IN THE COMPETITION APPEAL TRIBUNAL

Case No. 1046/2/4/04

Victoria House,
Bloomsbury Place,
London WC1A 2EB

7th June 2006

Before:
SIR CHRISTOPHER BELLAMY
(The 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 — Respondent
(Formerly The Director General of Water Services)

Supported by

DWR CYMRU CYFYNGEDIG
and
UNITED UTILITIES WATER PLC — Interveners

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HEARING DAY SIX

APPEARANCES

Mr. Rhodri Thompson QC and Mr. John O'Flaherty, instructed by Albion Water Limited appeared on behalf of the Appellant.

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

Mr. Rupert Anderson QC and Miss Valentina Sloane (instructed by the Head of Legal Services, Water Services Regulation Authority) appeared on behalf of the Respondent.

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

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

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THE PRESIDENT: We do not have Mr. Thompson or Mr. O'Reilly, but I think we ought to press on.

MR. O'FLAHERTY: Sir, he was hoping to be here as close to quarter to as possible.

THE PRESIDENT: Mr. O'Reilly has an instructing solicitor who will intervene if necessary, thank you very much.

MR. ANDERSON: Good morning, Sir.

THE PRESIDENT: Good morning, Mr. Anderson.

MR. ANDERSON: Could I just finish the Annex C characteristics of the industry very quickly?

THE PRESIDENT: Of course.

MR. ANDERSON: Which you can find, as I say, at Annex C to Professor Armstrong's report.

THE PRESIDENT: Yes.

MR. ANDERSON: We were at p.15 of that report. Paragraph 47, another feature of the water industry is the high proportion of common costs. This means that the incremental cost of serving an additional customer might be quite low because other customers already funding the common costs.

The next characteristic is dynamic efficiency. One of the criticisms of ECPR, and indeed one that Dr. Marshall made a great deal of was that whilst it ensures short run productive efficiency it might stifle long run efficiency gains, and a point we make in 49 is that that argument, we would say, is not forceful in the water industry because short term increases resulting from inefficient entry are potentially so large whereas the long term gains for innovation are less obvious. This is a topic that Dr. Bryan touched on in his evidence, and beyond the introduction of chlorination in the early 1900s there did not seem to be a great deal in the form of productive dynamic innovative development. But he did accept (this is our day 2, p.35) that such scope for dynamic or innovation as there is is more likely to be found in the domestic sector.

Section 6 on p.16 "Barriers to entry", we say there that entry to the water supply industry is difficult for many reasons. We say that most of those reasons are unrelated to ECPR and we list there what those are. They are not very surprising. That then brings us to our conclusion as to why we say that ECPR is an appropriate model for this industry. I should say by way of ensuring that I limit the length of time that I am on my feet that we have set out very full written submissions and the fact that I do not take the Tribunal to any particular part of it is not to be taken as meaning that I do not still rely on it.

THE PRESIDENT: No, absolutely, Mr. Anderson.

MR. ANDERSON: We rely on the whole of it.

THE PRESIDENT: We have read them and we will re-read them very, very carefully.

MR. ANDERSON: I am grateful, Sir. Paragraph 9 and then through the magic 10 of my skeleton argument finishes off the introduction and I move then on to excessive pricing that begins at para.11, and the three very familiar issues, potable/non-potable, stand-alone, ECPR. Before that we deal in the table at 21 with our principal objections to the methodologies if that had been advanced.

Dr. Bryan's industry in this case has, no doubt, earned him the respect of everyone in this room, me included, but we would say that these methodologies are all flawed for the reasons that we have set out in the annex to our rejoinder. A point was made yesterday about a particular methodology 3, Mr. Thompson handed up a document suggesting we had got the wrong quantities in our criticism of methodology 3. The short answer to what Mr. Thompson is now saying is that he has picked the wrong year in which to bring in new quantities. That methodology was based on 2002/03 figures, and we used 2002/03 volumes to criticise it. The document that Mr. Thompson produced yesterday goes back to 2000/01 figures and there was a significant drop in volume between those two years. So having switched the music back on, as it were, we switch it off there. I was not proposing to spend any more time on that. If it is a matter that interests the Tribunal we can deal with it I would suggest in writing afterwards, but that is the short answer. So we retain our criticism of methodology 3.

Methodology 7, which is the new one we have dealt with in one of the Annexes to this skeleton.

THE PRESIDENT: Yes, Annex 1.

MR. ANDERSON: Yes. So turning now to -----

THE PRESIDENT: Well wait a moment. It refers to Annex 1 on p.12, but is it Annex 1? Yes, I think it is actually.

MR. ANDERSON: It is Annex 2, Sir.

THE PRESIDENT: Yes, that is a misprint I think on p.12, you are quite right. Or, is it indeed Annex 3.

MR. ANDERSON: It is Annex 2. Annex 3 is essentially directed at Welsh's stand-alone calculation and adjustments we would make to that. Annex 1 deals in some more detail with the points I am making now, which is essentially the difference between potable and non-potable, non-potable and raw water. The Tribunal had four principal issues, and I take them up at 14. The first query was that does not the fact that potable and non-potable

distribution costs are treated slightly differently for the purpose of the RAGs, RAG 4 in particular, suggest that they are different?

THE PRESIDENT: I think we have the argument on that point, Mr. Anderson.

MR. ANDERSON: The second question is what about the fact that Welsh has classified the Ashgrove system as a raw water aqueduct in its returns, and again it is simply a point of classification. Strictly speaking they should not have done. What they are doing by lumping them together is saving themselves time and effort and splitting the costs out, but it is of no significance because those of course are returns for the purposes of the price determination. No point of substance can be derived from that exercise and that is the point we make ----

THE PRESIDENT: Out of that point has grown the whole raw water non-potable/potable comparisons.

MR. ANDERSON: I suspect that is right, Sir, yes. In the long term they perhaps had not saved themselves a great deal of ----

THE PRESIDENT: It possibly has created a bit of extra work, yes.

MR. ANDERSON: The third is the question of the relevance of the 300 mm pipes and we are guilty there. We introduced that in order to compare like with like on methodology – 3.

THE PRESIDENT: I thought that was 3, and I did get a little lost yesterday because I was not sure what had now happened to the 300 mm pipes which I thought had dropped out of the calculations anyway when Mr. Thompson was ----

MR. ANDERSON: They have not dropped out of what has actually been calculated in methodology 3, but we think that has rather been overtaken by events anyway with methodology 7 which we have concentrated on as the principal methodology. We would agree that the appropriate diameter to consider in this case is 600 mm. The important point though is that you must either use 600 mm for both sides of the equation or 600 mm for both sides, you cannot mix and match, which was the point that we were making there. Then query four was the cost drivers identified in 302 of the interim Judgment, and there is on that a significant amount of detail in evidence submitted by Albion, Dr. Bryan, and by Welsh with Mr. Jones. I have just a few observations if I could on those: first, in the terms of construction costs, we say those were essentially driven by pipe size and location related costs and there is no systemic difference arising out of what kind of water goes through the pipe. So far as location of pipes is concerned, we would submit that Welsh have got it broadly right, not Dr. Bryan. When one is looking at the 600 mm potable/non-potable mains, no significant difference between the two, a point Mr. Jones made was that since

there were no large non-potable customers in Cardiff and Swansea, you might actually put those to one side altogether as an anomaly and look at actual, comparable distribution mains, and, in his words – and this is at p.21 of the transcript on Day 3 – there is broad parity between the two systems.

Distance. Well, there are of course a considerable variety in the distance of potable systems, as there are, indeed, for non-potable systems, but there is no reason to suppose there is any systematic difference between the two.

Pressure. That, again, depends on topography and there is simply no basis upon which the Tribunal can conclude, as indeed there would be no reason why there would be, any difference between the two, similarly in pipe material. That leaves over complexity and integrity. Now, of course ----

THE PRESIDENT: And maintenance costs, probably.

MR. ANDERSON: Well, maintenance costs/integrity. I will take those together. It is the same point, actually, in relation to all three concepts. Of course, a potable mains is attached to a potable, local distribution network, and that local distribution network is going to be a great deal more complicated than what is attached to a non-potable mains. But, the point is that the costs which have been identified, and on which the 16p is related, are related to the potable and mains. Any costs associated with connecting to the local distribution network, maintaining the local distribution network, the integrity of the local distribution network, are not in that figure – they are attributable to the local distribution network. For that reason, we would say there is no fundamental reason why – and, indeed, on the material before the Tribunal no basis upon which the Tribunal could conclude otherwise – there is any real difference between the two. The complexity arises at the local level. That is where the investment and costs are to be found. That is Mr. Jones at p.23 on Day 3, at line 18.

THE PRESIDENT: I have one question in the back of my mind at this stage on this, Mr. Anderson, which is: how this argument has developed now, certainly on your case, is to look at the bulk bit of the potable system and compare that with the typical non-potable system which will always be a bulk system ---- normally be a bulk system of 600 millimetres. How far, in general, is that a legitimate way of looking at it, or would it not be realistic to compare a typical non-potable system as a whole with a typical potable system as a whole?

MR. ANDERSON: Well, then you have the difficulty firstly of de-averaging what are reported as regional costs, and you then have the difficulty of ----

THE PRESIDENT: Well, no, but you distinguish between potable and non-potable in the tariffs. So, just take it at that level.

MR. ANDERSON: Yes, but at a regional level – not on a system by system basis. We are not seeking to identify the costs of all the local distribution systems, and seeking to identify what those are on a local basis and adding them together. We have taken – and indeed the reporting requirements are to take – it on a global basis. We think it would be very difficult. One is simply getting into too great a level of dis-aggregation to start looking at an individual non-potable system, trying to look around for comparable potable systems and trying to look at the individual costs.

THE PRESIDENT: I am just trying to sort it out in my own mind. It is not quite an apt example, but if you have got a parish church and you have got a cathedral, you cannot really compare the costs of the south transept of the cathedral to the parish church because the south transept of the cathedral is part of a wider whole. It is just a different thing basically ----

MR. ANDERSON: I accept it is a different thing.

THE PRESIDENT: I do not know where that takes us, if anywhere. Possibly up a blind alley, I think.

MR. ANDERSON: With the greatest of respect, that does not take you, sir, a great deal further because the reality is that all the bits round the edge of the transept are dealt with separately anyway. We are only looking at the piece of floor in the middle, and it is the same, in a sense, between the parish church and the ----- I mean, what is being suggested, of course, is that the floor in the cathedral is much fancier than the floor in the parish church. The reality is, when one looks at it, that they are exactly the same – they are pipes that carry water. The frills round the edge ---- I say 'the frills'. That is an unfair way to describe a cathedral, but ---- the bits that are attached to it are irrelevant for these purposes because they are not included in the relevant figures.

THE PRESIDENT: It may not be a helpful analogy. I just do not know.

PROFESSOR PICKERING: Mr. Anderson, what does the authority say about returns to scale in relation to the potable system as compared with the non-potable? Are there increasing returns to scale, or are there diseconomies arising from the scale of a potable system particularly?

MR. ANDERSON: I would need to be helped by those behind me.

PROFESSOR PICKERING: I would be interested in a view at some point.

MR. ANDERSON: I am sure they have heard your question, Professor, and they will arm me with an appropriate answer.

Before I leave this question, there is, of course, the question of the raw water distribution costs – the new argument that is being advanced by Mr. Thompson and Albion. This is addressed in our Appendix 1 at paras. 47 onwards. The short point is this: the 2.2p – raw water aqueduct cost – is the cost of distributing water from a source to a treatment works. It is a very short distance on average – 2.5km. It is on that basis that Dr. Bryan has calculated his 2.2p. We say that if you seek to extrapolate from that, and cover the whole of the non-potable distribution network as well, you are going to have to pick a very much higher figure than 2.2 because the non-potable assets are not included in the figures from which that calculation has been derived. There are, before one even gets to that point, even in relation to the raw water aqueduct ---- We say that there are problems with the raw water aqueduct cost of 2.2p. We say there are difficulties with that. I know – and it may have been Day 1 when I was not here, or possibly Day 2 – the question was raised by the Tribunal, "Well, is the figure of 2.2p disputed?" It is. It is disputed here, as you will see, particularly if I can invite you to move to paras. 55 and 56. We say there is a fundamental flaw in Albion's cost arguments.

> "This flawed assumption takes a prominent role in their skeleton arguments. Albion wants to cross-check the regional overall bulk, greater than 600ml non-potable mains costs with a regionally averaged raw water aqueduct cost. Currently, the Dr. Bryan unit cost estimate is a geographic average that includes the ground water upland sources that tend to have much shorter lengths and smaller diameters of raw water aqueduct so the raw water aqueduct of 2.2p will equate to the transportation of water over the average distance of 2.5km through pipes with an average diameter of around 300ml where this will depend on how the average is calculated, largely through rural areas.. These three factors – small or average diameter, shorter average length of predominantly rural character, explain the claimed eight or tenfold difference between that and the non-potable distribution network. In addition, there may be capacity utilisation differences. Moreover, the unit charge for distinct bulk raw water aqueduct service may in fact be a lot higher than 2.2p. If Albion wants to de-average this cost, then further cost adjustments are required".

We then go on to derive the calculation of what would happen if one sought to compare like to like and extrapolate across to the non-potable distribution. If I can invite you to read paras. 58 and 59 – the challenge that is then raised in the Albion reply skeleton is well, if you do that calculation on throughput figures, which he has assumed that 80 per cent. of raw

water goes through the 600 mm you are going to produce this huge figure which makes nonsense. Two points: it does not address the fundamental point we are making, which is the point in para.56, but it also assumes throughput figures which are mere assertion. They are not, we would submit, based on anything. But the fundamental ----

THE PRESIDENT: I am sorry, I have slightly lost you, Mr. Anderson. It is a point I just need to make sure ----

MR. ANDERSON: Perhaps you should just take up the skeleton argument of Albion, the second one.

THE PRESIDENT: This is the reply skeleton.

MR. ANDERSON: It is at paras. 49 onwards on p.18. The Authority and Welsh take different points. The Authority does not address the relative costs of raw water and non-potable in its skeleton but advances an apparently new argument at Annex 1, and then they launch straight into the calculation that is on para. 58.

THE PRESIDENT: That is your calculation.

MR. ANDERSON: Yes, they have not taken issue with the fundamental objections that we have identified in the paragraphs up to 55. What they are essentially saying is on the basis of a number of assumptions the figure, if you calculate that 13.2p in para.58 with raw water on the assumption that I think it is about 80 per cent. passed through that size of raw water aqueduct, you would get too high a total distribution cost figure. We say that that calculation is based on an assumption is mere assertion and which we do not accept, but it does not address the fundamental point about the lower diameter pipes, the shorter distances in the predominantly rural areas.

THE PRESIDENT: Would it be feasible to try to agree on the figures, at least within a range so that we can concentrate on the principle?

MR. ANDERSON: We can try – I do not suppose we can do it today?

THE PRESIDENT: No.

MR. ANDERSON: We can try, but the fundamental point of objection is that given that the length of a raw water aqueduct is ----

THE PRESIDENT: When you take a different length then you get a different answer, that is your fundamental point.

MR. ANDERSON: You get back up because since non-potable distribution pipes are about eight times as long as raw water aqueducts just multiply two by eight, and you are getting back to square one again. So we say at the end of the day on the evidence before the Tribunal that Director's assumption that non-potable and potable are broadly the same was perfectly right

and the further argument based on raw water has not dislodged that in any way. If I could now turn to stand-alone costs?

THE PRESIDENT: Yes.

MR. ANDERSON: If I could just say by way of introduction, this stand-alone calculation is a calculation produced by Welsh in answer to a request from the Tribunal, it did not form of our Decision making and a sense we are offering our observations for the assistance of the Tribunal.

THE PRESIDENT: That is very helpful.

MR. ANDERSON: The first point that I want to make is whether it is appropriate to embark on some kind of a local cost analysis at all, either as a cross-check or in any sense as a basis for pricing.

THE PRESIDENT: That is a prior question, and it is one that we do want to hear about.

MR. ANDERSON: We have serious reservations about approaching pricing, access pricing on a local cost basis. That is an issue that is addressed in paras. 42 through to 57. There are a number of points I would like to emphasise if I may. They are summarised in 43. There are significant problems, informational problems, in disaggregating.

THE PRESIDENT: We can fully accept that it has not been necessary to do this, or anything along these lines up to now, and that might well play in the general analysis of the case. But one question is how far it would be difficult to do it if one set out in the future to do it, or make a slightly better stab at doing it than one has done up to now. Is it intrinsically more difficult in this industry than it is in any other capital intensive industry?

MR. ANDERSON: We would say, looking forward, it is going to be wholly unnecessary because looking forward we have now got the mandated costs' principle approach, and that is the debate I was having with you, Sir, at the end of yesterday, which is one only is interested then in identifying and quantifying avoidable costs.

THE PRESIDENT: But in that context, if one looks into the various highways and byways of s.66(e) including the idea of ARROW costs, could not one say that there is actually quite a lot of local costs that are going to need to be identified in even trying to operate that on the basis that you say is the basis, as you are going to look at the local avoidable costs and the ARROW costs, whether the local assets are stranded, what is the cost of that, etc. etc.

MR. ANDERSON: There may be an element.

THE PRESIDENT: It is all going to be much more "specific" than it has been up to now.

MR. ANDERSON: You may well be right and the Regulator has gone through a great deal of consultation with undertaker groups in these access pricing consultation groups and yes,

there are problems that have been identified and we have sought to address a number of them in our guidance but yes, you are right, there are informational problems that arise in the context, even under the costs' principle.

THE PRESIDENT: But it is envisaged to be doing it on a customer by customer basis and that is going to involve some looking at least at what the avoidable costs for that customer are.

MR. ANDERSON: That is correct, the avoidable costs are customer specific and they are low costs.

THE PRESIDENT: And whether these costs can be recovered in some other way means the costs that we are talking about, etc. etc.

MR. ANDERSON: It is perfectly true, Sir, I accept that. It does not, of course, require the unbundling or the de-averaging of the tariffs themselves that apply. We are talking about the situation of access, but that does not and I can come back to that – it is another debate that I had with you yesterday.

THE PRESIDENT: Yes.

MR. ANDERSON: It does not involve the de-averaging of the regional prices, and it is the de-averaging of prices generally that concerns us.

The point we make at 44 is that this sort of averaging was in principle accepted by Albion, and that is perhaps why it has not been gone into in quite the detail it might otherwise have gone into in the Decision itself.

Paragraphs 45 and following identify a number of the practical problems with obtaining de-averaged or local calculations and a point we do make at the bottom of p.20 is that in fact any local calculation, particularly the local calculation that has been advanced involves actually quite a lot of aggregated, or company-wide information and the critical ones, the important ones are the capital value and the cost of capital. Those are the two big ones that make a big difference to the difference between methodology 7 and the stand-alone calculation. I know this is a topic that my learned friend, Mr. Vajda, will be coming back to, but the particular concern that we have is that the local cost methodology of the kind adopted by Albion will lead to general under recovery of revenue, and that is a matter of concern to us for the reasons set out in the rest of para.49.

THE PRESIDENT: The point in 48, it would not be at all unusual in an industrial company to find systems of standard costs that are drawn from a number of different sources across the company as a whole, and in pricing policies you would not go down necessarily to a micro level, so to that extent any analysis of what might be called "local" costs will include some

figures or for some items, allocations across on some company-wide basis, I would have thought.

MR. ANDERSON: I think the only point we are making there is if you want to go down the route of dis-aggregating and identifying local costs you have to go the whole way.

THE PRESIDENT: Right, why can you not say "These are operating costs, and these are the company-wide return we need, and this is the company-wide way of calculating what the capital is and we add them all up and get a figure?

MR. ANDERSON: But it is a company-wide way only for the purposes of the pricing regime, the tariff arrangements that are in place. If you are taking something outside that role there is no reason why the individual who has, if you like, displaced the company should be getting the benefit of a lower cost of capital and a lower rate of return that the company itself has obtained because it is operating a regulated business with a large number of customers. You have, by definition, taken that out of the equation and one should approach that on the basis of a capital value that is appropriate to a separate business and a rate of return that is referable to what it would cost for an individual company to set up that business. Otherwise you are just being subsidised ----

THE PRESIDENT: That is the philosophical debate and that is the central philosophical debate I think on this point

MR. ANDERSON: Yes.

THE PRESIDENT: And is the Authority, as an Authority, contending that a common carriage charge can properly be calculated on the basis of including a rate of return on the creation of the asset, the newly created asset starting on a Greenfield basis and charged up to a new entrant on the basis of that is what you are doing, that is the submission effectively.

MR. ANDERSON: Well for the reasons that I was developing we would not support a stand-alone basis as the basis for access pricing. If you are against us on that and say "We disagree, we do not think your arguments on de-averaging or whatever are compelling, it should be done on a stand-alone basis", then we would submit that Welsh have got it right in principle. What you are seeking to do is to identify the economic value to the existing owner of a particular part of its assets. There are a number of ways you can do that one of which is to look at the replacement value. How do you calculate the replacement value? You cannot adopt a replacement value on the assumption that you do not need to replace it, it is self-defeating. So if it is to be a replacement value then you have to assume there is nothing there otherwise it is not a replacement value.

THE PRESIDENT: I think the key – or a possible key – is not necessarily the capital value you start with, whether it is MEA value or regulatory capital value or somewhere between the two, the key is what is the right way to look at the rate of return on that value. If one of the principles is that the company should charge a competitor what it would charge itself then you could apply, as one approach to the MEA value, the sort of return the company gets on its MEA value.

MR. ANDERSON: But that only applies in circumstances where that business is part of its overall business and benefits from a lower rate of return because it is part of a regulated business which supplies a large number of customers. If you have taken that out of the equation, then the logic for that no longer applies.

THE PRESIDENT: As an approach, does that not kill both common carriage and the 2003 Act stone dead because you are expecting, in effect, the entrant to build the pipeline?

MR. ANDERSON: Well, it does not kill them stone dead because the new entry envisaged under the new Act and the costs principle does not approach it on that basis. It approaches it on the basis of a retail price less the avoidable costs. That is, for better or worse, the policy that has been adopted – not a regional; not a stand-alone basis – because one of the objectives of the regime, we would submit, is to preserve regional pricing because the key point is that once you have started to de-average in a way that allows individual companies to see opportunities for new entry arising out of a re-allocation of costs, you are inviting what is sometimes called 'cream skimming' or 'cherry picking'. The response to that, of course, is, to the incumbent, to de-average all the prices rather than simply have a group of customers whose costs are below the average available for new entrants to pick off, leaving the rest of the customers to pick up the tab for the loss of that revenue. That is why the argument is that we retain regional average pricing to begin with.

Now, on that basis, if that is right as a matter of principle, then the obvious way of addressing the matter is ECPR, or costs principle, or a retail minus approach. Dr. Marshall may well be right ---- you may well be right that this regime will not attract large numbers of new entrants because there may not be that much of a scope for efficient entry. But, as I have said – and emphasise again – that is essentially a policy decision peculiar to this market, this industry because of the characteristics that I have taken some time to take you through.

THE PRESIDENT: If we just try to unpack it a little – because it is quite difficult stuff, this – I got the impression from Professor Armstrong's evidence, particularly the second example on what I remember as his p.5, that even ECPR enables a new entrant to benefit from

exiting regulatory subsidies where they exist. He can go in and benefit from the subsidy to retail customers, for example. So, ECPR, itself, does not prevent that sort of anomaly. In fact, it gives the entrant a chance to cherry-pick on the basis of the subsidy.

MR. ANDERSON: Yes. Of course, there are opportunities for entry under ECPR. I do not suppose Parliament would have gone to the trouble of introducing it if it thought there were none.

THE PRESIDENT: What is the conceptual problem in the following area: in what one would normally describe as a competitive market (using that phrase rather loosely) or a contestable market, sooner or later prices would converge towards costs of supply and particular customers who are being charged significantly more than the cost of supplying them would, sooner or later, be offered other prices by other competitors, and their prices will, over time, re-align Is it not inherent, as we were saying yesterday, in the introduction of some competition in this industry, albeit in a very limited part at the moment, that there will be some re-balancing ---- or, there will, or might be, some re-balancing between customers in which case the question then is whether, for those customers who are, by hypothesis, receiving a subsidy, though whether that is so or not is another question we need to come on to, then the question is whether it is actually the case that there is too much fat in the system, or that there could be better efficiencies that can be extracted by the rivalry process that you have unleashed. It is not at all self-evident that a reduction in price to one customer is necessarily and automatically passed on to another customer, even leaving aside the statutory provision that we saw last night.

MR. ANDERSON: It would not – unless that new entry results in an increase in the total costs in the industry. If that occurs, then there is an increase in the total costs of the industry that needs to be borne, and that will ultimately be borne, subject obviously to the regulator regulating properly so far as efficiency is concerned ---- That will ultimately be borne by other consumers of water. So, that is the first conceptual difficulty with simply approaching this market as if it were any other market ---- any other contestable market. The second difficulty is that it has been ---- This market is characterised by regionally averaged tariffs, and if a system is introduced which unwinds that over-arching principle, there will be winners and there will be losers. I think the concern that is expressed particularly by Mr. Morley in the debate leading up to the costs principle ---- the concern is particularly the losers rather than the actual beneficiaries, if you like, of individual instances of competition. So, the trade-off is between increasing overall industry costs and causing there to be losers

who bear those costs, and the benefits to individual customers and individual situations who benefit from a particular instance of competitive entry.

Now, that is ultimately, we would submit, a political policy decision that has been taken. That balance is struck in the regime that has been adopted. Those are essentially points that I am making in paras. 48 and 49, and then moving on to the geographical cross-subsidy at para. 51. We say that there would be important implications. At para. 51: undertakers have been encouraged to set tariffs. I thought I might just spend a very brief moment to deal with a point which arose yesterday, which I do not feel I dealt with adequately, which is the special agreements regime, and quite when this de-averaging came in.

Welsh introduced a standard non-potable tariff in 2003. There was no standard non-potable tariff before that time. I think it is correct that before that, non-potable customers were charged on a special agreement. But, of course, the reality is that the special agreement for most customers were broadly similar to the non-potable tariff, with the exception of Corus because there were special circumstances. Now, this is set out in our original skeleton argument for the first hearing.

THE PRESIDENT: This is the hybrid point, is it not? I think you said they were a hybrid.

MR. ANDERSON: Yes. But, the essential point is that other than the idiosyncrasies arising out of inherited special agreements which undertakers could not get out of, special agreements themselves are variations from what would be a standard tariff for circumstances not related to distance-related cost. For example, where there has been special capital investments there are particular levels of service being supplied. Those kinds of differences Not differences related to costs. So, special agreements, subject, as I say, to the historical inheritance point, are averaged prices that are varied not by reference to any distance-related costs. That is a point that we made clear in our skeleton argument last time with assorted references. Perhaps I could just ask you to ----

THE PRESIDENT: I think we had better look at it.

MR. ANDERSON: Page 60 of our original skeleton which was in answer to a question that I think the Tribunal raised before the last hearing: "To what extent do special agreements ---- " If I could just invite you to read ----

THE PRESIDENT: Yes. I think we remember the passage.

MR. ANDERSON: The point I am just making is the point that is underlined on p.61.

THE PRESIDENT: It is a major consideration in the case because we have since learnt that of the various cost drivers that seem to be in play, location is one of the most important. If you are applying Special Condition E, and you are charging two customers the same, even

though the costs of serving them are in fact different in relation to a significant costs driver, how does Condition E apply in that circumstance?

MR. ANDERSON: Condition E, referring, as it does, to undue discrimination ----

THE PRESIDENT: Why should location-related costs not be relevant to the application of Condition E?

MR. ANDERSON: Because I think the reality is that the undertakers that took over the businesses on privatisation inherited a structure of pipelines that happened to be where they were. The policy was, and still is, that accidents of where the pipes happen to be ought to be taken out of the equation.

THE PRESIDENT: Another policy is to try to get prices closer to the costs of supply, and if you are leaving out the principle cost, is there, or is there not, a difficulty in this area?

MR. ANDERSON: We would say not because the desire is to ensure that those people who happen to be located a long way away from the sources of water are not, for that reason alone, in any sense prejudiced. That is the policy, and that is the rationale. I think it is as simple as that.

PROFESSOR PICKERING: But, even if you persist with that argument – which is essentially bygones are bygones – why are we persisting, presumably, in that sort of approach in relation to new plants being established?

MR. ANDERSON: Of course, a new plant could establish itself near a water resource with a view to self-supply, for example. I mean, one witness (I think it was probably Mr. Jones) indicated that for every one non-potable customer they have, there are ten who self-supply. So, it is perfectly possible for future investment to have regard to costs of water, as far as future development is concerned, by that route, or possibly through themselves investing in some kind of water infrastructure. But, what we are really talking about is a structure of pipework that has been there since Victorian times.

THE PRESIDENT: This is a pipeline which was originally constructed in the 1950s, and the plant was originally constructed in the early 1990s (or it might have been the late 1980s), if my memory ---- But, it is a relatively new plant we are talking about here, are we not? A new customer? (After a pause): Is it still not the case, well, okay, it may be bygones are bygones, but the customer who is cheap to supply is effectively, on this view, in a real sense subsidising – the chap who has put his plant at the top of the hill is being subsidised by the chap who is close to the spring, as it were.

MR. ANDERSON: That is correct, that is, if you like, we would say the merit – you may say the disadvantage of – but that is what regional pricing is all about; not disadvantaging certain customers because they happen to be located far away from water resources.

THE PRESIDENT: The other side of the coin is disadvantaging the customer who is efficiently located.

MR. ANDERSON: Well if you are to realise that advantage, you will simply exacerbate the disadvantage caused to the plant that is located further away from a water resource, and that could have very serious implications. You can see the argument; I am sure, in relation to domestic customers.

THE PRESIDENT: Yes.

MR. ANDERSON: The same logic applies in relation to industrial customers, that is what it comes to.

PROFESSOR PICKERING: Well with respect the argument seems to me to be dismissing any consideration of allocative efficiency and while there is obviously a debate about the past to perpetuate it into the future seems to me to give rise to some quite serious messages and signals that are being sent about the importance of considering optimal location, especially in regard to the costs of the motor inputs of resources into a production process.

MR. ANDERSON: Allocative efficiency, so far as it can be addressed is addressed as part of the role of the regulator along with a number of other very important factors. You are no doubt aware of the House of Lords Committee report of yesterday.

THE PRESIDENT: We have skim read it, that is all, Mr. Anderson. We will read it length later, I suppose.

MR. ANDERSON: There are issues to be dealt with, there are problems. This is an industry, the water industry is an industry in which expenditure is in excess of the available revenue. There is a desire clearly to avoid undue price increases but there are, of course, problems in relation to the existing infrastructure. There are a number of factors that have to be borne in mind in adopting any regulatory policy in this sector, one of which is the advancement of allocative efficiency. But the policy nonetheless is to adopt a cautious approach to competition and to maintain regional average pricing for the reasons that I have identified.

THE PRESIDENT: I think this is the heart of the philosophical debate, whether we need to solve it in this case or not I do not know. Let us not go back over what we were on last night, but having introduced the possibility of competition for a very small number of very large customers the question whether you can or should maintain regional average pricing for that very small number of large customers surely as a matter of commonsense presents itself.

The compatibility of a competition regime, and regional average pricing for that small category of customers comes a bit more under the microscope does it not?

MR. ANDERSON: It does present itself, it has presented itself, the decision has been taken at least for the time being – no doubt it will be reviewed. Fortunately, of course, these are not matters, Sir, that you actually decide in this case.

THE PRESIDENT: Well except insofar as we may or may not need to wonder what is the relevance of local cost to this whole debate, but we have done that, so let us not go back

MR. ANDERSON: Yes, another point that I should perhaps just remind the Tribunal of is the whole question of price volatility that arises out of de-averaging . The point is that if one is operating on a de-averaged price, for example, if either Shotton or Corus went out of business on a de-averaged basis that would shoot the costs of the remaining business way up and could jeopardise the position of that company, which I think is just a variation of the winners and losers argument.

PROFESSOR PICKERING: Mr. Anderson, can I just put this to you? Let us consider a potential new entrant which would create a significant demand for water. The total system costs to a regional water company are given before the entry occurs. The new entrant has the option of locating at a point where water distribution costs would be minimised, or at a point where water distribution costs would be higher but that new entrant might obtain some other financial advantage. If, in the absence of any incentive to locate where the water supply costs would be minimised, i.e. in the absence of a price incentive, then would you agree that if he locates in the less advantageous, more costly, position so far as water supply is concerned, then the effect of that new entry is actually to increase the total system costs of supply of water in that region, but the consequences of that do not bear upon the individual water customer, but bear upon the rest of the industry. So, in fact, if you enhance total system costs in that way as a result of what some might argue would be an inefficient approach to pricing then you are actually imposing a disadvantage on the whole of the customers of that particular water supplier.

MR. ANDERSON: Of course I see the theoretical logic of what you say, Professor, that is absolutely right. Of course, what I would say is that the bulk of the distribution network for water in this country is already in place and, of course new investment in industry is likely to increase the costs of water distribution and they may or ma y not invest in an area that reduces the regional average cost or increases it. I can see the theory but that is the reality. Regional averaging, local cost based pricing might give such an incentive where regional averaging does not. I see that.

THE PRESIDENT: Could I just ask two other points on pages 22 and 23 of the skeleton.

MR. ANDERSON: This time around?

THE PRESIDENT: Yes, the present skeleton, the one we are battling through, Mr. Anderson, with great determination and skill, if I may say so. The two questions – just to put them – if we get to a paragraph like para. 53 which asserts that significant increases in water bills as an effective de-averaging will affect the financial viability of certain industrial customers. We have that as an assertion in the skeleton argument, but we do not actually have any evidence to that effect.

MR. ANDERSON: No.

THE PRESIDENT: I suppose that is the first point. The second point is, is it not a fair reading of the consultation paper, taken as a whole, that the authors of the consultation paper did not think there was a significant problem of cross-subsidy in the eligible customer sector?

MR. ANDERSON: Well certainly the authors of the consultation paper recognised that there did not appear to be an ongoing problem of cross-subsidy between the sectors. I do not think it addresses specifically the extent of the problem of cross-subsidy or consequences of de-averaging within classes of customer but it recognises that that is there and is to be preserved.

THE PRESIDENT: Does it, and if so where, because I think it would be helpful for us to find the passage. It could be said, perhaps, on one reading that it is implicit in the consultation paper that the opening up of competition in this relatively limited sector and the prospect of lower prices and all that sort of thing is something that is desirable and is not really spelled out in that paper that regional averaging should continue to apply in the sector open to competition. That is the question as to whether that is a fair reading?

MR. ANDERSON: I will ask those behind me to find you that ----

THE PRESIDENT: Yes, well come back to the passages which you think are the crucial passages that we must bear in mind on this point. It is true that there is a point in the paper where it talks about the undesirability of unwinding socially desirable subsidies, but is that not really talking about the household sector and the sectors that are not open to competition rather than the sector that is open to competition?

MR. ANDERSON: We would, of course, say that it is implicit in the maintenance of regional tariffs and the introduction of the costs' principle that the costs' principle which we say is retail minus for reasons we have been through *ad nauseam* last time around, supports the proposition that that must be the policy as well as in fact is the policy.

THE PRESIDENT: Anyway, come back to any passage in the consultation paper that we need particularly to look at – it is the point on 56 really and through. What, if anything, should we read into this bit of the consultation?

MR. ANDERSON: I think the points that we have made in the remainder of that section we have debated.

THE PRESIDENT: Yes, if I may say so, this morning at least we have thrashed quite a lot of important points. I think you can probably move on fairly rapidly now.

MR. ANDERSON: I will move on to whether there is a sufficiently robust method based on local costs. Again, as I say, we are in a sense observers in this area. We touched on a number of the points. As between the methodology 7 or the stand-alone our submission is that the stand-alone approach adopted by Welsh is much to be preferred to the bottom-up approach that has been adopted in methodology 7 for a number of reasons. First, the stand-alone approach is more robust, it is more reliable. Secondly, we believe it is conceptually to be preferred, since it properly reflects the economic value to Welsh of this asset, and obviously the economic value could be valued in a number of ways: one is the replacement value, another would be, for example, the market value but that does not help in case such as this. We believe that the approach adopted, the stand-alone approach is the preferred approach. Jumping to para .61, we have summarised the main difference between stand-alone and local cost price calculation, we would simply invite the Tribunal again ----

THE PRESIDENT: That is the point we have just had, I think.

MR. ANDERSON: Then para.66 onwards, we make a number of points about what we see as conceptual problems with the methodology 7, and if what is in para.66 and 68 are not sufficient they are spelt out in still more detail in the annexes to the skeleton argument, and then it makes very exciting reading. That really then takes us through to 71, which is our response to the stand-alone calculation that has been advanced by Welsh, and there were four main points. First, in principle we think it is the right approach. We have three issues with it, one is that we think they have taken it slightly too high a return on capital. We think that they have slightly over-estimated the capital cost, but we think they have under-estimated the … costs. Those are the three points. The figures are highlighted in those paragraphs. That then takes us to our conclusions on stand-alone.

If I can now turn to ECPR and margin squeeze. The principle issue is whether ECPR is a credible alternative pricing methodology to average accounting. The issue is not, we would submit, whether ECPR is the best or most suitable access pricing methodology for the promotion of entry into the water industry which was essentially the point that was

addressed with some passion by Dr. Marshall in her reports and in her evidence. We say it is certainly a credible methodology. It reflects, we say, the costs principle approach that was enshrined in legislation that existed at the time we took our decision, and it is present in other industries and in other countries. I refer you to Annex 4 to our skeleton, particularly pages 164 to 171, the four examples: there is Australia for local calls; Ireland for wholesale broadband access; Sweden for wholesale line rental; European Postal Director; US, Australian and New Zealand postal services.

PROFESSOR PICKERING: In that context, Mr. Anderson, Professor Armstrong rather distanced himself from the received wisdom on ECPR, as put forward by Baumol and the other advocates. Presumably the form in which you would argue that ECPR had been justified and adopted in other situations was that which relied upon Baumol and co. rather than on Armstrong, who admitted that this was really is first foray directly into ECPR as opposed to much wider issues of access pricing. So, how do you advise us that we should handle what Professor Armstrong said, which was perhaps not mainstream justification of ECPR in some respects?

MR. ANDERSON: Three ways: his experience in ---- I think what he said was that it was the first time he had had to deal specifically with ECPR alone. But, as part of, he is clearly extremely experienced, and has spent a great deal of time considering, analysing and looking at access pricing generally. That is the first point. The second point is that he readily accepted that the pre-condition of contestability as originally elucidated by Professor Baumol as part of ECPR, he did not accept was necessary in a context such as this. Price regulation was the substitute in an industry such as this.

PROFESSOR PICKERING: Baumol has always emphasised the importance of price regulation.

MR. ANDERSON: Yes. Yes. We can turn to what Professor Armstrong says. It is put out quite clearly in his second report at para. B.

> "Dr. Marshall repeatedly claims that the validity of ECPR depends on the market being contestable. I believe that the theory of contestable markets is widely discredited, if it was ever in favour, and that very few reputable economist would subscribe to its use as a basis for policy in an industry with sunk costs such as water. ECPR policy does not require markets to be contestable".

So, he is unequivocal.

> "At pp.5 to 6, Dr. Marshall suggests the validity of ECPR depends on there being no barriers to entry. In my understanding of a contestable market is that it is essentially one without barriers to entry".

THE PRESIDENT: But, whether he is right or wrong, he gets to his conclusion by a different route to the route adopted by Professor Baumol.

MR. ANDERSON: He does. That was going to be my third point – that there is undoubtedly, if you look at the evidence of Professor Armstrong, a robust internal logic that operates throughout the entirety of his theory. Two instruments needed in a market such as this: one to address excessive pricing (that is, price regulation); ECPR to facilitate efficient entry. With those two tools – and there is not a relationship between the two in any sense that one will generate efficiencies in the other ---- The reality is that in a market such as this, where certain policy decisions have been taken not to unbundled; to maintain subsidies, and where necessary between class; and to maintain price regulation, the relevant criticisms of excessive pricing at the retail level are addressed by the regulator through price regulation, and ECPR will address the question of efficiency of entry.

THE PRESIDENT: How does price regulation work in the large industrial, non-potable sector?

MR. ANDERSON: It works in a number of respects. Take the example of this case – and I do urge the Tribunal always to come back to this ---- The second bulk supply price was about as regulated a price as you could get.

THE PRESIDENT: It is not a cost-related price. It is a comparator price. "Other people are paying these prices – so, that is the price we will have."

MR. ANDERSON: The second bulk supply price, and whether the Director got that right or wrong, is not an issue, we would say, that the Tribunal can take ----

THE PRESIDENT: No. I am not saying we should. This is why the conceptual basis for the theory is important. Professor Baumol's argument – and I think it is probably implicit in Professor Armstrong's argument – is that you need price regulation. Why do you need price regulation? Because you want to see that the prices are not too divergent from costs. Therefore you have to have some kind of cost basis for your ----

MR. ANDERSON: One can accept not too divergent from cost in an industry such as this where it is a deliberate policy to include in that price certain additional factors such as the cross-subsidies, the universal service obligations, (as he put it) the need to clean beaches, and so on. So, there is no need ---- It is not a pre-condition of the regulated price that forms part of Professor Armstrong's model that the retail price should equate to marginal costs.

THE PRESIDENT: I am not saying that it is, but it should have some kind of relationship to cost somewhere.

MR. ANDERSON: It does – and that is the five-yearly review. That is the overall ---- It is done on the basis of an overall revenue requirement.

THE PRESIDENT: It appears to have been much weaker, historically speaking, in the large non-potable industrial sector than in other parts of the industry. Is that a fair comment?

MR. ANDERSON: Of course, there is tighter control of retail prices in the domestic sector. That is correct. But, it is still a regulated price. It is subject not only to the overall revenue requirements and efficiency requirements in the five-yearly review, but it is also subject to the Condition E requirement that there should not be undue discrimination, and, in the context of a bulk supply price, there is also the ability to go to the Director and seek a determination, which is what happened in this case. Of course, because it was the first case in which the Director had been called upon to look at a bulk supply price, it was consulted upon and considered in considerable detail before it was effectively approved.

THE PRESIDENT: When you said a moment ago that there is a policy decision not to unbundled, that is going back to the construction of Section 66(e), is it?

MR. ANDERSON: And the continued use of regional tariffs, yes.

THE PRESIDENT: The Section 66(e) on your case ----

MR. ANDERSON: Section 66(e) on our case, yes.

THE PRESIDENT: -- involves a decision to unbundled as far as avoidable costs are concerned, but not further than that.

MR. ANDERSON: It requires identification of avoidable costs, yes. We would say in this case that that is not a difficult exercise at all, as it turns out. The avoidable costs were quite clear. At the retail level there were very few ----

THE PRESIDENT: Do you accept Professor Armstrong's position that by 'avoidable costs' one means at least in the medium term?

MR. ANDERSON: Yes. I was going to come to that. What we mean by that – and if I could just look up the document that I had overnight ----- By 'medium term' we mean twenty-five years. If I could take you to ----

THE PRESIDENT: Do you mean twenty-five years as a medium term?

MR. ANDERSON: Yes. I think what I said in answer to your question was medium to long-term. The access code guidance ---- Perhaps I could take you to that. That is at Tab 15 of the new authorities bundle.

THE PRESIDENT: We have not taken our traditional break yet, Mr. Anderson, but I am anxious we get through that.

(Short break)

MR. ANDERSON: If you could turn to p.48, under "Equation" 6.5.1: "Water undertakers should apply the following general approach to provide access prices for each year that the licensee requires access." So you look at it over that period, and then you will see where I got my 25 years from over the page. "Combined supply arrangements…" – in the middle of the page under 6.6 – "…between water undertakers and licensees are likely to last for up to 25 years." Then the examples, for example at p.51 you will see that the format required, the example used as to what format is to be used is over a 25 year period, and then you will see opposite under 6.9, "Wholesale prices", second paragraph: "Common carriage access prices: water undertakers must also publish supply deficit information for each of their water region zones" I think that is. "This should provide a broad indication of how access prices may change over the 20 year period following the initial five years for which the water undertakers have provided access. Then you will see pages 71 through to 74, the examples again are 25 year examples.

THE PRESIDENT: If we look at p.51 for a while, just quickly on a point of fact, we have a wholesale fixed discount on a retail charge of 349, which stays the same, a variable discount on retail price, which apparently stays the same, and then a common carriage price that is changing slightly, it goes up and then goes down again. Can you tell me offhand what are the variables in that last column that is affecting ----

MR. ANDERSON: I cannot tell you but those behind me, I am sure, will. Could I just take instructions?

THE PRESIDENT: Thank you.

MR. ANDERSON: (After a pause): I am told it is to do with the supply and demand availability of the water supply. If it has a lot of water the money goes – it is described, I am told, on p.49.

THE PRESIDENT: Yes, and your submission is that this sort of calculation on p.51 is a realistic basis upon which new entry would come into the market?

MR. ANDERSON: Well, let me ask you to ignore the actual figures. The figures are there simply to show the format for calculating figures ----

THE PRESIDENT: Why should we ignore the figures, because this is the way the cost principle works.

MR. ANDERSON: Well because the actual figures are illustrative only. That is not in any sense to be taken as an indication of what we think the margins would be.

THE PRESIDENT: Well why not? What is the point of having figures that are not realistic figures?

MR. ANDERSON: Simply to show the format of how to do the calculation. We could have picked any figures. I mean that is made perfectly clear ----

THE PRESIDENT: You could have picked any figures?

MR. ANDERSON: It is made perfectly clear in the document, and if I can be told the reference I will show it to you.

PROFESSOR PICKERING: Mr. Anderson, could I just point out the footnote 64 on p.48, which his also relevant to the question that the President has just asked you. It seems surprising that there should be reference to avoiding a negative access price. I mean is that not again reinforcing the view that this is very small and may even become less than zero as a margin?

MR. ANDERSON: The margins might be small. The only point I am making is that the actual figures that are included in any of these tables are for illustrative purposes only. They are not intended to be indicative. If I can ask you to look at p.63, second paragraph down:

> "The numerical values used in this appendix are only provided to illustrate how this guidance should be applied. This should not be taken to indicate likely values of particular elements of income or costs."

PROFESSOR PICKERING: Why not use something that is different, and why include a footnote that refers specifically to the possibility of a negative access price?

MR. ANDERSON: Because that situation might arise, there might be certain circumstances where that might arise, I cannot say, but the only point I am saying is that the Tribunal should not be drawn into considering that the figures that appear in that access guidance are anything other than figures designed to assist in understanding the mechanism for arriving at an avoidable ----

THE PRESIDENT: What I think we would like, Mr. Anderson, perhaps not necessarily immediately, are the Authority's reflections on the Annex to Dr. Marshall's first report, where she sets out what she believes to be the actual access prices quoted by various water companies, and whether in your view those reflect the guidance that has been given and, if so, whether in your view they give any real scope for an entrant, however efficient, to come in.

MR. ANDERSON: If it is thought to be of assistance I am sure we will provide that, but it would need to be in writing after the hearing.

THE PRESIDENT: Yes, that is very kind.

MR. O'REILLY: If I can just clarify there, they are indicative access prices rather than access prices in individual cases.

THE PRESIDENT: In Dr. Marshall's report?
MR. O'REILLY: In the annex, yes.
THE PRESIDENT: And those are based on what? On the indications that the companies have given?
MR. O'REILLY: Indeed.
THE PRESIDENT: Are those indications in the public domain?
MR. O'REILLY: I believe they are.
MR. ANDERSON: They are indicative access prices, and they are in the public domain, and my understanding is that the appendix to Dr. Marshall's report was created by Aquavitae.
THE PRESIDENT: Yes, that is right. Yes?
MR. ANDERSON: So returning now to the application of ECPR, paras. 81 and following are a general discussion of topics on which I suspect the Tribunal knows what our position is and what our arguments are.
THE PRESIDENT: Yes, I think we have actually gone into quite a lot in this part of the case now, Mr. Anderson.
MR. ANDERSON: We have, and I do not think there are many points. I rely on it all. I ask you again to read it.
THE PRESIDENT: Yes, we will, absolutely.
MR. ANDERSON: I am not proposing to spend time on it now because I am conscious there are those to follow and we must finish today. We address from para.98 onwards various concerns the Tribunal has raised in the interim Judgment and in our submission what is set out there answers all those concerns. There is then the question of the starting point and we fully recognise, as does Professor Armstrong that ECPR does not address the appropriateness or otherwise of the retail price, but it must be regulated. A different tool is required for that and the tool has been exercised in this case.

I feel reluctant not to be going through this in detail because it is so important, but it is all set out there, and the points are there made, I do not need to make them orally, they are fully set out.
THE PRESIDENT: Yes.
MR. ANDERSON: Unless there are any questions arising out of those matters, that takes me to the conclusions on excessive pricing and that brings me now to margin squeeze on p.53 and the short point we would say in this case is that given that there are no other avoidable costs at the retail level there is complete coincidence between ECPR and the margin squeeze test and there is no infringement in our submission ----

THE PRESIDENT: It is just duplication.

MR. ANDERSON: That sets out the law, and the cases and the principal distinction between this case and cases such as *Deutsche Telekom* and *Genzyme* is that there were avoidable costs in those cases but they kept within their access price, that is the main difference, and it is a very important difference, and it means that those cases cannot be relied on to demonstrate any margin squeeze in this case.

There are a number of factual queries, and I did make the point at the very outset that it is important to identify precisely what it is that Albion does and purports to do in this case. The evidence was that what it does is that it works with Shotton to understand its business and to understand how water could be used more effectively. A lot of what it also does related to the potable activities which are included, so far as I can see, within the 5p margin that it seeks, but of course they are not at issue in this case and they should be put to one side.

Essentially what is being addressed is dealing with distribution within the mill, after the water has been delivered, and that has enabled water consumption to be reduced. It involves a number of specific mill related water problems such as the problems of the water becoming contaminated by oil. It involves some on-site treatment, and this is all set out on p.23 to about p.27 of Dr. Bryan's evidence. Technical advice – and we characterise that as consultancy services and not services that one would expect to be funded out of any margin on the supply of water. Now, that brings me ----

THE PRESIDENT: Yes, we went through all that yesterday, did we not?

MR. ANDERSON: We did, but I feel that I should come back to the question of water efficiency, and the role of water undertakers in water efficiency because it is important. Ofwat agrees that water efficiency is important and water companies have a duty to promote the efficient use of water by all their customers and that has been so since February 1996 after the Environment Act. The RAG3 document, to which you were taken, distinguishing between appointed and non-appointed activities does not expressly set out there the line that is to be drawn between the two, though conservation was red herring.

THE PRESIDENT: It also says that it is an indicative document.

MR. ANDERSON: Yes, Ofwat's criteria for assessing water companies' water efficiency measures are set out in a publication called, and I do have copies that I can hand up and around, called "Security of Supply Leakage and the Efficient Use of Water" 2004/2005, and these will not come as any great surprise to all those in the room as water undertakers.

If I could invite you to turn to the first page, which is p.50, the four criteria Ofwat look at when assessing whether a company has fulfilled its duty – it is the third one in particular that I am taking your attention to: "Is the level of company activity on efficient use of water economic?" What is meant by "economic"? That is at the bottom of the page in the last paragraph.

> "We expect companies to assess the role of water efficiency within a long term plan to balance supply and demand. It will be economic for the company to promote water efficiency measures where the cost of saving water by promoting and adopting a water efficiency measure is less than the cost of delivering additional water."

We can accept that some of Albion's water efficiency activities might constitute, therefore, regulated activities. Malcolm Jeffery on day 2, p.39, lines 17-19, described the water efficiency consultancy as being a foot in each camp as between consultancy outside the scope of water industry responsibilities. We do not accept that one person employed full-time at Shotton is economic. That person could save customers and society much more water by auditing many more customers in short visits than one customer full-time. We would not fund an appointed water company through the periodic review for providing each of its large users with a permanent water efficiency adviser on site as that would increase water bills. Our position is that if customers want such a high level of water efficiency service they should pay for it themselves and not make all large users pay for it via the tariff.

Sir, what is economic water efficiency varies, of course, between regions, depending on the level of water stress. As explained at para.173 of annex 5 to our skeleton most water efficiency audits take place in water stressed areas – Shotton is not located in such an area. That is why, as we understand it, Welsh carried out no water efficiency audits at commercial premises in the year 2000 and 2005 but instead developed a do-it-yourself audit on their website. But we accept that in the case of a large user such as Shotton even in a non-water stressed area there might be a need for a water efficiency audit every few years. The sorts of costs we are talking about in relation to water audits of the kind that would discharge the statutory duty ---- Well, it is typically £350 or so a year. But, perhaps in the case of a large company ---- a large user like Shotton, perhaps £1,000. That would equate, assuming that is a cost that had been, or should have been, incurred by Welsh, and has now been avoided as a result of Welsh's replacement by Albion as the supplier to Shotton, is something of the order of 0.015p per cubic metre. We do not believe it therefore has any

material effect on the access pricing at issue in this case. We do not believe that £340,000, or the 5p per cubic metre, which works out about £1,000 per day on water efficiency at a single site, is an economic use of limited resources in the water industry. The money could be far better spent if it were directed at more customers or at matters such as pipe leakage. If I could just finish by saying this: there is a vigorous and contestable market in the provision of consultancy services on water efficiency provided by undertakers who are not appointed water undertakers and who do not themselves supply water. We would urge the Tribunal not to seek to extend the level of regulation into that sector which is in fact a sector in which Albion operates.

THE PRESIDENT: Why don't water companies do it? Why don't the statutory companies do it?

MR. ANDERSON: Because they are water undertakers. They are not consultants.

THE PRESIDENT: But there is huge concern about water efficiency, and leakage and shortage. Why do they not do it? They can do it.

MR. ANDERSON: They can do.

THE PRESIDENT: But, why is it not assumed that they will? Mr. Jeffery tells us that they do not.

MR. ANDERSON: They do not, I know. I think the evidence from Albion is that they are unique in the industry in doing what they are doing.

THE PRESIDENT: Is that not a plus point?

MR. ANDERSON: Do not get me wrong. I am not denigrating what Albion does at all. I am simply saying that it is a separate activity -----

THE PRESIDENT: Well, you did start off by saying that they were an officious postman, and they did not do anything more than that.

MR. ANDERSON: I have never used the word 'officious'. Mr. Thompson introduced ---

THE PRESIDENT: A postman. Correct. … (overspeaking) … Let us strike 'officious'. They were just a postman.

MR. ANDERSON: Yes. I accept now they are a postman who offer a very valuable gardening service! (Laughter) Unless I can help you further, sir.

THE PRESIDENT: Mr. Anderson, I suppose two things. One is a question. We have seen a letter recently from the Chairman of the Authority, expressing concern about the slow take-up, as it were, under the Act. I wonder if you can help us at all as to what it is thought is going on there – why there has been such a slow take-up and what is envisaged as a next step, as it were. It may be those are not questions that you ----

MR. ANDERSON: Could I perhaps get back to you very briefly after the short adjournment if we are able to?

THE PRESIDENT: Yes . I suppose part of that question is, and it bears more generally in relation to a number of points that have been raised in the course of this case about the scope of the case and the role of the Tribunal and the specific facts, and the decision, and all the rest of it ---- I suppose the question is (and it is a theoretical question which you may well wish to duck completely) : if common carriage in this industry did not develop ---- or, if Section 66 did not develop as envisaged, would that be the kind of circumstance in which the provisions of the Enterprise Act providing for the possibility of a market investigation by the Competition Commission might be satisfied. That is a point that you might want to come back to after the short adjournment.

MR. ANDERSON: I suspect we would like longer to come back on that particular issue rather than simply half an hour.

THE PRESIDENT: As long as you need.

MR. ANDERSON: We will certainly look at those. Of course, DEFRA is already planning to re-visit this area within three years when it came into force. So, there are reviews being undertaken in any event. It is obviously being looked at a community level as well without any movement in any country other than England and Wales, but we will certainly consider those two points, sir.

THE PRESIDENT: I suppose the last point is just to put to you that we are clearly deciding this case, but it a matter of public record that we have now had a number of cases in this industry – about, I think, a total of half a dozen water companies have now come to us and told us that we really should not have supported a view, advanced also by the Director, that, for one reason or another, whether it is a new source, as in Bathhouse, or a greenfield site, as in the independent water company or retailers in the original Aquavitae case ---- For one reason or another – and I am not saying that they are good reasons or bad – there is no scope for entry, or it was not right, or it should not happen, or whatever. So, the overall impression we have got at the moment – and I just want to be correct as a matter of fact – is that at least up to now there has been little or no competition between water companies – at least in a way that might de-stabilise existing price structures, and little or no, possibly no, entry with the sole exception of Albion. If that is correct as a factual impression ---- If it is incorrect we would like to be corrected.

MR. ANDERSON: Certainly I know there are other licenses which have been granted. I will get back to you on the facts of it.

THE PRESIDENT: There are some new licenses – that is true – under the 2003 Act which have not, as far as we know yet, eventuated in any entry. But, you may be able to correct us. I think the existing examples pre. The 2003 Act are mentioned, I think, in the interim Judgment at various points. If there is anything you need to draw our attention to ---- I have exposed our general impression, and you can put us right.

MR. ANDERSON: I fully understand what you say, sir, and it is right to test the submissions and position that the Director and the Authority is advancing in this case. But, of course, I urge you once again to go back to the facts of this case.

THE PRESIDENT: That point is fully taken. Thank you very much, Mr. Anderson, and thank you too for these very helpful and comprehensive written submissions. (After a pause): Mr. Vajda, you have been very patient. With any luck, we have covered a certain amount of ground.

MR. VAJDA: Yes. I am assuming that I still have my ----

THE PRESIDENT: -- half a day.

MR. VAJDA: What I am going to propose – though I have not floated this on anybody – is that the Tribunal might wish to take a slightly shorter break at lunch time ---- I can see at the moment that if it is half an hour now until one, and then two to four, and then we have Mr. Randolph and reply by Mr. Thompson, and possibly ----

THE PRESIDENT: Let us press on, and see how we do.

MR. VAJDA: What I have done, I hope to assist, is to prepare a text which is going to be a sort of speaking note. (Handed) Can I reiterate the point that I think you, Mr. President, made and Mr. Anderson made – that it is very important to focus on the scope of this hearing.

THE PRESIDENT: Absolutely.

MR. VAJDA: That is: was this particular access price either excessive or involving a margin.

THE PRESIDENT: On this particular decision.

MR. VAJDA: On this particular decision.

THE PRESIDENT: I entirely agree.

MR. VAJDA: I am not going to get into the debate as to whether regional averaging is a good or bad idea because the question the Tribunal has to face is: did the Director commit an error in relation to this particular decision on these facts?

Now, what this document is, if I can just explain very briefly, is a sort of hybrid in that it seeks to collate a number of passages of evidence, and also to deal with some of the issues of law – particularly the stand-alone point that I know is troubling the Tribunal. I am not proposing to read this out verbatim. I am going to do is cover some bits more slowly, some

bits more quickly. What I would like to do is to start on p.2. Really, this, I think, is important, particularly in the light of the President's observations a moment ago to Mr. Anderson about the purpose of common carriage. I can clearly see, and understand, why the Tribunal is concerned about this. We have set out what the Tribunal said about this in its interim Judgment.

THE PRESIDENT: Mr. Vajda, I do not want to take you out of your stride, but if you give us, as it were, now, the real punch points, we can also save time by reading this in more detail over the short adjournment as well.

MR. VAJDA: Yes.

THE PRESIDENT: We will catch up with you over the short adjournment, in other words. You carry on as you had planned it.

MR. VAJDA: Yes. What I am focusing on now is para. 5. It is perfectly true that common carriage is an accepted method of introducing competition into the industry, but it does not follow, we say, that a company such as Albion has a competition law right to obtain common carriage on terms that enable it to earn a margin. Equally, the fact, again, that concerns the Tribunal, that common carriage has not yet occurred, or only to a limited extent, mean that Albion has a right to common carriage on a non-ECPR basis. Simply by way of analogy, and this may be more familiar to the President than, as it were ----

THE PRESIDENT: I should not assume so, Mr. Vajda.

MR. VAJDA: If one looks at European competition law it has, we all know, the fundamental objective of the single market –market integration. But, that does not mean that when one analyses cases under Article 81 or 82, that an individual parallel exporter – and I give the recent BAI case about the lack of conduct and the opinion of advocate generals in the Greek case ---- It does not mean that that translates to a right to have supplies in a particular situation. In other words, the end does not justify the means. This is important, sir. I will come on to deal with the point that I know is troubling you, and which you put to Mr. Anderson. Mr. President, you put your finger on it when you said, "Does taking MEA kill stone dead the access regime under the 1998 Act and the 2003 Act?"

THE PRESIDENT: You are taking new build?

MR. VAJDA: Yes. That is obviously an important point that I will deal with. In a sense, I can see that the President is focusing on, "What are the objectives?" We want to encourage common carriage. Is taking the Welsh approach or the Authority's approach on it ---- Is that going to ruin the objective of what we have had? That is obviously an important submission to deal with. If I can just deal with it in outline ---- So far as the 2003 Act is

concerned, that does, of course, impose now a statutory duty as a purely domestic ---- It is nothing to do with competition law. The regime that Parliament has chosen – and obviously there is a debate about that ---- We say that it is retail minus and it is a form of ECPR. That is effectively, what has been decided in this country.

THE PRESIDENT: Although, curiously, without dis-applying the 1998 Act ----

MR. VAJDA: Without dis-applying the 1998 Act. What we say – and I hope this has been something that the Tribunal will pick up – is that in applying the 1998 Act one should apply it consistently with the approach in the 2003 Act. It would be very odd ----

THE PRESIDENT: And vice versa presumably.

MR. VAJDA: And vice versa, yes.

Now, so far as the 1998 Act is concerned, on the stand-alone, just dealing with that for a moment ---- The stand-alone only comes in, and has only come into this case, at the request of the Tribunal. That is not a criticism. It is a comment. It has come in as a cross-check. Again, it is important to appreciate that the basis of the access price in this case was not on stand-alone, but was on a whole company average basis. Now, of course, the stand-alone – and I will come on to this – which the Tribunal wish to do, and on the basis that Welsh put forward, and the Authority ---- It comes in at a higher price than the average price, and on the Albion basis it comes in at a lower price. Obviously, we will have to look at that. Effectively, it is important to bear in mind that it was brought in at the request of the Tribunal as a cross-check.

THE PRESIDENT: We had a certain amount of evidence floating around about those costs.

MR. VAJDA: Yes, and I can see that ----

THE PRESIDENT: A certain amount of the original methodology was focused on that approach or a more local cost approach.

MR. VAJDA: Yes. Certainly when the Tribunal referred in its interim Judgment to OFT422, which is the relevant document in this industry – it does refer to stand-alone costs and is a perfectly understandable approach for the Tribunal to want to take in terms of costs cross-check ----

Moving on to p.3, para. 6, common carriage plainly has an important role in developing both upstream and downstream competition – that is, both upstream of the pipes and downstream of the pipes – where a third party (and this is either a water undertaker or, indeed, a company – a self-supply) has access to a newer and cheaper resource than the incumbent, and wishes to use the incumbent's network to distribute. That is obviously important because that means you do not have to duplicate, as it were, the set of pipes. You

can say, "I want my water to be carried on your system". That, of course, had advantage because that encourages competition at the upstream level. People might think, "Well, I'm going to try to find some new, cheaper forms of resources" It may not - and again this is important to bear in mind – this may not be such a big factor in places like Wales where it rains quite a lot, but might actually be rather important down in the south-east, where, to use Mr. Anderson's expression, there is water stress. Also, obviously, it will then have effect at the other end of the pipes because obviously you can then get in competition at that stage

THE PRESIDENT: That is a broadly speaking desirable sort of process.

MR. VAJDA: Absolutely. Absolutely. Again, that was, if you like, the basis of the appointment of it as an inset appointment. Now, the Tribunal is absolutely right – of course, it as not a condition of the appointment but, again, one has to say, "Where does that lead one in terms of competition analysis?" because the fact that they did not pursue that avenue, and they now want common carriage without developing a new source. I come back to my point: well, can you simply, as it were, go through the net? What we say is that, of course, Albion's case must be looked at, but it must be looked at properly under the 1998 Act with no sort of ---- If I can put it like this, it must be looked at with an open mind, with no pre-disposition that we are wanting to do something which I good; that this must be encouraged; therefore, we must win. You cannot fit a square peg into a round hole.

Then I have made the point about the 2003 Act at para. 7. At para. 8 I am going to come on to deal ---- To some extent I can be shorter because Mr. Anderson has dealt, to some extent, with Albion's activities. Of course, in terms of the shape of this case, sir, what Albion does is relevant really on the margin squeeze rather than the excessive price. I will deal with that. But, I do make the point here – and, again, one has to bear in mind that competition law of course is fact-specific – that common carriage of water ---- What is being proposed here is entirely different. For example, we had cases like *Deutsche Telekom* where obviously you need the local loop to effectively create a broadband service. What we say in this case is that the service that Albion is providing – which is plainly of value to Shotton because Shotton pays for it – does not require the provision of water.

That is all I want to say on, as it were, common carriage. I hope that has addressed some of the concerns – quite understandable concerns – that the Tribunal has about, if I can put it this way, the bigger picture. What I would like to move on to is another sort of important introductory point, which is a point that the Tribunal asked me about ----

THE PRESIDENT: Just putting it rather crudely, your submission is that although this is apparently an introduction of competition, or might be seen as such, it does not actually add

very much, if anything, to the general welfare, and does not actually save anybody any costs, and is a rather duplicating service and therefore it does not at all follow that there should be a margin?

MR. VAJDA: Well I would not put my case quite like this, because plainly the service that Albion is providing Shotton is a valuable service because Shotton has agreed to pay for it and indeed the point that Professor Pickering was making of trying to get the water consumption down that is plainly an important service to Shotton and I would be the last person to, in a sense, denigrate Albion's providing the service. But in a sense the issue here, and the way the President has put it to me is really looking – and this is where we come very much into margin squeeze – if you are going to say "Right, I want to have a margin to do my business", and let us assume it is, say, 5p for the sake of argument, that 5p plainly has to come off Dŵr Cymru, then one has to say where are the avoided costs? If , in fact, the avoided costs are much less than the 5p one says then where is the efficiency gain, because what will happen, and this is particularly significant. Obviously again one has to have regard to the case that Dŵr Cymru happens to be a non-profit making – it is like Network Rail – so effectively any gain that it makes in terms of revenue requirement goes back to its customers, not the shareholders. But even if, for the sake of argument it was like United Utilities and it had lots of shareholders and had expensive offices in plush parts of wherever ---

THE PRESIDENT: Perish the thought, Mr. Vajda.

MR. VAJDA: It is purely hypothetical.

THE PRESIDENT: They can afford Mr. Randolph.

MR. VAJDA: The point is not just "Well we are a poor little non-profit making …" the point is a broader one and in that sense what the President has put to me is entirely correct, yes, and it does not matter whether the company, the water undertaker is profit or non-profit making, we still come back to this key point.

The next key point and this begins at p.4, and again this is absolutely critical and the Tribunal was entirely right, as it were, to get to the bottom of how prices are determined.

THE PRESIDENT: I think we have learned a bit more about it in the course of this hearing.

MR. VAJDA: I have set out – and I am not going to read out – effectively what we took the Tribunal to at para.9 and have then set out a bit of the oral evidence. The important point here to bear in mind, and this is again in a sense where the Tribunal's understanding has moved on because we have had evidence that was not here before the interim Judgment, let us take, for example, the margin squeeze case for the moment – leave aside the excessive

pricing, because the President quite rightly pointed out yesterday it is rather curious because if excessive pricing leads to an access price of 4p, where the margin squeeze case leads to an access price of, as I understand it 19p, but let us just take the margin squeeze case, you knock 5p off Dŵr Cymru, that is going to be a loss of revenue from the large non-potable customers, and that loss is going to have to be made up somewhere else. Ofwat might say "We are not going to allow you to do it", in which case, so far as Dŵr Cymru is concerned it is going to be because it has no shareholders and means less goes back to the customer or it is simply able to carry out less maintenance, as it were, there is just less money in the pot.

THE PRESIDENT: Just on a background point, I think we have at some stage been supplied by the Dŵr Cymru I think it must be the 2005 accounts, which tend to suggest that over the next few years that Dŵr Cymru does envisage paying, returning money to customers. I think we have some evidence in the papers you have not quite spent the investment spend that was predicted, and that the company does seem to have some quite large financial reserves, but that is all background. It bears on the question: is it necessarily automatically the case that if in terms of one customer there is a price adjustment that necessarily has to flow through to the detriment of other customers?

MR. VAJDA: Yes, I take that point of course. We will all recall Mr. Thompson – with his beady eye – asking Mr. Jones "It is true, is it not, that your company has large reserves?" The implication is that there is a bit of cash there that can go out ----

THE PRESIDENT: The implication is that there is a bit of fat somewhere and a bit of competition will slim it down a bit.

MR. VAJDA: That cash can go into the – because of course Albion is a profit-making company and can go into the pocket of the shareholders of Albion, but the point is that if that cash goes from Dŵr Cymru to Albion it is not going to go back to the Dŵr Cymru customers, and indeed, not only that the Dŵr Cymru customers – and one has to remember here we are talking about Wales where there are a number of people on low incomes, it is not the richest part of the United Kingdom – face the risk of higher water bills. I put it no higher than that because obviously at the end of the day it would be Ofwat to make a determination. What we do say, and we say the Tribunal must take note of is that you simply cannot proceed on the basis that if there is going to be a loss of revenue from the large non-potable customers, there will be no knock-on effect on the households, that would not be – we say – a finding that would be open to this Tribunal to make in the light of this evidence, that is why we say at p.6 that we are sure that the Tribunal wished to revisit its interim approach at para.328

which his that there is no linkage between lower prices for some large users and higher prices paid by other customers.

THE PRESIDENT: On this point, what do we make of the various remarks in the consultation paper to the general effect that the industrial sector does not subsidise the household sector and that there is no question of a pass back to the household sector, if you allow competition in this bit of the market – what do we make of it?

MR. ANDERSON: The Tribunal has to assess all the evidence and that is certainly evidence in the consultation paper.

THE PRESIDENT: It is a statement of what Ofwat said was the position?

MR. ANDERSON: In fact, in my respectful submission and on the evidence in this case one can show that that is not a complete statement, and in another respect, again of which the Tribunal has had evidence, of the major subsidy between domestic and large users actually on the cost of capital – you will remember that we have had a debate about that – is because effectively what happens is because these are regulated companies, and they are regulated across the whole activities, they are low risk companies and can therefore raise money on low rates. That is absolutely fundamental because the largest part of every customer's bill is capital and the cost of … so it is actually crucial. That is, if you like, one of the things that Ofwat – if you go back to the final determination you see Ofwat is very concerned to ensure that the risk profile of these companies does not rise, otherwise that will have an effect on their cost of capital, which will feed immediately through into the cost of bills. Bear in mind in this respect also that for every £1 that a water company gets in revenue it is actually spending at the moment £1.20. So it is pouring quite a lot of money to fund these investments, and so the cost of capital is absolutely critical because even a small increase in the cost of capital will have a major impact on water bills, and that is one of the concerns of Ofwat.

THE PRESIDENT: All that line leads to the conclusion either that there should be no competition or that the competition should be extremely limited.

MR. VAJDA: No, with respect, my submission is not the Competition Act 1998 does not apply, what I am saying is that in relation to the margin squeeze I think what it does mean is that the Tribunal needs to consider very carefully how margin squeeze operates in this particular industry and indeed we would not accept the suggestion, again made in the interim Judgment, that there is some implicit contradiction between ECPR and, say, Chapter II, Article 82. The European Court has never considered this type of situation.

So far as excessive prices are concerned, I am not coming to you, Sir, and saying "I am striking out Mr. Thompson's excessive pricing case". I am not saying that. What I am saying is that when one is looking at excessive prices one has to be careful because an excessive pricing case is essentially a case about wrong cost allocation, that is what is being said, it is saying you are sort of putting costs and what I am saying, and this is very important, is a Tribunal needs to be very careful in looking at these cost allocations. Perhaps I can put it like this: if we go back to the leading case on excessive pricing, *United Brands*.

THE PRESIDENT: Yes.

MR. VAJDA: United Brands were said to be excessively pricing their bananas. Assuming that the Commission had been successful in the European Court and there had been some order that United Brands should reduce their price of bananas or whatever, there is no question there that that would necessarily have any impact, say, on the price of apples if United Brands were selling apples, because United Brands is not a regulated company. United Brands did not have a revenue requirement to meet. United Brands is operating in, if you like, an unregulated market and you simply say "In relation to bananas you apply the two stage test: is there a discrepancy between cost and price? And stage 2: is the price unfair?" There may be some question of objective justification but that is effectively how you do the exercise. What I am saying here, and indeed, what plainly the European Court would have well regard to, because the European Court would look at social objectives as well in competition policy, is that we are not saying that you cannot do an excessive price analysis here – as I say, I am not striking out Mr. Thompson – what I am saying is you have to be very, very careful when one is looking at an excessive price case which is based on 13, 14 or 12 different versions of cost allocation to see whether it is actually right, because here you have the potential knock-on effect on other people. That is, if you like, the big point I am making.

THE PRESIDENT: I think the reason we have had two stages in this case has been our feeling that we do really need to thoroughly understand the ramifications of it.

MR. VAJDA: Absolutely.

THE PRESIDENT: Anyway, you argue that there is at least a risk of a pass-through to household bills?

MR. VAJDA: Yes, I do not put it any higher than that. What I do say is that if the Tribunal were to ignore that risk, that would, in my respectful submission be a misreading of the evidence that the Tribunal now has the benefit of.

THE PRESIDENT: Yes.

MR. VAJDA: I think I can pass on over the page. What I would like to do before the short adjournment is to go to excessive prices on p.7. It is rather curious because although this is a Decision and an Appeal against the Decision we have not actually been to the Decision that often.

THE PRESIDENT: It seems to happen to us quite a lot, nobody ever goes to the Decision. We have got it in front of us.

MR. VAJDA: It is just a convenient way of going to *United Brands*.

THE PRESIDENT: Quite, well we remember what *United Brands* says.

MR. VAJDA: If the Tribunal would bear with me one moment, it is para.230 of the Decision (p.58). The basic test which we all know, is at para.250 of *United Brands*, is the price charged, does that bear no reasonable relation to the economic value of the product? So that is the test that is at 250. Then there are two steps that you need to take to get to that, and those two steps are set out in 252: "It is important to appreciate that these are two distinct tests. The first is whether there is a difference between costs actually incurred, and the prices actually charged is excessive", so that is step 1. Step 2: "If the answer to this question is yes, whether a price has been imposed which is either unfair in itself or when compared to competing products …" That is important, Sir, and this is a point that Mr. Anderson made yesterday, when the Tribunal said at para.384 of its interim Judgment, was it really right to use ECPR to negative a possible ----

THE PRESIDENT: Yes.

MR. VAJDA: That, with respect, is not a fair way of putting it.

THE PRESIDENT: The implication of that sentence was not right, it should have been more neutral.

MR. VAJDA: Precisely. The reason I mention this is because it is a two stage process, and the Director did not conclude, as it were, having done the cost price analysis that there was ----

THE PRESIDENT: And the difference between 19 and 23 would have been ----

MR. VAJDA: This is important because you have got this two step process. That may be a convenient moment, because what I am going to do after the adjournment is to go pretty rapidly through the whole company cost basis because in a sense that is points of detail, and I am going to spend a little time on a matter that I know is troubling you which is the stand-alone basis.

THE PRESIDENT: Thank you. Mr. Vajda, can I just comment and then you can come back after the short adjournment. 252 could be read as suggesting that you always need to, or you

should in most cases, try to establish what the costs actually incurred are – whatever we mean by "the costs actually incurred".

MR. VAJDA: Yes.

THE PRESIDENT: Once you have that then you ask yourself the question "in what sense is this price, or could this price be said to be unfair?" in which case you presumably look at those costs, you look at competing products, and look at various other things. I think they say later on in the Judgment words to the effect that there are various ways of doing this and economists have not failed to think up several, or words to that effect.

MR. VAJDA: Yes, and I think you, Mr. President, said something similar in *Nap*, you indeed made the point which is the fact that it may be difficult is not a reason for not doing it.

THE PRESIDENT: No, they did it in various ways.

MR. VAJDA: You do it in various ways. Finishing just on that point, when it says "the costs actually incurred" in this case, again it does not actually say in 252 the costs actually incurred on a stand-alone basis. I am not saying that we do not take the stand-alone basis, and I am going to come to that after lunch, but one has to bear in mind, assuming that we were sitting on the Plateau Kirschberg whether, if you like, a sort of regional average cost would strike the European Court in the Water industry as inherently inappropriate. What they might say is "You may need to do a cross check, but we do not see anything inherently inappropriate in the context of this case." We come back to this question, when it says "costs actually incurred" what costs are we referring to over what basis?

THE PRESIDENT: Yes, 251 is also relevant, but we can come back to that after lunch. Now, how do we all feel about having a slightly quicker lunch today? Shall we come back about 5 to 2?

MR. VAJDA: Yes.

THE PRESIDENT: We will do our best to read this over the short adjournment.

MR. VAJDA: I am very grateful, yes .

(Adjourned for a short time)

MR. THOMPSON: Sir, I do not want to delay things, but just to put down a marker, it does appear that this speaking note is, in reality, a very substantial, new skeleton argument, and I have now received another document. I do not think it is going to be possible for me to necessarily address every point that is now put out in some detail in writing by Mr. Vajda, which has obviously been prepared, some of it, over the weekend ---- He has had Friday to deal with it . We have had no warning of it, and it will be very difficult to address all these

points on the hoof on the basis of a quick read-through over lunch. I simply put that down as a marker, sir.

THE PRESIDENT: What flows from that, Mr. Thompson? We are not going to be able to effectively finish today?

MR. THOMPSON: I do not know. I am happy to say what I can today, but I think inevitably I would seek to reserve my position, to put in another written document, if necessary – obviously as short as may be, and not rehearsing matters. It appeared to me that this is really quite a hefty new set of submissions – and not simply a speaking note.

THE PRESIDENT: Let us see how we get on for the time being.

MR. VAJDA: Quite a lot of that work was done between four-fifteen and eight o'clock this morning. There we are. Can I just come back on one point in relation to reserves that my client wishes me to make? The reserves are effectively the money that was raised by Dwr Cymru in order to ensure that it has got a low cost of capital, they are not in any sense fat as a result of the lack of competition. I mean, Dwr Cymru in fact raised bout £3 billion. That is, if you like, what you have got in the reserve. It is being used for that purpose. It certainly would not be accepted that it is because they are inefficient, or anything like that.

THE PRESIDENT: No.

MR. VAJDA: We were just finishing off United Brands at p.7.

THE PRESIDENT: I think we have more or less got through to the end of this document. It is fairly dense in places, and so we have not necessarily followed all the subtleties and nuances of it.

MR. VAJDA: What I am going to do now ---- On excessive pricing, if you like, there are the two big points: there is average accounting ---- or the whole company, and there is stand-alone. What I want to do is to deal with whole company, but relatively rapidly, and spend a little more time on stand-alone because I know that concerns the Tribunal. On average accounting we have separated out – and, indeed, this, in a sense follows my cross-examination of Dr. Bryan – first of all, treatment. Subject to anything the Tribunal wants to deal with, I will not expand on that. The only point I would make – and it is not a point that I have any pleasure in making, but it is a point that I feel I need to make - is that one of the things that the Tribunal will have to consider is the credibility of Dr. Bryan as a witness. We do say, in relation to treatment costs, for somebody who has been in this industry for a long time, it was a very surprising omission to make no reference to capital costs, which everybody knows are a large part of this industry. I say no more about it.

THE PRESIDENT: In the original Notice of Appeal you mean?

MR. VAJDA: In the original Notice of Appeal. We have set out in our skeleton also, at para. 14 of this document what then happened. Indeed, we find it slightly curious that in the skeleton for this hearing Mr. Thompson repeated the fact that 1p was a generous estimate for treatment costs, given that his own client had accepted that it did not include capital costs.

Now, the other point on treatment costs which is a bit dense - but subject to the Tribunal I am not going to spend time on – is the question of the percentage of the costs of non-potable and potable treatment. We have dealt with that at 15. There are essentially two points here. The first was what was called the dual purpose ---

THE PRESIDENT: Yes. We followed the point, I think.

MR. VAJDA: You, Mr. President, said, "Can't we reach agreement on that?" We have sent a letter to Albion. There it is. The second point on p.9, which is, "Does one look at theoretical output or actual output?" and that was a point I put in cross-examination to Dr. Bryan ---- Our position is that we should take ---- In fact, the figure that Dwr Cymru took was an average, but if one was going to take one rather than the other, it would be theoretical rather than actual because one is looking at the capital cost of the asset.

THE PRESIDENT: Yes.

MR. VAJDA: Now, coming on to distribution, that is obviously where, if you like, the figures diverge quite considerably. I am going to deal with this quite quickly. There is the first point at 17, which is, as it were, that 'a pipe is a pipe is a pipe'. There is common ground that one looks at the MEA value. The Tribunal will recall that in Mr. Jones' evidence he gave that table of the MEA values. It is perfectly true that the unit cost will be more if it is in urban or suburban than it is in rural. That, I think, is common ground. We say that effectively the evidence is all of a piece in relation to that.

Moving on to p.10, again – and this is the point I think you, Mr. President, made to Mr. Anderson earlier today – we are looking at bulk distribution. So, we are looking at large pipes. The Ashgrove is 700, but we say that one ought to look at least at 600 and over. Then we make a point about construction costs which I am not going to expand.

So, what we say is that the starting point, subject to the points we will come to in a moment, is that the construction costs may be the same. Could I just ask the Tribunal to add in a reference to para. 20? This is from the cross-examination of Dr. Bryan. It is Transcript 2, p.16, lines 8 to 13. Now, in the Notice of Appeal there were four factors that were said to cause a difference in distribution ---- This has been dealt with, again very lengthily, in written submissions, and I propose to go over this quite quickly. The first point was

integrity which, in a sense, there is a read-across, we say, between 'a pipe is a pipe' ---- I mean, do you use different materials? You will recall that in cross-examination (this is at the bottom of p.10) I asked Dr. Bryan what he meant by 'integrity', and he said that it included matters of complexity. You will recall, indeed, Mr. Thompson's cross-examination of Mr. Jones – there is now a very heavy reliance placed on this complexity point. Again, it is a small point – and again it is a point which it gives me no pleasure to make – but we do say, in looking at the credibility of Dr. Bryan, that it is perhaps unfortunate that if this was such an important difference it was not actually set out in the Notice of Appeal originally.

Location – rural and urban. That is really the map point. Again, I do not propose, subject to any issue the Tribunal wishes to raise with me, to deal with that any further.

THE PRESIDENT: I am just slightly in the dark on this point: as to whether, when Mr. Jones very helpfully set out various construction costs in this first witness statement, I think, in relation to urban/rural/suburban, etc., whether he was using urban in the same sense that the Ordnance Survey is apparently using urban when it comes to the maps that you kindly showed us, or whether it is a different sense, and whether we were able to pinpoint what difference.

MR. VAJDA: I am told broadly less(?) I think the Tribunal are right to be cautious about that. The Ordnance Survey, in a sense, work on one basis, and we know that OFWAT have their own, as it were, unit ----

THE PRESIDENT: So, they are not necessarily ----

MR. VAJDA: They are not necessarily, and I would not want the Tribunal to proceed on that basis.

THE PRESIDENT: That is all we need to know for the time being, unless we come back to you.

MR. VAJDA: We would say there is a broad correlation. Plainly, laying pipes in an urban area is going to cost more than ----

THE PRESIDENT: We have all got a mental picture, I think, of what we mean by urban – not necessarily a little hamlet on a rural road.

MR. VAJDA: Yes. The next point that was made was a length. We dealt with this. Perhaps what I could invite the Tribunal to do is to go back ---- I say 'go back' ---- I have not even taken the Tribunal to our skeleton. But, if we go to paras. 32 to 34 ----

THE PRESIDENT: Incidentally, Mr. Vajda, I do not want you to feel under any time pressure this afternoon. If we cannot get through it, we cannot get through it.

MR. VAJDA: I hope to finish by five to four, which is my target. Indeed, one of the objects of having this is that I hope I can go a little quicker, but I am grateful for that indication. If we go to p.14 of our skeleton, para. 32 – Length. What was said was that what one wants to look at is the average length. We then have to look at it on both sides of the equation. So, the first method of looking at it is in relation to the non-potable system, which is, as we see at 32.1, the Ashgrove system. What is said is that that has a length of 16km. It has two customers. So, it is 8km per customer. That forms one basis of the comparison that we have summarised at para. 32, which is that potable mains at 20km plus are, on average, twice as long as the non-potable. So, obviously, if one is doing such a comparison, it has got to be done a like-for-like basis. So, we see how it has been done for the non-potable customer, and the point that we make then is how do you then do that in relation to the potable customer, and the point that we make at 32.2 is that the calculation for potable mains is carried out on a completely different basis, and the reference there is Annex A to Dr. Bryan's fourth witness statement, that the average length, and these are his words, the average distance between Dŵr Cymru's 10 largest potable customers and their closest treatment works, i.e. the sum of the distances for each customer to the nearest works divide by 10. But that abandons the per customer definition which was the basis of doing it for non-potable systems. The point that we make an arithmetical error, if one goes over the page at p.15, that we say well if we do it on a per customer base, we have to look at the approximate ----

THE PRESIDENT: Yes, you have the decimal point in the wrong place.

MR. VAJDA: Exactly. Now, we are not putting this forward as the correct methodology because everybody agrees that one wants to look at bulk pipes. What we are saying is one has to be very careful, and this comes back to this whole issue of cost allocation on excessive pricing, that one is comparing like with like, and that it is robust. That is the point that we are making.

If I could then ask the Tribunal to go back to our closing submissions at p.12. I did not cross-examine Dr. Bryan in relation to pressure, and I do not accept – and I am sure the Tribunal will not accept – what I thought was a slightly cheap point made by Mr. Thompson that I had sort of given up on this part of the case because I had stopped my cross-examination. That is not the way that we see that and indeed the President helpfully pointed out that in this Tribunal one did not have to put every point to every witness.

THE PRESIDENT: Well we would be digging in for a three month case if we did it on that sort of basis.

MR. VAJDA: Yes, now if we then turn to, we say, the new factors. These are effectively factors that have emerged since the Notice of Appeal, and I am not saying "This is not a pleading point you cannot take them", but again the Tribunal needs to form a view as to why these factors did not emerge at an earlier stage." But in terms of substance the critical or, if you like, a key issue is now the complexity point and the Tribunal will recall the cross-examination of Mr. Jones by Mr. Thompson on that basis. We say that there is no basis (p.13) for the assertion that complexity could double the cost of laying a potable main, because obviously the Tribunal here will be well aware – again one has to bear in mind, focus on the Decision, the Director made an assumption, was the Director right to make that assumption? It may be that the Tribunal will say "yes, there are some differences" but then we get onto the question of the quantum, and to something which is significant, and so I am focusing on the moment on the quantum. Does this complexity double the cost of laying a potable main? Mr. Jones gave evidence in relation to the cost of the ancillaries, those are effectively the joints and the hook-ups, and he also pointed out – this was when he was being cross-examined – that in a sense 'complexity' is, if you like the obverse of economies of scale, because they serve hundreds of people, they are complex, but that brings cost savings. We say that on complexity the evidence is that it does not actually increase costs and certainly that the evidence goes nowhere to support the idea that it doubles the cost.

THE PRESIDENT: This, I think, comes back to my slight uneasiness expressed earlier, and perhaps you will reassure me, or I will become reassured, about the general validity of comparing a bit of a conjunctive use system with a self-standing system, because you cannot completely ignore the fact that the transept is held up by the rest of the cathedral, it forms part of the rest of the cathedral and you are trying to, perhaps misguidedly, compare its cost with a parish church. I do not know quite where that takes one?

MR. VAJDA: Perhaps I could make this submission. We come back to the question – and this is all to do with was the access price excessive, that is why we are getting into this exercise – the Director made an assumption that the distribution cost was the same. There has been a challenge to that assumption and that challenge itself breaks down into a number of separate challenges and this is obviously in relation to complexity, that is effectively an issue that has been raised, and if one then gets to the situation – it seems to me the Tribunal would be able to reach two conclusions, one is "We really find that this does not get us anywhere", or alternatively – and this is a point that I made at the case management conference shortly after Easter – if in relation to this aspect of the case the Tribunal considered that there was evidence that the Director had not taken into account, and this was a particular thing that

ought to be gone into, that that ought to be done, because, for instance in relation to complexity there would be no basis, we would say, for the Tribunal to say "Actually, the Director failed to take account of complexity, and in fact the distribution cost is Xp, because we simply do not know."

I am being handed some further information on rural and urban, but I do not fully understand it yet so I shall give it to the Tribunal in ----

THE PRESIDENT: I think on the last point you make, Mr. Vajda, I think our present view is that we feel we should try and take a stab at deciding the case on the stuff we have got, and if it does not come up to proof it does not, and if it does it does.

MR. VAJDA: Yes, it is absolutely critical, excessive price when one is looking at the issue of cost allocation, and if one is going to depart from one cost allocation one has to make sure that it is robust.

THE PRESIDENT: Absolutely.

MR. VAJDA: The next point is, if you like, the drinking water point and, subject to the Tribunal, I do not really want to say much about that. I think the evidence is, yes, there is work done, but it is done on the smaller pipes, and so it is not a relevant difference in bulk distribution, that is the point there. If we go over the page, to p.14, what we have – and perhaps we can look at this because this was a point I was going to cross-examine Dr. Bryan on but did not – if we can just look at his evidence, which is Annex A to his fourth witness statement.

THE PRESIDENT: Yes.

MR. VAJDA: I think he produced what one might call a "criticality table".

THE PRESIDENT: Can you take us to the page?

MR. VAJDA: Yes, it is p.30. If you like the punch line is at para.98, it is clear from the analysis – that is the table – that potable mains score more highly than non-potable or raw, in other words that is a cost driving difference between the two.

If one looks at the cost drivers, or the factors that are said to make potable main more critical one of them is said to be their distance from the road, and it is said that .. take three potable mains which are more than half a kilometre from a road, whereas the raw mains are closer to the road, they are between 50 and 100 metres.

So what is being said there is that potable are further away from the road, yet raw and non-potable are closer, but then going back to p.14 of the closing submission, we say that that is inconsistent, or certainly begs a big question, because elsewhere it has been claimed that 75 per cent. of potable mains are in the urban areas where there are many roads, whereas only 25 per cent. of non-potable mains are in the urban area. Also, you will recall the assertion

in the Notice of Appeal that potable mains were more likely to be located under roads, and therefore were more expensive. So again, this goes to the issue of consistency of the evidence.

Then, if we look at another criticality driver, which is on p.31 of the evidence, distance from the depot, and it is said that "potable mains are typically further from the depots than other types of main", Dr. Bryan does not tell us where the depots are, but if they are located in urban areas and if effectively potable mains are further away that would suggest that they are generally located in rural areas. So one has a number of attacks that are being made, and the point that I am making – and I am sure that the Tribunal has well on board – is that one needs to look at all this evidence in the round, because some of it does sit at the very least uneasily with other bits of the evidence.

I come then to what appears to be the main case, or certainly has grown in importance, which is the raw versus the non-potable ----

THE PRESIDENT: Just before we go to that, it has sort of been covered by the points that you have just been making, but there is an amount of emphasis on the question of maintenance, and we have your point that if you are comparing bulk with bulk then there is not much maintenance of the bulk in potable as well as non-potable. We have a certain amount of evidence about the actual maintenance of this pipeline, in particular in Lynette Cross's witness statement, from which - and I suppose this is the question – one could perhaps draw the conclusion that there has not actually been a great deal of maintenance of this particular pipeline over the years. I think bits of it were done once when the A55 had to be straightened or something of that kind – A355 it may have been – but apart from that it seems to be walked once a year, and that is about it. You may well say we should not look at the specifics of a particular case in this sort of instance, but the question I am putting is would it be a fair inference on the evidence that there has been very little maintenance on this pipeline over the years? I do not mean the treatment works, I mean the pipeline?

MR. VAJDA: Yes, there are two points to make. The first, at the moment I am looking at it on a company basis, and again one has to be careful and what would plainly be wrong is to say Actually we are just going to compare the Ashgrove pipe with what happens elsewhere. You have to compare like with like. The second point is this is an extremely long term industry, and indeed I saw some raising of judicial eyebrows when Mr. Anderson said the medium term was 25 years, so that one must not take snapshot as it were – in terms of the point yes, it is perfectly true that the amount of maintenance that has happened in recent years is set out in Lynette Cross's statement, and yes, it is true that it is not, in absolute

terms, a large amount of money. Of course, the question of the maintenance, in a sense, of Ashgrove, if it comes in anywhere it comes in on a stand-alone basis ---- We would say that it would not be a correct finding of fact to say, "Well, there hasn't been very much maintenance on Ashgrove in recent years. Therefore, we can infer from that that there is less maintenance going on". For example, this is, in a sense, the risk factor. We have seen how Shotton is very, very dependent on water. I mean, it is absolutely critical to its well-being. The consequence of that pipe going down at Shotton would be quite devastating. So, the fact that it is walked through each year ----

THE PRESIDENT: It may not need much maintenance.

MR. VAJDA: But, I mean, it certainly needs to be as well-maintained as any pipe, because although that water is not being used for drinking purposes in Shotton, it is critical to the paper mill function.

Does that deal with the President's question?

THE PRESIDENT: Shall we go on to raw water and non-potable?

MR. VAJDA: Yes. Now, in relation to this we adopt what Mr. Anderson said for the Authority this morning. We essentially are making two points here in relation to this comparison. Let us assume for the moment – and, as Mr. Anderson has said, it is not accepted that 2p is the correct figure for all, but let us assume that it is – Step 1 is, it is said, that raw water distribution, is, give or take, 2p per cubic metre. We see that at Annex F to Dr. Bryan's fourth witness statement. That is based on the returns that Dwr Cymru made to OFWAT under RAG2. If we go over the page of the speaking note to p.15, we see the definition of the various items. The important point to bear in mind in relation to the raw water aqueduct is that it is everything upstream of the treatment plant. Now, Stage 2 of this process – and I think this was where there was a considerable amount of cross-examination of Mr. Jones by ----

THE PRESIDENT: Just before we leave 26, I have in the back of my mind that at an earlier stage in this case we had a figure for kilometres of raw water aqueducts and that that covered both what are now called raw water aqueducts, in the strict sense of sourced treatment and non-potable mains because Dwr Cymru did not feel it necessary in the regulatory system to break them down ----

MR. VAJDA: Yes, that is correct.

THE PRESIDENT: So, what are we talking about in 26? 'The regulatory account prepared by Dwr Cymru . . . The only mains identified as raw water aqueducts are those upstream of the treatment works.' What regulatory accounts are we talking about there?

MR. VAJDA: We are talking about the returns that Dwr Cymru made to the Authority, and I am told that they are what are called RAG4 accounts.

THE PRESIDENT: I just understood you to say – or, to agree with my recollection – that at a certain stage non-potable and raw water be put in together.

MR. VAJDA: That is correct. What I am trying to find, or asking those behind me to find, is the reference in the evidence to that. If I can put my finger on that ----

THE PRESIDENT: Is this something different, or is it a development of what has gone before, or what? Come back to it ---- or, those behind you or beside you ---- They can beaver away while we go on.

MR. VAJDA: Yes. Now, Step 2 – and this was, in a sense, the thrust of the cross-examination – is: if you take a system like S6 (because I think they were effectively two non-potable systems with treatment work … looked at – Ashgrove and S6), you have got, as it were, the upstream --- the bit ---- the raw water form the source to the treatment work ---- That is, it is said, at 2p, give or take, whatever. Then you have got the downstream, as it were, from the treatment works to the customer, which is non-potable.

THE PRESIDENT: Yes. It was said, roughly speaking ---- I have not got the distances right, but there are 50km of raw, and then there is a treatment works, and then another 8km of non-potable. What is the difference?

MR. VAJDA: Yes. The argument is: well, if you have got 2p at the … bit, you have then got 16p at the next bit ----

THE PRESIDENT: And there is something wrong somewhere.

MR. VAJDA: There is something wrong somewhere.

THE PRESIDENT: That is the argument.

MR. VAJDA: Yes. Yes. Now, the 'something wrong somewhere' ---- Our first answer to that is that in fact Dwr Cymru has a number of non-potable systems, and those all have costs. Those are systems that go from the source to the customer. There is no treatment work in between. You have to account for those costs somewhere, and so far as we can see this methodology does not do so because they do not fall into, if you like, the 2p calculation; they do not fall into the ---- because they are not works ---- they are not distribution from source to treatment works, and that is the basis of what Dwr Cymru put to the Authority in its returns ---- Nor do they, so far as we can see, feed into the costs of the other non-potable systems. In other words, those costs have been ignored completely. That, we say, is the first error. That is the point we make at paras. 25 to 29 of the speaking note.

THE PRESIDENT: What is, I think, being said is that if it costs 2p to carry raw water from a source to a treatment works, why does it cost more than 2p to carry raw water (which we are talking about) from a source to a customer's works?

MR. VAJDA: That is because that is classified as non-potable.

THE PRESIDENT: It is appreciated that it is classified as non-potable ---- or, it is labelled as non-potable. The argument is that it is something doing the same function, i.e. carrying raw water from Point A to Point B. That is the argument.

MR. VAJDA: That is the argument. There are a number of reasons. First of all, it is over a longer distance. Secondly – and this is perhaps again ---- and we deal with this further on in the ----

THE PRESIDENT: It is a longer distance. Yes?

MR. VAJDA: The other point is that ---- Yes, if we go to para. 35, when you are looking at water from source to customer, that is not the same as water from source to treatment plant because customers are quite often located in urban areas. We know – and that is common ground – that effectively laying a pipe in urban areas is more expensive. In other words, the fact that the water ---- There may be very little difference in the quality of the water, but it does not mean that there is no difference in the cost of the pipe because if you are looking at a pipe that goes from source to customer without a treatment work, that ---- you cannot assume that customers are going to be located where treatment works are located. That is the point that is made at 35.1. The second point which we make at 35.2 is that the raw water … does carry much larger volumes of water.

THE PRESIDENT: Is that the point that is developed in paras. 30 to 33?

MR. VAJDA: Yes, that is precisely so. Before I come on to that, can I just give the answer to the question that you, sir, asked me, if I can find the piece of paper? Yes. What Dwr Cymru did is that they put raw water and non-potable together in the asset inventory, but not in the regulatory accounts. I am sure we can probably find the passage in the evidence where that is ----

THE PRESIDENT: If someone could just identify for me the different documents to which you refer?

MR. VAJDA: Yes.

THE PRESIDENT: This volume point ----?

MR. VAJDA: Yes. The volume point. Now, the volume point ---- If we could just go to ---- This is a point I think I put to Dr. Bryan in cross-examination, but it may assist the Tribunal if we can go to ---- I am just trying to remember which annex it was ---- It is Annex F. In

fact we have it in the speaking note at the bottom of p.16. In doing his calculation for working it out on a per cubic metre basis for raw water ---- Because what he does is, he uses information from the returns and then he says that,

> "It is then necessary to identify the total volume using the network to derive the unit cost distribution for raw water".

So, you are looking at volumes on the one side. But, he does not look at volumes on the other side. That, we explain – and I hope it is self-evident – on p.17, as to why one obviously needs to take account of volumes to do a comparison in getting the unit cost of the distribution of water. We make that point at para. 32. Now, this was a point I put to Dr. Bryan in cross-examination, and his answer was that one has to take account of differences in other cost drivers in relation to the respective networks. Perhaps it is appropriate that we go to the body of his statement again at p.5, Table 28. What he does there is that he summarises.

> "Annex A has been summarised in tabular form below in an attempt to clarify whether distribution characteristics in the non-potable systems are more closely related to raw or non-potable systems".

Then the conclusion he draws from that table is at para. 29 over the page.

> "This table graphically illustrates for every cost driver examined above there is a clear relationship between raw and non-potable mains, and no cost driver comparability between potable and non-potable systems".

So, what he is saying is that for every other aspect, raw and non-potable are exactly the same. So, it is slightly odd, in answer to me ---- we would say not only odd, but inconsistent with the evidence that is being put forward in the fourth witness statement to say, "Well, one has to take into account differences in other cost drivers" when the thrust of the evidence presented in the fourth witness statement is that the cost drivers are exactly the same.

THE PRESIDENT: Yes.

MR. THOMPSON: I am sorry. It would be helpful if Mr. Vajda would point us to this part of Dr. Bryan's evidence. At the moment I do not really recognise it?

THE PRESIDENT: Day 2, p.12. Why do we not have a look at it? (After a pause) Yes, p.12.

MR. VAJDA: The answer at line 27: "So what Dŵr Cymru has then done is divide that fixed sum which relates to a very large volume of water going through a much larger raw water aqueduct system, i.e. a longer system and applying that fixed sum to the very smaller volume of water going through the non-potable system." It seems to be the suggestion there

that the aqueduct system – when it says "larger" it must mean "longer", maybe that was a wrong inference, but that is certainly how we understood that evidence.

THE PRESIDENT: I find this part of the argument a bit dense, I have to say.

MR. VAJDA: The key point, if you have to take account of volumes, and I put ----

THE PRESIDENT: We can perhaps sort it out in writing, but p.12 of the transcript seems to assume that Dr. Bryan has been working on a raw water aqueduct length of 542 or 583, not a raw water aqueduct length of 153, that is what it says.

MR. VAJDA: Yes, but you see if we go back to the table on para.28, you see "average length of the system raw" is 15 kms., and then if we go to para. 16 of Annex A, para.16, "In total these appear to comprise 153 kms of large raw water aqueduct with an average length per source of 15.3." So that is where he gets the 15 in table A, the table at para.28.

THE PRESIDENT: That is what is not completely clear.

MR. VAJDA: No, that is not, because obviously the thrust of table 28 is that they are pretty similar. There is then done the calculation, we say we have not taken account of volumes, and the riposte in the evidence seems to be "Well, actually there are other differences, one of which is that the raw water duct system is longer than the potable system, and if 543 is being used here one wonders why 153 is being used in the table at para.28. If the Tribunal wants further assistance in writing ----

THE PRESIDENT: On both sides, both sides accuse the other on this point in something resembling a schoolboy howler, and I am not really able to work it out in my head at the moment without going back through all the detail of all the various calculations. Let us press on for the moment and we will sort it out.

MR. VAJDA: Yes. Can I just say that Mr. Anderson – I think it was Mr. Anderson – passed me a note saying that non-potable mains are in fact included in third party services in the RAGs not resource costs, which includes the raw water aqueducts, so there is a separation in what goes to Ofwat.

THE PRESIDENT: The third party services, Mr. Anderson, is very dangerous ground in this case, I hesitate to ----

MR. ANDERSON: Yes, the only point I was making to try and assist the Tribunal was this question that the resource cost on which the 2p was derived excluded the non-potable assets that is the pipes of the non-potable assets, they were to be found somewhere else.

THE PRESIDENT: It does not have the costs of the assets in the third party services if I remember rightly, but there is a very considerable confusion as to what is in third party services at the relevant time.

MR. ANDERSON: The important point though is that the non-potable assets are not included in the resource costs.

THE PRESIDENT: We may have to go into that a bit further, I am not sure that is right, but never mind.

MR. VAJDA: This may be an appropriate moment then to move on to stand-alone.

THE PRESIDENT: Yes, why do we not do that?

MR. VAJDA: I will pass on paras. 34 to 36.

THE PRESIDENT: Yes.

MR. VAJDA: The Tribunal will recall that in its interim Judgment it actually referred specifically to OFT 422 at para.334.

THE PRESIDENT: Yes.

MR. VAJDA: And we set out at p.20 these definitions which the Tribunal … yesterday with Mr. Thompson, and I will come back to them in a moment, but we have emphasised the word "hypothetical" and I will come back to the significance of that in a moment, and also the word "only", that is to say it is one product company.

THE PRESIDENT: Yes.

MR. VAJDA: Where this becomes very important is in terms of – and this is what I said in opening – the capital value and the rate of return. The Tribunal, and perhaps I can slightly depart or interlace this with the text, the Tribunal as I understand it has raised effectively four points and if I can list them, and if there are some other points that I have failed to grapple with the Tribunal can … First of all, what I call 'the Greenfield site' point. The second point is, if you like, the breaking out of existing costs point, which is I think a point both the President and Professor Pickering put yesterday – it really arises out of 2.17 of the definition. The third point is "Is this appropriate?" Is the 414 approach appropriate to common carriage, which is I think a point the President put. The fourth point which, in a sense, is perhaps a variant on the third point is what is the consequence where MEA kills common carriage stone dead, which is the point that you, Sir, put this morning and I certainly dealt with it so far as the Water Act 03 is concerned, because I said that there is a different approach.

THE PRESIDENT: The point was not MEA as such, the point is what is the rate of return that you apply to the MEA on the company's recent performance. 1 per cent. on MEA would be about what it has been earning.

MR. VAJDA: Well, if I can put it, will this approach, if you like – because obviously one of the key issues when one moves to a stand-alone is what is the rate of return?

THE PRESIDENT: Yes.

MR. VAJDA: And the Tribunal is well aware of where the battle lines have been drawn.

THE PRESIDENT: Yes.

MR. VAJDA: Because we say that if you are looking at it on a stand-alone basis, you have to look at it on a stand-alone basis. What my friend says is that that is unrealistic because you are a regulated company, I can look at how much you have earned over the last few years and it is 0.8 per cent. And that is what you are entitled to.

THE PRESIDENT: Your calculation, if I have it in my head, we would like very much to be put right on this, appeared to assume a 100 year period, I think, and the equivalent of a repayment mortgage at 17 per cent., or something of that order, over that sort of period, that is the assumption behind it.

MR. VAJDA: Yes. I think those are the main concerns that the Tribunal has – obviously if there is another concern ----

THE PRESIDENT: No, that will do for the moment, I think.

MR. VAJDA: If I could go back to the text at the top of p.21, and this is really going to in a sense the Greenfield site point, what this approach we say in 414-422 is looking at is that of a hypothetical supplier. Now, it is important here, and I may deal with a number of points at the same time, another point that the President put, it may have been put to Mr. Thompson, or possibly to Mr. Anderson as well, is that we have got the pipes there ----

THE PRESIDENT: "We have got it there".

MR. VAJDA: Yes, but with respect that is precisely why you go to the stand-alone basis, because one has to remember what is the task that we are doing here? The task is to find out whether or not an undertaking is engaged in excessive pricing by reference to the assets that it has, and what this is doing is saying "Let us now leave aside the question as to whether or not the assets were acquired on the cheap, whether they were given to the undertaking by its grandmother", or anything like that, we are going to do an objective stand-alone analysis which means we are going to have to look at this from scratch. We are not looking at he assets. That is the important use of "hypothetical". We say at para.45 that this necessarily implies an approach based on the replacement or modern equivalent asset valuation.

THE PRESIDENT: That, I think, is quite close to being common ground.

MR. VAJDA: It is and, indeed, one of the points in a sense that you will recall, and perhaps we can just take up the skeleton of Albion for this hearing just to see the common ground that does exist.

THE PRESIDENT: Yes, 175, yes, page?

MR. VAJDA: It is para.70(3) where it is said that Dŵr Cymru has a gross MEA value for the Ashgrove treatment works within its register of 1.44. So, there is no dispute between the parties that one is taking MEA ----

THE PRESIDENT: I do not think there is.

MR. VAJDA: What is being said - and this is what is being said at para. 70(3) – is that the MEA value is 1.449.

THE PRESIDENT: That takes us to the detailed argument in relation to the treatment works as to whether CCV is a proxy for that.

MR. VAJDA: Yes. But, it is important to appreciate that one starts from the MEA approach. I think the Tribunal have been handed copies ----- If one goes to the top of p.22 of the script at 4.47.3, we set out a short passage in a report prepared by Oxera for the OFT. I want to make it absolutely clear that this is not the view ---- It comes with a health warning on p.1, as it were. This is a report that was commissioned for the OFT and it says ----

THE PRESIDENT: It is not a guideline

MR. VAJDA: Precisely. Having said that, they were asked by the OFT to look at this. If we go to Section 5, which begins at p.67, they then explain how one values assets. What they say is that the appropriate valuation … is the MEA basis. The most readily available estimate of assets ----"

THE PRESIDENT: Sorry? Where are you reading from?

MR. VAJDA: 5.3, sir. "However, these normally provide asset values based on historical costs which may bear no resemblance to the MEA value." Then there is a point about intangible assets, which we do not need to bother about. If we then go to p.69, which is dealing with tangible assets ---- Estimating the MEA value ---- They then explain how you obtain the MEA value. They say that you can take ---- You can start with audited accounts. They give examples of where historical costs would be close to the MEA value. They say then at 5.11,

> "In the particular where at least one of these conditions is not met, the historical cost should be cross-checked by comparing with estimates based on a number of other methods, including modified historical costs, industry costs and bottom-up cost models. In some case, such adjustment will be sufficient to obtain reasonably good estimates of the MEA value. In others, however, the competition authority may have to conclude that the MEA estimates are not sufficiently robust to allow a meaningful application of the internal rate of return methodology".

Then, Mr. Pickford has asked me to draw the Tribunal's attention to para. 59.

"The question arises as to how MEA estimates can be obtained, it is already noted that where there is rapid technological change or high levels of intangible assets … historical cost values used in accounts may bear little resemblance to the MEA value".

So, there is reference to long-lived assets.

THE PRESIDENT: I am not sure, at the moment, that this passage is helping very much because these assets are not subject to significant technological change. There has been quite a lot of price deflation, at least in recent years. We have not got any intangibles. So, doesn't that somewhat undermine MEAs in this context?

MR. VAJDA: No, with respect, not. What this is saying is that you have got to find the MEA, and there may be circumstances where historical ----

THE PRESIDENT: It is a long-lived asset. I suppose that is what you say.

MR. VAJDA: Yes. The important point about paras. 5.9 to 5.12 is that that is simply giving examples of where historical accounts may not be the correct answer. But, it is not exhaustive, and the important point in the present case is that for reasons that have been explained, it is not appropriate in this case – and we come back to the facts of the case, and this is what we say at para. 48, sir, at p.22 ---- whether you can use the CCV value of the 1.449 as a proxy for the MEA, and effectively that then boils down ----- Again, you have to focus on the facts of this case on three questions: (1) is it appropriate, when the CCV figure did not record the cost of originally constructing the asset? That we deal with over the page at p.23, paras. 50 to 55. Plainly, if the CCV figure does not record the cost of originally constructing the asset, it is impossible to see how that can be taken as a proxy for MEA in trying to work out the stand-alone cost. That is the point we are making. Again, it is a fact ---- It may be in relation to all the other assets of Dwr Cymru that CCV might be more appropriate, but it is plainly not appropriate in this case in relation to these specific assets.

The next question which we deal with at 48.2 – and this is, in a sense, a part of the point that the President put as well – is that in determining the cost of the replication of an asset, is it legitimate to assume that the asset to be replicated is already available for use at no cost? It is a point, sir, that you put: well, the pipeline and the treatment works ----- It is actually there. But, we say, with respect, that that is not the answer, because what one is looking at is replication. That is what the test is requiring one to do. So far as Dr. Bryan is concerned, he adopts a sort of a part of mix-and-match approach (and we deal with this at p.25) which is replication, but through remediation. The most striking example of that is, if

you like, the pipe within the pipe. But, the whole point of the stand-alone analysis 414 is that you have to proceed on the basis that the asset is not there. So, you cannot simply say, "Well, I'm going to assume the asset is there, and I'm just going to slide another pipe in between". That was the point that I put to Dr. Bryan in cross-examination, which we set out at para. 58 on p.26.

THE PRESIDENT: Would it not, on the other hand, be fair, Mr. Vajda, to point out in relation to the treatment works valuation that for whatever reason, first of all, Dwr Cymru did it on a CCV basis for the purposes of that particular exercise, and that in fact the company does not seem to keep MEA valuations for particular treatment works. So we have to construct one for this treatment works.

MR. VAJDA: The short answer, sir, is that it would not be fair, and the reason why I give that answer is as follows ----

THE PRESIDENT: Why did they use CCV values for the original exercise?

MR. VAJDA: Because the original exercise, if you remember, was to compare the treatment costs of potable and non-potable. Those were the ones they had. That was before ---- You will remember that it was because of, if you like, the error that was pointed out by Dwr Cymru to the Director, that one went from 7.2 to 3.2. That was long before the Tribunal said, "We want to go to stand-alone and then MEA2. What Mr. Jones has said – and perhaps again it is important I just flag it up, and it is a point we have made in writing – in his third witness statement at para. 13 ---- The Tribunal does not need to get it out, but what he points out is that in fact, having done the comparison to treatment cost on a CCV basis, it may actually have led to an under-estimate of the ratio of non-potable ---

THE PRESIDENT: He makes that point.

MR. VAJDA: Yes, he does. Effectively, if one is going to do this now on an MEA basis, effectively the 15 percent may not in fact be 15 percent; it may be nearer the 30 percent originally made. That was what was done. CCV was available, and was easy to do. But, it would have been wrong, in the light of what the Tribunal then requested us to do, using MEA, to say, "Well, we are going to take the CCV ----"

THE PRESIDENT: I think we just asked for observations on whether it could be done, and how it should be done, and whether it was relevant and all the rest of it. We did not go beyond that.

MR. VAJDA: Plainly, I can see that there is, in a sense ---- There may well have been, if you like, a misunderstanding between my clients and the Tribunal, but what, with respect, would

not be fair to say is that in any way my clients, in a sense, deliberately did something which was off the radar.

THE PRESIDENT: No. I am not saying that at all. All I meant was that Dr. Bryan was working on what he had, because they do not apparently have MEA values for treatment works for some reason.

MR. VAJDA: Yes. But, by the time Albion put in the skeleton argument that I have just taken you to ----

THE PRESIDENT: -- you had worked one up.

MR. VAJDA: Well, those had been put in evidence in January of this year, and we had worked one up because we took the view that it was necessary to work one up in order to comply with the request of the Tribunal which was formulated by reference to OFT422. That is why we worked one up. We worked one up because of the specific difficulties of CCV with this ----

THE PRESIDENT: Does 422 refer to MEA values?

MR. VAJDA: 422 ---- If we go back, we set it out, sir, at ------

THE PRESIDENT: It refers to a hypothetical supplier.

MR. VAJDA: Yes, exactly. As you, sir, said, there is no dispute that one had to take an MEA valuation. That is the point that Oxera make. The issue is: what is the MEA valuation in relation to the treatment works. In particular, it may well be ----- I am not saying that CCV is necessarily wrong in every case. The problem is that there is a difficulty with CCV in this case. That was a point that Mr. Jones made. In this part of the case I am not, in a sense, criticising Dr. Bryan ---- The issue is: is the 1.49, in the light of the information that the Tribunal now has ---- is that a reliable figure to take for MEA? We say it is not a reliable figure.

THE PRESIDENT: Yes. Yes.

MR. VAJDA: Then I think that deals with the second point which is the replication remedy point. Then, the third point – and we deal with this on p.26: should the asset be valued, ignoring the particular factors that affect the cost of replicating the asset in the location in which it is viewed? You will recall what Dr. Bryan did. His methodology was a mixture of pipe insertion and laying pipe in, as it were, virgin countryside. That, again, raises an issue of principle, which is: do you actually look at it, as it were, if I can put it like this, on an abstract basis, or do you look at it in terms of replicating the asset in question? We say that you look at it by reference to the asset in question. For example, leaving pipes to one side, if one looks at, say ---- If one is replicating an asset where land is expensive ----

ignoring the topography at the moment, where land is ---- That is, we would say, plainly a relevant factor to take into account in the stand-alone analysis. The fact that you could do this much cheaper in Scotland than in the Thames Valley is not, we say, something that should go into the stand-alone calculation. I stress that the stand-alone calculation – this is being used, as I understand it, by way of cross check. The other point that we would make here in relation to point C on p.26 is that the Tribunal will recall that effectively there are not just three but four stand-alone calculations in this case. There are three that have been put forward by the parties in this case, Ofwat, Dŵr Cymru and ----

THE PRESIDENT: Yes.

MR. VAJDA: There is also the estimate was put forward by Bechtell, and if I could just give the reference to that at 61(2), it is p.73 of annex D to the Albion reply. Of course the Bechtell report certainly was not done in a sense with a view to assisting any party in this litigation. It happens to come out quite close to the Dŵr Cymru approach, but we say that is plainly an independent approach to this question.

Can I just look very briefly at the consequences of the approach of Dr. Bryan, because plainly here what the Tribunal will have to look at are, if you like, because we are a very long, long way away in terms of ball park figures, and if I could invite the Tribunal to go to our skeleton?

THE PRESIDENT: Yes.

MR. VAJDA: If one goes to p.21, Sir, this is the criticism that is made of our approach where it is said it is massively inflated and obviously much too high and we know that the figure, again we are just looking at the treatment works not the pipes, but we are looking at a figure of 1.449. What we say is if you actually do a cross-check on that approach by reference to the operating cost that Dr. Bryan presents at Annex D, and I am sure the Tribunal has got Annex D – this is to Bryan 4 – and perhaps we should just look at Annex D to see how these figures come out. Does the Tribunal have Annex D?

THE PRESIDENT: Yes, we do.

MR. VAJDA: We look at the operating costs and we have 129,000-odd for distribution. We see that if you see the total costs of 153,000 and you knock off the operating profit of 24,000.

THE PRESIDENT: Yes, those are not seriously disputed.

MR. VAJDA: No, exactly. And if you look at the treatment costs over t he page, again not seriously disputed, it comes out about just under 160,000 and if we then go back to the skeleton, we say at para.46, "At the original offer price of 23p the revenue for providing common carriage for the Ashgrove system would have been approximately 1.5 million

yielding an operating profit of more than 1.2 million per annum", and we say that on that basis you would have had a return on the capital investment of some 40 per cent. Now, we make some further observations which, in view of the time, I am not going to read out, but effectively what we say is that this leads to a level of profitability ----

THE PRESIDENT: Yes, I think the main underlying point in this part which goes more to rate of return than these detailed calculations is whether a water undertaker in offering its existing system for common carriage can price on the basis of what it would cost a hypothetical new supplier to build a system like the one that is already there. That is the question of principle?

MR. VAJDA: No, with respect. I think the question of principle is was the offer price that was made on an average account, average company basis, excessive, and what the Tribunal ----

THE PRESIDENT: That is one of the questions.

MR. VAJDA: That was what it was based on because of course in a sense this is part ----

THE PRESIDENT: At the moment it is looking at two completely different things, because what – and let us assume there has been a misunderstanding – but I think the what the Judgment was undoubtedly trying to say is that you are trying to get at the actual costs in the Decision by starting from a top-down basis, which is total revenue and then taking out various bits for large customers, for distribution to large customers, treatment, etc. until you get down to an average accounting cost based price to large non-potable users. The question I think we are trying to get to was, if you start at the other end and you say "How much is it costing to supply a non-potable user in terms of operating costs and so forth and making some allowance for capital of the kind that you have made on the way down, if you make that all again on the way up do you get to the same figure?" In most cases you ought to get to the same figure. It did not actually envisage, in our mind at least, I think, speaking for my colleagues, a completely hypothetical calculation. Maybe stand-alone was an ambiguous word to use.

MR. VAJDA: When the President put to me, and said we take account of operating costs and so forth, the critical words are the "and so forth".

THE PRESIDENT: Yes, quite but ----

MR. VAJDA: The point is that most of the costs and indeed this is the point made in Annex C to Professor Armstrong's report, 60 per cent. of the costs of the industry are capital.

THE PRESIDENT: Absolutely, and that is what has been taken into account in the top down approach that is in the Decision. Having done it like that on the way down, we tried to do it like that on the way up, if you see what I mean, so it was a completely symmetrical way of

doing it, except it is looking, as the documents suggest, as if this was a single business instead of a global business, would it produce a different result. In most cases, assuming if the Ashgrove costs were typical of the average it would produce the same result.

MR. VAJDA: It would produce the same if they were typical of the average. The point is that we come back to 422 talks about the hypothetical supplier and the reason one does this is because effectively one says "There is a problem with simply looking at this by reference to the information that we have got from this company." If I can put it another way, supposing that Dŵr Cymru had been extremely inefficient and had spent £15 million building this treatment plant, when in fact somebody at the hypothetical supplier could have done it for £4 or £5 million, because Dŵr Cymru effectively gave paid holidays and gold plated cars to the construction workers. Plainly one is not going to say "Well let us just take the figure of £15 million that is sitting in Dŵr Cymru's books", the whole point of doing the stand-alone exercise when you look at the hypothetical person – you have to remember here, Sir, that abuse, on the question of excess prices is an objective concept. This is the advantage of the stand-alone – I say 'advantage', one has to be careful in using it because we have seen in this case it does not come up with the exact answer in relation to average accounting. It has the advantage that you are looking at it from an independent neutral perspective, and you are not looking at it by reference to whether or not, for example, the asset was gifted to the undertaking, whether or not ----

THE PRESIDENT: Absolutely. What we were trying to say was, make the same assumptions as you made on the top down approach as to capital and all the rest of it, try to look at Ashgrove separately and work up again from the bottom and see if you get to the same result, that was the cross check we had in mind. This is not a cross check really, it is a different way of doing it. It may be valid in itself, but it is not quite what we were looking for.

MR. VAJDA: It is not for me to say what the Tribunal was looking for and I apologise, but the Tribunal now has it, and the question is what is the Tribunal going to make of it, and the Tribunal also has Dr. Bryan.

THE PRESIDENT: Yes.

MR. VAJDA: The point is, as the Tribunal observed, both parties have effectively said that we have to look at this on an MEA basis. There is an issue which the Tribunal will have to resolve which is in looking at the MEA basis is the 1.449 the CC value, is that a relevant ----

THE PRESIDENT: But I think the point upon which we most need your help is this, if we accept all your MEA figures for argument's sake, to those figures you have applied a risk rate of

return over 100 years on the basis that this is new build, and the question in our mind, is that the correct approach to the rate of return aspect of an access price, bearing in mind that the whole thing is predicated on the basis that you are using an existing system which your clients do not have to build, even though they are getting the benefit for this purpose of an MEA value as if they did have to rebuild it. Can they get both that and the risk related return, that is the question?

MR. VAJDA: The answer is "yes" they can.

THE PRESIDENT: That is the point we really want to understand your position on, I think. It is more important than all the other points of detail about CCVs and all the rest of it. Are we now on the same wavelength?

MR. VAJDA: Yes, and I think it is really p.27 onwards in the closing submission.

THE PRESIDENT: Good.

MR. VAJDA: There is no dispute that if you took the hypothetical, stand-alone undertaking, supplying only the product, you need a rate of return in the region of 15 to 20 per cent. and we have set out at 65 the evidence. The dispute is this, what is said and what the President, you Sir, is putting to me is why do you look at this on a stand-alone basis when, in fact you are actually a multi-product company that is a regulated company?

THE PRESIDENT: Yes.

MR. VAJDA: The short answer to that is because it is a stand-alone analysis. You cannot have your cake and eat it. If one is going to have a stand-alone analysis one is looking at the cost of supplying that particular product and the critical factor that has emerged, I hope clearly in this case, which the Tribunal may not have appreciated earlier is that there is a huge cross-subsidy on the cost of capital from the domestic to the industrial users, because this is effectively, if I can put it like this and if I put it incorrectly no doubt somebody will correct me, that this is a low risk low rate of return industry. That is, if you like, the deal that the Government did on privatisation. You are a regulated undertaking, you are pretty low risk, and that is very important from the point of view of the Government because if the cost of capital increases that is going to have an impact on the household bills. So that is why, when one looks at it going backwards in the past, you have the figure of 0.8 per cent. Even Dr. Bryan accepts that in relation to new investment, his figure is 7.7, I do not know if you recall that?

THE PRESIDENT: Is it not low risk because of its monopoly characteristics?

MR. VAJDA: No, no, no, not at all. In my respectful submission it would not be open to the Tribunal to make such a point in the light of the evidence both of Dr. Bryan and Mr. Jones,

which is that if you are doing it on a stand-alone basis it is a question that the bankers will have to assess what the risk is. The evidence that was given by Mr. Jones is that, effectively, if you go to the City of London to say, "I want to build this system to serve Shotton and Corus", nobody in the City of London is going to lend you money at 0.8 percent. The Tribunal may find that an uncomfortable submission, but that is ---- As I say, in fact – and this is important – Mr. Thompson's clients have got the benefit of, if you like, to some extent, the privatisation deal, if I can put it like this, because they have been quoted an access price ----

THE PRESIDENT: I do not think the privatisation deal comes into it because that goes on to regulatory capital value. We are on MEAs at the moment.

MR. VAJDA: We are on MEAs, yes ----

THE PRESIDENT: It is a regulated business, and the reason it is regulated is because, as we have been told time and time again, it is a monopoly and you are allowed a return commensurate with that.

MR. VAJDA: As we have seen, the business is looked at by OFWAT as a whole. You have heard what Mr. Anderson has said both in writing and orally as to why he and his clients do not like stand-alone. But, leaving that ideological point to one side, as it were, the Tribunal have said, "We want to see stand-alone". Fair enough. My point is that you cannot have your cake and eat it. If you want to have stand-alone, you cannot mix and match. You are going to have to accept that the rate of return on a stand-alone is going to be very considerably higher than the rate of return on a whole company average basis. That is a fact of life, and that is what the evidence says. The fact that you happen to be ---- Put it this way: yes, you may well be able to go to the City of London, and they may say, "Well, actually, because you have a large regulated business we are not going to charge you 15 to 20 percent for this investment, but then you are going to be charged whatever it is" ---- The reality is that there is then a cross-subsidy because the banker in the City of London realises that, "I'm not just looking at stand-alone because there are other assets. There's another business which protects the money that I'm lending to the company".

But, if you are going to look at it on a stand-alone basis, you cannot proceed on that basis. You have to proceed on the basis that it is a one-product company. That is what stand-alone does. Now, as I said, stand-alone may not provide all the answers. Indeed, as you, Mr. President said in NAPP, and indeed the European Court said in United Brands, that is one of the reasons one looks at a number of methodologies, because this is a difficult area, and each methodology has, as it were, its pros and cons. Now, the Tribunal said they are not

happy with the average cost. Fair enough. Let us look at stand-alone. What one cannot then do is say, "Well, we're going to do stand-alone, but we're going to keep in part of the average cost basis on return on capital", because that, with respect, is not a stand-alone analysis as we understand it.

PROFESSOR PICKERING: Could I ask you to comment on the fact that apparently on the domestic sector there is a very high incidence of non-payment of bills by individual consumers. Now, that is a matter of risk. It is presumably dealt with not through the cost of capital, but through additional operating costs in terms of chasing up those debts. So, should we not be taking into account a different sort of risk, but on the other side? You may say that your clients do take that into account. If so, I would like to know how, and how that washes through in terms of the implications of price to industrial users.

MR. VAJDA: I would say this ---- The first thing I would say is that it would be, with respect, impermissible for this Tribunal to make any finding of fact in relation to ---- I am not, in a sense, hoping to duck the question, but the point you put to me, Professor Pickering, is a point that there has been no evidence on as the Tribunal has not asked for evidence on this. So, the Tribunal would have to be extremely cautious. In my respectful submission, it would be dangerous territory for the Tribunal to effectively say, "Well, there are actually risks on the consumer side because of bad debt". There has been no evidence led on that. To lawyers, that would be what we call speculation rather than evidence which has been put in writing and tested in cross-examination.

PROFESSOR PICKERING: I hear what you say, but I think it is important to recognise that on the basis of the risk argument that you are advancing, that is something which has a particular potential implication ---- I am not saying whether I accept the argument or not. But, insofar as you want to make comparisons about the impact in another sector, then one does at least have to take into account what may be happening there, does one not?

MR. VAJDA: The point I have made ---- Dr. Marshall made exactly the same point. If I can just remind the Tribunal of her evidence on this, Dr. Marshall, if you remember, really believed in vertical integration ---- (Laughter) What she said -----

THE PRESIDENT: She believes in trying to identify the separate costs of separate activities.

MR. VAJDA: Yes. The important point is that what she said, if one goes to the transcript on Day 4, p.43 ----- This is my cross-examination about the rate of return that one earns in the industry. Her answer,

> "If the businesses were separated between the pipeline and the competitive business – for instance, if there had been a separation between the large user

market that has been open for a long time, and the network, then what I would expect is that you would dis-aggregate the cost of capital and, other things being equal, the cost of … for the network would be lower and the cost of capital for the business open to competition would be higher."

We entirely agree with that, and that is the logic of the stand-alone analysis. You cannot have it both ways.

THE PRESIDENT: But, the business we are talking about here – which is the pipeline business – is not open to competition. What she is talking about there are the other bits of the business.

MR. VAJDA: We have had the evidence in relation to industrial customers. There are, if you like, two risks. One is the risk of Shotton or Corus shutting down, which plainly is what people in the City are concerned about, and that is why borrowing costs ----- It does not matter ---- If the bank is not able to effectively attach a mortgage on any of the other assets of Dwr Cymru it is going to be extremely worried. The fact the Dwr Cymru is a regulated business is not going to be of much comfort to the bank.

THE PRESIDENT: On the approach in the decision, Mr. Vajda ---- If Corus shuts down, or not, it is revenue neutral because you lose the revenue, but you save the costs.

MR. VAJDA: But the question that we are looking at now is: do you dis-aggregate the cost of capital on the stand-alone ---- My answer is: yes, you do, and you do so because if you are looking at this on a stand-alone basis, it is a much riskier business. The man from Barclays Bank is not going to lend money at the same rate of interest for a system that is going to be serving ---- in this case it happens to be two customers. It could be possibly even more risky if it was just one customer. He is not going to lend that money at 0.8 percent. That is simply not going to happen. I can see the Tribunal does not like my submission, but ----

THE PRESIDENT: No. No. What you are saying, in the abstract, is completely understandable. The question in our minds at the moment is whether it is the correct way to look at it in this case.

MR. VAJDA: If, for example, we had charged an access price of 32p and said that we justified it on a stand-alone basis when everybody had been working on an average costing for everybody ---- I can see there might be an issue ---- Indeed, when I interrupted Mr. Thompson's cross-examination of Mr. Jones ---- We say, "Well, this is a very unfair way because you never charge any of your customers in this way" ---- Mr. Thompson is absolutely right – we do not charge any of our customers in that way, but this is what we say the OFT422 requires to do, and it is effectively ----

THE PRESIDENT: What has happened here, I think, is that great play has been made in the use, in the Tribunal's judgment, in that particular sentence of 'stand-alone' – the words 'stand-alone'. But, if you go back to the origin of that, it was D21, attached to the reply, and Dwr Cymru's original attempt to work out the local costs of Ashgrove. That is what we were looking for. A great edifice has been erected on this word 'stand-alone', which I am not at all sure was ever really intended. But, whether it was intended or not, we have got it. Now we have got it, the question is: is it a relevant or helpful way of looking at it? You are saying that if you are going to look at it like this at all, then you have got to take the whole package.

MR. VAJDA: You have got to take the whole package.

THE PRESIDENT: We understand the submission.

MR. VAJDA: As I say, it is here by way of cross-check. In a sense, one of the reasons that the stand-alone price is more than the average company price is precisely because of the cost of capital. So, one might have an argument, if effectively you did charge an access price on the basis of stand-alone. One might say, "Well, why did you do it?" The position is the reverse in our case.

PROFESSOR PICKERING: Could we just establish that the OFT documents that you have referred to, and are set out in your outline speaking notes are merely what they say – they are guidance notes? You have just given the impression that they are, to some extent, obligatory, which I think would not be the case. Furthermore, the one that refers specifically to the water industry is 422, and, as you set out in your note, that says, "In cases where there may be excessive pricing, the Director may have regard to measures of the profitability or the stand-alone costs of an activity". That seems to me to be quite cautious, and I think it would be unhelpful for us to assume that that is a matter of a direction as to how something is to be handled.

MR. VAJDA: Professor Pickering, I am not saying that, with respect. It is clearly my fault that I have not made myself clear. I am not saying that this Tribunal must decide this case on excessive price simply by reference to stand-alone. What I am saying is that the access price was done on an average company basis. The Tribunal, for perfectly understandable reasons, said, "We want to have another cross-check". The Tribunal asked for stand-alone. There has plainly been a misunderstanding, as it were, between what the Tribunal was hoping to get and what it got. But, what it got from everybody was effectively trying to do it on an MEA basis. The two, if you like, big disputes between the parties in relation to the treatment works is: do you take one 1.4 or do you take 3 million? The second point, which the

President has put his finger on, is: if you have stand-alone, do you take 0.8 or do you take somewhere between 15 and 20 percent? All I am saying is that if you are going to ---- I am not asking this Tribunal to say that it must do a stand-alone exercise. It is the Tribunal that has asked if we want to do it. All I am saying is that if the Tribunal want to go down that route, what, with respect, would be a very odd situation is to say, "Well, now we've asked for this, we in fact think the rate of return ---- That cannot be right because it has been done ---- It is not having regard to the rest of the business". We say "Well, stand-alone is precisely what it says".

THE PRESIDENT: I think we have flogged all that now, Mr. Vajda. Shall we just take a couple of minutes? We have read on quickly through. I would have thought we could almost go straight in and briefly to margin squeeze when we come back.

MR. RANDOLPH: Sir, before ----

THE PRESIDENT: Yes, Mr. Randolph?

MR. RANDOLPH: I am just wondering whether the Tribunal have any thoughts about today and completion today and non-completion today, because the Tribunal had said yesterday that we would definitely finish today, and that was obviously the strong message that we had all taken away with us. I do not know about other people, but there may be difficulties with regard to tomorrow.

THE PRESIDENT: I do not think we are planning to go on tomorrow at the moment.

MR. RANDOLPH: I see it would be another day?

THE PRESIDENT: If it goes over it goes over, I think.

MR. RANDOLPH: Right, to a convenient day.

THE PRESIDENT: But we would like to get on, at least to you, I think.

MR. RANDOLPH: Yes, well I would like to get on to me.

THE PRESIDENT: And then we will see what position Mr. Thompson is in when we get to that. Thank you, we will just take five minutes.

(Short break)

THE PRESIDENT: Yes, Mr. Vajda?

MR. VAJDA: I am going to move on but I have one point on stand-alone. The purpose of stand-alone is to get rid of any cost subsidy, and if in fact there is cross-subsidy in relation to the cost of capital that has to be taken account of.

Can I move on, and I am going to take this very quickly. The Tribunal has kindly indicated that they have read this, and there are three points that I really want to make. One is the facts and we deal with the facts at paras. 82 onwards. The short point here is that what

Albion is doing is providing important and useful services to Shotton for which Shotton is paying, but they are not relieving Dŵr Cymru of any cost, the only cost that is being relieved, which is what the Director took account of in his Decision is the 3p which, if you remember is part variable and part of the fixed cost of the agreement with United Utilities. Now, there has been quite a lot of debate as to whether or not Albion's activities in this respect are regulated or not regulated activities, and we have set out the evidence on that. The Tribunal yesterday raised with Mr. Anderson some points about the duties of water undertakers and in the time available, because I am very anxious that the case does finish today, and I am going to sit down in moment, we have produced something which I hope the Tribunal now has, called Annex 1 to the skeleton, which has sought to set out, if you like, the statutory duties of water undertakers in relation to both what are called 'conservation activities' and also efficiency activities. So far as the promotion of efficient use is concerned, which dealt with towards the end of this document, that covers what Mr. Anderson put in this document this morning – "security of supply, leakage and the efficient use of water", and that is effectively Ofwat's guidance in relation to efficiency.

That brings me to a comment on the facts which is that in this case the avoidable costs are very easy to calculate, they have been calculated by the Director and we are not in the situation that may arise in other cases where you have a lump of fixed costs, unavoidable costs at the retail level and that, if you remember, is one of the concerns of Dr. Marshall. The Tribunal will have seen from this submission - and this brings me on to the second point I want to make – that in the present case there is no conflict between ECPR and Chapter II/Article 82, it simply does not arise because the avoided costs – Mr. Thompson said "Well, we were only arguing that we should take 0.7 of avoided costs, you should not take fixed costs", well the Director took both. Those are the costs that have been easily identifiable, and we say that the theoretical concerns of Dr. Marshall ---- Her evidence was – and this was a question I think you, sir, put to her, and we deal with it at para. 91 on p.35 – that she did not consider the facts of this case. She was looking at this ---- I would not hesitate to use the word 'theoretical' because Mr. Thompson -----

THE PRESIDENT: That comment could be made of both experts.

MR. VAJDA: But, she was not looking at the specific facts of this case. Mr. Pickford, has just given me ---- If the Tribunal wants the reference to para. 91, it is T4, p.20, lines 20 to 25, and T4, p.27 at l.4.

THE PRESIDENT: I have the impression that a number of these points are reasonably close to the points that Mr. Anderson was making to us in the course of his submissions.

MR. VAJDA: Yes. Obviously, what I am concerned about ---- I am looking at the clock. I said five to four. We had a five minute break.

THE PRESIDENT: You carry on until you fell you have done justice to it.

MR. VAJDA: I am also anxious that the case finish today. Really, the only other point I was going to make on this document ---- The points are similar to Mr. Anderson, but they do not coincide 100 percent. This is the last point I am going to make: we have not had time to go to the *IPS* case, which we refer to at p.39. But, what I would ask the Tribunal to do is to look at the Albion reply skeleton. This is significant. At p.22 Albion seeks, in a sense, to side-step IPS because 'Albion has made a very specific complaint that Dwr Cymru is, in fact, acting in an abusing manner specifically by charging excessive prices'. So, what we say is that that is a very clear signal that in fact the two cases are linked ---- When I say 'the two cases' ---- the two abuses in this case. We say it follows from that – and, indeed, for all the other reasons we put in the skeleton ---- It follows from that that if these prices are not excessive it really is impossible to see on what basis there could possibly be a margin squeeze, because just standing back ----- I mean, if they are not excessive, and this is a regulated company earning a reasonable return on its capital, regulated by OFWAT, how could it be said that there should then be a margin provided which would mean that other people will have to pick up the lost revenue for Albion to insert itself within the chain.

THE PRESIDENT: Yes.

MR. VAJDA: Two final points: I asked Dr. Marshall some questions about the *Iowa Utilities* case. I hope that has now gone into the bundle – Authorities bundle 2. We deal with that in our skeleton, but the short point in relation to that case is that it is an example of where the US Congress have adopted a retail minus approach. Now, I am not saying that that is determinative of this case at all, but they adopted a retail minus approach. There is not a hint of a suggestion in that report that it was done on the basis that there was already vigorous competition. They adopted it, and they adopted it in relation to the sale of a finished product. This supports my submission – and, indeed, the submission of the Authority – that one cannot sort of say, "Margin squeeze – good. ECPR – bad". It has to be a more subtle analysis than that.

The last point that I want to make – and this is really a point particularly in relation to Mr. Jones, in relation to the provision of information – is that a very serious attack was made in the Albion skeleton on the attitude and the provision of information by Dwr Cymru, and, indeed, by Mr. Jones in the provision of information. It was said for example, "It is inconceivable that a business on that scale does not generate clear and accurate accounting

information". If that sort of allegation was made in a judicial review proceedings, and there was cross-examination, one would have to cross-examine that individual on it, because these are serious allegations. We say that we have said there is nothing in them in our written observations, and we say that it would be wholly unwarranted – and this is, in a sense, not so much a plea for my corporate client, but in relation to Mr. Jones – to suggest in any way that he has been economical with the truth or matters of that sort. The fact is that he produced a calculation which is perhaps not the one that the Tribunal wanted – it may be not the one that Mr. Thompson wanted. There were no MEA figures. They had to be constructed. In those circumstances, it would be, in my respectful submission, wholly wrong for the Tribunal to make any adverse findings in relation to Mr. Jones.

I hope that that is actually two and a half hours exactly, with a five minute break ----

THE PRESIDENT: That is very kind of you, Mr. Vajda.

MR. VAJDA: Unless the Tribunal have anything further, I will sit down.

MR. RANDOLPH: Gentlemen, I can be brief – not least because I have not got that much to say. Also, I want to get on, because, echo-ing what Mr. Vajda said, I am very keen, and I think everybody is very keen, for this case to be finished today, and there is no reason, we would submit, that Mr. Thompson should not be able to reply to the position, as was previously planned and as was effectively agreed and set out yesterday.

THE PRESIDENT: You make your submissions, and let us see how we get on.

MR. RANDOLPH: Bearing that all in mind, I hope very much to be done within half an hour.

Nearly six months ago, gentlemen, this Tribunal handed down a lengthy interim Judgment. When I and my clients read it, I have to say that we were somewhat dismayed by the fact that the Tribunal had not been able to come to a final decision. But, having seen what benefit has arisen from this second tranche of the hearing, I think, if I may say so, the Tribunal was both bold and correct in taking that view, contrary to the wishes of, I think, all the parties that we came to a final decision then in December – bold because of that, and correct because this hearing has elucidated the position in a very useful manner. I say that for myself – but I hope also for the Tribunal.

THE PRESIDENT: We feel much better informed as a result.

MR. RANDOLPH: Exactly. That is critical because, as my learned friend, Mr. Vajda said in his opening, competition cases are fact-dependent. It is absolutely critical, we would submit – or, I would submit – respectfully, that this Tribunal has well in mind the actual facts (not potential facts, what might happen in the future, or whatever) ---- what actually happened at the time, and the regulatory framework. Those are absolutely critical. It seems to me that

this hearing has actually gone a long way to deal with that point. It also means, in my respectful submission, that the final decision taken by this Tribunal - and we hope it will be final – may well be different from that envisaged in the interim decision. Although the interim decision ---- although the Tribunal may be absolutely clear right from the hand-down that nothing had been decided, there were certain hints or statements which could lead one to think that actually the Tribunal was of the view at that time that X had been proved or Y had been proved. In particular, there were statements with regard to margin squeeze and the existence thereof, and the fact that it may well ---- or, it could well be the position that there had been some form of unlawful margin squeeze. We would submit – I would submit – respectfully that in the light of what we have heard over the lat five and a half days that this Tribunal must review the totality of this case. It cannot just bolt on evidence relating to the three particular points on which you sought our input because the new evidence goes well beyond that. Given also obviously the Tribunal's view that nothing had been decided ---- This harks back to something that I have mentioned on several occasions, and I am sure the Tribunal has well in mind - that nothing is decided. I am sure that the Tribunal will take everything into account.

When it does that, in my respectful submission it will be able to find that this appeal is not well-founded. It is not a terribly elegant sentence, but I think the Tribunal ----

THE PRESIDENT: No. We know what you mean.

MR. RANDOLPH: You know where I am. The position has shifted to a very large extent, we would submit, following on from the evidence that has been adduced, and the cross-examination of the witnesses. I am not going to deal with the detailed arguments that have been clearly set out in lengthy written statements and oral closing, and sometimes opening, submissions by my learned friends to my left. That is not our position here.

What I do want to do is address two particular things. First of all, key critical facts. Facts. Facts. Facts, we say, are very important. Secondly (and maybe interwoven with that), the issue about the keen-ness, or otherwise, of my clients, which is the point which was raised. My client is very concerned about this because although this has not come out from the evidence, because the evidence was based on the three issues that were particularly asked for following on from the interim Judgment, it is clear from the documents already in the case, we would submit, which have been pulled together and synthesised in my skeleton argument ---- that far from being un-keen to engage in the competitive process, and far from being un-keen to deal with Albion the record shows that at all material times United Utilities were willing to engage – and this is specifically on instructions, and I repeat it –

and remain ---- not just 'was', but 'remains' willing to engage with Albion. But, it has to be on a proper commercial basis.

THE PRESIDENT: But you have intervened in support of the Authority.

MR. RANDOLPH: Yes, we have, absolutely.

THE PRESIDENT: Not in support of Albion.

MR. RANDOLPH: No. No. Absolutely. We support the Director's decision entirely – which is effectively that there was no basis for the complaint that Albion put forward that, in some way or other, Dwr Cymru/Welsh Water had acted unlawfully, contrary to Section 18 of the Competition Act by abusing its dominant position. We entirely support that. We entirely support the rationale set out in the Director's decision. But, the mere fact that we support the Director does not mean that we are against competition **per se**, or, more importantly insofar as this client is concerned, that we are willing to engage in the competitive process with regard to Albion. On that point, sir, it may be useful to recall, as you will have no doubt seen from the skeleton and indeed the background facts, we were approached. We did negotiate. The negotiations fell down. The negotiations fell down for two reasons – one at either end of the pipeline, if you will. The first one was the fact that, as a matter of fact, there is an agreement between Welsh Water/Dwr Cymru and ourselves dating back to just around privatisation, which is described as a cost-sharing agreement in your interim Judgment. What that means is the fact that we do not recoup our costs. We do not recoup our costs, and that is important. Important, why? Because Albion has consistently said from Notice of Appeal onwards, "Oh yes, it is an agreement whereby United Utilities covers its costs." We pointed out on a number of occasions in our intervention, in my last closing submissions last year that that was not the case. It is still repeated today effectively, and I am not going to take you to it, I do not have the time, but for your note, para.41 of Dr. Bryan's witness statement of 7th April when linked with – and this is critical – when linked with Annex 5 to that witness statement at p.91. You will see again the assertion, which is wrong, that the costs are covered, our costs are covered. This is critical because it is a real fact, it is a real fact. In other words, the 3p that we pay, that is the deemed avoidable cost is not a full cost covering figure, far from it, it is a figure which was arrived at through a process just post-privatisation or pre-privatisation. There is no issue – and I want this to be absolutely clear – there is no issue of fault with regard to Dŵr Cymru, it is a question of negotiation, and that is a matter of fact and public record. United Utilities and Dŵr Cymru sought to enter into a negotiating process about that particular agreement. The negotiations failed. Again, that is not a fault, but we are where we are and therefore when you look at

the 3p and seek to use that as the basis, for example, for saying "Oh well, there is a huge margin between the price that Dŵr Cymru pays United Utilities and the price which it then seeks to charge Albion, that is not a fair comparison. So that is one end. This is the question of the reality ----

THE PRESIDENT: So it is a below cost supply?

MR. RANDOLPH: Yes, and I would recommend that the Tribunal maybe go to that agreement, I know we do not have bundles but in my filing system it is the second file.

THE PRESIDENT: Yes, we have it in mind.

MR. RANDOLPH: It is worthwhile, with respect, having a look at that. It forces us to sell below cost. Also we cannot terminate it without mutual consent, and it cannot be varied without mutual consent. So it is a fairly one-off arrangement.

THE PRESIDENT: I am wondering where that takes us on what the avoidable cost is, properly speaking, for this supply? It would suggest that the true avoidable cost is rather higher than the 3p?

MR. RANDOLPH: We are where we are. That is the price that is being paid under the agreement, but the bottom line is that you cannot compare that when Albion seeks to say "Oh well look at the margin between 3p and whatever pence per m^3 Dŵr Cymru are charging, that is not a fair comparison. You have to look at the reality. That is one end of this particular real landscape. The other end of the pipeline or real landscape is the Shotton end, and you will recall, Sir, from the documents in the case that United Utilities sought to again negotiate with Shotton and there were discussions and again it is in the papers, there were discussions about an alternative pipeline. So again it shows a willingness to enter into the competitive process.

That did not come to anything, simply by virtue of the fact that Shotton – again it is in the papers, it is in the Decision and I will give you a paragraph reference in a moment – that was because Shotton refused to commit to a long term financial arrangement. The question is why should United Utilities spend an enormous amount – and we have heard there is a large amount of costs involved – why should they spend an enormous amount on the hope that Shotton will remain a customer? Obviously these things have to be commercially viable; it was not commercially viable and so that did not come to anything.

THE PRESIDENT: If I remember, there was another report, not the Bechtell Report, but something called the Bolton Report ----

MR. RANDOLPH: Tina Bolton, yes.

THE PRESIDENT: -- which was somewhat sceptical about the viability of the project, although I do not know that we have actually seen that report.

MR. RANDOLPH: I do not know whether you have seen that, but on the other hand, this is a point that is raised in our skeleton, because we do have concerns about the interim Judgment where it says "Oh well, the viability of these may not be proved." You will have in mind in our skeleton where we point out the particular passages in the Decision, and the documents themselves which make it plain that, as far as the relevant authors of those documents were concerned, the alternatives were perfectly viable. I would urge the Tribunal to re-read my skeleton carefully on those particular points. It is at para. 12, dealing with the alternative pipeline, and the Tribunal concludes by stating it will proceed on the basis that this alternative pipeline was not a practical proposition. We then go on to submit that actually based on the documents and the Decision of the Director, that was something -- --

THE PRESIDENT: But it did not happen, Mr. Randolph.

MR. RANDOLPH: It did not, and the reason it did not happen is the reason I have just given, Shotton did not give us a long term financial commitment, and also the other end of the scale, we were seeking to renegotiate our long term agreement, supply agreement, with Dŵr Cymru and that came to nothing . Again, I make it absolutely plain this is not a question of blame, this is a question of commercial reality and my client sought to renegotiate and they were not successful. This is not an issue whereby Dŵr Cymru should be penalised – clearly not. They have their own interests at stake and we have ours, and that is the commercial process. It is not for this Tribunal to turn around and say "Oh well Dŵr Cymru should necessarily do X and Y". We are where we are, but these are the facts, gentlemen, these are the facts against which we would submit that this Tribunal must input the operation of the competition provisions, not some hypothetical "Oh what might happen in the future" scenario. These are the facts and it is on those facts that we say that clearly there is no case as set out by Albion.

One other point of fact, yesterday I think it suggested by the President that the inset appointment did not impose a condition that Albion should source from a separate borehole, absolutely correct. However, we would submit that it is absolutely clear based on the letter from Envirologic which is referred to in the Director's Decision at para.30, that they were to replace the existing source, and that statement is supported by statements of Dr. Bryan himself in a Guardian article, which is in the papers – it is at tab 2 to the Dŵr Cymru intervention annexes. I am not going to go to it because of the time, but again he makes it

absolutely plain that he was going ahead with this plan on the basis that he would use his own sources of water. Now, that is critical because at bottom this case is about a business plan that was not carried through. If it had gone through, if they had used their own sources of water, as we have seen in the other inset appointments, you will recall the long list, Sir, of 11 inset appointments. I hesitate to use the word 'bulk' – but the vast bulk of those are own source, and that may be an economic rationale, it may be an economic reality, you cannot get an inset appointment – a proper inset appointment – working without some of own sourcing. I am not going to go down that particular path, but it may be the reality. Certainly, that was the basis on which Albion put forward its proposal and it is on the basis of which that Dr. Bryan himself was quoted in the national press, and so we respectfully submit that this Tribunal can come off the fence. It did not in the Interim Judgment and I can quite understand why it did not come off the fence. It said it was not going to make a decision one way or the other (para.35 interim Judgment) We would submit the contemporaneous evidence from *inter alia* Dr. Bryan shows clearly that the particular business plan involved use of Albion's own assets, and that we say is absolutely critical, because again it might have worked, but it was not allowed to work, and on that basis, should competition law come in and give a benefit where the whole plan itself has not been put in to effect?

You will recall, Sir, just moving back to the front end of the pipeline, you remember, the UUDC Agreement, and the Shotton … is why there was not an agreement between Albion and United Utilities? You will recall, Sir, that United Utilities sought a s.40(a) price determination ----

THE PRESIDENT: As between Albion and United Utilities, do you mean?

MR. RANDOLPH: No, no ----

THE PRESIDENT: As between United Utilities an Dŵr Cymru?

MR. RANDOLPH: This is our famous cost sharing agreement. United Utilities sought a determination on that and the relevant letters for your note, Sir, are pages 86 and following in tab D to Albion's reply. You may not have those at the forefront of your minds at the moment, but nonetheless they do repay some careful attention, because they set out the basis and they set out also the prices – the potential prices at which water could be offered. That request by United Utilities was turned down by Ofwat for its own reasons, and so we are where we are. Again, this is the we are where we are point – reality check time – not in some fancy land.

So at the end of the day in terms of pure keenness we would make very strong submissions that United Utilities have gone out of their way to seek to engage in the competitive process and that has not been an issue. We are also somewhat troubled by the comments made yesterday and indeed today about the lack of competition between water undertakings and the fact that that might somehow be perceived to be a deliberate approach to competition.

THE PRESIDENT: Well the observer might say that very understandably in many ways this industry presents a typical oligopolistic type of situation where there is no particular incentive for one undertaker to invade the territory of another undertaker.

MR. RANDOLPH: Equally, Sir, an independent observer might take the view that this is a *sui generis* regulated industry with its own particular issues and should be treated as such. It is either half full or half empty and we look at it as half full.

THE PRESIDENT: As long as it is thought that it is imperative to maintain old company regional averaging it is quite difficult for any one water company to approach a customer of another water company on any basis that might undermine that supposed principle.

MR. RANDOLPH: Well you have heard enough today I think from ----

THE PRESIDENT: I am not saying it is wrong or right, it is just a consequence of the view that is taken as to what the right pricing policy in this industry is.

MR. RANDOLPH: Absolutely. But as I say it may well be that the Tribunal can take the view that this is a special industry with its own special issues and slowly but surely one is crawling towards the light, but the fact that one is crawling slowly does not mean that that should be seen as something wrong in itself , we are getting there.

THE PRESIDENT: I think we are worried as much about the "surely" as the "slowly".

MR. RANDOLPH: The "surely" yes, well I am sure it is sure and I am positive it is slow.

THE PRESIDENT: "Sure to be sure to be sure" – as they say.

MR. RANDOLPH: Absolutely. One point I do wish to touch on as well arising from my learned friend's Mr. Thompson's short submissions on remedies is this, we obviously do not accept that but that is really not within our bailiwick. We would say this, if the Tribunal were tempted to go down that path and we suggest it would not be a good idea, it would not be a good idea for many reasons, not least it would lead to this Tribunal becoming some form of a regulator, because effectively it would be setting as price, and what happens if something happened on that pipeline, which could change the price – the example given earlier by Mr. Anderson about, say, Corus going out of business. That might well impact on the price. There would have to be a constant to and fro between the relevant parties, interested parties and this Tribunal, which would normally happen as between the interested parties and the

Regulator, and this is something that the United States Supreme Court has strong inveigled and I am not going to go to it, it is the other case of *Verizon*, the second case. The first case we have heard about. It is the second case where a law firm sought to bring an action against Verizon and failed. But the critical point there, and it is in your additional authorities' bundle, tab 12 and pages 7 to 11. The US Supreme Court, obviously not binding on this Tribunal, but no doubt of interest, looks at the tensions between a regulated area where the regulator and regulating legislation or courts, and effectively it is saying "You have to be jolly careful" because you cannot get involved in the nitty-gritty of day to day stuff, because it is simply not the right exercise, with respect, of your jurisdiction. That deals with that point.

We also say in terms of facts, and evidence that we found it remarkable that it came out I think on day 2 that Dr. Bryan admitted that Albion had forsaken the ability to take the benefit of the costs that his company had saved Shotton, which he was entitled to – or rather his company was entitled to under the 70:30 rule in the Shotton Albion agreement for some client relation reasons. We say that is important because we heard there were substantial savings and presumably over the years Albion would have been entitled to substantial remuneration pursuant to that agreement. The question is, is Albion entitled to anything else in addition to that by operation of competition law? To put it bluntly, why, in those circumstances when Albion has voluntarily forsaken the benefit should Dŵr Cymru pick up the tab? – to put it in the vernacular. Why should they be forced to dig into their pockets when commercially Albion were entitled to substantial remuneration based on their good work, and it was good work no doubt because they have saved Shotton valuable water resources.

A final point on facts which I would wish to draw the attention of the Tribunal to is the admission by Dr. Bryan, and this has been touched on briefly in answer to Professor Pickering's question on day 2 at p.27, that it be possible to hire a professional consultant to advise on a range of the services provided, and there were no activities which Albion had replaced Dŵr Cymru for in their provision. We say that is absolutely critical and absolutely determinative of the margin squeeze issue. If there are no activities that have been replaced then there cannot be a margin squeeze, and just on that point I know that no one has leapt on to my bandwagon, or my stall that I set out in the skeleton with regard to the s.60 of the Rules – not of the Act, but s.60 of the Rules. It seems to me that if the Tribunal is going to go down a road which finds that there can be a margin squeeze in a situation ----

THE PRESIDENT: This is the reference point?

MR. RANDOLPH: This is the reference point. If the Tribunal is minded to go down a path whereby it has found that margin squeeze exists where, in the circumstances I have just described, and given the evidence we have just heard then that will depart in a very major way from the existing case law of the court, and the existing Decisions of the Commission and indeed, the existing case law from this Tribunal. Now, of course, this Tribunal is the master of its own jurisdiction and can depart from itself as it sees fit.

THE PRESIDENT: What case law do you have in mind, Mr. Randolph?

MR. RANDOLPH: Well *Genzyme* for example.

THE PRESIDENT: Yes.

MR. RANDOLPH: *Genzyme* here and the well known case law ----

THE PRESIDENT: And *Deutsche Telekom* and so forth.

MR. RANDOLPH: Exactly, and *Deutsche Telekom* which I have in my skeleton is under appeal. So we are in this rather difficult situation where this Tribunal will certainly be pushing – we would say greatly – at the present legal framework and we would say going well beyond – absolutely, definitely going well beyond – what the European Court and the Commission has held to be relevant in terms of margin squeeze. In that situation we would submit that it might bear in mind the possibility of a reference. Of course, the issue of delay is one that is raised every time one raises a reference. However, if one looks at that possibility or the possibility depending on the way the Decision from this Tribunal goes there could be – I am only putting it that high – there could be an Appeal to the Court of Appeal. The Court of Appeal would then be faced with exactly the same position except less 'competent' is probably the wrong word, less used to competition law issues, and might well find itself reviewing the position and thinking "Are we clear on this? Shall we not get a reference?" That would have meant a further delay before the big delay on the reference. My own submission on this is if this Tribunal is going to go down that particular path, no doubt it will think about this extremely carefully because it is a very major extension of the existing case law and it may well be the proper way to go about it, the appropriate way, would be to seek a reference to get the right result rather than seek to get a result through because of the delays inherent in this case which would then in turn possibly cause further delays.

So, for those reasons, Sir, we say that the Tribunal should review *de novo* the position on this Appeal, whilst obviously wishing to take into account that which is set out in its interim Judgment, but by no means taking it as a given, that the view of the Tribunal, as set out in the interim Judgment will remain the same.

THE PRESIDENT: I think we are with you on that point.

MR. RANDOLPH: I am very grateful, but it just seemed that coming with the evidence as it has come out everything has become so much clearer and we would say, in our submission, very much more helpful with regard to the Authority's position.

THE PRESIDENT: Just as a matter of technique it is not going to be that easy to just assume the reader is familiar with the interim Judgment and just give a Judgment on the three points we left over. I think we have to restructure the thing so it reads as a whole and takes in the whole picture.

MR. RANDOLPH: Indeed, exactly. I am very grateful because what I would not suggest would be some form of cut and paste, which I am sure this Tribunal would not do, but it would be unfortunate to have -----

THE PRESIDENT: If only we could!

MR. RANDOLPH: -- points slotted in but with the overall view as set out in the interim Judgment.

THE PRESIDENT: There was not an overall view in the interim Judgment.

MR. RANDOLPH: Indeed it was not, it was an overall interim view --- (laughter)

THE PRESIDENT: Or even an interim view!

MR. RANDOLPH: Indeed. I think I have made my position clear on that. I can be very brief, two final points arising out of the closing submissions from Albion and Aquavitae. Mr. Thompson referred to evidence adduced under my examination of Mr. Jones and suggested that there was no alternative to the present physical arrangement – this was with regard to the dominance issue. Of course, that examination was directed only at option B, which was one option of many options that are set out in the Director's Decision, dealt with a pipeline going to Sutton Hall. It was very much on its own and therefore the examination was not saying "Oh, there is no alternative to the present position". Mr. O'Reilly, in his closing submissions, sought to rely on what had been said by Mr. Hope on day 2 at p.62, if the Tribunal could go to that and look at it fully because it was selectively quoted – I am not going to go to it now, but it needs to be seen in its full circumstances.

I do not think I need to address you, Sir, on the question of dominance. We would be very much obliged if this Tribunal could come up with a final Decision now and not put it off for another hearing – the issue of dominance is not for now, especially given the fact that the Tribunal has already suggested on an earlier occasion that it would not be an issue, it is not in the Notice of Appeal.

THE PRESIDENT: We may as well take it up as you have raised it, Mr. Randolph. The problem of dominance is related to the plea by all parties that we should try and arrive at some 'final'

decision of some sort, and it seemed to us that there are two aspects to the dominance issue. The first aspect is have we got the evidence, is there more evidence than we have already got on that issue in the Decision and in all the papers we have got and all the rest of it, in fact, we have had quite a lot of evidence – even in this hearing – and it could be said that they are on dominance as well as on other issues. Then there is the question of making sure that we have any submissions that should need to be made on the issue of dominance were we to decide that we need to make a finding about it in order to give a legal basis – or a proper legal structure, particularly for any further proceedings that might go all over the place. In other words, it is a bit of a tidying up sort of an exercise and I think at some point we would like to hear how the parties think we should approach it. I think our present view is, and I am speaking I hope for my colleagues, that we ought to ascertain whether there is any more actual evidence anybody wants to put in on the issue of dominance, and/or whether there are further submissions that they would like to make on that issue in the event that we felt we ought to take a view on it – which I am not saying we would, but just in case we did, and if so what would be a convenient way of doing that? I will stop there, but that is just articulating what is in our mind. Obviously, we are very conscious of the cost and time and all the rest of it and would not want to make a particular meal of that end of the case if there was a sensible way of dealing with it.

MR. RANDOLPH: Well, I do not need to say anything about it now, it seems to me we would not be in favour of it, but I would take issue with the tidying up point. It could be a substantial issue ----

THE PRESIDENT: It could be a major point.

MR. RANDOLPH: -- and it is not really correct now to take it into account.

THE PRESIDENT: Well 'tidying up' was probably not the right phrase to use.

MR. RANDOLPH: No, 'wholesale re-evaluation' possibly, but ----

THE PRESIDENT: Or even 'wholesale re-evaluation'!

MR. RANDOLPH: Sorry, with respect. (Laughter). Sir, unless you have any questions those are my submissions. I have seen the time and I would hope very much that Mr. Thompson would be able to make a reply.

THE PRESIDENT: Well let us see what Mr. Thompson and Mr. O'Reilly think about it.

MR. THOMPSON: Well, Sir, ultimately I am in the Tribunal's hands. I have listened, I think since about half past twelve yesterday to a fairly wide-ranging set of submissions from Mr. Anderson, Mr. Vajda and indeed, Mr. Randolph, and I have obviously done my best to jot down point that occur to me as I go along, but given the time I do not know how long the

Tribunal wishes to hear my inevitably somewhat disjointed attempts to respond to these points. I will obviously do my best and it would be helpful to have some indication of how long the Tribunal is prepared to listen, and obviously there may be points of detail – I believe there were some points of detail which I think arose when I was not here this morning about raw water and methodology 3, where there may be some need for some further either possibly discussions or written submissions and I suspect there are points of factual detail which it may be difficult to deal with finally within perhaps half an hour or whatever the Tribunal wishes to allot today.

THE PRESIDENT: Before you go on, shall we just see what Mr. O'Reilly's position is? What is your position, Mr. O'Reilly?

MR. O'REILLY: I shall be no more than 30 seconds, Sir, since nobody has referred to the construction of s.66(e).

THE PRESIDENT: That is the point you are intervening on and that is your contribution to the debate, yes, thank you. So we have dealt with that anyway. I am inclined to suggest, gentlemen that we should rise for a couple of minutes. Yes, Mr. Anderson?

MR. ANDERSON: Could, I just say a few words on how the Tribunal, in my submission, ought to proceed? I am the Respondent in this case. I have stuck very closely to my skeleton argument. Mr. Vajda put in a further document which stuck very closely to his skeleton argument -----

THE PRESIDENT: It had quite a lot of new stuff in it.

MR. ANDERSON: There were no surprises in it. There was elucidation of the argument in his skeleton argument, augmented by the evidence. This case has been going on for some days. I accept that. There has been a break in the middle for re-grouping in the light of evidence. If it were not for the fact that it is twenty to five, there would be no question whatsoever, in my submission, that the appropriate course would be to press on. It is now twenty to five and we are in your hands, but we very strongly urge the Tribunal to continue today because, as is so often the case and the experience of this case demonstrates, if it is put off to a further date, it will expand.

THE PRESIDENT: I do not think we want to put it off to a further day, subject to this question of dominance that is floating about.

MR. ANDERSON: You say there is a question of dominance floating about. I would respectfully submit there is no issue before this Tribunal in this hearing on dominance.

THE PRESIDENT: Not in this hearing, no.

MR. ANDERSON: No. So, there is no issue of dominance to be dealt with. That may never arise. It arises only as ----

THE PRESIDENT: Well, that depends. Our present view is that we ought to establish with the parties whether there is any further evidence on dominance that they feel we ought to have were we to feel it necessary that we should decide that issue. If we did feel it necessary to decide that issue, possibly, we would then have to see what the procedure was for having submissions on it.

MR. ANDERSON: The question of dominance is a question that may, or may not, arise depending on whether you take a decision to set aside the Director's decision. If you go down that route and obviously you are not in a position at the moment to take a view on that ---- If you go down that route, there may be a number of matters that arise out of your Judgment which will require us to come back and decide how to proceed from that point.

THE PRESIDENT: At the moment, our present feeling is that we need to ascertain from the parties whether or not, were we to consider the question of dominance, there is further evidence that anyone would want to produce?

MR. ANDERSON: Could I just say in relation to that then that the position of the Authority is that before it could have reached any view on dominance – and it did not – it would have expected a considerable more amount of evidence and argument before it could have reached a final view on dominance. That is the Authority's position certainly.

MR. VAJDA: Mr. Thompson asked for time off after the evidence which the Tribunal granted. That is, in itself does not always happen. That was done. In my submission, he should now produce his reply. I fully accept there may be some points of detail on which both parties can put in written submissions, but really the oral part of this hearing should, in my respectful submission, be terminated today.

THE PRESIDENT: I think we will just rise for a moment to see what the position is.

(Short break)

THE PRESIDENT: Mr. Thompson, I think we will go on, if we may. If there are points of detail and maths that we simply cannot deal with tonight then we will give you a short opportunity to deal with anything new in Mr. Vajda's written submissions this afternoon.

MR. THOMPSON: I am grateful. The topics I was proposing to deal with as best I can ---- I suspect there will be some jumping about and overlaps – were issues of the scope and questions of policy, issues in relation to costs, questions in relation to retail, and issues in relation to credibility and some rather more general questions of that kind.

If I could say first of all in relation to dominance, the Tribunal will be aware that this has been part of our case, and was part of our case in the previous hearing. So, the suggestion that it is, as it were, not part of this appeal rests, I think, on the exchange between the Tribunal ad Mr. Vajda at one of the case management conferences. But, as far as the scope of this appeal is concerned, we have clearly been seeking a finding of dominance, and, indeed, a finding of abuse in accordance with the powers of the Tribunal.

THE PRESIDENT: It is the scope of the present hearing, I think, which was under discussion at the last occasion.

MR. THOMPSON: To that extent, as it were that was one step back from a year ago when I think dominance was in the frame. In relation to scope and policy, there were quite a lot of exchanges - I cannot take the Tribunal to them all, but they will have them in mind – between the Tribunal and Mr. Anderson where he repeatedly said the view had been taken about this or that, and coupled it with the comment that it was not for the Tribunal to take a view on this or that. In my submission, those are not really consistent positions for the Authority to take. It is not for him to tell the Tribunal what it must think about things, and then if the Tribunal appears not to agree, to say, "Oh, well, the Tribunal is not allowed to think about things". It seems to me that there may be points where, for example, primary legislation means one thing and binds the Tribunal, or possibly where government policy must be taken into account by both the Authority and the Tribunal. But, in general, in my submission, it is entirely appropriate – indeed, necessary, for the Tribunal to take a view on the issues of policy underlying this case, and that it is not appropriate to take the Authority's position as binding in any way, either as a matter of construction of primary legislation, or in relation to competition policy, particularly in the circumstances of this case, and, indeed, the other cases of which the Tribunal is aware where the effect of the Authority's conduct has, in practice, been apparently to lead to no competition in a market where it is quite clear from the legislation that there was intended to be some competition.

In relation to the other policy question which I would like to address – the question of dynamic efficiency – it does appear to me that there is a risk of the Authority substantially underplaying the benefits of dynamic efficiency. I obviously pray in aid some of the comments that have come from the Tribunal in this respect. If I might give a homely analogy, if there were a monopoly in relation to milk distribution in the United Kingdom, whereby good quality milk was supplied, but was supplied in one hundred year old milk churns and milk floats, and a quarter of the milk was lost, and people in London were only allowed to drink milk, or to put milk on their cereals in the summer months on weekdays,

then it does appear to me that there might be a question about whether, if a more dynamic retailer was put in charge of the distribution of milk, that that might have some beneficial effects on the way in which milk was distributed. It does appear to me that there are certain analogies here which could be prayed in aid, and where one might think that dynamic efficiency could helpfully stimulate improvements in service on the upstream markets.

Turning to the issue of costs, I have a number of points. If one took first of all the issue of comparators, I think Mr. Anderson said that we should look essentially at the other non-potable arrangements. In my submission, that is not appropriate as a cross-check because it would assume fair pricing in relation to those arrangements whereas in practice they have all effectively suffered with the same sort of problems that we have here, and are not really appropriate. We would say that the obvious comparator is the one that we have drawn - the distribution of raw water where it appears to be common ground that if not 2p, at least a very low price is in fact charged to every Dwr Cymru customer, all of whom of course receive raw water at approximately 2p - perhaps slightly more, but that sort of range - and given that eight of the ten comparators with which we are concerned in relation to non-potable water are in fact receiving precisely that service, and the other two very largely analogous service, it appears to us that that is a strong comparator, and gives a strong steer that our evidence, although it is criticised in certain respects by both Dwr Cymru and the Authority is, in fact, in the right ball park and their figures, which essentially align it to potable water are in the wrong ball park.

In relation to the question of discretion, which was an issue that was raised by Professor Pickering in the submissions of Mr. Anderson, and the scope for error here, we would respectfully remind the Tribunal that in the Thames case there was a fluctuation of, I think, 100 percent in one way or another, and we would not necessarily regard the Authority's approach in relation to discretion as being sufficiently, as it were, fine-grained.

On the question of special agreements and regional averaging, I think Mr. Anderson made the point that a lot of the special agreements were, as it were, pre-privatisation arrangements, and that it was all being worked out from privatisation onwards by a policy of regional averaging. In this respect it appears to me that Enclosure 5 of the Notice of Appeal bundle, at pp.22 to 23, may be of assistance. It shows the special agreement register for 2003/2004. If we run our eye down when these were agreed, you will see that the first was in 1995; the second, 1995; the third, 1999; the fourth, 1998; the fifth was agreed in 1960, but renewed in 1994; the sixth is the first one that was actually pre-privatisation in 1978; the seventh is a very long-term 1966 with no fixed termination date; the eighth was

1982, but you will recall that is the one which we have looked at which was apparently renewed in1998, although that was only put on the register this year; no. 9, 1994; no. 10, 1990; no. 11, 1993; no. 12, 1995; and no. 13 was originally 1956, but established in 2000. Then, over the page, 1999, 1999, and then a very long one - 1984 through to 20073. Then two more, 1985 and 1981, and then another one in 1998 at the bottom. Those are effluent agreements. In my submission, that would not support the Authority's position that this had been unwound since privatisation - rather, the reverse. Special agreements seem to be alive and well. You may recall that the special agreement that has sought to be unwound in relation to Corus has ended up in the courts.

We would also respectfully remind the Tribunal of the evidence that it is, I think, aware of, of the effects of potential competition in relation to the large industrial users of potable water, which led to a number of special agreements emerging. In particular, we understand that Thames, for example, targeted, I think, its top twenty customers. So, we would not accept that special agreements are, as it were, on the way out - rather, that does not seem to be the position at all.

The next point was the question of whether or not dis-aggregation was equivalent, or not, to separation of businesses. Our complaint - based in part on the evidence of Dr. Marshall, is that the problem is not separation of the businesses, but a failure to dis-aggregate these downstream costs, which makes it very difficult to know whether or not an appropriate margin is being offered. In our submission that is highly relevant to the margin squeeze issue and how the court should approach the submissions that have been made that there is really nothing going on here that warrants a margin. Effectively, the reality of the position is still behind a curtain or clouded in fog because of the failure to dis-aggregate downstream and upstream costs, which allows Dwr Cymru and the Authority to effectively belittle any retail activity, and give the very low figures that you have seen in the Authority's documents.

The next point is the question of switching costs where I think Mr. Anderson said that that was not an issue in this case. In my submission, that is plainly wrong. If one looks at Tab 9, p.31 of the enclosures, one will see the reality of the position. You will see a letter dated 20 February, 2001 to Julie Griffiths of OFWAT. At (1),

> "The price we were minded to charge Albion for the services requested was 23.2p. This is a 2000/2001 price. This price does not include chargers pertaining to the application. Whilst we have made no charge up to this point for the administration and other costs associated with the application, if we envisage significant costs

being incurred in the future, then these would be at the expense of the entrant in accordance with the OFWAT's directives".

So, in my submission, that is just a wrong point.

The next point was the question of whether efficiency in terms of costs was the same as effective competition, and whether or not there might be some willingness to countenance some loss of overall efficiency in order to improve the effectiveness of competition. If I may, I will just hand up a document in relation to that. (Handed) It is an OFWAT recording of one of the meetings which I think Mr. Jeffery attended ---- No. I think there was an apology from Mr. Jeffery, but he was sent a copy of the minutes. But, it was attended by Mr. Hope, who the Tribunal will remember is a witness in this case.

It is dated 4 May, 2005, just before the last hearing. If one turns to p.3, at the third bullet point,

> "Aquavitae referred to DEFRA's principle statement [I am not quite sure what that is, but it sounds like an official statement] where it states that short term increases for all customers should be allowed provided they are modest. All members agreed that there will be set-up costs and would need to fall on the generality of customers, such as the costs of attending advisory groups and industry forums. WaterVoice agreed that there are good arguments for spreading costs across all customers, but whilst they do not want ineligible customers unnecessarily burdened, they accept that in the short term there will be costs incurred on bills. They suggested that a strategic document that links back to the government's objectives and how costs will be recovered would be a useful communication exercise to explain where the costs come from".

So, in my submission, the perfect world of Professor Armstrong was not one that was signed up to by the government in relation to this market and open competition here.

The next point was the question of Methodology 3. I am at a slight disadvantage in that I did not hear what Mr. Anderson said this morning. As I understand it, he said that we were not comparing the like year with like, although he did not actually conduct the exercise that he said was the right one. We have two points on that. If he is right that the volumes were somewhat lower than we think they were, then that would obviously change the equation. But, on our calculation it would still mean that the cost recovery for non-potable was approximately double that for potable. I do not think that Mr. Anderson has actually given the alternative figure.

The other point we would make is that the point of correction seemed to be wrong, because if one looks at Enclosure 5, p.16 to the Notice of Appeal, at line 30 ----

THE PRESIDENT: Distribution Input.

MR. THOMPSON: -- you should find a volume figure for 2001/2002 of 893.91. Dr. Bryan has done the calculation in multiplying that by 365, and by his reckoning it comes to the figure that the Authority use in its rejoinder, which would suggest that the comparison was in fact a like-for-like one, and that the figures given to the Tribunal yesterday were correct. But, that is the type of thing which at this stage ----I have not got the calculator to hand. But, it appears to us that the calculation works, even on adjusted figures, and that the figures we gave you yesterday were correct. But, I stand to be corrected on that.

The next point - you will remember Mr. Anderson made the point that some EC authorities - some official of what used to be called DG4 - had cast some doubt on the possibility of competition in the water industry, and had said that 50 percent of distribution costs were used in relation to 100km of transport. We would note that here 60 percent of distribution costs are used in relation to 16km of transport. So, it appears again that the figure is questionable as to whether or not 16pence can possibly be right, given the short term, even by reference to this point relied on by the Authority.

Then I have a number of points which I think arose from Mr Vajda's submissions. First of all, in relation to complexity, in my submission Mr. Jones did indeed accept that complexity led to additional costs. The point that he made would have been even more expensive if they had separated out the simple, potable pipelines from the complex potable networks. But, he did accept that the complexity led to increased costs, as I understood him.

In relation to the vexed question of raw water and the comparisons, our understanding - and the point was put very clearly I think by Professor Pickering on Day 2, p.13 at lines 3 to 4 - and out point against Dwr Cymru is that we were talking about average costs, and it does not at all follow from that that the total costs of raw water and non-potable water are the same. The raw water system is obviously much larger because it covers all the water used by everybody, whereas non-potable only covers the non-potable. So, it is clear that the raw water system is much bigger, and so it is not surprising that it is much more expensive. But, it does not follow at all that they would not have similar average costs.

In relation to the Authority's point which I think was largely about the fact that there were large numbers of bore holes which mean that the average length of raw water pipes is actually quite short ---- our essential point on that is that the bore holes are really neither here, nor there, in terms of volume, and that the great volume of raw water goes through the

large pipeline. We have given some figures in our reply skeleton argument, which I understand Mr. Anderson may not accept. It appears to us that the substance is really clear beyond doubt, and, for example, one can find that in - if I can find my reference - Tab 5 of the Enclosures bundle at p.31. There you will see the number of sources; there are sixty-four bore holes (you see that at the top). However, they only account for 3.5 percent of the total output, as we understand it. So, the fact that there are large numbers of little boreholes -- for example, I think there are two boreholes providing reserve supplies to Bretton, but the vast majority of Bretton's supply comes from a single pipe out of the Dee ---- We would say that the fact that there are large numbers of little raw water supplies does not invalidate the basic point and the basic comparison that we rely on, and certainly that it would be quite implausible that there could be a much higher level of average price for the vast bulk of, for example, the raw water supplies into Cardiff and Swansea, and that that could lead to a much higher raw water figure, or that the comparison with non potable could be invalidated on that basis. That may be something which requires some further detailed work. But, in our submission the substance of the point goes through.

Then I have a point about the Oxera report that Mr. Vajda took the Tribunal to. In my submission - as I think the Tribunal rather tended to point out - when one actually looked at what Oxera said, it did not appear, looking at the actual accounting position, that it was necessarily a bad proxy for MEA. It all depended on the facts. So, it did not appear that it really undermined the position that Dr. Bryan adopted in cross-examination.

The next point, which I think goes to stand-alone and a point that was made by Mr. Vajda, is para. 46 of Dwr Cymru's skeleton argument.

THE PRESIDENT: The skeleton or what we had this afternoon?

MR. THOMPSON: I think it is the original skeleton argument. There is a point which I think you will remember - that he seemed to regard it as something against us, that it would have been very profitable for ---- It is p.l21 of the skeleton, the middle paragraph. "The original offer price of 23p, the revenue from providing common carriage through the Ashgrove system would have been approximately £1.5 million, yielding an operating profit of more than £1.2million per year". That seems to be taken as a point against us. Of course, our point is that that is an excessive price. So, the fact that it would have been very profitable to charge at that price does not seem to me to go against our case, but I may have misunderstood the point. But, it appeared to us that that was entirely consistent with our case that the price was an excessive one.

The next question was one of doubtful debts. There it is simply a reference. Professor Pickering raised the issue of doubtful debts. There is in fact evidence in the bundles on that in the fourth statement of Dr. Bryan (Tab 2, Annex A, p.46) where he addresses that in some detail.

Finally on the costs question, the *Iowa* case, which Mr. Vajda has referred to, I think, now in two forms, or certainly we now have another version of it. I am not sure where the Tribunal has that.

MR. VAJDA: What happened is that the wrong *Iowa* case got into the bundle.

THE PRESIDENT: We have now got the present case, but I am still a little hazy about what this case is relied on for, but ever mind, we can read it, and see.

MR. VAJDA: I hesitate to interrupt, but our skeleton should give a clue, I hope - or, more than a clue!

THE PRESIDENT: I am sure it does, Mr. Vajda. I have not necessarily got everything in my head at the moment. Do you mean this afternoon's skeleton or the original skeleton?

MR. VAJDA: The original skeleton.

MR. THOMPSON: I do not necessarily have a clue about why it has been referred to. The point I refer to is on the second page of the transcript that we have, under the heading 'Analysis'. You will see, in the middle, it says, "We will overturn an agency interpretation that conflicts with the plain meaning of the statute, or is an unreasonable construction of ambiguous statute, or is arbitrary and capricious".

So, that was the point I think I made before about it not being for the regulator to construe the legislation. But, the more important point which I think may be relevant to the stand-alone issue is that on the next page there is reference to something called 'the hypothetical network standard' In this case the Respondent, FCC, had applied something called TELRIC, which one sees at the top is the Total Element Long Run Incremental Cost. Do you see that?

THE PRESIDENT: Yes, it is a version of long run cost.

MR. THOMPSON: Yes. It then says under 'Hypothetical Network Standard',

> "The FCC explained that forward-looking methodologies, like TELRIC, consider the costs that a carrier would incur in the future for providing the in-connection or unbundled access to its network elements. These costs either can be based on the most efficient network configuration and technology currently available or on the ILEC's existing network infrastructures". Do you see that?

THE PRESIDENT: Yes.

MR. THOMPSON: As I understand it, here the FCC had worked on the basis of a very efficient network and one finds over the page the view of the court, and, in particular, the second paragraph the court says,

> "It is the cost to the ILEC of providing its existing facilities and equipment, either through interconnection or by providing the specifically requested existing network elements that the competitor will in fact be obtaining for use that must be the basis for the charges. The new entrant competitor, in effect, piggy-backs on the ILEC's existing facilities and equipment. It is the cost to the ILEC of providing that ride on those facilities that the statute permits the ILEC to recoup. This does not defeat the purpose of using a forward-looking methodology as the intervenors assert. Costs can be forward-looking in that they can be calculated to reflected what it will cost the ILEC in the future to furnish to the competitor those portions or capacities of the ILEC's facilities and equipment that the competitor will use, including any system or component upgrading that the ILEC chooses to put in place for its own more efficient use. In our view, it is the cost of the ILEC of carrying the extra burden of the competitor's traffic the Congress entitled the ILEC to recover, and to that extent he FCC's use of an incremental cost approach does no violence to the statute. At the bottom, however, Congress has made it clear that it is the cost of providing the actual facilities and equipment that will be used by the competitor, and not some state of the art, presently available technology ideally configured, but neither deployed by the ILEC, nor to be used by the competitor which must be ascertained and determined. Consequently, vacate and remand to the FCC".

So, as I understand it, it is obviously a slightly different situation from the one we are faced with. But, what the court in that case is saying is, effectively, "Look at the reality of the situation. Don't go to some hypothetical ideal". In my submission that has some relevance to the question of what approach should be adopted to the vexed issue stand-alone. One looks at the reality of the situation and, in effect, you can piggy-back on the position of the incumbent because that is the way it was intended to work. In my submission, that is consistent with our case.

I am conscious of the time ----

THE PRESIDENT: If you are all right to go on and the shorthandwriters ---- They are not here to ask, but they will get that message through the microphone -----

MR. THOMPSON: If I hear screaming then I will -----

THE PRESIDENT: If the door flies open and an outraged shorthandwriter appears, we will have to adjourn, but for the moment we will press on.

MR. THOMPSON: I will try not to speak too quickly.

In relation to retail, the first point I would note is that there does appear to us to have been some back-pedalling on the other side of the room in relation to the officiousness, or otherwise, of Dr. Bryan and his team. There is commending of his gardening abilities, at least. Indeed, I think both Mr. Vajda and Mr. Anderson were at pains to agree that what he did was valuable - it was just a question of who should pay for it.

In my submission it is relevant to bear in mind that a margin of the kind that we are seeking is not an entitlement - it is merely room to operate and to enter a market. The question of what Albion would actually be paid for its activities would be a matter for commercial negotiation with its customer, as in other markets, and any suggestion that this is some form of diktat whereby 5p would be paid to Albion for its services is completely misconceived.

The next point is the point I have touched on already - that because there is no dis-aggregation by Dwr Cymru, and no dis-aggregation required by the Authority, it is really quite impossible to know whether the points about the fixed costs and the variable costs of retail are correct or not. In those circumstances in our submission it is appropriate to place weight on the evidence that has been produced by Albion and, if I may say so, to err on the side of caution because otherwise there is a serious risk that what has happened for the last five years will happen for the next five years, and there will be no effective margin.

In that respect, I do recall, first of all, the figures that appear in the indicative guidelines from the Authority, whatever their legal status, and also the figures of Aquavitae, where you may recall a figure of, I think, 3.86 percent was identified in relation to common carriage for Dwr Cymru. By my calculations, on the sort of figures we are looking at, just under 4 percent of just under or just over, 25pence would be approximately a 1p margin, which the Tribunal will be aware would be a very slim margin indeed in which to buy the water which Mr. Randolph claims to be under-priced at 3p, and to carry out a retail business at the other end. It does appear to me that those figures are very much too low.

THE PRESIDENT: That is 4 percent not just for retail, but for acquiring the water.

MR. THOMPSON: You may recall, the retail margin was zero, and the common carriage margin was 4 percent, or just under, which would equate to about one penny as against a resource cost of 3 pence. I think the negotiated offer price was originally 9 pence. So, that would be, obviously, completely uneconomic.

The next point was the most extraordinary submission which I think we have heard in this case - the submission about Section 3 of the Water Act, and the fact that it would fall within, as I understood it, Dr. Bryan's business to concern himself with preserving butterflies and geological features surrounding Shotton Paper, and that that would be part of his retail business as a water company, but that it would not fall within his business to conserve the water. In my submission that is really quite a surreal submission for a water regulator to make and one which should obviously be dismissed. In this respect you may recall that Dr. Bryan gave evidence as to the quite substantial savings that had been achieved. Looking at the figures of what he said had been achieved, which is approximately 3 cubic metres per tonne of paper, our calculation over a year is that this would equate to approximately £380,000 worth of water. Dwr Cymru might not be pleased, because obviously that is less water being bought, but from the point of view of the customer it is obviously a saving - and also a saving to the general community in terms of the pressure on water supply.

The other point I would make in relation to the Section 3 point – it is a point that Mr. Anderson did touch on, but rather glossed over – it appears to be flatly inconsistent with the draft guidance which the Tribunal will recall I showed you yesterday, indicating that water conservation was one of the services that would be provided to large users, and, indeed, that it might be appropriate to have somebody allotted to a large user, apparently for that purpose.

The next point was in relation to access prices and ECPR. As I understood Mr. Anderson's submissions, he seemed to be saying that one would have a cumulative approach to ECPR and long-term savings so that if there was a twenty-five year agreement, one would look at the avoidable costs over a twenty-five year period. I do not know whether it is necessary to turn it up, but the Tribunal will remember that in the fourth bundle of authorities - or the additional authorities - at Tab 15, pp.48 to 51 - we saw some figures. In my submission, those figures were fairly plainly on a year by year basis, and there was nothing to suggest that there was any accumulation depending on the term. It was simply an annual figure. So, it does not appear to actually be correct that there is any sort of looking at how much would be saved if the contract went on for, say, twenty-five years, and whether more would be saved on that basis. Most of the figures were completely flat.

The next point related to the scope of Albion's activities. The Tribunal, I think, made the point that at the moment, because it only had one customer, inevitably its activities were somewhat limited. It is a point which I think we probably looked at last year, but I just

remind the Tribunal - and it is obviously relevant to the litigation involving Corus that we have seen - that at Tab 11 of the enclosures bundle to the Notice of Appeal, at p.9 you will see a letter from Corus to Dr. Bryan,

> "Dear Dr. Bryan, As I explained in our meeting on 10 July, we are very unhappy with the current situation in the water supply industry, and the lack of any real competition in the established regions. Having raised this matter with OFWAT, they suggested your company offers a realistic alternative to the large established operators. Will you therefore please confirm you are able to bid for the supply of water to three of our larger plants situated in Wales, namely, Llanwern ... and Shotton. The existing agreement for the supply of water to these plants expires in the Spring of 2004. If you are able to confirm your position with respect to these plants, we will take the necessary steps to open formal discussion and negotiation - ---"

You will appreciate that what actually happened was that Dwr Cymru tried to put them on to the new tariff, and there has been litigation since then. So, in my submission, that is relevant to the scope of Albion's activities, and why it cannot seem to get any further.

The next point is the basis for the appointment. As I understand it, there is really no doubt that the Tribunal's understanding is correct, and the sort of implication that there was something sort of slight of hand here is really quite unfair. If one looks at Tab 7 of the enclosures, at p.7 we see an OFWAT proposal under Section 8(3) of the 1991 Act. An explanation is given. In the last paragraph - and mine is highlighted, though I do not know if that is in everybody's copy:

> "The site currently receives water services from Dwr Cymru. If the Director appoints the entrant, it will require a bulk transfer of water from Dwr Cymru in order to enable it to supply Shotton Paper. If Dwr Cymru and the entrant are unable to agree the terms for that supply, the Director is minded to determine a price of 26 pence per cubic metre for the non-potable water and 59 per cubic metre for the potable water required by the entrant".

So, in my submission, that is not really consistent with saying that this was all somehow a bit of a mistake.

I am afraid I am jumping about a bit now. There is the IPS - the poudre margin squeeze case. I think it was said by Mr. Vajda that we had somehow necessarily linked the margin point and the excess price point (at para. 63(5) of our reply). It is probably worth just turning that up.

THE PRESIDENT: This is your reply skeleton, you mean?

MR. THOMPSON: Yes, that is right. Paragraph 63(5).

THE PRESIDENT: Yes.

MR. THOMPSON: You will see we say:

> "We do not understand the reliance placed on this case by the Authority, it bears no resemblance to the facts of this case. Here Albion has made a very specific complaint that Dŵr Cymru is in fact pricing in an abusive manner specifically by charging specific access prices, therefore the relevance of IPS fades away. Moreover, there is no issue as to Albion's relative efficiency compared to Dŵr Cymru at the downstream level, and the point is, in any event, irrelevant. As the Tribunal has itself found, no matter how efficient Albion or any other would be entrant, or Dŵr Cymru's downstream arm may be they could never be competitive in the sale of the downstream product so long as Dŵr Cymru's upstream arm allows them to earn only a zero margin."

So we are effectively making three points: first, the point that we are alleging excessive pricing, unlike in the IPS case. Secondly, that there was no issue about relative efficiency, unlike the IPS case and, in any event, the margin here was so low that nobody however efficient could make a point so that the IPS case was completely irrelevant, so I do not know what comfort Mr. Vajda seeks to draw from that submission.

The next point arises from Mr. Randolph's submissions. I think it is something I have touched on already but the Tribunal may want to see the reference. It is the point made at para.12 of our Notice of Appeal.

THE PRESIDENT: Yes.

MR. THOMPSON: At the bottom where we see "bulk supply 9p plus", which is really the hopeless position that any entrant would find themselves in if the figure of 3p turned out to be wrong, and the basis for that we find in tab 8.

THE PRESIDENT: In the enclosures?

MR. THOMPSON: Yes, p.21. You will see that this is an email which has been copied by Mr. Bryan to a Mr. Munroe who I understand is an employee, or was an employee of Albion, and it includes an email from Mr. Lafonne of NWW, which I think is now ----

THE PRESIDENT: Is now United Utilities.

MR. THOMPSON: I think so – to Dr. Bryan, who was then at Envirologic. You will see that Mr. Lafonne has carefully considered the basis of the price. The LRMC based price of 12.1p is a product of some detailed work, but after his careful consideration he is prepared to offer

that we revert to the 9p m^3 and to do so on the following basis, and then he gives various conditions. So it appears that the offer that was actually produced in February 2001 was 9p per m^3 and I must confess I had overlooked that in my opening submissions when I suggested that an 8p margin might be appropriate. I think it would follow from that that if that is the credible figure then in order to have effective competition in this market on the basis of that evidence, and the evidence of Mr. Jeffery one would effectively require at least a 14 p margin in order to be able to ----

THE PRESIDENT: You are effectively looking, as I have understood it, for a 5 p margin on top of the resource cost – whatever the resource cost is?

MR. THOMPSON: But the reality of the resource, the best evidence we have on what the resource cost would be to Albion as against to the Director, or as against to Dŵr Cymru, is that it would be in the order of 9p and might be more than that. Just for the Tribunal's note there is in, in fact, another document from the end of 2004 at tab D, p.85 to the reply, where we sought to negotiate with United Utilities, but we have been unable to resolve the matters, so that is where I think it lies as far as this case is concerned.

My final topic was issues of credibility where I think it was said that we had perpetuated a somewhat disingenuous submission about treatment in our skeleton argument by ignoring the costs of capital. I think it is just worth looking at what was actually said in our skeleton argument because it seems a curious mistake for us to have made.

THE PRESIDENT: In the main skeleton?

MR. THOMPSON: Yes, it is p.23. It is true that the first sentence – perhaps the drafting is infelicitous, but I do not think that really matters:

> "Albion's Notice of Appeal makes it clear that it considered 1p per m^3 to be a generous estimate for treatment costs. In the Authority's Defence the Authority states that this estimate is deficient, and these views are considered in Albion's Reply and the estimate is increased to 2p."

So I am not quite sure what sort of credibility issue is raised, but that is what actually happened. I think there was a point about, as it were, change of position in relation to complexity. In my submission there is absolutely nothing whatsoever in that point because it arose from the evidence of Mr. Jones and, in particular, para. 38 of his first witness statement where he indicated that there was a difference between potable and non-potable systems in relation to the conjunctive use systems which applied in relation to Cardiff and Swansea, and which actually accounted for, I think eight of the ten largest potable users. So, in my submission, it was perfectly reasonable for us to pursue that issue once that

evidence was produced in accordance with the Tribunal's wishes. There as also, I think – I may be doing an injustice but my impression was that there was some suggestion that there were issues going to credibility which Mr. Vajda chose not to cross-examine on. In my submission inevitably there is less weight to any challenge to credibility if an advocate does not cross-examine on those issues, and one should give greater weight to evidence where it has been cross-examined, and less where there has been no cross-examination at the choice of one of the party's advocates.

Mr. Vajda took exception to the criticism of Mr. Jones's position. I should make clear that we are not in any way impugning his personal position although we do continue to say that it is unfortunate – and I think it is a problem which the Tribunal will inevitably have to wrestle with – that there are some points of information which would be extremely helpful to resolving this case on an objectively satisfactory basis and which seems to be available in many other industries, which is not available in this industry and, given the amount of effort that has gone into a number of points in this case, it is unfortunate that that information is not available, but obviously the Tribunal has seen what the evidence is in that respect.

The final point is another point that arose from Mr. Randolph, which is the question of a reference. In our submission there is no requirement for a reference. The issue of margin squeeze has been considered in considerable detail by the Tribunal in the *Genzyme* case. This is another case of a zero margin. The position in relation to Albion is that it clearly does perform both a statutory function and also a practical function falling within the scope of the legislation. There may be an issue about the quantum of any margin and there is obviously an issue about the excessive pricing but, in my submission, there is no issue of principle of the kind that the Dŵr Cymru and the Authority seek to raise, and I note that neither of them are apparently seeking a reference, and in my submission there is no need for a reference in this case.

I think those are the points I wanted to make. It is inevitably somewhat on the hoof ----

THE PRESIDENT: Well thank you for that, Mr. Thompson. I am sorry the hour has been so late.

MR. THOMPSON: If there are any other questions obviously I would be more than happy to deal with them to the best of my ability now or to think about them and provide written answers if that is necessary.

THE PRESIDENT: No, we have no questions but I think the last topic, as it were, which does not I think concern you, but I think is principally for Mr. Vajda and the Authority, is this issue of dominance, Mr. Vajda. I am sorry it is late and I am not necessarily expecting you to

take a position tonight, but I think our feeling is in a case like this we want to minimise any loose ends there may be - it may not be appropriate to describe the issue of dominance as a 'loose end', or a 'loose beginning' for that matter, but there is certainly that issue. There are also one or two points, I think you have made, in the course of various submissions about treatment costs that I would be particularly anxious are 'bottomed-out as it were. It seems to us, at the moment anyway, that it is in all parties' interest that we do try to reach a definite conclusion on relevant points rightly or wrongly. In that connection our impression is that we have in our papers already quite a lot of evidence that is relevant to dominance and, in particular, we have had in the course of this hearing some very helpful evidence from Mr. Jones about the difficulties of constructing the pipeline that would not necessarily leap to the eye if one read the original annex to the Director's Decision. So as of now, which is 20 to 6 on this sixth day of the hearing we do not feel able to rule out the possibility that we may want to decide the issue of dominance. I think we are unlikely to be attracted to any suggestion that wholly or partially we should send something or other back to the Director if that should arise. You may win on all points in which case that does not arise, but if it were to arise the prospect of a further administrative stage in this already long running case is not a particularly attractive one from the point of view of a number of the parties, and the Tribunal and so forth. So my question I think is going to be – not necessarily for a response now, but if you can help me so much the better – were we to indicate that we would like to hear submissions on the issue of dominance, is there further evidence on that issue that your clients would wish to put in? I think that is the question?

MR. VAJDA: If I can be brief and just give you an indication. The first point is that we would say it would be inappropriate to deal at all with dominance before the Tribunal gives Judgment on this issue, because we take the view that dominance does require evidence and it would be wholly wrong to embark on that exercise because if in fact this Appeal is dismissed then the dominance issue does not arise – that is point one.

Point two is that if the Decision is quashed, a number of issues arise, and my clients would not accept at the moment that it is appropriate for this Tribunal to deal with the dominance issue – those are points I would wish to deal with at the time, I just flag them up now.

Point three – and I think I have made the point that, dominance, there is evidence on that that needs to be put, so if that is the position at the moment ----

THE PRESIDENT: One particular difficulty we have in mind – there are certain points that crop up, and they are in Mr. Jones's evidence among other places. We have Mr. Jones talking about the pipeline, we have various stuff about the boreholes at Shotton for example.

MR. VAJDA: Yes.

THE PRESIDENT: But certainly if we take Mr. Jones as an example we may have to make some findings on that evidence and those findings may, at a later stage, make it more difficult for the issue of dominance to be addressed, as it were, on a Greenfield site – if I may use that expression – and for that reason we want to make sure we have got stuff, or know what stuff there would be, or might be on this issue. Sometimes these issues do interrelate with each other.

MR. VAJDA: Yes. I am grateful that the Tribunal has raised this issue now, and I very much take the point that the President has put in relation – if I can put it this way – to the sort of read across on findings. But obviously it is something that I would wish to take instructions on, but as a general proposition we do say that we have to deal with this issue first because a dominance issue may be – I only say 'may', who knows?

THE PRESIDENT: Yes.

MR. VAJDA: It may be irrelevant, but I take the point that you have made that if, effectively for example in reaching a Judgment that the Decision should be quashed, and then there are certain findings which are made which may be, if you like, relevant to the dominance issue – issues of issue estoppel or whatever would arise and how that then plays into dominance and that is something I will consider, but as presently ----

THE PRESIDENT: I would be very glad if you would consider it because – if I may put it from the Chair as it were – I would feel more comfortable approaching the final Judgment in this case knowing I had all the evidence and any further submissions that there were, rather than something popping up later that had then come in at sort of dominant stage but actually did in some way or other impact on what we had already had, and it is just a question of trying to make sure that everybody has said everything they could possibly say and have not been shut out or disadvantaged at a later point.

MR. VAJDA: Yes. Obviously as so often in litigation there are factors that pull in different directions. For instance in dominance, although on has heard evidence from Dr. Bryan and Mr. Jones about the contaminated land and that sort of thing ----

THE PRESIDENT: Well we now have considerable emphasis on Bechtell and the cost of building it and all the rest of it.

MR. VAJDA: Plainly one thing one has to go into in the question of dominance is what is the relevant market and things like that? May be the most sensible thing, because I take it the Tribunal is not going to deliver Judgment now?

THE PRESIDENT: We are not going to give an extemporary Judgment in this case that is so.

MR. VAJDA: We are proceeding on the assumption that Judgment is going to be reserved. It may be we could respond possibly more fully than I am able to now in writing and obviously copy in all the other parties. At the moment that is my position but I take on board the point that you have made about in a sense 'read across' on findings, and I think it probably is more appropriate that you have ---

THE PRESIDENT: Well let us all reflect about it, but our rather staged approach to this is to think about well, is there any more evidence? If there is more evidence then there may be some issues of law, construction, whatever, we need to hear about, and we probably need to devise some way of tidying up loose ends so that we are in a position for everybody's sake to decide the matter. You can battle it out, or they can battle it out, or the Authority can battle it out, or the Intervener in Luxembourg or in the Strand, or wherever the next battlefield is – if there is one.

MR. VAJDA: If there is one. Well I am very grateful for the Tribunal raising that with me, and I think that those are my off the cuff views. We will reflect on what you have said and perhaps, assuming again that Judgment is not going to be delivered, say, within the next week ----

THE PRESIDENT: Perhaps I should say, and this may help everybody, the Tribunal's mental plan at the moment is to try to get on with this Judgment now. Whether, as we would hope, we could deliver it before the summer vacation I do not know, but 31st July would be one particular target date. That slightly depends, we have had an awful lot and we have to do justice to it, but it is not particularly our intention to be working on many other cases now until this is done, so there is a certain amount of momentum that we would like now to keep up, now that everybody has given so much time and attention to everything.

MR. VAJDA: Yes, well bearing that in mind we will respond rapidly then. While I am on my feet can I mention one matter, because it avoids a response in writing, and it is just a very short point that you, Mr. President, asked me about, the read across between Mr. Jones' "urban" and the ordinance survey ----

THE PRESIDENT: Yes, quite.

MR. VAJDA: -- I have been told by those instructing me that the best we can do on that is actually in the letter that we sent to the Tribunal on 2nd June.

THE PRESIDENT: I see, yes thank you, yes.

MR. VAJDA: I do not think I can do any better than it has been set out in the letter.

THE PRESIDENT: Thank you, right. Well at the end of this stage at least of the case we would very much like to say what an enormous amount of help we have had from all the parties to

the case. We are conscious of the work that has gone into it – an enormous amount of midnight oil and other sorts of oil has been spent. I think we should say particularly that the case has involved Dŵr Cymru in providing a lot of information and Mr. Jones's witness statements have been helpful and a great deal of work has gone into that. Although both parties have, from time to time, alleged that one party or the other has fallen down in some respect or other, we take the view at present that everybody has been doing their best to help us as much as possible, but I am sure that said, and there is recognition for all the teams here, I am sure that everybody in this room is particularly conscious – and, if I may say so, admiring – of the particular efforts that Dr. Bryan has made to bring the information forward and again to help us in the best way that he has been able to help us. So thank you particularly Dr. Bryan, but also thanks to each of the legal teams and their supporters and to all those who have given evidence – the experts and the other witnesses. It is something that we found extremely helpful and the process as a process is one that we feel has enabled us to be much better informed than we might otherwise have been, so thank you all very much indeed.

Thank you also for bearing with us while we have tried to finish this stage this evening.

(The hearing concluded)