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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

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**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.

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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 to 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 m<sup>3</sup>/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