CASE NO. 1046/2/4/04

IN THE COMPETITION APPEAL TRIBUNAL

BETWEEN:-

ALBION WATER LIMITED

ALBION WATER GROUP LIMITED

Appellants

- v -

WATER SERVICES REGULATION AUTHORITY

Respondent

supported by

(1) DŴR CYMRU CYFYNGEDIG

and

(2) UNITED UTILITIES WATER PLC

Interveners

SUBMISSIONS ON BEHALF OF THE APPELLANT FOR HEARING ON 13 FEBRUARY 2009

A. INTRODUCTION

1. These submissions are made in consequence of a series of judgments delivered by the Tribunal (and by the Court of Appeal) in Albion Water's appeal against a Decision of the former Director General of Water Services of 26 May 2004.

2. Albion's appeal arises from a Decision issued by the former Director General of Water Services, now the Water Services Regulation Authority ("the Authority") on 26 May 2004 ("the Decision"). The Decision concerned the proposed partial treatment and transport of water to be supplied by Albion Water Ltd ("Albion" or "the appellant") to Shotton Paper Mill ("Shotton Paper"), which operates a paper mill in North Wales, using non-potable water supplied through that part of the water pipe network belonging to Dŵr Cymru Cyfyngedig ("Dŵr Cymru") known as the "Ashgrove system".

3. In March 2001, Dŵr Cymru proposed to charge Albion an access price (referred to in these proceedings as the "First Access Price") of 23.2p/m^3, for partial treatment and common carriage of non-potable water to be supplied from the River Dee by United Utilities. Albion complained that the First Access Price was so excessive as to amount to an abuse of a dominant position.

4. Pending the outcome of its complaint and appeal, Albion has continued to supply Shotton Paper with non-potable water supplied to it by Dŵr Cymru at a price based on the same rationale[1] as the First Access Price but including the additional cost of the water as supplied by United Utilities to Dŵr Cymru rather than to Albion. That has been referred to as the "Second Bulk Supply Price" to differentiate it from the price at which United Utilities supplies the water to Dŵr Cymru ("the First Bulk Supply Price").

5. In the Decision, the Authority rejected Albion's complaint that the First Access Price infringed the Chapter II prohibition contained in section 18 of the Competition Act 1998 ("the Act"), finding that Dŵr Cymru's quoted price (i) did

not involve an abusive margin squeeze; and (ii) was not so excessive as to be unfair, and therefore unlawful.

6. On appeal, this Tribunal has found that parts of the Decision should be set aside for lack of reasoning and insufficient investigation (see the judgment of 6 October 2006 ([2006] CAT 23, [2007] CompAR 22) (hereafter "the First Tribunal Judgment").

7. Further, for the reasons given in a judgment of 18 December 2006 [2006] CAT 36, [2007] CompAR 328 ("the Second Tribunal Judgment"), the Tribunal found that Dŵr Cymru was dominant in what it considered to be the relevant market and, by quoting the First Access Price of 23.2p/m^3, while at the same time offering retail supply at 26p/m^3, had imposed on Albion a margin squeeze which constituted an abuse of a dominant position.

8. Dŵr Cymru appealed the Second Tribunal Judgment to the Court of Appeal on two discrete points of law but the Court of Appeal, by a judgment of 22 May 2008 ("the Court of Appeal Judgment"), dismissed that appeal, upholding the approach of the Tribunal in all respects.

9. By its Second Judgment, the Tribunal also decided to refer back to the Authority under rule 19(2)(j) of The Competition Appeal Tribunal Rules 2003 (S.I. No. 1372 of 2003) the issue of excessive pricing, for further investigation of the costs reasonably attributable to the service of the transportation and partial treatment of water by Dŵr Cymru, generally and through the Ashgrove system in particular, together with the associated question of whether, in the light of those costs, the First Access Price was an unfair price within the meaning of the Chapter II prohibition.

10. On 18 June 2007, the Authority reported to the Tribunal that:

[1] The prices charged have increased periodically on the basis of agreed indexation.

(1) it had found the First Access Price to be excessive, since it exceeded the costs attributable to the services that Albion would have required in 2000/01 from Dŵr Cymru for its common carriage proposal; but

(2) it did not consider that the First Access Price was, on the balance of probabilities, unfair in itself and that it was not, therefore, an abuse of a dominant position.

11. For the reasons given in a judgment of 7 November 2008 [2008] CAT 31 ("the Third Tribunal Judgment"), the Tribunal again ruled in favour of Albion, finding at paragraph 8 of the Judgment that:

(1) the First Access Price specified by Dŵr Cymru in March 2001 materially exceeded the costs reasonably attributable to the service of the transportation and partial treatment of water by Dŵr Cymru, generally and through the Ashgrove system in particular;

(2) the economic value of the services to be supplied was not more, or not significantly more, than the costs reasonably attributable to the service of the transportation and partial treatment of water by Dŵr Cymru, generally and through the Ashgrove system in particular;

(3) the First Access Price bore no reasonable relation to the economic value of the services to be supplied, and had both an exclusionary and exploitative effect; and

(4) the First Access Price was unfair in itself and therefore an abuse of Dŵr Cymru's dominant position within the meaning of section 18, and in particular subsection 18(2)(a), of the Act.

12. At paragraph 276 of the Third Tribunal Judgment, the Tribunal stated:

> "We have heard no argument on the question of remedy. The Tribunal may "give such direction … as the [Authority] could itself have given" under paragraph 3(2)(d) of Schedule 8 to the Act, provided the parties are given the opportunity to make representations. It is open to Dŵr Cymru and Albion to see if an agreed solution can now be reached. An opportunity for them to negotiate, in the light of the findings made by the Tribunal in this and earlier judgments, may well enable them finally to resolve this dispute, either directly or through mediation. Having said that, the Tribunal will hold such further hearings as are necessary."

13. The Tribunal is aware that there has been an exchange of correspondence between the parties in the light of the Third Tribunal Judgment and that some measure of agreement has been achieved. In particular, neither Dŵr Cymru nor the Authority is seeking permission to appeal and both accept in principle a liability for Albion's costs. Likewise, it is common ground that there is a need for a final order and that the interim order that has been in place in various forms since 2004, to preserve the competitive position pending the outcome of this appeal, should now finally be terminated.

14. However, it has regrettably not been possible to reach a consensus as to the appropriate remedy, nor has any concrete proposal been made by Dŵr Cymru or the Authority in respect of costs, and it does not appear to the parties likely that the remaining differences can be resolved by mediation. Consequently, the Tribunal has invited submissions on the question of the appropriate relief to be granted to Albion and on the question of costs.

B. RELIEF

15. In summary, Albion submits that it is entitled to the following declaratory and substantive relief consequent upon the various judgments of the Tribunal:

    (1) A declaration that Dŵr Cymru has abused a dominant position in breach of section 18 of the Competition Act 1998 by:

        (i) imposing on Albion a margin squeeze; and

        (ii) charging Albion a price that was excessive and unfair in itself.

    (2) An order to the effect that, subject to the supervision of the Authority:

        (i) the bulk supply agreement between Dŵr Cymru and Albion shall remain in force and specifying the price of the bulk supply of non-potable water supplied by Dŵr Cymru to Albion through the Ashgrove system; and

        (ii) Dŵr Cymru's non-potable retail tariff for the bulk supply of non-potable water shall exceed the wholesale price for such supply offered to Albion by a specified minimum margin.[2]

    (3) An order for costs, principally relating to counsel's fees incurred before the Tribunal since the previous costs order of the Tribunal in its judgment CAT [2007] 1, together with disbursements and a modest provision for solicitors' costs given the increased involvement of Palmers in the conduct of this litigation, prompted by the Tribunal itself, since the start of 2007.

16. It is submitted that it is only by awarding such relief that the Tribunal will give full effect to its judgment and a proper remedy to Albion in respect of the abusive conduct which it has suffered at the hands of Dŵr Cymru.

[2] In the Draft Order, Albion has suggested a minimum margin of 5p/ m^3.

17. Albion deals with each of these remedies briefly in what follows.

Declarations

18. Albion submits, and understands all other parties to accept, that declarations in the form sought by Albion should in principle follow from the various judgments handed down by the Tribunal in this appeal.

19. The only issue that appears to separate the parties is whether the Tribunal has found an ongoing abuse or whether its finding is limited to the date on which the original offer was made for the First Access Price. Albion addresses this issue below in the context of the substantive remedies that should be ordered by the Tribunal. In summary, Albion submits that it is plain that:

    (1) The commercial situation that has prevailed since March 2001 is the direct result of the matters of which Albion complained to the Authority, in that the First Access Price made it clear that the only commercial option reasonably open to Albion pending resolution of its complaint was to maintain its existing operations under the Second Bulk Supply Agreement.

    (2) The Tribunal has made clear findings, that have not been the subject of any appeal, that the conduct of Dŵr Cymru has constituted an ongoing abuse that could at any time since March 2001 have been terminated had Dŵr Cymru wished to do so (or had the Authority exercised its extensive powers under the Competition Act 1998 to require it to bring its abusive conduct to an end).

20. To put it in a nutshell, it is clear that Albion was not seeking simply an academic declaratory remedy as to the position in March 2001 in its original complaint and that is equally the case in February 2009 in the present proceedings before the Tribunal, notwithstanding the period of eight years that it has taken to establish the correct legal and factual approach to be adopted by the Authority in a case of this kind.

Remedy in Respect of Excessive Pricing

21. In relation to the "excessive pricing" issue, paragraphs 8 and 9 of the Third Judgment read as follows:

> "8. This Tribunal's conclusions may be summarised as follows:
>
> (a) The First Access Price specified by Dŵr Cymru in March 2001 materially exceeded the costs reasonably attributable to the service of the transportation and partial treatment of water by Dŵr Cymru, generally and through the Ashgrove system in particular.
>
> (b) The economic value of the services to be supplied was not more, or not significantly more, than the costs reasonably attributable to the service of the transportation and partial treatment of water by Dŵr Cymru, generally and through the Ashgrove system in particular.
>
> (c) The First Access Price bore no reasonable relation to the economic value of the services to be supplied, and had both an exclusionary and exploitative effect.
>
> (d) The First Access Price was unfair in itself and therefore an abuse of Dŵr Cymru's dominant position within the meaning of section 18, and in particular subsection 18(2)(a), of the Act.
>
> 9. In consequence of these conclusions, if necessary we shall hear further argument on the questions of relief and costs."

22. So far as the quantum of the excess of the price charged by Dŵr Cymru over costs is concerned, the Tribunal set out its findings in tabular form at paragraph 197 of the Third Tribunal Judgment:

Methodology for calculating the costs of the supply of non-potable water	**Result of methodology**	**First Access Price**	**Minimum percentage by which the First Access Price exceeds cost**
AAC+ (non-potable users generally)	15.8p/m^3	23.2p/m^3	46.8%
AAC+ (Ashgrove system)	13.8p/m^3	23.2p/m^3	68.1%
LAC (Ashgrove system)	13.6p/m^3	23.2p/m^3	70.6%

23. Although the Tribunal does not express it in these terms, the effect of its findings was that Dŵr Cymru's First Access Price was, as a minimum, between 7.4p/m^3 and 9.6p/m^3 in excess of the costs of supply.

24. It is equally clear that:

(1) the specific findings in relation to the Ashgrove system were that the figures accepted by the Tribunal were 13.8p/m^3 on the AAC+ basis favoured by the Authority and 13.6p/ m^3 on an LAC basis, equating to an overcharge of between 9.4p/ m^3 and 9.6p/ m^3;[3] and

(2) the Tribunal considered that these were conservative estimates of the level of overcharge:

> "We are satisfied that our findings on the various cost elements are a sufficient basis on which the *United Brands* questions can be determined. However, we would emphasise that these should not be taken to be the sum of our concerns at the cost justifications advanced. Other components of cost which we believe may also have been

[3] The difference between the AAC+ figure for the Ashgrove system and for non-potable customers generally is that the Tribunal excluded the costs of distribution pumping from the Ashgrove figures.

> overstated include stranded assets, water storage and common services including management charges. Had it been necessary, we would have examined in greater depth further issues relating to the estimation of operating costs and capital values": paragraph 189.

25. In the light of the Tribunal's Judgments, there have been exchanges of correspondence between the parties, in which Albion indicated that it was prepared to accept a proposal from Dŵr Cymru that it should offer to provide its "common carriage" services at the simple average of the three cost figures found by the Tribunal, 14.4p/m^3 ((15.8 + 13.8 + 13.6)/3).

26. There has, however, been no agreement as to how long Dŵr Cymru should be required to maintain that offer, and no agreement has been reached on any remedy for:

    (1) the margin squeeze abuse as found by the Tribunal; or

    (2) the excessive Bulk Supply Price currently being charged by Dŵr Cymru, on the basis that the Authority and Dŵr Cymru contend that this price is not the subject matter of the appeals before the Tribunal, which related exclusively to the First Access Price for "common carriage" quoted to Albion in March 2001.

27. Likewise, Dŵr Cymru wishes to vary the indexation mechanism used for any remedy from that agreed between the parties (and Shotton Paper) since 10 March 1999, with a view to allowing it to charge higher prices.

28. The issue of margin squeeze is dealt with below. Turning to the Bulk Supply Price currently being charged by Dŵr Cymru to Albion, it is Albion's submission that, notwithstanding that this price was not the direct subject matter of the complaint to the Authority or the appeal before the Tribunal, for the Tribunal to fail to give a remedy in respect of the Bulk Supply price would render enforcement of the competition law regime in a case of this kind entirely

ineffective and would deny Albion any meaningful remedy for the abuse of which it has been a victim since March 2001 and in respect of which it continues to suffer.[4]

29. Albion submits that, in the circumstances of this case, it is clearly within the jurisdiction of the Tribunal to order such a remedy in respect of the Bulk Supply price, notwithstanding that this price was not the subject matter of the appeal before the Tribunal (but see footnote 4 below).

30. In this respect, the Tribunal made the following finding in its analysis of the ECPR issue in the First Tribunal Judgment, paragraph 748:

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

31. This finding should not be controversial between the parties, in that the then Managing Director of Dŵr Cymru, Mr Mike Brooker, who is now a non-executive director of the Authority, wrote to Albion on 10 August 2001, stating that:

> "the proposed access price for common carriage has the same basis as the current bulk supply price for the inset appointment to the Shotton Paper site, less the water resource component."[5]

[4] Albion notes that the relationship between the First Access Price and the Second Bulk Supply Price is an issue specifically identified in the Notice of Appeal, paragraph 218(e): "whether the terms for the non-potable bulk supply price should be consistent with the common carriage access price". As relevant background, the Tribunal is also respectfully reminded of the extraordinary difficulties confronting Albion in persuading the Authority to examine and reach any sort of appealable decision on this case in a period of over two years prior to the commencement of proceedings before the Tribunal in 2004: see paragraphs 1-64 of the Notice of Appeal and associated correspondence and paragraphs 109-134 of the First Tribunal Judgment.

[5] See Annex D48 to the Reply in this appeal.

32. The Tribunal dealt with the question of the Bulk Supply Price again at paragraphs 329-354 of the Second Tribunal Judgment. In particular, at paragraphs 351-353, the Tribunal made the following findings in respect of jurisdiction:

> "There is a third jurisdictional route to arrive at the same result, which is as follows. Suppose that the OFT properly opens an investigation into certain conduct (conduct A) under section 25 of the 1998 Act, and comes to the conclusion that there is an infringement of the Chapter II prohibition. Suppose also that it follows from the OFT's conclusion that other conduct by the same undertaking (conduct B), which is closely related to and intertwined with conduct A, also appears to infringe the Chapter II prohibition. Suppose, further, that the OFT's decision about conduct A will be deprived of practical effect, because the complainant will be driven out of business by conduct B before the decision about conduct A can take effect. It seems to us, as a matter of common sense, that in those circumstances the OFT would have power to make an interim measures direction in relation to conduct B, and that its decision to refuse such a direction would be appealable to the Tribunal. The Tribunal would then itself have power to grant interim measures, under either Rule 61(1)(c), or under Rule 61(2).
>
> 352. That is, in effect, the situation in this case. As a result of the Tribunal's judgment, the Authority's investigation into the First Access Price is still open. Had that investigation been properly conducted, it would by now be apparent to the Authority that, not only was there an infringement of the Chapter II prohibition in relation to the First Access Price, but that there were also reasonable grounds to suspect an infringement in relation to the Bulk Supply Price. It would also be apparent to the Authority that there would be a risk of Albion going out of business before the decision on the First Access Price could take effect, by virtue of the level of the Bulk Supply Price. In those circumstances, we can see no reason why the Authority could not adopt interim measures under section 35 of the 1998 Act to preserve effective competition, for example pending a re-determination of the Bulk Supply Price. In the postulated circumstances, no other remedy would be available to the Authority to protect the public interest.
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> 353. We would not accept, and indeed it has not been suggested, that the Bulk Supply Price in this case is not subject to the Chapter II prohibition. As already set out in paragraphs 152 and 196 of the main judgment, it is plain that the 1998 Act is not ousted by the WIA91, albeit that the characteristics of the water industry are relevant to how the 1998 Act is applied in that context. The same applies to Community law. We do not see any jurisdictional reason why the Authority could not give either an interim measures decision under section 35, or a final direction under section 33 of the 1998 Act, in relation to the existing Bulk Supply Price."

33. Although the Tribunal does not offer any authority in support of this approach, referring the matter as one of "common sense", Albion submits that this analysis is plainly correct and is consistent with the approach that has been adopted by the Tribunal itself in earlier cases and to the analogous issue under Article 82 of the EC Treaty.[6]

34. In relation to the practice of the Tribunal, the present facts can be compared to the robust approach taken by the Tribunal in the *Genzyme* litigation, and in particular in the following passage from the final remedies judgment, [2005] CAT 32, paragraph 233:

> "In our judgment, the power to make a direction under section 33 of the Act includes the power to ensure that an infringement is not repeated, if the OFT in its discretion considers that such a direction is necessary. Moreover, in our view, the power "to bring the infringement to an end" covers conduct closely linked to, or to the like effect as, the infringement found, otherwise section 33 would be ineffective. Similarly, the Tribunal's powers to give such directions or make any decision the OFT could have given or made must, it seems to us, be construed as a power to give a direction that is adapted to the developments that have taken place in the course of the proceedings, provided that the underlying problem to be addressed remains the same or similar. Otherwise, a kind of "catch as catch can" situation could arise in which a dominant undertaking could, by constantly changing its arrangements, keep the competition authorities at bay indefinitely."

35. In relation to the analogous powers of the Commission under Article 82 of the EC Treaty, it is clear that the Commission enjoys extensive powers to impose behavioural remedies to deal with abusive conduct by dominant firms. For example, in the case of *Hilti*, OJ 1988 L65/19, [1989] 4 CMLR 677, Hilti was required by the European Commission's decision to refrain from measures "having an equivalent effect" to those found to have been abusive. This decision was upheld by the Court of First Instance in Case T-30/89, [1991] ECR II-1439, [1992] 4 CMLR 16. Similarly, Article 7 of Regulation 1/2003, which provides in part that the EC Commission:

[6] See Bellamy and Child, 6th edition, paragraphs 13.125-13.127 and Kerse and Khan, 2nd edition, paragraphs 6-024-6-025.

"may impose on [the undertakings concerned] any behavioural and structural remedies which are *proportionate* to the infringement committed and necessary to bring the infringement *effectively* to an end" (emphasis added).

36. Albion submits that its proposed orders are the minimum needed for a proportionate and effective remedy. Given the findings of the Tribunal as to the close links between the Bulk Supply Price and the First Access Price, Albion submits that the Tribunal should impose the remedy sought in relation to excessive pricing – as the Tribunal itself pointed out in *Genzyme*, there would be a serious risk that the 1998 Act would become toothless if dominant firms could evade enforcement by altering their commercial arrangements during the course of an investigation.

37. The same is no less true of the present facts, where a dominant firm offers a small company terms that are plainly not commercially sustainable in that they would lead to a negative margin were they to be accepted: see the factual findings at paragraph 289 of the Second Tribunal Judgment set out below. It would be an absurd outcome for no substantive remedy to be available to that company at the end of a protracted complaints and appeal process, during which it has barely survived trading on the basis of pre-existing arrangements that are in substance based on the same abusive conduct as the subject matter of the complaint, namely charges for partial treatment and bulk distribution of non-potable water constituting an excessive wholesale price and a zero margin.

38. In order to give real effect to the relevant provisions of the Act, it is necessary that the Tribunal make it clear that there has been an ongoing abuse throughout the period since 2001 and that it order a remedy in respect of the totality of the abuse. This is also entirely consistent with commercial reality in that the course adopted by Albion, of maintaining its business as best it could by continuing to trade under the Bulk Supply Agreement, was the best (indeed the only real) option available to it, the alternatives in 2001 being to exit the market altogether or to enter into common carriage arrangements on terms that the Tribunal has found would have been materially less favourable than the status quo. In effect,

Albion has minimised the adverse effect on competition, by continuing with the existing arrangements rather than taking either of two alternative courses, each of which would have aggravated rather than mitigated the harm to the public interest resulting from Dŵr Cymru's abusive and unlawful conduct.

39. Moreover, such an approach is consistent with the findings of the Tribunal in respect of margin squeeze, where it expressly found an ongoing abuse, for example at paragraphs 286-287 of the Second Tribunal Judgment: see below.

40. Finally, Albion notes that neither Dŵr Cymru nor the Authority has sought to appeal the approach of the Tribunal to jurisdiction (which formed the basis for its findings on interim relief) set out above. In this respect, it is notable that the Authority clearly considered such an appeal: see the Transcript to the hearing on 18 December 2006, page 3, lines 19-27:

> "It is, of course, clear from this further Judgment that there are matters of substance that the Tribunal has now decided which go considerably beyond, in our submission, what was contained in the main Judgment, that was in particular the Tribunal has now felt able to reach a conclusion on dominance, a conclusion on margin squeeze, *a finding that the second bulk supply price agreement is capable of giving rise to an abuse for precisely the same reasons as the First Access Price*; those are all matters of some significance to Ofwat. They would therefore wish to have a proper opportunity firstly in which to consider whether it is appropriate to appeal; and secondly, to prepare the necessary paper work in order to advance such an appeal" (emphasis added).

41. For all the above reasons, it is submitted that the appropriate remedy in respect of Dŵr Cymru's excessive pricing abuse is an order that, subject to any alternative direction of the Authority, the bulk supply agreement between Dŵr Cymru and Albion shall remain in force and that the price of the bulk supply of non-potable water supplied by Dŵr Cymru to Albion through the Ashgrove system shall be based on:

(1) a maximum price of 14.4p/m^3 (as appropriately indexed to reflect inflation); plus

(2) the costs of the Heronbridge bulk supply, as invoiced by United Utilities to Dŵr Cymru.

42. As noted above, the effect of imposing a maximum price of 14.4p/m^3 would be doubly conservative, in that it would give weight to the inclusion of "distribution pumping" that the Tribunal found should *not* be included in the costs of the Ashgrove system, and would not take account of the respects in which the Tribunal remained concerned as to Dŵr Cymru's costs. The Tribunal may consider that it would be more appropriate to take the lower Ashgrove specific figures of 13.6p/ m^3 or 13.8p/ m^3.

43. In relation to indexation, as explained in its letter to Dŵr Cymru of 19 November 2009, Albion sees no reason to change the approach that has been adopted by the parties since 1986:

> "The indexation provisions since 1986 have used the Producer Prices Index (PPI[7]). We have heard no argument that this indexation is in any way inappropriate and would propose that this be used to calculate current and future cost adjustments."

44. So far as Albion is aware, the only basis for RPI being proposed by Dŵr Cymru as the appropriate indexation approach is that it gives somewhat higher charging figures. Albion submits that, in the present context, that is not a good reason to adopt a different commercial approach from that previously accepted as appropriate by all interested parties.

Remedy in Respect of Margin Squeeze

45. So far as the "margin squeeze" abuse is concerned, the Tribunal made the following findings of fact at paragraphs 286-289 of the Second Tribunal Judgment:

[7] We understand from the ONS that PLLW has been discontinued and have been advised that PLLV is the closest equivalent

"286. There is no doubt in this case that *a margin squeeze exists as a matter of fact*. The Tribunal held in paragraph 871 of the [First Tribunal Judgment]:

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

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

> "772. However, it has not been seriously disputed by the Authority and Dŵr Cymru that, if the Decision is correct, Albion's common carriage proposal is dead. Albion is expected under the Director's ECPR calculation to supply Shotton at a margin of 0 per cent. Whatever the debate about the size of the margin needed by Albion, it is not seriously suggested that it could survive on a zero margin, and it has only done so, so far, because of the support of Shotton Paper and the interim relief ordered by the Tribunal. As Mr Jeffery points out in his witness statement of 11 November 2004, Albion necessarily incurs some staff costs, office costs, insurance costs, regulatory costs associated with its statutory appointment as an inset appointee, and so on.
>
> 773. *Similarly, and for the same reason, if the Director's approach is correct, Albion could not survive even under the existing arrangements: so long as Dŵr Cymru's retail price is at or about 26p/m³ and the price under the Second Bulk Supply Agreement is the same, Albion's margin between these two prices is effectively squeezed to zero.*
>
> 774. It follows that, in this particular case, the application of ECPR will prevent the development of a competitive supply situation as regards the Ashgrove system, and eliminate an existing new entrant. Under the

> 1998 Act, the Tribunal is not concerned with the interests of Albion as such, but it is concerned with the interests of the customer, here Shotton Paper (and possibly Corus) and the preservation of competitive choice. The adoption of a pricing rule which, in this particular case, would simply throw Shotton Paper back into the hands of its former monopoly supplier, would not seem to us compatible with the development of competition" (emphasis added).
>
> 288. Although that passage occurs in the part of the [First Tribunal Judgment] dealing with ECPR, the principle is the same. As already indicated, Dŵr Cymru arrived at the First Access Price by simply deducting the water resource cost from its existing Bulk Supply Price, which was itself the same as Dŵr Cymru's prevailing retail price (approximately 26.5p/m³ in both cases). It is thus manifest that, by setting the First Access Price at the level it did, Dŵr Cymru left Albion with no effective margin with which to acquire the water resource and at the same time meet all its own costs and overheads.
>
> 289. Moreover, it is plain, on the evidence before the Tribunal, that in this case the First Access Price would, in practice, not merely offer a zero margin, but a substantially negative margin. That is because, in practice, Albion would not be able to obtain the water from United Utilities at anything like the below-cost price of 3.3p/m³ enjoyed by Dŵr Cymru. The facts of this case thus give rise to a serious and severe margin squeeze."

46. As a matter of law, the Tribunal made the following finding in respect of the "margin squeeze" issue:

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

47. As in respect of the excessive pricing abuse, Albion submits that the Tribunal clearly found an ongoing abuse, indeed it expressly stated as much at paragraphs 286 and 287 of the Second Tribunal Judgment ("a margin squeeze exists as a matter of fact. …" The effect of that margin squeeze is, and was, to prevent

Albion from entering into a common carriage arrangement and to eliminate Albion as a competitor").

48. So far as the quantum of any margin squeeze is concerned (i.e. the margin that an efficient operator would need to provide retail services in competition with Dŵr Cymru), the Tribunal has not as yet made any specific findings. However, the Tribunal made the following comments in respect of the evidence available to it as at the date of the Second Tribunal Judgment:

> "In particular, the "distribution" element in the First Access Price discussed at length in the first part of this judgment reflects all the costs, other than treatment costs, attributable to large potable customers under the LIT, including customer-related retail costs, bad debts and the like. The result is that the First Access Price includes retail costs, even though under the proposed common carriage arrangement Dŵr Cymru would no longer be a "retailer" in the sense of a supplier to an end-user, but a supplier of water transport and treatment services to Albion": paragraph 782 of the First Tribunal Judgment.
>
> "Relying on *Genzyme v OFT* [2004] CAT 4 and the EC jurisprudence there cited, Albion submits that the Director erred in law at paragraphs 345 to 352 of the Decision in failing to determine the margin required by a reasonably efficient supplier of water to Shotton Paper operating in competition with Dŵr Cymru, and instead wrongly considered only the level of savings accruing to Dŵr Cymru as a result of Albion's activities.[8] Albion rejects the Director's argument that it does nothing which would entitle it to any margin, relying on its roles as a broker, as a statutory undertaker, as a retailer, and as a supplier of water management services, as set out in Mr Jeffery's statement of 9 November 2004. According to Albion, these latter services equate to those notified to the Director by Dŵr Cymru by letter of 2 December 1998 when justifying its new Large Industrial Tariff (LIT) for customers using more than 50 Ml per annum. The services supplied by Albion are said by Mr Jeffery to include water management, the provision of detailed water data, and advice on water use efficiency. Those services give rise to direct operating costs, before any contribution to central overheads or profit, of some £120,000 p.a. That is equivalent to 1.77p/m³, giving total costs of 3.47p/m³. On the basis of a profit

[8] This passage of the Tribunal judgment needs to be read in the light of the Court of Appeal Judgment, paragraphs 98 and 105, which found that the primary legal test for a margin squeeze is the margin required by an operator "equally" efficient with the upstream monopoly supplier. It should be noted that the Court of Appeal did not expressly rule that the Tribunal had made an error of law in considering the "reasonably efficient" competitor test, nor did it address the situation that would arise where it was not possible in practice to identify the downstream costs of the upstream monopolist or where, as in the *Genzyme* case, there were obvious reasons why those costs were not an appropriate benchmark.

before tax of 1.53p/m³, that would imply a retail margin of 5p/m³, according to Mr Jeffery": paragraph 848 of the First Tribunal Judgment.

"As to retail costs, those costs fall to be excluded from the calculation of Dŵr Cymru's transportation and treatment costs. Again, it does not seem to us that extensive work is likely to be required in order to establish retail costs. Albion's evidence before the Tribunal is that retail costs were likely to be of the order of 5p/m³ (Mr. Jeffery's witness statement of 9 November 2004)": paragraph 248 of the Second Tribunal Judgment.

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

49. It would appear from paragraph 303 of the Second Tribunal Judgment in particular that the Tribunal's provisional view was that it would be reasonable to equate the level of the margin squeeze to the minimum level of overcharge as it then appeared,[9] which the Tribunal considered to be in the range of 4 to 5.6p/m^3 depending on the correct figure for treatment costs. That would be consistent with Mr Jeffery's evidence but now clearly falls to be read in the light of the findings of the Tribunal in the Third Tribunal Judgment, in particular at paragraph 197.

50. For these reasons, Albion submits that the Tribunal should find that Albion should be granted a margin of at least 5p/m^3, on the basis that:

(1) the only evidence before the Tribunal is that of Mr Jeffery, which was clear that 5p/m^3 was the necessary margin for Albion's activities; and

[9] Those provisional findings have now been superseded by the findings of the Tribunal in the Third Tribunal Judgment, which concluded that the level of overcharge was substantially greater: see paragraphs– 22-23 above.

(2) that evidence is consistent with the Tribunal's other findings, and in particular with its findings on excessive pricing.

51. Consequently, Albion submits that the appropriate remedy for the Tribunal to award Albion in respect of Dŵr Cymru's margin squeeze abuse is an order that Dŵr Cymru's tariff offered to retail customers for the bulk supply of non-potable water shall exceed the wholesale price for such supply offered to Albion by a minimum of 5p/m^3.

52. As in respect of the excessive pricing remedy, it would be appropriate to make provision for inflation. If the PPI approach favoured by Albion were to be adopted the effect would be to increase the minimum margin from 5p/m^3 to 5.54p/m^3 (at 2009/10 tariff indexation, i.e. based on the November 2008 index). If the RPI approach favoured by Dŵr Cymru were adopted then the minimum margin should be 6.35p/m^3.

The need for a substantive remedy for both the "excessive pricing" and "margin squeeze" abuses

53. Finally in respect of substantive remedy, it should be emphasised that both elements of the remedy sought by Albion, namely that in respect of the excessive pricing abuse *and* that in respect of the margin squeeze abuse, are necessary to protect the position of Albion and its customers. To illustrate this by the figures that appear in the judgments, ignoring any adjustments for indexation:

(1) if the Tribunal were to cap the absolute level of charges to Albion at say 14.4p/m^3, it would remain open to Dŵr Cymru to charge the same price to Albion and to Shotton, so that Albion could still be "squeezed" out of the retail market; whereas

(2) were the Tribunal only to order a margin of 5p/m^3, that would leave open the possibility that the absolute level of charges to Shotton could be maintained at an excessive level, so that Shotton would obtain no benefit.

54. In effect, a "cap and collar" is needed for Dŵr Cymru finally to bring its stubbornly abusive conduct to an end.

C. COSTS

55. It appears to be common ground that Albion should be awarded its costs incurred before this Tribunal since the Tribunal's judgment of 8 January 2007, such costs to be apportioned between the Authority and Dŵr Cymru as agreed between them or, in default of agreement, on such other basis as decided by the Tribunal.

56. Albion has sent three detailed letters setting out the costs position, dated 12, 16 and 29 January 2009, seeking to agree payment of counsel's fees, solicitors' administrative costs and disbursements in a total sum of £201,479.30. Although the matter is in principle agreed, and Albion has provided counsel's fee notes, a detailed breakdown of disbursements and an outline schedule of solicitors' costs, no substantive response has been provided by either the Authority or Dŵr Cymru.

57. Albion considers that its overall costs, which have kept solicitors' costs and specialist accountancy or economic advice to an absolute minimum, remain modest given the duration and complexity of this case. Counsel's fees are based on hourly rates that have remained unchanged since the start of 2006. Albion is confident that its costs continue to compare very favourably with the

professional costs of the Authority and Dŵr Cymru in unsuccessfully resisting this appeal.[10]

58. It would therefore be highly regrettable if the Authority and Dŵr Cymru are unable to put forward a constructive proposal before the hearing on 13 February 2009, but Albion's position is clearly stated in the correspondence.

D. CONCLUSION

59. For all the above reasons, Albion respectfully submits that in order to give proper effect to its judgments, render effective the enforcement of the UK competition law regime in the circumstances of this case and to provide a meaningful remedy to Albion for the pricing abuses of which it has been a victim, the Tribunal should make an order in the terms set out in the Draft Order appended to this submission.

60. In this respect, Albion has marked in italics points that require resolution by the Tribunal and where Albion has amended the Draft originally sent to Dŵr Cymru and the Authority on 19 November 2008, since when, again regrettably, no constructive progress has been made.

61. Albion believes that all relevant correspondence has been copied to the Tribunal since November 2008. However, should it be of assistance, Albion will of course cooperate fully with the other parties in preparing any additional documentation that may be required prior to the 13 February hearing.

[10] If this is not accepted then it may be appropriate for the Tribunal again to ask the other parties to disclose the professional costs that they have incurred in these proceedings since the start of 2007, as it did in relation to its earlier costs judgment.

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Matrix,
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2 February 2009

CASES NO. 1046/2/4/04 AND 1034/2/4/04 (IR)

IN THE COMPETITION APPEAL TRIBUNAL

BETWEEN:-

(1) ALBION WATER LIMITED

- and -

(2) ALBION WATER GROUP LIMITED

Appellants

- v -

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

Respondent

supported by

(2) DŴR CYMRU CYFYNGEDIG

and

(2) UNITED UTILITIES WATER PLC

Interveners

DRAFT ORDER PURSUANT TO THE COURT OF APPEAL JUDGMENT OF 22 MAY 2008 AND THE TRIBUNAL'S JUDGMENT OF 7 NOVEMBER 2008

UPON the Court of Appeal having upheld the judgments of the Tribunal in respect of margin squeeze and dominance ([2008] EWCA Civ 536) and upon the Tribunal having handed down its judgment in respect of excessive and unfair pricing ([2008] CAT 31) (the "Judgments")

AND UPON agreement between the parties as to the terms of the Order which follow from the Judgments

IT IS DECLARED THAT:

1. In March 2001 and thereafter, Dŵr Cymru Cyfyngedig ("Dŵr Cymru") abused its dominant position within the meaning of section 18 of the Competition Act 1998 by quoting a First Access Price which:

   (1) was both excessive and unfair in itself; and

   (2) imposed an abusive margin squeeze.

IT IS ORDERED THAT:

2. Subject to paragraph 6 below, the common carriage access price offered by Dŵr Cymru to Albion Water Limited ("Albion") for the treatment and distribution of non-potable water through the Ashgrove system shall be:

   (1) the mean figure for distribution and treatment costs found by the Tribunal, *[14.4p/m^3]*, indexed according to the *[Producer Prices Index (PLLV)]*; plus

   (2) the agreed costs for any other necessary services required, such costs to be referred to independent arbitration if not agreed.

3. Subject to paragraph 6 below, the bulk supply agreement between Dŵr Cymru and Albion shall remain in force and the price for the bulk supply of non-potable

water supplied by Dŵr Cymru to Albion through the Ashgrove system shall be based on:

(1) *[14.4p/m^{3,} as indexed by the Producer Prices Index (PLLV)]*; plus

(2) the costs of the Heronbridge bulk supply, as invoiced by United Utilities to Dŵr Cymru.

4. The existing safeguards regarding payment into a jointly controlled account shall cease and be replaced by normal 30-day credit terms.

5. Subject to paragraph 6 below, Dŵr Cymru's tariff offered to retail customers for the bulk supply of non-potable water shall exceed the wholesale price for such supply offered to Albion by a minimum of *[5p/m^3 as indexed by the Producer Prices Index (PLLV)]*;

6. The Authority may if it thinks fit, after consulting interested parties and subject to their legal rights, modify the terms of paragraphs 2-5 of this Order, with a view to ensuring that those terms remain appropriate and effective for their purpose.

7. The Tribunal's interim Order of 20 November 2006 ceases to have effect as of the date of this Order.

8. *[Albion's costs incurred before this Tribunal since the Tribunal's judgment of 8 January 2007 shall be paid by the Water Services Regulation Authority and Dŵr Cymru, such costs to be assessed if not agreed by those three parties and to be apportioned between the latter two parties as agreed between them or, in default of agreement, on such other basis as decided by the Tribunal]*.

Lord Carlile of Berriew Q.C. Made: *[February 2009]*

Chairman of the Competition Appeal Tribunal Drawn: *[February 2009]*