional average costing, then that's
24 a consequence, that some customers pay more for the
25 service they take than other customers, due to accidents

1 of history -- or geography.

2 Q. You can put that folder away. We can turn to folder 2,
3 tab 15. This was the letter that was sent by Dr Boarer
4 to Ofwat, enclosing Welsh Water's new potable Large
5 Industrial Tariff, sent in December 1998, and then we
6 see the justification document attached to page 282. If
7 we go to paragraph 2.5 of this document -- so what this
8 document is doing is it's trying to persuade Ofwat to
9 approve the Large Industrial Tariff. You were aware of
10 that process, presumably?

11 A. Yes, I was aware of that.

12 Q. And it's explaining at paragraph 2.5 that:

13 "The [Large Industrial] Tariff will only apply to
14 potable water users. The tariff structure for
15 non-potable users already reflects the reduction in
16 price per cubic metre due to lower treatment and
17 distribution costs."

18 Welsh Water's own documents were reflecting the
19 lower distribution costs of non-potable water, weren't
20 they?

21 A. That's what it says here.

22 THE CHAIRMAN: Where are you reading that from?

23 MR COOK: Paragraph 2.5, page 283.

24 THE CHAIRMAN: Yes.

25 A. To reflect the fact that they didn't take full

- 1 treatment.
- 2 MR COOK: And it says also distribution cost, doesn't it?
- 3 A. Which is they take the larger mains and the smaller
4 mains, yes.
- 5 Q. So Welsh Water was well aware this was a lower cost
6 service that it was providing to non-potable users,
7 wasn't it?
- 8 A. In the fact that they didn't take full treatment and
9 they didn't take local distribution -- I'm not sure what
10 your question is getting at.
- 11 Q. This is not talking about lower distribution. Let's go
12 back to the document at bundle 2 tab 15. It's explaining why the
13 Large Industrial Tariff will not apply. The Large
14 Industrial Tariff is already taking account of the
15 reduction in distribution costs by virtue of non-use of
16 the local distribution network. So it's explaining why
17 there is a different price for non-potable due to their
18 lower treatment and distribution costs. So it's
19 reflecting the fact that both sets of costs were lower
20 than the LIT figures, wasn't it?
- 21 A. The tariff structure already reflects the fact that
22 non-potable don't take full treatment and that
23 non-potable don't use the local distribution. That's
24 what that's saying.
- 25 THE CHAIRMAN: No, no, the point that's being put is that

1 they are comparing large user non-potable with large
2 user potable.

3 A. Right.

4 THE CHAIRMAN: So the large user potable also, you are being
5 asked, does not use local distribution; it only uses
6 bulk distribution.

7 A. Yes.

8 THE CHAIRMAN: That's why the large user potable is cheaper
9 than the standard potable.

10 A. Yes.

11 THE CHAIRMAN: What's being put to you is: it's here saying
12 large user non-potable will be cheaper still because of
13 lower treatment -- we are all agreed about that -- but
14 there it's also saying lower distribution costs. What's
15 being put to you is: is that a recognition that even
16 looking just at bulk distribution, through the big
17 pipes, not local distribution, non-potable is cheaper
18 than potable large user?

19 A. I don't agree with that. I think it's what you said at
20 the beginning. What this says is it reflects already
21 that they -- that the tariff structure for them reflects
22 already the fact -- this is the Large Industrial Tariff
23 that we are now putting in place to reflect the fact the
24 large industrial customers receive lower distribution
25 costs. And this is saying that that's already included

1 in the non-potable. That's what I believe it means.

2 MR COOK: If you recall the minute -- the board meeting from
3 November 2000 that I took you to -- I can take you back
4 to it -- which was, I believe, at bundle 3, if you go to
5 that. I believe it was 75. It's paragraph 4.4.2. We
6 have seen it already -- saying that:

7 "The application will have a relatively neutral cost
8 effect for Welsh Water for so long as the average cost
9 of distribution can be applied to such arrangement."

10 So that's saying we have to use the affirming cost
11 of all distribution, recognising that if you didn't use
12 the average cost of all distribution, then the
13 cost-neutral effect wouldn't arise. That's what it's
14 saying, isn't it?

15 A. I'm not sure that follows. What this is saying is the
16 average cost of distribution -- I don't think I agree
17 with what you said. Could you say it again?

18 Q. Certainly. It's saying -- this is reflecting the
19 fact -- cost-neutral for so long as the average cost of
20 distribution is applied.

21 A. Yes.

22 Q. We both agree on that. That must be reflecting,
23 therefore, that if something other than the average cost
24 of distribution is applied, it won't be cost-neutral.
25 You would agree with that proposition as well?

1 A. Yes.

2 Q. So there must have therefore been a recognition, I'm
3 suggesting to you, that looking at a different form of
4 distribution cost, ie non-potable distribution costs,
5 would not be cost-neutral. That was the recognition,
6 wasn't it?

7 A. It may not be cost-neutral, no.

8 Q. So the recognition was that non-potable distribution
9 costs were different from potable distribution costs?

10 A. I think the recognition was de-averaged costs would be
11 different to average costs.

12 Q. Can I ask you to turn now on through the bundle to
13 tab 99 -- sorry, apologies --

14 THE CHAIRMAN: Have you finished with the Henderson email?

15 MR COOK: I have.

16 THE CHAIRMAN: Can I just ask -- this is tab ...?

17 MR COOK: The email is at tab 90.

18 THE CHAIRMAN: At the bottom there it says:

19 "So all we need to do is split resource and
20 treatment."

21 A. Yes.

22 THE CHAIRMAN: Do you know whether that split was ever
23 calculated?

24 A. Where this is going is the bit where we later on use the
25 30 per cent. He is recognising that he has done at

1 a high level the split between water distribution and
2 water resource --

3 THE CHAIRMAN: But what would be the resource?

4 A. Sorry, I beg your pardon, I answered the wrong question.
5 Yes, we had an internal accountant look at the split
6 from the activity-based costing table between resources
7 and treatment.

8 THE CHAIRMAN: Would that then be an average cost of water
9 across the whole company for the resource bit?

10 A. Yes, I think the way it was done is they -- the ABC
11 tables were split two columns between resources and
12 treatment and that was worked out as a percentage. That
13 percentage was then applied to the overall tariff to
14 split that out. So, yes, it would be an average.

15 THE CHAIRMAN: Do you know what, across the whole company,
16 the average cost of water is?

17 A. Which -- all water or ...?

18 THE CHAIRMAN: Is that what ABC would be looking at, all
19 water?

20 A. It would be look at the costs of the -- the ABC table is
21 the costs of all water split between -- there is some
22 third party supplies in there as well. It's allocated
23 out, but, yes, it would.

24 THE CHAIRMAN: Do you know what that is per cubic metre?

25 A. I think that's 73.3, in my analysis.

1 MR COOK: Madam Chairman, I think you got an answer which
2 would not have helped you there. The 73.3 was the
3 average price at which water was sold. I think Madam
4 Chairman is asking for the average resource cost
5 element.

6 THE CHAIRMAN: Yes. How much was Dwr Cymru paying on
7 average, across the whole company, for water?

8 A. For the raw water?

9 THE CHAIRMAN: For the raw water.

10 A. I wouldn't know, I'm sorry.

11 MR COOK: Madam Chairman, we are going to three or four
12 documents which do include these numbers within them.

13 THE CHAIRMAN: Okay.

14 MR COOK: Unfortunately, you will see there is no clear
15 answer to your question. But we will see a variety of
16 the numbers.

17 A. Because of the problem of the smearing of the shared
18 costs and the common costs, then depending on how you
19 attribute those costs is why the numbers come out
20 different.

21 Q. So if you go to tab 88, which actually is just slightly
22 before this email, but it's a letter from Ofwat of
23 28 November and this is Ofwat chasing for the first
24 time --

25 A. This is from North West Water. Am I on --

1 Q. Bundle 3, tab 88?

2 A. Yes.

3 Q. This is a letter from Ofwat of 28 November 2000, and
4 it's now two months, essentially, since Albion applied
5 for common carriage. This is Ofwat starting to chase
6 saying, "Have you got a price? If so ..."

7 It says:

8 "Has Dwr Cymru calculated an access price? If so,
9 has Dwr Cymru refused to inform Albion until after
10 mid December? If this is also correct, what are your
11 reasons for this?"

12 So that's the question being asked.

13 Go to tab 91 and we can see the answer that's given
14 to that. The answer comes from Mr Holton. We see his
15 signature at 722. Of course, his role was competition,
16 wasn't it, among other things?

17 A. Yes, key customer and competition manager.

18 Q. So he was the obvious person to be responding to Ofwat
19 on this issue. We see on the paragraph here at the
20 bottom of the first page that:

21 "Welsh Water informed Albion in a telephone
22 conversation of 23 November that a price would be not be
23 available until mid December following a scheduled board
24 meeting. This is considered normal procedure
25 considering the importance of the issue."

1 Presumably that was Mr Holton accurately expressing
2 what the position was at Welsh Water at the time, in
3 terms of how they viewed the access price; is that
4 right?

5 A. Yes.

6 Q. So this was something where he was saying there had to
7 be board approval for a price to be issued, given the
8 importance of the issue. That was what you understood was
9 the position as well, wasn't it?

10 A. The issue that the access price would be the common
11 carriage price for access to our network anyway. So it
12 wasn't Albion-specific. That is my understanding of
13 that, yes.

14 Q. So it had to be board-approved before it could be
15 issued?

16 A. We were seeking board approval. I'm not sure if it had
17 to be.

18 Q. If we go to tab 99, which is the next document, that is
19 an email at the bottom of the page from you to
20 Mr Holton, Mr Williams, Dr Boarer and Mr Henderson. It
21 says:

22 "Thinking over the discussion at this morning's
23 meeting ..."

24 So there had clearly been some kind of meeting that
25 morning between the five of you. You say:

1 "I believe that the threats of Ofwat -- backed by
2 the encouragement of ELL -- are hollow ... "

3 You go on to explain why in your view they will be
4 hollow. Then you go on to say:

5 "We should not give ..."

6 This is the final bit of your email:

7 "We should not give any information to either party
8 until we are fully prepared while responding reasonably
9 to all correspondence."

10 So the position was on 1 December that we have seen
11 Mr Henderson had put together effectively a first
12 thought about how the methodology would be operated.
13 There hadn't actually been a price produced at this
14 time, had there?

15 A. That's correct.

16 Q. And then we see Dr Boarer's response to you:

17 "Thanks for your thoughts, Paul. Agree with your
18 final position -- we need to be seen to be reasonable
19 but we cannot risk telling Ofwat anything that we would
20 not be happy to sign up to for the longer term."

21 So this was very much a situation where you weren't
22 willing to disclose anything about what you were
23 planning to do until you knew what the outcome of that
24 methodology was. You didn't know if that was something
25 that Welsh Water would want to be charging people.

- 1 Isn't it?
- 2 A. I think my point at the time was because we hadn't got
3 the model finalised, then sharing an incomplete model
4 was not in our best interests because we would be
5 arguing over something that wasn't a final model. So it
6 wasn't the answer that I was concerned about, it was the
7 model itself.
- 8 Q. Yes, but Dr Boarer was most certainly concerned about
9 the answer, isn't she?
- 10 A. Where does it say that?
- 11 Q. "We can't risk telling Ofwat anything that we would not
12 be happy to sign up to for the longer term."
- 13 A. I think that is our methodology -- sorry, a model that
14 we are not happy with. I didn't read anything else into
15 that.
- 16 Q. Making sure that the outcome is one that you are going
17 to be happy to sign up for the longer term. The only
18 thing you are going to sign up to for the longer term is
19 the price; that's right, isn't it?
- 20 A. As far as I was concerned, the model was the important
21 thing, to make sure the model was robust and
22 transparent. And quite clearly at that time it wasn't,
23 and therefore I was unwilling to release it. There was
24 never any discussion with me of what the answer was. It
25 was just not the right model.

1 Q. The income team certainly were very interested, weren't
2 they, in what the income result was going to be?

3 A. I think Jackie Boarer would have been interested, but
4 I can't answer for Jackie, either.

5 Q. You think she would have been?

6 A. Would have been what, sorry?

7 Q. Interested in the outcome?

8 A. She would have been interested in the number, yes.

9 Q. Madam, is that a convenient moment?

10 THE CHAIRMAN: Yes, thank you. We will come back at
11 2 o'clock.

12 (1.00 pm)

13 (The short adjournment)

14 (2.00 pm)

15 MR COOK: Mr Edwards, you say in your witness statement --
16 it's paragraph 37, if you want to look at it; it's your
17 first witness statement.

18 You say:

19 "In the event the issue of Albion's application was
20 not put before the Welsh Water board or the LCE until
21 January 2001. I don't recall precisely why this did not
22 happen in December as had been envisaged. I suspect it
23 was because there was no time on the agenda due to other
24 matters."

25 The reality is it didn't go on to the December board

1 agenda because there simply wasn't a price or, at that
2 stage, any finalised methodology for the board to look
3 at. That's right, isn't it?

4 A. That's my recollection. I'm not sure why it didn't
5 go in to the December board.

6 Q. We have been through and there simply isn't anything
7 approaching a price or a finalised methodology in
8 mid December when the board would have met.

9 A. I think that's fair to say, yes.

10 Q. If you can turn in bundle 3 to tab 100, this is a letter
11 from Ofwat of 11 December 2000 to Mr Holton, and we see
12 in this letter what they are doing is chasing up the
13 fact that it's now two and a half months after Albion's
14 application and there still hasn't been any issue even
15 of an indicative price at this stage.

16 We see the paragraph starts with the word "first".
17 This is Ofwat saying they:

18 " ... remain concerned with what appears to be an
19 unreasonable delay in providing Albion Water with an
20 indicative access price, [suggesting it] might represent
21 an infringement of the Chapter II prohibition ... I
22 said in my letter of 28 November, such a price could
23 have been produced much earlier, but your response does
24 not explain why you have been unable to do so to date.
25 Please explain why there has been such delay, what price

1 you have calculated, and confirm the date for giving the
2 price to Albion Water."

3 They go on to talk about other matters connected
4 with the UU negotiations.

5 If you turn to tab 101, we then see Welsh Water's
6 response to that letter the following day, which starts
7 off by saying:

8 "I'm pleased you recognise that Dwr Cymru (DCC) has
9 conducted discussions with Albion Water (AW) in an open
10 and transparent manner."

11 Let's be clear: this was based on what you had been
12 telling Ofwat. The reality was that the open and
13 transparent manner had not involved actually telling
14 Albion how you were planning to approach any of the
15 allocation of cost issues, despite the fact Albion had
16 been asking for some time, hadn't it?

17 A. That's correct.

18 Q. Even though you knew that was the information you need
19 to provide in accordance with the requirements of the MD
20 letters?

21 A. That's correct.

22 Q. What's noticeable about this letter -- you can look
23 through it, please, if you have doubts about it -- is
24 there is no explanation anywhere in this of where
25 Welsh Water had got to in terms of trying to come up

1 with a price and the issues that would arise from that.

2 Can you help us as to why that would be?

3 A. I'm afraid I can't, no. This is Dave Holton's letter.

4 Q. The issue from your point of view, we have seen earlier,
5 was the fact you didn't want to say anything to Ofwat
6 which might undermine the position you were taking
7 generally. You didn't want it reveal the fact that, as
8 we saw, your calculation of a price, the methodology
9 might still be in flux because that would undermine any
10 methodology you subsequently adopted. That's right,
11 isn't it?

12 A. If what you are talking about is the Paul Henderson
13 methodology, we weren't confident to release that
14 because we knew it wasn't right.

15 Q. You say you knew it wasn't right. How exactly did you
16 know it wasn't right?

17 A. Because I analysed it. I'm not sure if it would have
18 been around that time.

19 Q. We do not see any responses to it saying his methodology
20 is not right at all. He sends it to you and there is no
21 negative response back from him.

22 A. I didn't respond to that email we talked about earlier.

23 THE CHAIRMAN: The Paul Henderson email?

24 A. The first email, yes.

25 MR COOK: So what do you say you knew wasn't right about it?

1 A. Around this time, one the tabs here, the network access
2 prices and my handwritten notes on it, is my analysis of
3 the work.

4 Q. We will come to see those documents in a moment. In
5 fact, we are going to come to see those documents right
6 now.

7 If we go to bundle 9A, tab 354, you see those.
8 Madam Chairman, it might assist the members of the
9 Tribunal if you went to Albion's skeleton argument,
10 which you will find in bundle 11, tab 1. If you go to
11 page 3482, we have the table there that shows the
12 various changes in the numbers that take place between
13 the various documents. That would be a helpful
14 aide-memoire for the Tribunal.

15 It's bundle 11, tab 1 and the page is 3482. It's
16 the table at the top.

17 Mr Edwards, you should hopefully be looking at
18 bundle 9A, tab 354.

19 A. That's correct, yes.

20 Q. And what we have here are two documents effectively.
21 There is one starting at page 3281, headed "Network
22 access prices", which is a set of calculations, and then
23 there is a second set at 3288, which produce a different
24 set of numbers.

25 A. That's correct.

- 1 Q. Were these both carried out by Paul Henderson?
- 2 A. The typed network access prices was carried out by
3 Paul Henderson, and I believe the other is but I'm not
4 sure.
- 5 Q. So this is Mr Henderson building on the analysis that he
6 carried out originally that we saw in the email at the
7 end of November?
- 8 A. That's correct.
- 9 Q. And now actually trying to look at some of the data to
10 break the points down?
- 11 A. Yes.
- 12 Q. We see at the top of the first document at 3281, he
13 says:
- 14 "The brief was to determine network access prices
15 based on average prices."
- 16 Now look at the calculations he actually did. He is
17 following, isn't he, the methodology he had set out
18 earlier and now was engaging in the allocation process
19 in relation to the costs?
- 20 A. I think so, yes.
- 21 Q. Yes. So he is making the same assumption that
22 non-potable treatment is going to be cheaper than
23 potable treatment. He is now looking at how you might
24 do that apportionment?
- 25 A. Yes.

1 Q. And he is again assuming that it's appropriate to use
2 potable distribution costs as providing an appropriate
3 figure for the distribution costs that Albion
4 should pay?

5 A. For any entrant (inaudible).

6 Q. I wanted to have a look at the two calculations. If we
7 go to 3283, we can see a breakdown of the numbers for
8 the first set of calculations, which we see in the
9 middle of the page.

10 Madam Chairman, this was the first answer to the
11 question you asked earlier about what water costs. You
12 can see there were several other answers to the
13 question. The first one was the resource he calculated
14 was 12.65p; treatment he calculated to be 7p; bulk
15 distribution, 24.9; local distribution, 39.1; and the
16 local distribution -- effectively, that's a figure that
17 remains constant throughout all these items of work
18 because that's simply the difference between the top
19 band potable LIT and the general price for potable
20 water, isn't it?

21 A. It's consistent throughout Paul Henderson's work, yes.

22 Q. So we see there that's the first set of calculations
23 that he did?

24 THE CHAIRMAN: Which calculations are we looking at that you
25 are calling "the first set"?

1 MR COOK: All of this document, but it's the 3283 and then
2 the second set will be those at 3288.

3 So that was the general breakdown of potable prices
4 at 3283, and then we see what's suggested at 3286 is how
5 this will give a price for Ashgrove. I mean, first he
6 includes a resource price and that might be applicable
7 to Ashgrove generally, but that wouldn't be a common
8 carriage element. So he stops short of providing an
9 access price as a result of including the water element
10 as well, doesn't he?

11 But then we see he calculates bulk distribution at
12 24.97, which is a figure we saw from earlier. And then
13 treatment: He has used a 30 per cent figure, which he
14 applies to the roughly 7p we saw earlier for potable
15 treatment coming out at 2.1p for the treatment element.

16 And we see above how he has done that. He says:

17 "The only way we currently have to then estimate the
18 partial treatment price used in Ashgrove is the
19 30 per cent allocation made in the (previous)
20 submissions."

21 He mentions at the end of it that it's notable that
22 treatment in relation to the non-potable supplies,
23 treatment is only used at Ashgrove, and he refers to two
24 other locations. So in terms of partial treatment, with
25 a fairly small number of locations that would need to be

- 1 looked at to see what the costs were. That's right,
2 isn't it?
- 3 A. There is only a small number of locations for the
4 non-potable partial treatment, yes.
- 5 Q. And you agreed earlier with me that since Ashgrove was
6 the only place that was doing exclusively non-potable
7 treatment, it would provide quite a quick sense check,
8 to give you an idea of whether the 30 per cent was
9 accurate or not. Do you agree with that?
- 10 A. No, I think the 30 per cent was taking a sample of all
11 treatment works.
- 12 Q. He says here -- he's saying it's an old 30 per cent
13 figure, and he is suggesting to you, in terms of
14 updating -- seeing whether that was still right, looking
15 at Ashgrove would have given you an immediate idea of
16 what partial treatment cost as at that time, wouldn't
17 it?
- 18 A. At one site. It wouldn't give us an average idea.
19 I think the other sites were from reservoirs, so they
20 would have lower cost of partial treatment, I would
21 expect.
- 22 Q. So Ashgrove would actually give you a higher figure for
23 partial treatment?
- 24 A. Higher than average for partial treatment at one
25 treatment works.

1 Q. So that's the first set of calculations we get here.

2 If we go on to 3288, there is then a separate set of
3 calculations. I'm afraid it is written in much smaller
4 type, but if we see down next to the second holepunch,
5 we have the same breakdown of potable prices, but this
6 time he has calculated that resource costs 21.3p.
7 Treatment he is now saying is 10p, so that has gone up
8 from the 7p he calculated earlier. Bulk distribution he
9 is now saying is 13p, as opposed to the nearly 25p he
10 calculated previously, and then we see local direction
11 is the same figure, it is calculated the same way,
12 throughout.

13 And then we have a calculation at the bottom of the
14 page, which carries out the same resource, bulk
15 distribution from the earlier numbers and then
16 30 per cent treatment element.

17 It's right to say, isn't it, that both sets of
18 calculations are using the same approach, so they are
19 looking at the potable water figures and trying to
20 allocate costs within that potable water calculation;
21 that's correct, isn't it?

22 A. They are using the potable volumetric rate, yes.

23 Q. And that both sets of data are taking the number or
24 trying allocate based on the ABC figures?

25 A. The ABC figures and the modern equivalent, asset

1 valuation figures.

2 Q. Can you help us as to why there is such a dramatic
3 difference between the results that Mr Henderson is
4 getting?

5 A. I think this page, 3288, is an intermediate step to the
6 page 3282. So this is the middle step, and this is --
7 whether this is his first attempt, I don't know. It's
8 a subsequent attempt from the previous one to break down
9 the 83.74 volumetric rate, and he has done the detail
10 a lot more in the second one so it would probably be an
11 allocation issue.

12 THE CHAIRMAN: So are you saying 3288 is before 3286?

13 A. I believe it is, because 3286 is a much more polished
14 document and would probably be prepared for submission
15 either to Dave, Jackie or and/or the board, whereas this
16 is still a rougher sketch.

17 MR COOK: The reality is what he is doing is playing with
18 the numbers to see what happens if you change the
19 numbers around, isn't he?

20 A. I don't think so, but I don't know. I think he is
21 trying get a methodology that's robust.

22 THE CHAIRMAN: What is it that he has done differently for
23 3286 from 3288 that has led to the change? Putting
24 aside whether it's the right or wrong thing to do, can
25 you identify what has changed that's led to the

- 1 difference?
- 2 A. He starts off with the potable rate, 83.7, and takes off
3 the top band LIT, which gives you 39.1, which is the
4 same in both numbers.
- 5 THE CHAIRMAN: Yes.
- 6 A. The resource and treatment split looks the same, 38/62.
- 7 MR COWEN: Can I just ask you a question there while we are
8 on it.
- 9 A. Yes.
- 10 MR COWEN: What's the reason behind the percentage split?
11 Is it utilisation or is there any other rationale for
12 the percentage?
- 13 A. I think it's analysis of the activity-based costs and
14 the asset valuation between each of the services. So he
15 has taken the values from the activity-based costs
16 table, worked out the percentage split between the both
17 of them and then said: of the overall 83p, this is the
18 split between the two.
- 19 MR COWEN: So it's derived from the activity-based costing
20 system that you have in place, which you then provide to
21 Ofwat?
- 22 A. Yes.
- 23 MR COWEN: And the rationale for that sounds like it's
24 activity. What activity would drive which number?
- 25 A. The two activities would be water resource and treatment

1 and water distribution, if that's the question you are
2 asking. And then the cost of those -- the relative
3 weight of the cost of those would drive the percentage
4 split.

5 What Paul is trying to do is work out the percentage
6 split of the 83 between each the services, the
7 resources, treatment, bulk and local distribution.

8 MR COWEN: Maybe ask the question the other way. Why is it
9 that percentage rather than another one?

10 A. The analysis he has done is on page 3282, which shows
11 the split. And the left-hand column of that is the
12 resource and treatment would be the total resource and
13 treatment from the activity-based costs. The 41 million
14 was the distribution costs. Rates are separate in the
15 activity-based costing table, they are not included with
16 the services. CCD and infrastructure renewals is also
17 included in that table, and the operating profit is
18 included there, is a balancing number. The number at
19 the bottom, the 225, is the income figure. The four
20 lines above it are also from the activity-based costing
21 table. Therefore, he has implied the operating profit
22 from all the costs -- sorry, the revenue minus all the
23 costs, and then he has split between resource and
24 treatment and distribution.

25 My handwritten notes show that the split -- resource

1 and treatment, the direct costs, are directly applied to
2 resource and treatment. The rates are split pro-rate by
3 MEA. So that's how he has allocated between the two and
4 arrived at 38 per cent and 62 per cent.

5 MR COWEN: Maybe I'm being slow. It's not how he has done
6 it, it's why he has done it that I'm getting at.

7 What's the rationale for the percentage? The
8 implication is that there is some direct causal
9 relationship or activity that actually drives
10 a particular number and a reason for that. But it
11 doesn't appear that that's the case. It's a split,
12 which is in some ways arbitrary --

13 A. I think the rationale, the way he has done it --

14 MR COWEN: -- or discretionary, sorry.

15 A. I think what we are trying to do is trying to allocate
16 the total costs based on what's driving those costs, and
17 you are right, the split is -- we have judged it to be
18 on MEA value, certain splits, some of them very clearly
19 are direct caused by resource treatment and the others
20 have been judged to be allocated by -- split by MEA. So
21 I wouldn't say "arbitrary" is the right word --

22 MR COWEN: Quite. Highly discretionary.

23 A. Discretionary, yes.

24 MR COWEN: Thank you.

25 MR COOK: Basically, the two approaches he is taking are

1 slightly different discretionary approaches between the
2 two and producing different outcome numbers; that's
3 fair?

4 A. I think he is refining the numbers. I did look at this,
5 but I can't remember what the difference between these
6 two sheets are, I'm afraid.

7 Q. Can I ask you to turn in the middle of this document to
8 3285? This is Mr Henderson under the heading
9 "Consideration of non-potable prices", and what he has
10 been doing is considering how big the pipes are that are
11 being used to supply different customers, and you see
12 some customers are being supplied with very small
13 pipes -- if you look at the bottom, 76 millimetres --
14 whereas the biggest customer has a pipe that's
15 1.5 metres, 1500-millimetre. It's probably easier to do
16 it like that.

17 What Mr Henderson has done there is gone through and
18 identified some of the prices. We see that the customer
19 taking the very large volume through on a very large
20 pipe is paying, he says, 10p. So a very low price. And
21 we see in the middle he has then identified one customer
22 as Albion, paying 26. Another couple of customers, he
23 says are paying around 26. Somebody else in the middle
24 is paying 22.

25 So the mid-ranking customers, in terms of taking

1 volume, are paying between 22 and 26. Then finally, at
2 the bottom of the page, a customer is taking a very
3 small volume of water and paying 30p for water. That
4 seems to indicate that there was a pricing process going
5 on at Welsh Water -- that's what Mr Henderson is
6 analysing -- that suggests there is actually a different
7 charge being charged depending on the volume of
8 non-potable water you are taking. That's what that's
9 showing, isn't it?

10 A. I'm not sure there is a direct link between the volume
11 of water and the price you are charging, but -- because
12 of the link to historic prices.

13 Q. He's not linking it to historic prices, he is linking it
14 to volumes, isn't he? Just to be clear, in term of the
15 volumes you can see the percentage shows that the person
16 who is paying 10p is taking 16 per cent of the water,
17 and then you see the corresponding flow rates going
18 down.

19 So Mr Henderson has actually analysed to show clear
20 gradation in prices among non-potable users, hasn't he?

21 A. All he has analysed here, he has analysed -- this was
22 the table that was included in the earlier email that
23 showed that there was no evidence to allocate the small
24 mains to reduce the 49 to 26. So this is the evidence
25 here.

1 All he has done -- he has annotated the Albion
2 analysis of the mains with a price that had been
3 currently charged for each of those. Whether you can
4 draw that conclusion, I'm not sure. I wouldn't.

5 Q. What other conclusion would you draw? That's the reason
6 to put the numbers in, isn't it, to see how prices link
7 to volumes being taken? Why else would he put the
8 prices in?

9 A. I think it's the link of the price to the size band.
10 The whole of this exercise is to determine the price
11 band and how much is being charged to customers whose
12 pipes are that big.

13 Q. Yes. So we are seeing customers who have big pipes
14 paying low prices, and they are also taking very large
15 values which, of course, is the reason why they have big
16 pipes, and those customers who are taking small volumes
17 through small pipes are paying much higher prices.

18 So what he is doing is showing that there is
19 a volumetric scale of prices taking place within
20 Welsh Water, which is what you knew about at the time
21 because you saw these documents, didn't you?

22 A. I don't think -- what this is showing is the largest
23 customer paying 10p, who I assume is Corus in Llanwern,
24 who was on a historic agreement or interim agreement at
25 the time.

1 Q. It wasn't historic. The historic agreement had ended
2 some years previously.

3 A. It was an interim agreement between historic agreement
4 and trying to put Corus on to the standard non-potable,
5 large user tariff.

6 The group in the middle are all paying around
7 the 26p, and then there is one at the bottom paying 30p.
8 And I wouldn't be surprised if that was a second potable
9 supply to a site that took a lot bigger supply above,
10 but I'm not sure.

11 THE CHAIRMAN: The ones that don't have any price next to
12 them, why don't they have a price?

13 A. I can only assume it's because several customers take
14 them. There is no clear link. I don't know, I'm sorry.

15 MR COOK: I suggest to you what that shows is that
16 Mr Henderson was analysing at the time, you saw it at
17 the time, it indicates that there was no such thing,
18 that there had been de-averaging of non-potable prices,
19 hadn't there?

20 A. If I read that, it looks like the 26p in the middle
21 block is clearly, the 10p at the top is a different
22 agreement. So I wouldn't have read it that that was
23 de-averaging of pricing.

24 Q. They are different prices, so they cannot all be based
25 to average costs, can they? You knew that at the time,

1 didn't you?

2 A. Just because they are different doesn't mean they are
3 not based on de-averaged -- averaged prices. As I said
4 before, they could be the same, and based on
5 inflation -- I'm not sure what these are. Therefore,
6 I'm unable to say why they are different, but I wouldn't
7 draw the conclusion it's because we have de-averaged.

8 Q. One of the key points of disagreement between Albion and
9 Welsh Water at the time was whether there had been
10 de-averaging of pricing, and Albion was saying -- you
11 recall Albion making very clear -- right at the start of
12 the process that it viewed prices as having been
13 de-averaged previously, and Welsh Water understood that
14 if there had been de-averaging -- because the MD letter
15 said you should charge customers as you would charge
16 yourself, if de-averaging had taken place, it couldn't
17 engage in average pricing going forward. You understood
18 that, didn't you?

19 A. Yes.

20 Q. So it was something where Albion was saying de-averaging
21 had taken place. This is Mr Henderson carrying out an
22 analysis which shows prices are certainly not based on
23 the same. Was any analysis carried out which suggested
24 that de-averaging had not taken place?

25 A. Well, as far as I'm aware, de-averaging hadn't taken

1 place.

2 Q. And you get sent a document which shows you that you
3 had. Is that something which you should have enquired
4 about?

5 A. It shows that those numbers are different. It doesn't
6 show that they are averaged or de-averaged. This is an
7 argument that has been gone through several times.

8 Just because a price is different doesn't mean that
9 it has been de-averaged, and of all the prices I have
10 looked at since privatisation, the ones where we have
11 had full opportunity to negotiate the price have been
12 based on average pricing, and where we have been
13 constrained by previous agreements, inherited
14 agreements, we have looked to close down those
15 agreements and put an interim price in place with a move
16 or an intention to move to average pricing when those
17 agreements have been complete.

18 Q. So you agree that Welsh Water entered into agreements on
19 an interim basis, or otherwise, which were based on
20 non-average pricing for non-potable water?

21 A. Interim agreements. We were constrained with our
22 negotiation, we would have entered into agreements ...
23 I mean, it depends what you mean by based on average
24 pricing.

25 The start of our negotiation was the average

1 pricing, and then concessions were made. So they were
2 based on average pricing. The figure that we gave at
3 the end would not have been 26p.

4 Q. So effectively you are agreeing that Welsh Water was
5 entering an agreement which was ultimately not based on
6 an average price?

7 A. There are some agreements in the special agreements
8 register that are not based on the 26. Sorry, they are
9 based on them, but they are not at that level.

10 Q. So you recognise de-averaging had taken place then,
11 didn't you?

12 A. Where we had no choice.

13 Q. On that basis you knew under the MD requirements that
14 you couldn't impose simply average pricing in those
15 circumstances because Welsh Water wasn't doing it
16 generally?

17 A. It was doing it generally and we believed we had a case
18 to say explain why we hadn't. The MD letter says if
19 companies need to explain why they are doing what they
20 are doing, and we had, we believed, a rational and
21 strong explanation of why some of the agreements were
22 entered into in the mid 90s.

23 Q. Let's go to the next document, which you will find at
24 3/110, bundle 3, tab 110. It's the final tab in the
25 bundle.

1 You will see that this is the LCE document 01-001.
2 So this was the paper which was ultimately presented to
3 the board in January 2001. You are familiar with this
4 document?

5 A. I am, yes.

6 Q. I show you that simply so that we can recognise what
7 time we are talking about.

8 If we now turn back to tab 103, we can see the
9 background to this document. At the bottom of the page
10 we see an email from Mr Holton to Dr Boarer and
11 yourself:

12 "Jackie, first cut ..."

13 It's timed Sunday, 17th December 2000. It says:

14 "Jackie,

15 "First cut (although there is not much time for
16 subsequent cuts!!) Draft of LiCo paper -- attempted to
17 produce an series of modular paragraphs that can be
18 ordered to suit the logic and objective ... Have a look
19 if you get a chance and then we can hopefully find some
20 time tomorrow to hack it about."

21 Then he says at the bottom:

22 "Paul, can you please spare some time to help knock
23 it into shape tomorrow morning."

24 That's from Mr Holton.

25 You then respond that evening, saying you are not in

1 the next day, which is the reason why you are responding
2 on Sunday:

3 "Had a quick look at the paper and re-arranged it
4 slightly. This paper will be used in a formal CA98
5 case, and is being rewritten with this in mind."

6 What were you concerned about in this document?

7 A. I haven't seen the document since, so I'm not sure.

8 Q. Presumably, if you are saying "it will be used in any
9 formal CA98 case", you were trying to make sure that
10 anything that might be in it which might be unhelpful to
11 Welsh Water was going to be excised. That's fair,
12 isn't it?

13 A. Not necessarily. I think some the later correspondence
14 shows I was trying to in four(?) as well. As I say,
15 I haven't seen the document since, so I can't comment.

16 Q. You said not necessarily. So you accept it might well
17 have been that you were trying to ensure that matters
18 were removed that were unhelpful to Welsh Water?

19 A. I may have re-arranged phrases, but that's ...

20 Q. Because the reason, of course, we can't look at what you
21 did to the original document is that -- would it
22 surprise you to know that neither the original document
23 that was sent from Mr Holton to yourself and Dr Boarer,
24 nor the rewritten version, which you sent to Dr Boarer
25 and Mr Holton -- and we can see in the email at the top,

1 Dr Boarer had then said also pass it on to
2 Paul Henderson.

3 None of those copies of the paper are any longer
4 available. Why is that?

5 A. I have no idea.

6 Q. Because after all, there is no point in rewriting
7 a document to support Welsh Water's position if previous
8 drafts the document are available. That's right,
9 isn't it?

10 A. Sorry, can you repeat the question?

11 Q. There is no point in rewriting a document so it supports
12 Welsh Water's position if you allow previous copies of
13 the document to still be available? That makes sense,
14 doesn't it?

15 A. I think the documents will still be available on the
16 email system. So ...

17 Q. They haven't been produced. So we understand they are
18 not available.

19 Wouldn't it make sense that they would therefore be
20 destroyed to ensure that nobody could see the previous
21 drafts that were the unhelpful versions of the document?

22 A. I would not have expected that to happen.

23 Q. Can you help us as to any other reason why those
24 documents wouldn't be available?

25 A. I would have -- most of this -- I would have kept copies

1 of documentation. I think most of these documents have
2 got my handwritten notes all over them. I kept them at
3 the time and handed them over at the time of the
4 section 26 notice to the team.

5 I am aware of this now because it is being brought
6 to my attention because we have been chasing trying to
7 find it. The only reason that I might not have filed it
8 is because it was a Sunday and I wasn't there the next
9 day. However, since this time I know -- I have moved
10 desks and office six times from this time, so every time
11 we move, we lose files or we sort of rationalise our
12 filing system. And also, we had a major IT upgrade in
13 the mid 2000s, where the email system was changed, and
14 that's why I haven't got it because my emails only go
15 back to about 2003/2004. But apart from that, I'm
16 afraid I can't help you.

17 Q. But you said you would have provided it to the team in
18 June 2001. So all of the documents would have been
19 gathered together at that point?

20 A. I provided all the documents I had to the team in 2001.

21 Q. And presumably before any documents were sent to Ofwat,
22 they would have been copied by Welsh Water. You
23 wouldn't send originals, would you?

24 A. I believe there is more than one set produced.

25 Q. So the fact that we no longer have those documents

1 suggests that must have no longer been available by
2 June 2001. Is that fair?

3 A. It suggests they weren't in the bundle. I'm not sure
4 they would not have been available. That's a strong
5 correlation which I wouldn't draw.

6 Q. That does rather suggest, given there were several
7 different copies of this paper around, that they had
8 been simply deleted or thrown away by the individuals
9 involved, doesn't it?

10 A. I'm not sure if Jackie or Paul would have stored
11 documents. They would -- Paul Henderson would have
12 known that it was kept on the Internet site. There is
13 no reason other than the fact that I file things -- just
14 personally, I like filing things -- why anybody else
15 would keep them and there is no reason why they would
16 delete them.

17 Q. There is a reason, of course, why they would delete
18 them, which is that you had rewritten the document to
19 remove unhelpful material, hadn't you?

20 A. That's not the reason. I can't remember anything like
21 that happening.

22 What would have happened with the rearrange
23 slightly, there is another document later on where
24 Dave Holton would have produced bullet-pointed thoughts
25 on a paper and I would have re-arranged them so that

1 they read in a more fluent manner, and that's what
2 I continued to do with the documents. They were done,
3 I wouldn't say in a rush, but they were done with
4 a short amount of time, and that's why we kept everybody
5 in, so everybody then would add their idea to the paper.
6 And what I was saying there is, "I've had a look at
7 this. Don't change it unless you really have to because
8 I think it's a fair representation of what we are
9 doing."

10 Q. Can I ask you to look at the second bit of the email in
11 the middle of the page? If we turn back to 110,
12 tab 110, we can see the context of this.

13 As I understand it, if we go to page 801, so what
14 the LCE document is doing at tab 110 is it's setting out
15 a calculation of the price, which is going to be
16 presented to the board for approval. And it turns out
17 to be the indicative price that was offered to Albion in
18 the middle of January. And we see in the middle of
19 page 801 there is a calculation above it, which we will
20 come back to.

21 It's talking about the 30 per cent multiplier, which
22 is the figure used to adapt potable treatment to
23 non-potable treatment. It says:

24 "The 30 per cent multiplier was calculated from
25 talking to operational managers and asset managers at

1 the time the initial Shotton Paper/Albion Water
2 agreement (circa 1996) was being negotiated. Work is
3 currently being carried out to produce a robust asset
4 value-based price for the non-potable portion of the
5 treatment price."

6 Just to help us with that, that was a reference,
7 presumably, to the fact there had been -- as we saw --
8 back in November, the team was going out, gathering
9 together information that would allow it to test whether
10 the 30 per cent figure was accurate or not. That's
11 right, isn't it?

12 A. I believe that's the case, yes.

13 Q. So what's being said in this document is, "We are going
14 to do work to calculate a robust number and at the
15 moment all we have is the 30 per cent", which presumably
16 you recognised was, therefore, not robust?

17 A. I think we recognised it was five years old and
18 therefore would need to be updated. I believe at the
19 time Dennis Taylor would have done a very robust job.
20 I think it's doing him a bit of a disservice saying he
21 is just talking to operational managers and asset
22 managers. There would have been a bit more analysis
23 behind that. It's just that we were conscious it was
24 five years old.

25 Q. Well, no, it doesn't say that. It says:

1 "We are talking to operational managers and asset
2 managers."

3 So the person writing it clearly thinks that was all
4 that was done.

5 A. As I said, I believe Dennis would have done a more
6 detailed analysis than this suggests.

7 Q. You don't know that he did?

8 A. I haven't seen the analysis. I haven't for 15 years,
9 anyway.

10 Q. So you knew there was a 30 per cent figure, it was going
11 to be replaced with a more robust analysis, which was
12 going to be asset-based.

13 We can go back now to tab 103, your email. We don't
14 know, of course, exactly which sentence you are
15 referring to of the document, but we see you saying:

16 "I thought Paul ..."

17 That would be Mr Henderson:

18 "... was getting the asset info to calculate
19 a stand-alone non-pot tariff not to look at the company
20 average non-pot element of all treatment works -- is he
21 doing that as well?"

22 Just to be clear, you are talking about two things:
23 One is a stand-alone non-potable tariff, and the second
24 is calculating the average non-potable element of
25 treatment. Those are distinct jobs, aren't they?

1 A. That's correct, yes.

2 Q. And we see the reference, of course, from 110 was
3 looking at the company average non-potable element of
4 all treatment works, and you were asking for a second
5 job, looking at stand-alone non-potable tariff was going
6 to be looked at as well by Mr Henderson?

7 A. I thought Paul was looking at the non-potable tariff,
8 the stand-alone non-potable tariff. I believed the work
9 that he was doing at the time was to get the data for
10 the stand-alone -- so the non-potable systems.

11 THE CHAIRMAN: When you say stand-alone there, is that still
12 on a whole company basis or is that the Ashgrove System?

13 A. I'm not sure what it was going to be used for, but
14 I know he had engaged consultants to look at the assets
15 particular to all of our non-potable networks. So he
16 was looking at the stand-alone systems that supplied
17 non-potable water to all of our non-potable customers.
18 I'm not sure why he was going to use that. So Ashgrove
19 would have been one of those.

20 THE CHAIR: I see. So you are still talking about -- carry
21 on.

22 MR COOK: That's a surprising answer there, Mr Edwards,
23 because we haven't seen any references to consultants
24 being hired to do this work, other than, of course, the
25 invitation to tender back in October we saw. You

1 suggested that hadn't been taken anywhere.

2 So now you think there actually was a consultancy
3 process going on at this time?

4 A. I'm not sure if it's the same one as that. I have
5 talked to Paul Henderson recently about this email and
6 he confirmed he had got consultants looking at the
7 non-potable systems, but I have never seen that work.

8 Q. I take it from that that Mr Henderson is still employed
9 by Welsh Water?

10 A. He is, yes.

11 Q. So your understanding is that work was being carried out
12 at the time to test these matters?

13 A. I believe it was, yes.

14 THE CHAIRMAN: That work, just so that I understand, was to
15 try and work out what Dwr Cymru's costs for non-potable
16 business, if I can put it like that, were, rather than
17 to try and derive them from the potable costs with
18 deductions which could be done in a number of different
19 ways, if I can put it like that?

20 A. I'm not sure why that work was engaged. I know Paul was
21 looking to produce a non-potable Large Industrial Tariff
22 and I knew he was doing this work, but I'm not sure how
23 that work would inform that tariff, I'm afraid.

24 THE CHAIRMAN: But was it something that was related to
25 common carriage, or was it something related to the

1 supply of non-potable water?

2 A. Again, I'm unsure. It would all depend on when the work
3 was kicked off.

4 Paul was tariff manager and before the September
5 common carriage application he may have started this
6 work as a piece of work that was part of his workload as
7 tariff manager, and then, because I was unavailable
8 in September when this came in, he may have been asked
9 to do this, but I'm afraid, other than that, I don't
10 know.

11 MR COOK: In terms of, if you recall your compliance
12 checklist and I can take you back there if you like, one
13 are aspects of course of that was looking at whether the
14 costs were excessive compared to a stand-alone cost. So
15 effectively this was Mr Henderson carrying out some work
16 which would have allowed that comparison to take place,
17 wasn't it?

18 A. It may have allowed that comparison, yes.

19 Q. So that was the reason you were asking about it because
20 your client's checklist had suggested that was something
21 you should bear in mind, hadn't it?

22 A. No, I think I'm asked about it there because I knew we
23 would have to at some stage use what we had used the
24 30 per cent for, to split down the treatment between
25 partial treatment and otherwise. And I think what I was

1 asking for there is if Paul was doing this work,
2 I wouldn't have to do it. So it wasn't a checklist.

3 MR COWEN: Just for clarification -- I may be leaping to
4 a conclusion. On your handwritten notes on the previous
5 document at bundle 9A, tab 354 -- if I just mention it, you might be
6 able to clarify it -- there is a reference on page 3287
7 to NERA. I wondered whether or not that was a NERA
8 analysis that was being done that may be the same
9 consultants?

10 A. Is that my handwritten page?

11 MR COWEN: Yes.

12 A. I think we were looking at whether we would engage NERA to
13 do it. That was my to-do list, and NERA and DWS were
14 thoughts of who we could approach.

15 MR COWEN: Yes, okay. To do the stand-alone costing?

16 A. I think it's more to do with the whole pricing issue
17 rather than the stand-alone costs, but I don't think
18 that was ever progressed either.

19 MR COWEN: Thank you.

20 MR COOK: But you think effectively that Mr Henderson is
21 already doing some work, which is why you didn't
22 progress it?

23 A. I think Mr Henderson was doing some work on the
24 stand-alone non-potable systems, and I was asking
25 whether he was doing the other work as well.

1 Q. Effectively it would fall out of work on non-potable
2 systems, wouldn't it, the non-potable element of
3 treatment?

4 A. I think the non--- sorry, the partial element of
5 treatment would include the non-potable treatment works.
6 So we would do partial treatment of -- sorry, the
7 equivalent first stage treatment in filtering works and
8 we would probably use the non-potable element;
9 non-potable treatment works as a broad indicator of the
10 level or average -- the average split between partial
11 treatment and full treatment, if that answers your
12 question.

13 Q. But the work on looking at a stand-alone non-potable
14 tariff would show you the partial treatment costs of all
15 of those sites that were providing partial treatment for
16 non-potable water, wouldn't it?

17 A. Sorry, providing partial treatment for non-potable
18 water, yes.

19 Q. So you asked the question there, you say: I thought Paul
20 was doing these things. And then we see Dr Boarer's
21 response in a moment. She says she has passed on to
22 Paul Henderson, who hadn't been copied earlier,
23 presumably to find out -- so Mr Henderson knew about the
24 question. Can you recall her getting a response to that
25 question?

- 1 A. I don't recall it, no.
- 2 Q. It would have been quite an important response, wouldn't
3 it, because this response would have told you when and
4 what information you would have in order to compare the
5 price you were putting forward to one based on
6 non-potable costs? It's an important response to get,
7 isn't it?
- 8 A. It would have been useful to get, yes.
- 9 Q. Let's go back to the LCE paper itself. If we go to
10 page 801 in this paper, we will see the price that comes
11 out at the end of this process is 19.94p, which of
12 course is the one that's rounded up to 20p, to produce
13 the indicative access price.
- 14 I just want to take to you the figures above because
15 this is a third set of very different allocations of
16 costs that we see present here, showing resource --
- 17 THE CHAIRMAN: Which tab are you at now?
- 18 MR COOK: It's tab 110, page 801. Just to remind you, in
19 the network access documents we saw, resource had been
20 variously costed at 12p and 21p, in round numbers. It
21 was now being priced down at 4p. It's a fairly dramatic
22 set of changes, isn't it?
- 23 A. Yes.
- 24 Q. Based on these discretionary allocations?
- 25 A. Based on different mathematics.

1 Q. And then if we look at the treatment figure in this, the
2 one for general treatment was 29.48, and that compared
3 to treatment which had been variously put at 7p and 10p
4 in the previous calculations. So it had gone up by
5 somewhere between 200 and 300 per cent from those
6 earlier figures.

7 Again, there is a very dramatic change, isn't there?

8 A. Yes, there is.

9 Q. And the results were that bulk distribution was now
10 being put as low as 11p, and previously it had been 13p
11 or 25p. Again, this was simply playing with the
12 discretionary allocation to see what the outcome was,
13 wasn't it?

14 A. No.

15 Q. In terms of the calculation that's going on here, we
16 don't see the internal breakdowns, but if you look above
17 the table, under the second arrow, it says:

18 "Using the current 'scheme of charges' (standard
19 potable rate and the largest LIT), the submission to
20 Ofwat in 1998 for the construction of a potable LIT (to
21 allocated OPEX between R&T and Distribution) and the
22 'ABC' table of 1999/2000 ... "

23 So it's performing the same set of calculations that
24 the earlier work is, isn't it?

25 A. That's correct.

1 Q. I apologise, there is a point I forgot to take you to --

2 THE CHAIRMAN: Where do we get the calculation? How do we
3 know how that 4p figure for water has come from, or are
4 you coming to that?

5 MR COOK: Madam Chairman, all we know is the explanation
6 above it, the question I just asked, refers to a similar
7 process to the other two calculations we have seen. We
8 don't know what are the actual allocations that we used
9 to reach those figures, but it has come from exactly the
10 same set of overall accounting data.

11 THE CHAIRMAN: Is that right?

12 A. No, that's wrong. The numbers are in the tables, they
13 are my handwritten notes to the network access price.

14 THE CHAIRMAN: Yes. Where was that?

15 MR COOK: So this is in 9A/354.

16 A. The numbers are on page 3286.

17 THE CHAIRMAN: Right. So that "4, 11.1, 8.85", that's your
18 handwriting, is it?

19 A. That's correct, yes.

20 MR COOK: So effectively those are your views of allocations
21 that should be made?

22 A. No, I have corrected some mistakes in Paul Henderson's
23 work.

24 MR LANDERS: What's the correction? If you go from 12.65
25 to 4, what had been done wrong to cause you to make that

1 change?

2 A. The main error, if I can find it, is the allocation --

3 what Paul Henderson has done to calculate the splits

4 between resources and treatment, he has allocated the

5 MEA value as a quantum figure, because the actual cost

6 that should be included is the return on capital of the

7 MEA. And therefore, because he has got operating costs

8 at a fairly low level and very high modern equivalent

9 asset value costs, this has made the percentage split

10 between those two figures completely wrong. And when

11 I was doing the analysis, what I have done is, rather

12 than add in the MEA value to the operating costs, I have

13 added the profit element, which meant that the split

14 between the two is now correct -- wasn't -- sorry,

15 I have corrected the error, and because of the way the

16 allocation works from a top-down splitting out, the

17 values are different.

18 MR LANDERS: That would make the treatment costs very much

19 higher and the resource costs much lower?

20 A. That's right, yes.

21 THE CHAIRMAN: So on page 3283, you have crossed through

22 64 per cent for resources and substituted 12 per cent?

23 A. That's right.

24 THE CHAIRMAN: And increased 36 per cent for treatment to

25 88 per cent?

1 A. Yes. That's correct.

2 THE CHAIRMAN: And then that results in resource and
3 treatment being 33.50, rather than 19.7?

4 A. I think so, yes, it looks like it. It's a bit -- not
5 very helpful, but table 2 shows the difference.

6 The reason I say it's not helpful is the resource
7 column has got a number missing, so the figures in there
8 should be -- they are low, but at the bottom, where
9 I have written that in there, you can see the functional
10 expenditure split. The operating cost element is
11 36.5 million for treatment, 1.1, which suggests that the
12 costs are heavily weighed to treatment. But because the
13 resources -- there is a lot of infrastructure there, so
14 therefore high expenditure. The treatment is more
15 non-infrastructure, so plant -- there is a lower element
16 of MEA. So, therefore, when you add the profit element
17 of it, rather than the total quantum, it brings the
18 overall split much more in the favour the treatment than
19 resources.

20 MR COWEN: Just while we are on MEAs, I assume that you
21 didn't use an MEA that related to raw water pipe, you
22 used an MEA that related to some form of average for
23 potable water as well?

24 A. I think the MEA would have been taken straight from the
25 tables. I can't remember in the regulatory reporting

1 guidelines include the MEA for the potable or
2 non-potable.

3 MR COWEN: There would be a material difference between the
4 two because one would be more expensive on a replacement
5 basis than the other.

6 A. I'm not sure if that was the case.

7 MR COWEN: I don't know.

8 A. That was a question, was it? I don't think that's the
9 case. The way the MEA works is we have unit cost models
10 for work we have undertaken and we would have a record
11 of a length of main, and on average it costs us that
12 much to produce at that length. So it depends, the
13 non-potable main, what it's made of, but it would have
14 the same value as the length of similar main for potable
15 water.

16 MR COWEN: Because the dig costs would be the same?

17 A. The same. The materials are the same and the dig costs
18 are the same.

19 MR COWEN: Thank you.

20 MR COOK: You say that, but actually the referred work
21 I took you to showed that Ofwat concluded that the
22 capital value was actually 50 per cent roughly for
23 non-potable, as compared to potable, wasn't it?

24 A. The capital value or the capital costs, I'm not sure.

25 Q. The capital costs of actually putting the main in. So

1 it was the value.

2 A. If that's its case, then that would be the case.

3 Q. So we are looking at the LCE paper. So this was

4 a document that was effectively putting forward that

5 recommendation that was going to go to the Licence

6 Company Executive, and obviously did go to the board in

7 terms of the prices that should be offered to Albion.

8 You were very much aware, as we have established,

9 that Welsh Water had to price for Albion as it would

10 price for itself, weren't you?

11 A. From the MD letters?

12 Q. Yes.

13 A. Yes.

14 Q. There is no suggestion anywhere in the papers that

15 Welsh Water used the potable LIT, which had after all

16 only come into effect in 1999, to calculate the price

17 for non-potable contracts previously, had it?

18 A. I think they used the non-potable LIT as a proxy for

19 what we would do if we did an in-depth analysis to

20 remove the local costs. So it was there as a proxy to

21 obtain the number.

22 THE CHAIRMAN: That's the 39p?

23 A. That's -- using the LIT to calculate the 39p, that's

24 correct.

25 MR COOK: But that wasn't an approach that had been used

1 previously for non-potable contracts, had it?

2 A. No, it wouldn't have been.

3 Q. So you are planning to price on a different basis from
4 the basis you had priced yourself previously?

5 A. I think the concept of the Large Industrial Tariff used
6 what we had used before. Therefore, we believed it was
7 a good proxy for pricing on the same way as we had done
8 before.

9 At this time, in December, we were well aware of the
10 pressure from Ofwat and Albion to get a price, and
11 therefore we had to use methods to calculate that price.
12 And because of the fact that the LIT had been used on
13 a whole company average basis, we believed that was
14 a fair proxy for estimating what we would take off for
15 local costs and customer services.

16 Q. In terms of what you knew, you knew at this point,
17 because you seem to have been talking to Paul Henderson,
18 that you didn't have any updated, or any figures for
19 non-potable does generally. So you weren't in
20 a position to carry out any cross-check by reference to
21 a stand-alone system cost, were you?

22 A. That's correct.

23 Q. But that was something that needed to be done before
24 Welsh Water could be comfortable with the prices it was
25 offering, wasn't it?

- 1 A. Yes.
- 2 Q. We also see they had been using a 30 per cent multiplier
3 and we see the origin of that. You recognise that that
4 was five years out of date, and while you are sure your
5 boss would have done a better job than it described
6 there, certainly the person describing it is saying it
7 was hardly a scientific process, was it?
- 8 A. I think at the time it would have been an accounting
9 process, where the accounts are signed. I don't know,
10 but ...
- 11 Q. Can I ask to you turn back in bundle 2, please?
- 12 A. I have got a few documents on my desk, which ones do
13 I need to keep?
- 14 Q. I think you can put bundle 9A away, I hope. It's
15 tab 17, I want to take to you in this. It's the second
16 document, which is page 351A. These are the final
17 determinations of K for water and sewerage for 2000 to
18 2005, and you said you had been involved in the interim
19 determination of K in some detail?
- 20 A. Yes.
- 21 Q. Presumably you were aware at the time of what the sort
22 of key drivers were here, what the likely outcome was
23 going to be potentially?
- 24 THE CHAIRMAN: Wait a bit.
- 25 MR COOK: page 351A, Madam Chairman, is the final determination.

1 Over the page is the detail.

2 Sorry, I was just making the point you would have
3 been familiar with what the key elements that would have
4 been going into the process at this time were,
5 weren't you?

6 A. The periodic review?

7 Q. Yes.

8 A. Yes, I would.

9 Q. If we look at the bottom of 351B, we can see what the
10 key drivers were in terms of the final process, which
11 is -- it starts off providing an average household bill,
12 which is £302, and then we have:

13 "Passing on past efficiency savings and
14 outperformance," which leads to reduction of £32, which
15 is roughly 10 per cent. Then assumptions on future
16 efficiency improvements, minus £44, so roughly a
17 15 per cent reduction.

18 So this was Ofwat concluding that in efficiency
19 terms, both past and future performance was likely to
20 lead to a 25 per cent reduction in costs. That's right,
21 isn't it?

22 A. So you are saying 302 divided by 76?

23 Q. Yes.

24 A. Yes, on a whole company average basis, that's correct.

25 Q. Then we see there were an element of costs that were

1 going to go up, but those are costs associated -- it's
2 number 3 -- with improvements in drinking water and
3 environmental quality. So those were largely costs
4 associated with potable water, weren't they?

5 A. Costs with -- not necessarily. The environmental
6 quality was to do with the sewerage service, and I'm not
7 sure what split of the 37 million is.

8 Q. But certainly some of those costs appear to be
9 associated with drinking water?

10 A. Some of them would be, yes.

11 Q. And I think we can ignore the other ones as being very
12 small for present purposes.

13 So at the time, you knew that with the exception of
14 potable water and sewerage, there was going to be
15 a costs going up associated with those two, costs
16 generally were expected to fall by 25 per cent. That's
17 what Ofwat were saying. Are you familiar with that?

18 A. They had set us stiff efficiency targets, yes, I was
19 aware of that.

20 Q. So to the extent to which there had been a 30 per cent
21 calculation five years earlier, the proportion would be
22 less than 30 per cent because potable water costs were
23 going up but the costs generally are going down. That's
24 right, isn't it?

25 A. I don't think that necessarily follows.

1 Q. You knew certainly there were those changes going on.
2 Until you carry out the actual analysis, you do not know
3 what the change is likely to be.

4 A. I would accept that.

5 Q. So you knew there was a very real chance that
6 a 30 per cent figure from five years earlier, even if
7 accurate then, might very well no longer be accurate by
8 2001?

9 A. That's correct. I think that's fairly clear in my
10 documentation as well.

11 Q. There was a reference, as we saw, below the table at
12 page 801. So we are back to folder 3, page 801.

13 I think you can put 2 away again.

14 A. Sorry, 801?

15 Q. 801.

16 A. Yes.

17 Q. The bit below the table referring to the fact work was
18 being produced. So you knew 30 per cent might very well
19 no longer be right and work was being done to find
20 a robust asset value-based price.

21 Can you help us as to why you were comfortable with
22 recommending the board should issue a price on the basis
23 of a number that you knew might very well be inaccurate
24 and in circumstances in which work was being conducted
25 to find a more accurate figure?

1 A. I think that's why we called it indicative price. We
2 were aware that it wasn't a robust price, but it was in
3 the range that we expected it to be.

4 Q. If we look at the bottom of the page here, at page 801,
5 we see the first arrow "Risks", or under the bullet
6 "Risks", the bottom half of the page, and the first
7 risk is:

8 "Potential loss of income because of this
9 challenge."

10 This was being flagged up because you knew the board
11 would be very interested in what the outcome of the
12 process was in terms of Welsh Water's revenue, wouldn't
13 they?

14 A. That's right, yes.

15 Q. Particularly because we saw you were involved in the
16 document that indicated that 23.8 million of revenue was
17 potentially at risk from common carriage and the
18 Competition Act. So this was kind of the first
19 indication of whether those figures were real exposures
20 or not, wasn't it?

21 A. Yes, that's correct.

22 Q. Welsh Water was being paid at the time 26p by Albion.
23 It was now going to be paid based on the indicative
24 price figure of 20p, so a fall of 6p. That, based on
25 Albion's volumes, was a reduction in income of around

- 1 £400,000 a year. Were you aware of that at the time?
- 2 A. I'm not -- I don't recall being aware of it, but it may
- 3 have been -- the calculation may have been done.
- 4 I don't recall being aware of it.
- 5 Q. It's the kind of calculation you would expect to be done
- 6 by the income team, wouldn't you?
- 7 A. If it was done it would have been done by the income
- 8 team, yes.
- 9 Q. So Mr Holton?
- 10 A. Mr Holton or somebody in Jackie Boarer's team.
- 11 Q. And you knew that as far as the board were concerned
- 12 they would want to know what the total loss of income
- 13 would be, wouldn't they? What the potential exposure
- 14 was?
- 15 A. I would have expected one of the questions at the board
- 16 to be, "What does this mean? What does 20p mean for
- 17 Welsh Water's revenue?"
- 18 Q. We know from the board minute of 6 November 2000 that
- 19 the board had been assured previously that revenue
- 20 neutrality was a possibility. So this, of course, was
- 21 effectively contradicting -- circumstances had changed,
- 22 might be a better way of putting it, from when that
- 23 assurance had been provided to the board?
- 24 A. Can you take me to the assurance? I'm not sure they
- 25 were assured.

1 Q. Assurance might be to put it a bit strongly, but they
2 were told -- if we go back to 6 November, which we will
3 see at tab 75 in bundle 3.

4 A. Shall I keep this open?

5 Q. Certainly we will be coming back to it.

6 A. 73?

7 THE CHAIRMAN: 75.

8 MR COOK: 75.

9 A. I beg your pardon.

10 THE CHAIRMAN: This is the sentence that we have looked at
11 a number of times.

12 A. Yes. State of fact, I take that as, rather than
13 a promise.

14 MR COOK: I wasn't making a point about promises. The board
15 had been told as a statement of fact that this would
16 have a cost-neutral effect, and now the calculations had
17 been done it was very much not going to be a revenue
18 neutral effect, was it?

19 A. At 20p it would not be, no.

20 Q. Thank you. If we go --

21 A. In the short-term.

22 Q. Madam Chairman, I don't know if now is going to be
23 a convenient point to ...?

24 THE CHAIRMAN: Yes, okay. We will come back at 3.20 pm.

25 (3.15 pm)

1 (Short break)

2 (3.25 pm)

3 MR COOK: Mr Edwards, we are back at tab 110, page 801, with

4 the final bullet on that page saying the final risk was:

5 "The possibility of coming under competitor and
6 regulatory pressure to de-average prices for large user
7 non-potable customers on predominantly dedicated
8 systems."

9 This was flagging for the attention of the LCE and
10 the board the fact that there was a very real risk that
11 Ofwat would say you couldn't price on the basis of
12 average costs, you had to price on the basis of local
13 costs. That's what you are identifying, isn't it?

14 A. I think Ofwat took the opposite view. If there was any
15 reason to move away from average pricing, then we would
16 have to have a very strong reason to do that. This was
17 just a statement of fact: That was a risk. We were
18 coming under significant pressure from Albion Water to
19 de-average. So that's true.

20 Q. It says "and regulatory pressure".

21 A. That would be another consequence of the introduction of
22 the competition. So I see this as a statement of fact,
23 rather than a warning.

24 Q. Well, it's a document that is being prepared by you,
25 among others, for the board. So it's making sure they

1 are aware of matters. So it's under the heading "Risk",
2 so it's clearly a warning, isn't it?

3 A. It's a risk.

4 Q. It's a risk because you knew that MD163 hadn't actually
5 referred to average costs at all. We have had that
6 conversation: you knew full well it didn't refer to
7 average costs?

8 A. I think we have had the conversation before that we
9 believe it didn't say you couldn't average costs.

10 MR LANDERS: Sorry, did you say that this risk was likely as
11 a result of the introduction of competition?

12 A. It was a risk as a result of the introduction of
13 competition, and one of the risks that was identified in
14 earlier papers was the -- I think it's a letter from
15 Mike Brooker in response to one of the MD letters: the
16 fact that if we de-average, then there is a potential
17 for cherry-picking. That was the point I was making.

18 MR COOK: So effectively this was pointing out two risks.
19 One sort of an addition to the first bullet saying there
20 was a potential loss of income because effectively if
21 you were forced to de-average as well, then there would
22 be an even more pronounced loss of income, wouldn't
23 there?

24 A. I think, as I said yesterday, I think one of the main
25 concerns with de-averaging was the incidence effect on

1 all customers. So that would have been equally in their
2 minds at the time.

3 Q. But the second one you were identifying for the
4 attention of the board was the fact that what you were
5 doing was certainly not consistent with the guidance you
6 received from Ofwat?

7 A. Where does it say that?

8 Q. I was talking about MD163, which didn't make any
9 reference to average costs.

10 A. Which we didn't read as that. So we wouldn't have put
11 in this paper that because --

12 THE CHAIRMAN: When you are referring here to
13 a "predominantly dedicated system", would you describe
14 the Ashgrove System as a predominantly dedicated system?

15 A. Yes.

16 THE CHAIRMAN: And that's to be contrasted with the whole
17 network?

18 A. Yes.

19 THE CHAIRMAN: And you are saying you interpreted MD163 as
20 somebody seeking access to the assets, the assets being
21 the whole network, and here, aren't you identifying
22 a risk that actually the costs should be based on access
23 to the predominantly dedicated system, not the whole
24 network?

25 A. I think the whole network. We have only got the

1 South Wales area that is a complete network. So some
2 villages get a predominantly dedicated network to supply
3 them.

4 I think when I talk about "the network", I mean all
5 of our systems of delivering water which aren't
6 interconnected. So when I was answering the question on
7 MD163, I meant our network, as in all of our assets,
8 rather than --

9 THE CHAIRMAN: Yes.

10 A. But this -- in answer to your question, I think this
11 recognises the fact there could be pressure for this
12 dedicated system -- for, you know -- to be put under
13 regulatory and commercial pressure to de-average,
14 external pressure.

15 THE CHAIRMAN: In this particular case?

16 A. Well, this was the only case in front of us, but I think
17 it would be -- it would extend itself to all once it was
18 established in one area.

19 MR COWEN: Can I just understand that a little bit more
20 because your concern is that this would be an
21 unfortunate precedent, then?

22 A. I think so. Whether I would use "unfortunate" ...
23 I think we were concerned it will be a precedent.

24 MR COWEN: Okay, and why did you expect regulatory pressure
25 to be brought to bear, given your interpretation of MD163?

1 A. I think --

2 MR COWEN: Because if you were right that MD163 allows average
3 pricing, why would the regulator not just agree
4 with you?

5 A. I think the reason we were projecting the price as we
6 did is we were hoping the Regulator would agree with us.
7 But at this time there was no common carriage deal in
8 place for them to -- for us to be able to understand how
9 Ofwat would deal with it. So we were feeling our way.
10 So we were never sure how Ofwat would respond to it.

11 My recollection at the time is we believed that
12 Ofwat would support the way we were doing it. However,
13 Ofwat were very keen and very strong on pushing
14 competition, so we weren't sure how they would respond,
15 and I think that's what this is referring to, rather
16 than being concerned that what we were doing would
17 definitely be a worry to Ofwat.

18 MR COWEN: Yes.

19 MR COOK: Go to volume 4 now.

20 A. Do I need to keep this?

21 Q. I think we are done in volume 3. Done for now, at
22 least. It's tab 112 I would like you to go to,
23 Mr Edwards, the minutes of board meeting of
24 January 2001.

25 You didn't attend that, did you?

- 1 A. I don't recollect it, no.
- 2 Q. You are not listed as attending. But given you prepared
3 something that was going to go to the board for board
4 approval, presumably the result of that would have been
5 reported back to you; is that right?
- 6 A. If this was the -- as I believe it was -- where the 20p
7 indicative price was approved, then, obviously, I would
8 have been told it was approved.
- 9 Q. And you would have known the board had been told back in
10 November 2000 the result would be revenue neutrality,
11 and now they were being told there was going to be
12 a significant loss of income?
- 13 A. I don't know if they were told there was a significant
14 loss of income. It wasn't in the paper.
- 15 THE CHAIRMAN: We can do the maths.
- 16 A. They could do the maths.
- 17 MR COOK: It was an obvious question to ask, wasn't it?
18 And you also must have known that this was
19 effectively ratifying the board's earlier fears about
20 the £23.8 million of income being at risk from
21 competition?
- 22 A. They would be aware that the competition threat would be
23 starting to appear, if that's what you mean, yes.
- 24 Q. So from Welsh Water's point of view, the result you had
25 got to was one that was going to create a substantial

1 loss and open the door, create a precedent, unfortunate
2 or otherwise, for future competition. It's a fair
3 statement of the position at the time, wasn't it?

4 A. What position is that, please?

5 Q. I'll ask the question again. Having a common carriage
6 number of 20p was something that was going to lead to
7 a substantial loss and was opening the door, creating
8 a precedent, for future competition, cutting into that
9 £23.8 million of revenue, wasn't it?

10 A. I think at the time I was more concerned that the 20p
11 was not robust to interpretation from Ofwat.

12 Q. Presumably the income team, whose job, after all, it was
13 to protect income, would have been very much aware of
14 those matters, wouldn't they?

15 A. As I said earlier, the concern at the time was to make
16 sure we had robust numbers to share with Ofwat and the
17 incumbent, and the 20p wasn't robust and that was more
18 of a concern to me at the time than the consequence of
19 the number.

20 Q. You say more of a concern, so presumably the number was
21 a concern?

22 A. But I can't remember doing the maths of what the number
23 produced because I knew it wasn't going to be the final
24 number.

25 Q. If we look at the minute here, what it records is the

1 issue of "de-averaging of costs of supply remains
2 a complex issue".

3 I appreciate you weren't at the board, but that
4 certainly seems to indicate that the board were very
5 much aware that there was a very real risk that using
6 average costs of distribution wouldn't be acceptable.

7 A. I don't know if I read that into that sentence.

8 Q. They are certainly talking about de-averaging, saying
9 it's complex. So they are certainly very much alive to
10 the risk of de-averaging, aren't they?

11 A. They would be alive to the issue of de-averaging. I'm
12 not sure what else you can read from -- to be honest,
13 that sentence doesn't make much sense to me.

14 MR COWEN: Sorry, can I just ask a related question? Who at
15 the board would be concerned with or responsible for the
16 way in which you allocate costs in your books?

17 A. I think at that time, of those members, I think
18 Gedwyn Miles was the finance director, but he was -- I'm
19 trying to think. I think he was finance director of
20 Hyder for the latter years the 90s. So in terms of that
21 board, it would have been Gedwyn Miles.

22 MR COWEN: And he is not the person who put the
23 sophisticated, you know, computerised system in place?
24 That was Chris Jones.

25 A. I'm not sure if Chris was finance director at that time.

1 The SAP system was implemented in between 1996 and 1997.
2 It may have been -- Jeff Morgan, I think was the finance
3 director at that time.

4 MR COWEN: Thank you.

5 MR COOK: Presumably, Dr Brooker would also have been very
6 focused on this. We saw he was involved in the early
7 stages of writing back on the MD papers.

8 A. Yes, Dr Brooker would understand the issues.

9 Q. There is no reference in these minutes to approval being
10 given for the 19.94p to be issued as an indicative
11 price. Can you help us as to why that wouldn't be
12 included in this?

13 A. No idea, sorry.

14 Q. Your understanding was that it was something that was
15 approved by the board?

16 A. I don't have any recollection on the basis that it was
17 revealed to Albion very shortly after this. Then
18 I assumed it was approved at the board, but I have no
19 recollection.

20 Q. If we can go to tab 114, we can see there is a reference
21 to a meeting that you attended. Mr Jeffery and
22 Mr Monroe, Mr Holton came, of course, from Welsh Water's
23 side as well, and we see that this is the next day and
24 the indicative price of around 20p was issued. So
25 that's certainly consistent with it being approved the

1 previous day by the board, isn't it?

2 A. That's why I made the assumption I did in the previous
3 response.

4 Q. If we go to 132, tab 132, it follows from an exchange of
5 correspondence -- no need to go to the earlier letter,
6 but Ofwat are complaining that there hasn't been an
7 indicative price issued. That was a letter of
8 29 January. So effectively Ofwat were slightly behind
9 the times in terms of what had happened, and that's
10 something that Welsh Water writes back and explains.

11 If we go over the page, at 876 we can see
12 Welsh Water's explanation. This is your explanation, in
13 fact. Number 4:

14 "The price was unable to be considered at
15 the December board meeting. Hence the relation of price
16 was delayed until January. The price was released to
17 Albion the day after board approval was received."

18 You may not remember now, but at the time you
19 clearly thought there had been board approval given?

20 A. Yes.

21 Q. And we saw from the earlier documents that this was
22 something that was, you know, of considerable importance
23 to Welsh Water and something the board needed to
24 approve. That's fair, isn't it?

25 A. That's correct.

- 1 Q. So why, then, did the minutes not record the fact that
2 approval was being given for the issue of a price?
- 3 A. I'm afraid you are asking the wrong person. I'm not the
4 company secretary, so I wouldn't know.
- 5 Q. Was it because there was obviously a recognition of
6 the sensitivities involved in issuing a price which you
7 said in your evidence earlier you recognised was not
8 involved?
- 9 A. I can only the repeat the response of my last question:
10 I don't know.
- 11 Q. If we go back to 4/114, which was the minute of
12 a meeting with Albion, this was the minute of a meeting
13 where the indicative price of 20p was issued to Albion.
14 We can see there that Albion requested formal
15 confirmation of this together with a breakdown of the
16 derivation. Do you see that?
- 17 A. Yes, that's correct.
- 18 Q. And we had, of course, seen from the guidance that water
19 companies are expected to be ready to justify their
20 prices?
- 21 A. That's correct.
- 22 Q. You didn't, of course, provide any explanation to Albion
23 for the 20p figure at this time. Firstly, whose
24 decision would that have been not to provide any
25 explanation?

- 1 A. I assume it would have been Dave Holton's decision.
- 2 Q. And can you help us as to why that decision was taken?
- 3 A. Because it wasn't the final price.
- 4 Q. Yes, but it's not about final price. What they want is
- 5 a breakdown of its derivation. They want to understand
- 6 how you are getting there. So they are still asking for
- 7 the methodology element, aren't they, they have been
- 8 asking for since October?
- 9 A. That's correct. I think one of the things I was
- 10 trying to do at the time was in
- 11 recognition that this price would come under a great
- 12 deal of scrutiny was to ensure that it was presented in
- 13 a way that was very easy for people to see. And
- 14 therefore at that time we didn't have anything that we
- 15 could release to Albion or to Ofwat that would aid them
- 16 into understanding what we were doing, and therefore
- 17 I believe it was worth taking the time to make sure that
- 18 the price we would reveal was easy to understand from
- 19 both Albion and from Ofwat's point of view.
- 20 We were under no illusions as to what would happen
- 21 once the price was released. It would come under
- 22 a great deal of scrutiny, and therefore it was my belief
- 23 that we should aid that by producing what is quite
- 24 a complicated subject as easily as possible.
- 25 Q. The reality was that you weren't happy -- the board

1 wasn't happy -- with the 20p figure you had come up
2 with. That wasn't, in Dr Boarer's words, a price you
3 wanted to be held to long-term, was it?

4 A. The reality was the price was calculated incorrectly.

5 Q. You can't have thought that at the time because you
6 recommended it should go to the board for approval to be
7 issued?

8 A. I knew in December in my handwritten notes.

9 Q. Yes, but your handwritten notes were the ones which led
10 to the new price being put forward in the LCE paper. So
11 it was your figures that had resulted in the 19.94p.

12 A. My figures, the 19.94p, was based on Paul Henderson's
13 methodology for taking the volumetric rate through to
14 the splitting it out. However, this was incorrect
15 because we shouldn't have been taking the volumetric
16 rate, and that's my handwritten note. I think one of
17 the first notes I make, at the top, the volumetric rate,
18 it does not recover all of our income. There is a lot
19 of fixed elements that we charge. We have fixed
20 charges.

21 THE CHAIRMAN: What do you mean?

22 A. The 83p.

23 THE CHAIRMAN: Or whatever it is.

24 A. Yes, the volumetric rate.

25 THE CHAIRMAN: The standard potable tariff?

1 A. Yes, but that is calculated after we take into account
2 standing charges and fixed charges. So, therefore, it
3 wasn't the appropriate starting point.

4 MR COOK: You were looking at that back in December -- this
5 was 15 January, the board meeting. There was plenty of
6 time, if that was the case, to have made that adjustment
7 to take account of standing charges, wasn't there?
8 That's a relatively small change.

9 A. I think the analysis I did -- one of the reasons the
10 handwriting is so poor is because it was done on a train
11 after a meeting with solicitors regarding an appeal to
12 the Competition Commission on the IDOK, the interim
13 determination. So there was a significant amount of
14 work between that date and January on closing down the
15 IDOK. The way that the price review was to work was
16 that once the regulator has made a final determination,
17 we have a set number of days to accept that
18 determination or to appeal it, and therefore I was
19 engaged on that.

20 At the time, I had recognised that the figures were
21 not robust to be released. I had calculated based on
22 Paul's analysis to get a figure for the indicative
23 price, recognising that once the IDOK had finished
24 I would have to go back and calculate the correct price,
25 which is what turned into the FAP.

1 Q. If you were putting forward numbers you knew were not
2 robust, that you thought actually you have identified
3 a clear mistake in the methodology, why wasn't that
4 something you actually flagged up to the board in the
5 paper?

6 A. I think it was indicated as an indicative price. Where
7 is the board paper?

8 Q. If you want to go back -- I'm afraid it's in bundle 3,
9 tab 110.

10 A. I'm not sure why it isn't included.

11 Q. The reality is, Mr Edwards, that the reason why you were
12 suddenly getting involved in recalculating the price was
13 because the board hadn't been satisfied with a figure
14 that was going to lead to a massive drop in income and
15 make common carriage viable going forward, wasn't it?

16 A. That's totally incorrect. The reason I was involved was
17 to ensure that any price that we revealed to the
18 customer and to Ofwat was robust and suitable for
19 challenge. I think our concern was a lot more around
20 the regulatory and customer challenge to the way the
21 price was calculated, rather than the quantum of the
22 price.

23 Q. Mr Edwards, are you really suggesting that if you knew
24 there were fundamental flaws in the numbers that were
25 going to the board, that you wouldn't have actually put

1 that in the LCE paper you put together for the board?

2 THE CHAIRMAN: What are the fundamental flaws --

3 MR COOK: Mr Edwards is saying that they were using the
4 wrong basis of using the volumetric charge and taking no
5 account of fixed charge, so if he was saying that was
6 a material flaw, a fundamental flaw --

7 A. I'm saying it was a flaw, but as an indicative price of
8 20p, I believe that was suitable for taking forward, but
9 in terms of why it's not in the paper, I'm not sure.

10 MR LANDERS: Were you under any pressure to get the numbers
11 out quickly, the prices out quickly?

12 A. I think there was a great deal of pressure from Ofwat
13 and from --

14 MR LANDERS: But internally?

15 A. Internally, yes. I think the timescale, because of the
16 delay was, they were very, very keen to get the numbers
17 out as soon as possible.

18 MR COOK: You say timing pressure. The reality is that time
19 pressure wasn't that pronounced because it had been
20 three and a half months since Albion's application. You
21 had had plenty of time, hadn't you?

22 A. That was the reason for the timing pressure. In that
23 time we hadn't finalised -- we hadn't got a number that
24 we could -- we were confident enough to release to
25 customers and Ofwat.

1 Q. And we also know that Mr Henderson had been calculating
2 the basic methodology at the end of November. So you
3 had had six weeks between that and the board meeting to
4 come up with a price that you felt was accurate. So you
5 really weren't under a great deal of timing pressure
6 here, were you?

7 A. Who do you mean by "you"?

8 Q. The team had a significant period of time in which to
9 put forward a document that it was confident enough to
10 present to the board. So there really wasn't the timing
11 pressure you are now trying to suggest?

12 A. The timing pressure I was suggesting was on me to
13 create -- for the rest of the team I can't comment. I
14 was only partially involved with the team at the time.
15 The pressure was on me to create -- we were being driven
16 by the board dates to get numbers to the board and also
17 by dates of meetings -- the tripartite meeting.

18 Q. If you go to 123, tab 123 in bundle 4. Before I ask you
19 questions about that document, just to be clear: whose
20 decision was it that where you had reached in the LCE
21 paper was a satisfactory basis to go to the board?

22 A. Ultimately that would have been Jeff Williams. It was
23 Jeff Williams' paper.

24 Q. But, I mean, along the way. I mean, who would have gone
25 to Mr Williams and said that was satisfactory in their

- 1 view?
- 2 A. As I described earlier, Jackie Boarer and Dave Holton
3 would have produced the paper and I would have expected
4 them to have discussed it with Jeff Williams.
- 5 Q. So just in terms of understanding, it would be
6 effectively you were involved in the document
7 production, but Dr Boarer and Mr Holton were the ones
8 who would have been directly liaising with Mr Williams
9 about it?
- 10 A. Yes.
- 11 Q. If we do come to tab 123 now, this is an email from you
12 to Mr Holton and Mr Henderson. It's 5 February 2001.
13 What you are doing in this email -- we have some
14 spreadsheets over the page -- is you are suggesting
15 effectively a rather different way of coming to an
16 access price, aren't you?
- 17 A. I think it's a very similar way to the one that
18 Paul Henderson used.
- 19 Q. It's a similar approach, but you are using a different
20 starting point. You are not going to use simply the
21 potable tariff. What you are going to do is use what
22 you call the whole company average cost of water?
- 23 A. That's correct.
- 24 Q. So there is certainly a step change in the methodology
25 that's taking place?

- 1 A. In the first step, yes.
- 2 THE CHAIRMAN: You mean the whole company average price of
3 water? What Dwr Cymru charges to its customers, not the
4 provision at which it buys water itself?
- 5 A. It's the implied whole company average price of water
6 sold.
- 7 THE CHAIRMAN: Sold?
- 8 MR COOK: Yes. There is no need for the moment for us to go and
9 look at the detailed tables. What we see in the first
10 line of your email, you are saying that meant that the
11 ELLCC, which I take to mean the Albion common carriage
12 price, would be 23p per cubic metre?
- 13 A. That's correct, yes.
- 14 Q. Now, presumably you knew the immediate effect of such
15 a number would be that common carriage would be
16 financially viable for Albion?
- 17 A. I'm not sure when I would have done that, but there is
18 clear evidence that I was aware of that.
- 19 Q. And you knew as well that this meant that revenue
20 neutrality would actually be achieved as the board had
21 been told back in November 2000, wouldn't it?
- 22 A. I'm not sure if I would have made that conscious choice,
23 but, as you put it to me now, then that's clear.
- 24 Q. The reality is that's what you had been sent away to do,
25 hadn't you, Mr Edwards: You had been sent away to try

1 and produce that result, hadn't you?

2 A. No.

3 Q. Because if there couldn't been any concerns about the
4 price, why was it that you were suddenly certainly
5 engaging in a step change in the methodology over two
6 months after it had first been proposed by Mr Henderson?

7 A. As I explained, the reason we changed the methodology
8 was to produce a robust price that we could share with
9 both the potential entrant and Ofwat.

10 Q. But this was something where you had known about the
11 methodology previously, you had seen Mr Henderson's
12 original email on it, so you had known and been
13 satisfied about it for two months, and suddenly you come
14 up with a step change in approach?

15 A. I wouldn't accept that I had known about it for two
16 month. I wouldn't have said I was satisfied. At the
17 time, because of the work I was doing, I did not have
18 enough time to sit down and analyse thoroughly what he
19 was doing. Therefore, I was not confident to say
20 whether it was right or wrong.

21 When I did sit down and analyse it, I identified
22 a couple of errors and I set about to rectify those
23 errors, to make the methodology and the -- the way the
24 numbers were calculated robust and visible to everybody.
25 At no point was the actual result driving anything

1 I did.

2 Q. If we go to tab 121, this is the paper that was prepared
3 for the LCE, for the board in relation to the first
4 access price. So effectively that just brought into the
5 paper the email that you had sent on 5 February and then
6 provided in a slightly more readable -- certainly in
7 terms of my documents, a slightly more readable version
8 of the calculations that had been exhibited to that
9 email.

10 I would like to just clarify how exactly you had set
11 about, in terms of your change in the process you were
12 adopting -- forgive me just one moment, Mr Edwards.

13 (Pause)

14 It's a similar document to the one I handed up
15 earlier. I would just like you to take us through this
16 in relation to ... (Handed) It's a single page,
17 Mr Edwards. Perhaps if I could get you to read through
18 it first, then we will go through it and just understand
19 what you were doing. (Pause)

20 A. I have read the document.

21 Q. You have read the document. You understand what I'm
22 explaining there and I see you have been checking the
23 numbers. Is that a fair summary of how you
24 calculated it?

25 A. I haven't fully reconciled it and I'm not comfortable

1 commenting on that. I can see step 1 is wrong straight
2 away.

3 Q. In which case we will go through. We want to understand
4 how exactly you calculated it. Step 1 is:

5 "Take the unit cost of supply of all water, which is
6 calculated by dividing the total revenue from water
7 sales by the total volume of water sold."

8 What do you say is wrong about that?

9 A. It's not the total revenue from all water sales or the
10 total volume of all water sold.

11 Q. Could you tell us then exactly what it is you did use?

12 A. I think if you look at --

13 Q. It's page 852, I think?

14 A. page 857.

15 Q. Mr Edwards, it might be more helpful if you can take us
16 through the main schedules to this paper. As long as
17 you can do so, it's much easier to read and they are
18 intended to be the explanation of how it was operated.

19 Page 852 is the section dealing with whole company
20 average costs?

21 A. So the income is taken from the June return, JR2000 was
22 the June return for 1999 to 2000, table 23. Those are
23 three of the lines from the income table. They would
24 not be all of the lines on the income table.

25 Q. So you are not using the whole company average, then,

1 you are using some categories of income?

2 A. That's correct.

3 Q. Water services?

4 A. That's correct.

5 THE CHAIRMAN: What categories?

6 A. I haven't got the table 23 with me, but there are
7 elements of income that I haven't included here. One of
8 the main ones is the Elan Valley bulk supply just
9 because of the unique nature of the supply. We supplied
10 in between 200 and 350 megalitres a day to Birmingham,
11 to Southern Trent, at a rate that was agreed between
12 secretaries of state when the assets were transferred
13 from the ownership of Birmingham to Welsh Water, and
14 therefore it would have been inappropriate to include it
15 in this analysis.

16 MR COOK: I mean, this table is headed "Whole company
17 average costs", so what you have done is carved out some
18 items of income, so it is a subset of the company's
19 income.

20 A. Yes.

21 Q. But --

22 MR COWEN: Can I just ask the question why. Because what
23 you appear to be doing is taking total income over total
24 assets and trying to derive what the value would be, or
25 costs would be in this particular area.

1 A. Yes.

2 MR COWEN: To deduct anything from the income line just
3 deducts. Why? Whether it was agreed between the
4 secretaries of state or not --

5 A. I think because it was such a huge number.

6 MR COWEN: It was because it was big it was removed?

7 A. It was a very big volume of water and a very low price
8 that was paid for it. So the income from it -- it would
9 need a lot more level of granularity to make sure that
10 we recovered all the other costs from other customers.

11 MR COWEN: By removing it, that means all the other costs
12 have been borne in a disproportionate way by other
13 customers.

14 THE CHAIRMAN: Did you remove any costs from your
15 calculation to reflect the fact that you had removed
16 that large amount of water from the calculation?

17 A. I think the third party costs would have been removed as
18 well. So it wasn't -- we weren't trying to compare --
19 different elements, so that the average volume of water
20 isn't the whole volume supplied and the costs isn't the
21 whole cost either. I think third party costs are
22 excluded as well.

23 MR COOK: Did you check that there was a correlation between
24 third party costs and the categories of income that you
25 took account of?

1 A. I don't think there is a direct correlation.

2 THE CHAIRMAN: Let's go through how you did this calculation
3 and we may have more questions at the end.

4 So it's not really the whole company average cost of
5 water; it's the average cost of water taking part of the
6 income over part of the water sold?

7 MR COOK: To that extent, effectively step 1, you are just
8 saying -- I should add the word "most" in both cases
9 with that.

10 A. I would be more comfortable with that, yes.

11 Q. Yes. But other than that -- I mean, it's right to say
12 that's what you are doing, looking at total revenues for
13 most of the sales, total volume of a certain number of
14 sales and then calculating an average price of water?

15 A. That's correct.

16 Q. Which you say is 73.3p?

17 A. The average price was 76.2p, and then, as you took me to
18 earlier, the final determination has already been made
19 that the average tariff basket reduction would have been
20 10.5 per cent at the time. These figures were for
21 1999/00, so to reflect that I reduced 76.2 per cent down
22 to 73.3 per cent.

23 Q. Pence?

24 A. Pence, yes, sorry.

25 Q. Thank you.

1 If we then go down to step 2, is the description
2 I give there a fair one: just calculating what you call
3 the whole company average cost of resources and
4 treatment?

5 A. Which schedule is that?

6 THE CHAIRMAN: This piece of paper, I think, that Mr Cook
7 handed you his explanation of the FAP methodology.

8 A. I'm sorry, I meant -- his step 2, which schedule of mine
9 does that refer to?

10 MR COOK: I believe it will be schedule B.

11 A. I think there is a better description of what I did in
12 the Ofwat's decision, the seven-step analysis that was
13 done in the --

14 Q. I haven't taken you to that because actually that does
15 include an immediate mistake in it. So that's why.
16 There are mistakes in that Ofwat --

17 THE CHAIRMAN: Can you try and explain to us what you did?

18 A. I can, yes. Do you want me to make you through --

19 MR COOK: If you can take us through that document, if
20 that's possible.

21 A. If you show me where. You are saying:

22 "Calculate whole company average cost of resource
23 and treatment ... "

24 Q. Schedule B, page 851.

25 THE CHAIRMAN: I'm not quite sure why it says "from average

1 price of water" there, in that sentence. Shouldn't it
2 just be "calculate the whole company average cost of
3 resources/treatment"?

4 MR COOK: Madam Chairman, if you look at 851, you will see
5 that it is done by taking a percentage of the 73.3p
6 figure. So it's done by taking the percentage of the
7 step 1 figure.

8 THE CHAIRMAN: Yes. But that must be a subsequent step from
9 calculating what that split between water resource and
10 treatment and water distribution is.

11 MR COOK: At this stage we are simply looking --

12 THE CHAIRMAN: Okay, all right.

13 MR COOK: Hopefully it will become clear. It is a bit
14 complicated.

15 If we look at this, we will see what you have done.
16 On page 851 you have done a subservice split, and water
17 resource and treatment you calculated to 38 per cent,
18 and you calculate 38 per cent of the 73.3 figure you
19 have calculated in step 1.

20 A. Step 1 is -- appears to come from schedule D. Step 1
21 I agree with, that we calculated a unit cost of -- in
22 schedule C. I believe the next step I did would have
23 been schedule D.

24 Q. Yes. Schedule D is the detail of it, but the end result
25 is simply to come to a percentage. So you do the split,

1 which comes to a percentage, and -- which comes to 38,
2 you see in "Resource and treatment", and then you apply
3 that --

4 A. So step 1.5 was to calculate the 38 per cent.

5 Q. Okay, I'm happy to add that in.

6 A. Then that 38 per cent appears in schedule B, as you say,
7 and therefore average cost of water, because we are
8 providing two services, is split between water resource
9 and treatment and water distribution, as step 1.5, to
10 27.9 and 45.4.

11 Q. But it's the 27.9 that's significant in terms of your
12 subsequent workings, isn't it?

13 A. For the --

14 Q. For calculating the common carriage price?

15 A. For calculating part of the common carriage price, yes.

16 Q. Yes. Then, having worked out it was 27.9, you then work
17 out a split of that. We have seen what the split is
18 down on page 851, saying:

19 "Water resources, 3.9."

20 And:

21 "Water treatment, 24."

22 We see how you have split that. The percentages
23 actually come from schedule E, which calculated
24 a 14 per cent and 86 per cent split, but you then apply
25 those to break up the whole company average water

1 resource and treatment figure.

2 A. So step 2.5 was to calculate the split between resources
3 and treatment, and that was applied to resource and
4 treatment costs that you have done down as my step 2.
5 And the 24 and 3.9 equals 27.9.

6 Q. Sorry, 27.1? What was the figure --

7 THE CHAIRMAN: No, the 3.9 and the 24p, that's the split out
8 of the 27.9.

9

10 MR COOK: Sorry. I apologise, I heard 27.1.

11 So at that point you had sort of done those
12 calculations and then you sort of move away from
13 that for a moment and simply take the potable LIT top
14 band price, do you not?

15 A. Yes, at that stage I have got the price for -- the 73.3
16 split between water resources, water treatment and water
17 distribution. The next two steps were then to work out
18 the partial treatment, included in the treatment, and
19 also the bulk distribution, included in distribution.
20 So those are the next two steps.

21 Q. But in terms of how you do that, so step 4, you take the
22 top band potable LIT price, which we can see on page 856
23 you calculated was 43.9?

24 A. Yes.

25 Q. Again, taking account of the price determination that

1 had been made, and then you deduct from that the whole
2 company average cost of resources and treatment, don't
3 you, which is 27.9? But rather helpfully, it seems to
4 have changed to 27.6 here?

5 A. I think there is a typographical error. It should be
6 27.9, but the front sheet was 16, which is the 43.9
7 minus 27.9 is 16.0. So you are correct, that's
8 a typographical error.

9 THE CHAIRMAN: What is?

10 A. On schedule G, from the -- the figure I have taken from
11 schedule B I have written 27.6. That should be 27.9.

12 THE CHAIRMAN: Yes.

13 A. And therefore the remainder which I have got as 16.3
14 here, should be 16.0.

15 THE CHAIRMAN: That top band Large Industrial Tariff in
16 schedule G, is that the same tariff that was used in the
17 Paul Henderson email?

18 A. It's the same tariff, but I have calculated it slightly
19 differently. What Paul Henderson took was the -- the
20 way the tariffs were structured, there is a large fixed
21 cost and then a much smaller volumetric rate, and what
22 Paul Henderson took was the fixed cost plus the
23 volumetric rate at the point where large customers move
24 into that band. And what I have taken there is the
25 average income from all of those large users. So it's

1 the same LIT, yes, but the calculation I have done is
2 slightly different.

3 MR COOK: So you agree with step 5 as explained on my note?

4 A. Step ...? This is step 4, is it?

5 Q. Step 4 is getting the 43.9, and then step 5 is deducting
6 the whole company average cost of resources and
7 treatment from step 2 from that top band potable LIT
8 price.

9 THE CHAIRMAN: Where does the 45.4 figure in schedule B for
10 water distribution come from? Why isn't that 43.9?

11 MR COOK: 43.9 is a completely different number,
12 Madam Chairman. 43.9 is the top band LIT price, whereas
13 the earlier number is simply the calculation of
14 distribution costs generally.

15 THE CHAIR: I see. Yes.

16 MR COOK: So Mr Henderson, you agree with how I have
17 explained step 5?

18 A. Mr Edwards.

19 Q. I apologise, Mr Edwards.

20 A. Sorry, I agree with what, sorry?

21 Q. You agree with how I have explained step 5?

22 A. I think step 4 should calculate the top band LIT average
23 rather than taking the top band LIT price. I think
24 that's wrong. And then I have calculated the bulk --
25 I wouldn't say potable, I would say the bulk

1 distribution average price as -- let's have a look.

2 So you are saying 16.5, which I have got wrong
3 there, is calculated from the average LIT 1999/00
4 deflated to recognise the P0 adjustment, and I have
5 taken the one from the other.

6 Q. Just to clarify that, you mean it is simply the top band
7 LIT price --

8 A. Average of the top band income.

9 Q. Yes. So step 5's correct?

10 THE CHAIRMAN: So that 27.9 figure, which is being deducted
11 from the 43.9 at step 5, is that derived from 73.3
12 minus 45.4?

13 MR COOK: Madam, the 27.9 comes from step 2.

14 MR BEARD: I think the answer is yes, if you look at
15 schedule B because it says at the bottom of
16 schedule B -- I think this is where Mr Cook is going.

17 THE CHAIRMAN: Yes? Go on.

18 MR COOK: Yes. Sorry, I was just checking the Tribunal is
19 comfortable with how this breaks down in practice.

20 So you deduct 27.9 from 43.9, you get the 16,
21 Mr Edwards, and then step 6, to calculate the access
22 prices you take what I have called potable bulk
23 distribution, in any event the figure from step 5, the
24 16p, and then you have taken 30 per cent, the cost of
25 treatment you identified in step 3, and that 30 per cent

1 is the same one we have seen before, to reflect
2 non-potable treatment percentage. Is that right,
3 Mr Edwards?

4 A. Sorry, that was a question, was it? Yes, the
5 non-potable price is 30 per cent -- sorry, the partial
6 treatment price is calculated at 30 per cent of the
7 water treatment price and the bulk distribution price of
8 16p is inferred from the total distribution price --
9 sorry, from -- inferred from the large industrial
10 tariff.

11 Q. If we go up to the summary at the top, in terms of what
12 you have done, that's a fair summary, isn't it? You
13 take the top band potable LIT and then you take away the
14 whole company average, resource and treatment cost, and
15 then you add 30 per cent of the cost of treatment?

16 A. Do you mean bulk distribution there?

17 Q. It would be bulk -- well, it's simply the distribution
18 element. Common carriage price.

19 A. The bulk distribution is calculated from the average top
20 band LIT minus the water resource and treatment.

21 Q. Yes. And then you add 30 per cent of treatment?

22 A. 30 per cent of the treatment average price.

23 Q. So you agree with the summary?

24 A. If the summary is how we calculate the common carriage
25 price, yes.

1 Q. Yes. Thank you, Mr Edwards.

2 The reality is, Mr Edwards, that what you have done
3 here is, if we go back to the previous LCE paper --
4 I apologise -- which is bundle 3 again, tab 110. It may
5 not be necessary for everyone to turn it up. I'm simply
6 going to remind you of what the figure was.

7 Mr Edwards, what you have done is that calculated
8 a bulk distribution cost of 11p, and your new
9 methodology calculates a bulk distribution cost of 16p,
10 doesn't it?

11 A. 16p is correct.

12 Q. Yes. So the changes you have made to the methodology
13 had given potable bulk distribution cost, which is
14 nearly 50 per cent higher, 11.1 up to 16?

15 A. The 16 is 50 per cent higher than 11, you are saying,
16 roughly. That's the arithmetic, yes.

17 Q. And just to explain how that had happened, what in
18 practice you had done, Mr Edwards, is the way you had
19 managed to get that increase in the distribution cost
20 was taking what you called the whole company average
21 cost of resource and treatment, didn't you?

22 A. Are you saying the difference between the two
23 methodologies was moving from -- sorry, I will say that
24 the difference in the two methodologies was moving from
25 using the potable volumetric rate to the average cost of

- 1 water.
- 2 Q. What you have really done is you have actually moved
3 from, again, in 110, treatment cost of 29.48p, 29.5p and
4 now you have calculated a treatment cost that has gone
5 down to 24p.
- 6 A. The cost in 801 is 29, and the other one is -- that's
7 correct.
- 8 Q. Is down to 24.
- 9 A. 24.
- 10 Q. The way you have done that, Mr Edwards, is with a little
11 bit of accounting trickery -- and I'll tell you why
12 I say that -- which is what you have done is calculated
13 what you call the whole company average cost of
14 treatment. Because that's whole company, what's
15 included within that is a large volume of water which is
16 completely untreated, isn't it?
- 17 A. How do you mean?
- 18 Q. Well, you have calculated it by reference to -- you are
19 looking at the total income from -- the proportion of
20 the water sales you have taken account of, which
21 includes a large volume of water which is untreated.
22 It's non-potable water that has gone through no
23 treatment at all.
- 24 A. I'm not sure if that's included. It does include --
25 where am I?

1 Q. We come back to page 852. You see you have taken account
2 of a large volume of non-potable water?

3 A. So what page was it, sorry?

4 Q. Page 852 in bundle 4. That's your calculation. It's
5 tab 121.

6 A. Yes, I believe the 119.85 will include raw water.

7 Q. So a large proportion of that would be raw water?

8 A. I haven't got the breakdown in front of me.

9 A proportion of it would be.

10 THE CHAIRMAN: Well, an insignificant proportion?

11 A significant proportion?

12 A. The largest customers took partially treated, which was
13 Corus and Albion. I'm not aware of the numbers.

14 MR COOK: Something above a minuscule proportion.

15 A. It definitely wouldn't be a miniscule proportion.

16 Q. Certainly a significant proportion.

17 So within that certainly a significant proportion of
18 water which was complete untreated. So had no treatment
19 costs associated with it all. That's right, isn't it?

20 A. It does include some water which was not treated at all.

21 Q. It also includes the balance of that non-potable, the
22 balance of that would be water which was partially
23 treated.

24 A. That's correct, yes.

25 Q. So if we look on page 852, you can see, there is roughly

1 120 -- it's 119.85 -- megalitres of non-potable and that
2 would either be completely untreated or only partially
3 treated, wouldn't it?

4 A. That's correct.

5 Q. And you are suggesting in this that a 30 per cent
6 treatment cost would apply to partially treated. So
7 that volume of water would have a very low treatment
8 level associated with it measured over the total of
9 non-potable, wouldn't it?

10 A. As an individual line?

11 Q. Yes.

12 A. Yes.

13 Q. So what you have actually done is taken the cost of
14 treatment and spread it over all the water delivered by
15 Welsh Water, which inevitably gives us a lower average
16 cost of treatment than the actual cost of potable
17 treatment, doesn't it?

18 A. Than the actual average cost of potable treatment. Is
19 that what you are saying?

20 Q. Because you take the total cost of treatment and spread
21 it across all the water delivered, including water that
22 has little or no treatment, you end up with a lower
23 average treatment cost than the actual cost of treating
24 potable water, don't you?

25 THE CHAIRMAN: You should end up with a local average

- 1 treatment cost, I think is what you are saying.
- 2 MR COOK: Arithmetically you will do, and did, didn't you?
- 3 A. I haven't done that calculation.
- 4 THE CHAIRMAN: I think the starting point that Mr Henderson
5 used was a price for potable water, wasn't it?
- 6 A. Yes.
- 7 THE CHAIRMAN: And here instead your starting price is an
8 average of all the water, including a lot of raw water?
- 9 A. Yes.
- 10 THE CHAIRMAN: And the question is whether that affects how
11 you calculate the correct share of treatment?
- 12 MR COOK: Madam Chairman, it was simply a certain
13 arithmetical point at that stage that by taking all the
14 treatment costs and spreading it across all water sales,
15 it gives you a lower average treatment cost, doesn't it,
16 as a matter of arithmetic?
- 17 A. As a matter of arithmetic.
- 18 Q. So that's what you have called the whole company average
19 treatment cost, which is lower as a consequence of that
20 spread?
- 21 A. Which could be lower.
- 22 Q. It must be lower, mustn't it?
- 23 A. I haven't got the numbers in front of me and I'm not
24 comfortable saying it --
- 25 Q. Mr Edwards, it must be lower because you have included

- 1 a lot of water that has no treatment?
- 2 A. Okay.
- 3 Q. So the average cost must fall?
- 4 A. I accept that.
- 5 Q. So you calculate this reduced average treatment cost and
6 then you apply that to the potable LIT to calculate bulk
7 potable distribution, and that's the process you use,
8 isn't it?
- 9 A. That's the process, yes.
- 10 Q. The end result of that, because you are using this lower
11 average treatment cost, you end up inflating the cost of
12 potable distribution, don't you?
- 13 A. From the logic you are giving, yes.
- 14 Q. Yes. And that's in reality how you end up getting the
15 price above what Mr Henderson did previously up to 23.2,
16 because you are using an average treatment cost, which
17 is not the potable treatment cost?
- 18 A. This is the first time I have looked at it that way. So
19 it wasn't something that was in my mind at the time.
- 20 Q. Well, Mr Edwards, you must have been thinking about
21 whether this was an appropriate approach to take.
22 I mean, you were making changes which introduced
23 something which you called the average treatment cost,
24 weren't you?
- 25 A. Yes.

1 Q. And you knew -- it was your calculation -- that you were
2 going to take account of a lot of water which didn't
3 have full treatment on it, and inevitably that was going
4 to lead to a reduced treatment cost, wasn't it?

5 A. Well, as you say, as we have discussed earlier, I agree
6 that now, but it was never in my mind at the time.

7 Q. That's where the financial trickery comes in, and you
8 managed to turn the treatment that had been calculated
9 for potable treatment back in the LCE paper of 29.48,
10 you bring it down in this paper to 24p, don't you?

11 A. If you say financial trickery, I made it very clear when
12 I was doing these numbers what I was attempting to do
13 was replicate work that Mr Taylor had done, and
14 therefore I was -- (a) I was not aware of what I was
15 doing, when you put it that way, and (b) -- it was not
16 financial trickery. This was just a method -- I was
17 trying to produce a report that was robust and was
18 suitable to be challenged by Albion Water, suitable to
19 be challenged by Ofwat, which is why I included exactly
20 the reference of all of the numbers. And I believed
21 that using the non-potable -- sorry, the potable
22 average -- potable volumetric charge was not the right
23 figure and I believed this was a more appropriate way of
24 doing it.

25 Q. Then you deducted something which was reduced average

1 from a potable charge, and it should have been a potable
2 treatment charge you were using, shouldn't it?

3 A. Reduced average?

4 Q. You used a reduced average treatment charge rather than
5 a potable treatment charge, didn't you?

6 A. I think that's what you are telling me now I did. It's
7 not something I was aware of at the time.

8 Q. You had spent some considerable time on this and you
9 must have immediately seen that the result of your work
10 was to reduce the cost of treatment substantially,
11 didn't you?

12 A. I knew the numbers had changed, yes.

13 Q. You didn't give any thought as to why the numbers had
14 changed?

15 A. I think it was just -- no, I can't remember doing that
16 analysis.

17 Q. Did you give any thought as to why the numbers had
18 changed?

19 A. I would have worked from what Paul had done to what
20 I had done.

21 Q. And you saw that basically this was a way of producing
22 the result that Welsh Water wanted?

23 A. Certainly not. This was a way of producing an open and
24 transparent document that I could share with Ofwat and
25 the customer.

1 Q. And this amount of detail was simply burying away the
2 final little bit in the back of seven schedules,
3 wasn't it?

4 A. I produced the seven schedules to make it very clear
5 what I had done. I was conscious of the work that
6 Mr Taylor had done, and over the years we had been -- at
7 the very start of these processes we would be revealing
8 a price. Over the years we were revealing more and more
9 of how we were calculating that price, and I was
10 conscious that this was the first time that we were
11 exposing this to our customers as well Ofwat.

12 I wouldn't have done this much detail if I thought I was
13 hiding something.

14 Q. You knew that Welsh Water should price customers as it
15 should price itself, and presumably you had been happy
16 that the methodology in the January paper met that
17 requirement. Were you happy with that?

18 A. Is that the 20p?

19 Q. Yes.

20 A. I believe that was my concern -- the starting point of
21 the volumetric tariff was not the way we had calculated
22 prices before. I was aware of the way that Mr Taylor
23 had done it, and therefore I believed this was the way
24 that we had done it before was consistent with our
25 previous methodologies.

1 Q. If we go to 851 in this tab, 121 --

2 MR BEARD: I don't want to interrupt, but I'm slightly
3 conscious of time. I don't know if you are moving on
4 to --

5 MR COOK: I'm not moving on to another topic. I was
6 planning to ask about another 15 minutes of questions on
7 this paper and then that would be a natural break point.

8 THE CHAIRMAN: Mr Edwards -- sorry. (Pause)

9 I think we will break there. I think it has been
10 a long day for the witness in the witness box and we may
11 better progress if we have a break at that point.

12 MR COOK: Madam Chairman, I should mention that we have
13 approached Welsh Water in the light of the evidence we
14 have heard today. There is obviously a document that
15 has not been disclosed previously, which is a result of
16 the work that Mr Henderson was conducting with the
17 consultants apparently.

18 We haven't seen that work. We haven't seen when it
19 was being done, what the products of it were, so we have
20 approached Welsh Water and asked for that to be
21 disclosed, and we are waiting to hear from them.

22 MR BEARD: We have indicated we are making enquiries.

23 THE CHAIRMAN: Yes, thank you.

24 Do you know what time you are going to finish
25 Mr Edward's cross-examination tomorrow?

1 MR COOK: I think I have the best part of a morning left,
2 Madam Chairman.

3 THE CHAIRMAN: Very well.

4 Well, I repeat the warning that I have given to
5 witnesses, Mr Edwards, that you mustn't discuss your
6 evidence with anyone overnight, and we will resume at
7 10.30 tomorrow morning.

8 (4.35 pm)

9 (The court adjourned until 10.30 am the following day)

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I N D E X

MR PAUL EDWARDS (continued)1
Cross-examination by MR COOK (continued)1