Neutral citation [2006] CAT 36

IN THE COMPETITION APPEAL TRIBUNAL

Case No: 1046/2/4/04
1034/2/4/04 (IR)

Victoria House
Bloomsbury Place
London WC1A 2EB

18 December 2006

Before:

Sir Christopher Bellamy (President)
The Honourable Antony Lewis
Professor John Pickering

Sitting as a Tribunal in England and Wales

BETWEEN:

ALBION WATER LIMITED

Appellant

supported by

AQUAVITAE (UK) LIMITED

Intervener

-v-

WATER SERVICES REGULATION AUTHORITY
(formerly DIRECTOR GENERAL OF WATER SERVICES)

Respondent

supported by

(1) DŴR CYMRU CYFYNGEDIG

and

(2) UNITED UTILITIES WATER PLC

Interveners

JUDGMENT

APPEARANCES

Dr. Jeremy Bryan, Managing Director of Albion Water Limited, and subsequently Rhodri Thompson QC and John O'Flaherty appeared on behalf of the appellant, Albion Water Limited.

Michael O'Reilly (instructed by McKinnells, Lincoln) appeared on behalf of Aquavitae (UK) Limited.

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

Christopher Vajda QC and Meredith Pickford (instructed by Wilmer Hale) appeared on behalf of Dŵr Cymru Cyfyngedig.

Fergus Randolph (instructed by the Group Legal Manager, United Utilities) appeared on behalf of United Utilities Water plc.

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TABLE OF CONTENTS

I INTRODUCTION

1. Following an interim judgment on 22 December 2005 [2005] CAT 40 ("the interim judgment"), the Tribunal gave its main judgment in these proceedings on 6 October 2006 [2006] CAT 23 ("the main judgment"). The present judgment deals with the issues of substance and relief that now remain to be decided, following further submissions of the parties and hearings on 24 October and 20 November 2006. We use the same terms and abbreviations as in the Tribunal's previous judgments, in which the circumstances of this case are fully set out.

2. At paragraph 981 of the main judgment, the Tribunal summarised its conclusions as follows:

> "(1) There is evidence before the Tribunal that the treatment cost of non-potable water on an average accounting cost basis was over-estimated in the Decision. However the Tribunal is prepared to assume, without deciding, that treatment costs are in the range 1.6p/m³ to 3.2p/m³.
>
> (2) The matter of the "distribution" cost of non-potable water on an average accounting cost basis was not sufficiently investigated. In this respect the Decision is incorrect, or at least insufficient, from the point of view of the reasons given, the facts and analysis relied on, and the investigation undertaken, as regards in particular to the Director's conclusion in paragraph 302 of the Decision to the effect that it was not unreasonable to assume that the "distribution" costs of potable and non-potable water are the same.
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> (3) The evidence strongly suggests that the First Access Price was excessive in relation to the economic value of the services to be supplied, by reason of the absence of any convincing justification for the "distribution" costs included in the average accounting cost calculation.
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> (4) The cross-check as to the validity of the First Access Price by reference to ECPR in paragraphs 317 to 331 of the Decision cannot be safely relied on because (i) the 'retail' price used in the calculation is not shown to be cost-related, as regards the distribution element; (ii) the evidence strongly suggests that that price was itself excessive; (iii) the particular method of ECPR used in this case would eliminate existing competition and, in effect, preclude virtually any competitive entry, because the margins are insufficient; and (iv) the approach of the Authority in its

evidence and submissions was not the same as that in the Decision. None of the justifications for an ECPR approach advanced by the Authority persuaded us that we could safely rely on the approach set out in the Decision in the circumstances of the present case.

(5) As regards the allegation of margin squeeze, the existence of a margin squeeze was not seriously disputed. The Director's finding at paragraph 352 of the Decision that nonetheless there was no breach of the Chapter II prohibition was erroneous in law and incorrect, or at least insufficient, from the point of view of the reasons given, the facts and analysis relied on and the investigation undertaken.

(6) It is unsafe to assume, as the Director does in paragraphs 331 and 338 of the Decision, that the Costs Principle set out in section 66E of the WIA91 supports the conclusion which the Director reached in the Decision, since (i) the retail price used in the calculation in the Decision is not shown to have been reasonably cost-based, and the evidence strongly suggests that that price was itself excessive; and (ii) the Director's interpretation of ARROW costs under section 66E(4) is open to serious question, since that interpretation would on the evidence preclude virtually any effective competition or market entry, and give rise to a potential conflict with the consumer objective under that Act and with the Chapter II prohibition."

3. As indicated at paragraphs 982 to 983 of the main judgment, there are essentially three matters left to decide: (1) the issues arising in relation to dominant position; (2) the issues arising in relation to the remedies or orders that the Tribunal should now grant or make in the light of the main judgment on the issue of abuse; and (3) the question of interim relief.

4. At the hearings of 24 October 2006 and 20 November 2006, in exercise of its powers under Rule 20(4)(e) of the Tribunal's Rules, the Tribunal stressed the desirability of the parties reaching a consensual solution to this case if possible. By letter of 17 November 2006 the Tribunal proposed to the parties the possibility of mediation in the context of Rule 20(5). Those possibilities were not acceptable to Dŵr Cymru, who proposed instead an agreement with Albion as regards a re-determination by the Authority under section 40 WIA91 of the price for bulk supplies ("the Bulk Supply Price") currently paid by Albion to Dŵr Cymru under the Second Bulk Supply Agreement: see further below.

5. The Chief Executive of the Authority, Ms Regina Finn, attended the hearing on 20 November 2006 at the Tribunal's invitation, and told us that previous determinations under section 40 WIA 91 had taken between 4 and 10 months.

II DOMINANT POSITION: BACKGROUND AND ARGUMENTS

6. It is a prerequisite to the application of the Chapter II prohibition that the undertaking in question has "a dominant position in a market" within the meaning of section 18(1) of the 1998 Act. Although it appears from a number of passages in the Decision that the Director had doubts as to whether Dŵr Cymru was dominant (see e.g. paragraphs 113 to 211, summarised at paragraphs 213 and 214 of the Decision), the Director was prepared to assume dominance (paragraph 215). However, at paragraphs 216 to 225 the Director reached the conclusion that he did not believe that the Ashgrove system was an "essential facility".

7. In those circumstances, Albion asks the Tribunal to resolve any doubts there may be and make a clear finding to the effect that Dŵr Cymru has or had a relevant dominant position. In Albion's submission, the evidence to that effect is overwhelming and the matter does not require further investigation. The Authority's position, although somewhat equivocal, as explained below, is that there are further matters to be investigated before the Authority would be in a position to make a finding of dominance. The Authority further contends that the Tribunal has no jurisdiction to make a finding on dominance. Dŵr Cymru declines to concede dominance, and strongly contests the Tribunal's jurisdiction to make any ruling at all on the issue. Dŵr Cymru also contends that there are many further matters to be investigated before any such ruling could be made. United Utilities supports Dŵr Cymru, while Aquavitae, for its part, supports Albion.

8. We propose first to trace the somewhat unusual way in which the issue of dominance has presented itself in these proceedings, drawing largely on the summary already set out in Annex A to the main judgment, together with the arguments of the parties. We then set out the Tribunal's own analysis.

The Decision

9. The Director devotes some 30 pages of the Decision to considering whether Dŵr Cymru is dominant in a relevant market for the purposes of the Chapter II prohibition and the associated question whether the Ashgrove system is an "essential facility" (paragraphs 86 to 225).

10. As for the relevant market, the Decision states that the Director has been prepared to accept as a starting point for his analysis that the relevant product/service market is that for the transportation and partial treatment of water, and that the geographic market in which Albion alleges that Dŵr Cymru is dominant is that "for the transportation via the Ashgrove system, and the partial treatment of water abstracted from the Heronbridge abstraction point to Shotton Paper and Corus". However, the Director has not found it necessary to carry out a more detailed analysis or reach a final view of the relevant market in this instance (paragraphs 93, 101).

11. As regards dominance, the Decision states that although "there are certain factors which would point strongly to Dŵr Cymru being in a dominant position on the relevant market" (paragraph 212) and although "it may be unusual", according to the Decision "we do have reservations about whether Dŵr Cymru could actually be said to be in a dominant position" (paragraph 215). Those reservations appear to be based on the possibility that the relevant geographic market may be wider than that suggested by Albion (paragraph 213), and/or that Albion or United Utilities could enter the market. The Director does not agree that it would be uneconomic to duplicate the Ashgrove system, a view based on certain documents and various "desk top" calculations set out in Annex I to the Decision, or that Dŵr Cymru would engage in exclusionary conduct (paragraph 214). In particular, at paragraph 176 of the Decision the Director finds:

> "In summary, in light of the above, we consider that the cost of constructing new infrastructure to serve Shotton would not be sufficient to constitute a barrier to entry."

12. However, the Director states that he has not found it necessary to carry out "a more detailed analysis of dominance or to reach a final view on this point". The Director

proceeds on the assumption that Dŵr Cymru does have a dominant position on the relevant market (paragraph 215).

13. The Decision further analyses the issue of "essential facilities" at paragraphs 216 to 225. Referring to his analysis of dominance, the Director states that the cost of constructing new infrastructure to serve Shotton Paper would not be sufficient to constitute a barrier to entry, and that he is not satisfied that there are technical, legal or economic obstacles making it impossible or unreasonably difficult to construct such new infrastructure (paragraph 222).

14. As to whether the construction of duplicate water supply infrastructure would be contrary to public policy, the Director expresses the view that, in this particular case, there may not be sufficient public policy reasons to render the Ashgrove system an essential facility (paragraphs 223 to 224). The Decision concludes:

> "Although we would need to examine particularly the public policy questions in more detail, at this stage we do not believe that the Ashgrove system is an essential facility as Albion Water alleges. But in the light of our conclusions in this decision set out below, we have not found it necessary to rely on this view in this case." (paragraph 225)

The pleadings

15. In the notice of appeal, Albion contends that the Director misdirected himself in failing to commit himself to a firm definition of the relevant market, but that the widest market identified by the Director is that for the transportation and partial treatment of water to non-potable users in an area no greater than the water resource zone[1] in which Shotton Paper is situated (paragraph 106 of the notice of appeal).

16. At paragraphs 188 to 211 and Annex 2, pages 18 to 24, of the notice of appeal, Albion advances a detailed challenge to the Director's analysis of the issue of essential facilities. According to Albion, it was perverse for the Director to assess the viability of the construction of a new pipeline by assuming as his yardstick a retail price which Albion contended was itself unreasonable (paragraph 197). Albion makes further detailed criticisms of the Director's calculations, and contends that the Director has

[1] The extent of the "water resource zone" is not deliniated in the Decision or elsewhere.

seriously understated the difficulties of constructing an alternative pipeline, including the need to negotiate easements, a double river and railway crossing, contaminated land at Shotton Paper and the need to obtain planning permission; has failed to allow for the delays and commercial risks that such a project would involve; and has assumed totally unrealistic required rates of return. Albion also contests the Director's assertions that there are potential customers other than Shotton Paper and Corus, and that there are usable boreholes on the Corus site. According to Albion, those boreholes are unusable because of high salt content, and Albion knows of no other groundwater sources in the vicinity (Annex 2 to the notice of appeal, paragraphs 20 to 33).

17. At paragraph 217 of the notice of appeal, Albion asks the Tribunal to determine the matter of infringement itself, rather than remitting it to the Director. It is implicit in that request, repeated in paragraph 13 of the reply, that Albion has, from the outset of these proceedings, sought a finding from the Tribunal on the issue of dominance, which is of course a pre-requisite to any finding of infringement. Albion has repeated that request explicitly in oral submissions.

18. In the defence, the Director responds that the issues of relevant market, dominance and essential facility are, in his view, ancillary aspects of the Decision on which he has not relied. For that reason, the defence comments only briefly on Albion's contentions. According to the Director, "the relevant market might be as wide as the relevant water resource zone" (paragraph 99 of the Decision). The Director was aware of the Corus boreholes, but was not referring to any particular boreholes at paragraph 99 of the Decision. According to the Director, it would be feasible for another water company with average infrastructure costs lower than those of Dŵr Cymru to replicate the Ashgrove system, and charge a lower price. At paragraph 170 of the defence the Director states:

> "The Director was of the opinion that it was important to include his findings on the essential facilities question. The Appellant had argued that the relevant facility was essential and, given that this was the Director's first investigation into common carriage, it seemed appropriate to opine on this particular question. During the investigation the Director had explained to the Appellant that the case raised important issues relating to common carriage generally, and that it was important, both to the Appellant and the industry as a whole, that his detailed thinking

on this issue was publicly available and open to challenge, if necessary".

19. Dŵr Cymru's statement of intervention draws attention to the importance of self-supply by commercial and industrial customers in the water industry. Attention is drawn to an email sent to Dŵr Cymru by Corus dated 15 April 2004 asking whether Dŵr Cymru would be interested in a joint venture to develop Corus' borehole water for use by Corus but leaving the surplus available for other users such as Shotton Paper. According to Ms Cross, Dŵr Cymru has not pursued this proposal "but it is possible that the source could be further developed by others" (paragraph 29).

20. In its reply, Albion argues that the Director's approach to the issues of market definition and dominance "was highly unfortunate". According to Albion, the Director was plainly right to assume dominance, since Shotton has no realistic alternative for its substantial requirements of non-potable water, and Albion has no realistic alternative way of carrying water from the Dee to Shotton other than via Dŵr Cymru's pipeline. Equally, Dŵr Cymru enjoys clear monopoly power in the small market served by the Ashgrove system, there being no evidence that anyone is in a position to compete on that market in the foreseeable future. According to Albion, the approach in the Decision, whereby the Director failed to make a clear positive finding of the power of Dŵr Cymru in the market, was unsound. In his witness statement of 9 November 2004 Dr. Bryan states that the Corus boreholes mentioned by Ms Cross have no potential to supply Shotton Paper.

The submissions at the first hearing in May 2005

21. Before the first hearing in May 2005 the Tribunal posed various questions to the parties in a letter of 22 March 2005, including the questions "1. How is the Tribunal to approach the issues of market definition and dominance in this case? 2. To what extent, if any, is the issue of "essential facilities"…, to the extent that issue is conceptually separate from the issue of dominance, an issue in the appeal?".

22. In its skeleton argument for the May 2005 hearing, Albion submitted that Dŵr Cymru was plainly "super dominant" in the relevant market, which Albion considered to be "the transportation [and treatment] of non-potable water for supply to industrial

customers in the geographical area served by the Ashgrove system" (paragraph 95 of the Decision). That definition, according to Albion, would take into account both potential customers and potential suppliers of such water. Albion points out that this is not a case of refusal to supply, so the question is not so much whether Ashgrove is an essential facility, but whether Dŵr Cymru is dominant. According to Albion, Dŵr Cymru plainly is dominant, with a market share of 100 per cent and substantial barriers to entry. The barriers to entry, according to Albion, are that: the market is a very limited one that is already fully serviced by the Ashgrove System; any investment in a competing transport and treatment system to supply Shotton and Corus would be expensive; such a major investment to compete with an established monopolist would be highly speculative in the absence of a long-term contract with a major customer; there is no evidence that any competing water undertaker is actually intending to undertake the necessary investment in the short to medium term, so there is no imminent competitive threat to Dŵr Cymru's monopoly position; Albion itself is not threatening to make, and plainly could not justify, such an investment; Albion's licence is terminable on one year's notice, so for Albion there is a substantial regulatory risk; and the Director identifies no other third party who is a potential new entrant into this small market. The analysis in the Decision is "hopelessly inadequate" to cast doubt on these contentions. Those arguments were also advanced orally by Albion in the course of the first hearing in May 2005.

23. The Director's position, in answer to the Tribunal's questions, and at the first hearing, was that market definition, dominance and "essential facilities" were not "live issues" in the appeal. Dŵr Cymru and United Utilities supported that position.

The Tribunal's interim judgment

24. At paragraphs 145 to 147 of the interim judgment of 22 December 2005 the Tribunal said:

> "145. Since [the existence of a dominant position] is the assumption upon which the Decision is predicated, we do not need to consider in detail the Director's analysis, at paragraphs 86 to 225 of the Decision, of the issue of dominance in the relevant market and the associated issue of whether the Ashgrove System is indeed an "essential facility" for the purposes of the Chapter II prohibition. We

make it clear, however, that had we had to consider the issue of dominance, we would at first sight have had difficulty in agreeing with the Director's doubts as to whether Dŵr Cymru had a dominant position within the meaning of the Chapter II prohibition, and in particular his view that the suggested possibility of constructing a new pipeline to serve Shotton Paper instead of the Ashgrove System would arguably negative any such dominant position. The Director was, in our view, correct to assume that Dŵr Cymru had a relevant dominant position.

146. We would also observe that the Decision (at paragraph 213) is somewhat equivocal as to what is the precise ambit of the relevant market in which Dŵr Cymru is assumed to be dominant. Like the Director in that paragraph, we accept as a starting point that Dŵr Cymru is to be assumed to be dominant in the market for the transportation of non-potable water for supply to industrial customers in the geographical area served by the Ashgrove system (Decision, paragraphs 104 to 110).

147. We also accept that, as Albion suggests in its skeleton argument, if Dŵr Cymru is assumed to be dominant in the (upstream) market for the *transportation* of non-potable water for supply to industrial customers in the geographical area served by the Ashgrove system, the principal issue in the case is whether Dŵr Cymru has abused that dominant position so as to eliminate or significantly impede competition in the (downstream) market for the supply of non-potable water to industrial customers in that area, that downstream market for the *supply* of non-potable water being a market within which Albion and Dŵr Cymru are actual or potential competitors. The distinction between the upstream supply of transportation services, on the one hand, and the downstream supply of the water itself, on the other hand, needs to be kept in mind."

Evidence submitted by Dŵr Cymru in February 2006

25. In Jones 2, dated 20 February 2006, Mr. Jones discusses alternative means of supplying Shotton Paper at paragraph 18 onwards. Mr. Jones refers to "Option A", which is the replication of the existing Ashgrove system as a "standalone project". However, Mr. Jones states that there are at least three other options. He states:

> "Option B: instead of taking water from Heronbridge, it may be possible to purchase the water from United Utilities at, or close to, its Sutton Hall treatment works, which itself is fed inter alia by United Utilities' side of the Heronbridge abstraction works. The attached map at Exhibit CJ-A shows the location of the

works. Examination of this location on other maps of the surrounding area, such as the map provided by Albion in its Notice of Appeal (Annex 12/104), suggests that the Sutton Hall works is no more than 8km from the Shotton site, a distance over 8km shorter than the total length of the Ashgrove main. The effect of using a shorter length of main would be to save around £4.5m, assuming similar unit costs for the construction of the main to those presented in Annex 2 in connection with Option A. This would represent a reduction in the standalone price of around 9p/m³ (again using the assumptions presented for Option A – see Annex 2);

Option C: use of the boreholes owned by the steelworks next door to the Shotton site. Although Albion has asserted that this option is not feasible, the steelworks has been actively looking to exploit their potential for some time. It has now informed Dŵr Cymru that it is re-starting the boreholes and intends shortly to install a reverse osmosis plant to treat the water. Based on my knowledge of typical costs, I estimate that water could be abstracted, treated for hardness (assuming that were necessary), and delivered to the Shotton site for less than 12 p/m³. This cost includes the water, as well as the transportation, and is therefore comparable with the whole price paid by Albion, not just the proposed price for the common carriage element (see Annex 3); and

Option D: direct abstraction from the Dee. Shotton is located no more than l km or so from the Dee estuary. In order to treat estuary water to acceptable standards, reverse osmosis would almost certainly be required. If, however, reverse osmosis is economically feasible for the steelworks (see Option C above) then in my view it is likely to be feasible as part of a direct abstraction option.

Further, it is clear that this list is by no means exhaustive. Both the Director and Albion have made references to potential alternative sources, such as the Milwr Tunnel."

26. Annex 3 to Jones 2 refers to the contact between Ms Cross and Corus in April 2004. The view is there expressed by Mr. Jones that, although Dŵr Cymru is not in a position to carry out a detailed feasibility study, there would be a surplus of water of adequate quality from the Corus boreholes that would be available to supply Shotton Paper. That would be substantially cheaper than supply from the Ashgrove system, according to Mr. Jones.

27. Mr. Jones sets out Dŵr Cymru's "stand alone" calculation of the cost of replicating the Ashgrove system at Annex 2 to Jones 2. Dŵr Cymru considers the rate of return that

would be required by a reasonable investor would be 17.5 per cent. In forming that view, Dŵr Cymru took into account the following factors:

> "• the Deeside industrial park is not close to any significant towns or cities. Were either or both customers for non-potable water to shut down, it is possible that other potential water users would occupy the land in due course, but there is no guarantee that they would require much water at all, let alone non-potable water. Therefore, for the hypothetical service provider there would be a high probability that closure of the two plants would lead to the permanent "stranding" of the project, with no obvious alternative use for the non-potable water at Sealand in prospect;
>
> • the market perception of the credit risks of the two customers is not very favourable. The parent company for the paper mill has a BBB credit rating with Standard & Poors, which means that it "exhibits adequate protection parameters", but "adverse economic conditions or changing circumstances are more likely to lead to a weakened capacity of the obligor to meet its financial commitment". The credit rating for the steelworks' parent company is B+ from Standard & Poors, which puts it in the category of "junk" status and implies that the company's credit has "significant speculative characteristics".
>
> • since neither customer would be expected to be able to raise finance for a term anything like approaching the assumed life of the principal asset, the Ashgrove main, in practice it is similarly unlikely that an Ashgrove system service provider would be willing to extend, in effect, credit for the long term. In other words, in practice the provider would be looking to accelerate recovery of its investment, most probably by seeking a partial or full up-front capital contribution. This is common practice in the water industry. However, for the purposes of this exercise this complication is ignored, and we have assumed that a rate of return could be found that would be sufficient to satisfy investors and creditors that a long term investment was worthwhile;
>
> • Albion's own inset appointment application provides evidence of a particularly high required rate of return. The application shows "proforma" annual profits after tax of £109,175 (of which the non-potable side would contribute £90,679) on a capital investment which is shown as £24,000. This represents a return of over 450 per cent. It is likely that Albion incurred "up-front" costs in preparing for the inset application which were not shown in the application, but even if these were as high as £100,000, the proposed rate of return would still have approached 90 per cent;
>
> • it is my recollection that, during the late 1990s, when Dŵr Cymru was part of a wider corporate group that carried out private water supply projects both in the UK and abroad, a hurdle rate of return of 12 per cent (post-tax) was commonly used to evaluate projects;

• according to Albion, this is similar to the required rate of return of Pennon Group plc, Albion's ultimate parent in 2000/01, for projects of this nature. Albion submits that the company required a post-tax rate of return of at least 14 per cent, equivalent to a pre-tax rate of return in excess of 20 per cent;

• Dŵr Cymru's treasurer has made inquiries of a number of financial institutions with whom Dŵr Cymru has relationships and was informed that typical market rates of return for "private finance initiative" sewage treatment works are in the "early teens". Such projects have the benefit of Government backing, and would therefore be indicative of what rate of return might be required by the Ashgrove service provider if the customers were Government-backed; and

• most recently, Suez Environment (former owners of various undertakers in England) reported that its rate of return on capital employed in its European water business in 2004 was 17.7 per cent.

28. According to Mr. Jones, on the basis of a return on capital of 17.5 per cent, the equivalent annual cost of the project, calculated on a repayment basis assuming a life for the main of 100 years, for civil works of 60 years, and for mechanical and engineering works of 20 years, would be equivalent to 32.4p/m³. According to Mr. Jones, the capital cost of replicating the Ashgrove main in 2000/01 would have been £9.4 million, while the capital cost of replicating the treatment works would have been £3.3 million, giving a total capital cost of £12.7 million. That calculation does not take account of various further items of cost, namely:

"• the costs of compensation to landowners, land purchase costs, planning constraints/conditions, access costs, etc.

• any significant "in life" maintenance work which might be required for any of the assets;

• the lag between the time when capital expenditure is incurred, and revenues from the service begin to be earned;

• scientific services (i.e. water sampling and analysis) costs;

• regulatory costs, including the licence fee to Ofwat (if the service provider is an undertaker) and the costs of complying with regulatory requirements set by both Ofwat and the Environmental Agency;

• any contribution to other miscellaneous cost items, such as IT, administrative support, marketing, and research and development; and

• any contribution to the financing of the service provider' s (otherwise unviable) statutory obligations (if any)."

(Jones 2, paragraphs 28 to 29)

Dŵr Cymru's application of 20 April 2006

29. On 20 April 2006, Dŵr Cymru applied to the Tribunal for a ruling that, in the event of the Tribunal deciding to set aside the Decision or any part of it, the Tribunal would not exercise its power under paragraph 3(2)(e) of Schedule 8 of the Act "to make any decision which the Director could himself have made" and take an infringement decision. Applying *Burgess v OFT* [2005] CAT 25 Dŵr Cymru submitted: (i) the Tribunal was not best placed to obtain the necessary material; (ii) it would be procedurally unfair and contrary to Dŵr Cymru's rights of defence; and (iii) would not lead to expedition or cost savings. Albion submitted that Dŵr Cymru's arguments were premature and unmeritorious. At the case management conference on 24 April 2006, the Tribunal did not make an order as sought by Dŵr Cymru, but indicated that the hearing in June 2006 would not deal with the issues of market definition and dominance.

The Authority's evidence for the hearing in June 2006

30. In its paper of March 2006 in support of Professor Armstrong's first report, the Authority stressed that "water distribution exhibits strong natural monopoly characteristics", as a result of its capital-intensive nature, the high costs of duplicating an existing network, and the large economies of scale (paragraph 22).

31. The Authority also stressed the danger to the industry of "stranded assets": see for example, paragraphs 20, and 45 to 46 of that paper. Strong reliance was also placed by the Authority on paragraph 187 of the Consultation Paper, as reflecting Government policy to avoid stranded assets. References to the need to prevent infrastructure and stranded asset costs falling on the incumbent's remaining customers are also to be found in the Parliamentary debates to which the Authority referred us. In his witness statement (e.g. at paragraphs 28, 29 and 33) Mr. Hope emphasised the importance the Authority attached to avoiding stranded assets.

32. The evidence of Professor Armstrong on behalf of the Authority proceeded on the basis that network infrastructure in the water industry was a natural monopoly. For example, according to Professor Armstrong "competition is rarely feasible or desirable in network infrastructure" (Professor Armstrong's first report, p.2). Dr. Marshall fully

agreed with Professor Armstrong on this point, expressing the view that "access is an essential facility, which both incumbents and competitors need to use" (Dr. Marshall's first report, p.5).

33. The Authority, in its skeleton argument for the June 2006 hearing, considered that Mr. Jones had adopted the correct approach in the "standalone" cost calculation he provided (p. 73). The Authority however considered that a return on capital of 15 per cent would be more reasonable. That would give a cost of replicating the Ashgrove pipeline of around 25.0p/m³ on the basis suggested by Mr. Jones. On that basis the capital costs of replicating the main and treatment works would be around £8.5 million. According to the Authority, those calculations are not comparable to those in Annex I of the Decision, primarily because those scenarios were developed on an "incremental decision making basis" (p. 126). According to the Authority, regulatory estimates of the cost of capital for water companies "would not reflect the inherent risks associated with the standalone project" (p. 133).

The parties' position at the June 2006 hearing

34. In his answers in cross-examination on behalf of Dŵr Cymru, Dr. Bryan gave evidence on behalf of Albion to the effect that, to build an alternative pipeline, it would be necessary: to find land that had not been developed; to negotiate to obtain easements and wayleaves; to make substantial excavations; to deal with "huge complications" in terms of the river crossing; and to deal with the "even bigger complications" of the fact that Shotton Paper is surrounded by contaminated land containing tars and phenols from old coking works (Day 1, pp. 67 to 69). Dr. Bryan also drew attention to a study by Bechtel which costed a new pipeline and ancillaries at £9.7 million.

35. Albion submitted that Shotton Paper could have only three alternatives: (a) some sort of desalination of water out of the sea, (b) boreholes proximate to the sea, or (c) an alternative pipeline. There was no evidence that (a) or (b) were feasible and it was obvious that (c) was not either. There was no basis for saying there was any short-term alternative to the current monopoly supplier. No further evidence was needed on this point. The Tribunal should take account of the strain of litigation on a small supplier

facing a dominant undertaking. In Albion's submission, the finding the Tribunal should make on the issue of dominance is "blindingly obvious".

36. Albion further submitted that it was entirely appropriate, in a test case of this kind, for the Tribunal to take a final decision on whether or not there had been an infringement. As to the suggestion that this would be possible only if a statement of objections is first served by a regulatory authority, that is not the practice in the High Court: see *Attheraces v British Horseracing Board* [2005] EWHC 3015. It would be remarkable if the Tribunal, a specialist body, which had now been seized with the case for 2½ years, had held two major hearings and had before it a wealth of material, was not able to take a decision that the High Court could take in civil proceedings.

37. The Authority's position at the hearing in June 2006 was that it "would have expected a considerable more [sic] amount of evidence and argument before it could have reached a view on dominance" (Day 6, p.80). However, in an admittedly different part of its submissions the Authority also said: "Water distribution we say is a natural monopoly… [Due] to the capital intensive nature of the industry, the high cost of duplicating existing network, [and] the large economies of scale, water distribution exhibits strong natural monopoly characteristics" (Day 5, p.69).

38. As regards Dŵr Cymru, at the close of the hearing in June 2006 the Tribunal indicated to Dŵr Cymru that it did not feel able to rule out the possibility that it may wish to decide the issue of dominance, pointing out notably that aspects of Dŵr Cymru's evidence were potentially relevant to that issue. The Tribunal particularly wished Dŵr Cymru to appreciate that, if it made findings on the evidence placed before it by Dŵr Cymru, that could have a potential impact on the subsequent issue of dominance, were the Tribunal to decide that point. The Tribunal invited Dŵr Cymru to consider whether it wished to put in any evidence or submissions on the issue of dominance. Dŵr Cymru's response was that it understood a possible "read across" from other issues to the issue of dominance, and would consider the matter. Dŵr Cymru's primary position, however, was that the Tribunal should not deal with dominance, and that further evidence on dominance would be required (Day 6, pp. 94-97).

39. United Utilities submitted that the question of Shotton Paper being supplied from an alternative source was discussed with Albion from 1999 but did not proceed because United Utilities understood that Shotton Paper was unwilling to provide the necessary financial commitment. In United Utilities' submission, the Tribunal should either accept the Director's conclusion on the viability of an alternative pipeline or investigate the position fully.

40. It emerged in cross-examination of Mr. Jones, on behalf of United Utilities, that Option B in Jones 2 (a new pipeline from Sutton Hall) had not been discussed with United Utilities, and that no feasibility exercise had been carried out (Day 3, p. 46).

The correspondence in June and July 2006

41. On 19 June 2006 Dŵr Cymru wrote to the Tribunal to the effect that were the appeal to succeed on issues of abuse, there would need to be a further case management conference to consider how any issues of market definition and dominance should be addressed.

42. On 20 June 2006 the Tribunal wrote to the parties indicating its view that these proceedings should be brought to a conclusion as soon as reasonably practicable in one final judgment, particularly in view of the imbalance of resources between the parties. The Tribunal invited any further submissions by Dŵr Cymru, the Authority or United Utilities on the issues of relevant market or dominance, to be lodged with the Tribunal by 11 July 2006.

43. On 30 June 2006 the Authority responded to the Tribunal's letter of 20 June expressing doubt as to the ambit of the Tribunal's powers under paragraphs 3(2)(d) and 3(2)(e) of Schedule 8 to the 1998 Act to rule on the issue of dominance given that, in the Authority's view, the Authority was not in a position to reach a conclusion on dominance without further investigation and giving Dŵr Cymru an opportunity to respond. In the Authority's view, the Tribunal was not in a position to do so either, and contended that issues of market definition and dominance were outside the scope of the appeal. The Authority drew attention to the Tribunal's position at the case management conference of 24 April 2006 to the effect that market definition and

dominance would not be dealt with at the June hearing, and submitted that the Tribunal should do nothing until further submissions had been received following the Tribunal's judgment. Since the Authority did not consider that the issue of dominance fell for determination as part of the appeal, the Authority did not propose to submit any further evidence or submissions on the issue of dominance.

44. In a letter to the Tribunal of 3 July 2006 Dŵr Cymru submitted an application for permission to appeal the Tribunal's letter of 20 June 2006, on the basis that the Tribunal had no jurisdiction to rule on the issues of market definition or dominance, or that, if it did have such jurisdiction, it would not be a legitimate exercise of its discretion to do so. Dŵr Cymru's essential argument was that the Tribunal's powers under paragraphs 3(2)(d) and 3(2)(e) of Schedule 8 to the Act are limited to a decision that the Director could have made. In this case a decision could not have been made without further investigation by the Director and the issue of a statement of objections to Dŵr Cymru. On the issue of discretion, Dŵr Cymru submitted that the Tribunal is not best placed to obtain the necessary material, that it would be procedurally unfair, and that considerations of cost and expedition do not alter the position.

45. In a letter to the Tribunal of 5 July 2006, Albion contended that Dŵr Cymru was "now engaged in a war of attrition in which it is prepared to advance increasingly shrill procedural complaints", and invited the Tribunal to take a robust approach. Albion drew attention to the Director's letter of 26 June 2002 following Albion's application under section 47 of the Act:

> "We do not accept that we have made a CA98 decision on the relevant issues. But I have spoken to Philip Fletcher and we both have some sympathy with your view that you need a fully reasoned decision. The case does appear to raise important issues relating to common carriage generally and the calculation of access prices. I agree that it is important, both to you and the industry as a whole, that our detailed thinking on this issue is publicly available, and open to challenge before the Competition Commission Appeal Tribunals ("CCAT"), if necessary.
>
> I have therefore decided to re-open our file, investigate the points that concern you, and complete the further work necessary to issue a formal CA98 decision. This decision will be fully reasoned, will cover all the relevant aspects of your complaint, and will be published."

46. Albion submits that the Authority had all along been aware of the issues of market definition and dominance, and had investigated those issues which are discussed over some 130 paragraphs of the Decision. Copies of the section 26 requests to Albion, Dŵr Cymru and United Utilities show that the Director sought evidence about facts bearing on the issues of market definition and dominance. Albion submits that none of the caveats set out in the Decision on these issues withstand scrutiny. Dŵr Cymru had the opportunity of presenting evidence on the issue of dominance in reply to the Director's first request under section 26 on 29 June 2001, and subsequently. Albion notes the evidence of dominance before the Tribunal, including Dŵr Cymru's unilateral decision to increase its prices to Corus, and submits that no further investigation of those issues is necessary before the Tribunal is in a position to rule on the question of dominance.

47. In a letter to the parties of 17 July 2006, the Tribunal stated:

> "The purpose of the Tribunal's letter of 20 June 2006 was to ascertain whether there was further evidence or submissions that the parties might wish to submit on the issue of market definition and dominance, should the need arise for the Tribunal to consider whether to address that issue. The Tribunal was, and is, of the view that as a matter of case management it is better, and fairer, for the Tribunal to ascertain whether there is further relevant factual material relevant to the issue of market definition and dominance, while the matters are still fresh in everyone's mind, given that the Tribunal in its judgment may make findings on matters that are relevant to issues of dominance (see Transcript, day 6, pp 94-95).
>
> The position taken by the Authority and Dŵr Cymru is, however that: (a) the Tribunal has no jurisdiction to consider any factual material on the issue of dominance; and (b) in any event, the Tribunal should not consider any such material. That stance clearly sets out the position of the parties with regard to the Tribunal's invitation.
>
> Should the need arise, the Tribunal will rule on those points in a reasoned judgment which the parties may or may not wish to appeal. Unless and until it has reason to do so the Tribunal has not taken, and will not take, a decision either to accept or reject the submissions made by the parties in the letters of 30 June 2006 and 3 July 2006 (including those made by Dŵr Cymru on 24 April 2006)."

The main judgment of 6 October 2006

48. In the main judgment of 6 October 2006 the Tribunal, at paragraph 984, expressed the view that:

> "it is highly unsatisfactory for the issue of dominance to be left as it is, and for the issue of dominance to have become "detached" from the issues relating to abuse. A good deal of evidence bearing on the issue of dominance that was not before the Director is now before the Tribunal. In those circumstances the Tribunal proposes to consider with the parties how the matter of dominance should now be handled. To facilitate that consideration, Annex A to this judgment summarises non-exhaustively matters potentially relevant to the issue of dominance and to the most appropriate course to adopt in that regard."

The hearing of 24 October 2006

49. The matter of dominance was accordingly further ventilated at the hearing before the Tribunal of 24 October 2006.

50. In its skeleton argument for that hearing Albion reiterated that it seeks from the Tribunal, among other things, declaratory relief to the effect that:

> "Dŵr Cymru is dominant in the market for transportation of non-potable water for supply to industrial customers in the geographic area served by the Ashgrove system".

51. Albion submitted that at paragraphs 20 and 217(b) of its notice of appeal it requested the Tribunal itself to determine the matter of infringement, including the existence of a dominant position, pursuant to Schedule 8, paragraphs 3(1) and (2) of the 1998 Act. Albion considered that the Authority's failure to decide the matter itself, after three years of investigation, is a further reason for the Tribunal to take its own decision.

52. On the substance of the issue of dominance, Albion repeated its previous submissions and contended that the evidence on dominance is overwhelming, including the evidence of Dŵr Cymru and the Authority on standalone costs, and the expert evidence of Professor Armstrong and Dr. Marshall which was predicated on the existence of very high barriers to entry and a monopoly in network infrastructure. Albion submitted

that the matter was so clear that it was unnecessary to remit the matter for the Authority to have "another chew on the bone of dominance".

53. The Authority submitted that the appropriate course was for the Authority to investigate the issues of dominance alongside any other issues to be investigated, either by way of remittal or by way of further investigation pursuant to rule 19(2)(j) of the Tribunal's Rules. The Authority identified various matters relating to market definition and the possibility of alternative suppliers which, in its view, would require further investigation before the issue of dominance could be decided.

54. The Authority initially told the Tribunal that, in its view, there was "a serious question" as to whether dominance exists or not (transcript, p.31). However, after the short adjournment the Authority stated that that "may have given the wrong impression". In the Authority's view, the issue was primarily one of process, namely that the Authority did not feel it could come to a final view on dominance without giving the parties the opportunity to comment on the issues upon which, so far, it had taken no position.

55. Dŵr Cymru considered that issues of dominance should be dealt with in the first instance by the Authority, for the reasons given in its letter of 3 July 2006. Dŵr Cymru maintained its submissions as to the jurisdiction of the Tribunal, although accepting that, in the Decision, the side of the fence on which the Director came down "is probably more dominance than not". Dŵr Cymru understood the Tribunal's concerns about the issue of dominance, but still considered that the Tribunal was without jurisdiction to "nail the jellyfish". An alternative would be to refer dominance back under Rule 19(2)(j), together with other issues.

56. United Utilities supported the position of Dŵr Cymru, and emphasised that the Tribunal did not need to decide the issue of dominance. United Utilities considered that there were a number of further matters that would need to be investigated, including the feasibility of an alternative pipeline. United Utilities pointed out that during the administrative procedure it stated to the Director that it was not in a position to comment on the commercial feasibility of duplicating the Ashgrove system.

The Tribunal's ruling of 24 October 2006

57. In its ruling of 24 October 2006 [2006] CAT 25 the Tribunal decided that it was necessary to have a further hearing on the issue of dominance for the reasons given in paragraphs 1 to 8 of that ruling. It was then suggested by Dŵr Cymru, and accepted by all parties, that the issue of dominance could be dealt with in writing.

The arguments submitted subsequently to 24 October 2006

58. Albion submits that Dŵr Cymru is not only dominant, but "superdominant" (see *Napp Pharmaceutical Holdings Limited v. Director General of Fair Trading* [2002] CAT 1, paragraph 219), whatever market definition is adopted.

59. Albion considers that the relevant geographic market is the geographic area served by the Ashgrove system, which is the starting point assumed by the Director (paragraph 101 of the Decision). However, whether or not a wider geographic market is appropriate, for example to include the geographic area of England and Wales served by Dŵr Cymru, Dŵr Cymru would still have 100 per cent of that market. The suggestions in paragraph 213 of the Decision to the effect that the market could be considered to include customers other than Shotton and Corus, infrastructure other than the Ashgrove system, or the whole of the relevant water resource zone, are unsupported by any evidence. The fact that, whatever the relevant market, Dŵr Cymru has had for many years a stable market share of 100 per cent, points to an overwhelming presumption of dominance: Case 85/76 *Hoffman-La Roche v. Commission* [1979] ECR 461, at paragraph 41; Case 62/86 *AKZO v. Commission* [1991] ECR I-3359; OFT 422 at paragraph 3.10; OFT 415 at paragraphs 2.11 to 2.12.

60. According to Albion, the Director's suggestion that Dŵr Cymru's dominant position is negated by potential competition from Albion is ludicrous. As to United Utilities, the latter has never evinced any intention of entering the market and has never attempted to do so. The very preliminary discussions about investing in a new pipeline were not live in 2004, and United Utilities has indicated that it is not its intention to invest in a new pipeline. Moreover, United Utilities is involved in a number of commercial

interactions with Dŵr Cymru. In relation to absolute advantages enjoyed by Dŵr Cymru, Albion points out that Dŵr Cymru has an existing pipeline, whereas any new entrant would have to build a new pipeline at very significant cost, and that Dŵr Cymru has an existing source of supply (from United Utilities) at an advantageous price. The Director's conclusion at paragraph 138 of the Decision that Dŵr Cymru did not benefit from any absolute advantages preventing Albion (or United Utilities) from entering the market was utterly misconceived, according to Albion.

61. As to strategic advantages, Albion submits that the Director's conclusion, at paragraph 176 of the Decision, that the need to construct new infrastructure would not be sufficient to constitute a barrier to entry, is unsustainable. That approach confuses the question whether a barrier to entry exists with whether or not that barrier is "insuperable". The need to construct an alternative pipeline is a substantial barrier to entry which would, in any practical sense, be insuperable. The Director's analysis of viability at paragraphs 142 to 175 of the Decision also wrongly assumes that there would be no competitive response from Dŵr Cymru, and that a long term contract with Shotton Paper would be in place. A similar confusion between what is a barrier to entry and what is an "insuperable" barrier is also apparent in the Director's treatment, at paragraph 189 of the Decision, of the time needed to construct new infrastructure. The delay that would be involved, combined with the short period of notice applicable to Albion's inset appointment, constitutes a very significant strategic barrier for Albion. The cases referred to by the Director at paragraph 188 of the Decision were in a completely different context. Furthermore, the Director's analysis of exclusionary conduct by Dŵr Cymru at paragraphs 192 to 203 of the Decision overlooks the fact that Dŵr Cymru offered Albion a retail margin of zero. In addition, the conclusion at paragraph 204 of the Decision that Shotton Paper may have countervailing buyer power is wrong, since Shotton Paper has no viable alternative source of supply: see also the Environment Agency's letter to Albion dated 20 October 2006. Finally, says Albion, Dŵr Cymru's own conduct shows that it is able to act to an appreciable extent independently of its competitors, customers and consumers.

62. The Authority submits that it would not be "a useful expenditure of public resources" for the Tribunal to determine whether the Authority was correct in its assumption of

dominance and associated observations. The Authority did not make, and did not intend to make, any finding of dominance in the Decision.

63. The Authority considers that the observations in the Decision would not be adequate if a finding on market definition and dominance had now to be made. According to the Authority, before such a finding could be made it would be necessary to investigate (i) whether there are separate markets for the transportation of the relevant water and the treatment of that water (paragraph 93 of the Decision); (ii) whether the geographic market should include customers not currently served by the Ashgrove system (paragraph 97 of the Decision); (iii) whether the geographic market should include infrastructure other than the Ashgrove system (paragraph 98); (iv) whether the geographic market should be extended to the relevant water resource zone (paragraph 99); (v) whether the construction of duplicate infrastructure would be viable and the associated issue of essential facilities (paragraphs 113-117, 123-132, 142-192 and Annex I of the Decision); (vi) whether other potential entrants could supply Shotton (paragraphs 119, 209, 213-214 of the Decision); (vii) whether Shotton has access to boreholes (paragraph 205) of the Decision); (viii) whether the regulation of related charges constrains the setting of access prices, although the Authority "does not think this issue would require much work" (paragraph 211 of the Decision); (ix) whether Dŵr Cymru felt constrained by the emergence of Albion (paragraph 212 of the Decision); and (x) whether uncertainties on market definition could affect dominance (paragraph 215). Although the Authority does not consider that "a voluminous investigation would necessarily have to be undertaken" it would need, before taking a definitive position, to seek the views of the parties on these issues and to seek information notably from Shotton Paper, Corus, the Environment Agency, United Utilities and Dee Valley Water.

64. In particular, according to the Authority, Dŵr Cymru would need to be asked for its views, and the evidence before the Tribunal regarding the costs of replicating the Ashgrove system, which is at variance with the assumptions in the Decision, would have to be taken into account. According to the Authority, the Tribunal would not be in a position to make a finding on dominance, because a sufficiently reasoned decision would require the above issues to be considered, albeit that voluminous work would not be required, and the parties given the opportunity to make representations. The

Authority also maintains its position that the Tribunal has no jurisdiction to decide the issue.

65. Dŵr Cymru submits, first, that the Tribunal has no jurisdiction to determine the issue of dominance, on the grounds previously submitted. That issue should be determined first by the Authority, taking into account the guidance given by the Tribunal in its judgment of 6 October 2006. Otherwise, says Dŵr Cymru, that issue would be determined without the benefit of highly relevant information from Shotton Paper, Corus, Dee Valley and the Environment Agency which only the Authority can obtain. In addition, the "two tier" structure under the 1998 Act would not be respected. Moreover, says Dŵr Cymru, the Tribunal is under no obligation to determine every point raised in the notice of appeal. In any event Dŵr Cymru did not understand the Tribunal to require "a fully fledged defence" by Dŵr Cymru of why it is not dominant, a course which would "reverse the burden of proof".

66. According to Dŵr Cymru, the Director's approach of reaching no final conclusion on market definition was entirely in accordance with European and national practice, and endorsed by the Tribunal in *Freeserve v Director General of Telecommunications* [2003] CAT 5. Before making any finding of abuse, the Director would have had the burden of proof of establishing all the elements of dominance on the basis of "strong and compelling evidence."

67. In that context, a thorough investigation of alternative potential suppliers would be necessary. In addition to the examples given in Jones 2 (replication of the Ashgrove facilities, purchasing water from United Utilities Sutton Hall treatment works, use of Corus boreholes, or direct abstraction from the Dee estuary), further possibilities might be to refurbish and use the old pipeline formerly used to transport potable water from Sealand to the Wirral; to recycle water at the Shotton Paper site; or to transport water from other abstraction points, e.g. in Chester. The possibility of self-supply would also have to be investigated. The views of other water undertakers, holders of abstraction licences, specialist water recycling and efficiency companies, the Environment Agency, and industrial customers such as Shotton and Corus would have to be sought before a definitive decision could be taken. The fact that a customer deals with only

one supplier at a time does not of itself imply dominance: a full market analysis would be required.

68. United Utilities submits that the Tribunal's concern that there has been no determination of the issue of dominance is "wholly understandable"; nonetheless, "hard cases make bad law".

69. United Utilities supports the submissions that the Tribunal has no jurisdiction to determine the issue of dominance, and submits that that issue should be remitted to the Authority in such a way that the Authority would be able to give a speedy response. If, contrary to United Utilities' submission, the Tribunal were to determine the issue of dominance itself, the Tribunal should proceed with utmost caution, and would have to consider: (i) other water resources within a radius wide enough to encompass Heronbridge; (ii) information from the Environment Agency and others on other possible abstraction points on the River Dee, and on existing and potential boreholes; (iii) the possibility of abstracting water from the Shropshire Union Canal; (iv) the possible Milwr Tunnel source; or (v) recycled water. In addition "a detailed engineering exercise" would be necessary to determine the viability of constructing alternative infrastructure. The possibilities of supplies being made available from other water undertakers, from businesses with their own supplies, by Shotton Paper itself (self-supply), and by Albion pursuant to a licence under the WA03 would all have to be investigated. According to United Utilities, the alternative pipeline proposal to which the Boulton report refers was not pursued because of Albion's preference for common carriage, and not because of unwillingness on the part of United Utilities.

III DOMINANT POSITION: PRELIMINARY

Should the Tribunal consider the issue of dominance?

70. The first question that arises is whether the Tribunal should consider the issue of dominance at all. In our view we should do so. First, the issue of dominance has been raised in the notice of appeal, together with the closely associated question of essential facilities. Throughout these proceedings Albion has consistently argued that the Director was in error in expressing doubts on whether Dŵr Cymru enjoyed a dominant

position, and in rejecting Albion's argument that the Ashgrove system was an essential facility. Those arguments in our view expressly or by necessary implication form part of the grounds set out in the notice of appeal to be determined by the Tribunal on the merits in accordance with paragraph 3(1) of Schedule 8 of the 1998 Act.

71. It is true, as the Court of Appeal has pointed out in *Argos and Littlewoods v Office of Fair Trading* [2006] EWCA Civ 1318 at paragraph [6], that the Tribunal is not required to decide every point raised in appeals before it. However, the issue of dominance is of fundamental importance to the potential application of the Chapter II prohibition, and is a central issue raised by the appellant. Although the Director considered it was not necessary to reach a final view on dominance as long as there was no abuse, the Tribunal's main judgment shows that the latter assumption can no longer be safely made. Accordingly, Albion's submissions on dominance assume an importance they would not otherwise have had. In those circumstances it would not be right, in our view, simply to ignore the submissions that Albion has made to us.

72. Moreover, the treatment of dominance in the Decision may well have a major influence on other decisions the Authority may take, on the approach to be taken by the competition authorities in the United Kingdom and elsewhere, and on courts before whom similar issues may be litigated, not least in any subsequent civil proceedings between the parties to this case. In those circumstances, in our view it is necessary to have as much clarity as possible on the issue of dominance as it arises on the facts before us.

73. Those considerations militate strongly in favour of the Tribunal addressing the issue of dominance. Similarly the water industry, and those who advise undertakings in it, need so far as possible to know where they stand. As paragraph 170 of the defence expressly confirms, this case is a test case in which the Director - very fairly – set out his reasoning in full precisely so that it could be challenged.

74. The Decision deals with dominance over some 30 pages, and the Director conducted a very full investigation of that issue. Indeed, for the first two and a half years of the administrative procedure, from 2001 to 2003, the Director focussed almost entirely on

dominance and essential facilities, producing a draft decision in June 2003 that focussed only on those issues.

75. Yet, as already set out above, the Decision remains equivocal on the issues of dominance. That is, in our judgment, unfortunate particularly since the issue of dominance in a case such as the present is not intrinsically difficult to resolve. Despite the Authority's late submission that its concern was principally one of "process" – with the implication that the Authority did not really have much doubt on the issue of substance – and despite Dŵr Cymru's concession that the Director had found "more dominance than not", we think it unsatisfactory if the issue of dominance is simply left up in the air. It would also, in our view, be very unfortunate, in a case such as the present, if the system set up by the 1998 Act could not deliver a more definitive analysis of dominance after six years of investigation and appeals.

76. For those reasons the Tribunal considers that it should, so far as it properly can, consider the issue of dominance.

What are the Tribunal's powers to address dominance?

77. Paragraph 3 of Schedule 8 of the 1998 Act provides so far as relevant:

> "(1) The Tribunal must determine the appeal on the merits by reference to the grounds of appeal set out in the notice of appeal.
>
> (2) The Tribunal may confirm or set aside the decision which is the subject of the appeal, or any part of it, and may—
>
> (a) remit the matter to the [Authority[2]],
>
> (b) impose or revoke, or vary the amount of, a penalty,
>
> (c) . . .
>
> (d) give such directions, or take such other steps, as the [Authority] could itself have given or taken, or
>
> (e) make any other decision which the [Authority] could itself have made.
>
> (3) Any decision of the Tribunal on an appeal has the same effect, and may be enforced in the same manner, as a decision of the [Authority].

[2] The Authority in this case exercises the power of the OFT pursuant to section 54 of the 1998 Act.

(4) If the Tribunal confirms the decision which is the subject of the appeal it may nevertheless set aside any finding of fact on which the decision was based."

78. The Authority and Dŵr Cymru argue that the Tribunal has no jurisdiction to address the issue of dominance, largely on the ground that the Tribunal is not in a position to "make any other decision which the [Authority] could have made" within the meaning of paragraph 3(2)(e), since no statement of objections regarding dominance has ever been served against Dŵr Cymru.

79. In our view, the first answer to this submission is that, in addressing the issue of dominance (and essential facilities) set out in the Decision at paragraphs 86 to 225, the Tribunal's first task is to decide whether it should "confirm or set aside the Decision…or any part of it" in accordance with the first sentence of paragraph 3(2) of Schedule 8. That involves an analysis of the contents of the Decision and does not involve, at that stage, "taking any other decision" that the Authority could have taken under paragraph 3(2)(e). We therefore, in the first instance, consider whether we should "confirm or set aside" any part of the Director's analysis of dominance and essential facilities in the Decision. We consider later in this judgment the effect of paragraph 3(2)(e).

80. As explained above, the Tribunal made it clear at the end of the hearing in June 2006 that it did not rule out considering the issue of dominance, and invited Dŵr Cymru to consider whether it wanted to put in submissions on that issue. By letter of 20 June 2006 the Tribunal invited submissions from the parties on the issue, but both Dŵr Cymru and the Authority raised procedural objections. The Tribunal deferred the matter, but made it clear in the main judgment of 6 October 2006 that it wished to revert to the issue of dominance, setting out in Annex A to that judgment certain matters it considered relevant to that issue.

81. Following the Tribunal's further ruling on 24 October 2006, the parties made submissions on dominance. At Dŵr Cymru's suggestion that was done in writing, although the Tribunal had offered a hearing. In these circumstances the Tribunal considers that Dŵr Cymru and the Authority have been offered an ample opportunity to be heard on the issue of dominance.

Relevant law

82. As usually defined, a dominant position is:

> "a position of economic strength enjoyed by an undertaking which enables it to prevent effective competition being maintained on the relevant market by allowing it the power to behave to an appreciable extent independently of its competitors, its customers and ultimately of the consumers".

(See Case 85/76 *Hoffman-La Roche v Commission* [1979] ECR 461, paragraph 38; *Genzyme v OFT* [2004] CAT 4, at paragraph 188.) However:

> "such a [dominant] position does not preclude some competition … but enables the undertaking which profits by it, if not to determine, at least to have an appreciable influence on the conditions under which that competition will develop, and in any case to act largely in disregard of it so long as such conduct does not operate to its detriment."

(*Hoffman-La Roche v Commission*, cited above, at paragraph 39.)

83. In order to establish dominance it is necessary to define the market in which dominance is said to exist. As the European Commission's *Notice on Market Definition* OJ 1997 C 372/5 puts it at paragraph 2:

> "Market definition is a tool to identify and define the boundaries of competition between firms … The objective of defining a market in both its product and geographic dimension is to identify those actual competitors of the undertakings involved that are capable of constraining those undertakings' behaviour and of preventing them from behaving independently of effective competitive pressure."

84. In *Aberdeen Journals (No 1)* [2002] CAT 4 at paragraph 97 the Tribunal said that in defining the relevant market:

> "The key idea is that of a competitive constraint: do the other products alleged to form part of the same market act as a competitive constraint on the conduct of the allegedly dominant firm?"

85. In most cases, assessment of dominance will require consideration of the relevant product and geographic markets, market shares, any barriers to, and the likelihood of, new entry, as well as any countervailing buyer power: see generally the European Commission's *Notice on Market Definition*, cited above; OFT 403 *Market Definition*,

December 2004 and its predecessor of March 1999; and OFT 415 *Assessment of market power*, December 2004, and its predecessor of September 1999.

86. As to market shares in the relevant market, the Tribunal held in *Genzyme*, cited above, at paragraph 225:

> "In most circumstances, in the Tribunal's view, a market share of 90% or above, which has continued throughout the period of infringement and is likely to continue for several years, will be sufficient, depending on the circumstances, to infer the existence of dominance: See *Napp*, cited above, at paragraphs [156] to [160], and *Aberdeen Journals (No. 2)*, cited above, at [310], and the cases there cited."

87. As to barriers to entry, in *Genzyme* at paragraph 231 the Tribunal accepted the OFT's submission that the issue is whether entry barriers are sufficiently low that the behaviour of a firm with a high market share is constrained by the threat of new entry. In the Tribunal's view both the credibility and the timeliness of any suggested new entry is likely to be relevant.

88. As to buyer power, that will depend primarily on whether the buyer has any credible alternatives, as the Decision points out at paragraph 208.

The standard of proof

89. The standard of proof under the Chapter II prohibition is the civil standard of the balance of probabilities: *JJB Sports and Allsports v OFT* [2004] CAT 17 at paragraphs 195 to 196, not challenged in the subsequent proceedings in the Court of Appeal.

IV RELEVANT MARKET ISSUES

90. As indicated above, the identification of the relevant market is not an end in itself, but a working tool to assist in the assessment of dominance. The essential purpose is to identify the competitive constraints to which the allegedly dominant firm is subject: *Aberdeen Journals (No 1)*, cited above, at paragraph 97. The relevant market is customarily defined in both its product and geographic dimensions. That is necessary

> "in order to identify those actual competitors of the undertakings involved that are capable of constraining the undertakings' behaviour and of preventing them from behaving independently

> of effective competitive pressure"
> (The European Commission's *Notice on Market Definition*, paragraph 2)

91. The analysis of the relevant market is thus closely related to the issue of dominance, in which again the question is whether the undertaking is able to behave to an appreciable extent independently of its competitors, its customers and ultimately of the consumers, in accordance with the test set out in *Hoffman-La Roche*, cited above.

92. As the Commission's *Notice on Market Definition* points out at paragraphs 13 to 24, competitive constraints come from three main sources: demand substitutability (i.e. the products which are viewed as substitutes by the customer); supply substitutability (i.e. the possibility of other suppliers who are not yet supplying the relevant products in that market beginning to do so); and potential competition. According to the Commission's *Notice on Market Definition* at paragraph 20, supply side substitutability is not relevant to market definition unless its effect, in terms of effectiveness and immediacy, is equivalent to demand-side substitution. Similarly supply side substitution is not considered at the stage of market definition when such substitution "would entail the need to adjust significantly existing tangible and intangible assets, additional investments, strategic decisions or time delays" (*Notice on Market Definition*, paragraph 23). Neither, according to the Commission, is potential competition taken into account at the stage of defining markets. Both supply side substitutability and potential competition are examined at a later stage, in the context of considering barriers to entry and the issue of dominance (*ibid*, paragraph 24).

93. According to OFT 403, supply side substitution is relevant to market definition where it occurs quickly (e.g. in less than one year), effectively, and without the need for substantial sunk investments (paragraph 3.15). According to the OFT:

> "The OFT will not factor supply side substitution into market definition unless it is reasonably likely to take place, and already has an impact by constraining the supplier of the product or group of products in question. What matters ultimately is that all competitive constraints from the supply side are properly taken into account in the analysis of market power. Whether a potential competitive constraint is labelled supply side substitution (and so part of market definition) or potential entry (and so not within the market) should not matter for the overall competitive assessment. If there is any serious doubt about

> whether or not to account for possible supply side substitution when defining the market and calculating market shares, the market will be defined only on the basis of demand side substitutability and the supply side constraint in question will be considered when analysing potential entry." (paragraph 3.18)

At footnote 36 to paragraph 3.18 the OFT states:

> "Some competition authorities prefer to define markets solely on the demand side, leaving supply side issues to the analysis of new entry. Both approaches are valid and should produce the same conclusions on the question of market power, provided that supply side issues are examined at some point."

94. In relation to the relevant product market, therefore, the main element is demand side substitutability, in relation to which the relative characteristics, prices and intended uses of the products in question will be key considerations (e.g. Commission *Notice on Market Definition*, paragraphs 7, 36 to 43). One important question is whether, and how quickly, customers could change to substitute products in response to price changes. Supply side substitutability and potential competition, unless more or less immediate in effect, belong more conveniently to a later stage of the analysis, when considering barriers to entry.

95. As regards the geographic market, the analysis will focus mainly on identifying the geographic area in which it would be feasible for customers to switch to other suppliers (e.g. because of low transport costs) and over what time period. Again, a key consideration is how far suppliers in neighbouring areas represent a competitive constraint to the undertaking in question. According to OFT 403, when defining the geographic market, supply side substitution is analysed using the same conceptual approach as for the product market (paragraph 4.5). On that approach, supply side substitution which involves new investment or time delays is not relevant to the definition of the geographic market. According to the Commission, as regards the geographic market "the question to answer is again whether the customers of the parties would switch their orders to companies located elsewhere in the short term and at negligible cost" (*Notice on Market Definition*, paragraph 29).

The underlying facts

96. Dŵr Cymru's appointed water supply area covers much of Wales and certain parts of England (Annex 2 to the Decision). Within that area Dŵr Cymru is the only statutory water undertaker appointed under section 7 of the WIA91, apart from Albion whose inset appointment covers only the premises of Shotton Paper. At privatisation in 1989, Dŵr Cymru inherited the water resources and infrastructure (reservoirs, pipes, treatment works, etc.) which had previously been publicly owned and managed by its predecessor, the Welsh Water Authority. Only appointed water undertakers have statutory pipe-laying powers under the WIA91. Other suppliers who wish to lay pipes over private land have to reach private agreements with the land owners in order to do so.

97. The result is that Dŵr Cymru has, de facto, a monopoly over the network infrastructure needed for the supply of water within its water supply area. The only exception is the case of so-called "private supplies" which arise where the customer has access to a water supply (e.g. a nearby borehole) from which water supplies can be obtained without using Dŵr Cymru's pipes. It follows that, in effect, any customer in Dŵr Cymru's appointed area who does not have access to private supplies, or to some form of alternative infrastructure, is dependent on Dŵr Cymru's network infrastructure for the supply of water.

98. In the present case, the network infrastructure in question is Dŵr Cymru's Ashgrove system which supplies partially treated non-potable water to Shotton Paper and Corus. Those customers have no alternative means of supply unless either (i) private supplies of sufficient quality become available in sufficient quantities, or (ii) some form of alternative infrastructure is constructed. Similarly, Albion, as the statutory inset appointee for Shotton Paper, has no present alternative means of supplying Shotton Paper, other than via the Ashgrove system.

The Authority's position on relevant market

99. Against that background, the Director stated at paragraph 101 of the Decision that

> "we have been prepared to start our analysis of this case on the basis that the market on which Albion Water alleges Dŵr Cymru

> is dominant is that for the transportation via the Ashgrove System and partial treatment of water abstracted from the Heronbridge Abstraction Point to Shotton and Corus."

100. That was potentially a slightly narrower definition of the market than that suggested by Albion, which was

> "the market for the transportation of non-potable water for supply to industrial customers in the geographical area served by the Ashgrove system." (Decision, paragraph 88)

101. The Director did not, however, reach a final view on the relevant market. The Decision left open, at paragraph 93, whether there were separate markets for the transportation and treatment of the water respectively. At paragraphs 97 to 99 of the Decision the Director suggested that the relevant geographic market may be wider than that contended by Albion, possibly as wide as the relevant water resource zone. The Authority submits that neither the Tribunal nor the Authority could take any decision on dominance in this case unless those matters pertaining to the relevant market were further investigated. We reject that submission for the following reasons.

The relevant product market in the present case

102. The Director's working definition of the relevant product market is "the transportation and partial treatment of water". As already seen, the main test to be applied when considering a product market is "demand side" substitution, i.e. how far consumers could easily switch to substitute products. Demand side substitution in the classic sense does not arise in this case in respect of the primary product – water – since the ultimate customers, Shotton Paper and Corus, need water for their production processes and no alternative product will do. Similarly, leaving aside such fanciful suggestions as the use of road tankers, the transportation of water requires pipes and infrastructure. A person requiring the service of transportation of water – here Albion and, indirectly Shotton Paper – must in ordinary circumstances apply to the owner of the infrastructure to supply the transportation service requested, unless they are in a position to self-supply or some alternative infrastructure is available.

103. In the present case, Dŵr Cymru owns, and has owned since 1986, the only infrastructure, namely the Ashgrove system, capable of transporting to Shotton Paper

and Corus the very large volumes of water required by those customers. Similarly, customers elsewhere within Dŵr Cymru's operational area who require the service of the transportation of water (i.e. those who are not in a position to self-supply or have some kind of alternative infrastructure available to them) are in practice dependent on the transportation infrastructure provided by Dŵr Cymru. No demand side substitution arises in this case.

104. The principal suggestion in the Decision is that it would be feasible and economically viable to construct an alternative pipeline, by-passing the Ashgrove system. Dŵr Cymru also suggests that the Corus boreholes could, when operational, supply not only Corus but also Shotton Paper. These possibilities – the realism of which we consider in detail below – represent, at best, a form of supply side substitution. However, even now neither alternative has occurred, more than 5 years after Dŵr Cymru quoted the First Access Price. It is also manifest that neither of these alternatives could come into being except over a significant timescale and as a result of significant investment, as further discussed below. According to the approach in both the Commission's *Notice on Market Definition* and OFT 403, cited above, neither of these theoretical supply side possibilities could be sufficiently immediate or effective to impact on market definition. According to the approach of the Commission and the OFT, those possibilities are relevant, if at all, only to the question of whether Dŵr Cymru was dominant in the relevant market – a question which is analysed below – and not to the prior question of market definition. We see no reason to depart from the analytical approach of the Commission and the OFT on this point.

105. As for the question of whether the partial treatment of water is a separate product market from transportation of water, the customers here in question require both partial treatment as well as transportation since raw water is not an acceptable alternative. At all material times both services have been supplied together by Dŵr Cymru as an integral part of the Ashgrove system. In those circumstances we see no reason to doubt that during the period covered by the Decision the relevant product market was that for the service of the transportation and partial treatment of water, as assumed by the Director.

106. Although the suggestion has been made that Albion might build a more modern treatment plant on the Shotton Paper site, it is unclear what the feasibility or cost of this proposal would have been, and whether such a treatment plant would have been intended to replace the Ashgrove treatment works (paragraphs 171 to 174 of the Decision). Such a treatment plant has never materialised and we infer from paragraph 171 of the Decision that the proposal never reached even the stage of a pilot study. It is thus not relevant to the period covered by the Decision during which the product supplied by Dŵr Cymru was both the transportation and the treatment of water. In any event, the construction of a new treatment plant would involve significant investment and a significant time lag. On the approach of the Commission and the OFT, this unrealised and theoretical supply side possibility would have been insufficiently immediate or effective to be relevant for the purposes of product market definition.

107. In all those circumstances there is no reason to investigate the relevant product market any further.

The geographic market

108. The first point made about the relevant geographic market at paragraph 97 of the Decision is that there may be customers other than Shotton Paper and Corus in the vicinity of the Ashgrove system who could be supplied by Albion, either using the Ashgrove system, or constructing new infrastructure, or using the infrastructure of another undertaker such as United Utilities.

109. Dr. Bryan's evidence is that there are no such customers. Mr. Jones' evidence is that the Deeside industrial park is not close to any significant towns and cities and that there are no obvious customers for non-potable water at Sealand other than Shotton and Corus. We have no reason to doubt the evidence of Dr. Bryan and Mr. Jones. However, even assuming the hypothetical existence of such other customers, if they were to be supplied by Albion via the Ashgrove system, as paragraph 97 of the Decision suggests, Albion would still be dependent on Dŵr Cymru's infrastructure for such supply, and the market analysis does not change. The other theoretical possibilities mentioned in paragraph 97 of the Decision seem to us far too remote, as

far as the period relevant to the Decision is concerned, to be taken into account for the purposes of market definition.

110. The second point made about the relevant geographic market in paragraph 98 of the Decision is that Dŵr Cymru and/or United Utilities and/or Dee Valley Water plc ("Dee Valley") might own infrastructure which could be used to treat and transport the water to Shotton, either from Heronbridge or an alternative source. There is no evidence of Dŵr Cymru having any such alternative infrastructure, and even if it did that would merely reinforce Dŵr Cymru's market position. United Utilities does not even now have any infrastructure of its own within Dŵr Cymru's appointed area[3], so such infrastructure would have to be constructed. This supply side possibility would have involved the significant adjustment of existing assets, additional investment, strategic decisions and time delays, all of which rule out taking this possibility into account at the stage of market definition, according to paragraphs 20 to 23 of the Commission's *Notice on Market Definition*. The Director was well aware of those passages in the Commission's *Notice*, as shown by paragraph 87 of the Decision, last sentence. The same considerations apply even more forcefully to Dee Valley, in relation to which there is no evidence whatever that construction of the necessary infrastructure has ever been contemplated.

111. The third point made in paragraph 99 of the Decision is that the relevant geographic market could be extended to include water abstracted from points other than the Heronbridge Abstraction Point for supply to other customers within the relevant area, with the consequence that the area might "be as wide as the relevant water resource zone" and render access to the Ashgrove system unnecessary. None of these theoretical possibilities have in fact occurred either before, during or after the period covered by the Decision. Development of such alternative sources, even if theoretically possible, would again involve new infrastructure and thus the adjustment of assets, additional investment, strategic decisions, and time delays. According to the *Notice on Market Definition*, such future possibilities are not relevant to the question of market definition. Contrary to the apparent suggestion at paragraph 213 of the Decision, we are not concerned with whatever market shares United Utilities or Dee

[3] United Utilities has a management contract to manage facilities, including Ashgrove, on behalf of Dŵr Cymru but that is a different point.

Valley may have outside Dŵr Cymru's appointed area. Even though those companies may also draw on the water resource zone in which Heronbridge is situated, they would not have been able to supply Shotton Paper without constructing new infrastructure in Dŵr Cymru's appointed area.

112. On any view, it does not seem to us that the relevant geographic market could be wider than that part of the water resource zone including Ashgrove which falls within Dŵr Cymru's appointed area. Even within that wider geographic market, Dŵr Cymru enjoys 100 per cent of the market for the transportation and partial treatment of water.

113. For those reasons, it does not seem to us that the various points raised in paragraphs 97 to 99 of the Decision as regards the geographic market are relevant to the analysis of market definition, or need to be resolved or further investigated. As far as market definition is concerned, the essential point is that in the time period of the Decision there was no way of supplying Shotton Paper and Corus except via the Ashgrove system with water extracted from Heronbridge. Any other solution, even if technically feasible, would have required the construction of new infrastructure, substantial investment, with major sunk costs, and time delays. Whether those potential solutions exercised any kind of constraint on the extent and exploitation of Dŵr Cymru's market power in the relevant period is a matter we analyse below in the context of dominance. According to the guidance of the Commission and the OFT, such future possibilities are not relevant, or at least do not need to be resolved, at the stage of market definition.

114. However, as the OFT rightly points out at paragraph 3.18 of OFT 403, what matters is that all competitive constraints from the supply side are properly taken into account in the analysis of market power. We analyse in detail below the possible constraints on Dŵr Cymru arising from the alleged existence of alternative sources of supply or the possibility of Albion or neighbouring undertakers constructing an alternative pipeline. It does not matter from the point of view of the ultimate outcome whether the relevant geographic market is that served by the Ashgrove system or, for example, extends to other sources of supply theoretically to be found either in the vicinity or in neighbouring areas. In either case, the analysis of market power will be the same. For that further reason there is, in any event, no need to investigate further the precise parameters of the relevant geographic market.

115. We therefore reject the submissions that further investigations of the geographic market are necessary in order to decide the issue of dominance in this case.

Conclusion on relevant market

116. In all those circumstances we conclude that the Director rightly based his analysis in the Decision on the market for the transportation and partial treatment, via the Ashgrove system, of water abstracted from the Heronbridge abstraction point for supply to Shotton and Corus. Albion's very similar definition of the market, namely the market for the transportation of non-potable water to industrial customers in the geographic area served by the Ashgrove system is equally sustainable. Widening the market to include future supply side possibilities would not ordinarily be correct for the purposes of market definition, but even if such possibilities were to be included in the relevant market, the analysis of market power would be the same. Contrary to the submissions of the Authority and the interveners, there is no need to investigate further the exact parameters of the relevant market, for the reasons given above.

117. It is not, in our view, surprising that the relevant market in this case is somewhat narrow. There is no demand side substitution. The location where the customer needs the supplies is fixed. The product can be supplied only from one fixed point (the source) to another fixed point (the customer's location). The product cannot be supplied at all without fixed infrastructure connecting those points. Hence the relevant market is to be defined narrowly. Nonetheless, small relevant markets are still relevant markets for the purposes of the Chapter II prohibition.

V ANALYSIS OF DOMINANCE

The initial analysis

118. Since market share is, generally speaking, an important indicator of market power, market share plays a central role in the assessment of dominance. In *Hoffman-La Roche v Commission*, cited above, the Court of Justice said at paragraph 41:

> "Furthermore although the importance of the market shares may vary from one market to another, the view may legitimately be taken that very large shares are in themselves, and save in

> exceptional circumstances, evidence of the existence of a dominant position. An undertaking which has a very large market share and holds it for some time… is by virtue of that share in a position of strength…"

119. In Case 62/86 *AKZO v Commission* [1991] ECR I-3359 the Court said at paragraph 60:

> "With regard to market shares the Court has held that very large shares are in themselves, and save in exceptional circumstances, evidence of the existence of a dominant position (judgment in Case 85/76 *Hoffman-La Roche v Commission* [1979] ECR 461, paragraph 41). That is the situation where there is a market share of 50% such as that found to exist in this case."

120. In *Napp* at paragraphs 156 to 160, and *Genzyme* at paragraph 225, cited above, the Tribunal followed the above jurisprudence in holding:

> "In most circumstances, in the Tribunal's view, a market share of 90% or above, which has continued throughout the period of infringement and is likely to continue for several years, will be sufficient, depending on the circumstances, to infer the existence of dominance."

121. In the present case, Dŵr Cymru's market share within the relevant market, as discussed above, was 100 per cent throughout the period considered in the Decision, as well as before and since. During that period neither Albion, who sought the service of transportation and treatment, nor the customers Shotton Paper and Corus, for whom the partially treated water was being transported, had an alternative source of supply available.

122. Even if the geographic area were to be widened to include other sources or supply possibilities theoretically capable of serving Shotton Paper or Corus at some future date, the fact remains that throughout the period covered by the Decision, and for many years before and since, Dŵr Cymru has been the only undertaking within its appointed area capable of offering the service of the transportation and partial treatment of water for use by Shotton Paper and Corus, or indeed, any other customer within Dŵr Cymru's appointed area and potentially relevant to this case. Dŵr Cymru's market share of 100 per cent, on any plausible definition of the relevant market, has been stable for many years.

123. In those circumstances it seems to us at this stage of the analysis that there is a very strong presumption that Dŵr Cymru is in a dominant position.

124. The next step in the analysis is to consider barriers to entry, a matter dealt with in some detail in the Decision. The first and obvious barrier to entry is that from the point of view of supply to Shotton Paper and Corus there is no alternative to the Ashgrove system unless (a) some form of "self-supply" could be developed, or (b) an alternative pipeline could be constructed. Neither of these possibilities in fact occurred during the period covered by the Decision, or since privatisation, or more recently. The Ashgrove system was constructed many years ago using public funds, and was acquired by Dŵr Cymru for no material consideration save a small debt. Any new entrant would have to construct new infrastructure from scratch at a cost far in excess of the cost incurred by Dŵr Cymru in maintaining the existing pipeline. That in itself is a substantial barrier to entry.

125. As the Decision indicates, there are also a number of additional barriers to entry, apart from the development of infrastructure. One important additional barrier, or at least major strategic advantage, not considered in any detail in the Decision, is the fact that Dŵr Cymru not only controls the infrastructure, but has access to the source of water at Heronbridge. Any potential entrant not only has to develop alternative infrastructure, but also find a source. Even if the Heronbridge source were to be available, the evidence of United Utilities in this case is that the price of around 3p/m³ which Dŵr Cymru currently pays United Utilities under the First Bulk Supply Agreement is below cost. United Utilities has sought a significantly higher price from Albion for the supply from Heronbridge. Any alternative source would require the necessary abstraction licence, and the construction of infrastructure of one kind or another. At all material times these considerations have given Dŵr Cymru a further substantial advantage vis-à-vis any prospective entrant.

126. In those circumstances, in our view, the only remaining question is whether, despite Dŵr Cymru's market share and the undoubted barriers to entry during the period covered by the Decision, *potential* competition nonetheless represented an *effective* constraint on Dŵr Cymru's market power in the market for the service of the transportation via the Ashgrove system and partial treatment of water extracted from

Heronbridge. Such *potential* competition could theoretically be represented in this case by the possibility of (a) the development by Shotton or Corus of some form of "self supply", or (b) the construction of an alternative pipeline.

127. In particular, the relevant question is whether either of those alternatives exercised an *effective* constraint upon the price which Dŵr Cymru proposed to charge Albion for that service, so as to rebut the strong presumption of dominance arising from Dŵr Cymru's stable market share of 100 per cent and the barriers to entry already mentioned. Such an effective constraint would arise only if the possibilities of either private supplies or an alternative pipeline were sufficiently credible, realistic and immediate as to prevent Dŵr Cymru from acting, to an appreciable extent, independently of its competitors and customers, and ultimately consumers, in the period covered by the Decision, notwithstanding Dŵr Cymru's 100 per cent market share and the barriers to entry. In this case Albion is Dŵr Cymru's only actual competitor, and is also a customer. The ultimate consumers are Shotton Paper and Corus.

128. We now consider in more detail the possibility of private supplies, and then the possibility of an alternative pipeline.

Private or self-supply

129. There is no suggestion that, during the period covered by the Decision, Shotton Paper itself had access to some form of private supply on its own site. There is evidence from both Ms Cross on behalf of Dŵr Cymru, and Dr. Bryan on behalf of Albion, that certain boreholes exist on the Corus site. The first point to make is that these boreholes have not, we understand, been used to supply Corus, let alone Shotton Paper, at any time relevant to this Decision, particularly in the period 2001 to 2004. It is difficult to see why Corus (or Shotton Paper) would have continued to take supplies from Dŵr Cymru and its predecessors for many years if the Corus boreholes in fact represented a viable alternative in the relevant period.

130. Dr. Bryan's evidence is that the Corus boreholes have a limited yield and high saline content and have no potential to supply all or part of Shotton Paper's demand (Annex

2, paragraph 22, of the notice of appeal; paragraph 9 of his witness statement of 9 November 2004). We take it that the saline content results from the proximity of the boreholes to the sea. Ms Cross refers to an email from Corus of 15 April 2004 inquiring whether Dŵr Cymru would be interested in a joint venture to redevelop the boreholes which Corus apparently stopped using many years ago because of the saline content. Dŵr Cymru declined to participate in any such venture, but Ms Cross indicates "it is possible that the source would be further developed by others". Annex 3 to Jones 2, dated February 2006 speculates about the possible future development of these boreholes, albeit that Dŵr Cymru has conducted no feasibility studies. None of that bears on the period covered by the Decision. As far as we know, by December 2006, nearly six years after Dŵr Cymru quoted the allegedly abusive First Access Price in February 2001, the Corus boreholes had not yet become operational.

131. Mr. Jones told us in Jones 2 (February 2006) that Corus had recently told him that Corus plans to install a reverse osmosis plant for the purpose of developing the boreholes. We understand that a reverse osmosis plant is necessary because of the high saline content of the water in the boreholes. The need for such a reverse osmosis plant confirms that the boreholes were not usable in any time period relative to the Decision, which is up to May 2004 at the latest. More recently, Albion has produced a letter from the Environment Agency ("EA") dated 20 October 2006 which indicates that the EA has concerns that increased abstraction from these boreholes would result in increased saline levels which the EA would have a responsibility to prevent under the Water Framework Directive. According to the EA, it is also unlikely that Albion would be given an abstraction licence for 20 Ml/day in the area of the Dee Estuary Special Area of Conservation.

132. Our conclusion is that during the time period dealt with in the Decision, from 2001 to 2004, and for many years prior to that, the Corus boreholes did not represent a viable alternative source of supply. Even now, at the end of 2006, the boreholes have not yet been developed to supply Corus, and serious problems of saline content apparently still exist. In order to supply both Shotton Paper and Corus, the boreholes would need to supply a combined total of 32Ml/day. It remains even now wholly unclear whether abstraction licences could be obtained to cover that very large volume, or when (or if)

the reverse osmosis plant and other necessary infrastructure would be likely to become operational, or what the capital and operating costs would be.

133. There is no evidence to suggest that the possible development of the Corus boreholes exercised any constraint on Dŵr Cymru's pricing policy or conduct in the period from 2001 to 2004.

134. Dr. Bryan's evidence is that he knows of no other boreholes which could be relevant to the Tribunal's analysis and we have no reason to doubt his evidence on that point. The hypothesis that there were other boreholes (for which the necessary transportation and treatment infrastructure would also have had to be constructed) capable of supplying Shotton Paper during the period covered by the Decision is too remote a possibility to be taken into account.

135. In our view, it follows that the possibility of private or self-supply exercising some kind of competitive constraint, let alone an effective constraint, on Dŵr Cymru during the period covered by the Decision may safely be disregarded.

An alternative pipeline from Heronbridge

136. As far as an alternative pipeline from Heronbridge is concerned, the issue of a dominant position arises in the period between 2001, when Albion made its complaint, and 2004 when the Decision was taken. Throughout that period and up to the present time, there has in fact been no alternative pipeline to the Ashgrove system, either from Heronbridge or from anywhere else.

137. As to the *potential possibility* that an alternative pipeline from Heronbridge might have been constructed, so as to represent an effective competitive constraint on Dŵr Cymru's pricing policy, the evidence before the Tribunal is that any such construction would have been physically difficult, high risk and extremely costly. In addition, it is manifest that Albion would not be in a position to construct such a pipeline. United Utilities, the only other potential candidate, would have faced legal difficulties, in addition to the cost and risk. In addition, there would have been significant delays and the risk of retaliation by Dŵr Cymru. On the evidence before the Tribunal, in our view

the possibility of an alternative pipeline was never sufficiently credible, realistic or immediate to exercise any, let alone any effective, competitive constraint on Dŵr Cymru.

138. First, as to the physical difficulties, Dr. Bryan's evidence is that an appropriate route would have to be found between Heronbridge and Sealand, and negotiations carried out with land owners for way-leaves and easements. The excavations needed would be considerable and disruptive. There are the complications of a major river crossing and a railway crossing. In the immediate vicinity of Shotton Paper and Corus there is contaminated land containing tars and phenols from old coking works. Dr. Bryan contends that planning permission would be necessary. The need to overcome these physical difficulties is itself a substantial barrier to entry, in our view.

139. As to risk, Dŵr Cymru points out – and we accept – that any such pipeline would have no customers other than Shotton Paper and Corus. If both or either of these customers were to shut down, the pipeline would have no alternative use. That would make the construction of such a pipeline a high risk project, with the consequence that capital would have to be raised at a high risk-related rate of return. Dŵr Cymru further points out that neither of the customers in question have strong credit ratings, with the consequence that even if some form of financial commitment was sought from the customer, the investor could not rely on that commitment being fulfilled, thus adding to the risk. Dŵr Cymru considers that a rate of return of at least 17.5 per cent would be required over the assumed life of the asset, and the Authority considers the rate of return should be at least 15 per cent.

140. Dŵr Cymru and the Authority's calculations of the required rates of return are based on the assumed life of the assets, which in the case of the main is 100 years. The prospect of any investor or responsibly managed company taking on an investment project on the basis that Shotton Paper and Corus will still be there in 100 years time seems to us to be remote. The high risk nature of the possible alternative pipeline from Heronbridge reinforces the barrier to entry created by the need to construct such a pipeline. It is to be remembered that Dŵr Cymru on the other hand already has a pipeline, with the sunk cost having been incurred many years ago. It is manifest that

this situation gives Dŵr Cymru a massive strategic advantage as compared with any prospective new entrant proposing to construct a duplicate facility.

141. As to cost, Dŵr Cymru estimates the total cost at £12.7 million, but that excludes many further items of cost (Jones 2, paragraphs 28 and 29). The Authority's figure for capital costs is £8.5 million. On any view, those are substantial sums, and the need to raise that money is itself a further barrier to entry. Moreover, even making the very doubtful assumption that the project could be feasible at all, Dŵr Cymru calculates that the recovery of the investment would have required, in 2001, a common carriage price of some 32p/m^3. The Authority's figure is 25p/m^3. A supplier to Shotton Paper would, in addition, have to incur the water resource cost and include that cost in its price to Shotton Paper. United Utilities has sought from Albion a price significantly higher than the 3p/m^3 which Dŵr Cymru is currently paying United Utilities. On the figures placed before the Tribunal by Dŵr Cymru and the Authority, it is manifest that a new pipeline would have been uneconomic, since the retail price needed in 2001 to recover the investment and pay for the water resource would have had to have been above the retail price of some 26p/m^3 then on offer from Dŵr Cymru. The latter of course already had the existing pipeline, as well as access to the water resource at an advantageous price.

142. In addition there is the question of who could have constructed an alternative pipeline. Even if, as the Director claims at paragraphs 123 to 132 of the Decision, Albion as a water undertaker might have had statutory pipe laying powers, Albion is a small company with very limited financial resources. Moreover, Albion's inset appointment is terminable on one year's notice, and its supply agreement with Shotton Paper is only a ten year agreement. In our view it is impossible to imagine that Albion could have expected to raise the finance of between £8 and £13 million to construct an alternative pipeline on the basis of an inset appointment terminable on one year's notice.

143. As to United Utilities, the Authority has confirmed, in a letter to the Tribunal dated 29 November 2006, that United Utilities would not have had statutory pipe laying powers in Dŵr Cymru's appointed area unless it had obtained an inset appointment. In order to supply Shotton Paper, United Utilities would have had to obtain an inset appointment for the premises of Shotton Paper. However, Albion was and is already

the inset appointee for Shotton Paper. It follows that United Utilities could have used statutory pipe laying powers only if Albion's inset appointment were to have been terminated, and United Utilities had itself obtained an inset appointment for those premises. Throughout the period covered by the Decision, therefore, United Utilities faced the legal obstacle that it had no statutory pipe laying powers in Dŵr Cymru's appointed area. Without statutory powers, laying a pipeline of this kind would involve United Utilities negotiating voluntary agreements with land owners and/or applying to highway authorities for a licence. That would be a time consuming process which could be blocked altogether by objections from landowners. We find it very hard to imagine how, in practice, a pipeline from Heronbridge to Sealand could be laid without statutory powers, or that any responsible undertaker would embark on such a project without such powers. In addition, as set out below, it does not appear from the evidence that United Utilities was ever seriously intending to construct a pipeline for the purpose of serving Shotton Paper.

144. It is hard to see how the above problems could have been overcome. In any event, there would have been inevitable time lags in constructing such a pipeline. The Director (at paragraph 195) estimates at least two years, but it is not evident to us that the difficulties of this particular project were fully appreciated by the Director. For example, if it were to be done on the wholly unrealistic scenario of Albion's inset appointment being terminated and United Utilities obtaining a new inset appointment, that in itself could have taken several years, according to paragraph 186 of the Decision.

145. Even if, contrary to all the evidence, the building of a new pipeline could enable the owner of that pipeline to offer Shotton Paper a competitive price, the prospective investor would also face the risk of Dŵr Cymru simply reducing its own price and winning back the custom of Shotton Paper. In that event, the new pipeline would be stranded (since there are no other customers) and all the investment would be lost. That further risk would represent a further substantial barrier to entry.

146. At paragraphs 192 to 203 of the Decision, the Director contends that regulatory action would be sufficient to prevent the possibility of retaliatory action by Dŵr Cymru. However, as analysed in detail in paragraphs 169 to 174, 617 to 622, and 750 of the

main judgment, it would be open to Dŵr Cymru to offer Shotton Paper a special agreement. For the reasons there given, there is virtually no regulation of the supply of non-potable water by special agreement where infrastructure is dedicated to serving particular customers. The only available weapon in the Director's armoury would appear to be Standard Condition E, the scope of which would appear to be very uncertain in the postulated circumstances. The present case also shows that the regulatory procedures of the Director in 2001 could be both lengthy and ultimately ineffective. Nor could any investor be certain that the regulatory system would remain the same or be effective throughout the period of the investment. In all the circumstances, we seriously doubt whether, in 2001, a prudent investor would have regarded the then regulatory system as an adequate protection against the risk of Dŵr Cymru winning back the customer, with the consequent loss of the whole investment.

147. For the foregoing reasons the evidence before the Tribunal, largely produced by Dŵr Cymru, is to the effect that, as regards the period covered by the Decision, the prospect of a new pipeline being constructed in this case turns out on analysis to be distant, theoretical and unrealistic in commercial terms.

Summary at this stage of the analysis

148. Summarising at this stage of the analysis, it is possible to assemble the following from the evidence and the Tribunal's previous findings: (i) Dŵr Cymru has 100 per cent of the relevant market. (ii) That market share has been stable for many years. (iii) Dŵr Cymru owns the infrastructure needed to transport water to Shotton Paper. (iv) Dŵr Cymru had advantageous access to the water source at Heronbridge. (v) No private supply was in fact available to Shotton Paper during the period covered by the Decision. (vi) The Corus boreholes are not, even now, in a position to supply Shotton Paper. (vii) The construction of an alterative pipeline from Heronbridge could not realistically have been undertaken by Albion, even assuming that the latter had statutory pipe laying powers. (viii) United Utilities would not have had statutory pipe laying powers in Dŵr Cymru's appointed area during the period covered by the Decision, since it did not have an inset appointment. (ix) The construction of an alternative pipeline from Heronbridge to Sealand would have faced serious physical difficulties. (x) Any such project would involve capital investment of between £8.5

million and £12.7 million. (xi) Any such project would have been high risk and would have required a "high risk" rate of return. (xii) The likely rate of return required would have made it impossible for the owner of the pipeline to charge a price competitive with the price then charged by Dŵr Cymru, bearing also in mind that the latter already has an existing pipeline the sunk costs of which were incurred many years ago. (xiii) The construction of a new pipeline would have involved lengthy delays. (xiv) There is no certainty that in 2001 the regulatory system would have prevented Dŵr Cymru from taking retaliatory action.

149. Those factors in our view point overwhelming to the existence of a dominant position. We can therefore deal quite shortly with the passages in the Decision which suggest that a contrary conclusion could be reached.

The reasoning in the Decision as regards an alternative pipeline

150. The Director first considers whether Dŵr Cymru has any "absolute" advantages over potential entrants as regards pipe laying powers or access to sources, and concludes that Dŵr Cymru does not have any such "absolute" advantages (paragraphs 123 to 138). In this part of the Decision the Director seeks to apply OFT 415 in its September 1999 version, which considers that an absolute advantage occurs where the entrant cannot gain access to an asset or resource at any cost or only at a cost substantially higher than the incumbent (OFT 415, paragraph 5.4).

151. In our view, the first error in this part of the assessment is that the Decision does not address the question whether a potential entrant in this case could gain access to an asset or resource "only at a cost substantially higher than that of the incumbent" (paragraph 121 of the Decision). As already seen, a potential entrant could supply Shotton Paper or Corus only by making a large and risky investment, the cost of which could be substantially higher than the cost incurred by Dŵr Cymru in providing common carriage through the existing pipeline. Similarly, the evidence before the Tribunal is that the water resource cost would be substantially higher than that currently incurred by Dŵr Cymru. As already indicated, those factors constitute substantial barriers to entry.

152. We have already indicated that the possibility of Albion itself constructing a pipeline using statutory powers under sections 158 and 159 of the WIA91, as suggested in paragraphs 123 to 132 of the Decision, is wholly unrealistic as a matter of fact. The suggestion in paragraphs 131, last sentence, 132 and 138 that United Utilities could use statutory pipe laying powers appears to be erroneous, since United Utilities would require an inset appointment to exercise statutory powers in Dŵr Cymru's appointed area. The inset appointee for Shotton Paper was at all material times and still is Albion. United Utilities does not have, nor has ever applied for, an inset appointment in Dŵr Cymru's appointed area, for the premises of Shotton Paper.

153. As regards abstraction rights at Heronbridge, dealt with at paragraphs 133 to 141 of the Decision, we have already emphasised the fact that United Utilities has sought a substantially higher price from Albion than it receives from Dŵr Cymru (paragraph 135 of the Decision) thus conferring a substantial advantage on the latter. Other abstraction rights on the Dee controlled by United Utilities or anyone else would still require the laying of pipes in Dŵr Cymru's appointed area before they could be exploited.

154. At paragraphs 138 to 191 of the Decision, the Director considers whether there are "any physical or time constraints which would prevent Albion Water, United Utilities or anyone else from entering the market". At paragraphs 141 to 170, the Director considers the costs of duplicating the Ashgrove main and comes to the conclusion that duplication was likely to be economic. The same conclusion is reached as regards the treatment works at paragraphs 171 to 175. That leads the Director to conclude, at paragraph 176, "the cost of constructing new infrastructure to serve Shotton would not be sufficient to constitute a barrier to entry" (see also paragraph 222).

155. As far as Albion is concerned, we exclude the possibility of Albion building an alternative pipeline in its own right as unrealistic, for the reasons already given. As far as United Utilities is concerned, it is very unlikely that, in practical terms, United Utilities could construct a new pipeline without statutory pipe laying powers, which would require an inset appointment. The same is true of Dee Valley. There is no evidence that Dee Valley has ever contemplated constructing a pipeline or seeking an

inset appointment. Any third party that was not a water undertaker would not have statutory pipe laying powers.

156. The only possibility considered in the Decision is that United Utilities might construct an alternative pipeline. We do not see how, in practice, the absence of an inset appointment could be overcome. If that is correct, most of the analysis in the Decision is irrelevant as regards the period after Albion's inset appointment in May 1999. It is only in the alternative that we consider the three matters relied on by the Director as showing an alternative pipeline to be economically viable. Those matters are: (i) various studies carried out on behalf of United Utilities between 1997 and 1999; (ii) an exchange of emails between Albion and United Utilities at the end of 2001; and (iii) the Director's own "desk top" calculations. We take these three elements in turn.

– The United Utilities studies between 1997 and 1999

157. It appears on the face of the Decision that United Utilities did look at the possibility of constructing alternative infrastructure to serve Shotton Paper. There was apparently an initial study by Mr. Ken Hickman in 1997, which was described by United Utilities to the Director as "a simplistic look at potential costs" (paragraph 157 of the Decision). The matter, however, came to nothing in 1998. According to United Utilities that was because United Utilities did not consider the project to be feasible without a long term supply contract, and Shotton Paper were not prepared to enter into the long term contract that United Utilities required (paragraph 149 of the Decision). There was then a report by Bechtel in 1998 which was a "desk top study" which did not come to any conclusion or recommend a particular solution (paragraph 145 of the Decision). These studies were carried out prior to the grant of Albion's inset appointment on 1 May 1999. United Utilities told the Tribunal in its submissions of 20 October 2006 that, as to duplication, United Utilities' answers to the Director's requests under section 26 of the Act make clear that "United Utilities was not in a position to comment on the commercial feasibility or otherwise of duplication". On that basis it does not seem to us that these early studies, some years before the period covered by the Decision, carry the matter very far. Further, this was before Albion's inset appointment. Once that appointment had been made, the legal situation changed: United Utilities could not

have itself supplied Shotton Paper using statutory pipe laying powers without replacing Albion as the inset appointee.

158. Following an Oxera study of options in 1999, there is a further United Utilities document called the Boulton Report, prepared by Ms. Tina Boulton, apparently dated 2 September 1999. This is a short outline document. The Boulton Report recommended that United Utilities be prepared to enter into a bulk supply agreement with Albion[4] for the onward supply of non-potable water to Shotton Paper, if Albion were able to negotiate a common carriage arrangement with Dŵr Cymru (paragraphs 146 and 147 of the Decision). This proposal is referred to as the "the tariff solution", as opposed to the "engineering solution", i.e. the construction of an alternative pipeline. The Boulton report recommends the rejection of an engineering solution because:

> "(i) it would be extremely costly to construct a pipeline and Shotton are not willing to contribute any funding; (ii) the [Director] would view as [sic] economically inefficient; (iii) it is unlikely that the regulator would approve of any move that would leave the first new entrant in the water industry without a customer; and (iv) constructing a pipeline would require longer timescales than a tariff option [sic]." (paragraph 148 of the Decision).

159. Those four reasons seem to us to confirm the difficulties facing the construction of an alternative pipeline. According to the Boulton Report such an alternative would be, first, extremely costly. Secondly, United Utilities' perception was that the Director would view duplication as "economically inefficient". The evidence in this case supports that view, since the need to avoid the costs of stranded assets was strongly relied on by the Authority in its defence. Thirdly, the reference to the Director being unlikely to support "any move that would leave the first new entrant in the water industry without a customer" is, we take it, a reference to the fact that an engineering solution would involve United Utilities itself seeking an inset appointment for Shotton Paper, thus displacing Albion. The Boulton report, rightly in our view, saw that as a quite unrealistic scenario from the regulatory point of view. Finally, the Boulton report makes the self-evident point that the construction of a new pipeline would involve time delays.

[4] The document refers to Enviro-Logic, but the agreement would have had to be with Albion, the inset appointee.

160. It seems to us quite clear on the face of the Decision that by 1999 United Utilities, having examined the matter in a preliminary way, had decided not to proceed with further consideration of the construction of an alternative pipeline, recognising the obstacles. That, as far as we know, was still the position when Dŵr Cymru quoted the First Access Price at the beginning of 2001. Accordingly, this evidence does not in our view detract from the overwhelming inference of dominance which flows from the factors summarised in paragraph 148 above.

– *The emails at the end of 2001*

161. However, at the end of 2001 there was an exchange of emails between Albion and United Utilities which are described in the Decision in these terms:

> "152. In an e-mail from Albion Water to United Utilities Water dated 6 December 2001, Albion Water stated:
>
> "We […] need to explore an alternative approach to supplies at Shotton to increase the pressure for a favourable decision, or as a last resort, to deliver our own alternative. Jerry [Bryan] has asked me to explore costs for an alternative supply to Shotton/Corus. I write to see of [sic] you can help to quantify the cost of doing so, and to see in principle whether [United Utilities Water] would wish to undertake the work."
>
> 153. The e-mail refers to two possible alternatives, namely the duplication of the Ashgrove Pipe and the construction of a pipe from Milwr Tunnel to Shotton. The e-mail continues:
>
> 'At this stage the initiative needs to be absolutely confidential, and exploratory…in the short term I have to be careful not to undermine our position that [Dŵr Cymru] main is an essential facility. If we end up going for a new main to serve the site [Enviro-Logic] would have the support of the customer as long as we had exhausted other options first, but the financing options remain to be explored.'
>
> 154. United Utilities Water responded in an e-mail from John Lees dated 19 December 2001. It stated that:
>
> 'We would want to be involved in this. A fast and dirty look at the options shows them to be potentially viable to supply a competitively priced water at [sic] the volumes you have indicated. I would stress that it was not a detailed study, but the signs are good that it would be viable to

provide a "concrete and steel" option to the existing asset usage option.'

155. This e-mail appears to imply that, on the basis of United Utilities Water's initial estimate, and subject to a more in-depth study being carried out, it appeared economic and feasible to install a duplicate pipeline running from the Heronbridge Abstraction Point to Shotton. Importantly, the e-mail dated 6 December 2001 also appears to show that Shotton would be prepared to provide the necessary support…."

162. It is unfortunate that Albion did not disclose this correspondence to the Director. Nonetheless, the main issue is whether there was ever a realistic prospect, in the time period relevant to the Decision, of United Utilities constructing an alternative pipeline (and treatment works) so as to act as an effective competitive constraint on Dŵr Cymru as regards the First Access Price quoted to Albion for the transportation of non-potable water through the Ashgrove system, notwithstanding the many factors establishing the contrary and already summarised at paragraph 148 above.

163. Objectively speaking, the evidential weight of these e-mails seems to us to be slight. These emails post-date the quotation of the First Access Price. The alternative pipeline is considered by Albion in the email of 6 December 2001 to be "a last resort", costs have not been quantified, and financing possibilities have not been explored. United Utilities' response of 19 December 2001 was only "a fast and dirty look". It appears from paragraph 156 of the Decision that United Utilities was basing itself on Mr. Hickman's work in 1997 which United Utilities describes as "a simplistic look at potential costs" (paragraph 157). An e-mail from United Utilities to Albion of the following day, 20 December 2001, which gives an estimate for capital and operating expenditure, was also apparently based on updating Mr. Hickman's earlier figures (paragraphs 158 to 159 of the Decision). Again, United Utilities' response to Albion in the e-mails of December 2001 seems to us to have been an initial, superficial response. United Utilities never took the matter any further. In those circumstances we do not consider that these emails materially detract from, let alone outweigh, the factors already summarised at paragraph 148 above.

– The Director's desk top calculations

164. Nonetheless, at paragraphs 160 to 165, and Annex I, paragraphs 1 to 39, of the Decision the Director sets out his own calculations showing that, in his view, it would be economically viable to duplicate the Ashgrove system by building a new treatment works on the Shotton site and duplicating the main from Heronbridge. These calculations form a central element in the Decision.

165. In our view, in the light of the evidence now before the Tribunal, those calculations cannot be relied on. It is apparent that the Annex I calculations are again no more than "desk-top" calculations which take no account of the commercial realities already referred to. In the Annex I calculations four scenarios are considered: one where the duplication is undertaken by a large water and sewerage undertaker (WaSC) seeking a target return of 5.5%; and three where the duplication is undertaken by a small water-only undertaker ("small WoC") at alternative target rates of return of 6.5%, 10%, and 20% and over varying asset lives. It is presumably assumed that the large WaSC is potentially United Utilities, and that the small WoC is Albion. Those are the only potential entrants identified in the Decision, there being no evidence at all that Dee Valley ever intended, or would have been in a position, to carry out a project of this kind.

166. However, we have already found that Albion would never have been in a position to finance an investment of this kind, for the reasons already given. Similarly United Utilities would have needed an inset appointment in order to supply Shotton Paper, but never had such an appointment. Apart from these difficulties, it is accepted by both Dŵr Cymru and the Authority that the project would be high risk, a further factor not taken into account in Annex I to the Decision. According to the evidence before the Tribunal, the rate of return required on the investment would be 15 per cent (according to the Authority) and 17.5 per cent (according to Dŵr Cymru). Those rates of return are significantly higher than those used in Annex I, except on one scenario involving a small WoC (using a 20% return) which is shown in Annex I to be unprofitable

anyway[5]. Furthermore, the figures for total costs placed before the Tribunal by Dŵr Cymru (£12.7 million) and the Authority (£8.5 million) are significantly higher than those assumed in the Decision (£6.5 million). In addition, the evidence before the Tribunal is that it is unrealistic to assume, as Annex I does, that any third party would have been able to acquire the water resource at the advantageous price available to Dŵr Cymru from United Utilities.

167. We note also that the cash flow calculation in Annex I assumes that when the pipeline is constructed the retail price to Shotton Paper would be the New Tariff price of 26p/m³, slightly above Albion's then price to Shotton Paper. On that assumption, Shotton Paper would have no apparent incentive to support the project, and it is unclear what useful purpose such a project would serve.

168. Moreover, we have already found that the evidence strongly suggests that the First Access Price was excessive, with the implication that the same would be true of the New Tariff Price of 26p/m³ upon which the calculations in Annex I are based (paragraph 760 of the main judgment). The Tribunal does not accept that a calculation of economic viability can validly be based on an assumed retail price which the evidence strongly suggests to be excessive. The assumption that it would be feasible for competitors to enter the market at the prevailing price is open to the same objection as the *Cellophane* fallacy, unless it is shown that the prevailing price is itself at the competitive level, which is not the case here[6]. Dr. Bryan correctly pointed out in the notice of appeal (paragraph 197) the potentially perverse nature of this approach.

Conclusion on the passages in the Decision relating to the possible viability of the construction of an alternative pipeline from Heronbridge

169. It is mainly the elements set out above that led the Director to the conclusion at paragraph 176 of the Decision:

> "In summary, in the light of the above, we calculate that the cost of constructing new infrastructure to serve Shotton would not be sufficient to constitute a barrier to entry."

[5] Annex I uses shorter asset lives than those assumed in the calculations put before the Tribunal by Dŵr Cymru and the Authority and makes allowance for "residual values". We have not considered the validity of this.

[6] See *United States v. EL DuPont Nemours & Co.* 351 US 377 (1956) discussed e.g. by O'Donoghue and Padilla *The Law and Economics of Article 82 EC* (OUP 2006), pp. 81-84.

170. In our judgment, that conclusion is erroneous. It is not in doubt, in our view, that the need to construct a duplicate to the Ashgrove system, and the cost of doing so is a substantial barrier to entry, contrary to the statement at paragraph 176. The question is whether the possibility of such a pipeline being constructed, in terms of feasibility, cost and timescale, represented an effective competitive constraint as regards the First Access Price quoted by Dŵr Cymru notwithstanding the factors summarised at paragraph 148 above. However, the cost calculations set out at paragraphs 160 to 165 and Annex I, on which the Director relies heavily, cannot stand for the reasons already given. In that regard, the points made by Albion at paragraphs 196 to 211 of the notice of appeal are, in our judgment, well made.

171. That leaves, in effect, the inconclusive early studies in 1997 and 1998 prior to Albion's inset appointment; the fact that United Utilities rejected an engineering solution in 1999 for four good reasons; and the brief exchange of emails in 2001. In our view none of those documents gets anywhere near establishing an intention on the part of United Utilities to construct an alternative pipeline or anything more than an exploratory process which led to a decision not to proceed. In view of (i) the fact that United Utilities had no inset appointment , and (ii) the detailed evidence now before the Tribunal, largely provided by Dŵr Cymru and confirmed by the Authority, as to the physical difficulties, capital cost and high risk nature of the project, and the uncompetitive price that would necessarily result, it seems to us very difficult to contend that any such pipeline would ever have been a realistic proposition. There is thus in our view little in the evidence relied on in the Decision to outweigh the conclusion on dominance to be drawn from the factors summarised at paragraph 148 above.[7]

172. Even on the unrealistic hypothesis that the difficulties already mentioned could somehow be overcome, there is in addition the question of delay (paragraphs 178 to 191 of the Decision). The Director's analysis that it would take only up to 27 months

[7] We do not need to deal with Dŵr Cymru's assertion in a letter to the Director dated 5 July 1996 that the cost of duplicating the Ashgrove system would be 35p/m^3 , discussed in paragraphs 166 to 170 of the Decision save to note that Dŵr Cymru's evidence before the Tribunal is that the cost would be at least 32p/m^3 . Nor do we need to deal with the possible duplication of the treatment works alone, discussed at paragraphs 171 to 174 of the Decision. That suggestion, and other possibilities mentioned at paragraph 175, have never occurred and would not obviate the need for any potential supplier to use the Ashgrove main unless an alternative main were constructed.

(paragraph 185) to lay a new pipeline from Heronbridge is predicated on the use of statutory powers by Albion or United Utilities (paragraph 182). However, we have already held that it is unrealistic to assume that Albion would be in a position to lay a new pipeline, and that United Utilities, or indeed any other water undertaker, would not be in a position to do so without an inset appointment which they have never had or even applied for and which could take several years to obtain (paragraph 186). In those circumstances we consider erroneous the Director's conclusion at paragraph 189 of the Decision:

> "…that the length of time it would take for a WaSC or a WoC new entrant to construct the necessary infrastructure to supply Shotton would not amount to an insurmountable barrier to entry, and would not prevent a WaSC or WoC constraining an incumbent undertaker's market power through constructing, or threatening to construct, such infrastructure."

173. For the reasons already given, delay would amount to a substantial barrier to entry. The question is not whether the barrier is "insurmountable" but whether the barrier is substantial. Notwithstanding the long term nature of the industry (paragraph 186), on the particular facts of this case the time factor is in our view plainly a substantial barrier to entry. A similar error occurs in paragraph 191 of the Decision, which states that the fact that the entrant has to incur investment costs before receiving any revenues is not an "insurmountable" barrier to entry. Again, the issue is whether a substantial barrier exists, not whether it is "insurmountable".

174. In addition, there is the issue of public policy. Paragraph 223 of the Decision states that "in many circumstances, the construction of duplicate water supply infrastructure could be contrary to public policy" but goes on to state that, exceptionally, "there may not be sufficient public policy reasons to render the Ashgrove System an essential facility", although the Director would need to examine the public policy questions in more detail (paragraph 224).

175. The evidence adduced before the Tribunal by the Authority was that competition in network infrastructure was rarely desirable, let alone feasible. Furthermore, argued the Authority, it was important that, where competition takes place, the costs of stranded assets should not fall on the water undertaker's remaining customers. But in this case, that is precisely what would happen if an alternative pipeline were to be constructed,

by-passing the Ashgrove system altogether. In that event, Dŵr Cymru would not only lose the revenue it would otherwise have obtained from common carriage, but would have an asset, the Ashgrove system, that was completely stranded. We do not consider that the 1998 Act should be construed in such a way as to require or encourage the water industry to incur the costs of major construction projects which merely duplicate existing infrastructure unless there is a very good reason for doing so.

176. In all those circumstances we think that the distant, theoretical and unrealistic possibility of an alternative pipeline being constructed from Heronbridge does not alter the conclusion to be drawn from the facts summarised at paragraph 148 above on the existence of a dominant position.

Other alternatives

177. The various other alternatives suggested by the parties seem to us too remote to be worthy of consideration. No feasibility study has ever been carried out in relation to laying a pipeline from United Utilities' Sutton Hall treatment works to Shotton Paper, and there is no evidence that that was ever seriously considered in the period covered by the Decision. There is no evidence that abstraction from the sea, with the building of a desalination plant based on reverse osmosis, was ever considered to be a practical proposition at the time of the Decision. The Milwr tunnel suggestion involved access difficulties (paragraphs 42 to 43 of the Decision) and would again have required a new pipeline. There is no evidence that various other suggested possibilities, such as bringing back into commission a disused tunnel at Sealand, building a pipeline from other abstraction points on the Dee near Chester, or from the Shropshire Union Canal, were seriously considered in 2001, and no feasibility studies have been carried out or costed. All these theoretical possibilities would have involved additional sunk costs, and the high risks associated with constructing alternative infrastructure in the circumstances of this case. There is nothing to suggest that recycling, on the Shotton site, of the massive volumes required would have been practicable at the time of the Decision. In our view it is manifest that none of those theoretical possibilities were ever sufficiently likely to happen, still less to exercise an effective competitive constraint on Dŵr Cymru, in the time period covered by the Decision.

Retaliatory action

178. As regards the Director's conclusion, at paragraphs 192 to 203 of the Decision, that possible regulatory action would suffice to obviate the risk of retaliatory action by Dŵr Cymru, we have already set out our view that it is unlikely that a prudent investor in 2001 would have relied on the regulatory system to prevent the possibility of Dŵr Cymru taking retaliatory action. In any event, the evidence in this case is that, given the costs incurred, there would have been ample scope for Dŵr Cymru to reduce its price of non-potable water.

Buyer power

179. In considering buyer power at paragraphs 204 to 209 of the Decision, the Director correctly points out at paragraphs 207 to 208 that customers such as Shotton Paper could have meaningful buyer power only in certain narrowly defined circumstances: "if there are no potential competitors available, and the customer has no water of its own, it has nowhere to go but to the incumbent undertaker for treatment and distribution of its water". The Director's conclusion, at paragraph 209, that "there are potential competitors who could compete with Dŵr Cymru in the relevant market" (i.e. the market for the transportation and partial treatment of water) appears to us entirely unfounded. For the reasons already given, it is unrealistic to suppose that either Albion Water (who had the inset appointment) or United Utilities (who did not) were ever likely to construct an alternative pipeline in any time period relevant to the Decision.

Conduct

180. Paragraph 210 of the Decision points out that conduct may be indicative of Dŵr Cymru's market power. We agree. In this case Dŵr Cymru did not produce any information relating to its distribution costs for non-potable water, did not consider that it was necessary to know what those costs were, and made no attempt to find out. Shotton Paper was Dŵr Cymru's second largest customer. Any undertaker who is in the happy position of not knowing or needing to know what are the costs of serving its second largest customer is, in our judgment, plainly under no competitive constraint as to the prices it charges.

181. Moreover, in this case there is no evidence that the possibility of there being some competitive alternative had any effect on the First Access Price quoted by Dŵr Cymru. Indeed it is plain that that price was carried out by the mechanistic process of deducting the resource cost from the existing Bulk Supply Price (see below). That had nothing to do with any estimation of the price which a hypothetical rival might theoretically charge, were such a rival to construct an alternative pipeline. Had there been evidence of any competitive constraint affecting the level of the First Access Price we do not doubt that Dŵr Cymru would have drawn any such element to the Director's or the Tribunal's attention at some point during the past six years of investigations. Dŵr Cymru put in evidence on the Corus boreholes and the possibilities of an alternative pipeline, but did not suggest that either had any effect on its pricing policy. We note too that, in quoting the First Access Price, Dŵr Cymru must have known that it was imposing on Albion a nil margin, thereby demonstrating that it was able to act in the market for the transportation and partial treatment of water without regard to the position of Albion, who was its customer in that market, and also its competitor in the supply of water, and also without regard to the ultimate interests of Shotton Paper.

182. As to the suggestion in paragraph 211 of the Decision that Dŵr Cymru may have been constrained by the regulatory system, at the material time there was no regulation of access prices (other than the Chapter II prohibition). The evidence in this case shows that there was little, if any, regulation of the prices of non-potable water supplied to large industrial users and that such regulation as there was did not prevent Dŵr Cymru from charging a price which the evidence strongly suggested to be excessive.

VI CONCLUSION ON DOMINANCE

183. In those circumstances, the various doubts and reservations expressed in the Decision on the issue of dominant position are inconsistent with the evidence now before the Tribunal, for the reasons already given. We therefore set aside as erroneous in point of fact or analysis the paragraphs of the Decision expressing those doubts or reservations, notably the matters summarised at paragraphs 213 to 215 of the Decision and the supporting considerations and analysis set out notably in paragraphs 93 (first sentence), 97 to 99,131, 132, 138, 144, 150, 160 to 165, 176 to 177, 182 to 187, 189 to 191, 199 to 203, 209, 211 and Annex I.

184. Contrary to the submissions of the parties, we do not consider it necessary for the Authority to carry out any further investigations of the issue of whether Dŵr Cymru had a dominant position in 2001, or between 2001 and 2004. The Director has already investigated that issue in detail, as the documents referred to in the Decision and answers to the section 26 notices show. It is unlikely that anything is to be gained by going over that ground again. As to the legal, physical and financial difficulties of constructing an alternative pipeline from Heronbridge, and the high costs and risks of doing so, there is now ample evidence before the Tribunal, produced largely by Dŵr Cymru. There is sufficient evidence as regards the Corus boreholes. For other (hypothetical) boreholes new transport and treatment infrastructure would also have been necessary. As to the various other hypothetical and sometimes far-fetched possibilities advanced by the parties, it is clear that possibilities such as the Milwr tunnel, the Sutton Hall pipeline, a pipeline from the Shropshire Union Canal and extraction from the sea, either faced legal obstacles or were never seriously considered or likely to happen within any relevant timescale. It is unnecessary in our view to investigate further, at this distance of time, such hypothetical possibilities. Nor is it the case, as United Utilities suggested, that dominance could only be established after "a detailed engineering exercise". There is already ample evidence before the Tribunal to establish dominance, as summarised in paragraph 148 above. After the Director's detailed investigation, the possibility of further information from Shotton Paper, Corus, the Environment Agency, Dee Valley or any other third party altering the conclusions to be drawn from the evidence already before the Tribunal seems to us remote in the extreme.

185. When assessing dominance under the 1998 Act, it is unnecessary for the competition authority to investigate distant or theoretical possibilities with a view to dotting every "i" or crossing every "t" that could conceivably be imagined. While a sensible analysis is required, there is no need to make the issue of dominance more complicated than it really is.

186. In paragraph 212 of the Decision the Director stated:

> "There are certain factors in this case which would point strongly to Dŵr Cymru being in a dominant position on the relevant market. First, albeit depending very much on the precise market definition used, Dŵr Cymru might have had a 100% market

> share at all material times. Second, for whatever reason, no company has yet duplicated the Ashgrove System. Third, we have not seen any evidence that Dŵr Cymru itself felt constrained by the emergence of Albion Water during the Inset Application process (or by any other competitor), although we have not expressly sought such evidence."

187. At paragraph 215, last sentence, the Director said " we have made the assumption that Dŵr Cymru does hold a dominant position in the relevant market." Although described as "an assumption" that seems to us very close to a conclusion, given the matters referred to in paragraph 212. In any event, the evidence now before the Tribunal amply confirms that the Director's assumption was correct, as a matter of fact. We confirm the Decision in that respect.

188. In *Burgess v. OFT* [2005] CAT 25, the Tribunal considered the circumstances in which the Tribunal might exercise its power to "make any other decision that the [Authority] could itself have made" under Schedule 3(2)(e) of Schedule 8 of the Act. The Tribunal said at paragraph 132:

> "In our judgment, on the above basis the Tribunal should, if necessary, take its own decision rather than remit if (i) it has or can obtain all the necessary material (ii) the requirements of procedural fairness are respected and (iii) the course the Tribunal proposes to take is desirable from the point of view of the need for expedition and saving costs. Such an approach in our view is compatible with the overriding objective of deciding cases justly".

189. In the *Burgess* case, the Tribunal had before it all the material necessary to decide the issue of dominance, and indeed the issue of infringement (paragraphs 133 to 136). The Tribunal said at paragraphs 138 to 139:

> "138. As to procedural fairness, Austins/Harwood Park has participated fully in these proceedings and has been ably represented. At the case management conference on 19 October 2004 the Tribunal made it clear (transcript, page 14) that one option for the Tribunal was to take its own decision, and that Austins should file any evidence that it wished to file on the issues in the case. Austins, in our view, has had every opportunity to defend itself, knowing the options available to the Tribunal. In addition, as already pointed out, there is no question of a penalty being imposed upon Austins.

> 139. As to whether the Tribunal should proceed to take its own decision, a primary factor that weighs with the Tribunal is the regulatory delay that has already taken place. The facts of this case are not complex, but they do concern medium sized businesses serving a vulnerable class of consumer. We regard a delay of over two years in producing a decision in such circumstances as incompatible with the effective enforcement of the Act. To remit the matter now, for further investigation of indeterminate length, would not in our view be in the interests of the parties nor, more importantly, in the interests of the consumers concerned…"

190. In this case, on the issue of dominance, we do not consider that we are exercising a power under paragraph 3(2)(e) of Schedule 8, as distinct from confirming, under the first sentence of paragraph 3(2), the factual correctness of the assumption of dominance made in the Decision. That, it seems to us, is a relatively short step to take, particularly as Dŵr Cymru accepts that the Director has already found "more dominance than not".

191. Be that as it may, we consider that the *Burgess* criteria are in any event fulfilled in this case. We have already held that we do not consider any further investigation would be relevant or useful in the circumstances of this case. As to procedural fairness, at the hearing in June 2006 the Tribunal made it clear to Dŵr Cymru that the Tribunal considered that it was in a position to decide the issue of dominance (Day 6, pp. 94 to 97), and by letter of 20 June 2006 invited submissions on that issue. The response of Dŵr Cymru (and the Authority) was to raise procedural objections. The Tribunal again indicated in its judgment of 6 October 2006 that it wished to consider how the issue of dominance should be handled (paragraph 984) setting out in Annex A certain matters particularly relevant to that issue. Having heard further argument, the Tribunal gave a ruling on 24 October 2006 [2006] CAT 25 to the effect that it proposed to consider the issue of dominance, and offered a hearing. At Dŵr Cymru's suggestion, the matter was dealt with in writing, by consent. Dŵr Cymru has principally argued that the issue of dominance would require further investigation, a submission which we have already rejected. Dŵr Cymru did not answer, on the substance, the submissions made by Albion.

192. The argument to the effect that the Tribunal cannot make any finding on the issue of dominance because the Authority could not do so without serving a statement of objections in accordance with Rule 4 of the OFT Rules made under the Competition

Act 1998 (Office of Fair Trading's Rules) Order 2004 SI 2004/2751 seems to us to be unfounded. The words "any decision the OFT could itself have made" in paragraph 3(2)(e) of Schedule 8 seem to us to refer to the kinds of decisions the OFT can make (i.e. infringement/non infringement etc.) rather than to the procedure by which it makes them. The OFT could not, for example, apply section 66E of the WA03 because that is outside the OFT's jurisdiction, and the Tribunal is in the same position. Procedural fairness, which is what a statement of objections is intended to safeguard at the administrative stage, is achieved by different means at the level of the Tribunal. Indeed, the procedural means open to the Tribunal to secure fairness, in terms of the judicial nature of the proceedings, *inter partes* submissions, hearings in open court and so on, present in many ways wider opportunities for ensuring fairness than those that arise under the administrative procedure.

193. Dŵr Cymru argues that for the Tribunal to make a finding on an issue such as dominance conflicts with the "two tier" system of the 1998 Act, which envisages in an infringement case a decision by the OFT (here the Authority), followed by an appeal on the merits to the Tribunal and then an appeal on a point of law only to the Court of Appeal.

194. The first answer to this point is that, under the 1998 Act, the Tribunal in its merits jurisdiction acts in many cases as the primary decision maker on matters of fact. As the Tribunal said in *Burgess* at paragraph 130:

> "Indeed, in other contexts it is now commonplace for the Tribunal to act, in effect, as the decision-maker in cases where the evidence relied on by the OFT is challenged, very often on the basis of extensive new material introduced by the appellant and rebuttal evidence introduced by the OFT. For example, the Tribunal's role as, in effect, a primary decision-maker, is illustrated, albeit in a different context, by the extensive findings of fact made in the Tribunal's recent judgement on liability in *JJB and Allsports*, cited above".

195. In that latter case, the *Football Shirts* case [2004] CAT 17, the factual matrix on the basis of which the Tribunal made its findings went far beyond what was in the original statement of objections, and yet the subsequent appeal to the Court of Appeal was on a point of law only. If the Tribunal had to send back a case to the OFT every time an

allegation arose which had not been raised in a statement of objections, proceedings under the 1998 Act could never be brought to a conclusion.

196. Secondly, it may occur, as in the present case, that the appeal is against a non-infringement decision in the course of which it appears that, after all, the facts give rise to an infringement, contrary to the view of the OFT. In such cases it seems to us that the Tribunal should take a decision of infringement, after hearing the parties, only if the facts are agreed, uncontested, or plain and obvious. That was the case in *Burgess* and in the Tribunal's earlier decision in *IIB and ABTA v. Director General of Fair Trading* [2001] CAT 3. In such cases, the Tribunal's task is to apply the law to the facts and there is an appeal on a point of law to the Court of Appeal. In *Office of Communications v. Floe Telecom Limited* [2006] EWCA Civ. 768 ("*Floe*") the Court of Appeal was considering a case where the regulator had reached a non-infringement decision. We see nothing in the judgment of the Court of Appeal in that case – considered further below – to preclude the course we propose in circumstances where the Tribunal feels able to decide for itself what the correct result should have been (*Floe*, at paragraph 25).

197. In the present case, the evidence now presented to the Tribunal shows plainly and obviously that Dŵr Cymru had a dominant position in the relevant market at the material time. In our view no further investigation is required. To remit that issue to be decided by the Authority would serve no useful purpose, merely adding to the delay and cost of these proceedings. We bear in mind that Albion is a small company which has already suffered very serious delays in this case. Dŵr Cymru, which is very well resourced and ably advised, has drawn no point to our attention which could, even arguably, merit further scrutiny on the issue of dominance. We do not think that Dŵr Cymru can have it both ways: having argued extensively before the Tribunal that the construction of an alternative pipeline in 2001 would have been high risk and that the cost of doing so would have been well above Dŵr Cymru's existing retail tariff, Dŵr Cymru cannot at the same time credibly argue that the construction of such a pipeline was a realistic commercial proposition.

198. We find accordingly that at all material times Dŵr Cymru had a dominant position on the relevant market for the purposes of the Chapter II prohibition.

199. For the same reasons it follows in our view that the Director's conclusion at paragraphs 216 to 225 of the Decision that the Ashgrove system is not an "essential facility" cannot stand, since that conclusion is based on the Director's earlier reasoning to the effect that it would be feasible to construct alternative infrastructure to serve Shotton Paper and that the costs and difficulty of doing so "would not be sufficient to constitute a barrier to entry". On the evidence before the Tribunal that approach is unfounded. We therefore set aside paragraphs 216 to 225. However, in view of the conclusion we have reached on the issue of dominance, we do not need to consider the doctrine of "essential facilities" as a separate issue.

VII RELIEF AND REMEDIES: BACKGROUND AND ARGUMENTS

The factual situation

200. As indicated at paragraph 982 of the main judgment, it is now for the Tribunal to decide on the relief and/or remedies to be ordered in this case pursuant to paragraph 3 of Schedule 8 of the 1998 Act. Certain factual matters are relevant to these issues.

201. First, the contested Decision deals with the common carriage proposal whereby Albion would acquire non-potable water supplies direct from United Utilities at Heronbridge, and resell that water to Shotton Paper, paying Dŵr Cymru a common carriage price for the partial treatment and transportation of the water through the Ashgrove system. However, two hurdles need to be overcome before that proposal can take effect in practice.

202. The first hurdle is that, as a result of the combined effect of sections 66I and 66J of the WIA91, as inserted by the WA03, which came into effect in November 2005, Albion would now need a water supply licence under section 17A of the WIA91 in order to carry through its common carriage proposal, unless an exemption were granted under section 66K of that Act. Albion does not wish to apply for such a licence because that would mean surrendering its existing inset appointment. Albion has now asked the Welsh Assembly Government ("WAG") by letter of 29 October 2006 whether it would be prepared to grant such an exemption. Albion contends that, had the Director done his job properly, and had Dŵr Cymru not abused its dominant position, the proposed

common carriage arrangements would have taken effect in 2001, well before the 2003 Act was enacted and, as existing prior arrangements, would almost certainly have been exempted. Albion refers to a letter from Defra of 22 December 2004 which indicates that exemption from the licensing provisions of the WIA 91 is not excluded. However, the position of the WAG is not yet known. Section 66I of the WIA91 appears to envisage a statutory procedure for granting exemptions.

203. Assuming the grant of an exemption, the second hurdle to be overcome before the common carriage proposal would come into effect is that Albion needs to agree terms, particularly as to price, with United Utilities for bulk supplies from Heronbridge. United Utilities has now quoted a price to Albion well above that currently enjoyed by Dŵr Cymru. Nonetheless United Utilities has assured the Tribunal in open court that it sees no obstacle to a successful commercial negotiation being concluded. We assume that United Utilities will negotiate in good faith.

204. It appears to the Tribunal that, even assuming the grant of an exemption, the commercial viability of the common carriage proposal envisaged in the Decision will depend on: (i) the level of the access price properly chargeable by Dŵr Cymru; (ii) the price for bulk supplies agreed between Albion and United Utilities or, in default, determined by the Authority under section 40 of the WIA91; and (iii) the existence of a viable commercial margin for Albion.

205. In addition, pending the resolution of those matters, there is the question of the existing Bulk Supply Price payable by Albion to Dŵr Cymru for the bulk supplies of non-potable water supplied by Dŵr Cymru to Albion under the Second Bulk Supply Agreement, which Albion then resells to Shotton Paper.

206. As indicated at paragraphs 126 and 304 of the main judgment, Albion has been receiving financial support from its customer, Shotton Paper to enable it to survive. Following the Tribunal's interim order, by consent, of 2 June 2004, as amended by the Tribunal's further order of 11 May 2005, [2005] CAT 19, the position was that the Bulk Supply Price payable by Albion to Dŵr Cymru was reduced by those interim orders of the Tribunal by 2.05p/m³. Shotton Paper has been contributing support to Albion in the sum of 1.50p/m³, giving a margin of 3.55p/m³ altogether. However, with

effect from 10 November 2006, Shotton Paper ceased that financial support to Albion considering, understandably in the Tribunal's view, that in the light of the main judgment it was already paying an excessive price for its water supplies, and did not see why Albion's margin should come from Shotton Paper. In those circumstances, at the close of the hearing on 20 November 2006, the Tribunal, by order, amended the existing interim order so as to reduce further the Bulk Supply Price that would otherwise be payable by Albion to Dŵr Cymru by 3.55p/m³, thus restoring the status quo ante: see [2006] CAT 33. One of the matters the Tribunal has to decide is what course to take as regards that existing interim order.

Albion's submissions

207. Against that background, Albion's position before the Tribunal essentially is: (i) the Tribunal is in a position to, and should, make a final order finding that Dŵr Cymru has infringed the Chapter II prohibition, both as regards excessive pricing and margin squeeze; (ii) that if any matters are to be sent back to the Authority those matters should be limited to the precise determination of treatment costs, distribution costs, and retail costs, which matters can be dealt with shortly and are equally relevant whether the Authority is considering the matter in the context of the common carriage proposal, or in the context of a new determination of the Bulk Supply Price under section 40 of the WIA91; and (iii) pending either further work by the Authority on matters sent back by the Tribunal, and/or a new determination by the Authority as regards the Bulk Supply Price under section 40 of the WIA91, the Tribunal should by way of interim measure require a reduction in the existing Bulk Supply Price of at least 10p/m³ and secure for Albion a margin on that price of not less than 5p/m³.

208. As regards final relief, Albion seeks a finding by the Tribunal that the Decision should be set aside and a declaration that Dŵr Cymru has abused its dominant position, contrary to the Chapter II prohibition, by (a) charging an excessive price; and (b) engaging in a margin squeeze, on the grounds set out in the main judgment. According to Albion, there is ample material in the main judgment to support those findings. Albion further submits that the detailed supervision of any order should remain in the hands of the Tribunal.

209. On the excessive pricing issue, Albion submits that the Tribunal has already found excessive pricing on the balance of probabilities. Dŵr Cymru's distinction between an "unfair" price and an "excessive" price is a distinction without a difference, according to Albion. On the issue of margin squeeze the position is even clearer. According to Albion, the evidence is that there should have been a retail margin in favour of Albion of at least 5p/m³.

210. As to whether anything should be remitted to the Authority, Albion submits that this depends on the shape of the final order envisaged by the Tribunal. Albion invites the Tribunal to decide as much as possible itself. If, however, the Tribunal decided to refer any matters back to the Authority, the only issues outstanding are: the cost of carrying the water down the pipe; the cost of treatment at Ashgrove; and retail costs. Those matters could be put back to the Authority by the Tribunal in the context of the present proceedings. Only a short and limited reference back would be needed.

211. As to interim relief, Albion requests the Tribunal to make an interim order requiring Dŵr Cymru to reduce the Bulk Supply Price. According to Albion, the First Access Price was set so as to be consistent with the Bulk Supply Price and there is now no basis for maintaining the latter at its existing level. Albion relies on the Tribunal's finding, at paragraph 759 of the main judgment, to the effect that if the evidence strongly suggests that the First Access Price is excessive, the same must be true of the Bulk Supply Price. Albion also points out that among other things the Bulk Supply Price includes treatment costs of 7p/m³ rather than the 3.2p/m³ found by the Director to be appropriate, as well as retail costs which have nothing to do with bulk supply.

212. Albion argues that paragraph 2.17(e) of the notice of appeal in this case sought a determination by the Tribunal as regards the Bulk Supply Price, and Albion's interim measures application of 28 May 2004, which is the basis for the existing interim measures order, related to the Bulk Supply Price. According to Albion, the Tribunal's powers under Rule 61 of the Tribunal's Rules and Schedule 8 of the Act are wide enough to make the order sought, and the requirements of that Rule are satisfied. Were the Tribunal not to make an order, Albion would have to go "right back to the bottom of the snake having got virtually to the top of the ladder". The regulatory system would be toothless in the face of the difficulty Albion faces in reaching terms with both

United Utilities and Dŵr Cymru. The solution is for the Tribunal to make an interim order as regards the Bulk Supply Price. Albion emphasises that, in deciding what course to adopt, the Tribunal should bear in mind the wholesale regulatory failure which, it says, has already occurred in this case.

213. Albion's request for interim relief is supported by a witness statement by Dr. Bryan of 1 November 2006. Dr. Bryan gives details of the financial situation of Albion and its parent company Waterlevel Limited ("Waterlevel"). Albion draws attention to the loss, from 10 November 2006, of the support from Shotton Paper in the sum of 1.5p/m³. According to Albion, the continuing uncertainty of this case has been highly damaging to Albion's business, the introduction of effective competition has been delayed and damaged by the actions of Dŵr Cymru and the Authority, Albion's directors have suffered financial loss and the stress on them and their families has been immense. Shotton Paper too has been and will be damaged by the absence of any interim relief. The granting of interim relief is also necessary in the public interest to demonstrate to incumbents, customers, and potential entrants that the Tribunal is prepared to ensure that fair terms are available in the water industry. Without adequate interim or final relief, Albion is likely to cease trading.

214. As to the Authority's suggestion that outstanding matters can most conveniently be dealt with by the Authority making a new determination of the Bulk Supply Price under section 40 WIA91, rather than continuing work on the common carriage proposal, Albion would still wish to pursue the common carriage proposal. Albion would not wish to see matters "float away from the 1998 Act", or find itself back where it was in 1996. If, for example, United Utilities were to seek to increase the price it currently receives from Dŵr Cymru under the First Bulk Supply Agreement, Albion could still finish up with little or no margin.

215. In Albion's view the matters that remain for determination in this case, relating to distribution costs, treatment cost and retail margin, would all have to be dealt with in a determination under section 40 WIA91, and Albion does not see why it should have to choose between the two routes. Contrary to the submissions of the Authority, the close link between the Bulk Supply Price, the First Access Price and Dŵr Cymru's tariffs is shown by Dŵr Cymru's letters of 20 February 2001 and 10 August 2001. LRMC

calculations played little if any part in the original setting of the Bulk Supply Price, as shown by Dŵr Cymru's letter of 12 December 1996.

216. Albion can see some merit in Dŵr Cymru's proposal of an agreement that would maintain the existing reduction of 3.55 p/m³ in the Bulk Supply Price until the Authority's determination under section 40 WIA91, with the benefit of any reduction being back-dated to the date of the agreement, but sees disadvantages in the matter not being dealt with under the 1998 Act and being taken outside the Tribunal's jurisdiction.

217. In those circumstances Albion still seeks, on an interim basis, an order that the Bulk Supply Price be reduced by 10p/m³. To secure a margin, Albion also seeks an order that the price paid by Albion should be at a discount of not less than 5p/m³ from the price offered by Dŵr Cymru to any industrial user supplied by the Ashgrove system. In addition, Albion requests an order that the Authority should prepare a report for the Tribunal on the assessment of costs of (i) treatment, (ii) transportation and (iii) retail supply of non-potable water to industrial users within the area served by Dŵr Cymru within three months, as at the date of the complaint 11 December 2000, the date of the Decision 26 May 2004, and the date of the report.

The Authority's submissions

218. As to the final remedy, the Authority submits that further work would have to be done before any final conclusions were reached on abuse. The Tribunal's options are to do nothing; to remit the matter to the Authority; or to ask the Director to reinvestigate certain matters under Rule 19(2)(j) of the Tribunal's Rules. The Authority questioned whether, in the latter case, it would still enjoy its investigative powers under Section 26 of the Act. Any further work should be done by the Authority, rather than by the Tribunal taking its own decision.

219. In particular, according to the Authority, in the light of the Tribunal's judgment more work would need to be done before it could be said on the balance of probabilities that the First Access Price was excessive. Treatment costs, the level of non-potable distribution costs versus potable distribution costs, and a local costs cross-check would all need to be further worked on, as would the second limb of the *United Brands* test as

regards "unfair" prices. According to the Authority, all that work would be academic if there were, in fact, no realistic prospect of the common carriage arrangement coming into effect. On margin squeeze there would, according to the Authority be some further work to be done in so far as the Tribunal's findings depended on the evidence that the First Access Price was excessive, or on water efficiency considerations.

220. On the question of matters being referred back, the Authority submits that it would be inappropriate for it to do further work on the common carriage proposal when it is uncertain whether that proposal will ever go ahead. A better course, in the Authority's submission, is for the Tribunal to make no order, but for the Authority to make a new determination of the Bulk Supply Price under the procedure envisaged in section 40 of the WIA91. That would meet Albion's primary commercial objectives. In such a determination the Authority would have "appropriate regard" to the findings of the Tribunal in the main judgment.

221. In a letter to Albion also of the 15 November 2006, the Authority emphasises that, were it to review the Bulk Supply Price it would need to consider: (i) the extent to which LRMC estimates should be used in the particular circumstances of this case; (ii) the Tribunal's comments on comparative prices; (iii) the issue of retail costs; and (iv) the desirability of "facilitating effective competition" under section 40(6)(a) WIA91, as well as the observations of the Tribunal and other parties on competition within the water industry generally. However, the Authority does not consider that it would be appropriate to be working simultaneously on both the determination of a new Bulk Supply Price, and on matters consequent upon the Tribunal's ruling regarding the First Access Price. In a further letter to Albion of 17 November 2006, the Authority stated its view that a determination of the Bulk Supply Price under section 40 WIA91 would be preferable to an investigation of that price under the 1998 Act.

222. As to interim relief, the Authority's position is that the Tribunal has no jurisdiction under Rule 61, or otherwise, to make any interim order as regards the Bulk Supply Price. The Bulk Supply Price was established in 1996 on a quite different basis to the First Access Price, on the basis of LRMC, and there is no "read across" between the two prices. The Authority refers to Dŵr Cymru's letter of 21 August 1996, RD21/97 and correspondence with Enviro-Logic between June 1996 and January 1998 to show

that LRMC was taken into account at that time. The Bulk Supply Price was not part of the complaint, was not the subject of the Decision, and has not been investigated by the Authority. A separate procedure, under section 40 of the WIA91 exists for determining the Bulk Supply Price, and that process is entirely outwith these proceedings.

223. The existing interim order was made pending the conclusion of these proceedings. When they are concluded that order falls away. In so far as Albion has made a new application for interim relief under Rule 61(2) of the Tribunal Rules on the basis of Dr. Bryan's statement of 15 November 2006, any interim measures ordered on that basis would be appropriate only if the current appeals to the Tribunal were to continue. That in turn depends on the likelihood of any common carriage proposal being concluded, which is unclear. In a letter to the Tribunal dated 24 November 2006 the Authority advanced further arguments on the issue of jurisdiction, including the fact that it had never opened an investigation into the Bulk Supply Price under the 1998 Act, and contesting the admissibility of Case 1031, in which the Authority says the current interim order was made.

224. The Authority therefore considers that a new determination under section 40 of the WIA91, supported, as appropriate, by an interim agreement between Albion and Dŵr Cymru, as suggested by Dŵr Cymru at the hearing on 20 November 2006 (and in subsequent correspondence), is the best approach with no further orders from the Tribunal.

Dŵr Cymru's submissions

225. Dŵr Cymru supports the position of the Authority. As to final relief, considerable further work would be necessary on excessive pricing. Dŵr Cymru relies particularly on the reasoning of the European Commission as regards an "unfair" price in its *Port of Helsingborg* decision of 23 July 2004. In response to the Tribunal's request to indicate possible considerations relevant to determining whether the First Access Price was "unfair", Dŵr Cymru considers that the question of an unfair price would require a considerable degree of judgment, to be exercised in the first instance by the Authority. Relevant matters could include regional average pricing, which has never required pricing on a site specific disaggregated basis; the relatively advantageous prices

charged by Dŵr Cymru compared with elsewhere in the United Kingdom; the return on capital employed at Ashgrove compared with rates of return across industry in the United Kingdom generally; and the fact that the "true" cost of supply has yet to be determined.

226. As to margin squeeze, the only area for further investigation could be the water efficiency services referred to at paragraph 895 of the main judgment, but Dŵr Cymru maintains that if the First Access Price was not excessive, then the issue of margin squeeze would have to be re-opened: see *Industries des Poudres Sphériques,* cited at paragraph 874 of the main judgment.

227. However, according to Dŵr Cymru, it would not be appropriate to refer any matters back to the Authority because of the uncertainty surrounding the common carriage proposed. Dŵr Cymru argues that the common carriage arrangements cannot now come into effect as a result of the amended WIA91, and that the Government's response to consultation on exceptions to the WIA91, published in November 2005 ruled out exceptions or exemptions for common carriage arrangements. Dŵr Cymru submits that a reference back under Rule 19(2)(j) could not be a proper exercise of the Tribunal's discretion if public resources were to be expended for no useful purpose, which would be the case if there was no realistic prospect of the common carriage proposal coming into effect. According to Dŵr Cymru, Rule 19(2)(j) would not be well adapted to deal with a large issue such as that of "unfair price". If there were to be a reference back under Rule 19(2)(j), procedural safeguards would need to be established to protect Dŵr Cymru's rights of defence.

228. As to interim relief, Dŵr Cymru supports the Authority's position that the Tribunal has no jurisdiction to make an interim order as regards the Bulk Supply Price. However, Dŵr Cymru is prepared to enter into an agreement with Albion whereby both parties refer the determination of the Bulk Supply Price to the Authority under section 40 WIA91, without prejudice to Albion's rights under the 1998 Act. Pending that determination, Dŵr Cymru is prepared to accept a reduction of the Bulk Supply Price by 3.55p/m^3, which is the amount ordered by the Tribunal in its order of 20 November 2006. If the Authority later determines that the Bulk Supply Price should be reduced, Dŵr Cymru is prepared to agree that the lower price should be backdated to the date of

the agreement. Dŵr Cymru stresses the advantage to Albion of such an agreement in that the Authority has no power either to make an interim determination of the Bulk Supply Price, or to backdate any determination that the Authority might make. The agreement preserves all Albion's rights, and its existence, pending the Authority's determination. By contrast, submits Dŵr Cymru, the Tribunal would have no jurisdiction to make any interim order as regards the Bulk Supply Price, even if the present proceedings were pending before the Court of Appeal.

229. Dŵr Cymru also submits that the original interim order was made on the basis that Albion needed financial resources to meet its legal fees. Since it no longer needs legal representation once this appeal is terminated, that expense falls away and there is no further need for an interim remedy.

Aquavitae

230. Aquavitae asks the Tribunal to direct the Authority to revise its *Guidance on Access Codes* of June 2005 in the light of the main judgment within 28 days, and to direct that in the meantime water undertakers accord licensees under the WA03 a lawful margin in accordance with the Chapter II prohibition and EC law. The Authority and Dŵr Cymru oppose that application.

VIII THE EXCESSIVE PRICING ABUSE

The Decision

231. The issue before the Director in the Decision was whether the First Access Price of 23.2 p/m³ quoted by Dŵr Cymru to Albion in February 2001 was an unfair selling price within the meaning of section 18(2)(a) of the 1998 Act. The test for an unfair, in the sense of excessive, price, is set out in *United Brands*, cited at paragraph 308 of the main judgment, as follows:

> "248. The imposition by an undertaking in a dominant position directly or indirectly of unfair purchase or selling prices is an abuse to which exception can be taken under Article [82] of the Treaty.
>
> 249. It is advisable therefore to ascertain whether the dominant undertaking has made use of the opportunities arising out

of its dominant position in such a way as to reap trading benefits which it would not have reaped if there had been normal or sufficiently effective competition.

250. In this case charging a price which is excessive because it has no reasonable relation to the economic value of the product supplied would be such an abuse.

251. This excess could, *inter alia*, be determined objectively if it were possible for it to be calculated by making a comparison between the selling price of the product in question and its cost of production, which would disclose the amount of the profit margin; however the Commission has not done this since it has not analysed UBC's costs structure.

252. The questions therefore to be determined are whether the difference between the costs actually incurred and the price actually charged is excessive, and, if the answer to this question is in the affirmative, whether a price has been imposed which is either unfair in itself or when compared to competing products.

253. Other ways may be devised – and economic theorists have not failed to think up several – of selecting the rules for determining whether the price of a product is unfair".

232. In the Decision (paragraph 234) the Director posed himself three questions:

"(a) Did Dŵr Cymru misallocate any costs when calculating the First Access Price?

(b) Does the First Access Price bear no reasonable relation to the economic value of the service provided, when judged by reference to the difference between the costs actually incurred by Dŵr Cymru and the price charged?

(c) If the answer to (b) is in the affirmative, was the First Access Price unfair either in itself or when compared to competing services?"

233. In his conclusions at paragraphs 332 to 341 of the Decision, in relation to question (a) the Director found certain cost misallocations on the part of Dŵr Cymru (particularly as regards treatment costs) but drew no adverse conclusions in that regard. In relation to question (b), the nub of the Director's conclusion is to be found at paragraphs 335 to 341 of the Decision:

"335. The second question we considered was whether the First Access Price could be said to bear no reasonable relation to the economic value of the service provided, when judged by reference to the difference between the costs actually incurred by Dŵr Cymru and the price charged.

336. There is no legal definition of the "economic value" of a service. In United Brands, the ECJ simply referred to examining differences between costs and prices. Similarly, there is no definition of "excessive" in the context of pricing.

337. We have considered how best to assess costs, and whether the First Access price is excessive in relation to those costs. On the one hand, Dŵr Cymru adopted a particular approach to calculating the First Access Price which, with our adjustments to correct cost misallocation, would point to costs closer to 19.2p/m³, than the 23.2 p/m³ of the First Access Price.

338. However, as discussed above, we think that there are dangers in accepting only one approach when assessing costs and whether or not an access price is excessive. We therefore had regard to the Second Bulk Supply Agreement, the Costs Principle, and ECPR. The access price resulting from an ECPR approach based on the Second Bulk Supply Agreement would be approximately 22.5p/m³. We think that the Costs Principle would produce the same price.

339. In light of the above, and despite our dissatisfaction with the fact that the First Access Price did contain cost misallocation, we have doubts about whether the First Access Price could be said to bear no reasonable relation to the economic value of the service provided, when judged by reference to the difference between the costs actually incurred by Dŵr Cymru and the price charged.

…

341. We are therefore unable to answer our second question in the affirmative, we do not therefore need to address our third question, and we conclude that Dŵr Cymru did not abuse a dominant position in breach of the Chapter II Prohibition by engaging in excessive pricing."

The main judgment

234. In the main judgment the Tribunal concluded at paragraph 981:

"For the reasons given above we have reached the following conclusions:

(1) There is evidence before the Tribunal that the treatment cost of non-potable water on an average accounting cost basis was over-estimated in the Decision. However the Tribunal is prepared to assume, without deciding, that treatment costs are in the range 1.6p/m³ to 3.2p/m³.

(2) The matter of the "distribution" cost of non-potable water on an average accounting cost basis was not sufficiently investigated. In this respect the Decision is incorrect, or at least insufficient, from the point of view of the reasons given, the facts and analysis relied on, and the investigation undertaken, as regards in particular to the Director's conclusion in paragraph 302 of the Decision to the effect that it was not unreasonable to assume that the "distribution" costs of potable and non-potable water are the same.

(3) The evidence strongly suggests that the First Access Price was excessive in relation to the economic value of the services to be supplied, by reason of the absence of any convincing justification for the "distribution" costs included in the average accounting cost calculation.

(4) The cross-check as to the validity of the First Access Price by reference to ECPR in paragraphs 317 to 331 of the Decision cannot be safely relied on because (i) the 'retail' price used in the calculation is not shown to be cost-related, as regards the distribution element; (ii) the evidence strongly suggests that that price was itself excessive; (iii) the particular method of ECPR used in this case would eliminate existing competition and, in effect, preclude virtually any competitive entry, because the margins are insufficient; and (iv) the approach of the Authority in its evidence and submissions was not the same as that in the Decision. None of the justifications for an ECPR approach advanced by the Authority persuaded us that we could safely rely on the approach set out in the Decision in the circumstances of the present case."

235. It follows from the Tribunal's findings on ECPR summarised in paragraph 981(4) and section XII of the main judgment that paragraphs 317 to 331 and 338 of the Decision dealing with ECPR issues must be set aside.

236. On that basis, the analysis in the Decision could sustain a First Access Price of only 19.2p/m³, rather than 23.2p/m³, giving rise, on that basis alone, to an overcharge of some 21 per cent. That, from Albion's point of view, would represent an overpayment of some £250,000 per annum.

237. Moreover, on the basis of costs, the evidence before the Tribunal does not come anywhere near sustaining a First Access charge of even 19.2p/m³, leaving aside the issue of treatment costs. The figure of 19.2p/m³ is substantially based on the figure of

16p/m³ for "distribution" costs. However, for the reasons set out in section XI of the main judgment, the figure of 16p/m³ for distribution costs also cannot be sustained. The Tribunal's principal conclusions in the main judgment were: (i) the only justification put forward for the figure of 16p/m³, namely that non-potable distribution costs were the same as potable distribution costs, could not be sustained because account had to be taken of significant cost differences between potable and non-potable distribution costs respectively (paragraph 538); (ii) consideration of Dŵr Cymru's Large Industrial Tariff (LIT) justification in December 1998 suggested significant uncertainties as to the allocation to non-potable customers of about 50 per cent of the costs apparently included in the figure of 16p/m³, with further issues arising as regards a further 36 per cent of those costs (paragraph 546); (iii) the comparison between average "raw water" transportation costs and the claimed distribution costs of non-potable water showed that the latter was some 4 to 8 times higher than the former, a differential that was not explained on cost grounds in the context of Dŵr Cymru's average accounting systems. That added weight to Albion's contention that the figure of 16p/m³ was excessive, albeit that there was not a direct "read across" from Albion's raw water comparator to non-potable distribution costs (paragraphs 561 to 563); (iv) Dŵr Cymru was unable or unwilling to provide any historical information as to distribution costs attributable to the Ashgrove system or non-potable systems generally, despite requests from the Tribunal (paragraph 578); and (v) the calculations produced by the Authority and Dŵr Cymru showed that access prices in the region of the First Access Price could be supported only by assuming rates of return around 15 times Dŵr Cymru's normal rate of return, even assuming the capital values to be correct (paragraph 584). On the latter point, the Tribunal found at paragraph 603:

> "For the reasons given above, the evidence before the Tribunal regarding actual costs incurred or attributable, strongly supports Albion's contention that a calculation of the actual costs attributable to the Ashgrove system would show that both the distribution cost of 16p/m³, and the total cost of 19.2p/m³, found in the Decision on an average accounting basis, were not related to "the costs actually incurred" by Dŵr Cymru and accordingly were excessive."

238. The Tribunal concluded at paragraphs 631 to 637:

> "631….In our judgment, the evidence we have referred to above, taken as a whole, shows on the balance of probabilities that it was not reasonable for Dŵr Cymru to assume that the

costs of "distribution" of non-potable and potable water were the same at 16p/m³.

632. By various routes, Albion arrives at a figure of no more than around 2p/m³ for distribution costs...The Authority did not adduce any evidence to show what the component elements of the cost structure of a typical non-potable system might be, even indicatively, on an average cost accounting basis. Apart from one document relating to the operating costs of the treatment works, no original or contemporaneous accounting material was produced by Dŵr Cymru.

633. It must, in our view, have been obvious from the interim judgment that the Tribunal was seeking evidence in order to ascertain how, on an average accounting cost basis, the distribution cost of 16p/m³ could be justified, in its component elements, even indicatively. Instead of responding to the opportunity given to them by the Tribunal, Dŵr Cymru, and later the Authority, produced quite different "stand-alone" calculations on a "new build" basis, even though it was accepted, rightly, in evidence that those calculations did not, and could not, form any basis for charging.

634. We find it difficult to believe that Dŵr Cymru, and the Authority, would not have considered at an early stage of this case what accounting information was available that could be used to justify the average accounting cost figure of 16p/m³, even making various assumptions and estimates, but no such information has been produced. It is in our view significant that the only cost calculation produced by the respondent Authority, namely its "stand-alone" calculation of 25p/m³, comes within the "ball park" of the First Access Price of 23.2p/m³ only by assuming a rate of return some 15 times the rate that Dŵr Cymru normally earns on its existing assets, and allocating to the Ashgrove system the entire overheads of a self-standing water company. That in itself, in our view, is strong evidence that the First Access Price was excessive. Dŵr Cymru's higher figure of 32.4p/m³ is based on assuming an even higher rate of return, and inflating the MEA value of the pipeline at a time when, in our view, it must have known, or at least ought to have known, that the cost of mains laying was declining sharply.

635. This unfortunate history thus leaves the Tribunal, on the evidence, with a large unexplained gap between Albion's figure of 2p/m³ for distribution costs, which is supported by calculations on an average accounting cost basis, and the figure used in the Decision of 16p/m³, the components of which are not supported, even indicatively, by any

calculations at all, either in the Decision or otherwise. We do not think that Dr. Bryan could have been expected to do more, since all the information is or should be in the hands of Dŵr Cymru and the Authority.

636. In all those circumstances, and for the reasons given above, in our judgment the matter of the "distribution" cost of non-potable water on an average accounting cost basis was not sufficiently investigated. It follows, in our view, that on this aspect the Decision is incorrect, or at least insufficient, from the point of view of the reasons given, the facts and analysis relied on, and the investigation undertaken, as regards the conclusion set out in paragraph 302.

637. On the basis of Albion's estimate of distribution costs of around 2p/m³ and the range of some 1.6p/m³ to 3.2p/m³ for treatment costs, on Albion's figures the First Access Price should have been in round figures no more than 4p/m³ to 5p/m³. Even doubling Albion's figures to take account of elements possibly understated or omitted would produce a price broadly in the range of 8p/m³ to 10p/m³, less than half the First Access Price of 23p/m³. The evidence taken as a whole strongly suggests to the Tribunal that the First Access Price was excessive, in relation to the economic value of the services to be supplied, applying the *United Brands* test, by reason of the absence of any convincing justification for the "distribution" costs included in the average accounting cost calculation."

239. It follows from the foregoing that paragraphs 300 to 302 of the Decision, dealing with the relationship between potable and non-potable costs, as well as paragraphs 338 to 341, containing the Director's conclusions on excessive pricing, cannot stand.

The issue of abuse

240. For reasons substantially similar to those already discussed in relation to dominance, the Tribunal does not consider it would be right to leave the issue of abuse by reason of excessive pricing simply "hanging in the air" after six years of proceedings on Albion's complaint. In the Tribunal's view, a conclusion ought to be reached on that issue, one way or the other, in fairness to all parties. Given the advanced stage which this matter has reached before the Tribunal, and the need to minimize further delay, the Tribunal considers that that conclusion is better reached by the Tribunal taking its own decision under paragraph 3(2)(e) of Schedule 8 of the 1998 Act.

241. The Tribunal considers that, on the evidence, and subject to a further hearing, the Tribunal would be in a position to make a finding on the issue of abuse, one way or the other. However, for the reasons now explained, the Tribunal considers that it would be preferable if certain matters were, first, further investigated by the Authority under Rules 19(1) and 19(2)(j) of the Tribunal's Rules, which provide:

> "(1) The Tribunal may at any time, on the request of any party or its own initiative, at a case management conference, pre-hearing review or otherwise, give such directions as are provided for in paragraph (2) below or other directions as it thinks fit to secure the just, expeditious and economical conduct of the proceedings.
>
> (2) The Tribunal may give directions –
>
> …
>
> (j) to enable a disputed decision to be referred back in whole or part to the person by whom it was taken;…"

242. Rule 19(2)(j) derives from paragraph 17(4) of Schedule 4 of the Enterprise Act 2002, which provides:

> "(4) Tribunal rules may make provision enabling the Tribunal to refer any matter arising in any proceedings (other than proceedings under section 47A or 47B of the 1998 Act) back to the authority that made the decision to which the proceedings relate, if it appears that the matter has not been adequately investigated."

243. The Tribunal has decided to use its powers under Rule 19(2)(j) for the following reasons.

244. In the main judgment, the Tribunal found at paragraph 637 and elsewhere that the evidence taken as a whole "strongly suggests" that the First Access Price was excessive. That finding was deliberately expressed in cautious terms, to give the parties every opportunity to make submissions on what findings and orders the Tribunal should proceed to make, if any, on the issue of abuse, in the light of the main judgment, as well as on the Tribunal's jurisdiction in that regard. The parties have now had that opportunity. Albion and Dŵr Cymru have also been offered the possibility of mediation to resolve their differences.

245. It is implicit in the main judgment that the evidence at present before the Tribunal, summarised above, shows, on the balance of probabilities, that the First Access Price

bore no reasonable relation to the cost of the service to be provided, when judged by reference to the difference between the costs actually incurred by Dŵr Cymru and the price charged.

246. According to paragraph 250 of *United Brands*, cited above, a price which is excessive because it has no reasonable relation to the economic value of the product supplied would be an abuse of a dominant position. In the present case, there would, in our view, be strong grounds for the Tribunal to make a finding of abuse in relation to the First Access Price quoted to Albion. In addition to the difference between 19.2p/m³ and 23.2p/m³ referred to above, the evidence is that the figure of 19.2p/m³ is also excessive in relation to the actual costs incurred.

247. It seems to us, however, that it would be better if there were now to be a short further investigation of costs *before* a final conclusion was reached on the issue of abuse. In particular, where the issue is one of abuse, it is desirable that the question whether the price is "unfair" is to be assessed on the basis of a fully informed calculation of costs. In particular, the *extent* to which a price is unrelated to costs is relevant to the question whether that price is "unfair". Although at paragraph 637 of the main judgment the Tribunal expressed the view that the First Access Price was apparently at least double what could be justified on the basis of costs, in our view the difference between price and costs in this case should be ascertained more precisely than is possible at the moment, on the available evidence. In particular, it does not seem to us desirable, for example, to decide this case on the basis of the difference between 19.2p/m³ and 23.2p/m³ when the evidence is that the "gap" referred to in paragraph 635 of the main judgment is much larger than those figures suggest.

248. As Albion points out, the cost components in question are treatment costs, transportation costs and retail costs. Treatment costs, in the Tribunal's view, lie in the range 1.6p/m³ to 3.2p/m³. It should not, in our view, be difficult or time consuming to estimate treatment costs. As to retail costs, those costs fall to be excluded from the calculation of Dŵr Cymru's transportation and treatment costs. Again, it does not seem to us that extensive work is likely to be required in order to establish retail costs. Albion's evidence before the Tribunal is that retail costs were likely to be of the order of 5p/m³ (Mr. Jeffery's witness statement of 9 November 2004).

249. The main issue is "transportation" costs. Transportation costs, including any appropriate allocations, need to be distinguished from other costs currently included under the heading "distribution" costs. Costs relating to activities that are not fairly referable to the transportation of non-potable water, including but not limited to retail costs, need to be identified and excluded if appropriate. To have a full picture, transportation costs need, in our view, to be established both on the basis of an average for non-potable users generally and, as a cross-check, in relation to the Ashgrove system. In view of the information already before the Tribunal, this does not seem to us to be an onerous task. In any event, as explained below, the issues of treatment, transportation and retail costs will also need to be considered in the forthcoming determination of the Bulk Supply Price to be undertaken by the Authority. This case involves a single pipe through which non-potable water flows by gravity in large quantities from A to B for a distance of around 16 kilometres. It should not be intrinsically difficult, in our view, to establish the costs referable to an operation of that kind.

250. There is, in addition, the submission made by Dŵr Cymru to the effect that it follows notably from paragraph 252 of *United Brands*, cited above, that the fact that a price is excessive in relation to costs does not necessarily conclude the question whether the price is "unfair" for the purposes of the Chapter II prohibition. Dŵr Cymru relies on the Commission's decision in *Port of Helsingborg*, cited above, which itself refers, in a different context, to the Tribunal's judgment in *Napp*. In our view there is a certain ambiguity in paragraphs 250 to 252 of *United Brands* as to whether there is a distinction between a price which is "excessive" and a price which is "unfair". At present, we are not persuaded that, in a case such as the present, there is necessarily a distinction between a price that is "excessive", as distinct from a price which is "unfair", or that "economic value" is intrinsically difficult to ascertain. Paragraph 252 of *United Brands* refers to a price which is either "unfair in itself" or "when compared to competing products". The latter is difficult to apply in this case, since there is no substitute for the service of the transportation and partial treatment of water here in question. Moreover, as pointed out at paragraph 753 to 757 of the main judgment, other bulk supplies made by Dŵr Cymru are not necessarily reliable comparators.

251. As to whether the First Access Price was "unfair in itself", in our view this case does not concern the establishment of some *justum pretium* (just price) in the abstract sense, but the much more prosaic question of whether the costs of the "distribution" of non-potable water are the same as the costs of the "distribution" of potable water. The evidence before the Tribunal is that the former are considerably less than the latter, even on a regional average basis. The same is true if the Ashgrove system in North Wales is looked at on a self-standing basis, and not "averaged in" with the other self-standing non-potable systems in South Wales. To treat a class of customers (here, for non-potable water) as the same as another class of customers (here, for potable water) where the costs are significantly different would, in the absence of objective justification, be discriminatory: see e.g. paragraphs 623 to 625, 820 and 824 of the main judgment.

252. In those circumstances, it seems to us that the issue of whether the First Access Price was "unfair" should continue to focus primarily on the comparative situation of customers for potable and non-potable water respectively. However, the Authority will no doubt take into account any further submissions that may be made. Again, it seems to us that, in practice, the Authority's determination of the Bulk Supply Price, discussed below, will involve similar issues.

253. The Authority and Dŵr Cymru submit, however, that the Tribunal should send nothing back, principally on the basis that the original common carriage proposal is unlikely to go ahead as a result of the WA03. We do not accept that submission.

254. First, in our view it would be wholly unfair to Albion to leave this matter unresolved. Albion is a small company which has been trying for some six years to have its complaint determined, and has so far succeeded on the substance. In our view, it would not be in accordance with justice if that result, achieved by tenacity and force of argument against the combined forces of the Authority and an incumbent monopolist, should become an empty victory because some cost information is still not available and a few points remain to be decided. To conclude otherwise would simply mean that Dŵr Cymru's tactical approach in declining to supply accounting information in support of the claimed "distribution" costs of 16p/m³ would have paid off, leaving Albion with a Pyrrhic victory. Dŵr Cymru's claim that it is not possible to provide

even estimated accounting information to support the figure of 16p/m³ for "distribution" costs is not, in our view, credible.

255. Secondly, the Tribunal is not prepared to accept at this stage the abandonment of the original common carriage proposal. Albion has stated that it wishes to pursue the proposal, and we accept United Utilities' assurance that it is prepared to negotiate in good faith. The obstacle would appear to be the need for an exception or exemption under the WA03. That possibility was left open in DEFRA's letter to Albion of 22 December 2004, and the matter is now pending before the WAG.

256. It is not, in our view, unreasonable for Albion to be reluctant to give up its inset appointment, which has been the foundation of its relationship with Shotton Paper since 1999. In our view, the situation in which Albion finds itself is largely traceable to the actions of Dŵr Cymru and the Director. The Director did not deal with Albion's complaint expeditiously, nor according to law as indicated in the main judgment. Secondly, Dŵr Cymru obstructed the development of competition through common carriage by quoting a First Access Price which would have given Albion a zero margin and which bore no reasonable relation to costs.

257. Had one or other of those actions or inactions not occurred, we can see no reason in principle why Albion's common carriage proposal could not have gone ahead in 2001, or at any rate well before the coming into force of the WA03. In that event, we are not aware of any good reason why those arrangements, which would have been existing, pro-competitive, arrangements, of the kind encouraged by MD163, should not have benefited from an exception or exemption from the relevant provisions of the WA03.

258. The purpose of the WA03, as expressed particularly in the consumer objective set out in sections 2(2A) and (2B) of the WIA91 as amended, is to enhance the competitive possibilities in the water industry. It would, in our view, be perverse if the effect of that Act were to kill off the only competitive initiative in the water industry which so far has come anywhere near succeeding. It would, in our view, be even more perverse if that result should come about in consequence of conduct by Dŵr Cymru in contravention of the Chapter II prohibition and the failure of the Director to prevent it.

259. Thirdly, it appears to be common ground that the Authority will, in any event, undertake a re-determination of the existing Bulk Supply Price paid by Albion to Dŵr Cymru, under section 40 WIA91. That section provides that in determining the Bulk Supply Price, the Authority shall:

> "have regard to the desirability of –
>
> (a) facilitating effective competition within the water supply industry;
>
> (b) the supplier's recovering the expenses of complying with its obligations by virtue of this section and securing a reasonable return on its capital;
>
> (c) the supplier's being able to meet its existing obligations, and likely future obligations to supply water without having to incur unreasonable expenditure in carrying out works;
>
> (d) not putting at risk the ability of the supplier to meet its existing obligations or likely obligations to supply water."

260. It is true that the determination of a bulk supply price under section 40 is a separate statutory exercise. Certain points may arise which do not arise in relation to common carriage. Nonetheless we accept Albion's submission that in determining the Bulk Supply Price the Authority will inevitably be considering the costs of partial treatment and transportation relevant to the bulk supply provided by Dŵr Cymru to Albion. Similarly the Authority will need to address the issue of retail costs and determine the relevance or otherwise of such costs to the Bulk Supply Price.

261. In its letter to Albion of 15 November 2006 the Authority accepted, notably, that in the determination of the Bulk Supply Price it would have appropriate regard to the Tribunal's judgment; that the information generated in the appeal to the Tribunal about treatment and distribution costs was relevant to the Bulk Supply Price determination; that a margin to cover its retail costs was a significant concern to Albion; and that facilitating competition was an important factor in the exercise of the section 40 WIA91 powers, on which the observations of the Tribunal and other parties were relevant.

262. In those circumstances, the determination of the Bulk Supply Price and the investigation of the costs to which we have already referred will, to a large extent, cover common ground. A different time period is unlikely to affect the underlying

principles. It follows that, whether or not Albion obtains an exemption from the licensing provisions of the WA03, the Authority will still be likely to be investigating treatment, transportation and retail costs in the context of the section 40 determination. Since that work is likely to be done anyway, the fact that the Tribunal also requires it to be done for the purposes of this case does not add materially to the administrative tasks of the Authority. The question whether, in the light of further investigation of costs, the First Access Price was "unfair" is largely a matter of appreciation of the primary facts, rather than an additional element of investigation. In any event, the determination of the Bulk Supply Price may involve similar issues.

263. The Authority and Dŵr Cymru argue, however, that the Bulk Supply Price was arrived at on a quite different basis from the First Access Price, namely on the basis of long-run marginal cost (LRMC). The two prices are quite separate and there is no "read across" between them.

264. We reject those submissions. For the reasons already given, it is clear that there is a substantial "read across" between the two prices. Moreover, it is plain on the evidence before the Tribunal that, historically, the Bulk Supply Price was set on the same cost basis as the First Access Price.

265. Thus, in its reply dated 10 August 2001 to the Director's section 26 notice of 29 June 2001 Dŵr Cymru stated:

> "As a result of the pricing methodology adopted by Dŵr Cymru, there is *consistency* between the common carriage price offered to Albion Water and the bulk distribution and non-potable treatment components of the prices charged to other customers. **In particular, the proposed access price for common carriage has the same basis as the current bulk supply price for the inset appointment to the Shotton Paper site, less the water resource component.** This bulk supply price was set in 1999, at which time the Director General had the opportunity to dispute the basis for this price if he had seen sufficient grounds to do so. **There are no material differences from the supply characteristics of the proposed common carriage arrangement as compared to the 1999 bulk supply agreement.**
>
> (Bold added by the Tribunal)

266. In reply to the Director's letter of 29 January 2001, Dŵr Cymru stated in a letter of 20 February 2001:

> "The attached Appendix shows how the price has been calculated as well as the relationship between the potable Large Industrial Tariff and the non-potable price. **The latter is the price which would currently be charged for the Albion Bulk Supply, any difference is due to the annual price adjustment clause in the agreement.**
>
> (Bold added by the Tribunal)

267. That attached Appendix (Schedule A), shows that the First Access Price was arrived at simply by deducting the water resource cost (then 3.9p/m³) from the large industrial non-potable tariff price (then 27.1p/m³), which was regarded as the same as the Bulk Supply Price. In particular the cost of "bulk distribution" is identified as 16p/m³. Similarly, treatment costs are given as 7.2p/m³, the same figure as that used in calculating the First Access Price.

268. That correspondence shows very clearly that the existing Bulk Supply Price and the First Access Price were arrived at on exactly the same basis, the latter being arrived at simply by deducting the water resource cost from the former.

269. As to the question of LRMC, RD 21/97 states on page 6 that in arriving at the Bulk Supply Price the Director "had regard to" the estimate of LRMC provided by Dŵr Cymru and goes on to state "There is no substantial evidence to suggest the LRMC of non-potable water is below 26p/m³". We asked the Authority to identify the source of that figure. In a letter dated 15 November 2006 the Authority referred us to a letter dated 21 August 1996 from Dŵr Cymru which refers to "Large User Tariffs Long Run Marginal Costs," but does not mention non-potable water. A single table gives a few figures for Deeside, Cardiff, Swansea and South Pembrokeshire on the basis that an extra 20 Ml/day is required. Those for Deeside are raw water 3.7p/m³, treatment 20.3p/m³, distribution/transportation 21.0p/m³. No supporting calculations are provided.

270. It thus appears to be the case that in or around 1997 the Director came to the view that the Bulk Supply Price was not inconsistent with Dŵr Cymru's LRMC. However, in our view that is quite different from showing that the Bulk Supply Price was based on

LRMC. Moreover, on the evidence before the Tribunal, the Director's view about LRMC in RD 21/97 was apparently based on the most rudimentary information, consisting apparently of a single figure relating to potable water and unsupported by any calculations. That, in our view, would have been an inadequate basis for an LRMC calculation.

271. However, the main point is that the letters of 20 February and 10 August 2001, set out above, show quite clearly that, as far as Dŵr Cymru was concerned, the Bulk Supply Price was not based on LRMC but on Dŵr Cymru's then non-potable price and the costs shown in Schedule A to the letter of 29 January 2001, including the "distribution" cost of 16p/m³. That is further confirmed by the statement in Dŵr Cymru's letter of 10 August 2001 that "there are no material differences from the supply characteristics of the proposed common carriage arrangement as compared to the 1999 bulk supply agreement". We also note that in the Director's letter of 12 December 1996 indicating the Bulk Supply Price he was minded to determine, no mention was made of LRMC. That letter indicates that the principal matter taken into account by the Director was the price of other non-potable supplies, an element to which RD 21/97 also refers.

272. It is true that the Authority's letter of 15 November 2006, mentioned above, refers to LRMC, in the context of the forthcoming determination of the Bulk Supply Price, but that letter goes on to state "we may need to consider the extent to which LRMC estimates should still be used in the particular circumstances of a bulk supply agreement between Albion Water and Dŵr Cymru, against the background of this case". It is therefore not clear that LRMC should play a prominent, or indeed any, part in the forthcoming determination of the Bulk Supply Price.

273. In all those circumstances we adhere to the view that the proposed determination of the Bulk Supply Price will, to a large extent, cover the same ground as the further investigation of costs which we envisage.

274. We therefore see no good grounds for not requiring further investigation of the matters we have indicated.

The mechanism

275. There remains the question of the mechanism by which the Tribunal should send the above matters back to the Authority. In *Floe*, cited above, the Court of Appeal (Lloyd LJ, with whom Chadwick and Sedley LJJ agreed) said at paragraph 25 that the Tribunal's options were as follows:

> "If the appellant challenges a decision by a regulator, and establishes, on grounds taken in the notice of appeal, that the decision was wrong, whether as a matter of procedure or because of some misdirection of law or because the CAT takes a different view of the facts on the evidence before it, the Tribunal has a choice of a number of courses open to it. It may set aside the decision and remit the case to the regulator. It may feel able to decide itself what the correct result should have been, so that no remission or reference back is necessary. It may wish to retain for itself the task of deciding the eventual outcome but require further findings from the regulator, in which case it will not remit but may refer all or part of the decision back under rule 19(2)(j), with a view to deciding the appeal with the benefit of the result of that referral."

276. It appears from that judgment that, if the Tribunal sets aside the decision under appeal and remits the whole matter to the regulator under paragraph 3(2), first sentence, of Schedule 8, the appeal may no longer be subsisting, and the Tribunal may have no power to give consequential directions: see paragraph 28 of *Floe*. It is true that Lloyd LJ said at paragraph 28 that there may be cases, on unusual facts, where the setting aside of the decision and remittal of the matter to the regulator would not dispose of the appeal entirely. Similarly Sedley LJ accepted at paragraph 55 that the Tribunal could attach appropriate conditions to an order for remission requiring the OFT to act in a particular way, which order could, if necessary, be enforced through the High Court. However, the extent of these possibilities remains to be explored in future cases.

277. In the present case, the Tribunal takes the view that it is very close to being in a position to decide the issue of excessive price abuse, and that it would be appropriate for the Tribunal to do so. This case, in our view, falls squarely within the situation envisaged by Lloyd LJ in the last sentence of paragraph 25 of *Floe*:

> "It may wish to retain for itself the task of deciding the eventual outcome but require further findings from the regulator, in which

> case it will not remit but may refer all or part of the decision back under rule 19(2)(j), with a view to deciding the appeal with the benefit of the result of that referral."

278. We note again that *Floe* itself was a case in which the regulator had reached a non-infringement decision. Paragraph 29 of *Floe* also confirms that in such a context the Tribunal may set a time within which the matter is to be dealt with. In those circumstances we consider that Rule 19(2)(j) is the most appropriate mechanism to adopt.

Conclusion on the issue of the abuse of excessive pricing

279. On the issue of abuse of excessive pricing, the Tribunal considers that there would be strong grounds for making a finding of abuse. Nonetheless, for the reasons already given, the Tribunal considers it preferable that certain matters should, first, be further investigated by the Authority, notably to determine the *extent* to which the First Access Price was unrelated to costs, and to consider whether that price was unfair within the meaning of section 18(2)(a) of the 1998 Act.

280. The Tribunal therefore refers back to the Authority under Rule 19(2)(j) of the Tribunal's Rules for further investigation the matter of the calculation of the costs reasonably attributable to the service of the transportation and partial treatment of water by Dŵr Cymru, generally and through the Ashgrove system in particular, together with the associated question of whether, in the light of those costs, the First Access Price was an unfair price within the meaning of the Chapter II prohibition.

281. In investigating those matters the Authority shall give Dŵr Cymru and Albion a full opportunity to comment on the Authority's preliminary views before reaching any conclusions. There is no reason why that investigation should not proceed in parallel with the determination of the Bulk Supply Price where similar issues are likely to arise. The Authority is requested to report the results of its investigations to the Tribunal within six months of the date of this judgment, subject to any further direction of the Tribunal. The Tribunal will then determine the matter under paragraph 3(2)(e) of Schedule 8 of the 1998 Act.

IX THE MARGIN SQUEEZE ABUSE

The main judgment

282. At paragraph 919 of the main judgment, the Tribunal found

> "In the circumstances the Director's conclusion, at paragraph 352 of the Decision, that Dŵr Cymru did not infringe the Chapter II prohibition by engaging in a margin squeeze or 'price squeezing' was in our view erroneous in law and incorrect, or at least insufficient, from the point of view of the reasons given, the facts and analysis relied on, and the investigation undertaken."

283. It follows that paragraphs 345 to 352 of the Decision dealing with the issue of margin squeeze must be set aside. The same applies to paragraphs 360 to 361. The Tribunal's reasons in support of that conclusion are at paragraphs 848 to 918 of the main judgment.

Should the Tribunal decide the issue of margin squeeze abuse?

284. The issue to be addressed is whether the Tribunal should now proceed to take its own decision on the issue of the alleged margin squeeze abuse under paragraph 3(2)(e) of Schedule 8 of the 1998 Act. For the reasons already given above in relation to the issues of dominance and the excessive pricing abuse, we consider that we should consider whether the facts of this case do give rise to a margin squeeze abuse. In our view, we should do that in the interests of clearly establishing the legal position of the parties, saving time and costs, and avoiding further delay. In our view, the parties to these proceedings have been amply heard on the issue of margin squeeze, not least during the 6 day hearing in May/June 2006. As appears below, we do not consider that there are any further factual investigations which are necessary before we take such a decision. Unlike the position in respect of the abuse by excessive pricing, in our view all the necessary facts are before the Tribunal, and it is simply a question of applying the law to those facts.

The facts

285. As found in the main judgment, at paragraphs 863 to 865, a margin squeeze typically arises where a vertically integrated undertaking that is dominant in the supply of an

important input in a downstream market sets such a low margin between its input price (here, the First Access Price for the transportation and partial treatment of water) and the price it sets in the downstream market (here, Dŵr Cymru's retail price) that an efficient downstream competitor (here, Albion) is forced to exit the downstream market or is unable to compete effectively (OFT 414a, paragraph 6.1).

286. There is no doubt in this case that a margin squeeze exists as a matter of fact. The Tribunal held in paragraph 871 of the main judgment:

> "The issue of an alleged margin squeeze arises because, to operate the proposed common carriage arrangement, Albion would have to pay the First Access Price of 23.2p/m³, and also acquire the water from United Utilities. United Utilities submits that it was likely to wish to negotiate with Albion a higher water price than the price United Utilities currently pays Dŵr Cymru but, even if Albion paid only the price currently paid by Dŵr Cymru of some 3.3p/m³, Albion's total cost would still be some 26.5p/m³. Since the retail price currently offered by Dŵr Cymru under the New Tariff is 26.6p/m³, the *de facto* position is that the difference between the input price set by Dŵr Cymru (i.e. the First Access Price) and the price Dŵr Cymru sets in the downstream market (i.e. Dŵr Cymru's retail price of 26.6p/m³) is such that Albion would be unable to compete effectively and would be forced to exit the market. In effect, the difference between Dŵr Cymru's upstream and downstream prices would leave Albion with a zero margin, and thus unable to compete unless Shotton Paper were prepared to pay Albion more than Dŵr Cymru's retail price."

287. The effect of that margin squeeze is, and was, to prevent Albion from entering into a common carriage arrangement and to eliminate Albion as a competitor. As the Tribunal said at paragraphs 772 to 774 of the main judgment:

> "772. However, it has not been seriously disputed by the Authority and Dŵr Cymru that, if the Decision is correct, Albion's common carriage proposal is dead. Albion is expected under the Director's ECPR calculation to supply Shotton at a margin of 0 per cent. Whatever the debate about the size of the margin needed by Albion, it is not seriously suggested that it could survive on a zero margin, and it has only done so, so far, because of the support of Shotton Paper and the interim relief ordered by the Tribunal. As Mr Jeffery points out in his witness statement of 11 November 2004, Albion necessarily incurs some staff costs, office costs, insurance costs, regulatory costs

associated with its statutory appointment as an inset appointee, and so on.

773. Similarly, and for the same reason, if the Director's approach is correct, Albion could not survive even under the existing arrangements: so long as Dŵr Cymru's retail price is at or about 26p/m³ and the price under the Second Bulk Supply Agreement is the same, Albion's margin between these two prices is effectively squeezed to zero.

774. It follows that, in this particular case, the application of ECPR will prevent the development of a competitive supply situation as regards the Ashgrove system, and eliminate an existing new entrant. Under the 1998 Act, the Tribunal is not concerned with the interests of Albion as such, but it is concerned with the interests of the customer, here Shotton Paper (and possibly Corus) and the preservation of competitive choice. The adoption of a pricing rule which, in this particular case, would simply throw Shotton Paper back into the hands of its former monopoly supplier, would not seem to us compatible with the development of competition."

288. Although that passage occurs in the part of the main judgment dealing with ECPR, the principle is the same. As already indicated, Dŵr Cymru arrived at the First Access Price by simply deducting the water resource cost from its existing Bulk Supply Price, which was itself the same as Dŵr Cymru's prevailing retail price (approximately 26.5p/m³ in both cases). It is thus manifest that, by setting the First Access Price at the level it did, Dŵr Cymru left Albion with no effective margin with which to acquire the water resource and at the same time meet all its own costs and overheads.

289. Moreover, it is plain, on the evidence before the Tribunal, that in this case the First Access Price would, in practice, not merely offer a zero margin, but a substantially negative margin. That is because, in practice, Albion would not be able to obtain the water from United Utilities at anything like the below-cost price of 3.3p/m³ enjoyed by Dŵr Cymru. The facts of this case thus give rise to a serious and severe margin squeeze.

The law to be applied

290. In order to establish an abuse it is unnecessary to show that the abuse was committed intentionally or negligently. It is trite law that the concept of an abuse is an objective

concept (*Hoffman La-Roche,* cited above, at paragraph 91) and that a dominant firm has a special responsibility not to allow its conduct to impair genuine undistorted competition (Case 322/81 *Michelin v. Commission* [1983] ECR 3461, paragraph 57). The actual scope of the special responsibility of the dominant firm depends on the specific circumstances of each case: Case C-333/94P *Tetra Pak v. Commission* [1996] ECR I–5951, paragraph 24. However, that responsibility is particularly clear where, as here, the dominant firm enjoys a position of dominance approaching a monopoly, to use the words of Advocate General Fennelly in Cases C–395 and 396/96 *Compagnie Maritime Belge v. Commission* [2000] ECR I–1365, at paragraph 132 of his Opinion. In this case, Dŵr Cymru's position is not merely "approaching a monopoly": it has a monopoly. As far as Albion is concerned, there is no doubt that Dŵr Cymru "has a position of strength which makes it an unavoidable trading partner": *Hoffman-La Roche,* cited above, paragraph 41.

291. In our view, conduct by a dominant firm which will inevitably lead to the elimination or prevention of all competition and the preservation of its own monopoly, will ordinarily amount to an abuse of dominant position, unless objective justification is shown. Such conduct consists notably in "directly imposing unfair selling prices or other unfair trading conditions" contrary to section 18(1)(a), and "limiting production, markets or technical developments to the prejudice of consumers" contrary to section 18(2)(b), of the 1998 Act.

292. On the specific issue of margin squeeze, the accepted tests for a margin squeeze are set out in both the *Telecommunications Notice* and OFT 414a, cited at paragraphs 845 and 864 of the main judgment. Those tests are either (a) that the dominant company's own downstream operations could not trade profitably on the basis of the upstream price charged to its competitors by the upstream operating arm of the dominant company; or (b) that the margin between the price charged to competitors in the downstream market for the input product and the price which the dominant firm charges in the downstream market is insufficient to allow a reasonably efficient downstream operation to earn a normal profit (*Telecommunications Notice*, at paragraphs 117 and 118). OFT 414a at paragraphs 6.2 and 6.3 emphasises the second of these tests. The underlying principle is spelled out in various decisions of the European Commission, culminating in *Deutsche Telekom,* cited at paragraphs 866 to 869 of the main judgment.

293. Both those tests are satisfied in this case, as the Tribunal found in paragraphs 899 to 901 of the main judgment. In the first place, it is manifest that neither Albion nor any other reasonably efficient operator could earn a normal profit (or indeed any profit) when paying the First Access Price. In the second place, a notional retail business of Dŵr Cymru could not trade profitably either. As the Tribunal found at paragraph 901:

> "Moreover, in our view it is manifest that a "notional" retail business of Dŵr Cymru could not trade profitably at a retail price of 26p/m³ and an input price of 23.2p/m³. It would still have to acquire the water (costing at least 3.3p/m³). At a retail price of 26p/m³, a notional "retail arm" of Dŵr Cymru would itself have no margin to meet its costs, including overheads and profit. It follows that on this approach the alternative test for a margin squeeze is also met."

294. Furthermore, in this case Dŵr Cymru has made no attempt to identify separately, or allocate, the costs, direct or indirect, of the transportation service which it was asked to provide. The 16p/m³ for "distribution" costs, on which the First Access Price is based, incorporates costs, in particular retail costs, which are not related to the transportation service actually being supplied, as the Tribunal held in paragraph 906 of the main judgment. As the Tribunal found, the figure of 16p/m³ in fact represents Dŵr Cymru's "distribution" revenues (including its profit) from potable and non-potable customers alike. Those "distribution" revenues constitute, in effect, a balancing figure, representing what is left once Dŵr Cymru has deducted from its total revenues its estimated costs for "resources and treatment" and "local distribution": paragraph 465 of the main judgment. It has, however, been shown in section XI of the main judgment that the attempt to equate potable and non-potable "distribution" costs is not sustainable. Moreover, as paragraph 906 points out, no attempt was ever made to identify separately the costs of the transportation service sought by Albion. No relevant information was provided to the Tribunal on that point during these proceedings (paragraph 464).

295. In addition, Dŵr Cymru has failed to consider, even hypothetically, the costs that would be attributable to a notional "downstream" retail arm of Dŵr Cymru, as required by the *Telecommunications Notice* and, more specifically, by OFT 414a at paragraph 6.4. It is manifest that such a notional retail arm could not trade profitably on the zero margin in question (see paragraph 901 of the main judgment). The consequence is that

Albion and Dŵr Cymru were not put on an equal footing, as required by the margin squeeze test (paragraph 907 of the main judgment). Nor did Dŵr Cymru follow MD163, which requires that an incumbent "should charge entrants as it charges itself and be able to demonstrate that". That statement in MD163 is fully in accordance with the principles underlying the margin squeeze tests, and should have been followed. The fact that at paragraph 360 of the Decision the Director did not follow his own guidance does not, in our view, affect the existence or otherwise of an abuse by Dŵr Cymru.

296. At this stage of the analysis, it follows from the foregoing that the elimination by Dŵr Cymru of its only competitor, Albion, and the prevention of competition by common carriage by imposing on Albion a zero, or even negative, margin is properly characterised as an abuse of a dominant position.

297. Dŵr Cymru argues, however, that the Tribunal is not yet in a position to determine the issue of margin squeeze abuse, because, in order to demonstrate such an abuse, it must be shown that the input price (here the First Access Price) is excessive. Dŵr Cymru relies on the judgment of the Court of First Instance (CFI) in Case T-5/97 *Industrie des Poudres Spheriques v. Commission* [2000] ECR II–3755 ("the *IPS* case") at paragraphs 178 and 179:

> "178. The applicant therefore contends that PEM proceeded to apply what is known as 'price squeezing'. Price squeezing may be said to take place when an undertaking which is in a dominant position on the market for an unprocessed product and itself uses part of its production for the manufacture of a more processed product, while at the same time selling off surplus unprocessed product on the market, sets the price at which it sells the unprocessed product at such a level that those who purchase it do not have a sufficient profit margin on the processing to remain competitive on the market for the processed product.
>
> 179. None the less, it must be held that, in view of the arguments put forward above to the effect that the additional costs included in the price proposed by PEM in its offer of 21 June 1995 are justified, the applicant's complaints concerning the alleged exclusion effect of the price proposed by PEM must be rejected in view of the fact that the applicant has failed to prove even the very premiss on which its argument is predicated, namely, the existence of abusive pricing of the raw material. In the absence of

> abusive prices being charged by PEM for the raw material, namely low-oxygen primary calcium metal, or of predatory pricing for the derived product, namely broken calcium metal, the fact that the applicant cannot, seemingly because of its higher processing costs, remain competitive in the sale of the derived product cannot justify characterising PEM's pricing policy as abusive. In that regard, it must be pointed out that a producer, even in a dominant position, is not obliged to sell its products below its manufacturing costs.

298. In the *IPS* case PEM, part of the Péchiney Group, produced both primary calcium metal (the input product) and broken calcium metal (the downstream product) which was derived from primary calcium metal. PEM sold primary calcium metal to IPS, which produced and sold broken calcium metal in competition with PEM on that downstream market. IPS complained to the European Commission that PEM was trying abusively to exclude IPS from the market for broken calcium metal in various ways, including the misuse of anti-dumping procedures, failure to supply IPS's quality requirements, excessive pricing of supplies of primary calcium metal, and imposing a price squeeze in the market for broken calcium metal.

299. So far as relevant for present purposes, the CFI, in its judgment, found that IPS had alternative sources of supply available to it other than PEM (paragraph 57); that IPS had particular quality requirements for a low oxygen calcium metal product, which PEM had striven to meet by carrying out tests and adapting its factory at significant cost (paragraphs 75 to 93, 133); that, when PEM finally succeeded in providing a low oxygen calcium metal product meeting IPS's quality requirements, the price offered by PEM reasonably reflected the additional cost which PEM had incurred in producing a product to IPS's specifications (paragraphs 157 to 167); that the price PEM had quoted to IPS for the low oxygen calcium metal product was justified by additional costs and hence was not unreasonably high (paragraph 179); that the price at which PEM sold the low oxygen calcium metal product still gave IPS an adequate margin on the market for broken calcium metal (paragraph 182); and that IPS's difficulties arose from its higher processing costs (paragraph 185).

300. The *IPS* case was, therefore, entirely different from the present case on the facts. In particular, PEM incurred additional costs in seeking to meet IPS's particular quality

requirements; alternative supplies were available to IPS; IPS still had an adequate margin to compete on the downstream market; and IPS's principal problem was that it had higher processing costs than PEM. None of these factors are present here. Dŵr Cymru has done nothing to help Albion. Albion has no alternative sources of supply. Albion has no margin with which to compete on the downstream market. Dŵr Cymru has not incurred additional costs by producing a product (or service) to enhanced quality requirements requested by Albion. Albion's difficulties are not caused because it has higher costs than Dŵr Cymru. In those circumstances, we do not consider that paragraphs 178 and 179 of the CFI's judgment in *IPS* are transposable to the present case.

301. In particular, it does not seem to us that the *IPS* case introduces, by a side wind, a gloss on the Commission's and OFT's margin squeeze tests to the effect that a margin squeeze can be established only if it is shown that the input price is so unfairly high as to amount to an abuse. The comments made in the passage cited above in *IPS* seem to us to be directed to the specific arguments advanced in the context of that case, rather than purporting to lay down any more general proposition. It seems to us that an unfairly high price and a margin squeeze are essentially quite different concepts. The former is an exploitative abuse, while the latter is an exclusionary abuse, aimed at eliminating competitors. It is not necessary, in our view, to prove the former in order to establish the latter. As Professor Armstrong emphasised on behalf of the Authority, the margin squeeze test is about the *difference* between the input price and the downstream price of the dominant supplier, not about *the absolute level* of either price (e.g. paragraphs 742 and 743 of the main judgment). Even if, for example, Dŵr Cymru were to have succeeded in showing that there was no abuse of excessive pricing, the margin squeeze tests would still be met in this case: a notional retail arm of Dŵr Cymru would not be able to trade profitably at the First Access Price, nor would Albion be able to survive in the market. The *IPS* case, where the facts were quite different, does not, in our view, assist Dŵr Cymru.

302. In any event, in this case, Dŵr Cymru is not in the same position as PEM in *IPS*. The latter could show that its input price justifiably reflected a proportion of the additional cost of meeting IPS's quality requirements. However, for the reasons set out in Section

IX of the main judgment, Dŵr Cymru has not come anywhere near justifying the First Access Price on the basis of costs, as set out at paragraph 874 of the main judgment.

303. Even on the basis set out in the Decision, the First Access Price would be justified on an average accounting basis only to the extent of 19.2p/m³, and not the quoted price of 23.2p/m³. On that basis there should already be a margin of 4p/m³. That difference results from the Director's view, set out at paragraphs 291 to 296 of the Decision, that the average accounting cost of the partial treatment involved in this case was 3.2p/m³ and not 7.2p/m³. The evidence before the Tribunal is that the figure of 3.2p/m³ was overstated in the Decision, but the Tribunal is prepared to accept a range of 1.6p/m³ to 3.2p/m³ for treatment costs (paragraphs 315 to 321 of the main judgment).

304. In the light of the foregoing, in our view, there can be no doubt that the margin squeeze tests of the Commission and the OFT are met in this case.

305. The principal argument advanced by the Authority and Dŵr Cymru to avoid the orthodox application of the margin squeeze test was that the margin squeeze decisions such as *Napier Brown/British Sugar*, *Deutsche Telekom*, and *Genzyme* cited in the main judgment are all based on the idea that the price charged by the dominant supplier had failed to take account of the supplier's avoided costs, whereas in this case, according to Dŵr Cymru and the Authority, the First Access Price did reflect Dŵr Cymru's avoided costs. The Tribunal has already rejected that argument at paragraphs 908 to 911 of the main judgment. There is no suggestion in the text of those decisions that the basis of the reasoning is an "avoided cost" principle. The margin squeeze test looks at whether either an efficient competitor, or the incumbent's downstream arm, could compete and earn a normal profit in the downstream market at the incumbent's input price. If that is not the case, it is for the dominant firm to show objective justification. In our view, the avoided cost approach of Dŵr Cymru and the Authority is open to the same objections as the ECPR approach rejected by the Tribunal at length in section XII of the main judgment: see paragraph 910 of the main judgment.

306. In any event, during the course of these proceedings the Authority and Dŵr Cymru advanced various inconsistent arguments about "avoided costs". It was first submitted that only the water resource cost was avoided, but the Authority and Dŵr Cymru

ultimately submitted to the Tribunal that all retail costs should also be treated as avoidable (paragraphs 785 to 791, and 908 of the main judgment). However, that was not the basis of the Decision, and no attempt was made to ascertain what were the avoidable costs in this wider sense, either when quoting the First Access Price, or subsequently. In our view, on the facts, the "avoided costs" arguments were too inconsistent and imprecise to assist Dŵr Cymru or the Authority.

307. The Authority and Dŵr Cymru also argued that the latter could not be required to "subsidise" Albion. That, as an abstract statement, is not open to objection under the Chapter II prohibition, nor is a "subsidy" being advocated in this case. However, in this case Dŵr Cymru is a dominant undertaking which is in a position to control whether a competitor enters the market or not. Dŵr Cymru commands the infrastructure which the competitor needs to use and can set both the upstream price for the use of that infrastructure and its own downstream retail price against which a competitor has to compete. If the margin between those two prices is either zero or negative, no competitor can enter the market.

308. It is in those circumstances that a dominant undertaking, and certainly an undertaking with 100 per cent of the market such as Dŵr Cymru, is required to justify its pricing policy, otherwise it would be able permanently to foreclose any competition. The dominant firm is not required to subsidise its competitor, but it is required to show that the allegedly insufficient margin it imposes is objectively justified. The normal means of doing this is to show that a notional downstream arm of the dominant undertaking could earn at least a normal profit in the downstream market in question; or alternatively that a reasonably efficient competitor could do so. If that is shown, that is the end of the matter. A prospective entrant who cannot compete because it is inefficient, or has higher costs than the incumbents' downstream arm, is not entitled to be subsidised. It is also open to the dominant firm to show that, on a proper allocation of costs, the margin is not open to criticism.

309. In the present case, Albion does not, in our view, seek a subsidy, but a proper opportunity to compete on an equal footing with Dŵr Cymru's own "retail" activities. Self-evidently, a zero or negative margin prevents that competition. Dŵr Cymru has not shown any objective justification for that margin. It has not shown that its own

retail activities could make a normal profit in the downstream market at the margin in question; nor that any other competitor could do so, nor that Albion is inefficient. Dŵr Cymru has made no attempt to identify the costs properly to be allocated to the service of transportation, as distinct from the "distribution" function as a whole, which we understand to include, besides transportation, a range of other costs including notably retail costs, as well as other heads of costs discussed at paragraphs 503 to 546 of the main judgment. Moreover, Dŵr Cymru submitted inconsistent arguments on the issue of avoided costs. In its calculations Dŵr Cymru did not deduct the costs which it said towards the close of the hearing were also to be treated as avoidable, namely the costs of its retail function as a whole (e.g. paragraph 785 of the main judgment). It provided no information capable of substantiating the figure of 16p/m³ for "distribution" costs. The Director found in the Decision that 4p/m³ had been wrongly allocated to treatment costs. In all those circumstances, it is not a question of Dŵr Cymru being called upon to "subsidize" Albion. It is simply that the zero or negative margin which Dŵr Cymru imposed on Albion called for an objective justification, and Dŵr Cymru has failed to provide any such justification.

310. As regards water efficiency, the Tribunal found in the main judgment that Dŵr Cymru's LIT justification in 1998 presupposed the offer by Dŵr Cymru of water efficiency services. The LIT justification in turn formed the basis for the New Tariff introduced in 2003 which in turn reflected Dŵr Cymru's then retail price (some 26p/m³). The Tribunal found that those tariff prices should be taken to include the imputed cost of water efficiency services even though Dŵr Cymru was no longer providing those services (paragraphs 876 to 881 of the main judgment). The margin squeeze in this case would have the further effect of preventing Albion from offering water efficiency services on an economic basis. This additional element further supports the finding of margin squeeze, for the reasons given in paragraphs 876 to 895 of the main judgment.

311. In the light of all the foregoing we can see no reason to doubt that the margin squeeze imposed on Albion by Dŵr Cymru in this case amounted to an abuse of a dominant position.

312. We therefore find that Dŵr Cymru abused its dominant position in the relevant market by quoting a First Access Price of 23.2p/m³ that in fact imposed on Albion a margin squeeze between that price and Dŵr Cymru's then retail price of some 26p/m³. That margin squeeze arose because the margin between those two prices would not permit Albion, or any other efficient competitor, or a notional retail arm of Dŵr Cymru, to acquire a water resource and meet its own retail costs and overheads (let alone make a profit) were Albion or any other competitor to seek to compete with Dŵr Cymru by providing non-potable water to Shotton Paper via common carriage through the Ashgrove system. Had that margin squeeze succeeded, Dŵr Cymru would have, thereby, prevented any competition, preserved its monopoly, and eliminated Albion as a competitor, to the prejudice, notably, of the ultimate consumer Shotton Paper.

313. The Tribunal therefore declares that Dŵr Cymru has abused a dominant position by imposing a margin squeeze in the manner aforesaid.

X INTERIM RELIEF

The present situation

314. As already set out above, there is a subsisting interim order in this case requiring Dŵr Cymru to reduce the Bulk Supply Price to Albion by 3.55p/m³ until further order.

315. An interim order was first made in this case on 2 June 2004, by consent. The procedural history of that order is that on 1 April 2004 Albion, represented by Dr. Bryan acting in person, introduced an appeal before the Tribunal (Case 1031) claiming that the Director had taken appealable decisions rejecting Albion's complaint about the First Access Price. As part of that appeal, Albion sought an order for interim measures requiring Dŵr Cymru to reduce the Bulk Supply Price. The background to that request was that up to mid-2004 Albion had been receiving financial support from Shotton Paper of 3p/m³, which was due to be reduced by 50 per cent at the end of June 2004. The Tribunal held a case management conference in Case 1031 on 29 April 2004 and adjourned the matter to 2 June 2004.

316. On 4 May 2004 Albion formally asked the Director to make an interim measures direction reducing the Bulk Supply Price, to prevent serious damage to Albion. Albion followed up that request on 11 May 2004 with a revised application for interim measures. By letter of 26 May 2004 the Director refused Albion's application for interim measures on the grounds that (i) the Director had completed his investigation under section 25 of the Act and had no jurisdictional basis for granting interim measures, and (ii) urgency was not shown. On 28 May 2004 Albion lodged a document with the Tribunal headed "Application for Interim Measures under Rule 61(2) of the Competition Appeal Tribunal Rules 2003" seeking a reduction in the Bulk Supply Price of 2.6p/m³ to meet its fixed overheads and a further discount to give Albion "sufficient funds" to obtain specialist advice. At the subsequent case management conference of 2 June 2004 the Tribunal, by consent, made an interim order reducing the Bulk Supply Price by 2.05p/m³. The present appeal was lodged on 23 July 2004.

317. The Tribunal's interim order was varied on 11 May 2005 [2005] CAT 19 and varied again on 20 November 2006 [2006] CAT 33. The variation on 11 May 2005 was made in order to synchronise increases in the Bulk Supply Price with Albion's ability to pass on any such increases to its customer, Shotton Paper. As from 10 November 2006 Shotton Paper's financial support for Albion (by then in the sum of 1.50p/m³) ceased altogether. The Tribunal's order of 20 November 2006 required the Bulk Supply Price payable by Albion to Dŵr Cymru to be reduced by 3.55p/m³ with effect from 10 November 2006, thus putting Albion back into the position it was in before. The above orders have thus maintained the status quo in these proceedings for the past 2½ years.

318. Up to the present time the Tribunal's primary concern has been to ensure that Albion remains viable so that these proceedings are effective: [2005] CAT 19 at paragraph 10 and [2006] CAT 33, page 2. The interim orders have not, however, been made simply in the interests of Albion. They are also made in the interests of the maintenance of effective competition, which is in the wider public interest.

319. The Authority and Dŵr Cymru now contest the Tribunal's jurisdiction to maintain the existing interim order. The essential point made is that the existing Bulk Supply Price was not the subject of Albion's complaint, nor of the Decision, and has not been

investigated by the Authority. The procedure under section 40 WIA91 is the appropriate forum for determining the Bulk Supply Price, and that is outwith these proceedings. The Bulk Supply Price, it is said, was arrived at on a quite different basis. Dŵr Cymru is, however, prepared to agree to reduce the Bulk Supply Price by 3.55p/m³ pending the Authority's redetermination of that price under section 40 of the WIA91, with any decrease being backdated to the date of the agreement.

320. Albion, for its part, seeks a variation of the interim order requiring Dŵr Cymru to reduce further the Bulk Supply Price to at least 10p/m³ below its existing level, and to accord Albion a margin of at least 5p/m³.

The statutory powers

321. Paragraph 22 of Schedule 4 to the Enterprise Act 2002 provides:

> "(1) Tribunal rules may provide for the Tribunal to make an order, on an interim basis –
>
> …
>
> (c) granting any remedy which the Tribunal would have had power to grant in its final decision.
>
> (2) Tribunal rules may also make provision giving the Tribunal powers similar to those given to the OFT by section 35 of the 1998 Act."

322. The Tribunal's power to make interim orders is found in Rule 61 of the Tribunal's Rules which provides:

> "(1) The Tribunal may make an order on an interim basis –
>
> …
>
> (c) granting any remedy which the Tribunal would have the power to grant in its final decision.
>
> (2) Without prejudice to the generality of the foregoing, if the Tribunal considers that it is necessary as a matter of urgency for the purpose of –
>
> (a) preventing serious, irreparable damage to a particular person or category of person, or
>
> (b) protecting the public interest,
>
> the Tribunal may give such directions as it considers appropriate for that purpose

(3) The Tribunal shall exercise its power under this rule taking into account all the relevant circumstances, including –

(a) the urgency of the matter;

(b) the effect on the party making the request if the relief sought is not granted; and

(c) the effect on competition if the relief is granted.

(4) Any order or direction under this rule is subject to the Tribunal's further order, direction or final decision…"

323. The powers of the OFT (here, the Authority) to make interim orders are set out in section 35 of the 1998 Act which provides:

"(1) This section applies if the OFT has begun an investigation under section 25 and not completed it (but only applies so long as the OFT has power under section 25 to conduct that investigation).

(2) If the OFT considers that it is necessary for it to act under this section as a matter of urgency for the purpose –

(a) of preventing serious, irreparable damage to a particular person or category of person, or

(b) of protecting the public interest,

it may give such directions as it considers appropriate for that purpose."

324. As regards the OFT's power to make a final direction, section 33(1) of the 1998 Act provides:

"(1) If the OFT has made a decision that conduct infringes the Chapter II prohibition or that it infringes the prohibition in Article 82, it may give to such person or persons as it considers appropriate such directions as it considers appropriate to bring the infringement to an end."

325. As regards appeals to the Tribunal, section 47(1) of the 1998 Act provides that a third party may appeal to the Tribunal with respect to:

"(a) a decision falling within paragraphs (a) to (f) of section 46(3)

…

(e) a decision of the OFT not to make directions under section 35."

326. In the present case, the main appeal is brought under section 47(1)(a) and the Decision under appeal is a decision under section 46(3)(c) "as to whether the Chapter II prohibition has been infringed".

327. However, the Tribunal takes the view that the document lodged by Albion on 28 May 2004, when Dr. Bryan was acting in person, may fairly be regarded as an appeal to the Tribunal under section 47(1)(e) of the 1998 Act against the Authority's refusal of 25 May 2004 to issue an interim measures direction under section 35 of the Act, as well as being a self-standing application to the Tribunal under Rule 61(2) of the Tribunal's Rules. Those proceedings, whether an appeal under section 47(1)(e), or an application under Rule 61(2), or both, have been accorded a separate case number by the Tribunal, namely Case 1034 (IR).

328. At this stage, it does not seem to us to matter whether or not the original application for interim measures was brought in the context of the original Case 1031, which has been overtaken by events and may now be left to rest. The interim measures orders that the Tribunal has made or continued since the introduction of the main appeal at the end of June 2004 have, in our view, been made under the Tribunal's self-standing power under Rule 61, either in support of the main appeal (Case 1046), or as an interim order in what we regard as Albion's still subsisting appeal (Case 1034 (IR)) against the Authority's original refusal to grant interim measures in May 2004.

The relationship between the First Access Price and the Bulk Supply Price

329. Before proceeding further with the analysis, it is convenient to clarify once again the relationship between the First Access Price and the Bulk Supply Price.

330. We have already held, earlier in this judgment, that there is a strong "read-across" from the First Access Price to the Bulk Supply Price. As shown by Dŵr Cymru's letters of 20 February 2001 and 10 August 2001, referred to above, Dŵr Cymru arrived at the First Access Price simply by deducting the water resource cost from the Bulk Supply Price. The "distribution" costs of 16p/m³ and the treatment costs of 7.2p/m³ shown in Schedule A to the letter of 20 February 2001 are the same as the costs which underpin the First Access Price, and which were investigated by the Director in the Decision.

The fact that the Director also considered Dŵr Cymru's LRMC in an apparently rudimentary way when the Bulk Supply Price was first established does not alter the fact that the First Access Price and the Bulk Supply Price are the same, save for the water resource cost.

331. Although strictly speaking the Decision concerned the First Access Price, it was, in fact, impossible for the Tribunal to come to a conclusion about the First Access Price in these proceedings without considering the costs underlying the Bulk Supply Price. Moreover, in paragraphs 329 and 338 of the Decision, the Director relied on the validity of the Bulk Supply Price to support his conclusion as to the validity of the First Access Price. In consequence, the validity of the First Access Price and the validity of the Bulk Supply Price have become closely intertwined.

332. That was recognised by the Tribunal in the main judgment[8]. Thus at paragraph 748 the Tribunal held:

> "It seems to us that if the First Access Price of 23.2p/m³ is not shown to be reasonably related to costs, it must equally be the case that the even higher price of 26p/m³ under the Second Bulk Supply Agreement, used as the basis of the ECPR calculation in the Decision, is not shown to be reasonably cost-based either. The only difference between the First Access Price and the Second Bulk Supply Agreement price is that the resource cost of water is included in the latter and not in the former. Similarly, if the evidence strongly suggests that the First Access Price of 23.2p/m³ was excessive, the same must be true of the price of 26 p/m³ under the Second Bulk Supply Agreement. Those facts in our view fatally undermine the ECPR calculation set out in the Decision."

333. Having considered the various comparators apparently used in establishing the Bulk Supply Price at paragraphs 751 to 757 of the main judgment, the Tribunal came to these conclusions at paragraphs 757 and 760 respectively:

> "757. In those circumstances, the central problem facing the Tribunal is that there is no evidence that the prices in these various special agreements relied on as comparators in setting the price in the Second Bulk Supply Agreement were related to the costs of supply, and if so in what way. To the extent that the non-potable customers in question

[8] In the main judgment, the Bulk Supply Price is referred to more compendiously as "the price under the Second Bulk Supply Agreement".

were being charged prices similar to those charged to Shotton Paper, we have already shown in the first part of this judgment that the First Access price of 23p/m³ is not shown to be reasonably related to costs, on the evidence before the Tribunal. *A fortiori* that applies to the Second Bulk Supply Agreement price of the order of 26p/m³. If the price in the Second Bulk Supply Agreement of 26p/m³ is not cost-justified, and since the evidence strongly suggests that that price was excessive, it does not in our view assist that that price is based on a comparison with other prices which are not cost-justified either. We add that the only contemporary evidence we have which purported to give some cost justification for the price under the Second Bulk Supply Agreement (D21 to the Reply) has been abandoned by Dŵr Cymru, with the Authority's support, as not offering "incremental insight" (Jones 2, paragraph 16).

…

760. The price in the Second Bulk Supply Agreement of 26p/m³ is not, as such, under challenge in these proceedings. What is, however, under challenge is whether that price can safely be used, in a Decision adopted eight years later, as the basis for an ECPR calculation. Albion could not have foreseen that the price under the Second Bulk Supply Agreement indicated by the Director in 1996 would be used as the basis for an ECPR calculation in 2004. In our view, that price cannot be used for that purpose, essentially because that price has not been shown to be, even approximately, reasonably related to costs, as discussed in the earlier part of this judgment. The evidence also strongly suggests that that price is excessive in relation to costs as regards the distribution element. The same applies, by necessary implication, to Dŵr Cymru's earlier retail price to Shotton Paper of 27.2p/m³, and what we understand to be Dŵr Cymru's current offer price under the New Tariff of 26.6p/m³, to both of which the same objections apply."

334. Moreover, at paragraph 773, already cited above, the Tribunal held:

> "Similarly, and for the same reason, if the Director's approach is correct, Albion could not survive even under the existing arrangements: so long as Dŵr Cymru's retail price is at or about 26p/m³ and the price under the Second Bulk Supply Agreement is the same, Albion's margin between these two prices is effectively squeezed to zero."

335. It follows, in our view, that the determination of the First Access Price and the determination of the Bulk Supply Price cover a large degree of common ground and

raise substantially similar issues. Furthermore, to the extent that the Tribunal has already held that the First Access Price is not cost-related, and is excessive in relation to the actual costs incurred, logically the same is equally true of the Bulk Supply Price. More important for present purposes, Albion enjoys no margin between the Bulk Supply Price which it pays Dŵr Cymru (currently 27.63p/m³) and the retail price at which it currently supplies Shotton Paper (currently 27.63p/m³).

The need for interim measures

336. The existing and previous interim measures orders have been made by the Tribunal not solely in the narrow interests of Albion, but to ensure that these proceedings have an effective outcome, and that the possibility of competitive supplies being available through the Ashgrove system is preserved, in the interests of Shotton Paper, and potentially Corus. Those considerations seem to us even more valid at this stage of the proceedings, when Albion has substantially succeeded on the substance, than they were when the interim order was first made.

337. On the assumption that that there is no material increase in Albion's selling price to Shotton Paper, it does not seem to be in doubt that, in order to survive, Albion needs a margin between that price and the Bulk Supply Price. For the past 2½ years Albion has had the benefit of a reduction in that price of 3.55p/m³. It seems to us that there are powerful reasons for preserving the status quo. It is, in our view, strongly in the interests of Shotton Paper that Albion, its preferred supplier, continues to survive. It is equally, in our view, in the public interest that the only new entrant in the water industry in recent years should not be eliminated, as long as it is a viable competitor. We note, in particular, the Authority's recent letter of 28 November 2006 to the Minister for Climate Change and the Environment, supplied to the Tribunal, in which the Authority itself expresses concern at the lack of progress in introducing competition into the water industry, and emphasises the need to move matters forward with expedition, possibly by changes to the primary legislation.

338. In those circumstances, if Albion were now to cease trading for lack of an interim solution, that, in our view, would send an appalling signal to customers, potential entrants and incumbents alike, to the effect that the 1998 Act and the Authority as a

regulator were entirely ineffective. We express our regret that the Authority has seen fit to raise technical objections to the Tribunal's efforts to maintain the status quo. We make it clear that, for its part, the Tribunal is not prepared to run the risk that Albion might not survive pending the final determination of these proceedings and/or the proposed re-determination of the Bulk Supply Price.

339. In order to achieve that objective, some interim reduction in the Bulk Supply Price is necessary. On the evidence before the Tribunal, the basis for such a reduction plainly exists, since the evidence strongly suggests that Bulk Supply Price is excessive in relation to costs. On the basis of the Decision, a reduction of 4p/m³ would in any event be appropriate because of the recalculation of treatment costs. We do not think it could be seriously contended that a reduction in the Bulk Supply Price of 3.55p/m³ should not remain an appropriate interim reduction, to enable Albion to continue in business. It appears from Mr. Jeffery's witness statement of 9 November 2004, and from Dr. Bryan's more recent witness statement of 15 November 2006, that a sum of that order will maintain Albion's existence in the interim, albeit giving the company little or no surplus beyond its current outgoings.

340. We do not accept, as Dŵr Cymru has suggested, that the existing interim order was made primarily in order to enable Albion to pay its legal fees, or that the financial situation of Albion/ Waterlevel will improve materially if Albion recovers its costs in the appeal. The original interim order was, in our view, intended to enable Albion to remain in business. It is at present uncertain if, or when, its outgoings on legal costs will cease. In any event, the cessation of the monthly payments of legal fees which Waterlevel apparently makes is unlikely, it seems to us, to alter materially the financial situation of Albion/Waterlevel.

341. It is apparently the case that Dŵr Cymru has recently increased its non-potable retail tariff. However, Albion's ability to raise its price to Shotton Paper is constrained by its agreement with the latter. Moreover, a solution that involved Albion raising its price to Shotton Paper is unacceptable, in circumstances where the Tribunal has come to the conclusion that the evidence strongly suggests that the Bulk Supply Price is already excessive in relation to costs.

342. It seems to us that, in all those circumstances, there is every reason to maintain the status quo by continuing the existing interim order. Not to do so would, in our view, run the risk of serious damage to Albion, which would become irreparable if it were to cease trading. The matter is urgent in the sense that, without support in the sum of 3.55p/m³ or a sum of that order, Albion could go out of business. Such an order is, in our view, necessary to protect the public interest by ensuring the interim survival of Albion as a supplier to Shotton Paper and a competitor of Dŵr Cymru, as well as safeguarding the effectiveness of the 1998 Act in the wider public interest. The effect on competition if such an order is made is, in our view, highly beneficial in that it preserves the possibility of competitive supplies being available to the customers of the Ashgrove system, as well as reinforcing the Authority's long-standing attempt to increase competitive opportunities in the water industry.

343. We have considered whether it is necessary to continue the interim order in view of the fact that Dŵr Cymru has offered to enter into the agreement with Albion to reduce the Bulk Supply Price by 3.55p/m³, pending the Authority's re-determination of that price, and to backdate any reduction to the date of the agreement. That offer by Dŵr Cymru was welcome, and the fact of its existence is relevant both to the exercise by the Tribunal of its discretion and to other issues, such as urgency. Nonetheless, Albion is reluctant to enter into such an agreement if, thereby, it loses the protection of the Tribunal's jurisdiction. Against the background of this case, we are very reluctant to refuse Albion interim measures on the ground that it should have entered into the suggested agreement with Dŵr Cymru. Dŵr Cymru has now obstructed Albion's proposals for six years, has made many procedural objections, and has on occasion adopted a denigratory stance towards Albion's arguments. Relevant cost information has not been forthcoming, even on an estimated basis. Various misunderstandings have arisen, both between the parties, and between Dŵr Cymru and the Tribunal, for example as to the information sought on costs. Despite the Tribunal's indication, under Rule 20(4)(e) of the Tribunal's Rules, that serious consideration should be given to a settlement of these proceedings, possibly with the assistance of mediation, Dŵr Cymru has adopted a formal stance and insisted on a further regulatory procedure under section 40 of the WIA91, which will take a further indeterminate time. Recent correspondence between the parties, copied to the Tribunal, such as Dŵr Cymru's letter to Albion of 30 November 2006, seems to us to indicate prevarication on Dŵr Cymru's

part. There is a very large disparity of resources between the parties. Future events cannot be foreseen. In all these circumstances we think it better that a formal order be in place.

344. In those circumstances, the only issue, it seems to us, is the Tribunal's jurisdiction to continue the existing interim order.

The Tribunal's jurisdiction

345. As a result of the Tribunal's reference back under Rule 19(2)(j), this appeal is still subsisting. It seems to us that we have jurisdiction under Rule 61(2) of the Tribunal's Rules to protect the integrity of the appeal by maintaining the interim order until that reference back is completed and the Tribunal has made a final decision. For the reasons already given, we consider that the requirements of Rule 61(2) are satisfied.

346. We add that the grounds for maintaining the interim order are now stronger than they were when the interim order was first made, since it is now clear that the Bulk Supply Price is open to the same allegation of abuse of a dominant position as the First Access Price.

347. Similarly we would, in any event, maintain the existing interim order if, and so long as, there were the possibility of a further appeal from the Tribunal to the Court of Appeal under section 49 of the 1998 Act.

348. In our judgment, there is a second jurisdictional route which leads to the same conclusion. Albion has already made an application to the Director for interim measures, and the Director rejected that application on 25 May 2004. Albion's application of 28 May 2004 in Case 1034 (IR) may properly be regarded as an appeal under section 47(1)(e) of the Act against that refusal, or a self-standing application for interim measures arising in that context. The interim measure sought by Albion in Case 1034 (IR) is a reduction in the Bulk Supply Price. Contrary to the view which the Director took in May 2004, there is now no doubt that there are reasonable grounds for suspecting that the Chapter II prohibition had been infringed, within the meaning of section 25(4) of the 1998 Act, in relation to the Bulk Supply Price, for the reasons

already given. A proper investigation, at the time, would have established such reasonable grounds as at May 2004, and in our view such reasonable grounds have existed ever since. In those circumstances it was, and is, in our view open to the Authority itself to give interim measures directions under section 35 of the 1998 Act. In our view, its refusal to do so is independently appealable to the Tribunal under section 47(1)(e) of the 1998 Act, and has been appealed. In all those circumstances, the Tribunal would, in our view, have jurisdiction to make an interim measures direction, pending the determination of the interim measures appeal, if the conditions for granting interim measures were otherwise satisfied. Such jurisdiction is exercisable, it seems to us, either under Rule 61(2), which is widely expressed, or under Rule 61(1)(c).

349. We take the view that the Tribunal would have that jurisdiction, in an interim measures case, even if the Authority or the OFT has not begun an investigation under section 25, provided that there were reasonable grounds for suspecting an infringement, in which case the Authority or the OFT *could* have opened an investigation and proceeded to make an interim measures direction if the conditions were otherwise satisfied. We emphasise again that these powers do not exist merely to protect private interests, albeit that they do so indirectly, but more especially to protect the public interest by ensuring effective competition.

350. We add that, in our view, the Tribunal's powers arising by virtue of Case 1034 (IR) would still exist even if the present appeal (1046) had come to end, which it has not. In the context of Case 1034 (IR), there are, in our view, at the very least reasonable grounds for suspecting an infringement of the Chapter II prohibition in respect of the existing Bulk Supply Price. The criteria for an interim measures order are met. As the Authority itself emphasises, there is no other mechanism under the WIA91 for making any interim order in relation to the Bulk Supply Price.

351. There is a third jurisdictional route to arrive at the same result, which is as follows. Suppose that the OFT properly opens an investigation into certain conduct (conduct A) under section 25 of the 1998 Act, and comes to the conclusion that there is an infringement of the Chapter II prohibition. Suppose also that it follows from the OFT's conclusion that other conduct by the same undertaking (conduct B), which is closely

related to and intertwined with conduct A, also appears to infringe the Chapter II prohibition. Suppose, further, that the OFT's decision about conduct A will be deprived of practical effect, because the complainant will be driven out of business by conduct B before the decision about conduct A can take effect. It seems to us, as a matter of common sense, that in those circumstances the OFT would have power to make an interim measures direction in relation to conduct B, and that its decision to refuse such a direction would be appealable to the Tribunal. The Tribunal would then itself have power to grant interim measures, under either Rule 61(1)(c), or under Rule 61(2).

352. That is, in effect, the situation in this case. As a result of the Tribunal's judgment, the Authority's investigation into the First Access Price is still open. Had that investigation been properly conducted, it would by now be apparent to the Authority that, not only was there an infringement of the Chapter II prohibition in relation to the First Access Price, but that there were also reasonable grounds to suspect an infringement in relation to the Bulk Supply Price. It would also be apparent to the Authority that there would be a risk of Albion going out of business before the decision on the First Access Price could take effect, by virtue of the level of the Bulk Supply Price. In those circumstances, we can see no reason why the Authority could not adopt interim measures under section 35 of the 1998 Act to preserve effective competition, for example pending a re-determination of the Bulk Supply Price. In the postulated circumstances, no other remedy would be available to the Authority to protect the public interest.

353. We would not accept, and indeed it has not been suggested, that the Bulk Supply Price in this case is not subject to the Chapter II prohibition. As already set out in paragraphs 152 and 196 of the main judgment, it is plain that the 1998 Act is not ousted by the WIA91, albeit that the characteristics of the water industry are relevant to how the 1998 Act is applied in that context. The same applies to Community law. We do not see any jurisdictional reason why the Authority could not give either an interim measures decision under section 35, or a final direction under section 33 of the 1998 Act, in relation to the existing Bulk Supply Price.

354. We do not think that any of the above analysis is affected by the fact that any challenge to a future re-determination of the Bulk Supply Price by the Authority under section 40 WIA91 would be by way of judicial review to the High Court. That is in the future and in our view does not affect the present issues.

Albion's application

355. In view of the matters we have referred back to the Authority under Rule 19(2)(j), we do not think it would be right at this stage to order an interim reduction in the Bulk Supply Price of at least 10p/m³ as Albion requests, albeit that we fully understand the difficult situation in which Albion finds itself. Similarly, as regards the 5p/m³ margin which Albion requests, we do not think it appropriate at the interim stage, at least for the moment, to go beyond the maintenance of the status quo, which gives Albion a margin on its existing buying and selling prices of 3.55p/m³. There will be liberty to apply under the Tribunal's order in the event that circumstances change or new developments occur.

Aquavitae

356. Sympathetic though the Tribunal is to Aquavitae's request that the Tribunal order the Authority to withdraw its existing *Guidance on Access Codes*, and take other measures to require incumbents to accord a proper margin to licensees seeking to exercise their rights under the water supply licensing provisions of the WIA91, in our judgment relief of that kind is outwith the jurisdiction of the Tribunal under Schedule 8, paragraph 3, of the 1998 Act. We welcome the Authority's recent letter to the Minister of 28 November 2006 and trust that the difficulties that have arisen in the implementation of the water supply licensing provisions under the WIA91 will be speedily overcome.

357. The Tribunal notes, however, from the Authority's letter to Aquavitae dated 12 December 2006 that, despite its letter to the Minister of 28 November 2006, expressing concern about the lack of progress in introducing competition into the water industry, the Authority's view is that for the time being undertakers should continue to follow the Authority's *Guidance on Access Codes*. As Aquavitae points out in its letter of 14 December 2006, the Tribunal found, at paragraph 973 of the main judgment, that

market entry was unlikely to take place on the basis of that *Guidance*. The Tribunal further found that:

> "In our view, an interpretation of section 66E(4) which gives rise to a minus element which, in effect, precludes virtually any effective competition or market entry, is in potential conflict with the consumer objective set out in sections 2(2A)(a) and (2B) of the WIA91, and with the Chapter II prohibition, and thus open to serious question." (paragraph 976)

358. At paragraph 978 of the main judgment, the Tribunal held that the WIA91 does not disapply the Chapter II prohibition, and that sections 66D(9) and (10) leave open the possibility of a direction being given under the 1998 Act in relation to matters arising under section 66D which involve conduct suspected of being in breach of the Chapter II prohibition. In all those circumstances, the Tribunal is not satisfied that the Authority's current interpretation of section 66E(4) is correct, nor that the Authority's existing *Guidance* is lawful guidance, nor that statutory undertakers would be acting lawfully in following that *Guidance*, notwithstanding Condition R of their conditions of appointment, nor that paragraph 5 of Schedule 3 to the 1998 Act would necessarily be applicable. Plainly a most serious situation arises if the lack of competitive entry in the water industry is due to the Authority's own actions. It is, however, for Aquavitae and others concerned to pursue those matters, if so advised, by way of further complaints and/or requests to the OFT or the Authority under the 1998 Act, or by such action as may be appropriate in the High Court.

Conclusion on interim relief

359. For those reasons the Tribunal confirms, until further order, the existing interim order of 20 November 2006.

XI CONCLUSIONS

360. For the reasons given above the Tribunal unanimously:

(i) sets aside paragraphs 93 (first sentence), 97 to 99, 131, 132, 138, 144, 150, 160 to 165, 176 to 177, 182 to 187, 189 to 191, 199 to 203, 209, 211, 213 to 215, 216 to 225, 300 to 302, 317 to 331, 338 to 341, 345 to 352, 360 to 361, 371, and Annex I of the Decision.

(ii) confirms as correct the Director's assumption as to dominant position at paragraphs 212 and 215, last sentence, of the Decision, and finds on the facts that Dŵr Cymru had at all material times a dominant position on the relevant market within the meaning of the Chapter II prohibition.

(iii) refers back to the Authority under Rule 19(2)(j) of the Tribunal's Rules for further investigation the matter of the costs reasonably attributable to the service of the transportation and partial treatment of water by Dŵr Cymru, generally and through the Ashgrove system in particular, together with the associated question of whether, in the light of those costs, the First Access Price was an unfair price within the meaning of the Chapter II prohibition.

(iv) declares that by quoting the First Access Price of 23.2p/m³, at the same time as offering a retail price of some 26p/m³, Dŵr Cymru imposed on Albion a margin squeeze which constituted an abuse of a dominant position within the meaning of the Chapter II prohibition.

(v) continues until further order the Tribunal's interim order of 20 November 2006 reducing Dŵr Cymru's existing Bulk Supply Price to Albion by 3.55p/m³.

Christopher Bellamy	Antony Lewis	John Pickering

Charles Dhanowa
Registrar

18 December 2006