IN THE COMPETITION APPEAL TRIBUNAL

Case No. 1042/2/4/04

Victoria House,
Bloomsbury Place,
London WC1A 2EB

20th June 2005

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

And

DIRECTOR GENERAL OF WATER SERVICES Respondent

supported by

THAMES WATER Intervener

Mr. Rhodri Thompson QC and Mr John o' Flaherty appeared on behalf of the Appellant.

Mr. Jon Turner and Miss Valentina Sloane (instructed by the Director of Legal Services, OFWAT) appeared on behalf of the Respondent.

Mr. Stephen Tupper (of Watson, Farley & Williams) appeared on behalf of the Intervener.

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HEARING DAY ONE

THE PRESIDENT: Good morning, Mr. Thompson.

MR. THOMPSON: Good morning, Sir.

THE PRESIDENT: We seem to have an issue in this Appeal as to exactly what the points in the Appeal are and what is or is not within the Notice of Appeal in terms of the skeleton arguments which have been exchanged. It seems to us at the moment that we ought to sort that out first before we go any further and be clear (a) what points are still in issue; and (b) which points still in issue are properly within the amended Notice of Appeal.

MR. THOMPSON: Yes, Sir. Do you want me to fire away, or there is a pre-emptive strike which is ----

THE PRESIDENT: It sounds to me, at least at first sight, as if it would be convenient perhaps for Thames first of all just to take us to the documents and passages which it says are outside the Notice of Appeal to complete orally the arguments that are already before us in writing, and for you to reply if these matters are still in issue, but perhaps they are not in issue, I do not know.

MR. THOMPSON: I think they are in issue. I must say, I would not necessarily think that was the most convenient course, but I think it is one that Mr. Tupper is enthusiastic about.

THE PRESIDENT: It seems to me they have made the application so they ought to pursue it. Yes, Mr. Tupper, what we want to know, or be reminded of, please, is the basis of your argument for saying that the points that Mr. Thompson seeks to advance in his skeleton are outwith the Notice of Appeal as amended; and secondly, to identify for us where you say various points within the Notice of Appeal have now been abandoned.

MR. TUPPER: Sir, I will certainly do my very best to cover all of those. I have been able, obviously, to identify all of those which I would consider to be new points. There is a plethora of what I would call amended grounds, and then a few grounds where obviously they have tried, through the skeleton, to introduce either a new tack or a new remedy or a new ground. But I would concur with the Tribunal that the key provision that applies in this particular case, which I think is absolutely crystal on its face is contained in schedule 8 of the Competition Act. I know that this is a provision which is reviewed at great length in *Floe*…

THE PRESIDENT: Well, insofar as you are submitting that the Appeal has to be conducted within the four corners of the Notice of Appeal, and we should not go outside the Notice of Appeal unless the Notice of Appeal is amended, in principle we are with you on that point at this stage.

MR. TUPPER: Well then I think that we must turn our attention first to the amended Notice of Appeal and if we look at para.9 (bundle 1A)

THE PRESIDENT: Yes. As we can see para.9 of the amended Notice of Appeal starts with the following phrase and I believe it is a key phrase and one obviously that the parties on the other

side of the caption focused on, because Albion says "the specific grounds of challenge are that", and then goes on. I am not so sure whether or not the Tribunal would like to read this at its leisure rather than ----

THE PRESIDENT: Yes, we are familiar with the passage so there is no need to read it to us.

MR. TUPPER: So those set out the grounds, and it must be remembered, obviously, that this particular case has a tortured history involving an appeal and then an amended Notice of Appeal which was filed after several different stages, and many months had passed between the moment of first Appeal and the amended Notice of Appeal. So plenty of time for Albion to consider what its case is and get its grounds absolutely spot on.

It then goes on in para.10 to set out the remedy that it seeks from the Tribunal. The parties on the other side of the caption focused on this with obviously a great deal of interest, because it says:

> "In view of the conduct of Ofwat in the investigation of this case and the additional evidence now available, Albion contends that justice and the public interest require that this matter is remitted back to the Director …"

and so on and so forth.

THE PRESIDENT: Yes.

MR. TUPPER: This is repeated in para.90 which comes at the very end of the amended Notice of Appeal. Albion says without equivocation of any sort: "In light of the above grounds of Appeal Albion seeks an order from the Tribunal that this matter is remitted to the Director." If I may just beg the indulgence of the Tribunal for a moment, and as the Tribunal to go to para.8 where Albion says "By letters dated 5, 6 October …" etc., it obviously sets out there that it considered all of the grounds, and they have had plenty of time to discuss the grounds with the Director General and consider all of those points, and again reiterate that in para. 33. "This Appeal has been drawn narrowly to concentrate on important points of principle that are commercially relevant today, and are likely to remain so." Naturally Thames and the Director General was impressed that Albion was able to be so unequivocal about the grounds upon which it was moving this Tribunal to a Ruling and what the remedy should be in the circumstances.

Then if we can go to the skeleton we have a small change of tack. In para.11 we have a paragraph which starts again with the phrase: "Albion's principal complaints relate to…" but now two aspect of the reasoning ----

THE PRESIDENT: Just a moment, Mr. Tupper. (After a pause) Yes. Paragraph 11?

MR. TUPPER: Paragraph 11, which is the analogue of para.9 in the Amended Notice of Appeal because it attempts to set out the grounds, and the Tribunal will obviously recognise that in our application to strike we had differentiated between the grounds which have mutated, and the remedy which has comprehensively changed. So para.11 is the analogue of para.9, and then the analogue of para.10 is set out in para.87 of the skeleton. I think that probably this paragraph is worth a very brief recitation:

> "Albion has considered the question of an appropriate remedy and considers that it would be more appropriate to make specific findings on the issues raised in this skeleton argument. Albion submits that the Tribunal has sufficient information before it to make the following declarations and orders."

The Albion cites s.18(2)(a) of the Competition Act.

In essence, the remedy now being sought by Albion is no longer remittance, it is asking the Tribunal to replace. From the perspective of my client this is a flip-flop of alarming proportions. Remittance would have given Thames the opportunity, obviously to convince the Director General once more that the circumstances, the effort, the accounting methodologies, the numbers, the entire factual scenario is set out in 2000 and the subsequent years was entire and complete justification for the various pricing offerings it had made to Albion. So at a minimum under a remittance case … to fight this in the trenches, potentially obviously for a few more months, but we were utterly convinced that the Director General was entirely correct the first time, and that would then have brought this matter to a close. But now Albion would like this Tribunal to convert itself into a full finder of fact. Not only would it like the Tribunal to convert itself into a full finder of fact, but it would also like the Tribunal to find that, as regards grounds, they were not set out with any degree of specificity in the original amended Notice of Appeal. As a result Thames has not had an opportunity in its pleadings, in expert testimony, in witness statements to address those new grounds and, as a result, we are prejudice in a way which is truly quite fundamental.

So as a result, we have asked the Tribunal in essence to rule that all of the new grounds that have been set out in the skeleton be rendered nugatory, inappropriate, and not issues that can be argued before this Tribunal because it falls outside of the amended Notice of Appeal. Boiled down, the changes come out something like this, although it does take a certain amount of effort to divide exactly what Albion is now arguing, but boiled down, assuming that this Tribunal is aware that it has not moved to amend, and it cannot argue outside of the four corners of its amended Notice of Appeal, we have two grounds that remain as shifted grounds, from the amended Notice of Appeal concerning what is called the "overs

and unders", in the amended Notice of Appeal they argue that value should have been accorded to the totality of the water put into the Thames system. That argument is still there but it has been diluted by a suggestion that the Tribunal can rule that at a minimum we should have paid for the amount of water that exceeded the amount of water that might have been used by Albion's customers, and that at least they would contend is a banker, so there is an amendment there or a mutation. Also, it has mutated in the sense that in the amended Notice of Appeal the focus was entirely upon the second price of 13.6p per cubic metre. In the skeleton the attempt now to focus on the first price, this is the first provisional price, this is the price we were asked to provide on the basis of "Can you give us a provisional idea of how much it might cost to use your infrastructure?" (the 27p per cubic metre). Those two points we would concede are just about – only just about – contained in the amended Notice of Appeal.

In addition to that there have been four different withdrawals of arguments contained in the amended Notice of Appeal. First, the 13.6p per cubic metre now no longer looks as if it is being challenged.

THE PRESIDENT: Where do you get that from?

MR. TUPPER: Because there is an absence of any reference to the second price at any time, at any point in the skeleton arguments. So it is true it is one I am sure that Albion may suggest is still "at the party" as it were, but at least there is no reference, so by omission they have not sought to progress any arguments with regards to the appropriateness of the calculation as regards 13.6p.

They have conceded the balance in cost issue in its entirety and I think that it is probably easy to explain why. At no point did Thames ever suggest that Albion should pay the balancing costs, what Thames has suggested is that should there be any balancing costs identifiable and real balancing costs, then obviously that is a cost that must be picked up by the new entrant, so as a result it cannot possibly constitute an infringement of s.18 of the Competition Act to the extent that we never actually said that "you must pay" in any shape size or form.

They have also withdrawn, by omission, any arguments concerning the inadequacy of the investigation and they have also withdrawn by omission the arguments that they set out in some detail in the amended Notice of Appeal concerning a course of exclusionary conduct on the part of Thames, all of those have disappeared in the skeleton, and they have now raised two new points. There was a small seedling of a point concerning delay, but one which they in their amended Notice of Appeal said that they would not pursue, but has come back large and in full form ----

THE PRESIDENT: That is the reference to the "procedural shambles", that they are not pursuing the procedural shambles", you mean? Or is it a difference reference?

MR. TUPPER: This is basically the argument as I understand it, and I paraphrase, Albion have suggested the delay between the day, the date that they asked us for the original price, etc.

THE PRESIDENT: I was just trying to find where in the Notice of Appeal they said they were not going to pursue that?

MR. TUPPER: Paragraph 36 – I am grateful – this is in fact a series of paragraphs where they say "These are the things that we will not delay. They note their annoyance that it took four months".

THE PRESIDENT: That is a discrimination point in 36.

MR. TUPPER: Sorry, in fact, 35 then. The second phrase of 35.

> "Although Albion contends that the offered access prices were wrongly calculated and failed to reflect the value to Thames Water of the new resources, it will not contest …"

I think it is worth mentioning that delay did not feature in the so-called principal grounds set out earlier on in the amended Notice of Appeal, and I think it would probably be fair to say that if you do not focus on and actually set out the full case then I think we are entirely at liberty not to pay it much mind.

THE PRESIDENT: Can I just ask one question?

MR. TUPPER: Yes, sir.

THE PRESIDENT: In para.9.1 of the Notice of Appeal on p.4 when they say "The Director wrongly failed to find Thames Water abused its dominant position by (a) setting prices for common carriage at a level that made it impossible…" etc. How do we infer that that is referring only to the later 13.6p price and does not refer to the earlier 27p price?

MR. TUPPER: I believe that Thames is happy to concede that as regards the pricing issues set out in para.9 there is probably enough flex to suggest that both prices were being covered by the original argumentation. However, in this particular document, the amended Notice of Appeal if there is a reference to the price it is consistently a reference to the price concerning 13.6 p.

THE PRESIDENT: There is no supporting argument about the 27p, except to point out that the 27p remains as an offer as regards standard customers. The focus as regards margin squeeze in those sections and to the extent there is a reference to a price it is a reference to 13.6 per metres cubed. However, in the skeleton we have the switch in that 27p becomes the star of the show and 13.6p recedes into the background. But we do accept that 9.1 suggests that both prices

were being challenged in terms of the grounds that they then set out and all the argumentation that they make is generally as regards the 13.6p.

THE PRESIDENT: Just remind me, Mr. Tupper, 13.6p was a new price for non-domestic users, is that right?

MR. TUPPER: No, that is for large volume users. It is to a certain extent a relatively new pricing formula in the water industry and the theory, and it is the theory, goes something like this, as regards certain types of large volume purchasers as and when water is delivered to them it is generally delivered through the trunk mains, so it all goes through the major pipes, and to the extent there is use of any secondary pipes it is very short, sharp and sweet, and to the point. However, if you are a standard volume user there is every possibility of the water in getting to you will use much more of the infrastructure, and the remaining parts of the infrastructure is considerably more expensive to maintain. So as a result Ofwat decreed that water companies, if they felt that they wanted to, could set up a large volume tariff for the bigger users. Originally when we quoted the price, because we had not been specified to any great extent at that point by Albion exactly what they wanted and for whom, the original price that we presented to Albion was one which was based upon totality of the network, so a standard customer. So over a period of time Ofwat sought to persuade Thames that actually that should not be the case and that they should take the benefit of the pricing structure that is granted to large volume users. We would still to this day suggest that that particular pricing pressure was incorrect because when the water will actually come from the borehole it is absolutely sure as night follows day that the water that will end up with the customers of Albion will not be the same molecules. Those molecules of H20 could go anywhere in the system. When there is only one entity putting water into the system it is quite clear that the water that ends up certain customers will have used a certain amount of the infrastructure, not so clear when someone else is putting water into it. So we argued quite strenuously that there were good grounds for suggesting that the standard user price should be the one that applies to all of the water put into the system by Albion. However, early days, I think this is really the first time up for common carriage in the water industry.

THE PRESIDENT: Yes.

MR. TUPPER: We were persuaded that in fact a second tariff should be provided to Albion for any of their customers that would fall into the category of.

THE PRESIDENT: Of large users. Yes, thank you.

MR. TUPPER: So the two new elements concern delay and we would argue that truly is a new element because it certainly is not given any focus of any kind in the amended Notice of

Appeal and then we have the switch from remittance to replacement, and the Tribunal will know that there is a quantitative, qualitative difference between remittance and replacement.

We were fortunate that Albion focused on this itself in the amended Notice of Appeal and if you go to paras. 12 and 13 they set up their case on the basis of we are only asking for remittance and therefore we actually do not need to prove a great deal. All we need to do is to throw up some dust so long as there is at least the possibility that there has been an infringement and the Tribunal would be entitled to remit this to the Director General.

It goes on, in fact, to cite Freeserve and in fact in a way which probably I would struggle to match in terms of eloquence makes the case that I make now, which is if you are asking for replacement you have to do a lot better than Albion has done.

So in simple terms, to the extent that Albion was getting cold feet, as regards its original Notice of Appeal, what it should have done is to move the course in accordance with the rules, which are absolutely crystal clear – the rules set out in the Competition Act, so they are not just ones merrily and gaily introduced as a result of some views concerning appropriate procedure. There is no doubt that Thames's position is now very different from the one that they faced from the amended Notice of Appeal.

We were extremely grateful to the Tribunal for suggesting in a letter that was sent on 19th June that a skeleton is not a pleading and so therefore, in real terms it is a phantom, it does not exist. That is basically the way that we would like it. To the extent that, as a phantom, it does exist we would like it to exist for all of the withdrawals, and I think that that is probably fair, actually, because if they are going to withdraw certain arguments then regardless of whether or not they do it in the skeleton, or they do it in a letter, they do it by settlement, I think a withdrawal is a withdrawal, and I think they have conceded those points in an absolute way and therefore they are gone.

So at a minimum we would ask that the Tribunal state that as regards arguments today they must, and can, and only will focus upon what is left of the amended Notice of Appeal.

THE PRESIDENT: Do you have a position, Mr. Turner, or not?

MR. TURNER: Yes, we do. It is much as set out in our skeleton. We say that there are four respects at least in which new issues have crept in. I will briefly explain our position. We say that the attack on the pre-2002 price is new. If you have the amended Notice of Appeal there it is quite true that para.9(1)(a) introduces the point in general terms. Similarly at the back end of the pleading, at para.70, p.22, having repeated the issue on price, the first sentence says "The basis for this ground of appeal is set out at paras. 44 to 50 above." So those are the operative paragraphs. When you go back to those paragraphs, and in particular if you go to para.48,

which defines the complained of access price, you have there the incumbent's quoted access price being 27p per cubic metre for domestic customers, and 13.6p per cubic metre for large customers, and then a reference to how these have subsequently been increased outside the scope of these proceedings. From that, and from the table, or bar chart which you also see in para.49 everything that we had seen and responded to proceeded on the basis that it was the set of revised prices after 11th January 2002, which were the target of the amended Notice of Appeal. It was against that background we were startled by the consistent approach in Albion's skeleton argument where throughout the only reference to what the complaint is – 11(1)(a) is a good example (we have given all of the references in our skeleton at around about para. 21 ---- All of the references are consistently to Thames' provision of the original price offer of 27 per cubic metre as being plainly abusive, and the attack being upon the Director General for having failed to find that that was the case. That, indeed, was also the thrust of the Section 47 letter sent on 25 April, 2003 by Albion.

So, pausing there, whether you say that this is a radical shift in emphasis, or it has crossed the line and it is a new point, either way, in practical terms the centre of gravity of that part of the case has certainly moved. That is price.

So far as delay is concerned, there was no reference anywhere in the amended Notice of Appeal to the issue of initial delay and provision for an access price constituting an abuse.

THE PRESIDENT: This is the initial four months, is it not?

MR. TURNER: This is the initial four months between June 2000 and October 2000 when no price was provided. You will search in vain within the text of the Amended Notice of Appeal for any reference to that being one of the grounds.

The relevance of para. 36 of the Amended Notice of Appeal in this connection is that it appears in a section entitled 'Narrowing the Scope of the Appeal'. In that section Albion sets out a number of matters which it says are not the subject of the appeal. At para. 36 there is a reference to Thames Water's original refusal to give Albion an access price for large users. It says, "It is true that this was a clear case of discrimination". That was the characterisation in law given to the point, but reading that paragraph as a whole, it appears to put down a marker that Albion believes that Thames Water's delay was excessive, but that it does not propose to challenge it within this appeal – or, at least that is how we have read it. At all events, you will find nowhere else in the amended Notice of Appeal any reference to the delay point, other than what seems to be by way of a disclaimer there.

The third point which I concede could be treated more as a matter of emphasis rather than amendment is the issue of payment for water which is surplus to the requirements of

Albion's customers, or the question of whether whatever access price is arrived at, credit should be given against that in relation to the totality of all of the water introduced by Albion into Thames' system, including therefore the water which is intended for the customers. The Amended Notice of Appeal appeared at all the relevant points – and I will just give you the references 9(1)(b) ---- 9(1)(b) you see refers to the substantial additional water resources to be made available. It seems to be in general terms. 58 to 66, which comes under the heading 'The Benefit to Thames Water of the New Resource', and all of the argument of which is in terms of the totality of the resource throughout that section. Then, 71 to 77 (if you turn to p.23) - you will see that this is set out as the second ground of appeal, and that throughout that section again the reference is entirely to the totality of the water resource which is introduced. However, when you come to the skeleton argument all of the emphasis comes back the issue of the surplus water – water that was surplus to the requirements of Albion's customers.

THE PRESIDENT: Is that 9(1)(c) of the original Notice of Appeal?

MR. TURNER: 9(1)(c) of the original Notice of Appeal is dealing not with the giving of credit for surplus water – in other words, a payment is due – but a complaint that Thames was seeking to recover costs in relation to the surplus water and that, indeed, if you turn to para. 23 of Albion's skeleton (p.9) you will see there, in the parenthesis beginning on the third line, "It appears to be common ground that no such balancing service that has to date been identified as required in this case so that Albion does not pursue that part of the appeal".

THE PRESIDENT: You were going to give us some references to contrast the skeleton argument?

MR. TURNER: I have given you the Notice of Appeal references. If you turn then to the skeleton, para.11 on p.5 is where Albion sets out what it says are its core submissions and its principal complaints. You will see there that at 11(2) the reference now is back to 'Overs and Unders'. Then, throughout (we have given the references in our skeleton) the references include – 75(1) is a good example – a complaint about the surplus. You will see there that Albion says at p.22 that it has a twofold fundamental submission. 75(1) is the complaint that any surplus water provides an obvious benefit, and then 75(2) comes back to the totality point which we have seen in the Notice of Appeal. So, there is an explicit distinction drawn by Albion – recognition that there are two points there. But, the point which it says is its principal submission is the over-supply point.

THE PRESIDENT: Credit for over-supply.

MR. TURNER: Credit for over-supply. That is something which simply was not there in the Amended Notice of Appeal. That is the third point. (After a pause): Just to give you an

additional reference, paras. 18 to 23 of Albion's skeleton contains the development of the case on surplus water.

THE PRESIDENT: If you go to a paragraph like 7(6) in the Notice of Appeal, is that not talking about surplus water?

MR. TURNER: No. If you go down to the sentence beginning on the sixth line, "Given Thames Water's substantial supply deficit, it is obvious that the totality of such additional supply should be taken into account as a benefit to Thames Water". What we are talking about there is not supply which is additional to that required by Albion's customers' it is the additional supply to Thames' other resources. You will see it follows on from para. 75, so that in context you will see that the target is the elementary question of whether an additional significant supply of water in total provides benefit.

THE PRESIDENT: So, what you say in the Notice of Appeal, arguing that the benefit is the new supply – the totality of the new supply – and not just what is left over when they have supplied their particular customer.

MR. TURNER: Yes.

THE PRESIDENT: Paragraph 73 of the Notice of Appeal seems to imply that the Director was just looking at the surplus.

MR. TURNER: Yes. There was a complaint that we had wrongly limited the consideration to surpluses, but not a complaint that surpluses should be valued and credit should be given. That is the precursor to moving on to the complaint that the totality of resources introduced deserves a credit to be given against it. At all events, I draw this particular point to the Tribunal's attention because when you look at all of these provisions there has been a change in emphasis at the very least. It is true that if we go through with a fine tooth comb we can try to pick out bits and pieces, but the change in emphasis is clear. For our part, provided that explanation is given by Albion for the change of emphasis, we have signalled that we will deal with it, and we are content to deal with it. Our concern is to point out this clear change to the Tribunal, and also to draw attention that the requirements of the Rules should be obeyed.

Two other points came in with the skeleton argument. At paras. 38 and following of Albion's skeleton we have a Head of Complaint which does not follow through into any claim for relief about lack of adequate reasoning in the original decisions. That was something that also was entirely absent from the Amended Notice of Appeal. It is not an attack on the Section 47(6) refusal to vary or withdraw the original decision. It is an attack on the adequacy of the reasoning in the original decisions which has come in in the skeleton. Allied to that, at

diverse points throughout Albion's skeleton, there are procedure attacks on the Director General in relation to what is described as a shambles in his handling of the investigation.

THE PRESIDENT: You say, do you -----

MR. TURNER: -- that para. 34 of the Amended Notice of Appeal in that connection ----

THE PRESIDENT: -- made it perfectly plain they were not going to take a point on that.

MR. TURNER: They expressly said so. Now, I do understand that for forensic purposes it may be convenient to attack the Director General, but the question arises, first, "Where does it get any of us?"; and, secondly, "Is it an issue in the appeal?" We say it is not an issue in the appeal, and this is not some form of investigation into the Director's processes more generally; it is an investigation into the issues raised in the Notice of Appeal. So, we do resist the change of direction to attack the Director on the procedural issues. So in summary those are five significant developments.

THE PRESIDENT: Just list them for me again, Mr. Turner?

MR. TURNER: First is the attack on issues relating to the pre-January 2002 price. The second is the initial delay in providing any indicative access price.

THE PRESIDENT: Yes, that is the four month delay.

MR. TURNER: The four month delay. The third is the bringing to centre stage of an attack on oversupply, failure to give credit in relation to supply beyond that required of Albion's customers.

THE PRESIDENT: So credit for surpluses.

MR. TURNER: Credit for surpluses. The fourth is inadequate reasoning in the original file closure decision, and the fifth is the series of attacks made on the Director General's handling of the investigation. Our position is that in relation to the over supply versus the totality point we are certainly happy, provided an explanation is forthcoming for our part for that to be regarded as a change in emphasis which falls however within the ---

THE PRESIDENT: Well it might be a limitation on the original argument, we do not know

MR. TURNER: It could be regarded as such. For the others we think it would be wrong to ignore the fact that there has been this significant development. It must be acknowledged, and that in large part it does amount to an amendment of the pleaded case, if these are the points which are now in issue.

So far as the remedy is concerned, we for our part do not take the point. We day that you must decide this appeal by reference to the ground set out in the notice. The remedy that you may impose is a matter for yourselves, however, on a practical note, as opposed to

a jurisdictional note, Thames in our view make a fair observation but so far as they are concerned the ante was very significantly upped by the sudden decision to ask the Tribunal to make an infringement decision against them.

THE PRESIDENT: I think our existing case law tends to say that (a) we would need to have all the material that we would need to make such a finding; and (b) that we would need to make sure that every aspect of procedural fairness had been properly observed.

MR. TURNER: Sir, those are our views on what amounts in substance to amendment.

THE PRESIDENT: Thank you. Yes, Mr. Thompson.

MR. THOMPSON: Good morning, Sir. I obviously have submissions which I was proposing to develop in due course. I have been listening carefully to what Mr. Tupper and Mr. Turner have been saying. As I understand it, there is a protest of change of position but no actual objection to the issues being raised of the pre-January 2002 price and the overs and unders issue, so if in fact there is no objection to those matters being argued, and since they are the two principal points that we wish to argue, I am not sure how long I need to be in replying.

THE PRESIDENT: I think Thames is objecting to the pre-2002 price being raise, if I have understood Mr. Tupper.

MR. THOMPSON: I understood that he was saying that ----

THE PRESIDENT: Let us see what he says.

MR. TUPPER: Sir, I think that probably our position is this, we are happy to have a discussion as regards both prices because we can concede that in line 1 they do just talk about price generally. However, not on the basis that there will be a replacement, because to the extent that this Tribunal is minded to replace the Director General's decision with a fresh decision then at that point we would say we have not had sufficient opportunity to brief this to the kind of level and extent that we would have briefed it if there was any danger at any point that the Tribunal might decide to do that replacement. However, if this is a remittance issue, one that could be sent back to the Director General, we are happy to defend both prices, they are both easily defended and we are happy to do that, but if it is remittance only then fine.

THE PRESIDENT: If remittance issue, no objection to both prices.

MR. TUPPER: Yes.

THE PRESIDENT: And that is your position too, is it, Mr. Turner – or what?

MR. TURNER: In relation to the over supply, as I say ----

THE PRESIDENT: No, we are just on the first price at the moment, the pre-2002 price.

MR. TURNER: Our position on that is, having thought about it quite carefully, actually quite a lot of the same conceptual issues arise, so in a sense it seems idol to contest the point, but we do

say, as a matter of strict principle, there is a change, there needs to be an explanation and, ideally, an amendment.

THE PRESIDENT: Yes, thank you. Just in terms of formality, Mr. Thompson, because we have to be careful that we do not use the stage of skeleton arguments to go outside the four corners of the original Notice of Appeal, can you just take us to the bits of your Notice of Appeal that you say raise, or put in issue this first price ----

MR. THOMPSON: Yes, I should say, of course, by way of background that the Tribunal will bear in mind how this pleading came into being from our point of view, as well as from the other side's point of view, but at para.5(2) you will see reference to the s.47 letters, it is the third and fifth lines, where those are specifically there. If you turn into the bundle you will see what those letters were and what those issues were about, and that is at tab 6 of bundle 2.

THE PRESIDENT: Do you have a page?

MR. THOMPSON: If you look first of all at p.77, this was the first letter from Mr. Jeffrey to Ofwat after the original March 2002 letters, and if you look under the heading "Complaint 1",

> "I do not regard the production of a large user tariff alone as justification for not acting on the wider issue of price, the figure of 27p originally quoted. Our assessment was significantly lower."

Then if you turn over the page, "Complaint 4" ----

PROFESSOR PICKERING: Sorry, which page?

MR. THOMPSON: Pages 77 and 78.

PROFESSOR PICKERING: Thank you.

THE PRESIDENT: But then he goes on to say: "… happy to accept that no further work is justified if he is able to confirm …" etc.

MR. THOMPSON: Exactly. I think that is the point that Mr. Turner took against me in his defence about the price going forwards. Then on p.78 the first paragraph under complaint 4:

> "I find it difficult to accept your conclusions on this complain in the light of Ofwat's own access code guidance, which requires the method of charging for over and under supply of an entrant to be symmetrical."

THE PRESIDENT: We will come to over and under supply in a minute, but okay, right.

MR. THOMPSON: Then those points are developed in the subsequent letters referred to, ps. 83 to 86 which is the detailed complaint about over and unders, and in relation to price the detailed complaint was at p.92 of that bundle, so if we stick with price that is at p.92.

THE PRESIDENT: Yes.

MR. THOMPSON: You will see the essential complaint under 1 and 2 in fact was the 27p price. Dr. Bryan said

> "It took over a year to receive the revised price from the date of our complaint, during which time my company was prevented from competing with Thames in the relevant market."

And then the same complaint is made under complaint 2.

THE PRESIDENT: Yes.

MR. THOMPSON: Then at 83 to 86 one finds the lengthy complaint in relation to overs and unders, unfortunately the pagination has gone wrong, p.84 and 86 are the wrong way around, and so the end of the letter comes on p.84, and p.86 is in fact the second page of the letter. I do not think we need to go into that in detail now, but the whole issue is about the overs and unders issue. I think one can see that summarised at the top of p.86.

THE PRESIDENT: Yes.

MR. THOMPSON: So those were the two complaints as they appeared. You may remember at a case management conference last year I think you, Mr. President, referred to the fact that a letter had been written by Dr. Bryan setting out a large number of complaints which formed what I think the Tribunal indicated were the basis for a Notice of Appeal. We then sought to boil those down into their essential components, and that is what appears in para.9, and it is really 9(1)(a) and (b). We say that 9(1)(a) is a general complaint about both excessive pricing and margin squeeze, setting prices at a level that made it impossible for a provider of water resources and treatment services that were reasonably efficient, and equally more efficient than Thames Water to compete with Thames Water, and the Tribunal appreciate that this is a case, as it were, about intermediate supply, so we are not talking about consumer detriments. The competition detriment was precisely the inability of Albion to enter the market and we would say that in that context excessive pricing and margin squeezing come to much the same thing. So we would say that that was what that complaint was about and likewise 9(1)(b) was essentially the over and unders issue, although we would accept that in this pleading we sought, as it were, to generalise the point in order to raise points of general interest, whereas it is true that in the skeleton argument we have sought to focus down on the two core elements of complaint, but we would say that there has been no straying outside the scope of 9(1)(a) and (b) and that anyone would have seen that these were the core elements, if one had looked at the administrative history of this case.

THE PRESIDENT: So the core elements of complaint now are the approach taken, well let us just ----

MR. THOMPSON: If I give you just a very brief chronology of what happened, there was a complaint at the end of 2000, about Thames's failure to produce any price, and then there was a complaint at the beginning of 2001 that the price that was eventually produced, the 27p, was too high. That was the subject of investigation by Ofwat throughout 2001 and at the beginning of 2002, under pressure from Ofwat Thames dropped its price to 13.6p and then in March 2002 Ofwat took a decision in relation to the overall complaint, including delay, price and the overs and unders issue. Our point in relation to price is that our complaint, both in the original complaint and the Notice of Appeal was not limited to the eight weeks from January 2002 to March 2002, we say that it was obviously implicit, if not explicit, in our case that our complaint about price was for the whole period from the end of 2000 through to the beginning of 2002. Likewise, although in the amended Notice of Appeal we took the general point that it was necessary to give credit for water introduced into the Thames System, the underlying point about overs and unders was still there in the form of the original letter and, indeed, as a matter of commonsense there is obviously a different analysis where Albion is being paid for water by its own customer, which is where the water is going into the Thames network and then being used by a third party from where the water is entering the Thames' network and then is simply available for Thames's own use. All we say we are doing in the skeleton argument is addressing those two aspects of this same issue, but the general point is that Thames should give credit for the water that enters its system, and it may give more credit where it is available for itself.

THE PRESIDENT: What are you saying on that latter point, that they should give credit for the water that is surplus to your customers' requirement, or that they should give general credit for having more water?

MR. THOMPSON: We are saying that they should give general credit, but it may well be that they should give more credit where they are getting all the benefit of the water, whereas we should perhaps take account of the fact that we are being paid, and so we see it as a two-limbed analysis, and that that is why we have put it as we have done in our skeleton argument. But we would say that the underlying issue was giving credit for the benefit of having a constant introduction of water into the Thames System, so we have tried to refine the position in our skeleton argument to make it more precise, and to take account of the administrative history of the case.

THE PRESIDENT: Given that after 2002 and since 2002, you have had an offer of 13.6p, what is now the benefit of the Tribunal going into, whether the original offer of 27p was or was not excessive or abusive, or whatever, is that now not really ancient history?

MR. THOMPSON: Well this was the subject of discussion at the February 2004 case management conference, and we have obviously thought carefully about the submissions we made there, and the difference between something being historic and something being academic which, I think, was discussed after some questions from Professor Pickering and we would submit that we are entitled to seek a ruling in the unusual circumstances of this case where the Director has, in substance, made an investigation, sought a remedy and taken a decision and we say that the decision, as taken, is inadequately reasoned, and that he should have concluded that there was an abuse here, and when one looks at the decision that was taken, and the case law of this tribunal about what options are available to a decision maker in circumstances of this kind, then we say that there is a sufficient factual material here for the Tribunal to reach a conclusion about the nature of that decision and whether or not it was correctly taken; and that there is a clear commercial interest on my client's part in seeking a ruling on that issue.

THE PRESIDENT: Yes. What about the delay issue, which the respondents say was not really raised in the Notice of Appeal, which really disclaimed ---

MR. THOMPSON: Yes, I accept that there is an issue about delay. The way we have put it in our skeleton argument, if I can find it, is at para.13(3). We say that this initial abusive price was only provided ----

THE PRESIDENT: Yes, we have read it, thank you.

MR. THOMPSON: It is the words in the second sentence, in brackets "(or that there was a single abuse from the date of the original request up to 11th January 2002)". This is a point which, as it were, similar to the point that Mr. Turner takes against me in relation to procedural shambles and delay on the part of the Director. We say that, at the least, the issue of delay is relevant to the overall question of the excessive pricing. We did not formally abandon the issue of delay, indeed, we said in the paragraph that Mr. Turner has referred you to, that we considered that the delay issue is excessive. However, it is true that it did not form part of our para.9 specific statement in the Notice of Appeal, so I am content to proceed on the basis that the delay is no more than a factual issue which was clearly before the Director and taken into account, if on the strict reading of the amended Notice of Appeal it be found that the issue of delay was not really before the Tribunal and so to that extent I would concede that the issue of delay as a free standing form of abuse was not fully argued in the amended Notice of Appeal.

THE PRESIDENT: Yes.

MR. THOMPSON: I think those are the points that arise, apart from the issue of remedy.

THE PRESIDENT: Just a moment, and the same applies to procedural issues?

MR. THOMPSON: If there is a misunderstanding about the Notice of Appeal, the Tribunal will bear in mind the grounds on which complaint can be made about a decision, we think we are fully entitled to challenge the reasoning and to raise the issue as background against which the Tribunal reaches its conclusion on the merits or otherwise of this appeal, but we do not take it as a free-standing form of challenge, and so the position in my submission is essentially the same as in relation to delay.

In relation to remedy ----

THE PRESIDENT: What about reasoning, which was the other point I think Mr. Turner made, inadequate reasoning, in the original Decision?

MR. THOMPSON: I find that slightly difficult to understand because the whole basis for the grounds for contesting the Decision is errors of factual and legal analysis and so we do not see that as a separate matter that needs to be considered.

In relation to remedy, we understood Mr. Turner to take very much the same approach as we took. We thought that having narrowed the scope of the appeal we were entitled to make the submission that we make at para.87 of our skeleton argument, that if one takes the case on the narrow basis that we have argued it in the skeleton argument, then the position is sufficiently clear for a ruling to be made. But, I would agree with Mr. Turner that essentially this is a matter for the Tribunal once it has formed a view of the merits, or otherwise, of the case. Likewise, I would not want to shut Thames, or Mr. Tupper, out in a way that prejudiced them. Obviously, in one sense they are benefited by our seeking a positive ruling in that we have raised the high jump bar for ourselves. So, we would not say that there was any prejudice to Thames from our seeking a positive ruling. In a sense it gives them additional protections. So, we would not say there was any need to change the process that is followed now to deal with the issue of remedy, which, of course, is a matter that effectively comes at the end rather than at the beginning of the appeal process.

THE PRESIDENT: Thank you. Do you want to come back on that, Mr. Tupper?

MR. TUPPER: Just very briefly, sir, because I think it has obviously been well-briefed, and I think that the Tribunal can make a decision, but this idea of a high jump bar, as if this was some kind of Olympic sports, does leave me somewhat cold. To suggest that this is now just something that can be changed in terms of its character and nature in this way, with a wave of a hand, is somewhat shocking. We would have addressed all of these issues in a very, very different fashion if we felt that Albion was pushing for something other than remittance. He has raised his high jump bar at a time when he was not entitled to do so. He has adduced none of the

evidence that he suggested would need to be adduced in order to make any of these cases. Procedurally, it is scandalous what he is attempting to do.

(Short break)

(See separate transcript for Ruling)

THE PRESIDENT: I think we can now proceed to hear the argument in this case.

MR. THOMPSON: I am grateful, Sir. It is an introduction I have made before but the circumstances are similar in that I see myself as representing a David as against not only one but two Goliaths, and I think in those circumstances the tradition is to arm yourself with five smooth stones and set out the best one can. So I have five submissions.

First, relating to the nature of the March 2002 Decision, secondly, the s.47 application in respect of price, thirdly the s.47 application in relation to additional resources, and then two rather smaller pebbles, the issue of remedy which I think has now been addressed.

THE PRESIDENT: I do not think we want to hear anything on remedy at the moment, Mr. Thompson.

MR. THOMPSON: Fine, and then the other is the issue of Thames's points insofar as there are specific points raised by Thames. Before I start on that, if I could say by way of introduction, we do say and it is a matter we set out in more detail in our Notice of Appeal, that this is a case of importance in that it relates to a potentially important source of additional water for London. Albion had a coherent commercial strategy to use that water and Albion contends that Thames's conduct in this case had the effect of preventing competition in the London market, and we say that there are two issues that we now seek to pursue. We say that the Director's Decisions in March 2002 and then in April 2004 were incorrect and inadequately reasoned, and in relation to price they would act as an obstacle and in relation to any further private proceedings that we might want to take on that matter, and secondly, in relation to the issue of credit for new resources we say that that is a live issue which is of general importance, and that is a matter that I have said before in various fora when this matter has been before the Tribunal.

I will not say any more about the narrowing of the case and the pleading points, since those matters have already been dealt with. We say that the underlying issue in relation to the Competition Act has some similarities to those which I raised in the Shotton Appeal. Albion's perception is that the Director has adopted a regulatory stance of what might be called

"masterly inactivity" based on acceptance of Thames's assertions at face value, a piecemeal analysis without sufficient considerations of the implications of its rulings for the market as a whole and various procedural strategies which have been calculated to avoid challenging this Tribunal. Likewise we say that it has been a slow and reluctant regulator which has made it difficult for a new entrant. Indeed, we say that in some respects it appears to have been more rigorous in defence of its own Decision and the protection of Thames than it was in relation to the development of market competition. So we say that those are serious questions of general importance and these specific issues arise against that background of which we complain.

Thirdly, by way of introduction, in relation to two factual l issues the Tribunal will have seen reference to the stance of Pennon, Albion's predecessor's former parent company and what its position is in relation to water competition. That is a matter that appears at the end of the skeleton argument of the Director in the form of two emails. I think I can take that quite shortly by reference to the emails themselves. There is one dated 19th May, 11.45. They confirm that they hold a leasehold interest. "The interest being retained in the event that there is any value to be derived from selling the sites to a third party which may or may not be the Applicant", that the projects have now been fully costed, and so I think the essential position is that the matter was provisional and there is no specific linkage to my clients, and then that is said again, if one turns through there is an email from Mr. Woodier dated 8th June 2005 – it starts: "Beryl, sorry for the delay".

THE PRESIDENT: Yes.

MR. THOMPSON: Then there is a 20 per cent. pre-tax "would have been Pennon's hurdle rate for approving commercial projects." Then point 2, I think is taken, "Pennon never made any linkage between the Bath House Appeal and retaining interest in the site. Our purpose was to realise any potential in the acquired interest following the dissolution of the JV." It says:

> "As it stands we have not relinquished or disposed of our interest in Bath House at this time and therefore it is conceivable that Albion Water could be interested in acquiring the interest."

Our position on that is that Pennon held 50 per cent. of the shares in Envirologic up until May 2003, and had two senior directors on the Board of Envirologic, but it has held on to these rates, and there is no obvious other third party who would stand to benefit, so that although in principle what is said there is true, our submission is that the reality is that we are the likely beneficiary of their retaining that interest and, in any event, in relation to issues of competition we say it is irrelevant they are holding it for us as against an other potential competitor.

The other point that is taken by way of fact relates to a visit we made in the Hammersmith Hospital, and that appears at the end of the Thames skeleton argument I think in the form of a letter. It is a letter from Thames dated 10th June to Mr. Aitken. I think one can take this quite shortly, there is a chronology set out at the bottom of the first page and the second, saying that there are a number of occasions over the period where the bore hole has failed to operate effectively and so that Thames has had to come in as the supplier of last resort, and I think this is probably put forward as a sort of marker or possibly prejudicial remark in relation to the reality of this case. We say in relation to that that in fact, just to complete the picture, our understanding is that the borehole is now fully operational and has been since the start of June. Our understanding is that the problems with the boreholes at Hammersmith are essentially related to the pipe work between the boreholes and the hospital including the internal pipework at the hospital. The Albion Yard and Bath House we do not understand there to be a problem with the borehole itself, I think there has been some problem with the treatment works, but the borehole itself as we understand it has provided a constant potential source at least of water. We further say that Albion Yard and Bath House, in this respect at least, are simpler projects because the treatment works in those cases would be adjacent to the source so that there would not be the same problems that have prevailed at Hammersmith, but it may not be very central to any issues in the case in any event, but that is our position on that.

THE PRESIDENT: The letter of 10th June states Thames's understanding that as at 10th June they are still supplying the hospital from their mains?

MR. THOMPSON: Yes, my information is that that is not correct, and that since the beginning of June the water has been back on. I do not know whether Thames can confirm that.

THE PRESIDENT: Somebody can perhaps confirm that at some point – it is a factual issue that must be capable of being resolved.

PROFESSOR PICKERING: I do not know whether Mr. Tupper wanted to answer the comment about Hammersmith because ----

MR. TUPPER: Just to assure the Tribunal that it is all based on billing information and we should be able to obtain billing information and provide it hopefully by lunch time.

THE PRESIDENT: Thank you.

PROFESSOR PICKERING: Mr. Thompson, I wanted to ask you about the Pennon position on Bath House. You have commented that there was no obvious alternative beneficiary to Albion but then, as I heard you I think you went on to say but even if you did not become the beneficiary that was not relevant in relation to this case, but it does seem to me that if Albion does not

actually have a stake or an intention or if Albion is not moving to develop the se alternative sources of water supply, then I do wonder in my mind whether we are getting to a point where may be one has to ask whether you have a sufficient interest in the reality for the Tribunal to take these issues seriously. There is a competition policy issue about abuse of dominant position, but I do not think that that allows anybody to come along and say to the Tribunal "We are the upholders of competition" so therefore, presumably the Tribunal is entitled to ask some questions about the commercial realities and the possibility that there is (or has been) detriment to a genuine potential entrant.

MR. THOMPSON: Yes, I would not want to be misunderstood about that. My first submission was that we are the only identified likely entrant, so we are that person. All I was saying was merely that because Pennon says that in theory there might be somebody else does not undermine the relevance of this from a competition policy point of view. We are prepared to take on any other competitor it is just at the moment we do not see who it would be. We are the obvious person and so we would not accept ----

THE PRESIDENT: What are the circumstances exactly in which you would proceed with these developments? You have a price of 13.6 p per cubic metre, what is the obstacle?

MR. THOMPSON: You will have seen the record here.

THE PRESIDENT: 13.6 is still too high according to you?

MR. THOMPSON: There is the issue of credit for ….

THE PRESIDENT: There is the issue of?

MR. THOMPSON: The issue credit for our new resources. That is the point ----

THE PRESIDENT: Yes, I see.

MR. THOMPSON: That has always been the reason why this case continued, and you will recall the issue about the case study in that respect.

THE PRESIDENT: So if that were resolved in some way favourable to you, the commercial intention would be to develop these boreholes.

MR. THOMPSON: The whole issue is a question of price, you will appreciate, as to whether or not this is commercial viable. As I understand it there are a number of such issues and there are a number of boreholes, and the fact of the Hammersmith site indicates that at least in one case it has been thought to be viable. Obviously it is much more viable if you have a general policy and if you have a number of boreholes where you can spread your investment, but our case is that we have made significant investments in this, we do take it seriously, and we have taken the trouble to come to this Tribunal because of that.

THE PRESIDENT: The significant investment being the investment in the case you mean, or ----

MR. THOMPSON: The investment in time pursuing it, both originally and in trying to keep this matter open as best we can pending a resolution of these issues in our favour in the competition forum, and we regard that as crucial, as in other areas, to being able to take forward competition in this market.

THE PRESIDENT: But it is essentially the credit issue that is the ----

MR. THOMPSON: Yes, that is what has driven this Appeal from the start and you will recall the history of it.

THE PRESIDENT: So it is not actually the 13.6 p per cubic metre in itself but the question of the credit either for the totality or the surplus.

MR. THOMPSON: Yes, that is reflected in the historical record. I showed you the August 2002 letter, which focused on the question of the overs and unders issue, and then once the procedural position was made clear and this was published as a Decision in March 2003, Dr. Bryan wrote, and I have shown you that as well, where he did raise the question of the 27p as the core complaint in relation to that Decision going back in relation to price. So I should make it clear, and I think my skeleton argument should have made that clear, that as far as these proceedings are concerned and the question of abuse are concerned, we have now decided to limit our case to the first access price, and we are not pursuing the second limb that the Tribunal identified in these proceedings, given that the original decision was taken in two letters in March 2002 in relation to Thames having lowered its price on 11th January 2002 and so we are focusing on the historic position as at the date of those Decisions.

THE PRESIDENT: So when you say you are not pursuing the second limb, you are not pursuing the 13.6?

MR. THOMPSON: Yes, in these proceedings.

THE PRESIDENT: In these proceedings. I do not think anyone is actually contesting your standing to challenge the 27p per cubic metre price originally, but that is part of the historical background. Professor Pickering's question was directed to, "What is the actual commercial reality as of now?" Your reply as of now is – I think this is your client's view – that it is still commercially viable at 13.6 pence per cubic metre if the credit issue can be sorted out.

MR. THOMPSON: Yes. I mean, the credit issue is essentially a very large amount of money. It is a question of how much credit is due. If it is the long-run marginal cost, then it is of the order of 45 pence, and we would actually have a negative price. So, the commercial issue is not insignificant in relation to new resources.

THE PRESIDENT: Hammersmith, of course, has the advantage that it does not have to pay any common carriage charge.

MR. THOMPSON: Indeed. The unhappy position at Albion Yard is that there is an underground line between the obvious customer and the bore hole so that we have the pleasure of negotiating the Thames about getting the water to the customer.

PROFESSOR PICKERING: Could I just ask, Mr. Thompson, as I recall, at several points in the various bundles of correspondence, Thames have made it clear that they remain ready to discuss with you an appropriate arrangement in relation to Unders and Overs. Have you pursued that with them?

MR. THOMPSON: Sir, we can go into the documents, but the position is that they will only give a credit if there is, above any fluctuations, as I understand it, a constant surplus. Our point is that if we are putting in a constant amount of water we are entitled to credit for that constant amount of water, either in totality or deducting whatever water is taken out. But, the basic point is that they are receiving a constant amount of water and any suggestion that they are not, and that they are only receiving a fluctuating amount is actually a misunderstanding of the situation. What we are not at the moment in the business of doing is having a customer who only wants a quarter of a mega-litre of water, and producing water at, say, five megalitres of water out of the well so that we would have a massive constant surplus. We are not in a position to do that – to act, as it were, as a water trader on a large-scale. Our business is essentially water retail, or water resources and retail, and that is why the common carriage issue is of importance to us. We wish to effectively engage Thames to carry our water to our customers, but we think we should have credit for the water we put into their system. I do not know if that has answered your question.

PROFESSOR PICKERING: Well, I am not sure that it has, because it is not clear to me – but either you or Thames, or both of you might want to comment on this. I have read the papers as indicating that there is a willingness on the part of Thames to explore the basis of these relationships with you. I have not seen any evidence that Albion has taken this forward. I may be wrong – and please correct me if I am wrong - but if not it seems to me to be a pertinent point. The second thing is that presumably the simple non-engineer might well say that presumably if you have a client who requires – and you believe it to be - a stable quantity of water, then why not put into the system just that stable quantity of water so that there is no issue about unders or overs at all. If you guarantee your level of supply to match the level of demand from your particular customers, then notwithstanding Mr. Tupper's comment about it being different molecules (which is neither here, nor there), if supply and demand are in balance, why are unders and overs an issue? Is that not a way around this?

MR. THOMPSON: I have tried to explain. I think in broad terms that is correct, but in reality because you are not directly linked – it is not like Hammersmith where you are simply paid for whatever water comes out of the ground, and then Thames comes in from time to time. You are, in reality, putting in X amount of water (say, 1 mega-litre a day) in Albion Yard, and your customer is taking out a fluctuating amount, and it is not under our control how much water they take out. So, it is not a perfectly balanced system. Our complaint is essentially twofold: first of all, that Thames will charge us if our customer uses more than the, say, one mega-litre we are putting in , but will not give us any credit if our customer takes out less than the one mega-litre that we are putting in. We say that is unfair and abusive.

Secondly, we say that all our one mega-litre going into that part of the system saves Thames having to produce that one mega-litre itself, both in terms of transporting and pumping that water to that part of the system, and in principle that is a contribution to Thames achieving its regulatory obligations to have a certain amount of water available in order to discharge those obligations as the public water undertaker for London. So, that is why we are complaining.

PROFESSOR PICKERING: But, you also say that your putative clients are envisaging a stable demand for water.

MR. THOMPSON: Yes, it is broadly stable. That is why we say that the characterisation by the Director, simply writing down what Thames said – and you might say that Thames would not necessarily have a strong interest to encourage our efforts – is completely wrong. Indeed, in the Director's skeleton argument, the point that appears in the decision letter of 1 April, 2004, and is prominent in the defence about it being elementary industry knowledge that intermittent surpluses cause problems ---- I think I gave the example of somebody suddenly having water powering down on their head in the shower in Bishopsgate. That point appears to have been abandoned by the Director. That does not appear in his skeleton argument. So, that does not seem to be a problem. We say that the constant water that we are putting in should be credited.

THE PRESIDENT: Just on that point, Mr. Thompson, I think one can see where you are coming from as regards to surplus water going into the system, but if I may ask what is probably an idiot's question: if you are looking at the totality, if you get credit from Thames for that water, and also selling the water to your customer, are you not getting paid twice over effectively for the same amount of water?

MR. THOMPSON: We are doing two things: we are providing a benefit to Thames and we are providing a benefit to our customer. Our customer has no reason to pay for the benefit to

Thames, and Thames has no reason to pay for the benefit for our customer. So, in my submission, there is no reason why we should not get two credits. The hospital is using the water to drink or to treat its patients. Thames is having to use less electricity, or whatever, to provide the water for its system.

THE PRESIDENT: It is the sort of avoidable cost principle in reverse, is it not?

MR. THOMPSON: Maybe. Maybe. But, there are two benefits, and so there is no reason why there should not be two credits.

Can I now look at the issue of the nature of the March 2002 decisions, which is an issue which is raised, particularly by the Director in his skeleton argument? I think it has been accepted for some time that this is a valid Section 47 type appeal. But, in his skeleton argument, Mr. Turner characterises the decisions of March 2002 in a very particular way. It is really at paras. 33 and 34 of the skeleton, although it refers back to the decision letter of 1 April, 2004. You will see at para. 33,

> "The Director does not intend to argue before the Tribunal a decision to close the file on Albion's complaint about Thames' delay in offering it an access price is not an appealable decision, and inadmissible. Nor does the Director intend to argue before the Tribunal that the decision to close the file on Albion's complaint about Thames' initial access price of 27pence per cubic metre is not an appealable decision and inadmissible.
>
> "The Director's case on these matters is rather that he has a discretion not to pursue formal proceedings with a view to making an infringement decision (or a detailed decision of non-infringement), where this is a reasonable use of his resources".

Now, what I understand him to be saying there is that he made what I would call a Section 46 decision, but it was a decision in the exercise of a discretion not to pursue formal proceedings with a view to making an infringement decision, and that it was not a decision that the Chapter II prohibition had not been infringed. That is consistent with the wording of 1 April, 2004 letter which appears in Bundle 2 at Tab 1, p.10. Although I make nothing of the procedural shambles as a point of substance, you may recall that the 1 April, 2004 letter contains reasoning – it is a six page letter – which underlay the decision to reject the Section 47 application which appears, in fact, on p.24, dated 11 May. So, if you would just turn to that, you will see a letter dated 11 May which refers to my letter dated 1 April. So, formally, we are appealing against this rather short letter. The rather short letter refers back to the rather longer letter at pages 10 to 15. The point I am on now is a point that appears at p.12.

You will see that we are on the question of price – Complaint 2. The second main paragraph down:

> "From the terms of its letter of 25 April, 2003, Envirologic appears to believe erroneously that OFWAT has taken a decision that the Chapter II prohibition was not infringed by Thames Water's conduct in initially offering access to the network only at the higher tariff of 27 pence. In fact, we took no such decision. Once the conduct complained of had been resolved, the Director exercised his discretion not to investigate the matter further, and not to proceed to reach a decision as to whether or not the Chapter II prohibition had been infringed. This was a matter for the Director's administration discretion which he exercised properly and reasonably, having regard to the relatively swift resolution of the conduct complained of and the need to prioritise OFWAT's resources".

So, as I understand it, the Director's position is that there is a form of Section 46 decision which is of this character – i.e. a decision not to proceed. The point I am on here is that there is no such form of decision and that this must be taken to be a decision that the Chapter II prohibition was not infringed.

THE PRESIDENT: Well, if it was not a decision of that character, there is nothing to appeal.

MR. THOMPSON: Indeed, sir. So, the point I am on here is that the characterisation of the decision in this letter, and in the Director's skeleton argument is incorrect, and that this must be taken to have been a decision that the 27 pence price was not abusive.

It may be that the President at least is very familiar with this issue, and I can take it relatively shortly, but there are a number of points that I would like to make on the question, relating to the wording of the 1998 Act, and the case law of the Tribunal in relation to this issue. I think it can conveniently be found in the *Freeserve* judgment which is Tab 3 of the authorities bundle. We have put these authorities together ourselves. Can I just confirm this is 11 November, 2002 ----

THE PRESIDENT: There are various *Freeserve* judgments, and this is the admissibility one.

MR. THOMPSON: The relevant passage where the legislation is set out is at pages 21 to 23.

Paragraph 61 sets out Section 46(1) to (3), and then the relevant part is (3).

> "In this section 'decision' means a decision of the Director . . . (b) as to whether the Chapter II prohibition has been infringed ----"

And then there are various other forms of decision which largely apply to the Chapter

I prohibition, I think. Our understanding is that there is no such decision as para. 34 of the Director's skeleton argument suggests. So, that is an unpromising start for that submission from him.

The second point is that the Director himself does not seem to have taken this view at the relevant time, and one finds that in various places – first of all, if one looks at the first document in Bundle 2, Tab 1 ---- The documentary bundle, Bundle 2. It is the documents appended. One finds the published version of the decision dated 31 March, 2003, and if one turns over the page, in the penultimate paragraph on p.2,

> "The Director has concluded that the views put forward in a letter dated 8 March, 2002 to Envirologic and a letter dated 26 March, 2002 to Thames Water amounted to a decision that the Chapter II prohibition had not been infringed."

Then the two decision letters follow of 8 March and 26 March. The precise status of this summary document is maybe questionable, but in my submission one can see that this was not some mistake but was a deliberate public act concerning the nature of the decision. One can see that from the preparatory documents that led up to this publication which appear in Bundle 3, the defence bundle. I think at Tab 3 you should have the longest pile of documents called 'List of Documents' in chronological order, which is numbered 1 to 111. The relevant documents appear at pages 206 and following of that. This is the same letter we have seen already from Dr. Bryan complaining about the closure letters. Then, if you turn to p.209 you will see Dr. Bryan saying,

> "In the light of the Competition Commission Appeal Tribunal judgment in the matter of *Bettercare* and the DGFT, I am of the view that you have made a decision that Thames was not in breach of the Chapter II prohibitions of the Act. In fact, Thames seems to be of the view that OFWAT have made a decision".

So, that then set off a sequence of correspondence which you will find going through in the subsequent pages. So, at 7 August Miss Cooper says that they are considering the letters and will reply in due course. Then, on p.211 there is a more detailed answer, saying,

"In Dr. Bryan's letter dated 6 August, 2002 he said that he would consider the Director had made a decision that Thames was not in breach of the Chapter II prohibition …" and then the reference to *Bettercare* in the second paragraph. Then there is a reference to a judgment pending in the *Freeserve* case which the Director is awaiting. So, they then say that the judgment was delivered on 11 November, and "We are now considering its implications, if any, for your Section 47 application" and then an intention to reply by 25 November.

Then, on 13 December, Mr. Jeffrey writes a chasing letter at p.212. At p.213 Miss Brown, on 20 December says that they have been considering the impact of the Competition Appeals Tribunal judgment in *Freeserve*. I think something has got out of place in terms of the numbering, because if you then jump to p.231 you will see reference to a draft decision – that is, a letter dated 19 February, 2003. Then, at p.232 there is a letter, and the third paragraph down says,

> "I attach a revised draft Decision following comments we received from you and Thames Water. We intend to publish our Decision shortly."

And if you turn through to p.234 you will see in the last paragraph the draft says:

> "In the light of the judgments of the Competition Appeals Tribunal of 26th March 2002, 11th November 2002, on admissibility of *Bettercare* and *Freeserve* cases respectively, the Director has concluded that the views put forward in a letter dated 8th March, and a letter dated 26th March amounted to a decision that the Chapter II prohibition had not been infringed."

So that was the position leading up to the publication of the two Decision letters at the end of March 2003. We say that confirms that the Director's position cannot be right, and likewise at pages 239 and 241 you will find two letters from Ofwat to Dr. Bryan. 239 is a letter dated 7th April 2003 and the second paragraph refers to the publication in the first paragraph. In the second paragraph it says:

> "Following our publication we can take forward your application under s.47 of the competition Act requesting the Director to withdraw or vary his Decision that Thames Water had not infringed the Chapter II prohibition of the 1998 Act in relation to under supply and over supply."

Then two pages on in response to a short letter from Dr. Bryan in relation to the other complaints addressed in those decisions, on 16th April Miss Brown writes again to Dr. Bryan and in the second paragraph there is a reference to a

> "…s.47 Act application requesting the Director to withdraw or vary his Decision that Thames Water had not infringed the Chapter II prohibition of the 1998 Act in regard to four complaints identified in the letter we sent to you on 8th March 2002.

And so it is quite clear that the Director at that point accepted that he had made decisions in relation to all five of the complaints made by Albion and that that was the basis of the s.47 procedure being activated. When one looks at the position of how Thames and Albion understood it as being the principal, as it were, private parties interested in this matter. One finds that is confirmed not only in the s.47 applications that Albion made, but also Thames

appears to have taken the same view and one finds that in bundle 2, tab 5, p.37. It is the penultimate paragraph where Thames says:

> "We have provided Ofwat with all the information they requested in respect of the Competition Act 1998 complaint regarding Bath House and Albion Yard and they are satisfied that we have not behaved anti-competitively. They informed us that the file was closed on 26th March."

So that was Thames's understanding, so it appears that all three of the relevant parties – the Director, Thames, and Albion understood this to have been a s.46(3)(b) Decision, that the Chapter II prohibition was not infringed. The Tribunal may recall – I am sure the President will recall – the first water case with which it was concerned, was a case called *Aquavitae* where this issue was debated, and one finds that in the second bundle of authorities, tab 7. You will see that this is a judgment of you, Sir, and Mrs. Sheila Hewitt and Professor Zellick, dated 5th August 2003, and a certain identity of representation on the part of the Director, in that they were happy to have Mr. Turner and Miss Sloane representing them on that occasion. If one turns through the Judgment to para.131, there is reference there. It says: "In [the Director's] skeleton argument of 2nd April 2003" – just two days after he had published this Decision as a non-infringement decision in this case,

> "…the Director contends that his letter of 4 September 2002 and the associated correspondence cannot be fairly read as establishing that he has made a decision within the meaning of section 46(3)b) of the Act ' as to whether the Chapter II prohibition has been infringed'. According to the Director, the Tribunal's judgments in *Bettercare*, *Freeserve* and *Claymore*, cited at paragraph 5 above, are clearly distinguishable from the present case."

I refer to that paragraph simply because it is clear that the Director very much had this issue in mind at the very date on which he published this Decision as to the character of the Decision. So two days before he had published to the world that this was a non-infringement Decision.

If one then turns to the relevant principles I am sure that certainly the President has these principles well in mind, since he wrote them, the relevant paragraph is at para.174 on p.50. The points are set out in the form of three points under:

> "(i) The question of whether the Director has 'made a decision as to whether the Chapter II prohibition is infringed' is primarily a question of fact to be decided in accordance with the particular circumstances of each case.
>
> "(ii) Whether such a decision has been taken is a question of substance, not form, to be determined objectively, taking into account al the circumstances. The issue is: has

the Director made a decision as to whether the Chapter II prohibition has been infringed, either expressly or by necessary implication, on the material before him?

And then (iii) which is most important here:

> "(iii) There is a distinction between a situation where the Director has merely exercised an administrative discretion without proceeding to a decision on the question of infringement (for example, where the Director decides not to investigate a complaint pending the conclusion of a parallel investigation by the European Commission), and a situation where the Director has, in fact, reached a decision on the question of infringement. The test, as formulated by the Tribunal in *Freeserve* is whether the Director has genuinely abstained from expressing a view one way or the other, even by implication, on the question whether there has been an infringement of the Chapter II prohibition."

I think it is instructive just to look briefly at the facts of that case, which I think is the one case where the Tribunal has found that there was no decision, and that was a case where *Aquavitae* had deliberately not made any complaint, and one can find the principal difficulty in the case set out at para.187 of the judgment on p.53, referring to a letter of 7th September 2002.

> "The principal difficulty is that in his letter of 4 September 2002 the Director expressly states that he 'would of course consider any CA98 complaint on its merits relating to terms offered by companies', thus leaving open, or at least not precluding the possibility of the Director giving further consideration to the matter in the light of the specific complaint about particular terms offered by water companies offered in specific circumstances."

So there was a very striking difference between that case and the present case where there were not one but two complaints which had been investigated over a period of over a year and where a case closure decision had been made.

If I may I will take the Tribunal to one more, they are quite weighty and detailed authorities, the four cases that have been referred to, the *Aquavitae* case and then the three cases referred to in the Director's skeleton argument in that case, *Claymore*, *Freeserve* and *Bettercare*. They are all included in the bundles for the assistance of the Tribunal, but I think that the only other authority that is necessary to go to at this stage, is the *Claymore* case, because that specifically bears on the question of the borderline between the discretion not to make a decision and the making of a decision. The *Claymore* case is at tab 5 of the authorities' bundles. That is a judgment dated 18th March 2003, and so just before the decision was published in this case, and it is obvious from *Aquavitae* that the Director had considered this at

least by 2nd April, and then if one turns into the Judgment one can turn straight to p.39 where you find the analysis of the Tribunal at para.116:

> "The question in this case is whether the Director has made a decision 'as to whether the Chapter II prohibition has been infringed' within the meaning of section 46(3)(b). It is common ground that the wording of that section is wide enough to cover a decision that the Chapter II prohibition has *not* been infringed and that such a decision may be challenged by a third party under section 47."

The facts of that case are instructive, the principles are set out at para.122 at p.41 but the facts are instructive if one looks at para.125 over the page, it says:

> "In coming to this conclusion the director has not made a decision as to whether or not the Chapter II prohibition has been infringed."

So there was an express statement that there was no decision and likewise 126:

> "It is the Director's view that this decision does not constitute a decision as to whether t he Chapter II prohibition has been infringed."

But nonetheless the Tribunal found that there was such a decision and it is to some extent critical of the Director of Fair Trading's approach in that case. If one then turns on to paras. 158 and following, in fact, paras. 153, there is reference to a principal decision of the director that:

> "…a conclusion that there is insufficient evidence to prove an infringement does not establish that there is, in fact, no infringement."

Then the Tribunal considers that analysis in some detail and contrasting it to various other types of decision, and concludes at the end of para.155, for example:

> "Applying the appropriate standard of proof to the evidence that he has, the Director then makes a decision as to whether the evidence meets that standard. If it does an infringement has been established to the requisite standard of proof. If it does not, no infringement has been established to the requisite standard of proof on the evidence available. If the Director then takes as a decision to the latter effect, he makes, it seems to us, a decision 'as to whether the Chapter II prohibition has been infringed' within the meaning of section 46(3)(b)."

Then at paras.158 and following – I am conscious of the time, but it may be worth my while just making the ----

THE PRESIDENT: Well I think we are fairly familiar with some of this stuff, Mr. Thompson.

MR. THOMPSON: I am sure you are, Sir, it is ----

THE PRESIDENT: I do not know that you need take us through it in detail unless and until there is a submission that the whole appeal is inadmissible.

MR. THOMPSON: Well there does not seem to be, but there seems to be a rather nuanced submission that there is some other form of s.46 decision that either Chapter II prohibition has or has not been infringed, and obviously it is of some importance given the quality of the reasoning in the 6th March letter. If it was a decision that the Chapter II prohibition has not been infringed then in my submission it falls woefully short of the required standard.

THE PRESIDENT: Yes.

MR. THOMPSON: The point – just to conclude it – is paras.158 through to 164. there is a discussion of the relationship between the right to bring proceedings for judicial review of the exercise of an administrative discretion, and the right to bring an appeal in this forum. In my submission, the Director's submission at para.34 of his skeleton amounts to an attempt to bring back that distinction by some form of back door and my basic submission is that there is no such back door contained in s.46 of the 1998 Act. So to that extent the 1st April 2004 letter was something of an "April Fool" and there was indeed a decision made that the Chapter II prohibition had not been infringed.

THE PRESIDENT: If that is a convenient moment, shall we say five past two?

(Adjourned for a short time)

MR. THOMPSON: Sir, where we had got to is a submission that this was plainly a non-infringement decision, both in relation to price and in relation to credit for new resources, and our over-arching submission – if that is right, and it was, indeed, a Section 46(3)(b) negative decision – we say the only reasonable decision as at 8 March, 2002 in relation to the price (the 27 pence) was that that was an excessive and abusive price on the tests, and, likewise, that it was an abuse to give zero credit. Whatever the right figure would have been, it was plainly an abuse to give zero credit for new resources entering the Thames system.

Looking at 1 April, 2004, subsequent Section 47 decision, we say, first of all, that there was a serious error of law in the Director mis-characterising his own decision in the way that we have looked at this morning, and, secondly, there was a serious error of fact in relation to the intermittent surplus point. But, on the authorities, the March 2002 and April 2004 decisions, in our submission, stand and fall together, and we say that the March 2002 decisions were manifestly defective and cannot stand.

So, if we turn, first of all, to the issue of price, as I have said, I have shown the Tribunal the letter at Bundle 2, Tab 6, pages 92 to 95, from April 2003, and we say that that is an allegation of an excessive price in the form of a margin squeeze, and that also can be

found in the complaint documentation. If I may show you briefly Tab 6, Bundle 2 at p.62 – if one turns back to p.61 you will see that this was a letter to Miss Griffiths of OFWAT, dated 24 September, 2001 where Envirologic replies in some detail to questions from OFWAT contained in the letter dated 29 August, 2001. The relevant paragraphs over the page, on p.62, are paras. 4.2,

> "The proposed access prices prevent access to enter the market place. The LRMC for water resources and treatment in the Thames London area is 42 pence per meter cubed. If an access charge of 27 pence per metre cubed is added, then the total cost before …" [and that is supplier of last resort charges, and I think it was £10,000 a year was what was asked for] would be 69 pence per metre cubed, 10 percent higher than the Thames standard tariff. Experience indicates that the LRMC value is also indicative of short run marginal costs which Albion Water incurs in the development of ground water sources in the London area. Consequently, it is not possible to compete with the discounted standard tariff without consistent discounting of the network access charge".

So, that was the essential complaint. One finds that again on p.68, at the top of the page. Albion gives estimates of its own total costs - of abstraction of 11 pence, and treatment of 23 pence. So, a total of 34 pence. So, lower than Thames' LRMC, but they then go on,

> "If we are required to pay 27 pence per metre cubed for common carriage plus an SLR charge of £10,000 a year, as indicated by Thames, then our price would need to exclude the Thames standard tariff. Clearly, this would be unacceptable to customers and competition is thus been prevented at the domestic level. The fact that Thames has denied Albion a lower access charge for supplies to large users is further evidence of anti-competitive pricing.

So, that was the essence of the 27 pence complaint.

Likewise, that is how it was understood. If one looks at the publication document, which is p.1 of Tab 1 of the same bundle, the last paragraph on that page, where they summarise the complaint that the price that Thames Water is proposing to charge for conveying the water through its network, the access price was anti-competitive because its effect was to prevent competition. Since adding the access price to Thames Water's published . . . took cost for competitors above the standard Thames Water tariff.

We say that in the present context, excessive pricing and margin squeeze are two sides of the same coin. This is an exclusionary, not an exploitative, abuse – precisely because

we are unable to enter the market. The reason why the price is too high is precisely because it allow no margin – not because, as in other excessive prices cases – because it causes a consumer detriment of over-payment either to Albion or to Albion's customers. So, we say that par. 9(1)(a) of our Amended Notice of Appeal therefore accurately states the core proposition on which Albion relies, both in relation to excess pricing and margin squeeze.

In relation to excessive pricing, we say that what might be called the *Napp* criteria for excessive pricing are plainly fulfilled. One finds that at para. 50 of our skeleton argument. It is a citation within a citation. The *Napp* judgment cites a submission from the Director of Fair Trading which says that to show that prices are excessive it must be demonstrated that (1) prices are higher than would be expected in a competitive market; and (2) there is no effective competitive pressure to bring them down to competitive levels, nor is there likely to be. We say that that was manifestly the position here on the Director's own findings. He required the price to be cut in half in order to avoid anti-competitive effects, and it is plain that there was no other competitive pressure that would have brought those prices down. It took a year for the regulator himself to negotiate a reduction, and there is absolutely no evidence that the price would have been brought down by any form of competitive pressure, given that one was dealing with a new entrant in a market where the incumbent had had a monopoly position effectively for ever. So, we say that the two criteria for excessive pricing were manifestly fulfilled here.

Our submission there is at para. 57 of the skeleton argument. We refer back to the rather colourful quotation from a minute of a discussion between Mr. Jeffery and OFWAT at p.5 of our skeleton, at para. 13.1 where he says, "She asked about our response to Thames' high volume access charge. When I asked how far they had to bend Thames' arm, she replied, 'We broke it'". We obviously rely on that as a pretty graphic finding in effect by the Director ----

THE PRESIDENT: It shows the Director intervening quite effectively on your behalf. Quite what it shows by way of a legal finding I am perhaps a bit less clear.

MR. THOMPSON: Indeed. I mean, I perhaps over-state it, but in terms of how much pressure was required to change the position, at least for the purposes of the second limb, in my submission, that is quite a revealing quotation.

In relation to the margin squeeze, we set that out at paras. 61 to 68 of our skeleton. In particular, a test is set out quite clearly at para. 63 - the italicised wording. The important thing is that there should be a discount from that combined price which is sufficient to enable other home care providers to compete. If you put, instead of 'home care providers', 'retailers

of water', or 'integrated retailers of water', then we say that that is the relevant test, and that the quotations that I have taken you to indicate the problem that was facing my clients during 2001.

In response to this, the Director makes what is, in fact, a correct qualification at para. 41 of his skeleton argument, on p.16. He quotes para. 65 of our skeleton and says that the position is legally identical to that in the *Genzyme* case, and he points out that that is not correct, and the reason why it is not correct is that whereas in *Genzyme* the service provider was taking, as it were, a finished product from *Genzyme*, and supplying it on to the end user, in this case my client has two roles – one is the provider of the water upstream, and also the retailer downstream. So, in theory at least, if the upstream production costs were so low that they could trade successfully against Thames even at Thames' price, then there would not be a zero margin. So, the point is, indeed, more qualified, and appears from the documents I have shown you that the margin was clearly negative, both on Thames' own figures and on Albion's own figures. So, one could not say that it was as clear-cut a case as *Genzyme*, but it was still a very clear-cut case because it was actually a negative -----

THE PRESIDENT: So, it is not a case as in *Genzyme* where there was no margin. There was a margin, but an inadequate margin.

MR. THOMPSON: Yes, and on reasonable assumptions about the upstream market, it was actually a negative retail margin – both on Thames' own figures, used by the Director, and on Albion's own figures. It was actually a negative margin. So, it is . . . distinguishable, but we say no less clear-cut.

Sir, I think that is our position on the pricing issue.

We can now turn to the issue of new resources. We have looked at the Section 47 application letter, but, again, it may be worth looking at some of the complaint material. First of all, Tab 5 of Bundle 2 ---- This is a tab containing Thames' correspondence. I think the position is clearly set out at pages 30 to 32. In particular, 3.8 on p.31 – demand and supply matched.

> "Thames, as the incumbent, expects an entrant to supply water into the network to match the demand profile of its customers. An entrant should not supply water into the network not required by its customers. Small fluctuations from the daily demands of the entrant's customers would be accommodated by Thames by the routine operational management of the network".

So, that is the general position. If one then looks at (c):

"In exceptional circumstances, the balancing process could indicate that the consumption of an entrant's customers far exceeds the amount of water supplied by the entrant. Thames would have supplied these additional requirements of the entrant's customers, and, as such, we expect the entrant to reimburse us for the quantity of water supplied. Where an entrant's consumers consume an amount significantly less than that expected by the entrant, we suggest that this is a matter between an entrant and its customers. Thames would not pay for any over-supply into the network".

So, that was the essential position adopted by Thames, and this was an object of complaint throughout. For example, at p.64 of Tab 6 ---- This is the same letter we looked at before, dated 24 September, beginning at p.61. If one looks on to p.64, paras. 11 to 14, para. 11 sets out the position of Thames and then Albion says,

"The issue is relevant in that incremental sources are most efficient and effective when used on a continual and steady output basis. This is the basis upon which proposals have been made to Thames. As far as the distribution capacity and assets to balance diurnal peaks Thames does not propose to have a reciprocal arrangement for under and over-supply ----"

And there is a reference to the 8 March letter. It is then setting out the maximum yield from the two sources, and going on,

"It is also likely there would be surplus and deficit situations arising from the variants between the demand profile of the customers and the constant rate of input to the distribution system. I believe that monthly balancing periods are appropriate for charging purposes, but believe that Albion Water would best be able to balance demand and supply on an annual basis. Albion Water's view is that the benefit received by Thames in respect of the sources related to this application may be measured by the LRMC of resources and treatment for the area – 42 pence per metre cubed. The rationale for this view is that in the London zone Thames has a supply deficit. In other areas where there is a supply surplus, Albion Water accepts that there should be some symmetry between charges for over or under-supply. Further, when new customers are involved, Albion Water could accept that under-supply to its own customers should be chargeable at LRMC".

So, that was the position that Albion adopted during the complaint.

I think the Tribunal asked me about the order of magnitude of this effect. One finds that in the next letter at pages 66 to 68. This is again to OFWAT. In the second paragraph:

"You asked for information about the cost of abstraction and treatment of the water sources that are the subject of this application for network access, and of the related complaint. I believe that this is an important issue and have written separately to Mike Saunders with a view to developing an LRMC value for Albion Water's activities in London that is consistent with OFWAT-approved principles …"

Then there is an itemised calculation on various assumptions. I will draw the Tribunal's attention to (e) and then (h). So:

"(e) As a common carriage project for large user customers, using the prices proposed by Thames [so, that is the 27 pence] . . .

"(h) As (e) above, but with the network access price as proposed by Thames, discounted by the value of the deployable output introduced based on published LRMC value."

That comes to -18 pence. So, that appears to be assuming an LRMC figure of 45 pence as against the 42 pence. But, in any event, it is a substantial dispute on any view.

So, that is effectively saying that if full credit is given for the new water, then actually the cost of transport would be cheaper than the benefit of the additional water. I would add that the latest figures appear to be substantially higher in that, as I think is referred to in Dr. Bryan's, Thames has projected investments of a massive ---- or a substantial desalination plant which we understand to be very expensive and to be reflected in substantially increased charges to customers within the Thames area. So, if anything, that is an under-estimate.

THE PRESIDENT: So you are effectively submitting that the benefit to Thames on Albion's view far exceeds the conceivable cost of carrying this water across the road?

MR. THOMPSON: All I am submitting at the moment is that zero was the wrong figure, which is the figure which Thames offered and which the Director in effect approved, and that it was an abuse to give zero credit. So it is a point of principle about giving no credit whatsoever.

PROFESSOR PICKERING: Mr. Thompson, could I just ask you, a dominant firm that is approached and asked to indicate a price for something probably does so in the expectation that there is going to be a period of negotiation and to-ing and fro-ing, and may therefore indicate a price in the first instance that perhaps is higher than it knows in its heart of hearts that it is going to come down to. Does the statement of that first price, at a higher level than maybe the "competitive level" automatically constitute an abuse and at the time at which that offer is made? Is that what you are saying?

MR. THOMPSON: I do not think my submission involves that. I think my case obviously is at March 2002 when there has been a matter which was treated as a test case by the regulator and

the price was sustained and indeed no credit was given for a period of over a year. So in my submission it is not just any old price quoted, this was a considered price which, indeed, I think Mr. Tupper said this morning Thames would still be prepared to defend. So it is not just back of the envelope, any old price.

PROFESSOR PICKERING: No, nor would one suggest, especially in the regulated business, that any old price would be suggested, proposed, but it does seem to me that I am anxious to know whether you think that the first moment that a dominant business makes any offer at all, if that is in any sense less than fully acceptable on received criteria that immediately becomes an abuse. Is there a distinction between something that is less than helpful to a new entrant and something that is actually abusive, or are you saying that in the case of a dominant, or maybe even a super dominant business, that the two immediately go together?

MR. THOMPSON: I would not say that it was a completely rigid position, but obviously one needs to look at the particular facts, and this was a highly regulated industry for a very good reason, because you had a number of extremely entrenched monopolists, and a number of people, notably my clients, trying to enter their home patch. So that is a very exceptional situation and also the facts of this case, of the period of time that it required the regulator and the degree of intervention to get any movement is also relevant in my submission. This is certainly not a case that anybody who could be argued to have a dominant position, that their first price, if it is higher than the final price it emerges in the interim that is automatically abusive, that is not implicit in my case.

So we say the underlying issue is the benefit to Thames of an additional constant source of water out of which to meet the total demand of its customers, and the reason why one looks at the total demand is because Thames bears the supplier of last resort obligation, it cannot simply walk away, it has to meet the total demands. So we say on the face of it, if somebody reduces that obligation that is a clear benefit to Thames ----

THE PRESIDENT: Why is this an additional constant source of water, because if you are trying to supply the water that your customer is going to take, there is no surplus available to Thames?

MR. THOMPSON: Well one draws a distinction, if we had created a housing estate or had been appointed as a new housing estate and the water for that housing estate was going to be supplied from our borehole then that would be an additional source of demand and we would simply be meeting that supply. But the position here is these are the customers who Thames would otherwise have to supply out of its overall deficient network – network in deficit I should say, not that the network is deficient, that is no part of my case anyway – and therefore to provide an input into it is a benefit to Thames. It is a relatively simple proposition.

The next point I would make is in the context of the ECPR analysis, which the Tribunal will be familiar with, both Thames and the Director have in fact recognised this benefit and one can find that in the documents, for example, at tab 5 of the same bundle 2. At p.40 you will find a table headed "Efficient component pricing rule methodology, indicative water access prices 2002/3" and you have two tariffs, standard and large user, in fact three tariffs up there. Then you have "discounted tariff", tariff 1 and tariff 2 down the left hand side, and you will see that tariff 1 involves reduction by reference to short run avoidable costs, and reduces by 3p – do you see that, Sir?

THE PRESIDENT: Yes.

MR. THOMPSON: And then you will see tariff 2, "Less long run average incremental costs of resources and treatment, minus 22½p". As I understand it, and I am sure I will be corrected if I am wrong, the ECPR approach is indeed to give credit for water inputted into the system on two bases, either just discounting the short run avoidable costs, or discounting the long run incremental costs. What they do not do is say "you are only a little borehole so I am not going to give you anything."

THE PRESIDENT: Well just as a lay comment, and I am sure everyone will pounce on it and put me right, it does sound as if it would be logical under an ECPR approach if you are going down an avoidable cost route, to include the incremental benefit as a sort of balancing approach, that is to say, if the principle is that you are looking at avoidable costs there does not seem any reason not to include foreseeable benefits?

MR. THOMPSON: Yes, and I think my simple point is there is no reason to exclude foreseeable benefits in any system.

THE PRESIDENT: Yes.

MR. THOMPSON: And the same point at p.64, this is a letter from Thames to Mr. Jeffrey, dated 17th April 2003, under the heading "Network Access Prices":

> "As you are aware Thames use the ECPR methodology in calculating a network access price. Access price is determined on a case by case basis and takes account of, amongst others, the location and reliability of the source, and the volume of the proposed input. In the case of your application because the volume proposed for input by Albion is small, Thames will not be able to defer future investment in resource filament to the locality and hence the short-run avoidable cost ECPR access price is applicable."

My understanding is that that is either the 3p or some variant on the 3p, rather than the larger pence. But what they do not say is that "It should be 0p because you are only a borehole".

THE PRESIDENT: Do you understand what the short run avoidable cost is here, what they are saying the short run avoidable cost is? I understand it is 3p, but that represents what exactly?

MR. THOMPSON: Yes, Dr. Bryan points out there is a footnote on p.40 of tab 5. It is the operational cost of power, so pumping and chemical treatment – chemicals relating to resources and treatment, so that is recognising that those are not required where the water is being produced effectively by somebody else.

THE PRESIDENT: But there is nothing in relation to the water itself, it is just the treatment, the pumping cost and the treatment cost, but not the water itself.

MR. THOMPSON: I think the position is that the water is "God given" as it were, and so that all the cosets in this industry are sort of add-ons to the grace and favour of having this water appearing through your taps.

THE PRESIDENT: It is free.

MR. THOMPSON: That bit is free, so perhaps in a curious sense ----

THE PRESIDENT: Right.

MR. THOMPSON: If one then looks at the Director's position on this, that is most recently set out in the 2004 document at tab 17 of the authorities bundle – "Consultation on Access Code Guidance" which is apparently dated 18th October 2004.

THE PRESIDENT: Yes.

MR. THOMPSON: I think one can go straight into it, towards the end – I do not know if you have page numbers. Mine are in a slightly curious form, I have a lot of 4s and 5s, but do you have individual numbers?

THE PRESIDENT: We have individual numbers.

MR. THOMPSON: Mine has come out strangely, so I think it would start at p.53 which should be appendix 2.

THE PRESIDENT: Yes.

MR. THOMPSON: If one turns into that one will find something which says "Indicative common carriage prices". The first paragraph:

> "Indicative common carriage prices are calculated in the same way as indicative wholesale prices. Additionally undertakers will benefit from cost savings associated with resources and treatment. As minimum undertakers will make savings in Opex for reduced costs for pumping and chemicals. There may also be savings by being able to reschedule or avoid capital expenditure. Pumping and chemical costs are likely to be modest so licensees are much more likely to find competitive opportunities where entry would result in the undertakers saving capex."

Then if one turns on to "Case specific common carriage prices" you will see a paragraph starting "In this example". It says:

> "In this example, let us assume that the licencee's water resource is close to the customer they intend to supply. Assume that this results in £500 reduced pumping and leakage costs for the undertaker. It also enables a local reinforcement project scheduled for construction in year three and forecast to cost £200,000 to be deferred indefinitely."

So it appears that, broadly speaking, there were three categories of benefit recognised. There is an operational expenditure reduction in relation to pumping and chemical treatment. There is a leakage reduction where the water resource is close to the customer, and there is then a capital reduction where the volume is sufficient to justify such a reduction. That seems to be the Director's approach, but again there does not seem to be any suggestion that there is any category of supply which is effectively worthless.

THE PRESIDENT: But what Thames are saying in this case is that there is saving in operating costs that comes up to 3p, there is no re-scheduling of capital expenditure, so that does not come into it, and therefore the right number is 3p.

MR. THOMPSON: No, with respect they are saying that the right number is zero.

THE PRESIDENT: Sorry, the avoidable costs I thought we had established a minute ago on this approach was 3p, is that right?

MR. THOMPSON: Indeed, but on the facts of this case they said they were going to give us zero.

THE PRESIDENT: Because – just take me back to where they say that, Mr. Thompson?

MR. THOMPSON: That is the 8th March 2001 letter.

THE PRESIDENT: Yes.

MR. THOMPSON: Which is at p.32, tab 5, bundle 2. TW would not pay for any over supply. They certainly would not pay for any regular supply, they just do not give any credit at all for supplying to the network.

THE PRESIDENT: Not even theoretically for operating costs

MR. THOMPSON: No.

PROFESSOR PICKERING: So why can you not just say then "In those circumstances we will not over supply into the system?

MR. THOMPSON: Well there is another problem, the trouble with this case is there are a very large number of problems facing my clients. One of the other issues, which is, as it were, off the page is that Thames refused to accept partial supplies, so that effectively you were caught between the devil and the deep blue sea. You either had customers and had enough water for

all those customers, or you added on one more customer in which case you could only supply part of its requirement, and Thames said "No, we will not accept that". So in effect one could not have the position of a partial supply, so you are almost bound to have a surplus, because in order to have enough you were going to generate surpluses.

PROFESSOR PICKERING: So what you are saying your client was asking for was not just common carriage of a quantity of water to supply those identified and specified customers, but you were asking Thames to accept that you would be putting surplus water into their system without a specific customer in mind, and you were asking them to give you credit for the fact that you were not able to match up supply and demand?

MR. THOMPSON: We were saying that in order to cover the requirements of our customer we had to have enough water for their maximum demand. By definition they were not going to be constantly at their maximum demand all the time. So if this scheme was going to work at all there were bound to be surpluses. Those surpluses would be entering the Thames' system, indeed all the water that would be entering the Thames' system would be available to Thames but they were proposing to give us no credit at all for that water.

PROFESSOR PICKERING: They do not have to take what you want to put in, do they? On the bottom of p.31, just before the point that you have referred us to, it does actually say "small fluctuations from the daily demands of the entrant's customers would be accommodated by TW by the routine operational management and network", so the implication is that marginal unders and overs would be taken as coming out in the wash, was it not?

MR. THOMPSON: I would need to look at that, we may be moving into the area of balancing charges, where Thames were saying that they would charge us if they had to provide balancing services, I need to look at that. But as I understand it that was never taken any further on the facts and so that is not being pursued, but let me just go back to that. (After a pause) …

PROFESSOR PICKERING: I am sorry. If you want to come back to this, Mr. Thompson, feel free to do so.

MR. THOMPSON: I think our general point is that, first of all, there is a symmetry point. If we are going to be expected to supply, if the fluctuation goes and so we are temporarily in deficit, then we ought to have a credit for the additional water which Thames has in its system, which it can use. The broader point we make is that at the minimum both Thames and the Director recognise a short term benefit of something of the order of 3 pence per metre cubed, and we say we should have that generally because that water is coming in, and Thames is not having to supply it into the system. I think you will recall that there is a further issue about leakage

because you may remember, when we were in the Albion Yard itself, the point was made that introducing water, as it were, so far down the network reduces the pressure that is required for the system as a whole – because otherwise the water has to be pumped from Thames Ditton, or wherever it is that the water is originating.

PROFESSOR PICKERING: Just help me on this: why would Thames not be able to stand up and argue today that while the 27 pence that they quoted to you was actually taking account of the 3 pence value, or some other value that they were already attributing ---- It may well be that there is a ready answer to that, and that I could find it, but if you know what it is, then you will save me finding it.

MR. THOMPSON: I do not know now. I has never been asserted, as far as I am aware, that credit is in fact given. As I understand it, the point has always been that credit does not have to be given.

THE PRESIDENT: Mr. Thompson, it may be, again, that I am missing something, but is Thames' position more or less set out just a couple of pages on at p.38 of Tab 5, in their letter of 31 July, 2002 where effectively they are saying at the bottom of the page that they will accommodate, up to a point, over and under-supply with an agreed balancing period, and then there will be a net reconciliation, and that should really accommodate most expected fluctuations in demand from the customer, but that if there is, as it were, a situation of permanent over-supply, then, well, in the first place they might want to discuss purchasing the water from you, but they do not see that sort of situation as permanent over-supply as something that calls for them to give you credit because you are simply, as it were, demanding to put the water into their system even though your customer does not really need it, and that is likely, in the long run, to just turn out to be an extra expense for Thames, certainly most of the year round when they have got more water than they need – or words to that effect (I am summarising rather crudely what that letter says). That is their case, is it not?

MR. THOMPSON: Yes. I was going to come on to the point about 'it would be better to leave the water in the ground'. That does not feature very prominently in either of the decision letters, but it has now popped up in the Director's skeleton argument, and so I thought I ought to deal with it.

THE PRESIDENT: We will deal with that in a moment. But, just coming to the credit that you say you should have at least for the surplus, how do we calculate the credit? What are you saying in actual terms, in actual figures? Are you saying that you should have at least some equivalent to the saving on operating costs resulting from treatment and leakage savings – at

least – and then something on top of that for the water? And if there were a case where you could say that they are saving on investment, then you would get something on top of that for that, which is probably not this case, but in principle that is what you would get.

MR. THOMPSON: Well, we certainly say the first.

THE PRESIDENT: It is at least the savings on treatment and operating costs.

MR. THOMPSON: We also say that we get the second on the particular facts of this case ----

THE PRESIDENT: The benefit of the water.

MR. THOMPSON: Well, the particular facts that we are injecting water into a system ----

THE PRESIDENT: -- in an apparently recognised situation of under-supply in the London area.

MR. THOMPSON: Yes. But, the third thing we say – and this takes one to the fact that this is really, in a way, the underlying importance of this case ---- Rather as in Shotton, the question arose of how you treat the rather particular circumstances of one customer when you are trying to talk about a retail margin, here we say that it is a wrong approach to look only at what, say, Bathhouse introduced into the system, and say, "Bathhouse is only a funny little borehole. That is not going to enable us to have a desalination plant on the Thames. So, we will give you nothing".

In my submission – and it has been our submission throughout – in this sort of industry, in order to have a realistic impact on competition, and if you are going to take test cases of this kind, you need to be looking at some form of average, and either you look at the overall proposition that my clients had (where you may recall that we were proposing to put in fourteen megalitres of water on the boreholes that we had identified – so, something of the order of the Ashgrove network, or at least of the Shotton network, that was the sort of scale that we were looking to put in), or else you look more generally at what sort of market you are talking about that this is supposed to be a test case for. Because if you slice up the salami into thin enough slices, then of course no individual slice will make any difference to competition. One of our principal sources of complaint about the Director generally is that in all these cases, he says, "Well, I'm going to take a test case"; he takes a very small test case; he applies a very lenient approach; and then he says, "I don't need to do anything"; and then he comes along five years later and says, "It's a great mystery as to why there's no competition in this market". We say it is because he looks at it in this micro way, and applies test cases in a way that has inevitably has almost no effect on the price or competition.

So, we say that in order to look at the resource benefit, you have to treat this properly as a test case and see what would happen if these boreholes all over London were putting in water. Would that make a substantial contribution to Thames? We say that it would, and that

that is the right approach, and that is why we talk about long range marginal costs, because we say that that is the obvious proxy because that is the basis upon which Thames itself charges, and Thames itself works out its prices. So, that is why we use it.

THE PRESIDENT: So, you say – paraphrasing it probably rather inelegantly – that if you just look at this as one borehole and say, "Well, that's too small to worry about. That's not going to save us any investment" ---- Looking at it in each case at that sort of micro level, you will never create the conditions in which you might one day find that there is not just one, but 2,000 of these boreholes all over east London, which might save you investment of various kinds.

MR. THOMPSON: Indeed. You will see from the papers that our proposal was a fourteen megalitre project of a number of boreholes all over the place.

PROFESSOR PICKERING: But you argued it on the case of two boreholes.

MR. THOMPSON: That is because that is how the director has operated. I can show you an example. For example, it is a specific point that we raised where we challenge the ECPR price that eventually emerged from Thames, and we said, "Why don't you investigate this?" and they said, "Oh, no, we're looking at ECPR in Shotton. So, we won't investigate ECPR here". Again, you find yourself moving around the country, fighting these little battles, and the incumbent and the Director saying, "None of this makes any difference. Go away", whereas if you looked at the thing properly, across the whole industry, you would find that you had a very uncompetitive industry where people could not get in because the regulator was not putting enough pressure on the incumbents.

The document I have in mind is at Bundle 2, Tab 4, p.22. You will see it is a letter at almost exactly the same time as the Section 47 application in this case. So, Dr. Bryan is writing here. This time it is a complaint against Bristol Water relating to access prices for common carriage. There is reference to an alleged abuse in relation to Bristol Water. Then, in the second half of the paragraph:

> "As you know, we are currently carrying out an investigation into Envirologic's complaint against . . . relating to common carriage to supply . . . water to Shotton, who had explained to you on several occasions the appropriateness of ECPR in the context of network access charging may be examined as part of our work on this complaint. I know your concerns relating to the access price Thames has offered you in relation to Dulwich. If you were to submit a formal complaint against Thames under the 1998 Act, it is likely we would not carry out a separate 1998 investigation

into this case for the same reasons that we are not doing so in relation to your complaint against Bristol Water".

So, you have an individual case about ECPR in London, and we were told, "No, don't worry about that, because we're looking at Shotton in Chester". Then, nothing happens about ECPR there, and so you are no further on. We say that the same approach is manifested here. They say, "Oh, you're only a little borehole. So, we don't need to worry about you, and it doesn't matter if you do not get any money", and then that becomes the blueprint for competition in relation to boreholes. We say that is a completely hopeless approach to regulations.

THE PRESIDENT: So, what approach should they have taken? What assumption should they have made about what boreholes we are talking about?

MR. THOMPSON: Well, we say that the proper approach -- what one might call the market opening price – would be to look at the average benefit to Thames and that is why we rely on the long run marginal cost, because we say that that is the right approach ---- That is how Thames itself would look at it. That is how the Director himself would look at it in regulating Thames. So, there is no injustice to Thames if the same approach is adopted in relation to us. You will appreciate, from the wonderful world of pricing that we discussed in Shotton, that many of these things are taken on an average basis. Indeed, as Mr. Tupper said, one is not often talking about the actual water that is being supplied to somebody else. So, often one is operating in quite an abstract way. So, we say that there is no reason why the same abstract approach should not be taken, and an average cost benefit taken in a case of this kind.

THE PRESIDENT: So, in other words, if you are doing the whole thing on the basis of a long run marginal cost, you should also take account of the long run marginal benefit.

MR. THOMPSON: Yes. Putting it crudely, yes.

PROFESSOR PICKERING: So far as our proceedings are concerned, obviously we are clear about your appeal against the Director. But, Albion's real concern, surely, is to become a significant water supplier. You referred just now to the prospect of supplying fourteen megalitres. That is solely in the Thames Water area; is that right?

MR. THOMPSON: That is right.

PROFESSOR PICKERING: I do not think we need a lot of detail – just to get the principle of the thing. So, Albion's business proposition, which it felt was viable, was that it could supply fourteen megalitres of water a day into the Thames Water system in London, which it believed would actually be beneficial to Thames because it understood that Thames was supply-deficient. Did Albion ever go to Thames with that as an overall proposition?

MR. THOMPSON: Can I just ask Dr. Brown? I am not sure that it would have operated quite like that. I suspect it would have been case by case, but ----- (After a pause): I think there are two balances to it. At the level of strategy there was what was called the 'Guide It' strategy which is described in our Notice of Appeal. There, I think, up to 20 megalitres a day was thought to be realistic out of the boreholes. The sources that had identified ----- there is a further part of the forest where there is a dispute between Albion and Thames as to whether Thames was targeting the boreholes that it had identified. So, I think Albion was somewhat reluctant to say, "And here's another borehole" just in case Thames said, "Oh, and by the way, we've found one next door, or offered a particularly favourable price to the obvious beneficiary from that borehole". So, I think we may get dragged into some rather difficulty confidential disputes between the parties.

THE PRESIDENT: I see. You did not want to tell them quite where the boreholes were, or how many there were.

MR. THOMPSON: I think that is the gist of it.

PROFESSOR PICKERING: But is it reasonable for you to complain about the Director not having the vision to assess your position in terms of the totality of what supply you were proposing if you had not put that in the first instance as an overall commercial proposition to the incumbent?

MR. THOMPSON: I would quite like to come back on that, if I may. I suspect that there are documents which set out the broader proposition quite clearly, but I have not got them under my fingertips at the moment.

So, returning to the decision, and to the Director's skeleton argument in this case, we say that he was wrong to accept what we say were somewhat self-serving accounts of the benefits that Thames was likely to obtain from individual boreholes. One finds that, for example, at para. 57 of the Director's skeleton argument where he quotes two letters from Thames to Mr. Jeffery. That is the Director's submission. We say that that is a sufficiently rigorous approach to regulating a monopolist who is coming under competitive pressure – simply to write down whatever he happens to say in a letter back to you, or in a letter to the competitor.

The next point we make is a more specific one in relation to the decision itself, and in particular the reasoning contained in the letter of 1 April, 2004 which appears at pages 10 to 15 of Bundle 1, Tab 1. It is at p.13. As we understand it, the only reasoning in this letter is contained in the middle paragraphs – the ones starting:

"Envirologic said that you would like to see the evidence behind the statements in OFWAT's letter of 8 March, 2002 that there was no evidence to suggest that Thames would get a significant benefit from this supply, and that over-supply in such instances as associated costs and balancing and buffering. In its letter dated 21 September, 2001 to OFWAT Thames said that ----"

And then there is a quotation, and then the middle sentence,

"There is, however, no value to us from unpredictable, intermittent inputs into a part of our network. Surplus water is likely to be available when least needed, and the hydraulic management of the system is hindered by water being injected into the system when not required. The effect of this will be felt by customers close to the point of entry".

Then there is a 'therefore' which is slightly curious:

"OFWAT did not therefore agree with Envirologic that Thames Water should always provide a credit where there is over-supply".

So, as far as we understand it, that was all that was said, because it then goes on about buffering charges. That seems to have been the only reasoning on this subject that there was, which was simply a quotation from a letter from Thames. We say that that was based on a misapprehension of fact that Albion was proposing to input a fluctuating surplus of water that was liable to cause management problems in the vicinity of that water, and that this error was repeated in the defence which one finds in Bundle 3 at para. 58 of the defence. The Director says:

"It is a matter of basic knowledge in the water industry that intermittent and unpredictable inputs can give rise to problems, particularly close to the point of injection such as unacceptable changes in pressure at the customer's tap. The question of exactly when and how reliably any such surplus water might be made available can also affect the calculation of its value."

So that was that was the point that was made. We pointed out in the reply, and in our skeleton argument that that was a misunderstanding of what was going to happen, and one finds that at paras. 69 and following of our skeleton argument.

Sir, can I just answer Professor Pickering's query? The answer is to be found at para.62(3) of our amended Notice of Appeal which says that "Envirologic have notified the Environment agency by June 2000 of sources with a total yield of 15megalitres per day", and then there is a quotation saying that these represented only a portion of the total sources. So it

was to that extent official, that had been notified to the Environment Agency who are responsible for the extraction, so that is the answer.

PROFESSOR PICKERING: But not specifically raised with Thames?

MR. THOMPSON: I will confirm that. Sir, there is the quotation from the letter first of all of 8th March, and then I have shown you the one of 1st April 2004, and then our points are at paras. 72 and 73 of the skeleton: The current position is that Thames is supplying the customer that Albion wishes to supply and is accommodating any fluctuations in demand from those customers as part of its business. Given that these are commercial rather than residential customers their consumption is relatively constant, but Thames is currently having to manage any fluctuations in demand. Albion's proposals to introduce a relatively small, by the standards of Thames' overall network, but constant new source of water into Thames' Water's network was broadly in balance with the intended demand of its customers. That did not introduce unpredictable intermittent inputs into a part of Thames' Water's network, that network was unchanged in terms of customer demand. The only proposed change being the introduction of a constant additional supply. So the fluctuation was over in the distance somewhere which Thames was managing anyway, and there was a constant input in some other part of the system. So we say that the Director merely misunderstood factually, and it appears to us -----

THE PRESIDENT: I am struggling a moment, Mr. Thompson I have to say, just help me. 72 and following asserts that your intention was to introduce a new source of water that was broadly in balance with the intended demand of the customers.

MR. THOMPSON: Yes.

THE PRESIDENT: So that over a period, if you did it properly supply and demand would be, broadly speaking, in balance over a year or six months, or whatever it is. As I understand it, Thames was broadly content to manage it within agreed limits, so that you could deal with changes in the customer demand through the night or holiday times or whenever, your intention being to match supply and demand. I cannot quite understand why the viability of the project depended crucially on you getting credit for any surplus that there might be when it was your intention to avoid any surplus arising in the first place. Do you follow my question, or shall I ----

MR. THOMPSON: I follow your question which is why, in part; the case is not limited to surpluses. We say that there is an underlying point about the value of the new resource.

THE PRESIDENT: Well the way that the case is put in this argument is to deal with surpluses, it is the top of p.23: "Albion submits any surplus water entering the network if it was not matched

..” etc “… would provide an obvious benefit”. So what is the underlying argument? Does the underlying viability of this project, according to you, depend on getting credit for the total supply of the water and thus the theoretical saving to Thames of the costs associated with the total supply, or does it depend on getting credit for the surplus? Which is it?

MR. THOMPSON: Well the former is obviously a much more substantial benefit, because, certainly, as originally planned the intention was that they should be, as you put it to me, broadly in synchronisation with one another. So it is obviously a much larger commercial benefit if there is credit given for the input generally.

THE PRESIDENT: But that, as I understood it, was not really the thrust of the present skeleton argument. The present skeleton argument was concentrating much more on the surplus, which was what we were really discussing in our opening debate on what was admissible and what was not. I had rather assumed, when we gave our judgment at the beginning of the day that you had really cut your case down a bit from what it was originally?

MR. THOMPSON: Well, no we have not changed it, I do not think there has been any complaint about the position in 75(2), at least to date there has not been any complaint about it. The difficulty with 75(2) is ----

THE PRESIDENT: What Mr. Turner had submitted to us was that what had come centre stage was a credit for surpluses, as compared with what he had understood the original Notice of Appeal to be, which was I think a general credit.

MR. THOMPSON: Yes, I do not think Mr. Turner was suggested that we dropped that, because it is still there at 75(2).

THE PRESIDENT: Yes, but it is now round the other way, as it were, is it not? It is a subsidiary point, it comes after 75(1). Maybe this is just shift in the forensic way of putting it rather than any shift in the overall ----

MR. THOMPSON: It is shift in the forensic way of putting it.

THE PRESIDENT: -- any shift in the underlying case. But if we try and link it back to what is alleged to be the viability of this project and whether Albion can actually make a commercial go of it, I was led to believe earlier, or at least I had understood earlier that whether it is profitable or not actually depends on this issue being resolved in Albion’s favour, and the question then is what is this issue? Is it the totality that is necessary to enable Albion to make a go of it commercially, profitably, or is it just the surpluses?

MR. THOMPSON: Again it is difficult because of the historic nature, and because there are so many cross-currents here. It has been put with some force by Mr. Turner and Mr. Tupper that looking forwards there will be an other issue which cuts across all this which is the issue which

we have considered in Shotton, namely, the correct construction of the 2003 Act, but I think it is common ground here that we are not going to try and go back into that complicated question, because you will appreciate that going forward, although Thames made an undertaking in 2002 that it would retain 13.6p for these two boreholes its general policy, evidenced for example in relation to Dulwich, is that it will charge ECPR based access prices where the only discount it would give would be 3p as I understand it for a small borehole. So if we came to that issue we would have a further set of issues about commercial viability, but we cannot deal with that today. Today we are dealing with the two issues of the access price as an historical matter, and also the question of giving some benefit at least for the new resources going in. We had, as it were, a high case that we should get benefit for all the water that goes in, or a lower case that we should at least get a symmetrical benefit for the surplus as against the deficit, and our high case we say we should get a benefit of some kind for all the water we put in. Our low case is that we should at least get a symmetrical benefit for the surpluses.

THE PRESIDENT: Yes, I follow what the case is, but does the actual factual situation that we have now got here lead us into a degree of unreality because you were inviting us a moment ago to say that it is not right for the Director to look at all this just on the basis of a single borehole you have to look at the whole possibility, not just pick them off, as it were, one by one. In this particular case we have a one by one situation, because we have Bath House and Albion Yard, in which Thames, for historical reasons, have already made an offer, but we know that those are the only boreholes to which that offer is likely to apply. So if we are going to look at it on some wider basis should we not be looking at it on the basis of all the boreholes as the pricing strategy is currently envisaged which would be an ECPR type strategy? But then I had understood you to say that even if you have an ECPR type strategy then you should still be getting credit for the water on the basis that there should be a long run marginal benefit taken into account as well as the long run marginal cost, which might take us into the Act, I just do not know.

MR. THOMPSON: I think if one was going to move on to that issue, I suspect that we would inevitably be straying into the true construction of the Act, and I think everybody has foresworn that as a feature of this appeal, although I am actually going to make one or two brief references to it in a moment, if I may.

THE PRESIDENT: But would you, for example, be submitting if we invited you to do so, or wanted help on this point, that the Act, were it in force, would suggest or require that this kind of benefit, which you say is a benefit, they say it is not a benefit actually, they say it is

a dis-benefit, actually because the last thing we want is this water at certain times, but assuming it were a valuable benefit as you submit, would that be something that the Act would require the pricing authorities to take into account?

MR. THOMPSON: We say, if you recall, that the way the 2003 Act is supposed to work is that you work out your costs of providing this common carriage and that is the basic sum that you are entitled to recover. You give credits for benefits which is provided for, but you are also entitled to charge what is called "a qualifying amount" relating to the discharge of your obligations as it were as a public service provider, subject to arrow costs. The Director interprets the costs' principle not to be a costs' principle at all but to be a retail minus principle, and we made various adverse submissions about the nature of his construction. So it is very difficult for us to deal with this in the abstract because were it to be found that the Director has got the wrong end of that particular stick, then I suspect that the future regulation of water pricing might be rather different from what has been envisaged up until now, so it is quite difficult to deal with that as a fixed point, because the construction of the 2003 Act is quite a basic issue.

THE PRESIDENT: Within that basic issue, which we may or may not have to address in the Shotton Appeal, this Appeal appears to present perhaps slightly more directly than Shotton, perhaps not, I do not know, but this Appeal appears to present the argument being put forward by Albion that in arriving at the price they should get a credit for the fact that they are giving Thames a valuable benefit in a situation where Thames is short of water, they are actually giving them some water which should, other things being equal, be to their benefit. Now, leaving aside the dispute as to whether it is actually of benefit or not, and assuming for argument's sake that it is to their benefit, is that a benefit that, according to you, would and/or should or could be taken into account if one was applying the 2003 Act?

MR. THOMPSON: Yes, we say that it would be a benefit.

THE PRESIDENT: And that follows from the construction of the Act?

MR. THOMPSON: Yes.

THE PRESIDENT: I think we might need at some point, perhaps when you have had a chance to consider it, just a short submission on that point just taking us through where you say that is to be found in s.66(a) and following.

MR. THOMPSON: Yes, I may come on to that in a moment, I think. This is going slightly off my course ----

THE PRESIDENT: Yes, I am sorry, Mr. Thompson, I have probably taken you all over the shop.

MR. THOMPSON: Not at all. Our understanding of the Director's basic point was that because these surpluses were unpredictable, and because they only arose from fluctuations in demand,

that there would be, as it were, sudden injections of water into the Thames' system which would be difficult to manage, and we say that that is a manifest error that that was never intended, the surpluses such as they are would only arise at the demand end, if the hospital happened to turn its taps off for a short time, and that was a problem which Thames has to manage anyway. So we say that the 1st April letter, like the 8th March 2002 letters, proceeds on a basic misunderstanding of the facts. We take some comfort in that respect in that this point does not feature, as far as we can see in the Director's skeleton argument, but is replaced by two other arguments. First of all, what I would say that ECPR and AAC (average accounting cost) methodologies do not mix, so you cannot take an ECPR type benefit if you are working on the basis of average accounting; and secondly, the point that I think is being put to me, that it is better to leave the water in the ground until there is a drought, as I understand it, that there is no benefit in taking this water out of the ground until there is a drought.

We say these points suffer from two defects. One they are irrelevant because they were not part of the decision letters; and secondly, that they are thoroughly bad points anyway. In relation to ECPR and average accounting costs, the Director's points are at paras. 52 to 56 of his skeleton argument.

THE PRESIDENT: Yes.

MR. THOMPSON: The first reason why we say they are bad points is that they are actually inconsistent with the Decision letters and one finds that at bundle 2, tab 1. (After a pause) Page 3 is the letter to my clients. Then, p.4 deals with complaint 4. You will see in the middle of that paragraph it says. "If your new sources provided significant benefit to Thames, it might be reasonable for Thames to give credit for over-supply". Likewise, at p.6, under Point 4, in the middle of the second paragraph, it says, "If Envirologic's new sources provided significant benefit to you, it would be reasonable for you to give credit for over-supply". Likewise, at para. 13, under the quotation we looked at a moment ago, it says, "OFWAT did not therefore agree with Envirologic that Thames Water should always provide a credit where there is over-supply". So, there does not seem to be any objection in principle to mixing an average accounting approach with giving benefits for additional supplies.

Likewise, you will recall that in the Shotton case, there was an issue about benefits in relation to some lagoons that were provided by another purchaser of water. Again, there does not seem to have been any objection to mixing the benefit obtained from those lagoons with an average accounting approach – for example, para. 46 of the Shotton decision. I do not think it is necessary to go to it.

Finally, we say that it is inconsistent with the costs principle where on our construction we say that the incumbent's expenses, i.e. its costs, are reduced by the benefits and/or the avoided costs of the incumbent. So, we say that there is no inconsistency between working out the debit side on an average accounting basis, but then giving a credit for avoided costs as in the ECPR approach. If one wants to look at the legislation, that is at Tab 15 of the authorities.

THE PRESIDENT: But it is still the case, it seems to me, on the Director's view, that the benefits are either operating cost benefits in saving on chemicals and pumping, or the benefit of deferring capital expenditure, and in this case, according to the Director, or perhaps according to Thames, or both, neither is really applicable, and that the mere fact that you have got some more water does not, as far as I can see, count as a benefit.

MR. THOMPSON: But, as I understand it, I have shown the Tribunal the Director's own document, and also Thames' own document ----

THE PRESIDENT: Yes.

MR. THOMPSON: -- that in fact it does count as a benefit under the ECPR, at least to the extent of the short term costs.

THE PRESIDENT: In terms of saving on treatment and pumping, yes.

MR. THOMPSON: So, the legal point that need concern this Tribunal is the point of principle at para. 52 which is that you cannot mix average accounting and ECPR because that is the reason why he says you do not take into account these benefits at all, as I understand it. So, that is the point I am addressing here, and I am saying that is inconsistent with the decision letters. It is inconsistent with the approach in Shotton, and it is inconsistent with the costs ----

MR. TUPPER: Can I just, on a point of order because it was agreed by the parties that references to Shotton would be limited to documents that were sent to me a short while ago by e-mail ---- This is the second time now Mr. Thompson has broken that undertaking that he would not refer to the Shotton case, because -----

THE PRESIDENT: It is probably because I have unsuspectingly led him into areas where he probably did not particularly want to go anyway.

MR. TUPPER: If I may just remind him of his undertaking ----

THE PRESIDENT: Bear with us, Mr. Tupper. We will make sure you are completely protected. (To Mr. Thompson): Yes. You cannot mix the Act and the ECPR. Now you are going to tell us about that under the Water Act; is that right?

MR. THOMPSON: Yes. Just in response, as I understand it, the decision in Shotton is not controversial, because that has been published for almost a year, I think. What was said in

Shotton is not secret either, because that is on the CAT website. So, I was not proposing to say anything that I have not said already in a form that is readily available to Mr. Tupper.

66(e). You will recall 66(e)(1)(a) refers to any expenses reasonably incurred in performing any duty under Section 66(a) and (c) in accordance with the agreement or determination ---- In this case, common carriage, or its equivalent, is provided for in 66(b). I think we have set that out in our skeleton argument. We say that that is the costs involved not only in the set-up, but in the provision of that service. Then, in addition, one is entitled to recover the appropriate amount in respect of qualifying expenses which are then defined in 66(e)(2). We made the submission that this is general in its nature, relating to how it is carrying out its functions, and so they are not relevant to the specific supply.

The Director, as I understand it, treats 66(e)(1)(a) as limited to some sort of set-up costs, even though there is no provision for that; and (b) to equate to the retail price, even though there is no reference to the retail price. But, for the present purposes, the reference is the end wording in 66(e)(1) where there is a reference to the extent that those sums exceed any financial benefit which the undertaker receives as a result of supplying water to the premises of the relevant customers. We say that those financial benefits include the benefits of this kind. I am not sure that that is a matter in dispute, but that is what we say.

THE PRESIDENT: Very well.

MR. THOMPSON: Then we say we are entitled to the so-called arrow costs as a discount from the public service obligations which are referred to as qualifying expenses in this revision.

The other point that seems to be raised at para. 59, where there is a quotation, again it is simply a recitation of Thames' account of the matter without any critical reasoning applied to it, but the Director says, "The basis for this finding was Thames' explanation of how its network operated, which Albion has at no time addressed in this appeal". Well, the first bit is the bit we have discussed, which was addressed at length in the pleadings, and where the point does not seem to be argued by the Director positively. The only other point is the point about leaving the water in the ground, as I understand it. It is put quite vividly in the last paragraph: "In order to resource terms, it would be better to leave the surplus water in the ground and to tap it when there is a dry year, rather than use it in years of surplus". That does not seem to us to be an issue that was raised by the Director in his decision letters, or at all, or in his defence. We say it is a bad point anyway. Thames' regulatory obligations are to have sufficient deployable resources to meet the requirements of its customers. A constant additional input contributes to the discharge of that obligation. As I understand it, in the language of the industry, Thames is required to have headroom, i.e. to have sufficient water

available to meet its regulatory obligations, including in times of a drought. We say that this account of the matter also suffers from what I have called the salami problem – that if Thames and the Director treat this as a test case, we say it must not view the matter in isolation. There is the 'Guard It' point in our Amended Notice of Appeal. There is Albion's – or Envirologic's – overall resources, as evidenced in the skeleton argument (for example, at paras. 3 to 5, and in the Notice of Appeal at paras. 22 to 27), and evidenced by Dr. Bryan's witness statement at Tab 10 of Bundle 2 (I do not think it is necessary to turn it up), paras. 41 to 48 and paras. 76 to 79.

We say more generally that this approach is related to the common carriage paper and the procedural objections that we took in our Amended Notice of Appeal. I do not rely on them in isolation, but we say that they are relevant at this point. We say that if the Defendant selects cases as test cases, and analyses those cases in isolation, and then tests those cases by reference to benefits to the incumbent viewed in isolation, and fails to take account of the wider implications of his approach, we say it is not surprising that he never actually achieves anything in terms of opening the market to competition.

That was what I wanted to say about the additional resources.

I think all I wanted to say about remedy, insofar as I am permitted to say, has been said already. We say that given the defects in the decision, and the narrowness of the appeal, this is a matter where the remedy, in the terms we have asked, could properly be given ----

THE PRESIDENT: I do not think you want to go into that at this point, Mr. Thompson.

MR. THOMPSON: So, I think that only leaves specific points raised by Thames, and I think that there are only really two that need addressing because I have already talked about ECPR and the costs principle, and the issue of prejudice to Thames arises in relation to the remedy. So, I think the only two points are that Mr. Tupper suggested that we were arguing that the 27 pence Albion use was a form of *per se* infringement whereas, as he says, it was a matter that was subject to objective justification. I do not know if the Tribunal wants to turn that up, but it is a point that appears in the skeleton argument in relation to this issue. We say that is a misunderstanding of our case – it is paras. 21 and following of the Notice of Appeal. What we say is that the Director had been seized of this matter since September 2000, and had investigated the matter using his statutory powers over a period of about sixteen months. One finds that evidenced in the detailed exchanges of correspondence (between pages 146 to 178 of Tab 3, Bundle 3). Thames had had abundant opportunities to make its position clear, and had written at length on several occasions to the Director, and no doubt had also had meetings. The Director had comprehensively rejected Thames' explanations.

So, we say that in those circumstances there was, in reality, no defence or objective justification available to Thames or that the Director had specifically rejected that defence. We say that there is no reason for this Tribunal to take a different view from the position adopted by the Director himself. That appears, I think most vividly, in a letter in November 2001 which appears at pages 165 to 166 of Bundle 3, Tab 3. In the third paragraph, last sentence, it says, "Compliance with the Competition Act remains the incumbent's responsibility". In my submission, that is a clear assumption that Thames was subject to the obligations of the Competition Act. Rightly so. Then, over the page is a detailed analysis in relation to discount applied for large users – and, in particular, the third paragraph. There is a calculation, and it concludes, "In terms of 2001 prices, we would expect to access charges to larger users . . . 13.6 pence input plus an annual charge of £8,315. To avoid any accusation of anti-competitive behaviour to maintain a revenue neutral approach in respect of distribution costs, we would expect the same approach to apply in respect of very large users". Although that is put in polite terms, it is the consequence of a long series of exchanges, and we say that the Director had, by this stage, and it is evidenced also after that, reached the conclusion that the access price was approximately double what it ought to be in this particular case.

The other point that I think should be addressed is at para. 36 of the Thames skeleton. I think it is a point that Professor Pickering put to me. The second sentence: the first price was merely an indicative price, and was never actually imposed on Albion. That is the point that is made at para. 36, in the second sentence. I think the implication is that an offer of a price of that kind cannot be an abuse, and cannot fall within the scope of Article 82 or the Chapter II prohibition, and that seems to be confirmed by para. 37. It says, "Given that the price was indicative only, Thames contends that it cannot, as a matter of both plain common-sense and of law, constitute directly or indirectly imposing unfair purchasing or selling prices. Whatever the construction of Section 18(2)(a) itself maybe we say that offering an indicative price which is far too high for an entrant to get in in a market of this kind would be a paradigm case of an exclusionary abuse on the right facts, but there is no problem about that as a matter of principle. We say that it is, in fact, *a fortiori* of the usual exploitative pricing case, and, as I have said already, that it has close links to a margin squeeze where someone is excluded from the market altogether by an excessive price. So, we say that that is no obstacle to our case.

Those are our submissions, unless there are any other questions.

(Short break)

THE PRESIDENT: We thought we would probably go on until about 20 past, Mr. Turner, if that is convenient to you?

MR. TURNER: Yes, I was going to ask, Sir, a short introduction today to lay the framework. I was going to begin with the naming of parts, just refer to the subject matter of the proceedings to bring us back to the job that the Tribunal has to do in this case.

As we said in our skeleton this is an appeal against a decision of the Director General under s.47(6) of the Act as it then stood. We have set the provision out in para.3. It is an appeal against the Director's refusal to vary or withdraw a decision which we have made closing the file on five heads of complaint by Albion.

The principal focus of attention therefore for the Tribunal is on these matters - the reasons which were put to the Director by Albion in support of the argument withdrawing or varying the Decision; the reasons which were given by the Director when he refused to do that. The reasons which were put to the Director were in primarily letters of 21st March 2002, 6th August 2002, and then 24th April 2003. You will find the reasons that were given by the Director for refusing to vary or withdraw the original Decision essentially in the letter of 1st April 2004, that is common ground. In examining this question it is necessary to have in mind the factual and regulatory context. Just before doing that, and in view of the time constraints today if I may I will begin with certain matters of clarification and response to lay the foundation in relation to what Mr. Thompson was saying today. Therefore I will begin by talking about what this case is about and what it is not about.

What it is not about, in my submission, is any issue of commercial relevance to an access price which Albion would receive going forward in the future. It is common ground that s.66(d)(iii) of the Water Act as amended imposes an obligation on water companies to make charges for access in accordance with the cost principle, the cost principle being the principle set out in s.66(e). The consequence of that is that there will be a legal requirement in relation to access pricing, pricing in accordance with that legal requirement will not be an abuse.

Going forward the job to be done will be to construe the Water Industry Act legislation. It is s.66E that therefore will apply. It is not the 13.6p, and it is not any argument as to a credit to be given against an access price, however arrived at, unless that fits within the rubric of the new legislation.

There is a further relevance (which we have indicated in our skeleton) to the Water Industry Act legislation, and that is in relation to s.66J. Perhaps it is convenient for the Tribunal just to pick up bundle 8 which contains the new legislation? In my copy the Act is in tab 15, and 66J is on p.48 of the printed out version. This relates to the surpluses point:

"(1) Subject to subsections (2) and (3) and section 66K below, no person shall introduce water into a water undertaker's supply system other than the undertaker itself."

That is the prohibition.

"(2) Subsection (1) above shall not apply where the water is introduced –

(a) by a licensed water supplier in pursuance of its licence, or

(b) by another water undertaker under an agreement for a supply of water in bulk."

If you look over the page at 66K:

"(1) The Secretary of State may by order made by statutory instrument grant exemption from section 66I(1) or 66J(1)."

Now the consequence of this provision will be that, other than in the case of introducing water into the system for supply to the customer, and other than in cases where an exemption or an exception applies it will not be possible to pump surplus water into Thames Water system because that will be prohibited.

THE PRESIDENT: Does it not depend on what the terms of the licence given to the licensed water supplier are?

MR. TURNER: The terms of the licence given to the licensed water supplier will be those referred to in s.17A(2) and (5), which are the very beginning of that tab. 17A(2) is the retail authorisation, and 17A(5) is the supplementary authorisation. Those refer to a license being for the introduction of water into the system essentially "for the purpose of supplying water to the premises of customers of the company".

THE PRESIDENT: Yes.

MR. TURNER: The consequence of this is that a licence will relate to the quantity of water which is necessary to introduce into the system for supplying the customers of the new entrant, but there is a prohibition in relation to the supply of water other than under that arrangement, except in the circumstances which are to be laid down in subordinate legislation.

THE PRESIDENT: There will be some kind of tolerance to take into account fluctuations in the customer's demand at different times of day and night and so forth.

MR. TURNER: Yes, one cannot speculate as to precisely how this is going to be done, but just as Professor Pickering pointed out, the arrangements under the current circumstances were that there was a supply envelope with a margin of tolerance. One imagines that there would need to be something to recognise practically the limitations.

THE PRESIDENT: But the idea is that one would be supplying a customer and not producing surplus water that on any view the customer would not need, and then foisting, as it were, that water on the water undertaker.

MR. TURNER: Yes, it would need to be the subject of agreement.

THE PRESIDENT: Yes.

MR. TURNER: Do we know when any of this is coming into effect? Have these statutory instruments been made yet?

THE PRESIDENT: We believe that an announcement has very recently been made, and we shall provide details tomorrow morning, that the provisions of the Act with which we are concerned will come into force at the beginning of December this year. So far as subordinate legislation under section 66K is concerned, we believe that regulations are in the process of being drafted.

The first point relates, therefore, to the relevance of this going forward and the question of surpluses. Secondly, and as appears to be accepted the case is not about the Director's procedural handling of the investigation; and thirdly, it is not a test case. Although reference was made on a number of occasions to this being a test case, in fact, efforts were made by the Director, not least, to try to compromise this litigation on the basis that would lead to genuine commercial value to Albion, but those attempts failed. In no sense, therefore, does the Director view this case as a test case for anything.

Fourthly, this is not a case about a large number of boreholes amounting to a yield in excess of or in the region of 14 megalitres a day (or any other amount). It is entirely uncertain what amount of water can viably be drawn from the boreholes in the London area.

Mr. Thompson referred to the "guard it" strategy, which is one of the documents in the papers, and if I may ask the Tribunal to the extract which we have, that is in bundle 2, at tab 5, p.52. The extract begins at p.50, report at March 1999, entitled "Controlling London's rising ground water", and on pages 51 to 53 there is a summary. In that summary, if your eyes drop to the bottom of p.51 there is a reference to the later phases of a strategy involving the reuse of existing boreholes and the construction of new ones, this being to establish control in central London of rising ground water levels. If you turn the page you will see that it continues:

> "The larger yielding sites in the control network could be utilised for treatment and pumping into the public supply system. It is estimated that from phases four and five

about 30 megalitres a day could be treated and pumped into London's public distribution network."

Then towards the end of (e):

"There is no guarantee of success when drilling at any particular site and provision will need to be made for many exploratory boreholes being drilled and then abandoned."

(f) refers to the Metropolitan Water Company, and relates more specifically to likely demand for private borehole supplies of the kind that the Tribunal saw at Hammersmith. In relation to (g) we return to the question of boreholes being used for public supply. The comment that is made at the end of (g) is this: "Quite a costly level of treatment is likely to be necessary to bring the ground water up to potable standards. So, boreholes developed in this way would be long-term investments and would reduce the volume of water available for private supplies".

Now, there are two points which I ask the Tribunal to take from that. The first is the reference, of course, to larger yielding sites in the controlled network being the ones primarily envisaged for treatment and pumping into the public supply system. The other, obviously, is the uncertainty surrounding these matters. It is a matter of great uncertainty. Thames, for example, itself had investigated neighbouring boreholes to the ones in issue in these proceedings, and if you turn to Bundle 3 (the defence bundle) at p.261, you have there one of the letters that was the precursor to the 1 April, 2004 reasoned refusal. On the second page of that letter (p.262) in the second full paragraph, Thames points out that,

"At the time of Envirologic's abstraction license and common carriage application, our utility business was also assessing the technical and economic feasibility of an adjacent borehole at Thames Water's site at Mile End. An existing on-site borehole yielded poor ground water quality, but suggested high treatment costs may render the commissioning of a supply uneconomic for an abstraction of 2.2 megalitres per day. Envirologic's combined licensed abstraction for the two sources was just 1.1 megalitre per day".

Now, none of this is to say that the two boreholes in issue in this case are necessarily unviable – of course it is not. But, nor is it to say that it is safe for this Tribunal to assume, or to work on the assumption, that there is available a large amount of water to be drawn out of London boreholes and that it is a safe assumption – a working assumption for the Tribunal or the Director – that that water is available to be drawn down.

The only argument in this case is, and always has been, about the access price relating to two specific boreholes, and if you have that bundle still open in front of you, and you turn back to the very first documents in the case, at the beginning of the file, Tab 3, on p.1 you have

Mr. Jeffery of Envirologic writing in May 2000 to Thames Water, specifying the projects that they wished to proceed with - network access for Bathhouse, network access from Albion Yard, and then a sewer connection agreement. Then, at p.5, in an e-mail sent in July 2000, half-way down that page Mr. Jeffery clarifies, "On network access, there are two sources that were the subject of our discussions – the Bathhouse, Bishopsgate – 130,000 metres cubed per annum – and Albion Yard, Whitechapel – 280,000 metres cubed per annum. In both cases, test pumping has been carried out and abstraction license applied for". Then he goes on to talk about how he had requested zonal maps with an indication of pressure and leakage rates by zone 'to assist me in making an assessment of the degree of benefit which a local source would introduce'. So, he, there, at that very early point as a businessman, is looking at the matter on the very specific level in relation to the specific sources where he was proposing to develop boreholes.

Finally, then, by way of introduction, the issue of viability. It was said early on today that Albion was the obvious candidate for developing these boreholes – in fact, the only obvious candidate. Well, that is perhaps correct, subject to one major qualification, which is that Pennon attempted to sell the interest in these boreholes to Thames Water and that Thames looked at these boreholes, assessed the matter, and said that from their point of view it was not commercially worthwhile. That is in the evidence. If you turn to Thames intervention bundle, Bundle 4, and the statements of Mr. John Shaw – the engineer who accompanied us on the site visit – at Tab 12 ---- It is a short statement in which he talks about the assessment that he carried out for Thames. All I need show you for present purposes is the conclusion on the very last page, p.7 – "The results of the surveys and the report led Thames to conclude that Albion Yard and Bathhouse were in such poor condition that no further assessment was justifiable and Thames declined Pennon's offer to progress with negotiations for water supply from these boreholes".

THE PRESIDENT: But what was the proposition, Mr. Turner – that they wanted to sell them?

MR. TURNER: Yes. They wanted to sell the interest to Thames, to see if Thames would be interested in acquiring or developing these boreholes for use for their own public water supply system. It is set out in para. 21.

PROFESSOR PICKERING: When was that approach made, and that review undertaken? I cannot see immediately a date, Mr. Turner?

MR. TURNER: Paragraph 5 refers to 'late 2003', p.2.

PROFESSOR PICKERING: Which is missing in mine. That explains it.

THE PRESIDENT: I think it is missing in all our bundles, actually.

PROFESSOR PICKIERING: Pages 2 and 5 are missing as well. But tell us now – because it is relevant to your flow ----

MR. TURNER: September 2003. That, at least, is the date when Thames conducted the due diligence visit and prepared a report on opportunities.

The site visit confirmed at least that these are relatively small boreholes, and that there is some substantial work and thinking still to be done before one can safely conclude that they are likely to be viable commercial propositions, subject only to getting a fair access price – that being the subject matter, as I apprehend it, of these proceedings. That is a qualification which I do ask the Tribunal to bear in mind at the outset. So that is my twenty minutes, we will leave it there until tomorrow.

THE PRESIDENT: 10.30 tomorrow then, thank you.

(Adjourned until 10.30 a.m. on Tuesday, 21st June, 2005)